CHAPTER - III

REGULATORY FRAMEWORK OF MUTUAL FUNDS
3.1 INTRODUCTION

The UTI was established by the UTI Act, 1963 as a corporate body (as a Trust), and it was regulated since its inception by various provisions of the Act and Regulations framed thereunder. The constitution, management, investment objectives, business policies, pricing strategies and the system of income distribution etc., are all regulated within the framework of the legislation and bye-laws adopted there under.

In June, 1987, the Government of India by notification permitted public sector banks and financial institutions to set up their own mutual funds. Public sector banks are required to obtain permission from the Reserve Bank of India (RBI) under the Banking Regulation Act of 1949. Financial Corporations and Investment Corporations like Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC) have to get the approval of the Central Government and the Ministry of Finance to set up mutual funds.

In order to regulate the public sector bank mutual funds, the RBI issued for the first time a set of guidelines on July 7, 1989. The Ministry of Finance issued further guidelines on June 28, 1990 which should be followed by all mutual funds except the UTI which was constituted under a special statute. Under these guidelines the Central
Government prescribed the procedure for establishment of mutual funds, their management, investment objectives, policies, disclosures, pricing valuation of units' accounts, etc. In the light of those guidelines several public sector banks, financial institutions and investment Corporations have set up separate subsidiaries for mutual fund operations.

The Securities and Exchange Board of India (SEBI) which was constituted as an interim body in July 1988 had no powers to make any regulations initially, but it acquired statutory status only on January 30, 1992. Till then it was empowered only to prescribe accounting and disclosure requirements. Stock market scam forced the government to regulate the saving instruments. The SEBI Act was passed by Parliament on April 4, 1992, which empowered the government to regulate mutual funds. The Securities and Exchange Board of India (Mutual Fund) Regulations, which were notified in January 1993, provided for the first time a formal regulatory framework for all mutual funds except UTI.

In this Chapter, an attempt is made to describe the salient features like significance of regulations, objectives, regulations in India, SEBI regulations 1996 and new guidelines, self regulatory mechanism and its objects etc.
3.2 NEED FOR REGULATION

Regulation of any financial activity is significant for two reasons.

i. to eliminate chances of fraud and manipulation and

ii. to maintain the credibility of the organisation in the mind of the public

Investors, particularly small investors, are more concerned about the safety of their investment rather than high returns. If safety is not assured, there is a possibility of high default risk. The investors in units of mutual funds are exposed to high default risk compared to the investors of other alternative investments such as bank deposits, national savings schemes debentures of companies etc. Bank deposits enjoy insurance protection through Deposit and Credit Guarantee Corporation. The saving instruments promoted by the National Savings Organisation through Post Offices are guaranteed by the Government of India. The debenture/bond holders of corporate sector are protected by the mortgage or security of assets. In contrast, investors in mutual fund schemes are exposed to high risk both of default and the market vagaries. Hence there is a need for a strong regulatory framework for the mutual fund activities.

3.3 OBJECTIVES OF REGULATIONS

The objectives of regulations are as shown below:

i. to ensure that mutual funds are managed for the benefit of investors with a responsibility of charging rational management fee,

ii. to establish confidence among investors that the resources mobilised are invested according to the investment objectives of the schemes.

iii. to assure the investors that they receive adequate and accurate information about their investments.

iv. to formulate rules for investment and

v. to provide procedure for accurate and fair valuation of investments - Net Asset Value, Repurchase Price and Redemption Price.

3.4 REGULATIONS IN INDIA

In order to bring mutual fund practices in India on par with those in developed countries the mutual fund regulations were rationalised in 1996 by amending the Security and Exchange Board of India (Mutual funds) Regulations, 1996. The provisions have been designed to safeguard the investor interest, check speculative activities and ensure financial discipline through better transparency in dealings.

As to the regulatory framework, the Reserve Bank of India had initially issued guidelines for bank sponsored mutual funds in 1987, followed by guidelines laid down by the Union Ministry of Finance in 1991. Thereafter, the Securities and Exchange Board of India (SEBI) issued guidelines in 1991 and a comprehensive set
of regulations relating to the organisation and management of mutual funds was drawn up in 1993. Consequent upon the increase in the number of mutual funds and the types of schemes offered by them there has been a lot of competition in this industry. It was, therefore considered necessary to ensure that all mutual funds follow uniform norms for valuation of investments and accounting practices, so that the investors could judge their performance on comparable parameters. SEBI issued new mutual fund regulations in December 1996, which provided for a scheme-wise report and justification of the performance, disclosure of large investment and disclosure of the movements in the unit capital.2

Regulation and control of mutual funds in India have to be studied from the following angles, viz., (1) legal structure of the mutual fund (2) role of SEBI, the regulatory body of mutual fund and (3) scope for self-regulation.

