

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: DR. K.M. ABRAHAM, WHOLE TIME MEMBER**

ORDER

DIRECTIONS UNDER SECTIONS 11 AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATIONS 18, 75 AND 76 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) REGULATIONS, 1996 IN THE MATTER OF HSBC GILT FUND

Date of hearing: October 30, 2009

Appearance:

For HSBC Mutual Fund, Board of Trustees of HSBC Mutual Fund, HSBC Asset Management (India) Private Limited and its Chief Executive Officer:

Mr. D.D. Madon, Senior Advocate
Mr. M. P. Bharucha, Solicitor
Mr. Vikramaditya, Chief Executive Officer, HSBC Asset Management (India) Private Limited

For the Securities and Exchange Board of India:

Ms. Asha Shetty, Deputy General Manager
Mr. Vijayakrishnan G., Deputy Legal Adviser
Mr. Himadri Shekhar Verma, Assistant General Manager
Mr. T. Vinay Rajneesh, Legal Officer

1. On an examination of the complaints received from certain unit holders of HSBC Gilt Fund, a scheme launched by HSBC Asset Management (India) Private Limited (hereinafter referred to as AMC), the news item titled "*Forget Due Diligence and Lose Gilt Edge*" which appeared in the daily '*The Economic Times*' on July 24, 2009 and the corresponding replies of HSBC Mutual Fund (hereinafter referred to as the Fund), the Securities and Exchange Board of India had alleged that by changing

- a. the name of the scheme from '*HSBC Gilt Fund - Short Term Plan*' to '*HSBC Gilt Fund*';

- b. the benchmark index; and
- c. the duration of the scheme,

the fundamental attributes of the scheme were changed in January 2009 without following the procedure specified under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (hereinafter referred to as the Mutual Funds Regulations). In view of the same, a notice dated August 7, 2009 was issued to the Board of Trustees of HSBC Mutual Fund, HSBC Mutual Fund, the AMC and its Chief Executive Officer calling upon them to show cause as to why appropriate action including directions under Sections 11 and 11B of the Securities and Exchange Board of India Act, 1992 read with Regulations 18, 75 and 76 of the Mutual Funds Regulations should not be taken. The said show cause notice alleged that the Fund and its Board of Trustees have violated Regulations 18(9), 18(15A), 18(22) of the Mutual Funds Regulations, Clauses 2, 6 and 9 of the Code of Conduct under the Fifth Schedule thereof and paragraph 5(ii)(a) of the SEBI Circular dated May 23, 2008. It was also alleged that the AMC had violated Regulations 18(9), 18(22), 25(1) and 25(16) of the Mutual Funds Regulations, Clauses 2, 6 and 9 of the Code of Conduct mentioned under the Fifth Schedule thereof and paragraph 5(ii)(a) of the SEBI Circular dated May 23, 2008. In view of the above, it was alleged that the Chief Executive Officer of the AMC had failed to ensure that the Fund complied with all the provisions of the Regulations, Guidelines and Circulars issued in this regard from time to time and thereby violated Regulation 25(6A) of the Mutual Funds Regulations. For the sake of convenience, the Fund, its Board of Trustees, the AMC and its Chief Executive Officer are hereinafter collectively referred to as 'noticees' and individually by their respective names. The noticees filed their common reply to the show cause notice, vide letter dated September 4, 2009. Thereafter, an opportunity of hearing was granted to the noticees on October 6, 2009 which was rescheduled to October 30, 2009 on the request of the noticees. On the said date, Shri D.D. Madon, Senior Advocate appeared on behalf of the noticees and made submissions. Mr. M.P. Bharucha (Solicitor) and Mr. Vikramaditya (Chief Executive Officer of the AMC)

were also present in the hearing. The primary submission of the noticees was that the impugned changes made by them in the scheme were not changes in fundamental attributes, as defined by SEBI, for them to adhere to the prescriptions specified under Regulation 18(15A) of the Mutual Funds Regulations.

