



## Role of Securities & Exchange Board of India (SEBI) in Regulating Mutual Funds

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### ABSTRACT

Mutual funds are financial intermediaries which collect the savings of investors and invest them in a large and well diversified portfolio of securities. The advantages for the investors are reduction in risk, expert professional management, diversified portfolio, liquidity of investment and tax benefit. This fast grown industry is regulated by the Securities and Exchange Board of India (SEBI). Today there are around 40 mutual funds and over 300 schemes with total assets of around Rs. 6.4 lacs crores. Since the mutual funds involve a huge amount of retail investors, therefore, this paper attempts to analyse whether SEBI is able to regulate the activities in Mutual Fund Market and whether its regulatory role is capable to protect the interest of huge investors. This study also attempts to analyse the shortcomings (if any) in the regulatory regime and suggest some measure to increase its effectiveness.

**Keywords:** SEBI, Mutual Fund, Retail Investors, Regulatory Regime

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## **1. INTRODUCTION**

### **1.1 SEBI's Background**

Capital market was growing at a very fast pace in India particularly after liberalization in Industrial Policy in 1991. Controller of Capital Issues (CCI) was looking after new issues. Department of company affairs was also looking after some aspects. However, need was felt to have a single authority to regulate and administer the securities law. With this in mind, SEBI (Securities and Exchange Board of India), which was earlier established as an administrative body in April 1988, was given a statutory status under section 3 of Securities and Exchange Board of India Act, 1992 on 30<sup>th</sup> January 1992. Controller of Capital Issue (CCI) was abolished with a view to have SEBI as a single agency to look after over capital market.

### **1.2 Mutual Funds**

Mutual funds are financial intermediaries which collect the savings of investors and invest them in a large and well diversified portfolio of securities. The major advantages for the investors are reduction in risk, expert professional management, diversified portfolio and tax benefit. By pooling of their assets through Mutual Funds, Investors achieve economies of scale.

Mutual Funds are to be established in the form of Trust under Indian Trust Act, and are to be operated by Asset Management Company (AMC). Mutual Funds dealing exclusively with Money Market Instruments are to be regulated by RBI. Mutual Funds dealing primarily with capital market and also partly in Money Market Instruments are to be regulated by SEBI. All schemes floated by Mutual Funds are to be registered with SEBI.

### **1.3 SEBI Regulation on Mutual Funds:**

Securities & Exchange Board of India had issued a set of regulations and code of conduct as SEBI (Mutual Fund) Regulations, 1996 on 9<sup>th</sup> December 1996 for the smooth conduct and regulation of mutual funds. Recently, SEBI has issued updated regulations as SEBI (Mutual fund) Regulations 2011 on 07 Jan 2012 covering all amendments up to Dec 2011. These guidelines lay down certain criteria for investment, disclosure, accountability and distribution of profits to its members. The salient features of these regulations include various aspects relating to Registration of Mutual Fund, Constitution and management of mutual fund & rights and obligations of trustees, Constitution and management of Asset Management Company and custodian, Restrictions on business activities of AMC and its obligations, Schemes of mutual fund, Investment objectives and valuation policies, Advertisement code, Code of conduct, Restrictions on investments, Investment valuation norms, Accounts and Offer documents.

## **2. LITERATURE REVIEW**

There are some Indian studies which viewed UTI as a developmental financial institution and critically examined the role of UTI in providing industrial finance but not attempted to evaluate the performance of UTI Schemes in terms of returns and risk. Hence, these studies cannot be considered as research work on the Indian Mutual Funds.