The following Acts and Regulations guide the mutual fund industry in India.

1. UTI Act, 1963

2. Guidelines from the Government, regulatory bodies like RBI and SEBI

3. Companies Act, 1956-for trust company

4. SEBI (Mutual funds) Regulations, 1993 replaced in 1996

The Unit Trust of India (UTI) was constituted by the Unit Trust Act 1963 enacted by the Parliament. The UTI is governed, regulated and decontrolled under the provisions of the said Act and rules framed thereunder. The constitution, management, investment objectives, business policies, pricing strategies and system of income distribution are all regulated within the frame work of legislation and bye-laws adopted thereunder. With effect from July 1994, UTI came under the purview of SEBI. SEBI was given the power to inspect, operate, ask for books and records of UTI although no amendments are made to its status and organisational structure.3

After the Government granted permission to the public sector banks and financial institutions to set up subsidiaries to conduct mutual fund business, there were practically no regulations existed for such funds. The only restriction was that banks entering into mutual fund industry without the prior permission of RBI, and the other financial institutions were required to obtain approval from the Central Government to set up mutual funds.

The RBI came out with a set of guidelines in July 1989\(^4\) which prescribe a course of action to be followed by banks with regard to constitution and management of mutual funds, investment objectives and policies, ceiling limits on investment portfolio pricing policies, income distributions, accounts and disclosures. The Government came out with further guidelines in June 1990\(^5\) covering all mutual funds except UTI.

In March 1991, the government in principle handed over the regulation of mutual funds to SEBI. The new government that assumed office at the Centre in June 1991 initiated a series of measures popularly known as "New Economic Reforms" which included drastic reforms of the financial sector too. The Government accorded statutory status to Securities and Exchange Board of India (SEBI) as an autonomous body through the enactment of the SEBI Act in Parliament on April 4, 1992 for the promotion and regulation of the capital market, SEBI was conferred with legal status and therefore was empowered to enforce discipline on all institutions in the capital market.


\(^5\) Government of India, Ministry of Finance, File No.1/44/SE/86-pt IV, dated June 28, 1990:
market including the mutual funds. Under SEBI control and regulation, mutual fund industry was thrown open to private sector and joint sector players after 1991.

The then Union Finance Minister, Dr. Manmohan Singh, in his budget speech stated that to encourage a healthy growth of the capital market and to promote the development of mutual fund activity, a comprehensive set of guidelines would be evolved for the operation of mutual fund. An Eleven member Committee under the Chairmanship of S.A. Dava, Chairman, UTI was constituted to make recommendations regarding the orderly functioning of the mutual funds. The Committee submitted its report in September 1991.

In October 1991, SEBI issued guidelines for the formation of Asset Management Companies (AMC). The purpose of the formation of AMC is to manage the mutual fund schemes. Thus a two-tier structure was developed for mutual funds - Trust and AMC. In February 1992, the Government of India announced comprehensive guidelines, whose objective was "to install a sense of competition, transparency and fair play and spur the mutual funds to a greater level of efficiency

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and investor friendliness". In March 1992, SEBI has issued guidelines for the authorisation of mutual funds. SEBI (Mutual Funds) Regulations came into force with effect from January 20, 1993.\(^8\)

In India SEBI regulates the mutual funds by issuing guidelines for their operations, ensures dissemination of information and safety of the investors funds.

The scope of the SEBI guidelines for mutual funds is as follows:

i. They apply to all mutual funds whether the fund primarily invests in capital market or money market instruments.

ii. Money market mutual funds are to be regulated by the Reserve Bank of India.

iii. Other schemes which invest partly in money market and partly in capital market are regulated by SEBI.

iv. All the schemes of mutual funds that are floated must be brought to the notice of SEBI before launching them for the public subscription.\(^9\)

Further, the regulations laid down eligibility criteria and disclosure


requirements for schemes of the mutual funds by the AMC. The regulations also laid down an advertisement code to be followed by mutual funds and provided for SEBI's right to inspect mutual funds and take action for the violation of any provisions of the regulations.

After the issue of 1993 mutual fund regulations, there is a greater degree of transparency in the operation of mutual funds than it was before. The level of investors' protection in the regulated post 1993 schemes is much higher than pre-1992 unregulated schemes. There has been some progress towards evaluation of uniform standards and operational norms. One area which still lacks common standards and uniformity in approach is accounting and investment valuation.

