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Regulatory Framework of Mutual Funds in India

3.1 Introduction

The importance of assessing the impact of regulatory constraints on the performance of mutual funds cannot be underemphasized. Mutual funds need to be regulated to overcome the investor-manager conflict of interests that might arise. Such post-contractual opportunistic behaviour can compromise the interest of the investors and expose them to risks such as poor portfolio selectivity, excessive churning leading to higher costs, higher portfolio risks than what was indicated in the offer document and other organizational risks such as delayed settlement of transactions. Hence, the regulator steps in to overcome such market failures with the objective of ensuring ideal type market conditions as would have prevailed under perfectly competitive markets. Given the rapid growth of the mutual fund industry in terms of the number of fund houses, number of funds and the variety of funds it is assumed that it approximates a contestable market which Baumol et al (1982) discussed. So, the need for anticompetitive type of regulations is not envisioned as necessary.

But, however, regulations are not costless. They involve both a direct (compliance) cost and indirect (negative impact on performance) cost. Hence, it is important to understand if regulators have been excessive in their constraints. It is difficult for a regulator to get the exact degree of control to be imposed and hence the dangers of under or over-regulating are possible. Under-regulation can mean that the investor is exposed to unexpected risks and over-regulation means that the investor is exposed to lower returns. To get the constraints perfectly right is not the issue as such precise calculations of regulatory cost-benefit analysis is not easily done and perhaps not possible. A regulatory regime must aim at getting its regulations right with minimal error margins.
3.2 STAKEHOLDERS IN REGULATION OF MUTUAL FUNDS IN INDIA

The Indian Mutual Fund has come a long way since the establishment of UTI in 1963 the first and the foremost mutual fund in the country by an act of parliament, known as UTI Act 1963. The government was conscious of the fact that the mutual fund should be a route to attract small savings from large levels of investors mainly small and medium income segments.

Over the years, the mutual fund sector has passed through several phases of growth which may be seen as follows:

- Mutual Fund set up by government and Public Sector Undertaking (PSU) Banks.
- Mutual Fund set up by Foreign and Indian partner.
- Mutual Fund set up by private players only.

By now the industry has taken root in our financial system and is actively involved in strengthening the capital market led system of economic growth through the process of disintermediation. Indian Mutual Funds are regulated by SEBI, whose regulations are quite comprehensive and qualitatively superior to those of many other countries. Association of Mutual Funds in India (AMFI) represents the Asset Management Companies (AMCs) in India. Established as a non-profit organization on 22nd August, 1995. This association is dedicated for promoting and protecting the interest of mutual funds and their unit-holders, increasing public awareness of mutual funds and serving the investor’s interest by defining and maintaining high ethical and professional standards in the mutual fund industry.

Though RBI role is to regulating banking industry in India but as many mutual fund companies are backed by banks so indirectly RBI has significant contribution and role for safeguarding the interest of investors and other stakeholders in India.

List of all stakeholders in Indian mutual fund industry is as follows:

- RBI
- SEBI
3.3 PRINCIPLES OF REGULATORS:

Since now, there are so many numbers of funds making this mutual fund sector complex and complicated at times as strong need is felt to regulate all the mutual fund players including sponsors, investors, fund managers, intermediary for orderly growth of the sector and also for ensuring the conduct of business in transparent and legitimate manner. The mutual funds in India regulated by various regulators like SEBI, AMFI, other SROs,
RBI, and Investor’s Association of India etc. The following principles are advanced for good governance.

- To correct identified market imperfections and failures in order to improve the market and enhance competition;
- To increase the benefit to investors from economies of scale; and
- To improve the confidence of investors in the market by introducing minimum standards of quality.

Regulatory measures can be broadly classified into following categories:

- Imposing capital requirements for investment management firms;
- Monitoring and auditing the operations of investment management firms;
- Disclosure and rating of management firms;
- Providing insurance; and
- Setting up minimum standards for investment management firms.

- A close linkage must be established between the regulator and industry.
- The regulator should have enough authority to enforce the regulatory measures.
- The regulators should not indiscriminately change their views as his may create instability in the market and loss of public confidence.
- The regulators should treat the investors as facilitators in the smooth functioning of the system.

3.4 RESERVE BANK OF INDIA (RBI)

Reserve Bank of India is the apex monetary authority of the country. It formulates implements and monitors the monetary policy and thereby plays a key role in maintaining price stability and ensuring adequate flow of credit to productive sectors. RBI is the regulator and supervisor of the financial system in the country. It prescribes broad parameters of banking operations within which the country’s banking and financial

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system functions. It was established on April, 1935 according to the Reserve Bank of India act 1934.
Earlier bank sponsored mutual funds were under the dual control of RBI and SEBI. Presently RBI is only the regulator of all Banks. SEBI is the regulator of all mutual funds. Mutual funds are affected by the RBI stipulation on structure, issuance, pricing and trading of government securities.

3.4.1 Money Market Mutual Funds and RBI
In 1995, the RBI permitted private sector institution to set up of “Money Market Mutual Funds (MMMFs)”. They can invest in treasury bills, call and notice money, commercial bills accepted/co-accepted by banks, certificates of deposits and dated government securities having unexpired maturity upto one year. Mutual Funds dealing exclusively with money market instruments have to be registered with RBI. All other schemes floated by Mutual Funds are required to be registered with SEBI.
As per RBI regulations, NRIs make investment in India in mutual fund in following manner:

- Investments (other than bank accounts and deposits) on repatriation basis: In units of domestic mutual funds.
- Other investments on non-repatriation basis: Units of domestic mutual funds and units of Money Market Mutual Funds in India.

RBI helps in fighting with liquidity problems in mutual fund industry also. One interesting example was, “RBI had for the first time on October 14, 2008 introduced a 14-day liquidity window to provide credit to mutual funds in need. The measure gently helped the mutual fund industry returned to normally as redemption pressure had eased considerably and inflows had started to come in”.³³

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³³ A.P. Kurain, Chairman, Association of Mutual Funds in Economic Times, December 2008, (Current Chairman of AMFI: Milind Barve)
“While borrowing was much less than the limit provided by RBI, the announcement of the measures was made at the most appropriate time. Else there was a possibility of three or four fund houses going bankrupt”.

It was set up by the RBI and functioned under the regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI.

In annual budget of 1999-2000, RBI has also permitted mutual funds to undertake Forward Rate Agreement (FRA)/Interest Rate Swaps (IRS) with banks, primary dealers and financial institutions for the purpose of hedging their own balance sheet risks. Mutual Funds cannot, however, undertake market makings in FRAs/IRS. RBI also supervises the operations of bank-owned Mutual Funds. While SEBI regulates all market related and investor related activities of the bank/FI-owned funds, any issue concerning the ownership of the AMCs by banks falls under the regulatory ambit of the RBI.

3.5 SECURITIES AND EXCHANGE BOARD OF INDIA (SEBI):

The Indian mutual fund industry witnessed robust growth and stricter regulation from SEBI since 1996. The mobilization of funds and the number of players operating in the industry reached new heights as investors started showing more interest in mutual funds. Safeguarding the interests of investors is one of the duties of SEBI. Consequently, SEBI (Mutual Funds) Regulations, 1996 and certain other guidelines have been issued by SEBI that sets uniform standards for all mutual funds in India. All the mutual funds have to be registered with SEBI. The regulations have laid down a detail procedure for launching of

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34 U.K. Sinha, Chairman and Managing Director, UTI Asset Management Company in Economic Times, November 2008 (Current Chairman and Managing Director of UTI AMC: Leo Puri)
schemes, disclosure in the offer document, advertisements, listing and repurchase of close-end schemes, offer period, transfer of units, investments, among others.