Since 1986, a number of articles and brief essays have been published in financial dailies, periodicals, and a few in the professional and research journals. The available literature can be divided into three categories; **(i)** Informative and descriptive, **(ii)** regulatory issues, **(iii)** Managerial aspects and Performance evaluation. A brief review of the literature is presented here:

- i) A number of academics, professionals, and journalists have written articles explaining the basic concept of mutual funds, their characteristics and reviewed the trends in the growth of mutual funds. They also emphasised the importance of mutual funds in the development of the capital market in India. A few under this category are: **Sudeep Ghosh, Madan Gopal, Vidyashanker, Batra, Sunil Garodia, Sarkar, Agrawal,** and **Sadhak, Verma's** book on mutual funds covers the conceptual and regulatory aspects to the Indian Mutual Fund with some informational data and guidelines to the investors in selection of mutual funds. **Gupta** made a Household investor Survey in April 1992. The main objective of the survey is to provide data on the investor preferences on mutual funds and other financial assets. The findings are more appropriate to the policy makers who design the financial products (Fund Schemes)
- Seema Vaid's** study covers conceptual and the regulatory framework, review of the growth of mutual funds, and primary information about mutual fund schemes. **Kulashreshtha** offers certain guidelines to the investors in selecting the mutual fund schemes.
- ii) A few articles highlighted the importance and issues for the regulation of mutual funds. Among them the notable are: **Barua, Narayan Bhatt, Bhanu,** and **Bhatt.** Finally, in 1996, SEBI framed regulations for mutual funds.
- iii) A few articles touched upon certain aspect of portfolio management and other issues involved in the management of mutual funds. The notable among them are **Sengupta, Lal and Sharma,** and **Saha and Murthy.**
- Barua** and other (1991), made a pioneering attempt to evaluate the performance of 'Master Share' scheme of UTI from the investor point of view. **Sharad Shukla** (1991) evaluated the **Sharpe, Jensen, Treynor** ratios for the period January 1988 to June 1991. **Ajay Shah** and **Susan Thomas** studied the performance evaluation of 11 mutual fund schemes, on the basis of market price data. **Jaideep** and **Sudip Majumdar** (1994) evaluated the performance of five growth-oriented schemes for the period of February 1991 to August 1993. **Kaura** and **Jayadev** (1995) evaluated the performance of five growth oriented schemes in the year 1993-94. **Later on, a number of studies were undertaken but most of the studies are related the performance of the schemes.**
- On the basis of review of available literature it can be concluded that the work on the role of SEBI in regulating mutual fund has not been done yet. Therefore, in this research project we will try to go in deep whether SEBI is regulating mutual funds in proper way or not.**

### 3. SIGNIFICANCE & OBJECTIVES OF THE STUDY

Today there are around 40 mutual funds and over 300 schemes with total assets of around Rs. 6.64 lacs crores. This fast grown industry is regulated by the Securities and Exchange Board of India (SEBI). Today the investor is being offered service standard (daily NAV, reduced transaction time, on the query answering etc.) comparable to that of western countries. And has a choice of a diverse range of products, with Internet being widely used, mutual funds minimise the costs and improve turnaround time in transactions in future. Since the mutual funds involve a huge amount of investors, therefore, it has been tried and analysed whether SEBI regulatory role is up to the mark or have some shortcomings.

The main objectives of this study are as under: -

- To appraise different rules and regulation laid down in India to regulate the Mutual Funds.
- To analyze the working of SEBI in regulating Mutual Fund Markets.
- To examine the effectiveness of SEBI's functioning in this regard and to suggest suitable measures for the effective regulation of Mutual Funds.
- To study the difficulties experienced by the Mutual Funds.
- To study the role & effectiveness of SEBI in protection of Investors in Mutual Funds.

#### **4. HYPOTHESIS**

In this research the following hypothesis have been tested;

1. *There is no significant effect of SEBI regulations in facilitating the Mutual Funds to channelising the savings of Investors.*
2. *Most of the Investors are not aware about the SEBI (Mutual Fund) regulations. There is no significant effect of these regulations in protection of Investor's interest.*
3. *There is no significant effect of these regulations in regulating Mutual funds.*
4. *There is no significant effect of these regulations on fund managers to innovate and implement the investment strategies to optimize the returns (NAV of a scheme).*

#### **5. RESEARCH METHODOLOGY**

The study is based on primary and secondary data. The main sources of secondary data are various journals, periodicals, News Papers, Newsletters of MF Companies and SEBI's documents, Mutual Fund Companies report etc.