**SEBI (MUTUAL FUND) REGULATION, 1996**

The state of mutual fund industry became a cause of concern to SEBI as the performance of several mutual funds has been under cloud during 1994-95 and 1995-96. Investors' confidence has waned and their response to the schemes was lukewarm. The SEBI has prepared an approach paper in 1995 titled 'Mutual Funds 2000'.¹⁰ This paper identified various ways to improve the working and the regulation of the mutual fund industry.

The SEBI approved in principle the proposals made in the Mutual fund 2000 Report and the Report of the Expert committee. These proposals are incorporated in new regulations. The 1993 Regulations have been replaced by the Securities Exchange Board of India (Mutual fund) Regulations of 1996, through a notification on December 9, 1996. In 1997, SEBI released Mutual fund 2000 vision document

**COMMITTEE ON ACCOUNTING POLICIES**

SEBI has constituted an expert committee under the chairmanship of Dr. L.C. Gupta in May 1994 to look into the accounting standards, policies of mutual funds norms, and methods of computation of net asset value of various schemes, repurchase, reissue prices and management fees charged by AMC. This Expert Committee on the Accounting Policies, Net Asset Values (NAV) and Pricing of Mutual Funds submitted its report on December 12, 1995. The SEBI accepted the recommendations of the Expert Committee. The SEBI (Mutual Fund) Regulations 1996 have therefore laid down the Accounting Policies and Standards in its Ninth schedule.

The highlights of the Report of the Committee are as follows.

1. Uniform basis for computation of value of assets for computation of NAV.
2. Investments should strictly be valued at the last quoted closing price in the

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Stock Exchange where investment is principally traded and carry investment in balance sheet at market value.

3. All non-trading investments are to be valued in good faith. Equity instruments being valued on the basis of capitalisation of earnings solely or in combination with the NAV. Debt instruments should generally be valued on an yield to maturity basis.

4. A notable formula for valuing rights of shares till they are traded.

5. NAV for all schemes should be calculated on weekly basis preferably on Wednesday, with the publication of the same at least on a weekly basis.

6. Forward pricing of securities be taken for calculating daily NAV while for weekly NAV's it could be historical prices.

7. Repurchase price should not be lower than 93 percent of NAV and the price should not be higher than 107 per cent of NAV provided that spread between the two does not exceed seven per cent calculated on the sale price.

8. All major expenses like management fee and other periodic expenses should be accrued on day - to - day basis.

9. Changes in the investments and number of units should be recorded in books before first valuation after the date of transaction.

10. Two tier structure for AMC fees, i.e., (i) 'basic annual fee' computed as a percentage of the average weekly NAV, and (ii) an 'additional fee' calculated
as a percentage of the net growth of scheme (second being an incentive structure for better performance by AMC).

11. AMC to pay where scheme fails to meet assured minimum targeted returns out of its own funds and not of the scheme corpus.

12. Disclose custodian and registration fee for investments held.

13. Disclose total income and expenditure expressed as a percentage of average Net Assets calculated on weekly basis.

14. The basis on which management fees have been paid to AMC should be disclosed.

15. The portfolio turnover as a ratio to weekly NAV, the ratio of expenses to net assets and gross income to net assets should be disclosed.

16. Investments have to be disclosed in the form of major classification in the note to the balance sheet.

17. Equalization account be treated to credit part of sale proceeds and debit part of repurchase outgo.

Big daddy UTI will also now come under SEBI. Almost all schemes of UTI will be covered by the rules of SEBI. Three more schemes of UTI namely Unit Linked Insurance Plan (ULIP), College and Career Fund (CCF) and Charitable and Religious
Trusts Scheme, which were launched before the new regulations were effected, will be added along with other 70 schemes that come under the purview of SEBI. SEBI has consented to the proposals of the Association of Mutual Funds of India (AMFI) for the uniform standards of valuation of Net Asset Value (NAV) by mutual funds.\(^{12}\)

The SEBI (Mutual Fund) Regulations 1996\(^{13}\) while eliminating many of the rigidities of 1993 regulations, introduced new provisions regarding disclosure, transparency, obligations on the part of mutual funds, AMC, trustees and the key personnel. The important aspects of these regulations are as shown below.

These regulations are applicable to all mutual funds investing primarily in capital market and also partly in money market instruments subject to the following conditions.

1. Money market mutual funds that would invest exclusively in money market instruments would be regulated by RBI on the basis of specific guidelines laid down by it. However, money market schemes of other mutual funds would be regulated by the SEBI. These regulations will be in conformity with the

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\(^{13}\) The Gazette of India - Extraordinary Part II-section-Sub-Section (ii) Notification December, 9, 1996.
guidelines issued by the RBI for money market mutual funds investing exclusively in money market instrument.