3.5.1 Regulatory Framework

SEBI, the regulatory authority for the Indian Mutual fund industry has consistently introduced several regulatory measures and amendments in order to protect the interests of small investors. The Securities Exchange Board of India (Mutual Funds) Regulations, 1996, is the principal regulation for the Mutual fund industry in India. This was amended several times with the latest amendment being issued in 2012.

The key provisions of the ‘SEBI Regulations, 1996’ include:

- All the schemes to be launched by the AMC needs to be approved by the Board of Trustees and copies of offer documents of such schemes are to be filed with SEBI.
- The offer documents shall contain adequate disclosures to enable the investors to make informed decisions.
- The listing of close-ended schemes is mandatory and they should be listed on a recognised stock exchange within six months from the closure of subscription. However, the listing is not mandatory in case (i) the scheme provides for monthly income or caters to senior citizens, women, children and physically handicapped; (ii) if the scheme discloses details of repurchase in the offer document; or (iii) if the scheme opens for repurchase within six months of closure of subscription.
- Units of a close-ended scheme can be opened for sale or redemption at a predetermined fixed interval if the minimum and maximum amount of sale, redemption and periodicity is disclosed in the offer document.
- Units of a close-ended scheme can be converted into an open-ended scheme with the consent of a majority of the unit-holders and disclosure is made in the offer document about the option and period of conversion.
- Units of close-ended scheme may be rolled over by passing a resolution by a majority of the shareholders.

- No scheme other than unit-linked scheme can be opened for subscription for more than 45 days. Further, the minimum subscription and the extent of over-subscription that is intended to be retained should be specified in the offer document. In the case of over-subscription, all applicants applying up to 5,000 units must be given full allotment subject to over subscription.

- The AMC is required to refund the application money if minimum subscription is not received, and also the excess over subscription within six weeks of closure of subscription.

- A close-ended scheme shall be wound up on redemption date, unless it is rolled over, or if 75% of the unit-holders of a scheme pass a resolution for winding up of the scheme; if the trustees on the happening of any event require the scheme to be wound up; or if SEBI, so directs in the interest of investors.

In addition, the SEBI took various measures and issued guidelines to facilitate operations of mutual funds. As part of these measures, mutual funds were allowed to invest in foreign debt securities in the countries with full convertible currencies and with highest foreign currency credit rating by accredited credit rating agencies. They were also allowed to invest in government securities where the countries are AAA rated. Moreover, guidelines were issued for valuation of unlisted equity shares in order to bring about uniformity in the calculation of NAVs of mutual fund schemes. In order to allow mutual funds to invest in both gold and gold related instruments, the SEBI amended its regulation in 2006. The amended regulation, “Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulation, 2006” permits introduction of Gold Exchange Traded Fund (GETF) Schemes by mutual fund. The new mutual fund scheme can invest primarily in gold and gold related instruments, subject to certain investment restrictions.
With SEBI regulations, all mutual funds have been brought under a common regulatory framework to ensure greater degree of transparency in their operations and adherence to a common structure. This act spells out numerous restrictions and requirements designed to protect the interests of the investors, and ensure that each mutual fund scheme is managed and operated in the best interest of its unit holders.

1. Legal character of mutual funds in India

To begin with, it is useful to understand the legal composition of a mutual fund. A mutual fund is a legal entity. In India it is organized in form of a trust. The SEBI (Mutual Fund) Regulations, define a mutual fund as a fund established in the form of a trust by a sponsor, to raise money by the trustees, through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations. This imposes three limitations on a mutual fund and determines its basic legal character. First, it allows the mutual fund to raise resources through sale of units to the public. Second, it permits the mutual fund to invest only in securities prescribed in the SEBI (MF) Regulations. This implies that mutual funds cannot invest in property or a real estate or in any other assets, as the securities prescribed in the regulations are only shares, debentures and equity-linked instruments. Third, it requires the mutual fund to be set up in the form of a trust under the Indian Trust Act. This is reinforced by clause (b) of regulation 8, which requires as a condition of registration that mutual funds should be set up only as trusts.

In the context of Indian mutual funds, it needs to be mentioned that the Indian Trust Act was enacted in 1882, essentially to govern private trusts and charitable institutions. A trust is defined as an obligation annexed to the ownership of property and arising out of a confidence reposed in and accepted by the owner for the benefit of another. The person who creates the trust is called the author of the trust. The person for whose benefit the trust is created is a beneficiary.
Under the trust law the chief classes of beneficiary for those benefit a trust could be created are four in number:

- A person who is not yet born but a property belongs to that person.
- Those who lie under some incapacity in respect of the administration of their property (such as infancy, lunacy, or absence)
- A property in which a number of persons are interested in common as a result of which complexities and difficulties arise in its management.
- When persons have conflicting interest in the same property.

**Beneficial ownership Vs. Registered Ownership**

In brief, these beneficiaries are not capable of administering the property effectively. Trust form of organization appears suitable to meet the requirements of the investors who are unable to play the role of principals in their investment management process. The trust structure attempts to bifurcate the role of the principal (that is, the owner) into two parts – the beneficial owner and the registered owner. The trustee assumes the role of the principal and intercedes between the investor and the asset manager. He exercises the oversight function on the investment manager.

**Trustees are fictitious owners of Trust Property**

The relationship between the beneficiary and the trustee is one of principal and agent. However, between the trustee and a third person, the trustee assumes the role of fictitious owner of the trust property. This enables the trustee to personate or represent the beneficiary in dealings with the world at large.

The trustee has the right to possess the title deeds of the trust property and to reimburse himself expenses incurred in the execution of the trust. He can also indemnify against breach of trust. As per trust law, a trustee is bound to keep clear and accurate accounts of
the trust property. Further, he is bound to furnish the beneficiary full and accurate information as to the state of the trust property at all reasonable times.

*Unit holders cannot challenge trustees*

In a trust structure, the beneficial owner has no power to challenge the bona fide actions of the trustee. Given this, the effectiveness of the trust structure depends on how trustworthy the trustees are. SEBI Regulations provides stringent qualifications for the appointment of trustees. Persons with ability, integrity and standing can be appointed as trustees. The regulation had spelled out the rights and obligations of the trustees, the disqualification from being appointed as trustees etc, to ensure that they carry out their fiduciary responsibilities in the best interest of the unit holders. The act has delineated a code of conduct to be abided by the trustees.

As per SEBI Regulation, the instrument of trust should be in the form of a deed. The trust deed contains clauses for safeguarding the interests of the unit holders.

**2. The Structure of Mutual Funds in India**

The SEBI Mutual Fund Regulations have defined the structure of a mutual fund and segregated the various constituents into separate legal entities. The mutual funds are set up as trusts are to be managed by a separate asset management companies (AMCs). The custody of the assets is to be with a custodian, which is independent of the sponsors and the AMCs. Arms-length relationships have been sought to be built into the various constituents of a mutual fund, primarily through the requirement that two third of the trustees and also 50% of the board of directors of the AMC must be independent and not associated or affiliated to the sponsor. Various documentation viz. trust deed, investment management agreement, which are to be executed, delineate the responsibilities of the asset management companies and the trustees.
Independent Custodian

Regulation 25 of the SEBI (MF) Regulations requires that mutual funds should have a custodian who is not in any way associated with the AMC. Further, the regulations require that the custodian is not the sponsor or trustee of any mutual fund and that the custodian or its directors will not be in any way be directly or indirectly affiliated or associated with any AMC. The custodian cannot act as a sponsor or trustee of neither any mutual fund nor it can act as a custodian of more than one mutual fund without the prior approval of SEBI. The underlying purpose of these regulations is to ensure that the custodian meets the test of independence along with the mutual fund so as to prevent any conflicts of interests.

