Lesson - 4

MUTUAL FUNDS - RELEVANT REGULATIONS

4.0 Objective:

After going through this lesson you will be able to understand about the Mutual Fund Industry in India. Its role and relevance in mobilizing small scale savings and Relevant Regulatory Mechanism.

Structure:

4.1 Introduction:

The basic aim of Human Life is to be free from burdens about tomorrow. People are earning money and often they are in a dilemma where to invest their hand earned money with safety. Most of the investors prefer to build their portfolio according to their own ability, knowledge and experience. Whether they are right or wrong, infirmative or ignorant - experienced or in experienced they will continue the same pattern. If the investor wants to manage his financial matters successfully he requires good knowledge in varied subjects such as Finance, Economics, Taxation, Law, Accounting and statistics. It is not necessary to have a basic degree in all these subjects but basically he must have an aptitude in this area and the investors should have reading habit about. financial matters every day and have to possess the ability to analyze the Financial Data.

If the Investors possess the ability, he can make his own decisions on issues like what to buy when to buy, what to sell, when to sell and what to hold. "Experience makes the man perfect" and if an investor is able to manage his portfolio successfully, the results will be fruited. But Investment Management is a complex system and it is impossible for an investor to be acted independently. The investor has to watch the trends in the stock market. In the Modern busy life most of the people do not find time to handle their own investments, the avenue available to them is "MUTUAL FUNDS".

DEFINITIONS:

1. A Mutual Fund is a special type of investment institution that acts as an investment conduct. It pools the savings, particularly of the relatively small investors and invests them in a well diversified portfolio of sound investment. Mutual Funds issue securities (known as units) to the investors (known as unit holders) in accordance with the Quantum of money invested by them. The profits (or losses) are shared by the investors in proposition to their investments.

2. According to **Mr. James Pierce** "The Mutual Fund is an important vehicle for bringing wealth to holders and deficit units together directly".

3. **Franic Relly** defines Mutual Fund as "Financial intermediaries which being a wide variety of securities within the reach of the most modest investors".

4. According to Securities Exchange Board of India (SEBI) Mutual Fund Regulations 1993 "Mutual Fund means a Fund established in the form of a Trust by sponsor to raise moneys by the Trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations.

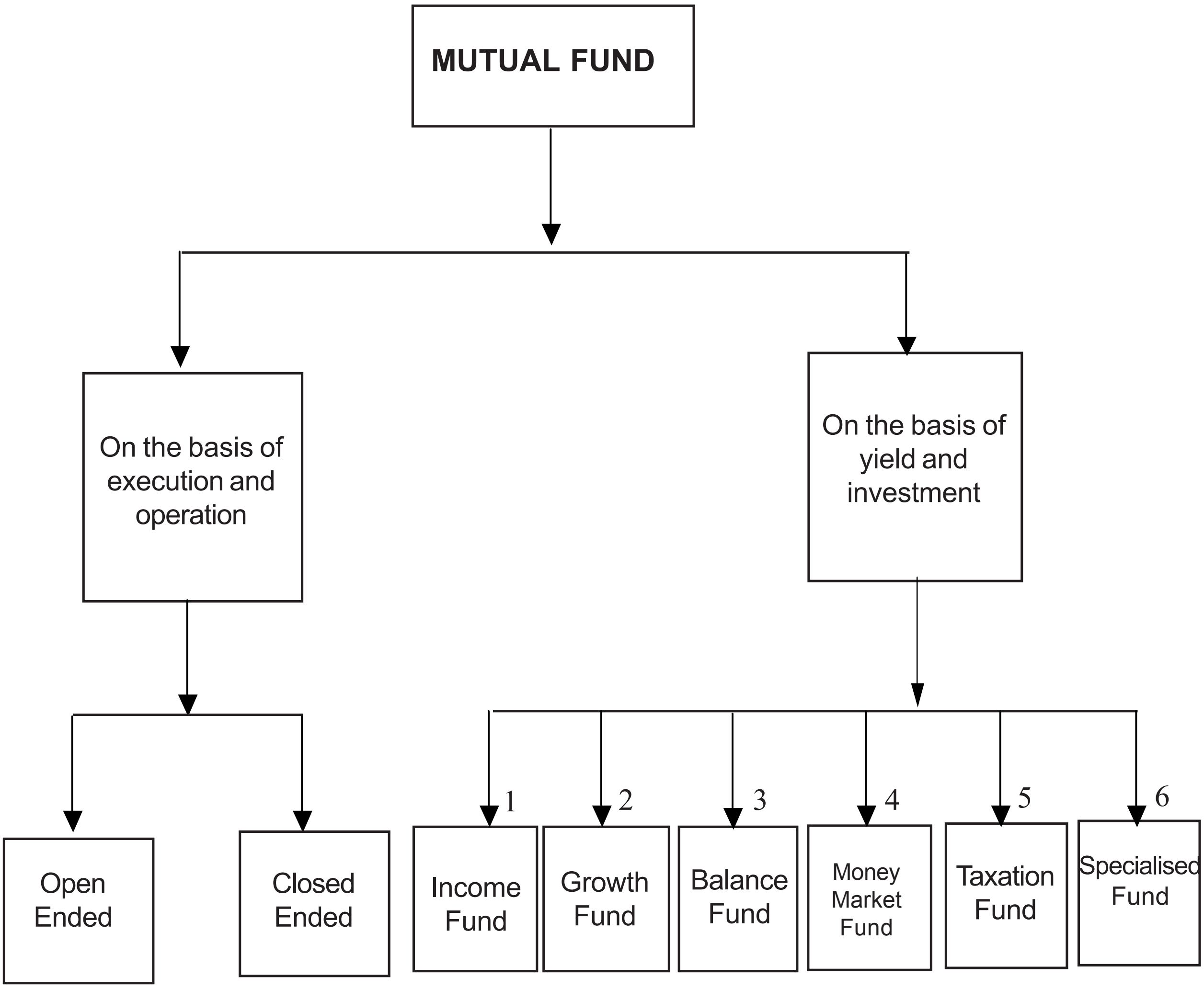
5. According to **J. Fred and Brigham Eugene F**. Unit Trusts are corporations which accept dollars from savers and then use these dollars from savers and then use these dollars to buy stocks. Long Term Bonds, Short term debt instruments issued by business or Government units, These corporations pool funds and thus reduce risk by diversification.