2. Off-shore funds which have non-residential investors and are regulated by the provisions of the countries where they are registered shall be outside the purview of these guidelines. These funds continue to be governed by the rules and procedures laid down for purpose of approving and monitoring their performance by the Department of Economic Affairs, Ministry of Finance and Government and RBI directives on the subject.

3. Mutual funds with special characteristics, eg. Funds dealing with assets other than securities may be specially exempted by the Government from the purview of these guidelines.

CONSTITUTION AND STRUCTURE OF MUTUAL FUNDS IN INDIA

Mutual funds shall be authorised for business by SEBI. There are four players for the constitution and management of mutual funds. They are: sponsor of a mutual fund trust, trustees, Asset Management Company as fund managers and custodians. The basic requirements are briefly stated below in accordance with SEBI (Mutual funds) Regulations, 1996 which have replaced 1993 Regulations which have earlier replaced the guidelines of 14.2.1992.
Exhibit-3.1

Constitution and Structure of Indian Mutual Funds

\[ \text{Sponsor Company} \]

Which establishes the mutual fund in the form of a Trust and registered with SEBI

\[ \text{Mutual Fund Trust Managed by a Board of Trustees} \]

Holds the funds of mutual funds in trust for unit-holders and ensures compliance of SEBI regulations the trust deed guidelines etc., and appoints an

\[ \text{Asset Management Company} \]

Floats mutual fund schemes and manages funds in accordance with SEBI Regulations, and the terms of the asset management agreement

\[ \text{Custodian} \]

Appointed by Trustees to provide the necessary custodial services. Bankers and Registrars and Transfer Agents are appointed by Trustees.
**SPONSOR**

Mutual funds shall be sponsored by a company registered under the Companies Act 1956 or a schedule bank or an all-India or State level financial institution. One or more public or private limited companies can jointly float a mutual fund. Mutual funds (other than UTI) are to be set up as Trusts, governed by board of trustees or trustee companies and are to be managed by an Asset Management Company (AMC).

The sponsoring company or companies shall have (1) a sound track record, (2) general reputation and (3) fairness in all business transactions. Besides these, the two additional requirements are (i) the company or companies should have a good organisation and management pattern to reflect its reputation and market standing; and (ii) secondly the sponsors should be able to contribute at least 40 per cent of the minimum net worth or Rs.10 crores towards the net worth of Asset Management Company through cash transfer from its/their accumulated resources. In addition to it, the company must be able to contribute to the corpus of the mutual fund trust.

**TRUST**

Mutual funds shall be constituted in the form of Trust under the Indian Trust Act 1882 and the trust deed shall be duly registered under the provisions of Indian Registration Act. The trust deed is executed by sponsors in favour of trustees. SEBI has laid down certain conditions of appointment, responsibilities, rights and obligations of the trustees.
The functions of the trustees are not defined in SEBI Regulations, 1996 but the main functions of the trust are:

i. Planning and formulating schemes

ii. Seeking SEBI approval and authorisation to such schemes.

iii. Marketing of schemes for public subscription.

iv. Seeking RBI approval in case NRI's subscription to mutual fund is invited.

v. Attending to trustee functions.

The trustees are responsible for the actions of AMC.

**ASSET MANAGEMENT COMPANY**

Mutual funds are managed and their schemes are operated by separately appointed Asset Management Companies. The AMC is appointed by the sponsor or by the trustees, if so authorised by the trust deed. The AMC to manage the assets of mutual funds is to be approved by SEBI. SEBI lays down the terms and conditions of such appointment.

1. AMC which is already existing should have sound track record, general reputation and fairness in all their business dealings.

2. No appointment of a director of an AMC shall be made without the prior approval of the Trust.
3. The directors of AMC are to be the persons having adequate (at least 10 years) professional experience in finance and finance-related fields.

4. At least 50 per cent of the Board shall consist of independent directors not connected with sponsoring organisation.

5. The AMC has at least a minimum net worth of not less than Rs.10 crore.

6. The Key personnel of the AMC should not have been working for any AMC or mutual fund or any intermediary whose registration has been suspended or cancelled at any time by the Board.

7. The AMC takes decisions relating to the investment of funds.

**CUSTODIAN**

The mutual funds shall appoint and use the services of a custodian registered with SEBI. Responsibilities to be discharged by the Custodians on behalf of mutual funds include receipt and delivery of securities, holding of securities, collecting income and handling of costs, corporate actions etc., there are four important functions which are attended to by custodians in addition to the above stated responsibilities. They are (i) attending to shareholders transactional activities such as issue, transfer, exchange, redeem, maintain detailed records of transactions, receipt of dividends and purchase of securities etc. (ii) Maintaining records of confirmation of transaction, check registers, certificates, files, commission reports, tax reporting etc.
Custodial charges range between 0.15 per cent to 0.20 per cent on the net value of customer's holding.