3. Registration of mutual funds

All mutual funds are required to register with the Securities and Exchange Board of India. Registration is intended to provide adequate and accurate disclosure of material facts concerning the mutual fund. SEBI regulations have laid down an eligibility criteria u/s 7, for the purpose of grant of a certificate of registration with a view to ensure that players have a sound track record and general reputation of fairness and integrity in all their business transactions.

Regulation 20(e) states that the AMC shall have a minimum net worth of ₹10 crores. This is to serve both as an entry barrier as well as to enable the AMC to provide for its own infrastructure such as office space, personnel and systems independent of the sponsor.

Any shortfall in the net worth would have to be made up by the sponsor immediately. The initial contribution to the net worth should be in the form of cash and all assets should be held in the name of the AMC. This is necessary to bring about a complete arm length relationship with the sponsor and its affiliates. In case the AMC wants to carry out
other fund management businesses, it should satisfy the capital adequacy requirement for each such business independently.

In case the AMC wishes to float assured return schemes or launch no load funds, it should satisfy SEBI that its present net worth would be adequate to meet any financial obligation which may arise; and if required the net worth should be increased. The AMC is allowed to deploy its net worth profitably as it may deem fit, provided that there is no conflict of interest between its manner of deployment and the interest of the investors in the schemes managed by it; and this would be overseen by the Trustees. The AMCs are also allowed to invest in the mutual fund schemes launched by it; in case an AMC chooses to do so either during the initial offer period or subsequently in case of open ended schemes, the AMC’s policy in this regard should be clearly disclosed in the prospectus and in the director’s report in the balance sheet of the relevant scheme of the mutual fund.

**Regulator ensures that the basic infrastructure in place**

Mutual funds are allowed to launch schemes only when SEBI is convinced that the AMC has systems in place for its back office, dealing room, accounting, compliance and investor grievance redressal, appointed all key personnel including fund manager(s) for schemes appointed a compliance officer to take care of regulatory requirement and investor complaints, prepared a compliance manual and designed internal control mechanisms including internal audit systems, instituted a mechanism for handling investor complaints, appointed registrars and custodian and laid down parameters for their supervision, laid down norms for empanelment of brokers and marketing agents and appointed auditors.

The bio-data of all the key personnel should be filed with SEBI and an undertaking given by the trustees/board of directors of the AMC that the AMC would file half yearly statements of dealings in securities by the persons identified as key personnel in the AMC
or the Trustee Company. No person who has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence or of violation of securities laws shall be appointed as key personnel in any AMC or trustee company.

4. Governance of mutual funds

Mutual fund schemes are repositories of trust and of investor’s hard earned money. The task of providing protection to them is a difficult one. Mutual funds are unique in a way as that they are organized and operated by people whose primary loyalty and pecuniary interest lies outside the enterprise. Consequently the very structure of mutual funds has inherent conflicts of interest, creating great potential for abuse. The existing SEBI Regulations have tried to address the issue, through separation of various entities which constitute a mutual fund – sponsor, trustees asset management companies and custodian, and also requiring that 2/3rd of the trustees and half of the board of directors of AMC must be independent of sponsor or its affiliates. The beneficial owners of the trust, i.e. the unit holders have also been given a role, as their approval is required by the fund/ AMC to enable it to bring about certain changes in the fund or to wind up a scheme. The SEBI regulations have made it mandatory that the trustees shall obtain the consent of the unit holders in important matters. The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of the unit holders, shall be carried out unless it is made known to the unit holders and the unit holders are given an option to exit at the prevailing Net Asset Value without any exit load.

The unit holders have a right to terminate the asset management company. The appointment of an asset management company can be terminated by majority of the trustees or by 75% of the unit holders of the scheme. Any change in the appointment of the asset management company shall be subject to prior approval of SEBI and the unit holders.
5. Operations of mutual funds

This section will show the regulatory provisions pertaining to the operations of the mutual fund and their implications on unit holders’ protection.

Business of the asset management company

Regulation 23 of the SEBI regulations provides that AMC shall not undertake any business activity other than management of the mutual funds and such other activities as financial services consultancy, exchange of research and analysis on commercial basis as long as these are not in conflict with the fund management activity itself, without prior approval of the trustees and SEBI.

Disclosure requirements

Mutual funds are required to disclose to SEBI regular, comprehensive disclosures of their operations. In addition, each fund must provide unit holders with annual report along with a statement on portfolio holdings, and it must furnish unit holders and prospective investors with an up-to-date prospectus. The prospectus contains full disclosures on the fund’s management, investment objectives, purchase redemption procedures and other business practices, including load charges, if any. It is often criticized that big investors trade to the disadvantage of small investors. Mutual funds shall disclose large unit holdings in the scheme, which are over 25% of the NAV. The offer document discloses the constitution of the mutual fund including the details regarding the sponsor, the trustees, the AMC, the custodian and the responsibilities and functions of each constituent of the mutual fund; the detailed investment objective of the scheme and the investment pattern likely to be followed by the AMC, the risk profile of the investments; and risk factors. The offer documents also contains other information pertaining to the redemption of units, the tax benefits available to unit holders, the principles of valuation of investments, the method of calculation of NAV, frequency and mode of distribution of income, the duration of the scheme, the detailed breakup of the expenses that will be
incurred for the management of the scheme and the extent to which expenses are loaded on the scheme.

Mutual funds are required to disclose full portfolio of their schemes every half year, either by sending a complete statement of scheme portfolio or by publishing it by way of an advertisement in one English daily circulating in the whole of India and in a newspaper published in the languages of the region where the head office of the mutual fund is situated.

Advertisements

Mutual funds must adhere to specific rules regarding the sale, distribution and advertising of mutual funds. Advertisements or sales literature must be carefully worded and explained. The advertisement for each scheme shall disclose investment objective for each scheme. The offer document and advertisement materials shall not be misleading or contain any statement or opinion, which is incorrect or false. These steps ensure that potential investors are aware of the benefits as well as the potential risks involved in mutual fund investing. With a view to ensure that an asset management company may not in promoting its schemes use untrue and misleading information or withhold important facts from investors SEBI has prescribed an advertisement code. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code.

Only AMFI certified agents can sell mutual fund units

Mutual funds are advised to ensure that their agents/distributors do not indulge in any kind of malpractice or unethical practice while selling/marketing mutual fund units. SEBI has prescribed a detailed code of conduct for mutual fund intermediaries i.e. agents and distributors. With a view to implement this code of conduct effectively the AMFI certification examination was made mandatory for all distributors and agents of mutual funds. All promotional material must contain an express warning note to the fact that risk is connected with the investment and returns to date are not a guarantee of future return.
Mutual funds cannot provide guaranteed return, unless such returns are fully guaranteed by the sponsor or the asset management company. When guaranteed by the sponsor or the AMC a statement indicating the name of the person who will guarantee the return, is made in the offer document; or the manner in which the guarantee to be met has been stated in the offer document.