2. I have considered the show cause notice issued to the noticees, the reply of the noticees, the submissions made on their behalf during the hearing and other material available on record. Before proceeding to consider the issues involved, it would be useful to discuss the key facts of the case for a better appreciation. The AMC had launched a scheme by the name "HSBC Gilt Fund" during the year 2003. The scheme is an open ended scheme which sought to generate reasonable returns through investments in government securities (also referred to as G-Secs in this Order). The said scheme had two plans - Long Term Plan and the Short Term Plan. In the offer document, it was mentioned that the Short Term Plan was suitable for investors seeking to obtain returns from a plan investing in gilts (including treasury bills) across the yield curve with the average maturity of the portfolio normally not exceeding 7 years and modified duration of the portfolio normally not exceeding 5 years. The Long Term Plan was intended to suit investors with surpluses for medium to long periods and that the plan would invest in gilts (including treasury bills) across the yield curve with the average maturity of the portfolio normally not exceeding 20 years and modified duration of the portfolio normally not exceeding 12 years. During the year 2009, the AMC, vide letter dated March 3, 2009 had informed SEBI that certain changes were made in the scheme and had also enclosed therewith a copy of the 'notice cum addendum' published in the newspapers, The Financial Express and Nav Shakti. From the said letter and its annexures, it was noticed that the AMC and the board of trustees had approved the following changes to the HSBC Gilt Fund-Short Term Plan, which was to be made effective from March 12, 2009:

- i. Change in the name of the scheme from **HSBC Gilt Fund – Short Term Plan** to **HSBC Gilt Fund**;
- ii. Change in the benchmark index from “**I Sec Si-Bex**” to “**I Sec Composite Index**”; and
- iii. Change in **the duration** (modified duration) of the portfolio, as mentioned below, which was substituted in the scheme information document:

“The scheme is suitable for investors seeking to obtain returns from investing in Gilts (including Treasury Bills) across the yield curve with the modified duration of the portfolio not exceeding 15 years. Liquidity conditions and other macro-economic factors affecting interest rates shall be taken into account for varying the portfolio duration. However, this can undergo a change in case the market conditions warrant and according to the fund manager’s view.” [Emphasis supplied]

3. While the said changes were under examination in SEBI, certain investors had complained to SEBI that their value of investments in the scheme had come down and alleged that the same was because of the abrupt changes in the investment objective (shifting the investments from ultra short term to long term bonds) of the scheme in January 2009. It was also brought to the notice of SEBI that the name and the benchmark index of the scheme were also changed and that the investors were not informed of the sudden changes in the scheme. Further, it was also reported in the newspaper (The Economic Times) that the Fund had shifted nearly 80% of its assets from ultra short term to long term bonds and that the actual portfolio duration exceeded 12 years in January 2009. When SEBI sought explanation on the said complaints and the newspaper report, the Fund/AMC had replied that the addendum dated January 5, 2009 was duly communicated to all the distributors. On an examination of further information from the Fund/AMC, it was noted from the month-end

portfolio composition of the scheme that the investments were made in government securities of longer duration (G-Secs maturing in the years 2014, 2017, 2018, 2019 and 2032). It was further noticed that unitholders/investors were not informed of the change in the modified duration (the modified duration of the portfolio of the short term plan was “normally not exceeding 5 years” which was changed to “not exceeding 15 years”) before effecting the said change and were only informed by way of the notices/addendum in January 2009 only after extending the duration. Thus, it was alleged that by changing the duration, the benchmark index and the name of the scheme, the ‘fundamental attributes’ of the scheme were changed in January 2009 without following the procedure under the Mutual Funds Regulations.

4. From the foregoing facts and the charges levelled against the noticees, the following issues arise for my consideration:

- a. *Whether the impugned changes made in the scheme amounted to changes in the fundamental attributes of the scheme, in contravention of Regulation 18(15A) of the Mutual Funds Regulations and SEBI Circular dated May 23, 2008?*
- b. *Whether the Board of Trustees and the Fund have contravened Regulations 18(9) & 18(22) and Clauses 2, 6 and 9 of the Code of Conduct prescribed under the Fifth Schedule of the Mutual Funds Regulations?*
- c. *Whether the AMC had contravened Regulations 18(9), 18(22), 25(1) & 25(16) and Clauses 2, 6 & 9 of the Code of Conduct prescribed under the Fifth Schedule of the Mutual Funds Regulations?*
- d. *Whether the Chief Executive Officer of the AMC had failed to ensure that the Fund/AMC complies with all the provisions of the Regulations, Guidelines and Circulars issued in this regard from time to time, in violation of Regulation 25(6A) of the Mutual Funds Regulations?*