6. In the Indian context, Mutual Fund Trust accepting savings from the investors and invest the same as per the objectives incorporated in the trust deed to manage diversified portfolio which in turn assume reasonable returns to the investors.

4.2 Origin of the Mutual Fund System:

The origin of the concept of Mutual Fund dates back to the very dawn of commercial activity. It is rewarded that Egyptians and PHOENICIANS sold their shares and caravans with a view to spreading the risk attached with the risky ventures. The real credit of introducing the modern concept of Mutual Fund goes to the Foreign and Colonial government Trust, London established in 1986. Thereafter a large number of close ended Mutual Funds were formed in the U.S.A. Twice is followed by many countries in Europe. In all most all the countries both open ended close ended types are popular.

Broadly Mutual Funds can be classified as shown below:



1 4.3 Objectives of Mutual Funds:

1. To provide an Investment opportunity to the Investor especially the small income group of people to participate in the growing corporate sector.
2. To mobilize the savings of the public and channel them into productive Investments.
3. To provide a good return on Investment to the unit holders.
4. To cater to the needs of different investors.
5. To strengthen the capital market.

4.4 Types of Mutual Funds:

These funds are of various types and set up for various purposes and objectives. Broadly Mutual Funds can be classified as

A. Open Ended Funds

B. Close Ended Funds

(A). Open Ended Funds and its Features:

In these funds investors can buy and sell units on a daily basis. The scheme has permanent existence and a flexible changing corpus fund. In other words investors are free to buy and sell any number of units at any point of time at prices which are linked to the net asset value.

Features of Open Ended Funds:

1. There is complete flexibility with regard to their investment or disinvestment. The investor can join and come out from the fund as and when he desires.
2. The units are not publicity traded and the fund is ready to repurchase them and resell them at any time.
3. The main objective of this fund is income generation. The Investors get Dividend. Rights or Bonuses as rewards for their investments.
4. The Investor is offered instant liquidity in the scheme that the units can be sold on any working day.
5. Generally the listed prices of the units are very close to their Net Asset Value. The funds fixes a different price for their purchase and sales.

(B). Close Ended Mutual Funds and Features:

This type of scheme has a fixed corpus and operates for a fixed period. At the time of maturity the entire Corpus Fund is invested and the proceeds are distributed to the unit holders in proposition to their holdings after deduction of expenses of the fund by the Trustees. Hence, after final distribution the scheme ends. In close ended scheme, the funds donot, purchase their own shares. Instead, their shares are traded either on an organised exchange or in the over the counter market. If any investor wants to buy or sell shares of a closed ended fund would simply place the order with the broker in his place as if the Investor wanted to buy or sell shares of any company. The contributions from the members are collected during a definite time period of few days to a few months. Listing of close ended scheme on a recognised stock exchange is mandatory.

Features:

1. The period and the target amount of the fund is fixed before hand.
2. Once the period is over and the target is reached the door is closed for the investors and they can not buy any more units.
3. These units are publicly traded through stock exchange.
4. At the time of resumption the entire investment pertaining to a close ended scheme is liquidated and the proceeds are distributed.
5. The Fund ceases to be a fund after find distribution.
6. The main objectives of this fund are capital appreciation.
7. From the investors point of view it may attract more tax since the entire capital appreciation is realized in ToTo.

4.5 Advantages of Mutual Fund Schemes:

1. Safety of investment
2. Stable and fair return
3. Risk reduction and diversified portfolio
4. Investors are relieved of the botheration of managing investments.
5. Helps in expansion of capital markets.
6. Benefit of professional skill of fund managers.
7. Due to Mutual Funds capital formation takes effect.
8. Variety of schemes are available to choose from and some schemes of excellent liquidity.
9. Common Investors are relieved and the problem of managing their portfolio themselves will be eliminated.

Disadvantages of Mutual Funds:

1. The basic problem in Mutual Funds schemes is liquidity. This means capacity or ability to convert into cash.
2. It this being the yardstick most of the schemes are said to be illiquid.
3. Closed ended schemes are to be registered in the recognized stock exchanges and this type of schemes will also setter illiquidity due to the reason that the Net Asset Values may be less than the prices quoted.
4. Mutual Fund Schemes are always subject to market fluctuations.
5. It is felt that mutual funds lack transparency.

4.6 Organisation and Management of Mutual Funds:

A mutual fund can be constituted in the form of a trust and the instrument of trust should be in the form of a Deed duly registered under the Indian Registration Act - 1908 executed by the sponsor in favour of the trustees named in the instrument.

The Trust Deed should contain apart from the rules prescribed by the SEBI, such other clauses that are necessary for sateguarding the interests of the unit holders. However, no trust deed should contain clauses that has the effect of (A) Limiting/Extinguishing the obligations/ Liabilities of the trust in relation to any Mutual Fund/Unit holder or (B) Identifying the Trustees/Asset Management Company for loss/damage caused to the unit holders by their acts of negligence/commissions omission.