The relevant data pertaining to Mutual Funds have been obtained from the investors, intermediaries and professionals associated with Mutual Fund market and 30 leading Mutual Funds operating companies such as ICICI Mutual fund, HDFC Mutual fund, Can Bank Mutual Fund, SBI Mutual Fund, Tata Mutual Funds, Birla Mutual Funds etc. A sample survey technique is adopted to elicit the opinions of various respondents. Out of 400 approached individuals, 296 responded to our inquiries made. For reaching on the conclusion various relevant statistical tools like average, ratio, percentage, z test, t-test...etc are used. Period under this study have taken from the year 2000 and onwards. A suitable questionnaire is prepared for collecting primary data from professionals and investors. The areas covered for sampling are Delhi, Noida, Ghaziabad, Faridabad, and Gurgaon, five leading cities of three states of India.

#### **6. SEBI'S ROLE TO REGULATE MUTUAL FUNDS**

The role of SEBI can be understood from the following points:

### **6.1 Securities Market Awareness Campaign**

SEBI believes that **'An Educated Investor is a Protected Investor.'**

A comprehensive Securities Market Awareness Campaign was launched on January 17, 2003. The campaign includes workshops, audio-visual clippings, distribution of educative materials in English, Hindi and local languages, a dedicated investor website with inventory of booklets/pamphlets/FAQ's and periodic advertisements in All India Radio (AIR) and print media. Till Mar'12, 3217 workshops were conducted covering around 493 cities/towns in India.

### **6.2 Recognition to Investor Associations:**

SEBI recognises investor associations, extends financial support for conducting investor education programmes, and also addresses various issues raised by them to protect the interest of the investors. SEBI has so far recognised 10 Investors' Associations.

### **6.3 Portfolio Disclosure**

Transparency is essential for corporate governance and portfolio disclosure is an important means of keeping the investors informed about the way their moneys are being used to create financial assets. Therefore, SEBI has made it mandatory for mutual funds to disclose the entire portfolio of any scheme.

### **6.4 Transparency in Investment Decisions**

SEBI has taken a far-reaching step towards ensuring due diligence and transparency in all investment decisions by advising all mutual funds 'to maintain records in support of each investment decision which will indicate the date, facts and opinion leading to that decision'.

### **6.5 Screening of mutual funds at the entry level:**

Every mutual fund shall be registered with SEBI and the registration is granted on the fulfillment of certain conditions laid down in the regulations for 'efficient and orderly conduct of the affairs of a mutual fund'.

### **6.6 SEBI has outlined the advertisement code too:**

All mutual funds are bound to publish a scheme-wise annual report or an abridged summary through an advertisement within six months of the closure of the financial year. The trustees of a mutual fund are bound to convey to the investors any information that has an adverse impact. A mutual fund is also to publish half-yearly unaudited financial results through an advertisement.

### **6.7 Prescribed Norms for Investment**

SEBI has prescribed norms for investment management with a view to minimising/reducing undue investment risks. There are also certain restrictions, which are aimed at ensuring transparency and prohibiting mutual funds from excessive risk exposure. These restrictions and limitations have strong similarities with those imposed in the US and the UK.

### **6.8 Inspection & Penalties**

SEBI inspects the books of accounts, records and documents of a mutual fund, the trustees, AMC and custodian. SEBI also imposes a monetary penalty in case of violations of regulations specified. The regulatory framework indicates that SEBI is a highly powerful regulator. There is strong emphasis on ex-post investigation and disciplining of mutual funds through financial penalties.

6.9 As financial journalists play a critical role for investors’ education, SEBI decided to conduct a one-day workshop on capital market for the financial journalists at different centers.