5. The first issue that needs to be determined in the present case is whether, by changing the name of the scheme from ‘HSBC Gilt Fund – Short Term Plan’ to ‘HSBC Gilt Fund’; changing the benchmark index from ‘1 Sec Si-Bex’ to ‘1 Sec Composite Index’ and changing the duration of the portfolio, the Fund/AMC had changed the fundamental attributes of the scheme, as alleged in the show cause notice. In this regard, the noticees had submitted that the

scheme was launched with the investment objective of generating reasonable returns through investments in Government Securities of various maturities. According to the noticees, the difference between the long term plan (HSBC Gilt Fund-Long Term Plan) and the short term plan (HSBC Gilt Fund-Short Term Plan) was not the maturity of the government securities invested in, but the investment horizon of the investors in the scheme. The noticees had contended that, as per their offer document, the fundamental attributes of the schemes were the following:

- a. *it was an open ended scheme;*
- b. *scheme would invest in government securities of various maturities; and*
- c. *would not invest in any securities (such as shares and/or debenture or bonds) issued by any entity other than the Central Government or a State Government*

and that the changes effected by them in the scheme were not the fundamental attributes. The noticees have also contended that the investment pattern which is the relevant part of the description of fundamental attribute does not refer to the modified duration or average maturity and submitted that 'investment pattern' relates to the nature of the securities in which the corpus of a given fund/scheme may be invested namely, equity or debt or money market investments and allocation between such securities. It was stated that the average maturity/modified duration was not a fundamental attribute of the scheme. According to the noticees, if modified duration was to be considered as a fundamental attribute, the fund houses should have been mandatorily required to stipulate the same in the offer document and that the same was not done by SEBI. They contended that there was no assurance that the average maturity and modified duration of the portfolio would be within a particular range and that the same could undergo a change. The noticees supported the said contention by submitting that the investors were cautioned (in the scheme information document) that "*[the average maturity/Modified Duration] can undergo a change in case the market conditions warrant and according to the fund manager's view.... It must be clearly understood that the features and investment patterns stated*

above are only indicative and not absolute and that they vary substantially depending on the perception of the Investment Manager, the intention being at all times to seek to protect the interests of the unitholders and meet the objective of the Scheme/Plan(s)". The noticees have submitted that the investors (in the scheme) were made aware from inception that the investments would vary substantially based upon the perception of the funds' manager and that it was expressly stated in the offer document that "*However, this can undergo a change in case the market conditions warrant and according to the fund managers view*". The noticees further contended that on March 2, 2009, the combined offer document was altered by a notice cum addendum which in its relevant part substituted the existing paragraph, which provided that the scheme is suitable for investors seeking to obtain returns investing in Gilts (including Treasury Bills) across the yield curve with the modified duration of the portfolio normally not exceeding 15 years. It was also mentioned that the liquidity conditions and other macro-economic factors affecting interest rates shall be taken into account for varying the portfolio duration and that the same could undergo a change in case the market conditions warrant and according to the fund manager's view. They had also stated that the copies of the notice cum addendum were circulated to all distributors and the same was also uploaded and available on its website.

6. During the course of hearing, the learned senior advocate *inter alia* submitted that none of the three impugned changes mentioned in the show cause notice were changes in the fundamental attributes of the scheme and therefore the compliance with the requirements of Regulation 18(15A) of the Mutual Funds Regulations do not arise. He contended that the definition of investment pattern is only about the *interse* allocation between equity, debt and money market and that the class of securities in which they had invested was all along only in gilts. The learned counsel also contended that the show cause notice is also silent as to which of the provisions of the SEBI Circular dated February 4, 1998, apply to warrant an inference that there has been a change of fundamental attributes. According to him, the change in the name of the

scheme, bench mark index and the duration, do not fit into any of the criteria mentioned in the aforesaid circular.

7. I note that in terms of Regulation 18(15A) of the Mutual Funds Regulations, the trustees are mandated to ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interests of unit holders, shall be carried out without complying with the requirements mentioned therein. Regulation 18(15A) is reproduced herein below:

“Rights and obligations of the trustees

18(1)

.....