The contents of Trust Deed prescribed by the SEBI are as follows:

1. i. A trustee in carrying out his responsibilities as a member of the Board of Trustee/Trustee Company should maintain an arms length relationship with companies/institutions/financial intermediaries and any corporate body with which he may be associated.

   ii. No trustee should participate in the meetings of the Board of Trustees/Trustee company when any decisions for investment in which he may be interested are taken..

iii. All the Trustees must furnish to the Board of Trustees/Trustee Company particulars of Interest that they may have in any other company/Institution/Financial Intermediary/Any Corporate Body by virtue of their position as Director, Partner or with which they may be associated in any other capacity.

2. The minimum number of Trustees would be four.

3. The Trustees must take into their custody/under their control all the property of the schemes of the mutual fund and hold it in trust for the unit holders.

4. Unit holders would have beneficial interest in the trust, property to the extent of individual holding in respective schemes only.

5. It would be the duty of the trustees to act in the interests of the unit holders.

6. It is also the duty of trustees to provide or cause to provide information to unit holders and the SEBI as may be specified by the SEBI.

7. The Trustees should appoint an Asset Management Company (AMC) approved by the SEBI to float schemes for the Mutual Fund after approval by the trustees and the SEBI and manage the funds mobilised under various schemes in accordance with the provisions of the Trust Deed and the SEBI regulations. They should enter into an investment management agreement with the AMC. For this purpose and should enclose the same with the Trust Deed.

8. It is the duty of the trustee to take reasonable care to ensure that the funds under the schemes floated and managed by the AMC are in accordance with the trust deed and the SEBI regulations.

9. The trustees have the power to dismiss the AMC under specific events only with the approved of the SEBI in accordance with these regulations.

10. Appointment of a custodian and responsibility for the supervision of its activities in relation to the Mutual Fund and enter into a custodian agreement for this purpose.

11. The Auditor for Mutual Fund must be different from the Auditor of the AMC.

12. The responsibility of the Trustees to supervise the collection of any income due to be paid to the scheme and for claiming any repayment of tax and holding any income received in trust for the holders in accordance with the Trust Deed and the SEBI regulations.

13. Broad Polices regarding allocation of payments to capital or income.

14. Explicitly for bid the acquisition of any asset out of the Trust Property that involves the assumption of any unlimited liability or should not result in encumbrance of the Trust Property in any way.

15. Forbid the Mutual Fund from making or guaranteeing loans to take up any activity in contravention of the SEBI Regulations.

16. Trusteeship fee if any payable to trustees.

17. No amendment to the Trust Deed can be carried out without the prior approval of the SEBI and unit holders. However in case of subsequently conversion of Board of Trustees into a Trustee Company such conversion would yet require the approval of the unit holders.

18. The removal of the Trustee in all cases would require the prior approval of the SEBI.

19. The procedure for seeking approval of unit holders under such circumstances as are specified in the SEBI regulations.

20. A meeting of the Trustees would be held at least once in every two calender months and atleast six meetings should be held every year.

21. The Quorum for a meeting should be specified with atleast one Independent Trustee/ Director present.

22. The minimum number of Trustees would be four.

The sponsors of Mutual Funds or Trustees would appoint the AMC with the prior approval of the SEBI. Its appointment can be terminated by a majority of trustees or by 75 percent of the unit holders of the scheme. Any change in its appointment also requires prior approval of the SEBI as well as the unit. For grant of approval of the AMC by the SEBI the applicant has to fulfill the following:

(a) An existing AMC should have a sound track record/general reputation and fairness in transactions and should be a fit and proper person.

(b) The Directors of the AMC should have adequate professional experience in Finance and Financial Service related fields and have not found guilty of Moral Turpitude or convicted of any Economic offence or violation of any Securities Laws.

(c) The key personnel of the AMC have not been found guilty of Moral Turpitude or been convicted of Economic offence or violation of Securities Laws or worked for any AMC or Mutual Fund or any intermediary during the period when its registration has been suspended or cancelled at any time by the SEBI.

(d) The Board of Directors of such AMC has atleast fifty percent directors who are not associate of, or associated in any manner with the sponsor or any of its subsidiaries or the Trustees.

(e) The Chairman of the AMC is not a trustee of any Mutual Fund.

(f) The AMC has net worth (paid- up capital and free reserves minus miscellaneous expenditure not written off/adjusted or deferred revenue expenditure intangible assets and accumulated losses of not less than Rs.10 crores.

4.7 Mutual Fund Sector in India:

In our country Unit Trust of India (UTI) started the First Mutual Fund in the year 1964. Subsequently some other leading funds both in public and private sector has entered the arena. These are classified into two categories.

1. Portfolio Classification of Mutual Funds.

2. Functional Classification of Mutual Funds.

1. Portfolio Classification of Mutual Funds:

These are specific funds which are structured for feeding a particular investable purpose. Therefore different Mutual Funds are designed to meet the objective of funds provide fixed returns for those who prefer safety. The savings of investors are invested in various kinds of bonds in which investment is made primarily with different types of savers.

(a) Bond Funds: These are meant for safety. Bond funds specialise in building a portfolio or corporate or Municipal Bonds. These are conservative in nature and suitable to investors seeking both safety of Principal and Income.

(b) Stock Funds: These funds are established for those who are willing to accept significant risks in the hope of every high return.

(c) Income Funds: A pure income scheme aims at generating and distributing regular income (monthly, quarterly, half-yearly or annually) to the investors. Pure Income Scheme aims at maximization of Regular Income without pursuing for growth objectives. A substantial position of the corpus in invested in high yielding fixed income instruments such as Debenture, Bonds etc., Declaration of Regular Dividends/Interest is the main objective in such schemes. For example SBI Magnum Regular Income Scheme similarly Unit Trust of India has many monthly income schemes. These schemes are very beneficial to the retired and aged investors giving the later an assured level of income with total safety of capital. IND-JYOTI and SWARNA PUSHPA of Indian Bank are purely income oriented.

