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Assistance to Mutual Funds - Report of Mr. Lewis J. Mendelson

Financial Institutions Reforms and Expansion (FIRE) Project

April 1997

Financial Institutions Reform and Expansion (FIRE) Project
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April 7, 1997

Mr G A Shenai
Chairman of AMFI
Managing Director Canbank Mutual Fund
Orient House
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Dear Mr Shenai

At the request of the Association of Mutual Funds in India ("AMFI"), Price Waterhouse LLP ("PW") arranged for continuing assistance to AMFI by Mr Lewis J Mendelson, a former senior official of the United States Securities and Exchange Commission ("SEC") and an expert in mutual funds As you are aware, his assistance which began in July and August, 1996, is aimed at improving the credibility of the mutual fund industry and helping it to gain wider public acceptance

Initially, PW recommended a comprehensive strategy to strengthen AMFI and helped to design an AMFI Investor Awareness Campaign, including providing drafts of brochures to be used in the campaign Mr Mendelson's assistance continued in October and November 1996 He provided guidance to AMFI, revised certain of its draft brochures and Code of Conduct and helped to structure its Campaign, including laying the groundwork for the visit to India of Mr David Silver, former Chief Executive Officer of the Investment Company Institute ("ICI"), the trade association of the U S mutual fund industry, and an internationally recognized authority on mutual funds Mr Mendelson returned with Mr Silver in January 1997 They were assisted in India by Mr R N K Prasad

This assistance is carried out under the US Agency for International Development Financial Institutions Reform and Expansion ("FIRE")project which is administered by PW

I. PURPOSE OF ASSISTANCE

The purpose of Mr Mendelson's visit was to help AMFI to continue to implement and develop its program to improve the credibility of the mutual fund industry and the public's acceptance of mutual funds Specific goals included

- assessing the regulatory environment for mutual funds,

- recommending actions to strengthen AMFI and the fund industry, and
- helping the mutual fund industry to achieve its full potential in bringing savers into the securities markets and improving the depth and liquidity of those markets

Messrs Silver's and Mendelson's views and recommendations received wide exposure Mr Silver presented the Keynote Address "Reflections on Regulation the Role of Industry" before the Third Annual Seminar on the Mutual Fund Industry sponsored by the UTI Institute of Capital Markets and AMFI and participated in a panel discussion on "Regulation of Mutual Funds" as part of the Sixth Technical Session He also discussed the mutual fund regulatory environment with the concerned department heads and staff of the Ministry of Finance in New Delhi and, with Mr Mendelson, participated in round table discussions, workshops and seminars with securities industry leaders and mutual fund sellers in both New Delhi and Mumbai Mr Mendelson prepared a written summary of Mr Silver's views "An Assessment of the Regulatory Framework for Mutual Funds "

Mr Mendelson, as a participant in the Seventh Technical Session of the UTI/AMFI Seminar "Mutual Funds Through 2000," spoke on "Reforms That Will Improve the Securities Markets and Provide New Opportunities for Investors " He recommended a number of significant changes in mutual funds and the industry's approach which are needed for the fund industry to take advantage of those opportunities

During AMFI's General Membership Meeting, Mr Silver discussed the organization and operation of the ICI, the factors which contributed to the growth of the fund industry in the United States and presented recommendations for strengthening AMFI and developing India's fund industry Mr Silver and Mr Mendelson later discussed these recommendations in detail with AMFI's Chairman and Board of Directors Mr Mendelson prepared a summary of Mr Silver's recommendations, "The Role of the Investment Company Institute in Promoting The US Mutual Fund Industry A Model For AMFI?" and prepared an Action Memorandum for implementing those recommendations

Mr Silver and Mr Mendelson also briefed Ambassador Wisener, members of his staff and the leadership of USAID on the purposes of this visit, the status of the Indian Mutual Fund Industry and the steps it needs to take to achieve greater acceptance