(15A) The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unitholders, shall be carried out unless,—

- (i) a written communication about the proposed change is sent to each unitholder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the mutual fund is situated; and*
- (ii) the unitholders are given an option to exit at the prevailing Net Asset Value without any exit load.*

.....” [Emphasis supplied]

8. The expression “*fundamental attributes*” have not been defined in the Mutual Funds Regulations. However, the same has been dealt with in the SEBI Circular dated February 4, 1998. The relevant portion of the said Circular has been reproduced herein below, which elaborates what a ‘fundamental attribute’ is:

“.....

(a) The words "fundamental attributes" as mentioned in clause (d) of sub-regulation (15) of regulation 18 are being elaborated as below:

(i) Type of a scheme

- *Open ended/Close ended/Interval scheme*
- *Sectoral Fund/Equity Fund/Balance Fund/Income Fund/Index Fund/Any other type of Fund*

(ii) Investment Objective

- *Main Objective - Growth/Income/Both.*
- *Investment pattern - The tentative Equity/Debt/Money Market portfolio break-up with minimum and maximum asset allocation, while retaining the option to alter the asset allocation for a short term period on defensive considerations.*

(iii) Terms of Issue

- *Liquidity provisions such as listing, repurchase, redemption.*
- *Aggregate fees and expenses charged to the scheme.*
- *Any safety net or guarantee provided. “*

Therefore, as per the aforesaid circular, there would be a change in the fundamental attributes if the type of the scheme, the investment objective of the scheme and any terms of the issue, are altered.

9. In the present case, the change in the modified duration of the scheme needs to be seen in the light of the fact that the scheme originally had two plans. The Short Term Plan which sought returns from investments in gilts including treasury bills across the yield curve with the average maturity of the portfolio normally exceeding 7 years and the modified duration of the portfolio normally not exceeding 5 years. The average maturity in the case of the Long Term Plan was normally not exceeding 20 years and the modified duration of the portfolio normally not exceeding 12 years. After the Long Term Plan was wound up, only the Short Term Plan was continued. Subsequently, the said plan underwent certain changes, the major change being the change of the modified duration from “normally not exceeding 5 years” to “not exceeding 15 years”. Even according to the noticees, the Long Term Plan was to cater to investors with a medium to long term investment horizon and that the Short Term Plan was to cater to investors with a short to medium term investment

horizon. With the aforesaid change, the said modified plan (Short Term Plan) as compared with the erstwhile Long Term Plan of the scheme has the defining attributes of the long term plan. It also needs to be recalled that the Long Term Plan, which had a long average maturity period and modified duration and catered to the investors with medium to long term investment horizon, was wound up as the said plan did not fulfil the condition of having a minimum of 20 investors and other conditions as laid down under SEBI Circular dated December 12, 2003.

10. I find that though the expression “fundamental attributes” is not defined in the Mutual Funds Regulations, the same was elaborated in the SEBI Circular dated February 4, 1998, as reproduced above in this Order. The regulatory intention behind prescribing certain conditions before effecting changes in the fundamental attributes of any scheme or any other change which would modify the scheme, is that the unitholders/investors of the scheme would be made aware of the proposed changes, may consider the same and exit from the scheme, if they found that the proposed changes were not in their interests. The objective behind the same is that the investors should not be disadvantaged by such adhoc or sudden changes made in the scheme. In the present case, the AMC had shifted nearly 80% of fund collected under the scheme from ultra short term to long term bonds, in a single day. Though, the Fund/AMC have cited liquidity crisis and the corresponding volatility of the assets under management, as the reasons for increasing the duration, the same according to me is a very important factor which could have influenced the decision of the investors/unitholders on whether to remain invested in the scheme or to exit. Regulation 18(15A) of the Mutual Funds Regulations provides for the communication about the proposed changes to the unitholders and giving them, an exit option. However, the SEBI Circular dated February 4, 1998, while elaborating the fundamental attributes for the purposes of Regulation 18 of the Mutual Funds Regulations, has not explicitly mentioned that “average maturity” and “modified duration” would be construed as fundamental attributes. On this