**Investment restrictions**

Investments by mutual funds are subject to investment restrictions. These restrictions are essentially prudential investment norms, most of which are universally followed by mutual funds to ensure portfolio risk diversification. For example, investment in equity shares or equity related instruments of a single company are restricted to 10% of the NAV of a scheme.

**Daily pricing**

In open-ended schemes unit holders are always free to vote with their rupees by not buying a product if the fees are too high or vote with their feet by redeeming the units if they are unhappy over the performance of schemes. Mutual funds are required to update the NAV of the scheme and the sale/repurchase prices of their schemes on the AMFI website on a daily basis in case of open-ended schemes. Price determination of units is not an arbitrary process. SEBI has prescribed the accounting and valuation norms. While determining the prices of the units, the mutual fund shall ensure that the repurchase price is not lower than 93% of the NAV and the sale price is not higher than 107% of the NAV. Provided that the difference between the repurchase price and the sale price of the unit shall not exceed 7% calculated on the sale price.

**Borrowings by mutual funds**

Since leveraging has risks attached to it, mutual funds can borrow only to meet the temporary liquidity needs for the purpose of repurchase, redemption of units or payment
of interest or dividend to the unit holders. Provided that the mutual fund shall not borrow more than 20% of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months. The trustees are required to ensure that borrowing is used as a measure of last resort and determine whether the mutual fund could borrow should be disclosed in the scheme’s offer document.

**Reporting requirement**

Every mutual fund has to appoint compliance officer. The compliance officer ensures the compliance of the mutual fund schemes with SEBI regulations. It receives circulars notifications from SEBI and puts the same to the respective department for necessary action. The officer receives relevant information from various departments/officers of the trust, compiles the same into standard formats and submits to SEBI/AMFI etc. he vets the offer document to ensure the offer document discloses all the information as required by SEBI. This helps SEBI to do continuous offsite inspection.

**Risk management system in mutual funds**

Recognizing the need to establish a minimum level of risk management system conforming to international standards, AMFI formed a committee for studying the present system of risk management and proposing ways and means of strengthening the same. They have made certain recommendations to ensure a minimum standard of due diligence or risk management system for all the mutual funds in various areas of their operations like fund management, operations, customer service, marketing and distribution, disaster recovery and business contingency, etc. the report has been submitted to SEBI and has been adopted as the regulatory framework for risk management in the Indian mutual fund industry.
6. Grievance mechanism

Mutual funds need to specify in the offer document the name of contact person whom unit holders may approach in case of any query, complaints or grievances. The names of the directors of Asset Management Company and trustees are also given in the offer documents; and they can also be approached. Historical information about the investor’s complaints and redressal form a part of the offer document. Investors can also approach SEBI for redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with them till the matter is resolved.

Some of the provisions in the “SEBI Regulations, 1996” were amended several times till now and the latest in 2011-12. Highlights of “SEBI Guidelines (2011-12)” relating to mutual funds are as follows:

A. Fees and expenses

1. Investment Management & Advisory Fee: The AMC may charge the Scheme(s) with investment and advisory fees within the limits of total expenses prescribed under Regulation 52 of the SEBI (Mutual Funds) Regulations 1996.

2. Brokerage & transaction costs: Brokerage and transaction costs incurred for execution of trades and included in the cost of investment shall be charged to the Scheme(s) in addition to the limits on total expenses prescribed under Regulation 52(6). Currently, SEBI has prescribed that these expenses shall not exceed 0.12 per cent of the value of trades in case of cash market transactions and 0.05 per cent of the value of trades in case of derivatives transactions.

3. Service Tax on Fees & Expenses: Service Tax on investment and advisory fees shall be charged to the Scheme(s) in addition to the limits on total expenses prescribed under Regulation 52(6). Service Tax on expenses other than investment and advisory fees, if
any, (including on brokerage and transaction costs on execution of trades) shall be borne by the Scheme(s) within the limits of total expenses prescribed under Regulation 52(6).

4. **Additional expenses for geographical penetration:** To improve the geographical reach of the Scheme(s) in smaller cities / towns, as may be specified by SEBI from time to time, expenses not exceeding 0.30 per cent of daily net assets may be charged to the Scheme(s), in addition to the limits on total expenses prescribed under Regulation 52(6) of the SEBI (MF) Regulations, subject to certain conditions. The amount so charged shall be utilised for distribution expenses incurred for bringing inflows from such cities. However, the amount incurred as expense on account of inflows from such cities shall be credited back to the Scheme(s) in case the said inflows are redeemed within a period of one year from the date of investment. Currently, SEBI has specified that the above additional expense may be charged for inflows from beyond ‘Top 15 cities’. Top 15 cities shall mean top 15 cities based on Association of Mutual Funds in India (AMFI) data on ‘AUM by Geography - Consolidated Data for Mutual Fund Industry’ as at the end of the previous financial year.

5. **Additional expenses under Regulation 52 (6A)(c):** Additional expenses, not exceeding 0.20 per cent of daily net assets, may be charged to the Scheme(s) towards Investment Management and Advisory Fees and the various sub-heads of recurring expenses mentioned under Regulation 52 (2) and (4) respectively, in addition to the limits on total expenses prescribed under Regulation 52(6).

6. **Investor Education and Awareness initiatives:** The AMC shall annually set apart at least 2 basis points (i.e. 0.02%) on daily net assets of the Scheme(s) within the limits of total expenses prescribed under Regulation 52, for investor education and awareness initiatives undertaken by the Fund.

7. **Exit Load:** All exit loads (net of service tax) charged, if any, from the Effective Date, shall be credited to the Scheme(s).
Thus the total expenses of the Scheme(s) including the investment management and advisory fee shall not exceed the limits as specified under Regulation 52.

**B. Single plan structure for schemes**

Mutual funds/AMCs shall launch schemes under a single plan and ensure that all new investors are subject to single expense structure. Existing schemes with multiple plans based on the amount of investment (i.e. retail, institutional, super-institutional, etc) shall accept fresh subscriptions only under one plan. Other plans will continue till the existing investors remain invested in the plan. For details on the changes affecting our schemes/plans please read our addendum (see link below).

**C. Harmonizing applicability of NAV across schemes**

Under all Schemes (other than liquid schemes), in respect of applications for purchase / switch-in of units of an amount equal to or more than ₹ 2 lakh, the closing Net Asset Value (NAV) of the Business Day on which the funds are available for utilization shall be applicable provided that:

- Application for purchase / switch-in is received before the applicable cut-off time.
- Funds for the entire amount of subscription / purchase / switch-in as per the application are credited to the bank account of the respective schemes before the cut-off time.
- The funds are available for utilization before the cut-off time without availing any credit facility whether intra-day or otherwise, by the respective scheme.

Where application is received after the cut-off time on a day but the funds are cleared on the same day, the closing NAV of the next Business Day shall be applicable. All multiple applications for investment (at the first holder’s PAN level) in a particular scheme (irrespective of the plan / option / sub-option) received on the same Business Day, will be aggregated to ascertain whether the total amount equals to ₹ 2 lakh or more and to determine the applicable NAV. For investments of an amount equal to or more than ₹ 2
lakh through systematic investment routes such as Systematic Investment Plans (SIP), Systematic Transfer Plans (STP), Flex STP, Swing STP, FLEXINDEX Plan, the units will be allotted as per the Closing NAV of the day on which the funds are available for utilization by the Target Scheme.

