

REGULATORY FRAMEWORK GOVERNING MUTUAL FUNDS IN INDIA

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Abstract

The mutual fund sector in India is constantly changing. Several Indian business organisations are funding investor education. Mutual fund investing is still seen as a hazardous option of investment. One of the most adaptable and comprehensive investments for those who are prepared to invest is a mutual fund because of the variety of possibilities accessible to an investor. The reason for establishing these organisations gave rise to the necessity to regulate the mutual fund business. The mutual fund industry's primary goals have been to safeguard investors' interests by adhering to solid fund management principles and to serve as a conduit for investors' resources to be directed to the most fruitful region through the capital market route. Additionally, because buying, selling, and holding different listed scripts or debt instruments is a part of mutual fund market activities, they have a big influence on liquidity, investments, savings, and the state of the financial markets as a whole. The industry's basic market structure makes it necessary for its own regulation. The likelihood of speculative actions has grown as a result of the private sector's introduction into the area. If such operations are not controlled, stock prices may be manipulated. All of these indicated that in order for the mutual fund business to expand, an appropriate regulatory framework needed to be created. This article examines the mutual fund regulatory system, which makes them a safer choice for maximizing investors' returns.

Key words- AMC, Audit, Inspection, NAV, SEBI etc.

1. Introduction

A commercial product called a mutual fund makes stock or bond investments. It is a professionally managed investment pool used to buy different assets and combine them into a robust portfolio that will deliver you significant returns in addition to the benefits obtained with no risk involved presently being given through the market.

1.1 Origin of Mutual Fund in India

The (UTI) Unit Trust of India, which was founded by the Indian government in 1964 with the goal of boosting domestic modest savings and directing these assets toward the capital markets. This was the beginning of the Indian mutual fund sector. The UTI act 1963, is the precise law under which the UTI was established. Unit 64, the first open-ended equity programme offered by the UTI, was introduced in the 1964 and quickly became one of the most popular types of mutual fund investments available throughout the country. In 1987, the govt. authorised additional banks and insurance companies in the public sector to advertise mutual fund schemes. As a consequence of this deregulation, Mutual fund plans were introduced in every state by six public-sector banks, such as the Life Insurance Corporation as well as the General Insurance of India. Securities and Exchange Board of India, Mutual Funds Regulations (1993), which were later implemented by SEBI, opened the door for the entrance of participants from the private sector into the mutual fund market. When UTI was the only participant in the business the value of the assets that were under control rose to about Rs. 67 billion during the years 1963 and 1988. The mutual fund industry's total assets reached roughly Rs. 610 billion during the second phase, which spanned from 1988 to 1994, when government-sponsored financial organisations like banks and insurers were given the green light to provide mutual funds. By the end of 1994, there were 167 mutual fund schemes in operation. With the entry of private companies during its third phase, which started in 1994, the mutual fund sector saw exponential expansion. The first private mutual fund that was ever founded was the Kothari Pioneer Mutual Fund in conjunction with an international fund. As of September 30, 2002, there were 384 total schemes and 1069 billion rupees in total assets under administration.

1.2 Structure of a Mutual Fund in India

Mutual funds are established via a trust that consists of a sponsor, trustees, an asset management firm (often known as a "AMC"), and a custodian. A single or more sponsors that function as a company's promoter, establishes the trust. For the interest of the owners of units, the mutual fund's trustees retain its assets. The AMC, which has received

SEBI approval, manages the money by investing in different securities. The SEBI-approved custodian is responsible for safely storing the fund's securities.

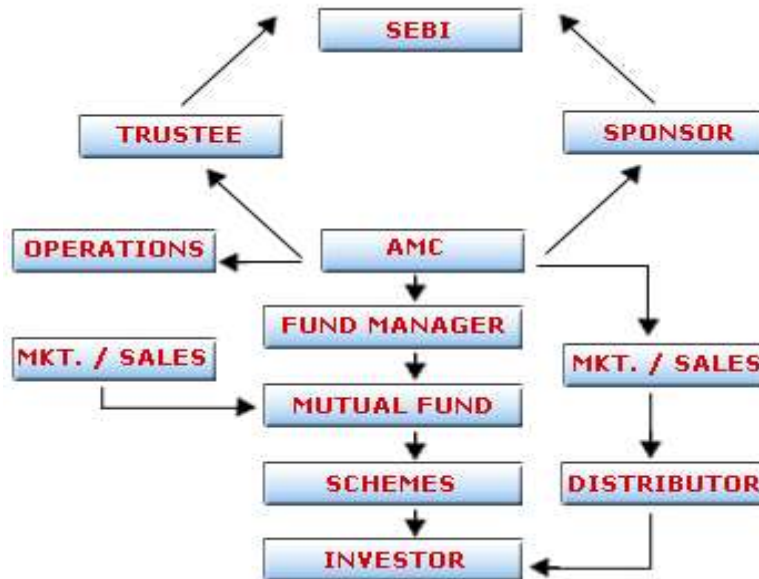


Figure 1: Source: Diya Nigam, Edition 2015, New Delhi

The trustees are given broad supervision and management authority over AMC. They keep an eye on the mutual fund's compliance and performance with SEBI regulations.