Mutual funds run by the subsidiaries of the public sector banks have their respective sponsor banks as custodians. Foreign banks with high degree of automation in handling securities have assumed the role of custodians. With the establishment of stock Holding Corporation of India, the work of the Custodian of Mutual fund is handled by it for various mutual funds.

To sum up, the consolidated activities of sponsors, trustees, AMC and custodian form the basis for organisation and management of mutual funds. Through the segregation of these constituents into independent legal entities, arms length relationship has been sought to be maintained. Therefore the new structure envisages the following pattern:

**Schemes of Mutual Funds**

SEBI has laid down several provisions for pre-launch and post-launch disclosure to ensure that investors take their own decisions on the basis of information supplied to them.
No new scheme shall be launched by the AMC unless the same is approved by the trustees and a copy of the offer document should be filed with the Board. The Board may suggest modifications in the interest of investors and such modifications shall be made in the offer document. Advertisement of every scheme shall be in conformity with the advertisement code specified by the SEBI. There is also a provision for disclosing the name of the trustees and directors of AMC in the prospectus of the funds and also the investment objectives and strategy. The Board can direct the AMC to stipulate the minimum amount, it seeks to raise under the scheme and the extent of over subscription to be retained. If it fails to receive minimum subscription, application money shall be refunded to the applicants.

Mutual funds are allowed to launch both open-ended and close-ended schemes. Every close-ended scheme shall be listed in the recognised stock exchange within six months from the closure of subscription, except those which provided monthly income or cater to special class of persons like senior citizens, women, children or physically handicapped persons providing repurchase facility to all unit holders with some conditions. Such repurchased units can be reissued. The units of close-ended scheme may be converted into open-ended scheme if such option is stated in the offer document and majority of unit holders give consent to that effect.
i. The mutual funds are allowed to initiate and operate both close-end and open-end schemes.

ii. Each close-end scheme must have a minimum corpus of Rs.20 crore.

iii. Each open-end scheme must have a minimum corpus of Rs.50 crore.

iv. In case of a close-end scheme, if the minimum amount of Rs.20 crore or 60 percent of the targeted amount, whichever is higher is not raised, then the entire subscription has to be refunded to the investors.

v. In case of an open-end scheme, if the minimum amount of Rs.50 crore or 60 percent of the targeted amount whichever is higher, is not raised, then the entire subscription has to be refunded to the investors.

The regulations also allow for the reissue of units in case of close-ended scheme and conversion of the close-ended scheme into an open-ended scheme. This provision is expected to impart liquidity for the units and create a retail market.

A unit certificate is freely transferable unless and otherwise prohibited. No guarantee of returns can be made unless such returns are fully guaranteed by the sponsor or AMC and the name of the person who will guarantee the returns and the manner in which the guarantee will be met are made in the offer document. A close-ended scheme shall be wound up on the expiry of the duration of the scheme unless it
is rolled over for a further period under regulation.

**INVESTMENT NORMS**

The money collected under any scheme shall be invested only in transferable securities in the money market or in the capital market or in the privately placed debentures or securitised debts. The money collected by Money Market Mutual Funds shall be invested only in money market instruments.

Currently there are two types of restrictions on the investments. One set of restrictions prescribed by UTI Act of 1963 and UTI General Regulations, is applicable only to its investments. The second set, issued by SEBI, is applicable to all other mutual funds. As per the UTI Act, it can invest up to 10 to 15 percent of the outstanding equity capital of a company. SEBI prescribes the following investment norms:

i. No mutual fund under all its schemes can own more than five per cent of any company's paid-up capital carrying voting rights.

ii. No mutual fund under all its schemes taken together can invest more than 10 percent of its funds in shares, debentures, or other instruments of any single company.

iii. No mutual fund under all its schemes taken together can invest more than 15
percent of its funds in the shares and debentures of any specific industry, except in the case of those schemes which are specifically floated for investment in one or more specified industries in respect of which a declaration has been made in the offer letter.

iv. No individual scheme of mutual funds can invest more than five per cent of its corpus in any one company's shares.

v. Mutual funds can invest only in transferable securities, either in the money market or in the capital market. Privately placed debentures, securitised debt and other unquoted debt instruments holdings cannot exceed 10 per cent in the case of growth fund and 40 per cent in the case of income funds.