**7. ANALYSIS & FINDINGS**

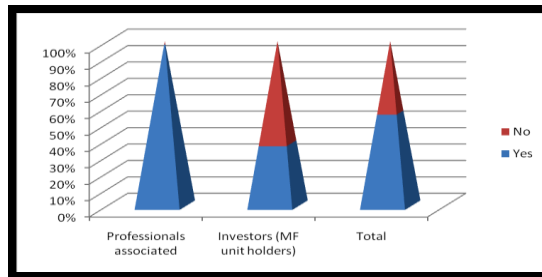
On the basis of the data collected and analysed, the followings are the findings of the study:

**7.1 Awareness of SEBI regulations & its role to channelise the savings**

Out of the investors responded, only 38% of the investors are aware about the SEBI regulations while 98.4% of the professionals associated with MF Industry are aware about the updated regulations and appreciate the regulations in building the investors’ confidence to invest in Mutual Funds. Investors do not acknowledge the role of SEBI regulations.

**Table-1: Awareness about SEBI regulations and its role**

Respondents	Yes	No	Total
Professionals associated	90	02	92
Investors (MF unit holders)	77	127	204



**7.1.1 Null Hypothesis**

*There is no significant effect of SEBI regulations in channelising the savings of Investors to Mutual fund.*

The results of the test show that at 5 % level of significance, null hypothesis is rejected. (Using z test) *There is a significant role of SEBI regulations in channelising the savings of Investors to Mutual fund. Although, there is a significant difference between investor’s and associated professional’s view about the role of SEBI. (Using t test)*

**7.1.2 Null Hypothesis**

*Most of the Investors are not aware about the SEBI (Mutual Fund) regulations. There is no significant effect of these regulations in protection of Investor’s interest.*

The results of the test at 5 % level of significance accept the null hypothesis. (Using z test) *Large numbers of investors are not aware about these regulations. Although, there is a significant difference between investor’s and associated professional’s view about the role of SEBI in protecting the investor’s interest. (Using t test) Professionals do admire the role of SEBI while Investors do not give any credit to SEBI.*

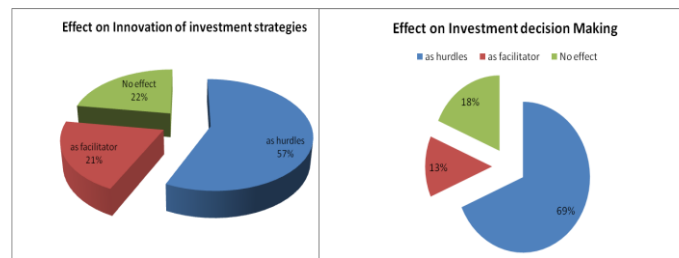
**7.2 Effect of SEBI regulation on Investment decision-making by Fund Managers:**

The respondents associated with Mutual Fund Industry reveals that SEBI regulations do affect the decision making process by fund Managers. They have to consider first these regulations before

taking any decision regarding investment. These often demotivate the fund managers to innovate the investment strategies that may optimize the unit holder’s wealth. Most of fund managers are reluctant to innovate new strategies on account of strict investment norms specified by SEBI.

**Table 2: Effect of SEBI regulations on investment decision making and innovative investment strategies**

Effect	Investment decision making	Innovation of investment strategies
as hurdles	63	58
as facilitator	12	21
No effect	17	23



**7.2.1 Null Hypothesis**

*There is no significant effect of the regulations on fund managers to innovate and implement the investment strategies to optimize the returns (NAV of a scheme).*

The results of the test show that at 5 % level of significance, null hypothesis is rejected. (Using z test) Significant numbers of professionals do consider these regulations first before implementing any innovative investment strategies.

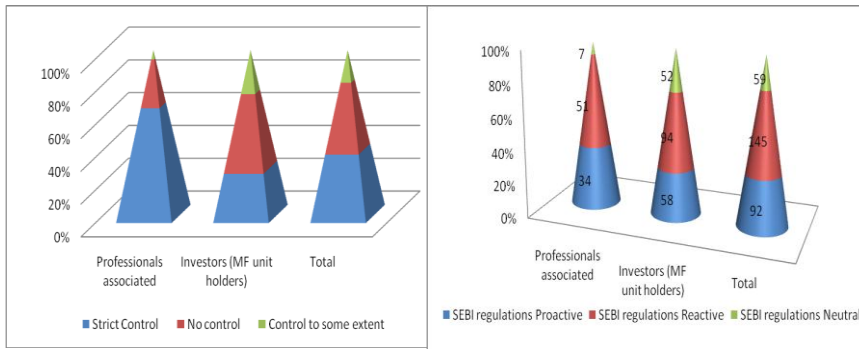
**7.2.2 Null Hypothesis**

*There is no significant effect of the regulations on fund managers to innovate and implement the investment strategies to optimize the returns (NAV of a scheme).* The results of the test show that at 5 % level of significance, null hypothesis is rejected. (Using z test) Significant numbers of professionals do consider these regulations first before implementing any innovative investment strategies.