D. Prudential limits and disclosures on portfolio concentration risk in debt-oriented schemes

As specified by SEBI, the total exposure in a particular sector (excluding investments in Bank CDs, CBLO, Government Securities, T-Bills and AAA rated securities issued by Public Financial Institutions and Public Sector Banks) shall not exceed 30% of the net assets of debt scheme(s) of the Fund and this requirement shall be complied with on or before September 12, 2013.

E. Periodic disclosures

(1) Scheme Portfolio: Portfolio of the Schemes as on the last day of the month will be available on the website by the 10th of the next month.

(2) Half Yearly Financial Results: Schemes’ un-audited half-yearly financial results will now only be available on the website within one month from the close of each half year i.e. on 31st March and on 30th September each year.

3.6 AMFI

With the increase in mutual fund players in India, a need for mutual fund association in India was generated to function as a non-profit organization. Association of Mutual Funds in India (AMFI) was incorporated on 22nd August, 1995.

AMFI is an apex body of all Asset Management Companies (AMC) which has been registered with SEBI. Till date all the AMCs are that have launched mutual fund schemes are its members. It functions under the supervision and guidelines of its Board of Directors.
Association of Mutual Funds India has brought down the Indian Mutual Fund Industry to a professional and healthy market with ethical lines enhancing and maintaining standards. It follows the principle of both protecting and promoting the interests of mutual funds as well as their unit holders.

AMFI is an industry association, incorporated in 1995. Some researchers say it is not an SRO, so it can just issue guidelines to members. It cannot enforce regulations. “AMFI uniquely positioned for a regulatory role and could become India’s first SRO. This proposed SRO should appoint representatives capable of regulating the industry and SEBI also not want to appoint any of its representatives on the board”35. But on the other side some of the experts include it into SRO category even in its present status.

3.6.1 Objectives of AMFI:

- To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
- To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
- To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.
- To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry.
- To develop a cadre of well trained Agent distributors and to implement a programme of training and certification for all intermediaries and other engaged in the industry.

To undertake nationwide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.

To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.

### 3.7 MINISTRY OF FINANCE

Ministry of Finance is the supervisor of both the RBI and SEBI. Aggrieved parties can make an appeal to MOF on the SEBI or RBI ruling relating to the mutual funds.

### 3.8 SELF-REGULATORY ORGANIZATION (SRO)

A self-regulatory organization (SRO) is an organization that exercises some degree of regulatory authority over an industry or profession. The regulatory authority could be applied in addition to some form of government regulation, or it could fill the vacuum of an absence of government oversight and regulation i.e. The stock exchanges are regulated by SEBI, but they are registered SROs. It means SEBI is a frontline regulator and SRO is a sub-regulator that reduces the burden of SEBI.

#### 3.8.1 Objectives of SRO

- Promote the investor protection and insure the market operate in a fair manner.
- Treat all its members in a fair manner.
- Resolve any possible conflict of interest amongst the members.

### 3.9 INCOME TAX AND MUTUAL FUNDS

**Tax treatment for the Investors (Unit Holders)**

As per the taxation laws in force and Chapter VII of the Finance (No. 2) Act, 2004 pertaining to Securities Transaction Tax (STT), the tax benefits / consequences as
applicable, to the Mutual Fund in respect of its Mutual Fund schemes (being an equity oriented fund / other than equity oriented fund / money market mutual fund / liquid fund) and investors investing in the Units of its Mutual Fund Schemes [on the assumption that the units are not held as stock-in-trade] are stated as follows:

1. **Tax Benefits / Consequences to the Mutual Fund**: The entire income of the Mutual Fund will be exempt from income-tax in accordance with the provisions of Section 10(23D) of the Income-tax Act, 1961 (the Act). The Mutual Fund will receive all income without any deduction of tax at source under the provisions of Section 196(iv) of the Act.

2. On income distribution, if any, made by the Mutual Fund, additional income-tax is payable under section 115R of the Act, in the case of its Schemes (other than equity-oriented funds i.e. such fund where the investible funds are invested by way of equity shares in domestic companies to the extent of more than 65% of the total proceeds of such fund).

3. Upto May 31, 2011, the additional income-tax on distribution of income to an individual / Hindu Undivided Family (HUF) shall be payable by the mutual fund at the rate of 13.519% (including applicable surcharge, education cess and secondary and higher education cess) and at the rate of 21.63% (including applicable surcharge, education cess and secondary and higher education cess) on distribution of income to any other investor. The additional income-tax on distribution of income by a money market mutual fund or a liquid fund shall be payable at the rate of 27.038% (including applicable surcharge, education cess and secondary and higher education cess). With effect from June 1, 2011, the additional income-tax on distribution of income by a money market mutual fund or a liquid fund to an individual / HUF shall be payable by the mutual fund at the rate of 27.038% (including applicable surcharge, education cess and secondary and higher education cess) and at the rate of
32.445% (including applicable surcharge, education cess and secondary and higher education cess) on distribution of income to any other investor. The additional income-tax on distribution of income by any other fund to an individual/ HUF shall be payable at the rate of 13.519% (including applicable surcharge, education cess and secondary and higher education cess) and at the rate of 32.445% (including applicable surcharge, education cess and secondary and higher education cess) on distribution of income to any other investor.

As per the Act, a money market mutual fund means a money market mutual fund as defined in the SEBI (Mutual Fund) Regulations, 1996 and a liquid fund means a scheme or plan of a mutual fund which is classified by the SEBI as a liquid fund in accordance with the guidelines issued by it in this behalf under the SEBI Act, 1992 or regulations made thereunder.

4. The availability of credit for dividend distribution tax in the hands of the non-resident investor would depend upon the tax laws of the country of which he is a resident and/or the applicable tax treaty of such country with India.

**Securities Transaction Tax**

5. As per Chapter VII of the Finance (No. 2) Act, 2004 pertaining to STT, STT shall be payable, wherever applicable, as follows:

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Taxable Securities Transaction</th>
<th>Rate</th>
<th>Payable by</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Purchase of an equity share in a company or a unit of an equity oriented fund, where</td>
<td>0.125 per cent</td>
<td>Purchaser</td>
</tr>
<tr>
<td></td>
<td>a. the transaction of such purchase is entered into in a recognized stock exchange; and</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. the contract for purchase of such share or unit is settled by the actual delivery or transfer of such share or unit.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Sale of an equity share in a company or a unit of an equity oriented fund, where</td>
<td></td>
<td></td>
</tr>
<tr>
<td>---</td>
<td>---------------------------------------------------------------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>a. the transaction of such sale is entered into in a recognized stock exchange; and</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>0.125 per cent Seller</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>b. the contract for sale of such share or unit is settled by the actual delivery or transfer of such share or unit.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Sale of an equity share in a company or a unit of an equity oriented fund, where</th>
</tr>
</thead>
<tbody>
<tr>
<td>3</td>
<td>a. the transaction of such sale is entered into in a recognized stock exchange; and</td>
</tr>
<tr>
<td></td>
<td>0.025 per cent Seller</td>
</tr>
<tr>
<td></td>
<td>b. the contract for sale of such share or unit is settled otherwise than by the actual delivery or transfer of such share or unit.</td>
</tr>
</tbody>
</table>

| 4 | a. Sale of an option in securities |
|   | 0.017 per cent Seller |
| b. Sale of an option in securities, where option is exercised |
|   | 0.125 per cent Purchaser |
| c. Sale of a futures in securities |
|   | 0.017 per cent Seller |

| 5 | Sale of a unit of an equity oriented fund to the Mutual Fund. |
|   | 0.25 per cent Seller |

6. Tax Benefits / Consequences to Unit holders

i. Income-tax

All Unit holders

Income received, otherwise than on transfer (subject to the exemption of long-term capital gains provided for in section 10(38) of the Act, discussed elsewhere in this Statement), in respect of units of a mutual fund would be exempt from tax under Section 10(35) of the Act.
• **Tax Deduction at Source**

*All Unit holders*

No income-tax is deductible at source, on any income distribution by the Mutual Fund under the provisions of Section 194K and 196A of the Act.