In October 1997, the Reserve Bank of India in its credit policy has announced that all fund managers registered with the SEBI would be allowed to invest in overseas markets. Indian mutual funds can invest in American Depository Receipts (ADR's) and Global Depository Receipts (GDR's) of an Indian Company within an overall limit of $500 million. Investment by each mutual fund ranges from a minimum of #20 million and maximum of #50 million but should not exceed 10 per cent of net assets managed by them as on the date of the last audited balance sheet.  

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Mr. B.G. Deshmukh, Chairperson of SEBI's mutual fund committee told that the SEBI has tightened norms for investment disclosure standards for directors and employees of mutual funds. Mutual fund employees involved in research, dealing and investment decision would now have to take prior permission before making investments.\(^\text{15}\)

SEBI allowed mutual funds to invest in securities and units of unlisted Venture Capital Funds (VCF’s) up to a limit of 5 per cent of net assets in the case of open-ended mutual fund schemes and 10 per cent of net assets in the case of close-ended mutual fund schemes.\(^\text{16}\)

**NET ASSET VALUE AND PRICING OF UNITS**

Every mutual fund shall compute and carry out the valuation of its investments of portfolio and publish the same in accordance with the valuation norms specified.

There are provisions relating to the computation of Net Asset Value and

\(^{15}\) B.G. Deshmukh, The Hindu, dated Jan-10, 2000, page 18.

\(^{16}\) Special Correspondent - "MF's allowed to invest in unlisted, VCF's", The Hindu, July 14, 2001, p.16.
pricing of units. Every mutual fund shall compute the Net Asset Value of each scheme by dividing the net assets of the scheme by the number of units outstanding on the valuation date. The NAV of each scheme shall be calculated and published at least in two daily newspapers at an interval of not exceeding one week. The NAV of any scheme for special target segment or any monthly income scheme not required to be listed in any stock exchange may be published a monthly or quarterly as may be permitted by the Board. It may be declared on the daily basis at the option of the mutual fund.

The price at which units may be purchased or sold and the price at which such units are repurchased by the mutual fund be made available to the investors at least once a week (in case of open-ended scheme). The repurchase price shall not be lower than 93 per cent of NAV and the sale price not higher than 107 per cent of NAV. The repurchase of the units of close-ended schemes shall not be less than 95 per cent of NAV.

The price of units will be determined on the basis of last determined NAV unless (a) the scheme announces NAV on daily basis and (b) the sale price is determined by adding to the future NAV, a fixed premium which is declared in advance.
**DISTRIBUTION OF DIVIDEND**

Mutual funds are required to distribute at least 90 per cent of their profits annually in any given year.

Besides the above mentioned rules, there are guidelines governing the operations of mutual funds seeking to ensure greater investor protection through detailed disclosure and reporting by the mutual funds. SEBI has also been given wide ranging powers to oversee the constitution as well as their operations including a common advertising code. Further, SEBI can impose penalties on mutual funds after due investigation, for their failure to comply with the guidelines.

All mutual funds should publish scheme-wise annual report or an abridged summary through advertisement within 6 months of the closure of the financial year. The trustees of a mutual fund are bound to convey to investors any information having an adverse bearing on the investment.

Mutual funds are permitted to borrow not more than 20 per cent of the net assets of the scheme for a period not exceeding 6 months for meeting dividend payments and redemptions.

SEBI has also prescribed norms for investment management with a view to
minimise risks. It can inspect the books of accounts, records, documents of a mutual fund, trustees, AMC and Custodian and call for any information.

The regulatory and supervisory powers of SEBI’s stand is strengthened by the Securities Law (Amendment) Ordinance, 1995 which empowers SEBI to impose penalties for the violation of any regulations. Under this Amendment, SEBI can file complaints in the courts without prior approval of the Central Government.

The Ordinance further empowers SEBI with certain extra powers to check the violation of regulations. The Board can impose monetary penalty under the following situations:

i. If any mutual fund violates the terms and conditions of certificates of registration, the Board can impose a penalty not exceeding Rs.10,000 for each day during which the failure continues or Rs.10,00,000 whichever is higher.

ii. If a mutual fund fails to comply with listing conditions, a penalty not exceeding Rs.5,000 for each day or Rs.5,00,000 whichever is higher, can be imposed.

iii. If a mutual fund fails to dispatch Unit Certificates in the manner provided it shall be liable for penalty not exceeding Rs.5,000 per day for each day during which such failure continues.
iv. A mutual fund is also liable for penalty if it fails to refund application money (specified in the regulations), not exceeding Rs.1000 per day during which such failure continues.

v. A mutual fund can be penalised if it fails to invest the money collected under a scheme in the manner, or within the period, prescribed in the regulations. Such penalty will not exceed Rs.500000 for each failure.

vi. A penalty of Rs.500000 for each failure of the AMC can be imposed if it fails to comply with any restrictions provided in the regulations.