**7.3 Effect of SEBI regulations on the participant players and on controlling malpractices (fraudulent, unscrupulous...etc) in Mutual Fund Market**

The results of this study reflect that SEBI has so far not been able to control the market players and their activities in an effective manner. The SEBI regulations often are reactive rather than proactive. To some extent, these regulations are able to regulate the operations of Mutual fund market but not able to curb the malpractices (fraudulent, unscrupulous, etc) effectively.

Table-3: Effect of SEBI regulations on Mutual Fund market activities				Table 4: SEBI Regulations: Proactive or Reactive ?		
Respondents	Strict Control	No Control	To some extent	Proactive	Reactive	Neutral
Professionals	61	26	5	34	51	7
Investors (unit holders)	58	94	52	58	94	52
Total	119	125	57	92	145	59



### 7.3.1 Null Hypothesis

*There is no significant effect of these regulations in regulating Mutual funds.*

The results of the test show that at 5 % level of significance, null hypothesis is rejected. (Using z test) Although, there is a significant difference between investor's and associated professional's response about the effectiveness of SEBI regulations. (Using t test) Professionals do accept the effective role of SEBI while Investors do not.

### 7.4 Role of SEBI: Proactive or Reactive?

The results of this study indicate that SEBI regulations often are reactive rather than proactive.

### 7.5 SEBI Investor Awareness Campaign:

The results of this study indicate that SEBI Investor education initiatives are not known to investors. A large proportion of Investors are not familiar with Investor Awareness Campaign

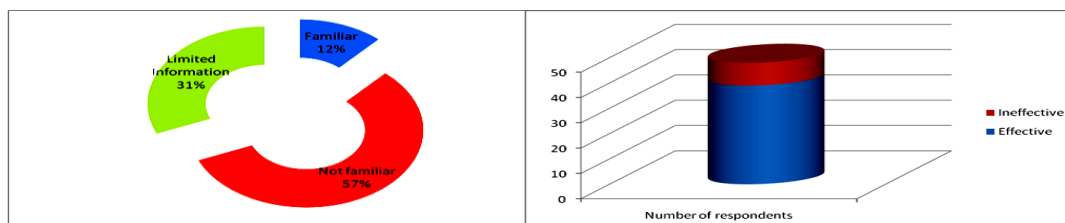
### 7.6 Effect of SEBI Grievance Redressal Mechanism:

The Analysis of data collected indicates that SEBI grievance redressal mechanism is very effective. More than 80% of complainant got their grievances resolved. The respondents who had never complained about their grievances could not comment anything on its grievance redressal but those who had approached SEBI consider it to be very effective.



No. of Respondents	Familiar	Not familiar	Limited Information
Investors (MF unit holders)	24	116	64

	Effective	Ineffective	Can't say
Number of respondents	39	09	156



### 7.7 SEBI's Functioning: A Critical Review

Since March 1991, SEBI has supervised all the Mutual Funds (excluding UTI) several times. SEBI has conducted certain special investigations from time to time. Though the reports are confidential (according to SEBI officials) the financial press has reported certain important points. They are as follows:

(i) In the case of BOI Mutual Fund it is found that the pages of the investment registers containing the details of the transactions in equity shares of Reliance Industries had been torn off. Further, in the case of Festival Bonanza Growth Scheme, BOI Mutual Fund has handed over Rs. 20.50 Crores to stockbrokers. BOI Mutual Fund apparently bought the shares of Karnataka Ball Bearings, a firm deep in the red, at a price higher than warranted.