(d) Money Market Funds: This is very unique concept in India. Investment is made in Treasury Bills and Bonds. Here, the investor has an option to exit from the scheme after a period of more than 30 days.

(e) Specialised Funds: These are to envisage specialising investment in securities of certain Industries or specific income producing securities. Such funds like IT Fund, Pharmacy, Petro Fund carry more risk.

(f) Leveraged Funds: These funds are borrowed funds used in order to increase the size of the portfolio and benefit the share holders.

(g) Balanced Funds: Balanced Funds are those where assets are of an insidious mixture of industrial stocks and Bonds with a view to have modest risks of investment and secure reasonable rate of returns. The funds are employed in high grade common stock with 25% to 40% investments in conservative fixed income securities like debenture/bonds and preference shares.

(h) Growth Funds: A pure growth scheme aims at generating long term capital appreciation for the investor. In this scheme substantial portion of the corpus fund i.e. fund collected is invested in high growth equity shares or other equity related instruments of corporate companies. Growth Funds do not invest in Bonds and Debentures but concentrate wholly on equity investment or in money market operations. Thus, they are able to provide the growth opportunities to their shareholders depending upon their portfolio. They do not guarantee any minimum dividend or give any assurance of Minimum Capital appreciation. Although declaration of dividend is not prohibited but the main objective remains capital appreciation. For example can share and can growth of Canara Bank, Dhan Vika of LIC, Indmoti & Indratna of Indian Bank. Master Growth and Master Gain of Unit Trust of India are growth oriented schemes. Morgan stanley growth fund is a growth fund with a corpus of Rs.981.80 crores from 14,15,611 investors. It is the largest private sector fund and the second largest Mutual Fund Scheme in India. Taurus Mutual Fund and Centurion Quantum Growth Scheme also belongs to this category and also a growth scheme. Major part of the funds is invested in equity whereas in income scheme the major part is invested in fixed returns bearing securities i.e. the investment of certain Mutual Funds.

(i) Dual Purpose Funds: Income and growth are the twin objectives which are achieved by offering halt of the amount of funds to those investors who wish regular income and half to those who wish growth.

(j) Real Estate Funds: These are close ended type. The Fund is named because the collected amount will be invested in Real Estate Ventures.

Functional Classification of Mutual Funds:

This is based on the characteristic of Mutual Fund Scheme opened for subscription. On this aspect the Mutual Funds are classified into open ended and close ended Funds.

4.8 Geographical Classification of Mutual Funds:

National Boundaries provide territories restrictions on the sale and purchase of Mutual Fund Units or shares as in the case of commodity trade or service. In view of this Mutual Fund which operates within the Nation Boundaries are different from those which are meant for subscription of foreigners or the nationals living outside. This classification can be done in two ways.

1. Domestic Mutual Funds

2. Off Shore Mutual Funds

Domestic Mutual Funds are the saving schemes which are open by mobilizing savings from the public within the country. Ex: UTI, GIC, LIC, SBI, CAN BANK, PNB MF, BOIMF, RELIANCE, TATA, DBS CHOLAMANDALAM, FIDELITY, ABN AMRO, BIRLA, SAHARA are the Domestic Funds catering to the needs of public.

The basic objective of opening off shore Mutual Fund Schemes is to attract Foreign Capital for Investment purposes in the country. From Investment point of view, off shore Mutual Fund open up Domestic Capital Market to the International Investor and for Global Portfolio Investments.

The major point of difference between off shore Mutual Funds and Domestic Mutual Funds is the currency and country risk for the global investors as the source of funds from abroad because of high risk and higher return in invested funds can be expected. Like Domestic Mutual Funds, the off shore Mutual Funds can also be functionally classified into close ended or open ended funds.

The major off shore funds opened so far have been close ended schemes providing redemption of the units for individual investors only at the end of the period specified in the scheme. For example UTI's INDIA FUND 1986. INDIA GROWTH FUND, SBI's INDIA MAGNUM, CAN BANK's INDO-SWISS HIMALAYAN FUND, 1990 COMMON WEALTH EQUITY FUND are close ended off shore funds.

4.9 Characteristics of Indian Mutual Fund Scheme:

1. Assurance of Minimum Returns:

Mutual Funds in general do not assure any minimum returns to the investor. Returns are paid to the investors, common separate with the returns earned by the fund on the portfolio as portfolio consists of market risks. Contrary to this, the Indian Mutual Fund Schemes launched during 1987 to 1990 assured specific returns while marketing their schemes. In 1991 (SEBI together with the Union Ministry of Finance ordered that the Mutual Funds do not assure minimum returns. Recently the SEBI (Securities Exchange Board of India) has formulated a policy that mutual funds with a track record of 5 years will be allowed to offer fixed returns. SEBI shall prescribe the returns to be assured from time to time. However, no funds will be allowed to offer fixed returns for more than one year.

2. Multiple Options: Most of the Mutual Fund Schemes are offering different options to the investor under scheme. For example, a Growth Oriented Scheme may offer option of either regular income plan: Dividend shall be distributed to the investors. Second Dividend will be reinvested and the total amount will be paid at the time of redemption. Ex: LIC MF offered DHANA VARSHA with the following options.

1. Immediate Monthly Income
2. Differed Monthly Income
3. Accumulated Income and Benefits Under Section 80(1) of the Income Tax Act 1961.
4. Growth with Capital Gain.

3. Lock in Period: Mutual Fund Scheme offer documents contain a clause of lock-in-period ranging from one year to three years. Until the completion of the minimum period the investors are neither to trade the units on the stock exchange nor to avail repurchased facility.

4. Liquidity:

This means conversion of the asset or security into cash.