II. CONTENTS OF REPORT

The report reviews progress in implementing the AMFI Comprehensive Strategic Plan and the AMFI Investor Awareness Campaign It analyzes the strengths and weaknesses of the current regulatory environment for mutual funds and charts a course that the Mutual Fund Industry and AMFI can follow to strengthen the industry, its products, services and regulation It includes specific objectives, steps and priorities for strengthening AMFI and outlines changes in the operation of the industry necessary for it to gain wider acceptance

III. NEXT STEPS

In view of the excellent progress made by AMFI, PW recommends that AMFI and the fund industry would benefit from continued expert consultation in connection with

- strengthening AMFI, including conferring with AMFI' s leadership and members on improving AMFI's internal structure and administration, prioritizing goals, hiring staff and enlisting a broader range of members to participate in committees and thereby increasing their level of involvement in and support for AMFI and helping to achieve AMFI's objectives,

- supporting AMFI's Investor Awareness Campaign by reviewing and perfecting the strategy and materials to be used in its Investment Awareness Campaign and designing courses and materials necessary for training brokers, sub-brokers and other sellers of fund scheme units,

- raising industry levels of professionalism and compliance by assisting in completing the AMFI Code of Conduct, structuring and planning initial training of fund trustees, directors, compliance officers and other employees of AMC's, and creating other compliance mechanisms, such as an AMFI Model Compliance and Operations Manual and internal reporting forms and schedules,

- helping to structure an AMFI regulatory and legislative programme by assisting in
  - creating a Model AMFI Advertising Code,
  - preparing an AMFI Valuation Guideline for valuing portfolio securities,and
  - identifying legislative goals and working with SEBI, the Ministry of Finance, the Reserve Bank of India, and other concerned Government Departments to increase the industry's impact on regulatory matters that affect its vital interests and those of its unitholders, and
  - analyzing the differences between UTI's structure, operations and regulation and those of the funds fully regulated by SEBI and outlining the steps necessary to restructure UTI to bring it under the full regulation by SEBI, and

- promoting changes in the operation of the industry by preparing legislative strategies for broadening the range of products and investment techniques offered by the fund industry

IV. DISTRIBUTION OF THE REPORT

Under the terms of the PW/FIRE Project, the report will be distributed to USAID and SEBI We request your permission to distribute the report to selected participants in the Indian Capital Market and we will advise you of the same We will not distribute the report in its entirety to the media directly, however, we will note comments on its contents from time to time in response to media enquiries

We want to express our sincere appreciation for the warm welcome and cooperation which AMFI, its Board Members and particularly its Investor Awareness and Code of Conduct Committees have provided to Mr Mendelson, Mr Silver and our staff

Upon reading this report and its recommendations, please feel free to contact me with any questions I can be reached at tel 496-3599, fax 496-3555 Thank you

Sincerely,

W. Dennis Grubb

W. Dennis Grubb
Principal Consultant Capital Markets

Enclosure

cc Mr Pratip Kar
Executive Director
Securities Exchange Board of India

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I. EXECUTIVE SUMMARY

This is a review of the continuing technical assistance given to the Association of Mutual Funds in India ("AMFI") by the FIRE Project during January and February, 1997, as part of its ongoing effort to assist the fund industry in improving its credibility and gaining wider public acceptance

FIRE, with the aid of its mutual fund consultant, Lewis Mendelson, had earlier designed a comprehensive program to improve the credibility of the industry which called for AMFI to establish five departments or committees professional standards, government relations, statistical research and analysis, information services and membership services FIRE, working closely with AMFI, also designed and laid the foundation for an AMFI Investor Awareness Campaign, a long term educational and promotional effort built around seven basic documents, five of which were provided by FIRE as first drafts to AMFI and two for which FIRE provided specifications to AMFI

FIRE subsequently revised three of its original drafts, including the draft AMFI Code of Conduct, in accordance with AMFI's comments, and invited Mr David Silver, former Chief Executive Officer of the Investment Company Institute ("ICI"), the trade association of the U S mutual fund industry, to join Mr Mendelson during January 1997, as a Special Consultant in this assistance