(ii) Can Bank Mutual Fund has entered in transactions with its sponsor, Canara Bank, to give the benefit of Fund resources. In one single transaction fund has acquired Rs. 300 Cr worth shares. Highlighting the irregularities in securities transactions, The Janaki Raman Committee appointed by RBI found that, some Mutual Fund have misappropriated the funds by indulging in irregularities. To inquire about irregularities in securities transactions, the Government of India has appointed a Joint Parliamentary Committee [JPC], the committee also probed about involvement of Mutual funds in these irregularities. The following comments made by the committee are worth noting:

“The committee regrets to note that Some Mutual Fund has violated almost all the guidelines and regulations of the Ministry of Finance, RBI and SEBI. In many cases, the sponsor and its subsidiary have derived benefit through the operations of fund at the cost of investors.”

“The manner in which Mutual funds had invested the funds indicates that it had not exercised sufficient care, prudence and diligence in the interest of investors and in several instances exposed the investors to high degree of risks without disclosure of it to the investors. This is in the view of the committee is a serious breach of trust”

The committee regrets to note that several funds indulged in serious malpractices/irregularities detrimental to the interest of investors. Failure to exercise adequate control by the authorities concerned resulted in recurrence of the same and regrettably, the irregularities came to be regarded as market practice. It is systematic failure of this order that set the stage for the scam. The system is as much in need of rectification as culpable individuals are in need of punishment". In August 2003, SEBI barred Samir Arora, the famed fund manager of Alliance Capital Mutual Fund, and the FII/sub-accounts of US-based Alliance Capital Management, from trading directly or indirectly in the capital market with allegations of insider trading. SEBI also critically scrutinized the rallies in the stock market and estimated that of substantial part of FII investment came through participatory notes (P-notes).

During various investigations, it was revealed that nearly \$3 bn was invested by the Overseas Corporate Bodies (OCBs) registered in Mauritius, whose beneficiaries were resident Indians. The OCB's funds were largely unregulated and caused a lot of volatility and a subsequent rash in the markets. Therefore, SEBI further tightened the FII regulations to ensure that P-notes are not misused. The SEBI board has restricted the issue of P-notes by FII to only regulated entities.

## **8. PROBLEMATIC ASPECTS FOR FURTHER REGULATION**

An analytical view of crucial issues for further regulations is presented here.

### **8.1 Voting Right to Mutual Funds:**

As per Companies Act, trust cannot exercise any voting power, but it can be exercised by a public trustee who is a government official, which is as good as not exercising at all. The recently formed AMFI has urged for voting rights to mutual funds so as to have a say in decision-making. Mutual Funds sponsors like bank and Financial Institutions, in their role as merchant bankers and lenders have access to inside information which coupled with voting rights encourage the fund managers to indulge in unscrupulous practices, such as insider trading where regulations are weak. Undoubtedly, firm's wealth would improve, but it may be at the cost of the corporate health.

### **8.2 Ceiling on Corpus Amount:**

SEBI regulations have not stipulated any maximum amount to be collected under each scheme. Retention of over subscribed amount creates difficulty not only in management of the fund but eventual problems may crop up at the time of redemption also. Therefore, there should be a limit on the retention of over subscribed amount. The other viewpoint is, if limitation on corpus amount is imposed, the entry for more and more investors into the mutual fund would be closed and the objective of mutual funds gets defeated. However, in the present situation where the mutual fund industry is in the nascent stage and not fully professionalised.

### **8.3 Capital Adequacy:**

Safety of the principal amount can be achieved by guarantee offered by the Government, like post-office saving deposits. Alternatively, safety can be assured through capital adequacy, which is presently applicable to bank deposits, debentures and equity shares. Mutual Funds, whose main activity is to invest in marketable securities, are put to risk of default. The collapse of market may affect the interest of investors and safety of depression, the investor, and the AMCs should have capital adequacy norms. The norms are to be formulated after a thorough study of the issue.

