

SECURITIES AND EXCHANGE BOARD OF INDIA
MUTUAL FUNDS DEPARTMENT
Mittal Court, A Wing, Gr. Floor,
224, Nariman Point, Mumbai 400 021

MFD/CIR/09/014/2000
January 5, 2000

To:

All Mutual Funds registered with SEBI/
Unit Trust of India

Dear Sir,

Further to our circular letter dated October 21, 1999, please find enclosed a copy of the amendments to SEBI (Mutual Funds) Regulations, 1996 published in The Gazette of India dated December 8, 1999 for your information and implementation.

The clarifications pertaining to the notification and additional guidelines as approved by SEBI Board are also being issued under Regulation 77 of the SEBI (Mutual Funds) Regulations, 1996 as follows:

I. Investment restrictions:

1. All investment restrictions shall be applicable at the time of making investment.
2. With reference to the proviso to clause 10 of Seventh Schedule to the SEBI (Mutual Funds) Regulations, 1996, the investments by index funds shall be in accordance with the weightage of the scrips in the specific index as disclosed in the offer document. In case of sector/industry specific scheme, the upper ceiling on investments may be in accordance with the weightage of the scrips in the representative sectoral index/sub index as disclosed in the offer document or 10% of the NAV of the scheme whichever is higher.
3. Clause 11 of the Seventh Schedule to the Regulations pertains to investment in unlisted securities. Necessary gazette notification clarifying the same shall be issued in due course.

II. Responsibilities of Asset Management Companies (AMCs) and the Trustees :

1. In order to strengthen the compliance mechanism, all information and documents relating to the compliance process shall be authenticated / adopted by the Board of Directors of the AMC. In like manner, Trustees shall review all information and documents received from the AMC as required under the compliance process.
2. All asset management companies shall adopt a management information system for reporting to their trustees. The report shall contain specific comments on all issues related to the operation of the mutual fund as undertaken by the AMC including those mentioned in Annexure I.
3. The half-yearly report on the activities of the mutual fund to be submitted by the trustees to SEBI under Regulation 18(23)(a), shall cover all issues relevant to operation of the mutual fund including those given in Annexure II. The Trustees may mention in their report, if they so desire, that they have relied on the reports obtained from the independent auditor or internal/ statutory auditors or the compliance officer as the case may be. However, the report must mention that the trustees have satisfied themselves about the adequacy of compliance systems in the mutual fund.

The AMCs and the trustees may update the reporting formats (Annexure I and II) by including relevant provisions of further amendments to regulations or guidelines/circulars issued by SEBI from time to time (including the notification dated December 8, 1999) and shall specifically comment on their compliance.

4. For effective discharge of responsibilities under the Regulations, the AMC shall provide infrastructure and administrative support to the trustees. The mutual fund may decide to appoint independent auditors and/or may have separate full-fledged administrative set up for the trustees. However, the expenditure incurred in this regard shall be within the limits as specified in Regulation 52(6). AMCs may place correspondence and reports submitted to SEBI before the trustees.
5. For the purpose of reporting transactions in securities by the trustees under Regulation 18 (11), it is clarified that only those transactions are required to be reported which exceed the value of Rs 1 lakh.

Please acknowledge receipt.

Yours faithfully,

P.K.NAGPAL
DIVISION CHIEF
MUTUAL FUNDS DEPARTMENT

Encl. : as above

GAZETTE OF INDIA

EXTRAORDINARY

PART II - SECTION 3 - SUB-SECTION (ii)
PUBLISHED BY AUTHORITY

SECURITIES AND EXCHANGE BOARD OF INDIA

NOTIFICATION

MUMBAI, THE 8th DAY OF DECEMBER 1999

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS)
(AMENDMENT) REGULATIONS, 1999

S.O. 1223 (E). In exercise of the powers conferred by sub-section (1) of section 30 of the Securities and Exchange Board of India Act, 1992 (15 of 1992), the Board hereby makes the following regulation further to amend the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, namely:

- I. 1. These regulations may be called the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 1999.
2. They shall come into force on the date of their publication in the Official Gazette.
- II. In the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996, (hereinafter referred to as the said regulations),-

1. In regulation 2, for clause (y) the following clause be substituted, namely;

(y) Trustees mean the Board of Trustees of the Trustee Company who hold the property of the Mutual Fund in trust for the benefit of the unitholders."