The broad objective of the assistance provided by Messrs Silver and Mendelson was to help to develop and implement AMFI's program to improve the credibility of the mutual fund industry and the public's acceptance of mutual funds Their reports and recommendations were designed to reenforce the FIRE Project's earlier recommendations, particularly with respect to the comprehensive plan to strengthen AMFI, and to energize AMFI's efforts to promote regulatory reform and higher professional standards Specific goals included

- assessing the regulatory environment for mutual funds,
- assisting in strengthening AMFI and the fund industry,
- helping the mutual fund industry to achieve its full potential in bringing savers into the securities markets and improving the depth and liquidity of those markets, and
- better informing policy makers, fund salesmen, securities industry leaders, the media and the investing public about mutual funds

Messrs Silver's and Mendelson's views and recommendations received wide exposure Mr Silver presented the Keynote Address "Reflections on Regulation the Role of Industry" before the Third Annual Seminar on the Mutual Fund Industry sponsored by the UTI Institute of Capital Markets and AMFI and also participated in a panel discussion on "Regulation of Mutual Funds" as part of the Sixth Technical Session Mr Silver, discussed the mutual fund regulatory environment with the concerned department heads

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and staff of the Ministry of Finance in New Delhi, and, with Mr Mendelson, participated in round table discussions, workshops and seminars with securities industry leaders and mutual fund sellers in both New Delhi and Mumbai Mr Silver's "Assessment of the Regulatory Environment for India's Mutual Funds," was subsequently transformed into a single document by Mr Mendelson

At the Seventh Technical Session of the UTI/AMFI Seminar, "Mutual Funds Through 2000," Mr Mendelson discussed "Reforms That Will Improve the Securities Markets and Provide New Opportunities for Investors " He recommended a number of significant changes in mutual funds and the industry's approach which are needed for the fund industry to take advantage of those opportunities

During AMFI's General Membership Meeting, Mr Silver described the organization and operation of the ICI, explained the factors which contributed to the growth of the fund industry in the United States and presented recommendations for strengthening AMFI and developing India's fund industry Mr Mendelson summarized those recommendations in a short paper, "The Investment Company Institute's Role in Promoting the U S Mutual Fund Industry A Model For AMFI?" Together, Mr Silver and Mr Mendelson discussed these recommendations in detail with AMFI's Chairman and key board members Subsequently, Mr Mendelson presented FIRE's Action Plan for implementing these recommendations to AMFI which, in large measure, has concurred in the Plan

Mr Silver and Mr Mendelson also briefed Ambassador Wisener, members of his staff and the leadership of USAID on the purposes of this visit, the status of the Indian Mutual Fund Industry and the steps it needs to take to achieve greater acceptance

Mr Silver's and Mr Mendelson's recommendations are intended to

A) improve mutual funds and their schemes as products and the way the mutual fund industry conducts business through assistance in developing sounder more diversified products and maintaining product integrity and simplicity,

B) strengthen the regulatory framework in which mutual funds operate to provide greater protections to unitholders, and

C)strengthen AMFI, helping it to develop the operations, structure, capacity and policies to become a strong, continuous, effective and respected voice for the fund industry

Improve funds and the way the industry does business. The transformation of the securities markets should accelerate developing changes in the composition, product mix, identity and regulation of the mutual fund industry to create greater flexibility and protections which will mean new opportunities for mutual fund investors To take full advantage of these opportunities, the fund industry will have to change its products, services, sales techniques and approach as follows