(a) Open ended Mutual Funds offer the facility of repurchase and the close ended schemes are also offering repurchase after a minimum period of 2 to 3 years.

(b) Mutual Fund Units can be pledged or mortgaged in favour of Commercial Banks or Financial Institutions and can obtain a loan according to the rules and regulations of the Bank or Financial Institutions.

(c) Mutual Fund units can be transferred in favour of any individuals. However, the Tax Planning Schemes units are not transferable.

5. Incentives to Early Subscribers:

Most of the close ended Mutual Fund Schemes are offering incentives to encourage early subscription by investors. This is more prevalent in Tax Planning Schemes.

4.10 Tax Benefits Available to M.F. Investors:

1. Under Section 80(L) of the Income Tax Act 1961, Income received on units or mutual funds are qualified in a deduction upto Rs.7000 along with other specified securities and deposits.

2. Benefits Under Wealth Tax: Investment in Mutual Funds would be treated on par with investments entitled to exemption with overall limits of Rs.5 lakhs and permitted in Section 5(IA) of the Wealth Tax Act 1957.

3. Benefits Under Gift Tax: No tax shall be changed on gifts of Mutual Fund limits provided the aggregate value of gifts made during the year does not exceed Rs.30,000/-. Further the gift made to a relative who is dependent on the unit holder for support and maintenance on the occasion of the marriage of the relative is exempted provided the value of the gift is upto Rs.1,00,000 each such relative.

4. Tax Benefits for Eligible Institutions: Investment in Mutual Fund units by religious or charitable Trusts is an eligible investment under Section 11(5) of the Income Tax Act. Eligible institutions such as those covered in the units would qualify the tax exemption in respect of income and corpus under the applicable sections of the Income Tax Act 1961.

5. Tax Benefits for Corporate Sector: A Corporate Sector is entitled to deduction in computing its income in respect of dividend received by it from another Domestic Company under Section 80 M of the Income Tax Act. For this purpose UTI is considered as a domestic company. Due to this reason UTI is having an advantage when compared to other Mutual Funds.

4.11 Mutual Fund in Public & Private Sectors:

In our country there are three categories of players in the Mutual Fund Industry.

1. Unit Trust of India.
2. Mutual Funds floated by Public Sector Banks and Insurance Companies.
3. Private Sector Mutual Funds.

1. Unit Trust of India:

Popularly known as UTI has laid the foundation for Mutual Fund industry. UTI being a public sector company had assumed monopoly in savings mobilisation of house hold sector through its various Mutual Fund Schemes beginning from 1964 to outer to the needs of different investors i.e. Monthly Income Schemes. Capital Gains Schemes, Equity Linked investment plan etc., Recently it has been divided into two UTI -1, AMC-1 which covers only unit 1964 scheme and all other schemes are managed by AMC-2.

2. Public Sector Banks:

The monopoly of UTI in the field of Mutual Fund Industry was broken in 1987 with entry of Public Sector Banks and sponsoring Mutual Fund Trust. Under the Indian Trust Act, presently there are 5 Public Sector Banks having Mutual Funds in operation. They are:

1. State Bank of India.
2. Canara Bank
3. Bank of India
4. Punjab National Bank
5. Indian Bank.

1. State Bank of India : Capital Markets Ltd., a subsidiary of SBI manages Mutual Funds. It has an investor base of more than Ten Lakhs with total investment of Rs.4,300 crores in all the schemes. SBIMF has launched an off-shore fund to tap Foreign Investment known as INDIAN MAGNUM MUTUAL FUND. This is the largest off-shore, country fund with subscriptions in W.S. $200 million.

2. Canara Bank Mutual Fund: It is sponsored by Canara Bank and is the 2nd largest. Mutual Fund aimed to maximize capital appreciation with a provision to distribute earnings.

3. Bank of India Mutual Fund: It was launched in July 1990 at the time when capital market was booming. It has created a trust known as Bank of India Finance Ltd., as its Fund Manager. For the first time this scheme introduced the concept of capital gain benefits for the investor and collected Rs.484 crores.

4. Indian Bank Mutual Fund: It has been set up with main objective to mobilize savings from the Indian Public and to invest them to get a good return on investment and achieve long term capital appreciation and this process assist, capital formation and Industrial Development of the country and to provide investment expertise for the benefit of investors. The main objective of the trust is to pool the funds received from subscription acquisition, holding securities, trading or disposal of securities or any other assets whatever for the purpose of having the effect of providing facilities for participation by the persons as beneficiaries in profits or income arising there form.

5. Punjab National Bank Mutual Fund: It is like the Punjab National Bank as Trust under the Indian Trust Act. It offers regular income and capital appreciation. It offers several schemes for investors.

6. LIC Mutual Fund: It was setup in 1989 as a seperate trust by LIC. The basic objective of LICMF is to collect savings of people especially from Rural and Semi Urban areas and providing good returns. Liquidity and capital appreciation. LIC is the largest Insurance Companies in the world serving more than 8 crore policy holders.

7. GIC Mutual Fund: It has been set up as a trust by GIC and its 4 subsidiaries. The basic objective of GICMF is to mobilize savings from the public and canalize them to the capital market with a view to provide safety, security, returns and liquidity to the investors.

Apart from the Mutual Fund Players in the public sector there are several private players who are mobilizing funds from the public. Mutual were conceived as institutions for providing small investors with avenues of investment in the capital market. Small investors generally do not have adequate time to speed in the capital market. Knowledge, experience and resources for directly accessing the capital market and as such they can rely on investment intermediary which undertakes judicious investment decisions and provides the consequential benefit of professional expertise.