2. In regulation 18,

(a) for sub-regulation (11), the following sub-regulation shall be substituted, namely;

"(11) Each trustee shall file the details of his transactions of dealing in securities with the Mutual Fund on a quarterly basis."

(b) in sub-regulation (15), in clause (d), the following proviso shall be inserted after the existing proviso and before the explanation, namely:

"Provided further that in case of an open ended scheme, the consent of the unitholders shall not be necessary if:

- i. the change in fundamental attribute is carried out after one year from the date of allotment of units.
- ii. the unitholders are informed about the proposed change in fundamental attribute by sending individual communication and an advertisement is given in English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated.
- iii. the unitholders are given an option to exit at the prevailing Net Asset Value without any exit load."

(c) after sub-regulation (24), the following sub-regulations (25), (26) and (27) shall be inserted, namely;

"(25) Trustees shall exercise due diligence as under:

A. General Due Diligence:

- i. the Trustees shall be discerning in the appointment of the directors on the Board of the asset management company.
- ii. Trustees shall review the desirability of continuance of the asset management company if substantial irregularities are observed in any of the schemes and shall not allow the asset management company to float new schemes.
- iii. The trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons.
- iv. The trustee shall ensure that all service providers are holding appropriate registrations from the Board or concerned regulatory authority.
- v. The Trustees shall arrange for test checks of service contracts.
- vi. Trustees shall immediately report to Board of any special developments in the mutual fund.

B. Specific Due Diligence:

The Trustees shall:

- i. obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees.
- ii. obtain compliance certificates at regular intervals from the asset management company.
- iii. hold meeting of trustees more frequently.
- iv. consider the reports of the independent auditor and compliance reports of asset management company at the meetings of trustees for appropriate action.
- v. maintain records of the decisions of the Trustees at their meetings and of the minutes of the meetings.
- vi. prescribe and adhere to a code of ethics by the Trustees, asset management company and

its personnel.

- vii. communicate in writing to the asset management company of the deficiencies and checking on the rectification of deficiencies."

"(26) Notwithstanding anything contained in sub-regulations (1) to (25), the trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly."

"(27) The independent directors of the trustees or asset management company shall pay specific attention to the following, as may be applicable, namely:-

- i. the Investment Management Agreement and the compensation paid under the agreement.
- ii. service contracts with affiliates - whether the asset management company has charged higher fees than outside contractors for the same services.
- iii. selection of the asset management company's independent directors
- iv. securities transactions involving affiliates to the extent such transactions are permitted.
- v. selecting and nominating individuals to fill independent directors vacancies.
- vi. code of ethics must be designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions.
- vii. the reasonableness of fees paid to sponsors, asset management company and any others for services provided.
- viii. principal underwriting contracts and their renewals.
- ix. any service contract with the associates of the asset management company."

- 2. In Regulation 21, in sub-regulation (1), in clause (f), for the existing explanation, the following explanation shall be substituted, namely:

"Explanation: For the purposes of this clause, "net worth" means the aggregate of the paid up capital and free reserves of the asset management company after deducting therefrom miscellaneous expenditure to the extent not written off or adjusted or deferred revenue expenditure, intangible assets and accumulated losses."

- 3. In Regulation 22, in clause (e), the following proviso shall be added, namely :

"Provided that in case of an open ended scheme, the consent of the unitholders shall not be necessary if:

- i. the change in control takes place after one year from the date of allotment of units.
- ii. the unitholders are informed about the proposed change in the controlling interest of asset management company by sending individual communication and an advertisement is given in one English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is situated.
- iii. the unitholders are given an option to exit at the prevailing Net Asset Value without any exit load."

- 4. In Regulation 24, in sub-regulation (2), the words "portfolio management services", shall be inserted after the words " in the nature of" and before the words " management and advisory".

