

**DIVISION CHIEF
MUTUAL FUNDS DEPARTMENT**

MFD/CIR/ 6 / 73 /2000
July 27, 2000

**All Mutual Funds Registered with SEBI/
Unit Trust of India**

Dear Sirs,

Re : Recording of investment decisions by Mutual Funds

Some of the inspection reports of mutual funds indicate substantial depletion of assets of some of the schemes. We have also come across instances wherein the companies have never paid interest and principal amount to mutual funds particularly when the securities were bought on private placement basis. While going through the portfolio statements of the mutual funds, we find non-performing assets (NPAs) and some of the scrips valued at a negligible amount. All this is reflected in the NAVs of the mutual funds.

Sub-regulation (2) of Regulation 25 of SEBI (Mutual Funds) Regulations, 1996 stipulates that the asset management company (AMC) shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.

With a purpose to implement the regulation in an effective manner and to bring about transparency in investment decisions, the AMCs are hereby advised to maintain records in support of each investment decision which will indicate the data, facts and opinion leading to that decision. While the AMC boards can prescribe broad parameters for investments, it is important that the basis for taking individual scripwise investment decision in equity and debt securities should be recorded. While there should be a detailed research report analysing various factors for each investment decision taken for the first time, the reasons for subsequent purchase and sales in the same scrip should be recorded. The contents of the research reports may be decided by the asset management companies and the trustees.

AMC boards may develop a mechanism to verify that due diligence is being exercised while making investment decisions. They may pay specific attention in case of investment in unlisted and privately placed securities, unrated debt securities, NPAs, transactions where associates are involved and the instances where there is poor performance of the schemes.

The AMCs shall report the compliance of the above in their periodical reports to the trustees and the trustees shall report to SEBI in their half-yearly reports. Trustees may also check its compliance through the independent auditors or internal/statutory auditors or other systems developed by them.

This circular is being issued in accordance with the provisions of the Regulation 77 of the SEBI (Mutual Funds) Regulations, 1996. The details of its compliance and the system developed in this regard may be informed to us by August 16, 2000. After placing the matter before the Boards of AMCs and trustees, a final detailed compliance report may be sent to us.

Yours faithfully,
P. k . Nagpal