#### **8.4 Borrowing powers:**

SEBI regulations have not specified about borrowing powers. The basic feature of open-ended Mutual Funds is to provide liquidity by continuous repurchase and resale. On repurchase requisition, the fund will sell some of its securities and meet the investor requirement. But if the fund invests in securities-which are not liquidable at optimum/fair price or the encashment may be delayed because of various reasons. In this context, SEBI regulations may have to permit open-ended fund to borrow in order to accommodate the liquidity interest of the investor.

#### **8.5 Insurance coverage for Mutual Fund Investors:**

Deposit Insurance Corporation of India provides an insurance coverage to some extent to deposit holders of banks. Similarly, Mutual Fund investors should also have such coverage against the risks associated. In the UK, Securities and Investments Board organises a compensation fund-which is contributed by financial services companies including unit trusts.

#### **8.6 Norms for Portfolio Turnover Rate:**

Portfolio turnover rate indicates the extent of portfolio activity and depends on the investment objective of the scheme. The turnover rate also influences the stock market price level, investment costs and the level of risk associated. SEBI regulations do not specify norms for portfolio turnover rate for different schemes. Portfolio turnover rate should to be disclosed in the annual report.

#### **8.7 Nomination Facility:**

To facilitate easy transmission of the units, mutual funds should be permitted to provide the service of nomination facility to the unit holders. Presently UTI is offering such facility to its unit holders. The same should be extended to other mutual funds by amending the SEBI regulations.

#### **8.8 Shared Trustees:**

The trustee has the power of superintendence and direction over AMCs. They monitor the performance and compliance of SEBI regulation. Many trustees are associates with more than one mutual fund that may diversify the attention of a trustee and can not fully entertain the interest of a particular mutual fund.

### **9. SEBI (MUTUAL FUND) REGULATIONS, 2011**

SEBI has now reviewed all old regulations and introduced modifications, wherever necessary. It has issued revised set of regulations on Jan 7, 2012. It includes all amendments to previous regulation (1996) up to Dec 30, 2011. Some of the above-suggested changes have been incorporated by SEBI by issuing the new regulation in 2011.

There is an expansion of the derivatives segment, the Corporatisation and demutualization of the bourses, the central listing authority, sweat equity norms, delisting norms etc. It has already amended the takeover code and modified the portfolio management service guidelines. Disclosure standards have been improved; initial public offer documents have become more streamlined with more information on business and revenue models.

### **10. SUGGESTIONS FOR EFFECTIVE REGULATIONS**

The following suggestions can be given on the basis of this study:

**10.1 To empower investor to make informed decisions & achieve fair deals:**

SEBI should ensure that the checks and balances in the surveillance system work well to curb manipulations, which should be backed by prompt scrutiny, investigations and punitive actions. SEBI has to exercise due diligence to ensure timely crackdown on price manipulation, and impose stringent penal action and have a close tab on fund flows to protect investor interests.

**10.2 Suggestions for consumers and participants to think that markets are efficient, orderly and clean:**

SEBI can encourage more market players. It can reconsider the participation of OCBs by making it mandatory for them to announce their beneficiaries rather than completely banning them.

It should proactively examine issues of contentious nature. In most cases, It has taken action only when there is a referral from a court or investor forum or the government (*e.g.*, UTI's assured return schemes). SEBI should make all disclosures available freely to everyone. It has taken the first step towards it through its website EDIFAR.nic.in.

**10.3 To further establish an appropriate, proportionate and effective regulatory regime in which all the 'stakeholders' have confidence:**

SEBI has done a commendable job in terms of stringent regulation. However, the penalties must be more severe and appropriate, so that they deter the market participants from indulging in malpractices. It must ensure that new norms for corporate disclosures have more depth and are implemented over a shorter time period.

The SAT dismissals of major SEBI orders show a poor rate of conviction. SEBI needs to ensure that it exercises its penal powers (up to Rs. 25 cr three times the ill-gotten profits) on proper grounds and leaves no room for reversals, as happened in cases of BPL, Videocon, UB group. etc.