- Expand the product mix stress the "family of funds concept, and introduce "Money Market Fund Schemes "
- Lengthen their duration from short to long term, from five years to a lifetime
- Move from offering predominantly closed-end to predominantly open end funds
- Sell on the basis of understanding and managing risk rather than assured or guaranteed returns
- Emphasize the advantages of regular investing over time
- Introduce standardized performance measurements to cover yield and total return over defined periods
- Create reasonable expectations
- Regulate all sellers of mutual funds Assure that they are trained, qualified and certified by their own self regulatory association or by SEBI
- Improve registrar services through technological changes, stronger regulation and competition

Strengthen the Regulatory Framework. An appropriate regulatory framework and a vigorous, well-trained and effective regulator can add immeasurably to the level of confidence in the markets SEBI has introduced a comprehensive program of increased protections for mutual fund investors, including clearly defining the role and responsibilities of the trustees in managing mutual funds and protecting the interests of unitholders This is positive step forward Areas in which further improvements might be made include

- Making sponsors more accountable,
- Strengthening controls over affiliated transactions,
- Removing opportunities for fund managers and their associates to profit from non-advisory functions,
- Assuring that net asset value and is calculated, and fund performance is advertised, on a uniform basis,
- Requiring forward pricing and shortening the interval between valuations,
- Assuring better disclosures of fees and expenses
- Improving SEBI's enforcement capability, and
- Creating greater transparency by making SEBI a center for distribution of information about mutual funds and the securities markets

Strengthen AMFI. To help AMFI to develop the operations, structure, capacity and policies to become a strong, continuous, effective and respected voice for the fund industry, FIRE recommends that AMFI immediately take steps to

- Build a Professional Staff ,
- Influence the Regulatory Environment,
- Promote High Professional Standards,

- Provide Guidelines and Training,
- Take the Lead in Investor Education,
- Build a Data Base and Create a Research Department, and
- Create an Operations Department

II. BACKGROUND

In July and August 1996, Fire project designed a comprehensive program to improve the credibility of the fund industry and the public acceptance of mutual funds FIRE's recommendations emphasized the need for greater transparency, efficiency and integrity in funds dealings with their unitholders and investors The comprehensive program recommended by FIRE, required AMFI to establish five departments or committees professional standards, government relations, statistical research and analysis, information services and membership services

FIRE, working closely with AMFI also designed and laid the foundation for an AMFI Investor Awareness Campaign involving a long term educational and promotional effort FIRE drafted of five of seven brochures which were to be used in the AMFI Investor Awareness Campaign

- a Guide to Investing in Mutual Funds,
- a Glossary,
- a Sales Agent's Handbook,
- a discussion of the impact of regulatory and technological reforms on the markets, and
- an AMFI Code of Ethics and

provided to AMFI specifications for two other documents an AMFI Membership Directory and a study of Mutual Fund Performance AMFI's Guide, "Making Mutual Funds Work for You," and its Agents' Handbook, "Selling Mutual Funds Made Easy, "which were circulated earlier, were modified in response to Committee member's comments and now await publication

The AMFI Code of Ethics. The AMFI Code of Ethics, earlier drafted by the AMFI Code of Ethics Committee with the help of the FIRE Project, was revised by AMFI's Board of Directors and circulated for comment and approval by AMFI's members

III. FIRE RECOMMENDATIONS

A. Promote Changes in the Products, Services, Operations and Perception of the Industry by:

- Expanding the product mix to offer a wide variety of funds to meet all investors needs, stressing the "family of funds" concept and introducing "Money Market Funds,"

- Selling mutual funds as long term investments Investors and the industry would benefit if the duration of funds was changed from short to long term, sales promotion focussed on lifetime investment programs and stressed that, over the long term, equities have consistently outperformed other investments

- Emphasizing that regular investing over time (Rupee Cost Averaging) reduces risk of market fluctuations, takes advantage of compounding and improves chances for better returns

- Promoting the liquidity and simplicity of mutual funds by offering predominantly open end funds While closed end funds have served specific needs and are useful for holding less liquid securities, open end funds have proven to be far simpler and more attractive to investors