point, the learned senior advocate has argued that the investment pattern only mentions about the *interse* allocation between equity, debt and money market and that the class of securities in which the noticees had invested under the scheme still continues to be in 'gilt'. Paragraph (2)(a)(ii) of the said Circular mentions that "investment objective" would be a fundamental attribute and that the investment pattern outlined under the same would refer to asset allocation of the funds collected under a scheme in the equity/debt/money market while only retaining the option to alter the asset allocation for a short term period on defensive considerations. I also note that the scheme offer document also contained the clause: "*However, this can undergo a change in case the market conditions warrant and according to the fund managers view*" and "*[the average maturity/Modified Duration] can undergo a change in case the market conditions warrant and according to the fund manager's view.... It must be clearly understood that the features and investment patterns stated above are only indicative and not absolute and that they vary substantially depending on the perception of the Investment Manager, the intention being at all times to seek to protect the interests of the unitholders and meet the objective of the Scheme/Plan(s)*". The learned senior counsel had argued that it was specifically mentioned in the offer document that the average maturity and the modified duration could undergo a change in case the market conditions warrant and according to the views of the concerned fund manager and contended that SEBI did not object to the same while scrutinising the offer document. He further contended that the impugned changes were done in consultation with SEBI and that the noticees could not be penalized for the same. The said submission does not appear to be convincing. The change in the duration could be done having regard only with the short investment horizon of the investors therein, as specifically envisaged under the Short Term Plan. The sudden change in investing substantial funds of the scheme in long term gilt instruments from short term instruments had in turn changed the average maturity and the modified duration of the scheme portfolio, drastically varying them, so as to modify the scheme virtually into a Long Term Plan. However, in the circumstances of the case, while literally interpreting the SEBI

Circular dated February 4, 1998, it would become difficult to find the noticees guilty for effecting the change in the modified duration in the HSBC Gilt Fund, as a change in the fundamental attribute, as the said Circular does not in specific terms define change in the duration as a change to a fundamental attribute. I also note that Regulation 18(15A) of the Mutual Funds Regulations prescribes the procedure and manner for not only effecting the changes in the fundamental attributes of a scheme; but also prescribes the same manner for effecting *“any other change which would modify the scheme and affects the interest of unit holders”*. The change in the duration of the scheme is a change which certainly affects the interest of the unitholders of the scheme. Any fund house making any changes so as to modify the scheme which affects the interests of the unitholders would be liable for the contravention of Regulation 18(15A) of the Mutual Funds Regulations, if they had effected such changes without complying with the procedure mentioned therein. Though, the impugned change in the duration effected by the AMC in the scheme may attract *“any other change which would modify the scheme and affects the interest of unit holders”*, I shall not arrive at any adverse findings against the noticees in this regard, as the present show cause notice has alleged that the impugned changes were only changes in the fundamental attributes of the scheme. As mentioned above, the change in the duration has not been specifically mentioned as a fundamental attribute, in terms of the Circular dated February 4, 1998 and also for the reason that the show cause notice has not alleged that the change in the duration is a change which had modified the scheme and affected the investors, it would be incorrect on my part to hold the noticees guilty of contravening the provisions of Regulation 18(15A) of the Mutual Funds Regulations. Therefore, it would also not be possible to hold the noticees guilty for not complying with the requirements mentioned under paragraph 5 ii a of SEBI Circular dated May 23, 2008.

11. As regards the change in the benchmark index, the learned senior counsel had submitted that the “I Sec Composite Index” was a more

appropriate benchmark and that the same was recommended by AMFI (Association of Mutual Funds in India). According to him, even as per the SEBI Circular of 2002, the benchmark indices could be changed at a subsequent date and that the same has to be recorded and reasonably justified. He also contended that the said circular did not mention that the change in the benchmark index should be done in compliance with Regulation 18(15A) of the Mutual Funds Regulations. In this regard, I note that an index becomes a benchmark when it is used as a standard for evaluating the performance of an investment. In the present case, as long as the average maturity and modified duration was short, the Fund/AMC was using the I Sec Si-Bex as the benchmark. Pursuant to the change in the modified duration, they had adopted the I Sec Composite Index, which according to them was a more suitable benchmark for the comparison of the scheme which is a composite of government securities of short, medium and long term maturities. I note that in terms of SEBI Circular dated April 15, 2002, benchmarks for debt oriented schemes shall be developed by research and rating agencies recommended by AMFI on a regular basis. The said Circular also mentioned that the other guidelines like change in benchmark indices at a later date, giving management perceptions, review of performance by the AMCs and the Trustees and reporting compliance to SEBI, shall be in terms of SEBI Circular dated March 26, 2002 (deals with benchmark indices for equity oriented schemes). In terms of the Circular dated March 26, 2002, the benchmark indices may be decided by the AMCs and the trustees and any change at a later date shall be recorded and reasonably justified. The aforesaid SEBI Circulars do not prescribe that a benchmark index used by a mutual fund for a particular scheme is a fundamental attribute and any change in the same would require compliance with the provisions of Regulation 18(15A) of the Mutual Funds Regulations. I note the submission that the benchmark index was changed as the duration was modified. As the SEBI Circular dated February 4, 1998 has not expressly mentioned that the changes in the duration, name of the scheme and the benchmark index to be fundamental attributes, the noticees cannot be held

