

## **Introduction of Code of Conduct for Fund Managers and Dealers**

### **1. Objective**

1.1. The objective of this memorandum is to place a proposal to amend current SEBI (Mutual Funds) Regulations, 1996 for introducing code of conduct for Fund Managers and Dealers.

### **2. Background**

2.1. The SEBI (Mutual Funds) Regulations, 1996 (hereinafter referred to as "MF Regulations") prescribes an obligation on the Asset Management Company (AMC) and Trustees to follow the Code of Conduct as incorporated in the Fifth Schedule of the Regulations.

2.2. Further to strengthen the governance of the AMC, it has inter alia been prescribed in MF Regulation 25(6A) that "The Chief Executive Officer (whatever his designation may be) of the asset management company shall ensure that the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund".

2.3. It has also been prescribed in MF Regulation 25 (6B) that the fund managers (whatever the designation may be) shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.

2.4. However, no such provision is provided in MF Regulations in respect of Dealers who execute the transactions of the Mutual Fund. Further, no such provision exists in

respect of Chief Investment Officer (CIO) who has substantial influence on the decisions of the Fund Managers who report to him.

2.5. While appropriate clauses are in place in the MF Regulations to put onus on the AMCs and Trustees to follow Code of Conduct as prescribed in Fifth Schedule of the Regulations, there is neither any Code of Conduct for Fund Managers including CIO or Dealers nor any provision for any responsibility on Chief Executive Officer (CEO) to ensure that the said Code of Conduct is followed by Fund Managers including CIO and Dealers.

2.6. Since in current scenario the Fund Managers including CIO and Dealers are dealing in large amounts of investors' money at the execution level, it is imperative that explicit responsibility is cast on them, in the form of a Code of Conduct.

### **3. Issue under consideration**

3.1. During the meeting of Working Group constituted under the aegis of MFAC for Inter Scheme Transfer and Accounting related issues, the requirement of Code of Conduct for Fund Managers and Dealers was deliberated considering questionable practices observed. The Working Group was of the view while the base issues of known questionable practices was sought to be addressed, in addition to holding Mutual Funds responsible for questionable practices, fixing responsibility of key individuals responsible for executing such transactions, may yield better results in controlling questionable practices.

3.2. In view of the above, the Working Group has recommended the Code of Conduct for Fund Managers and Dealers. Further Working Group has recommended that the same should be part of MF regulations, and that all Fund Managers and Dealers shall be bound by the same. In addition, each AMC should be tasked with putting in place processes to ensure that all their Fund Managers and Dealers adhere to the Code of Conduct in letter and spirit.

#### **4. Discussion in Mutual Funds Advisory Committee (“MFAC”)**

4.1. The draft Code of Conduct for Fund Manager and Dealers as recommended by the Working Group was taken to MFAC in the meeting held on January 28, 2020 to deliberate whether any modifications in the content of the draft Code of Conduct is required. The committee deliberated on the proposed Code of Conduct and agreed with the recommendation of the Working Group.

4.2. Further, it was agreed in MFAC that AMC should be tasked with putting in place robust processes to ensure that all their Fund Managers and Dealers adhere to the proposed Code of Conduct in letter and spirit. Further, under MF Regulation 25 (6A), CEO has been given responsibility to ensure that the Mutual Fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time. Accordingly, it is appropriate that the CEO is given responsibility to ensure that AMC has systems in place to ensure that the Code of Conduct for Fund Manager and Dealers are being adhered to in letter and spirit. Any breaches of the same should be brought to the attention of the Board of Directors of the AMC and Trustees.

#### **5. View on Chief Investment Officer (CIO)**

5.1. It was observed during past inspections that in certain schemes CIO is also the Fund Manager while in other schemes Fund Manager/(s) report to the CIO. It was also observed that CIO is also part of Investment Committee of the AMCs. Hence in all the cases he has substantial influence on the investment decision taken by the Mutual Funds. In past, SEBI has also initiated action against the CIO considering him as Fund Manager. Therefore, it was felt that it may be clarified as explanation to MF Regulation 25 (6B) that Fund Managers includes Chief Investment Officer. Accordingly, Code of Conduct for Fund Managers shall also be made applicable to the CIO.

## 6. Proposal

6.1. Considering the above, it is proposed that Fifth schedule of MF Regulations should be amended to add Code of Conduct for Fund Managers (including CIO) and Dealers, so as to make them accountable in case of any breach of the said Code of Conduct. Further it is also proposed that CEOs may also be made responsible to put in place a system to ensure that Fund Managers (including CIO) and Dealers shall abide by the said Code of Conduct. Accordingly, necessary draft amendments in the SEBI (Mutual Funds) Regulations, 1996 are placed at **Annexure-A**. Further, Draft Notification to be issued is placed at **Annexure-B**.

6.2. The Board may consider the proposal made under Para 7.1 and approve the draft amendments and authorize the Chairman to take steps to implement the same by amending the SEBI (Mutual Funds) Regulations, 1996, with consequential and appropriate changes, as may be required, and to notify the necessary regulations and/or issue circular/(s) in this regard.

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