- 5. In Regulation 25, in sub-regulation (8), the following proviso shall be added, after the existing proviso, namely :

"Provided further that the mutual funds shall disclose at the time of declaring half-yearly and yearly results;

- i. any underwriting obligations undertaken by the schemes of the mutual funds with respect to issue of securities associate companies,
- ii. devolvement, if any,

- iii. subscription by the schemes in the issues lead managed by associate companies
- iv. subscription to any issue of equity or debt on private placement basis where the sponsor or its associate companies have acted as arranger or manager."

6. In regulation 45, a proviso shall be added, namely:

"Provided that mutual funds shall enter into derivatives transactions in a recognised stock exchange for the purpose of hedging and portfolio balancing, in accordance with the guidelines issued by the Board."

7. In the Third Schedule, after clause 19, the following clauses 20, 21 and 22 shall be inserted, namely:

"20. The trust deed shall state that a meeting of the trustees shall be held at least once in every three months and at least four such meetings shall be held in every year.

21. The trust deed shall specify the quorum for a meeting of the trustees.

Provided that the quorum for a meeting of the trustees shall not be constituted unless one independent trustee or director is present at the meeting.

22. The trust deed shall state that the minimum number of trustees shall be four."

8. In Fifth Schedule, after existing clause 7, the following new clauses 8, 9 and 10 shall be added, namely:

"8. Trustees and the asset management company shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business

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 judgement.

10. The asset management company shall not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements."

9. In Sixth Schedule,

(i) in clause 6, the following sentence shall be added at the end, namely:

"Any advertisement that makes claims about the performance of the fund shall be supported by relevant figures."

(ii) in clause 12, the following sentence shall be added at the end, namely:

"Any advertisement containing information regarding performance, NAV, yield or returns shall give such data for the past three years, wherever applicable."

(iii) after existing clause 14, the following clauses 14A and 14B shall be added, namely :

"14A. Any advertisement reproducing or purporting to reproduce any information contained in a offer document shall reproduce such information in full and disclose all relevant facts and not be restricted to select extracts relating to that item which could be misleading."

"14B. No celebrities shall form part of the advertisement."

10. In the Seventh Schedule,

(i) for the existing clause 1, the following clauses 1 and 1A, shall be substituted, namely :

"1. A mutual fund scheme shall not invest more than 15% of its NAV in debt instruments issued by a single issuer which are rated not below investment grade by a credit rating agency authorised to carry out such activity under the Act. Such investment limit may be extended to 20% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of asset management company.

Provided that such limit shall not be applicable for investments in government securities and money market instruments".

"1A. A mutual fund scheme shall not invest more than 10% of its NAV in unrated debt instruments issued by a single issuer and the total investment in such instruments shall not exceed 25% of the NAV of the scheme. All such investments shall be made with the prior approval of the Board of Trustees and the Board of asset management company."

(ii) in clause 6, a proviso shall be added, namely:

"Provided that mutual funds shall enter into derivatives transactions in a recognised stock exchange for the purpose of hedging and portfolio balancing, in accordance with the guidelines issued by the Board."

(iii) in clause 9 -

- a. the word "scheme" shall be added after the words "mutual fund" and before the words "shall make",
- b. the words "of all the schemes of a mutual fund " shall be deleted.

(iv) after the existing clause 9, the following new clauses 10 and 11 shall be added, namely :

"10. No mutual fund scheme shall invest more than 10 per cent of its NAV in the equity shares or equity related instruments of any company.

Provided that, the limit of 10 per cent shall not be applicable for investments in index fund or sector or industry specific scheme".

"11. A mutual fund scheme shall not invest more than 5% of its NAV in the equity shares or equity related investments in case of open ended scheme and 10% of its NAV in case of close ended scheme".