liable for contravening Regulation 18(15A) of the Mutual Funds Regulations and the SEBI Circular dated May 23, 2008. In view of the above, issue (a) in paragraph 4 above is answered in the negative.

12. In respect of issues (b), (c) and (d), my findings are as under. As held above, the noticees cannot be said to have changed the 'fundamental attributes', though they may have made certain material changes in the scheme. It is reiterated that the spirit and the regulatory intention behind prescribing the conditions for effecting the changes in a scheme is to ensure that the unitholders are given prior notice of the proposed changes and to afford them with reasonable opportunity to take an informed decision in respect of their investments in the scheme to safeguard their interests. The noticees may be technically correct in stating that the changes made by them are not fundamental attributes, as per the aforesaid SEBI Circular, and therefore there is no legal compulsion on them to adhere to the procedure and manner prescribed under Regulation 18(15A) of the Mutual Funds Regulations. However, the vital point that the noticee seems to have sadly overlooked is the aforesaid Regulations clearly extend to all changes that affect the interests of unitholders . It is a genuine expectation of the Regulator that institutions in the securities market, more so the more well established players among them, not only merely mechanically satisfy provisions in the devised legal framework but would also elevate standards of compliance to reflect the spirit of investor protection echoed in the various Regulations and Circulars issued in this regard. They also cannot ignore their obligation of disseminating 'timely information' to the unitholders as laid down in Clause 2 of the Code of Conduct specified in the Fifth Schedule of the Mutual Funds Regulations. This obligation is cast on trustess and asset management companies with the object of informing the unitholders about any change in the scheme to enable such unitholders to take an informed decision. In this regard, Regulation 18(9) of the Mutual Funds Regulations casts an obligation on the trustees to ensure that all the activities of the asset management company are in accordance with the

Mutual Funds Regulations. Further, Regulation 18(22) prescribes that the trustees shall abide by the Code of Conduct as specified in the Fifth Schedule of the Mutual Funds Regulations. In terms of Regulation 25(16) of the Mutual Funds Regulations, an asset management company is also required to abide by the Code of Conduct as specified in the Fifth Schedule. The relevant Clauses of the Code of Conduct alleged to have contravened by the Fund, its trustees and the AMC, are reproduced herein below:

“2. Trustees and asset management companies must ensure the dissemination to all unitholders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.

.....

6. Trustees and asset management companies shall carry out the business and invest in accordance with the investment objectives stated in the offer documents and take investment decision solely in the interest of unitholders.

.....

9. Trustees and the asset management company shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.

.....”

13. The noticees have submitted, in this regard that the AMC had ensured that both the addendum dated January 5, 2009 and the notice cum addendum dated March 2, 2009 were uploaded and available on their website and circulated to all the distributors. It was further contended that the trustees and the AMC had been carrying out the business and investment activities in line with the stated objectives in the offer document and that the offer document enabled the fund manager to take the duration call and that the fund manager's decision was solely in the interest of the unitholders depending upon the then prevailing market conditions. It was submitted that, post issuance of the addendum dated January 5, 2009 regarding the change in average maturity and modified duration of the scheme, the matter was discussed by AMC with SEBI giving reference to the changes done in the modified duration prior to the issue of notice cum addendum dated March 2, 2009 regarding the proposed change in name and the benchmark index of the scheme. In the present case,