**RIGHTS OF UNIT HOLDERS**

The Association of Mutual Funds in India (AMFI) in its investors' concise guide 'Making Mutual Funds Work For you' spelled out the rights of unit holders of mutual funds. They are:

i. to receive Unit Certificates or statement of accounts confirming unit holder title within 6 weeks from the date of the closure of the subscription or within 6 weeks from the date of request for a unit certificate received by the fund.

ii. to receive information about the investment policies, investment objectives,

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financial position and general affairs of the scheme.

iii. to receive dividend within 42 days of its declaration and receive the redemption or repurchase proceeds within 10 days from the date of redemption or repurchase.

iv. to vote in accordance with the Regulations to:
   a. Either approve or disapprove any change in fundamental policies of the scheme which are likely to modify the scheme or affect the interest of unit holder.
   b. Change the AMC.
   c. Winding up the Schemes.

v. to inspect the documents of the Mutual funds specified in the scheme's offer document.

In addition to the above rights, the unit holder can expect the following from the Mutual Funds:

i. to publish their NAV, in accordance with the regulations, daily in case of open-ended schemes and periodically, in the case of close-ended schemes;

ii. to disclose the scheme's portfolio holdings, expenses, policy on asset allocation, the Report of Trustees on the operation of schemes and their future outlook through periodic news-letters, half-yearly and annual accounts.
iii. to adhere to a Code of Ethics which require that investment decisions are taken in the best interest of the unit-holders.

3.5 SELF - REGULATION - (AMFI)

Self-regulations must be considered more relevant and appropriate for investor's protection. For this purpose mutual fund in India - both in public and private sector have formed a self-regulatory organisation in 1993 called the Association of Mutual Funds in India (AMFI) registered under Section 25 of the Indian Companies Act, 1956. The AMFI plans to have an internal disciplinary council which will take action against any practice that lowers the image of the industry. Educating the investor to explain the nature of mutual funds, what investors can expect from them, differences between investments in the secondary market and those in funds, construction of Net Asset Value, techniques of evaluating the fund performance, etc., shall be the prime objective of AMFI.

The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to ensure the maintenance of standards in all areas with a view to protect and promote the interest of mutual funds and their unit holders.
OBJECTIVES

* 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 others engaged in the industry.

* to undertake nation wide 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 or in association with other bodies.

AMFI, the apex body of all the registered Asset Management Companies including Unit Trust of India was incorporated on August, 22, 1995 as a non profitable organisation. As of now, all the 35 Asset Management Companies that have
launched mutual fund schemes are its members.

AMFI functions under the supervision and guidance of a Board of Directors.

AMFI's activities come under the following five categories.

1. Interaction with the regulator on a regular basis to improve the regulatory framework.

2. Promoting and establishing professional standards in different areas such as valuation, accounting, disclosure and compliance etc., to match with international levels.

3. Training of intermediaries and certification of agent-distributors. AMFI has developed training programs as well as certification system.

4. Investor education.

5. Dissemination of information on Mutual Fund Industry. AMFI has a website which provides NAV's of all schemes of all Mutual Funds on daily basis as well as other information. AMFI releases quarterly and monthly data through AMFI UPDATE and AMFI MONTHLY.

AMFI works through a system of standing committees and working committees consisting of members of the association. AMFI represents the Indian Mutual Fund Industry both in the Area Ocean Regional Conferences and International
Investment Funds Conferences.\textsuperscript{18}

It has already published the investor's concise Guide "Making Mutual Funds Works for You" and also the Agent's Concise Handbook "Selling Mutual Funds: MADE EASY". AMFI will keep a close watch on changing perceptions and responses of investors, mutual fund operators and the regulator with a view to send early warning signals and suggesting corrective measures. It will undertake the campaign for educating investors about mutual funds, act as an information bank to disseminate information, maintain high standards of industry and keep track of regulatory changes.

The AMFI should work as a complementary organisation to SEBI. It is difficult to expect SEBI to clear every offer document when there are a large number of AMCs managing thousands of funds. Sahadevan K and Thripal Raju M\textsuperscript{19} suggest that ... "In the interest of the development of the industry, the minimum standards should be set up and operational aspects should be left to self regulatory organisations

\textsuperscript{18} Mutual Fund Year Book, 2000 : pp.2,3.

\textsuperscript{19} Sahadevan K and Thripal Raju M "Mutual Funds - Data, Interpretation and Analysis" Prentice Hall India (P) Ltd., New Delhi, 1997, p.20.
like AMFI". Self regulation is the best regulation and the AMFI should devise ways and means of self-discipline at the same time promoting investor's awareness of various aspects of mutual fund schemes.