[F.No. SEBI/LE/ 21876/99]

D.R. MEHTA
CHAIRMAN

Foot Note:

1. The principal regulation, SEBI (Mutual Funds) Regulations, 1996, was issued under S.O. No. 856(E), dated December 6, 1996 published in the Gazette of India, Part II, Section 3 (ii), dated December 9, 1996.
2. SEBI (Mutual Funds) Regulations, 1996 was subsequently amended by the SEBI (Mutual Funds) (Amendment) Regulations, 1997, issued under S.O. NO. 327 (E),

published in Gazette of India dated April 15, 1997.

(3) SEBI (Mutual Funds) Regulations, 1996 was subsequently amended by the SEBI (Mutual Funds) (Amendment) Regulations, 1998, issued under S.O. No. 32(E), published in the Gazette of India dated January 12, 1998.

Model Compliance Checklist Annexure I

The Compliance certificate to be submitted by the AMC to the Trustees on an half yearly basis should contain specific comments on the following :

- If the AMC is carrying on other activities whether the same are conducted as per the Regulations and whether it continues to meet capital adequacy requirements for each of the activities.
- Net worth of the AMC
- Change in the directors on the Board of Directors of the AMC.
- The investments have been made in accordance with the Regulations, Trust Deed and investment objectives of the scheme.
- Utilisation of services of the sponsor or of any of its 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 change in the interests of directors on the Board of directors of the AMC.
- Borrowings of the mutual fund giving details of date, nature of instrument, source, amount borrowed, purpose of borrowing, interest rate, security offered for the borrowing, percent of borrowing to net assets on date of borrowing, date of repayment or proposed manner of liquidation of the debt; if borrowing is from any associate of the sponsor or AMC reasons for borrowing from such entity and competitiveness of the terms.
- Investments/ redemption by the AMC, Sponsor any associate of the Sponsor in any of the Schemes and inter-scheme investments giving details of name of the schemes, date, price, value, charges levied.
- Transactions in securities by the key personnel of the AMC in their own name or on behalf of the AMC giving details of names of the personnel, name of the security, purchase/sale details like quantity, rate, value, name of broker, whether transaction is on personal account or immediate family or fiduciary.
- Valuation and pricing of the units.
- Maintenance of proper books of accounts records and documents for each scheme.
- Identification and appropriation of expenses to individual schemes and conformity of expenses as per limits laid down by SEBI.
- Ability to honour guarantee commitment in respect of any guaranteed return scheme.
- Deficiency/ warning letters if any, received from SEBI and corrective action taken.
- Transactions (during preceding 2 quarters) with brokers associated with the sponsor which shall not in the average of 5% or more during any block of 3 months in all of its schemes.

- Transactions (during preceding 2 quarters) with non-associate brokers in the average of 5% or more during any block of 3 months together with justification for exceeding the limits.
- Justification about the purchase and sale of securities of group companies of the sponsor or the AMC by the mutual fund during preceding 2 quarters.
- Details of investments in listed securities of group companies of the sponsor (not to exceed 25% of the net assets of all the schemes of the mutual fund).

The Compliance certificate to be submitted by the AMC to the Trustees on a Bi-monthly basis should contain specific comments on the following :

- Investments made in excess of 10% of the paid up capital of a company, giving details of the date of purchase, name of the company, purchase price, value and holding percent in the capital carrying holding rights, whether any of such companies are associates of the sponsor/AMC, justification for making the investment.
- Inter scheme transfers – detailing dates, name of transferor and transferee schemes, securities transferred and price, value of transfer and reasons for the transfer.
- Investments by any company amounting to more than five per cent of the net asset value of a scheme indicating names of companies/schemes and their association with the Sponsor or the AMC, if any
- Concentration of business with brokers in excess of 5% of quarterly gross business of the mutual fund, giving details of date, name of broker, value of business, brokerage paid, percent of business to total business for the day, whether the broker is associated with the sponsor or through a firm which is an associate of the sponsor and justification for such transactions.
- Transactions that resulted in short sales or carry forward giving details of date, scrip, name of the broker, rate, quantity in custody.
- Despatch of repurchase/ redemption proceeds within 10 days and transfer of units within 30 days to unit holders, status of redressal of investors' complaints giving ageing schedule and reasons.