It must also ensure that skilled staff to make its case and decisions stronger, handles major violations of markets and investors' interests. *e.g.*, Sterlite, BPL, Videocon, Anand Rathi and Associates, Hindustan Lever etc.

**10.4 About cautious investment in unlisted securities, privately placed securities, unrated debt securities, and Non-Performing Assets**

All the AMC's are advised to observe specific attention on investments in unlisted, privately placed, unrated debt securities, non-performing assets (NPAs), and transactions where associates are involved as these investment are highly risky. SEBI should include some specific provisions in its regulations to ensure the proper safeguard against the risk associated with these investments (securities).

**10.5 Suggestion Regarding Compliance Certificate**

The compliance certificate to be submitted by the AMC on a half-yearly basis should contain specific comments on the followings:

- If the AMC is carrying on other activities, whether as per the regulations, and whether it continues to meet the capital adequacy requirements for each of the activities.
- If the investments have been made in accordance with the regulations, trust deed and investment objectives of the scheme.
- If the utilization of the services of the sponsor or any of the AMC's associates, employees or their relatives for any securities transaction is in accordance with the offer document and the brokerage and commission paid to such affiliates.

- Details of any changes in the interests of the directors on the AMC's board of directors.
- Investments/Redemption by the AMC or sponsor in any of the schemes and inter-scheme investments, giving details, date, price, value and charges levied.
- Transactions in securities by the key personnel of the AMC, whether in their own name or on behalf of the AMC, giving details of the names of the personnel, name of the security, and purchase/sale details like the quantity, rate, value and name of the broker; whether the transaction is on personal account or conducted by the immediate family or fiduciary.
- The identification and appropriation of expenses to individual schemes and whether the expenses are in conformity with the limits laid down by SEBI.
- Deficiency/Warning letters, if any, received from SEBI and the corrective action taken.

#### **10.6 Suggestions Regarding Transparency in Investment Decisions**

SEBI has taken a far-reaching step towards ensuring due diligence and transparency in all investment decisions. While the AMC boards can prescribe the broad parameters of investment, it is important that the basis for the decision to invest in individual security-equity or debt—should be recorded. The AMC should report on the matter of compliance to the trustees and the trustees shall report to the SEBI in their bi-annual report.

#### **10.7 Suggestions to Provide More Power to Self Regulatory (SRO)**

Association of Mutual Fund Industry (AMFI) needs to be given the status of SRO through legislative measures, and to be declared a 'juridical person'.

**10.7.1** SEBI should delegate certain supervisory powers to AMFI so that it can function as the first-line supervisor such as Screening of applications for licenses and the 'fit and proper test' for AMC, intermediaries, registrars and transfer agents, fund managers.etc, routine audit matters, investigation relating to investors' complaints, implementation of the advertisement code, etc., valuation of the portfolio, routine disclosure of portfolio assets; and Periodic investigations to uncover any possibility of moral hazards, fraud, etc.

**10.7.2** AMFI must set up an appellate body, which could act as an arbitrator between members and AMCs, between investors and AMCs, between AMFI and AMCs.

#### **10.8 Suggestions Regarding Risk Management Function**

It is recommended that all funds should have an independent risk management function responsible for identifying, evaluating or measuring all risks inherent in a mutual fund organisation, as well as establishing controls to mitigate such risks. This function should be separate from fund management. A Risk Management Framework manual detailing the policies & procedures, systems, organisation controls and specific risk management measures for the above risks should be mandated by SEBI, with an implementation time frame.

#### **10.9 Suggestion to Provide Insurance Cover**

It is recommended that funds should be required to buy insurance cover against third party losses arising from errors and omissions. The level and type of cover should be determined by the Trustees, subject to a minimum level of Rs. 5 crores. However, Mutual Funds with assets of less than Rs. 100 crores may take insurance cover for an amount of less than Rs. 5 crore as determined by their trustees. The premium for this cover may be paid for in accordance with Chapter VII,

Section 52 (4) (b) (x) of the SEBI (Mutual Fund) Regulations, 1996. R&T agents and custodians should also be required to take separate cover for errors and omissions.

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