3.6 MONEY MARKET MUTUAL FUNDS

The Reserve Bank of India had taken the initiative to launch Money Market Mutual funds (MMMFs) by appointing a Task Force on September 3, 1991 under the Chairmanship of D. Basu, Dy. Managing Director of State Bank of India. The Task Force submitted its report to RBI on January 21, 1992. On the basis of the recommendation of the Task Force, RBI issued guidelines on April 29, 1992, indicating the formation, management and scope of money market mutual funds. With a view to provide greater liquidity and depth to money market and in order to make the scheme more flexible and attractive to banks and financial institutions certain modifications to the existing scheme have been introduced. The salient features of the modified scheme and the guidelines were announced by RBI on November 23, 1995.

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3.7 NEW GUIDELINES OF SEBI²²

SEBI has issued detailed new guidelines for valuation of securities and for identification and provisioning of Non-Performing Assets (NPAs). The guidelines have been made effective as under:


iii. Guidelines for valuation of non-traded and thinly traded debt securities effective from December 1, 2000*

* AMFI software package on Bond Valuation developed by CRISIL has since been modified on the lines of the Guidelines and the same is being installed at all AMC’s office to enable them to switch over to the new methodology from December 1, 2000.

* SEBI has also issued circular to all Mutual Funds in the matter of recording of Investment decisions by Mutual funds.

²² AMFI website: SEBI Update: Quarterly reports.
CIRCULARS OF SEBI

The SEBI has issued guidelines through its circulars on the following subjects:

INITIAL OFFER PERIOD, ALLOTMENT OF UNITS AND DESPATCH OF ACCOUNT STATEMENTS

* Initial offer period is reduced to 30 days in case of open-end schemes.
* Allotment of units and dispatch of account statement to be completed within 30 days from the closure of the issue.
* Open-end Scheme to start ongoing sale and repurchase within 30 days from the closure of initial offer period.
* Disclosure of portfolio on half-yearly basis to be done in the prescribed format with immediate effect.

UNCLAIMED REDEMPTION AMOUNT

Detailed guidelines on the treatment of the unclaimed redemption amount have been issued.

* AMC ANNUAL REPORT

AMC's Annual Report to be made available to unit holders on the website of mutual funds and to be supplied to unit holders on request.

* EXPENSES NOT CHARGEABLE TO SCHEME

Regulation 52(4) amended specifying expenses which can not be charged to mutual fund schemes. Trustees have been authorised to approve expenses, that can be charged to the scheme if the same are attributable to the schemes.
* **INVESTMENT IN UNRATED DEBT INSTRUMENTS**

Prior approval of Board of Trustees and Board of AMC has been done away with, for investment in unrated debt instruments subject to certain conditions. Such investments can now be approved by a committee to be constituted by Mutual funds.

* Updating of the offer documents on continuous basis SEBI has stipulated the frequency at which abridge offer document is to be revised and updated besides indicating essential items which require to be revised accordingly. It has also indicated that pending revision of abridged offer document, an addendum giving details of changes be circulated to all distributors and unit holders.

* The time frame for despatch of dividend warrants has been reduced from 42 to 30 days from the date of the declaration of dividend.

* **Report of securities transactions by the Directors of AMC**

* Directors of AMC are required to report details of securities transactions which exceed the value of Rs.1 lakh to Trustees on quarterly basis.

* **Mutual Funds are required to update their NAVs sale and repurchase prices on AMFI website by 8.00 P.M every day in respect of their open-ended schemes.**

* **Guidelines issued for launching ongoing scheme, any additional plans which differ from the main scheme in terms of portfolio, maturity or any other characteristics. Such plan should be launched as a separate scheme.**
* Valuation of securities & provisioning of Non Performing Assets (NAP)

Following amendments were made in the SEBI circular dated September 18, 2000 and October 30, 2000 in respect of valuation of securities and provisioning of NAPs.

* The period for determining whether a security is traded or non-traded has been reduced from sixty days to thirty days.

* Provisioning for NPA is required to be made by debiting to the revenue account and aggregate carrying value with market value of NPA to be disclosed in the balance sheet.

* NPA has been defined as investments not providing any income in the form of dividend or interest.

* Uniform day for publication of NAV of close-ended schemes.

* Mutual Funds are now required to compute and publish the NAV of close-ended schemes on every Wednesday.

* All mutual Funds to inform SEBI the progress made by Mutual Funds in implementation of guidelines/directions issued by them during the period January 5, 2000 to February 15, 2001 on various matters.

* A revised format for Half-Yearly disclosure of un-audited financial results has been prescribed to be published before the expiry of one month form the close of each half-year.