no prior intimation of the changes in the scheme was given to the unitholders. The noticees have submitted that it was not practically feasible for them to inform each unitholder individually of the investment decisions of the fund manager and that the information regarding the changes were uploaded in their website and made available to their distributors. I cannot accept the plea of “practical feasibility”. Had the Fund informed the unitholders beforehand that it was proposing to change the duration and invest in long date maturing gilts, they could have taken an informed decision. Those investors who were not comfortable with the changes could have exited from the scheme with the return based on the Net Asset Value which was prevailing prior to January 5, 2009, when the modified duration was extended from 5 years to 15 years. The same could have avoided room for investor grievances after the changes were done. This act of the Fund/AMC undermines the faith of its unitholders in them and tantamount to a breach of trust. It is also to be noted that the noticees were under a legal obligation of ensuring the dissemination of adequate, explicit and timely information about the investment policies, investment objectives, financial position and general affairs of the scheme. The essence of the Clause 2 of the Code of Conduct is that investors/unitholders were to be given timely information about the investments policies and objectives etc. If no prior communication in respect of the changes was given to the unitholders, how could an informed decision be taken by them? Thus, the intimation in respect of the proposed change is very relevant and cannot be considered to be trivial. The noticees without informing the unitholders of the proposed change of the duration in the scheme, had merely issued a notice/addendum informing them of the changes, giving them no time for consideration. This conduct of the Board of Trustees and AMC is very much against Clause 2 of the Code of Conduct. In terms of Clause 6, the trustees and the asset management company were mandated to carry on the business and invest in accordance with the investment objectives stated in the offer document and take investment decision solely in the interest of unitholders. By changing the duration as opposed to the original duration mentioned in the offer document, without

intimating the unitholders before effecting such changes, the Board of trustees and AMC have acted in a manner which was not in the interests of its unitholders and thus contravened Clause 6 of the Code of Conduct. For the aforesaid reasons, it becomes clear that the Board of trustees and the AMC have not followed the standards of service to their investors/unit holders of the scheme enjoined on them and have failed to ensure proper care, thereby contravening Clause 9 of the Code of Conduct. Thus, the Board of trustees and the AMC are guilty of having contravened Regulations 18(9) & 18(22) of the Mutual Funds Regulations and Clauses 2, 6 & 9 of the Code of Conduct prescribed under the Fifth Schedule to the Mutual Funds Regulations. Further, the AMC by failing to take adequate steps to ensure that the investments of funds pertaining to the scheme are not contrary to the provisions of the Mutual Funds Regulations, by not giving timely information and adequate opportunity to the unitholders regarding the material changes in the scheme by the AMC and trustees in advance, has contravened the provisions of Regulation 25(1) of the Mutual Funds Regulations. In view of the above findings, I conclude that the Chief Executive Officer of the AMC had failed to ensure that the mutual fund complied with all the provisions of the Mutual Funds Regulations, the Guidelines and Circulars issued from time to time, thereby violating Regulation 25(6A) of the Mutual Funds Regulations. In view of the foregoing, the issues framed in (b), (c) and (d) in paragraph 4 above are answered against the noticees.

14. Therefore, in view of the foregoing, I am of the view that the board of trustees of the Fund and the Fund have contravened the provisions of Regulations 18(9) & 18(22) of the Mutual Funds Regulations and Clauses 2, 6 and 9 of the Code of Conduct laid down in the Fifth Schedule of the Mutual Funds Regulations. Further, the AMC has contravened Regulations 25(1) & 25 (16) of the Mutual Funds Regulations and Clauses 2, 6 and 9 of the said Code of Conduct. The Chief Executive Officer of the AMC having failed to ensure that

the mutual fund complies with all the relevant legal provisions has contravened Regulation 25(6A) of the Mutual Funds Regulations.

15. Therefore, for the reasons stated above, I, in exercise of the powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Sections 11 and 11B thereof and the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, hereby warn the Board of Trustees of HSBC Mutual Fund, HSBC Mutual Fund, HSBC Asset Management (India) Private Limited and its Chief Executive Officer that they shall strictly comply with the law governing their conduct and business of mutual fund in the securities market. The show cause notices dated August 7, 2009 issued to them is accordingly disposed of.

**DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**

**PLACE: MUMBAI
DATE: APRIL 23, 2010**