4.12 Pricing Method of Mutual Funds:

(a) Open Ended Scheme: In this scheme the investors can buy and sell units on a daily basis. The scheme has permanent existence and a flexible changing corpous fund. In other words Investors are free to buy and sell any number of units at any point of time at prices which are linked to the Net Asset Value (NAV) of the units. NAV is calculated as follows. For example ‘X’ company has introduced a scheme known as “FORTUNE”. The size of the scheme is 200 crores. Now the NAV is

NAV = 200 crores/100 crores Units x value of each unit x 10 = 2 x 10 = Rs.20.

The value of each unit of Rs.10 is worth of Rs.20. Hence Net Asset Value (NAV) = Rs.20. This NAV is the basis for fixing the repurchase price and fixed price. When the open ended Mutual Fund Investor wants to sell his units, he usually receives an amount equal to the funds NAV times the number of units sold. As the NAV changes with the changes in sharp price, the prices at which the investor can buy or sell the units. There will be a small difference between the buying and selling price because of the transaction cost and stamp duty involved in the buying and selling. As a matter of fact, open ended scheme provides complete fee flexibility to the investors and the investor is at liberty to invest or disinvest scheme. NAV of a Mutual Fund scheme is as important as EPS to a company’s share before and after investment. Hence there is a need for a proper computation of NAV by taking into consideration the accurate value of investments, income earnes on the investment and the related expenditure.

Closed ended scheme units are listed in stock exchanges and are traded like equity shares of any other industrial company. However in the Indian situation some of the funds extended the facility of repurchase to the closed ended schemes also. The reason for this is that the stock exchanges are located in the metro cities that are not easily accessible to the rural and semi-urban investor prices policies of close ended schemes, the fixation of repurchase price plays a vital role in the close ended schemes also. Theoretically repurchase price should be equal to Net Asset Value (NAV). But the policies of Mutual Funds regarding computation of repurchase price and divergent.

4.13 Regulatory Frame Work of Mutual Funds:

Regulatory Frame Work of Mutual Funds is to give suitable direction to the functioning. The need for regulation is SAFETY of the principal amount and this is very essential for any financial instrument. Where this is not assured there is a possibility of high defaulterise and the investor requires protection. The investors of Mutual Funds/Unit Trust are exposed to high default risk in comparison to investors of other alternative instruments such as Bank Deposits, Debentures and Equity Shares. The Government of India guarantees the savings instruments promoted by the National Savings organisation through post office. Hence the saver/investor is protected various deposits mobilised by commercial banks are protected by the capital adequacy norms laid down by the RBI (Reserve Bank of India) and the credit guarantee corporation gives protection to the bank deposit, holders to some extent. Thus, the investors of Bank Deposits are protected by capital adequacy and Insurance. Various Debenture holders of the corporate sector are protected by the Asset structure of the company capital adequacy.

In contrast, the investors of Mutual Funds/Unit Trust are exposed to both high risk, both default and market risk. Hence there is a need for a strong regulatory frame work.

Objectives of Regulatory Frame Work: The Mutual Fund Regulations should meet the following objectives:

1. Ensure that the Mutual Funds are arranged for the benefit of the investors with fiduciary responsi bilities by charging a rational management fee.

2. Establish confidence among the investors that the funds pooled are invested with clear investment objectives and policies and protect the physical integritty of the assets.

3. Assume that investors receive adequate and accurate information about their investment.

4. Ascertain that funds should not become the investment for the sponsor encouraging the self-dealing and affiliated party transactions by using their privileged positions.

5. Formulate rules for accurate and fair of investment, Net Asset Value, Repurchase price and redemption price.

In the context of the specialised financial intermediaries, the regulations must encourage the operational freedom of the fund managers and creativity in finding out the innovative products. At the same time regulations should provide the utmost protection to the investor. According to **DAVID SILVER**, President Investment Company Institute U.S.A. the following are the principles necessary for Mutual Funds.

1. Prohibition of regulations of various forms of self-dealing or affiliated party transactions.

2. Economic Regulations on Management remuneration.

3. Restriction on unfair or unsound capital structures.

4. Clear disclosure of investment objectives and policies

5. Protection of the physical integrity of the Asset of the pool.

4.14 Regulation and Investor Protection in India:

Securities Market Regulation in India is in process of evolution and cannot be identified either with the UK or the US type of regulation. In India, under the present frame work the regulation of all participants in the securities market is the responsibility of SEBI with the exception of issuers of capital.

SEBI's basic objectives as the Prime Regulator of capital market activities in India are to protect the interest of investors. This objective has been started in the preamble of the Securities and Exchange Board of India Act, 1991, thus to protect the interests of investors in securities and to promote the development and to regulate the securities market and for markets connected therewith or incidental thereto. Accordingly all the capital market activities including that of Mutual Funds are covered under the above objective so far as investor protection is concerned.

The Securities and Exchange Board of India (Mutual Funds) Regulations 1993 was the first attempt to bring Mutual Funds under a regulatory Frame Work and to give direction to their functioning. However it was observed in the course of time that the industry needed a more flexible work environment. Therefore SEBI came out with new regulations in 1996 which eliminated many of the rigidities contained in the 1993 regulations and at the same time introduce new provisions as regards disclosure transparency and obligations on the part of Mutual Funds, AMC's Trustees and key personnel. The Securities and Exchange Board of India (Mutual Funds) Regulations 1996 (Hereafter Regulations) has many similarities with the Investment Company Act, 1940 of the USA so far as Mutual Fund Regulation as investor protection are concerned. The Regulatory and supervisory powers of SEBI also stand strengthened by the Securities Law (Amendment) Ordinance 1995 which empowers SEBI is also allowed to file complaints in the courts without prior approval of the Central Government. SEBI has thus emerged as an autonomous and powerful regulator of Mutual Funds in India. The regulations lay down measures to protect Mutual Fund Investors. Some of the measures are briefly discussed below:

SEBI has incorporated several provisions to check Mutual Funds at the entry level similar to the provisions of "fit and proper" test in the U.K. Every Mutual Fund shall be registered with SEBI and the Registration will be granted on fulfillment of certain conditions laid down in the regulations for efficient and orderly conduct of the affairs of a "Mutual Fund". The regulations further stipulate that the sponsor must have a sound track record and experience in the relevant field of Financial Services for a minimum period of five years professional competence, financial soundness and general reputation of fairness and integrity in all business transactions.