2. Regulatory Framework of Mutual Fund in India

The establishment, operation, and discipline were the three topics covered by the SEBI rules. Standards for mutual fund registration, constitution, and administration were necessary for their development. Operational standards included information on mutual fund schemes, investing goals and constraints, and valuation practises. The much-needed disciplinary component included several elements, such as inspection and disciplinary processes.

According to SEBI requirements, each mutual fund must be set up as a trust, with a board of trustees and a separate custodian appointed. The regulations provide precise permission requirements for mutual fund sponsors and the creation of a separate asset management firm. Asset management companies' (AMCs) commercial operations are constrained, and there are restrictions on how much they may charge for the costs of the schemes. The laws also stipulate strict reporting requirements for asset management organisations as well as accounting and transparency standards. The regulating authority, SEBI, is allowed to examine a mutual fund and take enforcement action against it if it violates any rules.

3. Registration of Mutual Fund

The Board will approve registration when the following requirements are met. In all of his commercial dealings, an excellent reputation for fairness and honesty, as well as a proven track record, are essential qualities in a sponsor. As a result, the sponsor must have worked in some aspect of the financial services at the very least over the last five years and be financially secure for the preceding 5 years. The last three to five years, with the most recent year, the guarantor must make a net profit after depreciation, interest, and taxes, and its net worth must be more than the capital investment it made to an asset management business in the year before.

4. Operation of Trustees

Two-thirds board of the mutual fund's trustees must be unaffiliated with the fund's sponsors in order for the fund to be considered to have an independent board of trustees. Mutual fund trustees may not be an AMC, an AMC official, or an AMC employee. A company's directors are eligible to act as trustees of other trusts if the corporation itself is a trustee, so long as those trusts' purposes do not contradict with those of mutual funds. Additionally, unless they are

independent trustees with the previous consent of the mutual fund of which they are trustees, Trustees of one mutual fund cannot be trustees of another.

5. Sponsor

According to the rules governing mutual funds, the sponsor has to have a proven track record, a good name in the community, and a history of acting fairly and honestly in business operations. The 40% of AMC's net worth must come from the sponsor. When a single individual or entity holds 40% or more of an AMC's net value, they are deemed sponsors and must comply with the eligibility standards set out in the Regulations of Mutual Fund. In addition, its directors, sponsor, and the mutual fund's CEO must have been convicted of a felony involving moral turpitude, committed a fraud, or committed an economic crime.

6. Asset Management Company

An AMC must be chosen through the guarantor or trustees to look after the assets of mutual funds. The candidate must meet certain eligibility requirements under the Mutual Fund Regulations in order to be eligible for registration with SEBI as an AMC.

- The sponsor is required to possess at least 40 percent of the AMC.
- In addition to not having been convicted of any economic crimes or securities law violations, the AMC's board members should have significant professional knowledge in the finance and financial services sectors.
- The AMC is required to constantly maintain and have a net worth of at least one hundred million Indian rupees.
- At least half of this AMC's board of directors is independent of the guarantor, some of its affiliates, and the trustees.
- The AMC's Chairman is not a trustee for any of the several mutual funds.

There must be a distinct board in the AMC setup, with at least 50% independent trustees/custodians and at least 50% independent directors/directors. Trustees are responsible for the assets, while AMC oversees the findings; harmony between the two is essential. The Securities and Exchange Board of India (SEBI) stipulates that closed-ended plans must have a corpus of at least 50 crores, while open-ended schemes must keep a corpus of at least 20 crores. Earnings from schemes should be invested within nine months. As part of the scheme's rules, it may only borrow up to 20% of its assets in the event of an emergency. The trustee is responsible for ensuring that all governing documents are followed and signed, thus they must be an expert in their field and a person of impeccable character. There has to be an itemized breakdown of the expenses associated with each plan. Among other things, close-ended plans are restricted in their ability to invest in or purchase debt and money, as well as in their ability to remain unlisted. The objective of the particular mutual fund scheme must be taken into account while making investments. No more than 10% of the net asset value of the plan may be allocated to equity investments.

7. Custodian

In accordance with the regulations governing mutual funds, the mutual fund is required to choose a custodian who will be responsible for providing custodial services for the fund's schemes. Only organisations with significant organisational sturdiness, computerised service capacity, and other infrastructural capabilities are permitted to serve as the custodian. The custodian must be registered with SEBI and completely delinked from the AMC. According to the (Custodian of Securities) SEBI Guidelines, 1996, any individual who wishes to engage in the business of acting as a custodian of securities is required to register with SEBI & satisfy certain eligibility requirements in order to be permitted to do so. A custodian cannot act as custodian for a mutual fund created by the same sponsor or its affiliates or subsidiaries if the sponsor or its associates own at voting rights of the least fifty percent associated with 50% or more of the custodian's directors represent the sponsor or its affiliates.