• **Capital Gains Tax**

*Foreign Institutional Investors*

Long-term capital gains on sale of Units, held for a period of more than twelve months, would be taxed at the rate of 10% (plus applicable surcharge, education cess and secondary and higher education cess) under Section 115AD of the Act (subject to the exemption of long-term capital gains provided for in section 10(38) of the Act, discussed elsewhere in this Statement). Such gains would be calculated without indexation of cost of acquisition. Short-term capital gains would be taxed at 30% (plus applicable surcharge, education cess and secondary and higher education cess) (subject to the concessional rate of tax provided for in Section 111A of the Act, discussed elsewhere in this Statement).

As per Section 111A of the Act, short-term capital gains on sale of units of an equity-oriented fund, where such transaction of sale is chargeable to STT, shall be subject to tax at a rate of 15 per cent (plus applicable surcharge, education cess and secondary and higher education cess).

**Exemption of capital gain from income tax**

- As per Section 10(38) of the Act, any long-term capital gains arising from the sale of units of an equity-oriented fund where such transaction of sale is chargeable to STT, shall be exempt from tax.
- Income by way of long term capital gain of a company shall be taken into account in computing the Book profit and income-tax payable under Section 115JB (Minimum
Alternate Tax)[MAT]. The matter is however not free from doubt in case of Corporate Foreign Institutional Investors.

**Other Unit holders**

- Long-term capital gains in respect of Units, held for a period of more than twelve months, will be chargeable under Section 112 of the Act, at concessional rate of tax, at 20% (plus applicable surcharge, education cess and secondary and higher education cess) (subject to the exemption of long-term capital gains provided for in Section 10(38) of the Act, discussed elsewhere in this Statement).

- The following amounts would be deductible from the full value of consideration, to arrive at the amount of capital gains:
  - Cost of acquisition of Units (as adjusted by Cost Inflation Index notified by the Central Government in case of long term capital gain) and
  - Expenditure incurred wholly and exclusively in connection with such transfer (excluding any sum paid on account of STT)

- However, where the tax payable on such long-term capital gains, exceeds 10% (plus applicable surcharge, education cess and secondary and higher education cess) of the amount of capital gains computed before indexation, such excess tax shall not be payable by the Unit holder, at his option.

- In case of resident individuals and Hindu Undivided Families, where taxable income as reduced by long-term capital gains, is below the basic exemption limit, the long-term capital gains will be reduced to the extent of the shortfall and only the balance long-term capital gains will be subjected to the flat rate of income-tax (plus education cess and secondary and higher education cess).

As per Section 111A of the Act, short-term capital gains on sale of units of an equity oriented fund where such transaction of sale is chargeable to STT shall be subject to tax
at a rate of 15 per cent (plus applicable surcharge, education cess and secondary and higher education cess). Further in case of resident individuals and HUFs where taxable income as reduced by short-term capital gains, is below the basic exemption limit, the short-term capital gains will be reduced to the extent of the shortfall and only the balance short-term capital gains will be subjected to the flat rate of income-tax (plus education cess and secondary and higher education cess).

**Exemption of capital gain from income tax**

- As per Section 10(38) of the Act, any long-term capital gains arising from the sale of units of an equity-oriented fund where such transaction of sale is chargeable to STT, shall be exempt from tax.

- Income by way of long term capital gain of a company shall be taken into account in computing the Book profit and income-tax payable under Section 115JB [MAT].

- As per the provisions of section 54EC of the Act and subject to the conditions and investment limits specified therein, capital gains (subject to the exemption of long-term capital gains provided for in section 10(38) of the Act, discussed elsewhere in this Statement), arising on transfer of a long-term capital asset shall not be chargeable to tax to the extent such capital gains are invested in certain notified bonds within six months from the date of transfer.

- As per the provisions of Section 54F of the Act and subject to the conditions specified therein, in the case of an individual or a HUF, capital gains (subject to the exemption of long-term capital gains provided for in section 10(38) of the Act, discussed elsewhere in this Statement) arising on transfer of a long-term capital asset (not being a residential house) are not chargeable to tax if the entire net consideration received on such transfer is invested within the prescribed period in a residential house. If part of such net consideration is invested within the prescribed period in a residential house, then such gains would not be chargeable to tax on a proportionate basis. For this purpose, net
consideration means full value of the consideration received or accruing as a result of the transfer of the capital asset as reduced by any expenditure incurred wholly and exclusively in connection with such transfer.

**All Unit holders**

Under the provisions of Section 94(7) of the Act, loss arising on sale of Units, which are bought within 3 months prior to the record date (i.e. the date fixed by the Mutual Fund for the purposes of entitlement of the Unit holders to receive income or additional units without any consideration, as the case may be) and sold within 9 months after the record date, shall be ignored for the purpose of computing income chargeable to tax to the extent of exempt income received or receivable on such Units.

Under the provisions of Section 94(8) of the Act, where any person purchases units ('original units') within a period of 3 months prior to the record date, who is allotted additional units without any payment and sells all or any of the original units within a period of 9 months after the record date, while continuing to hold all or any of the additional units, then any loss arising on sale of the original units shall be ignored for the purpose of computing income chargeable to tax. The amount of loss so ignored shall be deemed to be the cost of purchase of the additional units as are held on the date of such sale.

**Tax Deduction at Source**

**All Unit holders**

No income-tax is deductible at source from income by way of capital gains under the present provisions of the Act in case of residents. However, the provisions of section 195 of the Act may apply to non-residents (other than Foreign Institutional Investors and long-term capital gains exempt under section 10(38) of the Act).
Tax deducted at source pertaining to NRI Investors$ As per the Finance Act 2012, with effect from July 1, 2012, a list of transactions is proposed to be specified, wherein the rate for tax deduction at source needs to be determined by the assessing officer. In case the transaction of sale of mutual fund units by an NRI gets covered within such list, then an application would be required to be made to the assessing officer to determine the tax deduction at source rate @ after providing for indexation.

In the case of foreign companies the rate of tax to be deducted at source on short-term capital gains referred to in section 111A would be 15% (plus applicable surcharge, education cess and secondary and higher education cess) and at the rate of 40% (plus applicable surcharge, education cess and secondary and higher education cess) in case of short-term capital gains (other than under section 111A), unless a lower withholding tax certificate is obtained from the tax authorities, and at the rate of 20% (plus applicable surcharge, education cess and secondary and higher education cess) in case of long term capital gains, unless a lower withholding tax certificate is obtained from the tax authorities.

With effect from 1 April 2010, where tax is deductible under the Act, and the deductee has not furnished a Permanent Account Number (PAN) to the deductor, tax should be deducted at source at the highest of the following rates:

- At the rate specified in the Act
At the rates in force
At the rate of 20% (plus applicable surcharge and education cess and secondary and higher education cess)

Gift of Units

With effect from 1.10.2009, as per the provisions of section 56(2)(vii) of the Act, certain specified property transferred, without consideration / adequate consideration, exceeding specified limits, are taxable in the hands of the recipient individual / HUF (subject to certain exceptions).