SEBI has laid down conditions of appointment and obligations of trustees and detailed guidelines on trust deed. The Asset Management Company (AMC) to manage the assets of Mutual Funds is to be approved by SEBI also lays down the terms and conditions for approval being that the AMC are to be persons having adequate professional experience in finance and financial service related fields. Mutual Funds must have a custodian to be approved by SEBI and one of the preconditions for approval is the "Sound Track Record, General Reputation and Fairness in Transactions".

SEBI had laid down several provisions for pre-launch and post-launch disclosure to ensure that investor can take informed decision on the basis of factual information supplied by a Mutual Fund.

No new scheme can be launched by any Mutual Fund unless the same is approved by the trustees and a copy of the document has been filed with the Board. SEBI has also stipulated that the AMC should stipulate the minimum amount it seeks to raise under the scheme and the extent of over subscription to be retained. There are clear regulatory provisions regarding listing of closed ended schemes, refunds, transfer and sending of unit certificate to investors. There is also a provision for disclosing the names of trustees of mutual funds, all Directors of AMC in the prospectus of the funds, as also investment objectives and strategy and approximate percentage share of investment to be made in various instruments. No guarantee of return can be given unless it is fully guaranteed by the sponsor a AMC and a statement indicating the manna of guarantee and the same of the person who will guarantee the returns is made in the offer documents.

SEBI has outlined the advertisement code to be followed by Mutual Fund in making any publicity regarding a scheme and its performance.

All mutual funds are bound to publish a scheme wise Annual report or an abridged summary through an advertisement within six months of the closure of financial year. The trustees of Mutual Fund are bound to convey to investors any information having adverse bearing on investment. A Mutual Fund is also to publish half-yearly un-audited financial results through an advertisement.

SEBI has prescribed norms for investment management with a views to minimize/reduce under investment risk. There are also certain restrictions which are aimed at ensuring transparency and prohibiting Mutual Funds from excessive risk exposure. These restrictions and limitations have strong similarities with such provisions in the U.S.A. and U.K.

SEBI can inspect the Books of Accounts Records and Documents of a Mutual Fund Trustees, AMC and custodian.

In addition Securities Law (Amendment) Ordinance 1995, further empowers SEBI with certain penal actions for violations of Regulations. SEBI can impose monetary penalty under the following situations.

* If any Mutual Fund violates terms and conditions of certificate of Registration, SEBI can impose penalty not exceeding Rs.10 lakhs.

* It a Mutual Fund fails to comply with listing conditions a penalty not exceeding Rs.5000 for each day or Rs.5,00,000 which ever is higher can be imposed.

* It a Mutual Fund fails to dispatch unit certificate in the manner provided it shall be liable for penalty not exceeding Rs.5,000 per day for each day during which such failure continues.

* A Mutual Fund is also liable for penalty, if it fails to refund applications money (specified in the Regulations) not exceeding Rs.1000 per day during which such failure continuous.

* A Mutual Fund can be pevalized if it fails to invest the money collected under a scheme in the manner or within the period prescribed in the regulation such penalty will not exceed Rs.5,00,000 for each failure.

* A penalty of Rs.5,00,000/- for each failure of the AMC can be imposed if it fails to comply with any restrictions provided in the regulations.

As we can see the regulatory frame work as stated above indicates that SEBI is a highly powerful regulator. The Indian Regulatory mechanism is centered on statutory provision. There is a strong emphasis on ex-post investigation and disciplining of Mutual Funds through financial penalty for violation of regulation. The implict tone of regulations is correction through control. There are enough provisions for disclosure. Thus, the Regulator, mechanism and supervisory control are both strong enough for protecting the interests of investors. However the protection can be strengthened further by including a few more elements like investor's protection fund and credit rating.

Indian Mutual Funds have so far never failed to pay reasonably good returns on investments. They have been paying more than guaranteed returns (whenever promised). However keeping in view the emerging scene of competition, the entry of Mutual Funds with unknown track record and growing market volatility, the introductions of investors and protection fund would increase the investor confidence in Mutual Funds and reduce the risk of Mutual Fund investing. Modalities of the Fund can be jointly worked out by SEBI, the Mutual Fund industry and the Government. The Fund can be run on the principle of insurance and managed by a separated body.

Voluntary credit rating can be introduced for Mutual Funds Schemes to help investors to take an informed view of products management and expected performance.

4.15 Role of SRO's:

Self Regulatory Organisations (SRO) should be an integral part of the regulatory mechanism in a financial service industry. The establishment of a strong SRO for Mutual Funds in India becomes imperative, particularly in view of the imperfections of the market system in the current period of Economic transition. Economic transition is often characterized by market volatility. Speculation and frandulent activities which may lead to market failures and exposes investors to great risks. Statutory regulations and ex-post investigation could well fail to prevent market failure unless the explicit and implicit implications of provisions are understood and implemented. An SRO can play an important role in disciplining members and assist the Regulatory Authority in Protecting investor's interest. Further SRO can be effective in the following ways:

* It can help the Mutual Fund Industry to grow on business principles by helping member organisations to overcome environmental, organisational and procedural constraints.
* It can develop an internal code of conduct to be followed by members to prevent them from adopting un-ethical Business Practices.
* It can also conduct periodic checks on the activities of member funds. This will increase the changes of fair business, prevent frauds and increase the confidence of investors.
* It can undertake investor education through publication and seminars.
* An SRO can also develop a code of conduct for associates the Registrars, Custodians, Brokers and Agents.
* SRO's can actively undertake research studies and training for members as well as investors. SRO's can play an active role in promoting the Mutual Fund culture by conducting Research and Producing Literature.
* Business growth and Development require efficient and trained Managers. The Associa-

tion can undertake the training to develop a band of competent Managers for Mutual Funds.