Annexure II

BROAD COVERAGE OF REPORT OF TRUSTEES TO SEBI

Trustees shall submit reports for the half year ended September and March. Reports should reach SEBI within 2 months from the end of the half year.

The report of the Trustees should give specific comments on the following :

- Performance of schemes.
- Activities of the AMC with specific reference to transactions with affiliates, concentration of business with affiliate brokers, compliance with investment restrictions and inter scheme transfers, net worth of the AMC.
- Ability of the AMC/sponsor to honour the guaranteed returns in case of any Scheme guaranteeing returns.
- Deployment of funds of the scheme in accordance with investment objectives and not for

any option trading or short selling or carry forward transactions.

- Valuation and pricing of units – whether in accordance with the Regulations.
- Publication of Annual Report and furnishing of half yearly and annual accounts statements to unit holders and SEBI.
- Listing of scheme on stock exchange as per terms of the offer document effecting of transfer and despatch of units to unit holders within 30 days and timely despatch of repurchase/ redemption proceeds and dividend warrants.
- Action taken on deficiency and warning letters by SEBI.
- Before launch of scheme, AMC had systems in place for back office etc. appointed all key personnel, auditors, compliance officers, prepared manual, specified norms, etc.
- AMC shall appoint Registrar & Share Transfer Agents, who are registered with SEBI, provided that if the work is done in-house, then the rates charged must be competitive and for higher rates reasons for charging higher rates must be disclosed.
- AMC has been diligent in empanelling brokers in monitoring securities transactions and avoiding undue concentration with any broker.
- AMC has not given undue and unfair advantage to any associate.
- In case, any company has invested more than 5% of NAV scheme , an investment made by the scheme or by any other scheme of the same mutual fund in that company or its subsidiaries shall be justified.
- Whether the AMC has dealt with any associate broker more than 5% of the quarterly business done by a mutual fund.
- In case the AMC has dealt through any other broker other than a associate broker in excess of 5% or more of the aggregate purchase and sale of securities made by the mutual fund in all its schemes, the AMC has recorded in writing the justification for the same and all whether all such investments have been reported to the trustees on a quarterly basis.
- Utilisation of the services of the sponsor or any of its associates, employees, etc. by AMC – whether disclosure made in the annual accounts.
- Whether AMC submitted quarterly report on its activities and complied with Regulations.
- Transactions of mutual fund are in accordance with the trust deed.
- Funds pertaining to a scheme have been invested in accordance with the Regulations.
- All activities of AMC are in accordance with the Regulations
- Details of transaction in securities by key personnel in their own name or on behalf of the AMC.
- Whether AMC filed with the trustees detailed bio-data of all directors of AMC along with their interest in other companies within 15 days of their appointment in any change in the interest of directors every six months.
- Whether directors of the AMC filed with the trustees, a statement of holding of securities

at the end of each financial year along with dates of acquisition.

- No conflict of interest between the manner in which the AMC has deployed its network and the interest of the unitholders.
 - Remedial steps as necessary taken by the trustees, in case the conduct and business of the mutual fund is not in accordance with the Regulations.
 - Certifying that they have satisfied themselves that there have been no instances of self-dealing or front running by any of the trustees, directors and key personnel of the AMC.
 - Certifying that AMC has been managing the schemes independently of any other activities and the unitholders' interest has been protected.
 - Comments of the independent trustee on the report received from the AMC regarding the investments by the mutual fund in the securities of the group companies of the sponsor.
 - Confirmation that the mutual fund has not made any investment in - any unlisted security of an associate or group company of the sponsor, any security issued by way of private placement by an associate or group company of the sponsor or listed securities of group companies of the sponsor which is in excess of 25% of the net assets of all the schemes of the mutual fund.
 - In case the mutual fund has an aggregate of securities which are worth Rs.10 crore or more as on the latest balance sheet date, whether transactions on or after January 15, 1998 are only through dematerialised securities.
 - Whether unitholders' consent obtained wherever necessary in accordance with Regulations.
 - Any other matter the trustees would like to report to SEBI.
-