The term "property" includes shares and securities. Units of a mutual fund could fall within the purview of the term "securities".

As per the Act, "property" would refer to capital assets only.

Clubbing of income

Subject to the provisions of section 64(1A) of the Act, taxable income accruing or arising in the case of a minor child shall be included in the income of the parent whose total income is greater or where the marriage of the parents does not subsist, in the income of that parent who maintains the minor child. An exemption under section 10(32) of the Act, is granted to the parent in whose hand the income is included upto ₹ 1,500/- per minor child. When the child attains majority, the tax liability will be on the child.

Deduction under section 80C

As per section 80C, and subject to the provisions, an individual / HUF is entitled to a deduction from Gross Total Income upto ₹ 1.00 lac (along with other prescribed investments) for amounts invested in any units of a mutual fund referred to in section 10(23D) of the Act, under any plan formulated in accordance with such scheme as the Central Government may notify.
Securities Transaction Tax

All Unit holders

As per Chapter VII of the Finance (No. 2) Act, 2004 pertaining to STT, the STT shall be payable by the seller at the rate 0.25 per cent on the sale of a unit of an equity-oriented fund to the mutual fund.

Other Benefits

Investments in Units of the Mutual Fund will rank as an eligible form of investment under Section 11(5) of the Act read with Rule 17C of the Income-tax Rules, 1962, for Religious and Charitable Trusts.

Tax Treaty Benefits

A non-resident investor has an option to be governed by the provisions of the Act or the provisions of a Tax Treaty that India has entered into with another country of which the non-resident investor is a tax resident, whichever is more beneficial to the non-resident investor. The provisions of Section 195 and/or Section 197 of the Act would need to be complied and also documents will have to be furnished by the non-resident investor in this regard.

ii. Wealth-tax

Units of the Mutual Fund are not treated as assets as defined under Section 2(ea) of the Wealth-tax Act, 1957 and therefore would not be liable to wealth-tax.

iii. Gift-tax

The Gift-tax Act, 1958 has ceased to apply to gifts made on or after October 1, 1998. Gifts of Units of the Mutual Fund would therefore, be exempt from gift-tax.

3.10 INVESTOR’S ASSOCIATION

Individual investor or group of investors may also formed association for safeguarding their interest so that their grievances can be heard by appropriate and competent authority in timely manner. In India, they are working in various formats informally and formally.
3.11 REGULATIONS FOR REAL ESTATE FUNDS IN INDIA

Securities and Exchange Board of India has recently notified SEBI (Mutual Funds) (Amendment) Regulations, 2008 for Real Estate Mutual Funds (REMFs) to invest directly or indirectly in real estate assets or other permissible assets.

The regulations defines “real estate” to mean immovable property, which is (i) located in India in cities specified by the Board or in Special Economic Zones(ii) constructed and usable (iii) evidenced by valid title documents (iv) legally transferable (v) free from encumbrances (vi) not subject matter of any litigation, but excludes (I) project under construction, or (II) vacant land, or (III) deserted property, or (IV) land specified for agricultural use, or (V) a property which is reserved or attached by any Government or other authority or pursuant to order of court of law or the acquisition of which is otherwise prohibited under any law in force.

Real Estate Mutual Fund Schemes may be launched by an existing mutual fund having adequate number of key personnel and directors having adequate experience in real estate or new entrants carrying on business in real estate for at least 5 years. They will also have to fulfill all other criteria applicable to a mutual fund.

Such schemes will be subject to the conditions that (1) it is close ended and its units shall be listed on a recognized stock exchange (2) the units issued shall not confer any right on the unit holders to use the real estate assets held for the scheme and any provision to the contrary in trust deed or in the terms of issue shall be void (3) the title deeds pertaining to real estate assets held by scheme shall be kept in safe custody with the custodian of the fund (4) shall not undertake lending or housing finance activities (5) all financial transactions of the scheme shall be routed through banking channels and they shall not be cash or unaccounted transactions

The Real Estate Mutual Fund has to follow the prescribed permissible pattern of investments, which is
• The fund has to invest at least 35% of the net assets of the scheme directly in real estate assets and balance in mortgage backed securities (but not directly in mortgages), equity shares or debentures of companies engaged in dealing in real estate or in undertaking real estate development projects (whether listed on a recognized stock exchange in India or not), and in other securities. Taken together, investment in real estate assets and real estate related securities shall not be less than 75% of the net assets of the scheme;

• No fund shall, under all its mutual fund investment schemes, invest more than 30% of its net assets in a single city;

• No fund shall, under all its mutual fund investment schemes, invest more than 15% of its net assets in the real estate assets of any single real estate project. “Single real estate project” means a project by a builder in a single location within city;

• No fund shall, under all its mutual fund investment schemes, invest more than 25% of the total issued capital of any unlimited company

• No fund shall invest more than 15% of the net assets of any if its mutual fund schemes in the equity shares or debentures of any unlisted company;

• No fund scheme shall invest in:
  o any unlisted security of the sponsor or its associate or group company;
  o any listed security issued by way of preferential allotment by the sponsor or its associate or group company;

• Any listed security of the sponsor or its associate or group company, in excess of 25% of the net assets of the scheme.

• No fund shall transfer real estate assets among its scheme;

• No funds shall invest in any real estate assets which were owned by the sponsor or the asset management company or any of its associates during the period of last 5 years or in which the sponsor or the asset management company or any of its associates hold tenancy or lease rights.
However, all is not well with these regulations. The Reserve Bank of India has protested to the finance ministry that NRIs and foreign institutional investors (FIIs) investment in REMFs would lead to indirect foreign investment in real estate. Foreign investment through REMF route will not face the similar guidelines as are applicable to foreign direct investment in real estate. The said guidelines are (a) Minimum area to be developed for serviced housing plots shall be 10 Hectres and for construction - development projects 50,000 square meters. In case of a combination project, any of the two conditions shall be fulfilled. (b) Minimum capitalization of US$ 10 Million for wholly owned subsidiaries and US$ 5 Million for joint ventures with Indian partners. The investments have to be brought in within six months of commencement of business of the company. Original investment cannot be repatriated before a period of three years from completion of minimum capitalization. However, the investor may be permitted to exit earlier with the prior approval of the Government through Foreign Investment Promotion Board (FIPB). (c) At least 50% of the project must be developed within a period of five years from the date of obtaining all statutory clearances. The investor shall not be permitted to sell undeveloped plots. (d) The project shall confirm to the norms and standards, as laid down in the applicable building control regulations, bye-laws, rules, and other regulations of the State Government /Municipal/Local Body concerned. (e) The investor shall be responsible for obtaining all necessary approvals, including those of the building/layout plans, developing internal and peripheral areas and other infrastructure facilities, payment of development, external development and other charges and complying with all other requirements as prescribed under rules/bye-laws/regulations of the State Government /Municipal/Local Body concerned. (f) The State Government /Municipal/Local Body concerned, which approves the building/development plans, shall monitor compliance of the above conditions by the developer.

Despite the above rules and regulations, the mutual fund industry has been unable to launch REMFs due to lack of ‘clarity’, want of transparency and uncertainty prevailing in
the real estate sector. Moreover, there being no regulatory framework for the real estate sector for its efficient functioning, have also refrained mutual fund houses from launching such funds.