The Association of Mutual Funds in India (AMFI) was formed in August 1995 by the Indian Mutual Funds with a view to promoting and protecting the interest of Mutual Funds and their unit holders, incresing public awareness of Mutual Funds and serving the investors interest by defining and maintaining high ethical and professional standards in the Mutual Funds Industry. To achieve this objective, AMEI has undertaken investor's Awareness programming and is also working to bring out a comprehensive code of ethics for Mutual Funds.

4.16 UTI Restructuring and Committees on Mutual Funds:

UTI, Country's Largest Mutual Fund in an un-precedented move suspended sale and purchase of U.S.-64 in June -01 sending shock waves across the country. The move to suspend U.S.-64 was aimed at achieving the twin objectives to restructure the investment portfolio of the scheme in face of volatile stock market as well as to wait for the market to become stable so that the equity investment of U.S. 64 fetch high returns.

There were more than 20 million investors in U.S. 64 with a total investment of Rs.20,000 crores. Investment in U.S. 64 was little more than 25% of the total fund of Rs.75,000 crores managed by UTI. Unlike other schemes U.S. 64 was not linked to NAV and many times higher rewards were given to unit holders. It is reported that many investment decisions were taken by UTI without sufficient financial prudence and sound analytical basis. It is also reported that individuals took many investment decisions defying the views of evaluation committee.

Things were not good for UTI since the beginning of liberalisation. In 1998 Government sanctioned a bail out package of Rs.3300 crores to restore the health of UTI. DEEPAK PAREKH Committee recommended UTI restructure its investment portfolio to fixed income securities and move to a Net Asset Value (NAV) based system. The committee suggested that UTI should being its operations under the supervision of SEBI.

Being a behemoth in capital market the problem of UTI led to steep fall in prices of many shares and drastic erosion in market capitalization. Since UTI does not have sufficient funds to deploy, the share prices of many corporates are subdued despite better financial results. Following uncertainty so surrounding the fate of UTI, the redemptions were huge and for the first time the total investment in UTI has fallen below Rs.50,000 crores out of Rs.1,00,000 crores investment in the Mutual Fund Industry. Government have decided to bailout UTI once again in order to project the interests of investors and restore their confidence. For this purpose Y.H. MALEGAM Committee was asked to review the recommendations of Deepak Parekh Committee and suggest follow-up action while TARAPORE COMMITTEE was asked to look into UTI's investment over the past 10 years to find it extraneous considerations played a role in the trust's investment decisions. The committee suggested as follows:

Y.H. MALEGAM COMMITTEE:

1. Three tier structure in line with SEBI regulations comprising a sponsor. A trustee company and an Asset Management Company (AMC).
2. W.S. 64 to be Net Asset Value based before UTI restructuring. Before shifting to NAV mode appropriate provisions should be made to meet shortfall arising out of the gap between the available Assets of U.S. 64 and the guaranteed price to individual unit

holders owing upto 3000 units.

3. The UTI Act should be repealed and a new act to be enacted. Government must be completes distanced from UTI.

TARAPORE COMMITTEE:

1. Setting up of Board of Trustees and Three Asset Management Companies one each for income funds growth funds and U.S - 64.
2. UTI could hold 49% of the capital of the three AMC's and this would overtime enable greater private participation in UTI.
3. UTI should empower AMC Committees and take on responsibilities of investment decisions before the move to a NAV basis in January 2002.
4. Only Individual investor should be allowed in U.S.-64.
5. SEBI Act should prevail.

4.17 Key Words:

(A) Mutual Fund : Mobilisation of Funds by Organisations in Public Sector and Private Sector for purposes of investment in stock market securities so as to give adequate returns to the investors who cannot invest directly.

(B) AMC : Asset Management Company.

(C) UTI : Unit Trust of India

(D) LIC : Life Insurance Corporation

(E) SEBI : Securities Exchange Board of India.

(F) FOF : Fund of Funds

(G) MMMF : Money Market Mutual Funds.

(H) NAV : Net Asset Value.

4.18 Self Assessment Questions:

1. Define Mutual Funds and its activities.
2. Explain about various categories of Mutual Funds.
3. What are the objectives of Mutual Funds.
4. What are the advantages and disadvantages of Mutual Funds.
5. What are the features of Open Ended Schemes.
6. What are the features of Close Ended Schemes.
7. Discuss the role of Mutual Funds in India.
8. What are the characteristics of Indian Mutual Fund Schemes.
9. Explain the tax benefit available to Mutual Fund Investors.

10. What is the Pricing Method of Mutual Fund Schemes.

11. Discuss the objectives of Regulatory Frame Work.

12. Explain how the Regulations helps Mutual Funds Investor Protection.

13. Explain about Self Regulatory Organisations (SRO's).

4.19 Reference Books:

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Investment - An Introduction to Analysis - Fredrick Amling; U.S.A.

Banking and Financial Systems - S.N. Maheswari, R.N. Paul; Kalyani Publishers Ludhiana.

SEBI Guide Lines for Mutual Funds

Indian Mutual Fund Industry - Association of Indian Mutual Funds.

- Dr. A. SATHISH BABU