8. Approval of Schemes

A mutual fund may be authorised to provide its investors with a selection of several plans. The trustees must approve each plan, and the offer document must be submitted to SEBI. All relevant information necessary for investors to make educated investment choices should be included in the offer document, such as information on the maximum investments that the scheme is planned to make in the listed shares of the sponsor's group firms. If SEBI doesn't respond to the offering papers within 21 days, the AMC may make them public.

9. Investment Criteria

The funds raised via any mutual fund scheme may only be used to purchase transferable assets on the money market, the stock market, privately issued debentures, or securitized loans. On the other hand, in the case of securitized loans, this kind of fund may put its money into Mortgage or asset-backed securities. Additionally, mutual funds must settle their transactions using dematerialized assets if the entire value of their holdings of securities is more than Rs. 100.00 million.

10. Limitation of Expenses and Fees

The Regulations of Mutual Fund set limits on the fees the AMC may collect as well as on the amount of expenditures that may be added to the Fund. Subject to the following limitations, If the mutual fund's Assets under 1 billion rupees at any point in the accounting year, the AMC may collect investment and advisory fees of up to 1.25 percent of the year's weekly average net assets and 1 percent of the surplus above 1 billion rupees. In addition to the foregoing, the asset manager may assess the following recurrent costs: trustee fees and expenses; custodian fees; audit fees; costs of transferring funds between accounts; costs of communicating with investors; dividend/redemption cheques, costs of issuing account statements, and warrants; and Legal fees and writs.

11. General Obligations

Asset management companies are required to keep accurate records, books of accounts, and documents for each scheme they manage. They must also disclose to the Board where these documents are kept, records and books of accounts, as well as the financial standing of each scheme at any given moment. Every asset management business is required to keep all of its records, books, and papers for a minimum of eight years. The asset management company will use the accounting standards and practises detailed in the Ninth Schedule to properly record the scheme-wise sale of the fund's assets as of the accounting date in question. Every plan's fiscal year will end on March 31st.

12. Inspection and Audit

Additionally, inspection and audit processes are included in the rules. To carry out the infrastructure, examination of documents, books of accounts, records, systems, and processes or to conduct an investigation into the operations of asset management companies, mutual funds, trustees, and SEBI may designate one or more individuals as inspecting officers. SEBI has the authority to check the books of accounts to confirm that they are kept in accordance with standards, to determine if the Act's and these rules' requirements are followed, and to determine whether the system and processes are sufficient. SEBI has the authority to look into any complaints made by investors or by anybody else on any issue affecting trustees, the operations of mutual funds, or asset management firms. The SEBI will make sure that the mutual fund, trustees, or asset management organisation are doing their business in a way that is beneficial to investors or the securities market. Before directing an inspection or inquiry, the Board will provide the trustees, asset management firm, or mutual fund at least ten days' notice. However, if the Board determines that no such information that investors need to make informed decisions must be made available, it may order that the examination proceed without such notice. Any employee of the mutual fund, director, trustees, officer, or asset management business may have their statements examined or recorded by the inspecting officer throughout the course of the inspection or inquiry. Every officer, asset management firm, director, and employee of the trustee, or mutual fund shall be obligated to provide the inspecting officer with all necessary assistance in connection with the inquiry. As soon as the inspection or inquiry is over, the inspectors must report to the Board. The Board or the Chairman is responsible for taking any action necessary after reviewing the inspection or investigation report, including any action needed by the SEBR, 2002. The Board should be able to hire an auditor to examine the mutual funds or trustee's financial records and operations.

13. Conclusions

From the aforementioned research, it can be inferred that The SEBI is the government agency in India that is in charge of monitoring the country's various financial markets, including mutual funds. In addition to monitoring and controlling the operations of the securities market, SEBI also enforces rigorous laws and regulations to safeguard your interests as an investor. A mutual fund technically consists of 5 entities: the Sponsor, Trustee, AMC, Custodian, and RTA. Every investor must abide by the KYC requirements, which SEBI has mandated in order to safeguard financial transactions. The laws have highlighted the duties of mutual fund trustees, who are in a unique position to advance unit holders' interests and guarantee that mutual funds are handled responsibly and morally. The trustees maintain the public confidence by acting independently. In order to improve mutual fund performance and win back investors' trust, SEBI is using its interface with AMFI to gauge how the new laws would affect how mutual funds operate. Additionally, SEBI is continuing its collaboration with AMFI in an attempt to make the latter an

organisation that is better able to represent the mutual fund industry. At the same time, SEBI has initiated a campaign to raise the amount of attention that the industry pays to its customers.

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