Real Estate sector in India is surrounded by a lot of ambiguity in the absence of a regulator. There is no control over prices of the real estates throughout the country, providing a thriving ground for malpractices and mis-selling. Under this situation, it is right that the mutual funds have delayed launching REMFs as the investors’ hard-earned money would be at stake.

Also with respect to taxation of these schemes, the current regulation treating such funds as “debt funds” for taxation (as they will invest directly in real estate projects), has also precluded mutual fund houses from launching such scheme as such tax status fails to enthuse investors.

3.12 KNOW YOUR CUSTOMER (KYC) NORMS FOR MUTUAL FUNDS

The objective of KYC guidelines is to prevent mutual fund companies from being used, intentionally or unintentionally, by criminal elements for money laundering activities. KYC procedures also enable mutual fund companies to know/understand their customers and their financial dealings better which in term help them manage their risks prudently. Mutual fund companies should frame KYC policies incorporating the following four key elements:

- Customer Acceptance Policy;
- Customer Identification Procedures;
- Monitoring of Transaction; and
- Customer education
3.13 CUSTOMER ACCEPTANCE POLICY (CAP)

Mutual fund companies should develop a clear Customer Acceptance Policy laying down explicit criteria for acceptance of customers. The Customer Acceptance Policy must ensure that explicit guidelines are in place on the following aspects of customer relationship in the mutual fund company. No account is opened in anonymous or fictitious/benami name(s). Parameters of risk perception are clearly defined in terms of the nature of business activity, location of customer and his clients, mode of payments, volume of turnover, social and financial status etc. to enable categorization of customers into low, medium and high risk. Documentation requirements and other information should be collected in respect of different categories of customers depending on perceived risk and keeping in mind the requirements of PML Act, 2002 and guidelines issued by Reserve Bank of India from time to time. No account should be opened or on existing account be closed where the mutual fund company is unable to apply appropriate customer due by a mandate holder or where an account may be opened by an intermediary on the fiduciary capacity and necessary checks before opening a new account so as to ensure that the identity of the customer does not match with any person with known criminal background or with banned entities such as individual terrorist or terrorist organizations etc.

3.14 CUSTOMER IDENTIFICATION PROCEDURE (CIP)

Customer Identification means identifying the customer and verifying his/her identity by using reliable, independent source documents, data or information. Mutual Fund Company needs to obtain sufficient information necessary to establish, to their satisfaction, the identity of each new customer, whether regular or occasional, and the purpose of the intended nature of banking relationship.
3.15 MONITORING OF TRANSACTIONS

Ongoing monitoring is an essential element of effective KYC procedures. Mutual Fund Company can effectively control and reduce their risk only if they have the means of identifying transactions that fall outside the regular pattern of activity.

However, the extent of monitoring will depend on the risk sensitivity of the account. Mutual Fund Company should pay special attention to all complex, unusually large transactions and all unusual patterns which have no apparent economic or visible lawful purpose. Mutual Fund companies should ensure that a record of transaction in the accounts is preserved and maintained as required in terms of section 12 of PML Act, 2002. It may also be ensured that transaction of suspicious nature and/or any other type of transaction notified under section 12 of the PML Act, 2002, is reported to the appropriate law enforcement authority.

3.16 RISK MANAGEMENT

The Board of Directors of the mutual fund company should ensure that an effective KYC program is put in place by establishing appropriate procedures and ensuring their effective implementation. It should cover proper management oversight, systems and controls, segregation of duties, training and other related matters. Mutual Fund companies may, in consultation with their boards, devise procedures for creating risk profiles of their existing and new customers and apply various Anti Money Laundering measures keeping in view the risks involved in a transaction, account or banking/business relationship. Internal audit and compliance functions have an important role in evaluating and ensuring adherence to the KYC policies and procedures.
3.17 CUSTOMER EDUCATION

Implementation of KYC procedures requires mutual fund to demand certain information from customers which may be of personal nature or which have hitherto never been called off. There is, therefore, a need for mutual fund companies to prepare specific literature/pamphlets etc. so as to educate the customer of the objectives of the KYC programme. The front desk staff needs to be specially trained to handle such situations while dealing with customers.

3.18 NRI’S INVESTMENT IN MUTUAL FUNDS

NRI can invest in mutual funds in India and these investments can be made on a repatriable or on a non-repatriable basis, as preferred by the investor. To invest on a ‘repatriable’ basis, the NRI must have a Non Resident External (NRE) or FCNR Bank account in India. The Reserve Bank of India (RBI) has granted a general permission to ‘Mutual Funds’ to offer mutual fund schemes on repatriation basis subject to the following conditions;

- The mutual fund should comply with the terms and conditions stipulated by Securities and Exchange Board of India (SEBI)
- The amount representing investment should be received by inward remittance through normal banking channels, or by debit to an NRE/FCNR account of the non-resident investor.
- The net amount representing a dividend/interest and maturity proceeds of units may be remitted through normal banking channels or credited to NRE/FCNR account of the investor, as desired by him subject to payment of applicable tax.
- The RBI has granted a general permission to ‘Mutual Funds’ to offer mutual fund schemes on non-repatriable basis with certain conditions. Funds for investment should be provided by debit to National Reconnaissance Office (NRO) account of the investor. Alternatively, funds may be invested by inward remittance or by
debit to NRE/FCNR account. The current income in the form of dividends is allowed to be repatriated

An NRI does not require any approval. Only the OCB’s and FII’s require approval of the RBI to invest in mutual fund schemes. Non-resident Indians are increasingly inclined towards ploughing back redemption proceeds from various NRI deposit schemes and investing them in real estate and stock markets. They are picking up equity stakes in Indian companies and form a major component of the country’s Foreign Direct Investment (FDI).

Knowing time horizon of the investment, risk and return expected on the investment and scrutinizing overall financial position and long term goals before investing is the key to wise investment. For an NRI, no specific approval for investing or redeeming from mutual fund is required. Only OCB’s and FII’s require approvals for it.

Government securities/UTI can be transferred or sold to NRI’s provided the transfer/sales are arranged through an authorized dealer. Repurchase can be done directly by UTI. In case of the purchase being made out of NRO accounts, it can be remitted abroad. The portfolio investment scheme allows NRIs to acquire shares/debentures of Indian companies or units of domestic mutual funds through the stock exchange(s) in India.

There is an overall of 5% of paid-up share capital of the company/paid-up value of each series of convertible debentures for purchase by NRIs/OCBs. For domestic mutual funds, there is no ceiling. In order to invest on a repatriable basis, NRI must have an NRI/OCBs. For domestic mutual funds, there is no ceiling.

In order to invest on a repatriable basis, NRI must have an NRI/FCNR bank account in India. The mutual fund should comply with the terms and conditions stipulated by SEBI, the amount representing investment should be received by inward remittance through normal banking channels or by debit to NRE account/FCNR account of the NRI. The
dividend/interest of units may be remitted through normal banking channels or credited to NCR/FCNR account of the investor.

For investment made on repatriation basis, the net income or capital gains after tax arising out of investment is eligible for repatriation subject to regularity guidelines at the time of the repatriation. In the case of investment is made on a non-repatriation basis, only the net income, i.e. dividend arising out of investment is eligible for repatriation. Approval for units of domestic mutual funds from the Reserve Bank is valid for a period of five years from the date of issue. This can be renewed by a request by means of a simple letter.