- Selling on the basis of understanding and managing risk rather than assured or guaranteed returns Helping investors to understand that all funds involve risk, but depending upon their policies and portfolio mix, the degree of risk can be lessened, will enable the fund industry to sustain investor loyalty and maintain its own credibility

- Introducing standardized performance measurements to cover yield and total return over defined periods Requiring that funds adhere strictly to such standards without variation in their reports and advertisements would eliminate confusion and promote better understanding of fund performance, comparability of investment results and increased competition

- Creating reasonable expectations by sticking to the basics and explaining the product well A mutual fund should not be sold as if it were an IPO (initial public offering), or a bank account with an assured return Attempts to guarantee rates of return or redemption prices distort the product and the public's perception of it Failed guarantees or payments out of capital to meet assured returns erode public confidence and undermine the industry

- Regulating salesmen All sellers of mutual funds should be trained, qualified and certified by their own self regulatory association or by SEBI

- Improving registrar services Fund registrars must provide rapid reliable services

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B. For Strengthening the Regulatory Environment

1. Establish a level playing field. The protections which the law or regulatory framework provide should apply equally to all funds and investors in like financial products The complete integration and harmonization of UTI's operations with those of the rest of the fund industry would strengthen the entire industry and rationalize the entire regulatory framework

2. Prohibit Self-dealing and Other conflicts of interest. SEBI's regulations require that the trustees quarterly review the fairness of all transactions carried out between the mutual funds, an AMC and its associates If an AMC enters into a securities transaction with any associate a report to that effect must immediately be sent to the trustees The definition of "associate" should be expanded It hinges on 10 percent control and appears to cover only first tier associates To ensure that trustees have a full opportunity to fulfill their responsibilities, a number of internal safeguards are needed, including advance review procedures, to enable trustees to carefully evaluate and authorize the fairness of proposed transactions in advance To improve trust and confidence, such transactions should be disclosed in advance to investors and subject to approval by an independent third party

Care should be taken not to permit any ancillary source of profit to those affiliated with mutual funds so significant that it detracts from the single minded loyalty demanded of fiduciaries For example, permitting persons associated with a scheme, such as an AMC, to speculate in fund shares has been shown in other countries to undermine such loyalty

3. Economic Regulation of Remuneration of Affiliates. The 1996 Mutual Fund Regulations include comprehensive regulations setting maximum fees that may be charged by AMC's for advisory services, define what expenses must be borne by the AMC, and limit total fund expenses as a percentage of total assets They also set parameters for selling expenses and sales loads that may be borne by unitholders These outside limits do not guarantee efficient rates Competition and economies of scale aided by good disclosures and informed investors are also part of the answer As unitholders come to realize this and focus on the impact of expenses on fund performance, the expense ratios of India's funds should decline Unitholders also need a specific right to bring lawsuits against mutual funds, defaulting trustees and other fiduciaries which misrepresent the truth or do not live up to representations they have made They should also have the right to sue if fund advisory fees are unreasonable

Fund sponsors need to be more accountable to unitholders Sponsors organize funds, appoint trustees, set up AMC's and directly or indirectly control their operations Often mutual fund schemes are bought on the basis of the sponsor's reputation The 1996 Mutual Fund Regulations contain a general requirement that sponsors, among others, "shall make such disclosures or submit such documents as they may be called upon to do so by (SEBI) " This principle is a recognition of the need to assert jurisdiction over sponsors and points the way toward future reporting requirements, if and as necessary Trustees are required to ensure that the AMC has "not given any undue or unfair advantage" to any "associates" or dealt with any associate of the AMC "in any manner detrimental to the interests of unitholders " The trustees' ability to exercise that kind of control over the sponsors should be reenforced The accountability of sponsors to unitholders is not commensurate with the sponsors' powers

4. Unsound Capital Structures. Mutual funds must make sense as an investment for the common man Liquidity and simplicity should be among a fund's most attractive features The 1996 Mutual Fund Regulations are intended to guard against the worst features of complicated capital structures "Pyramiding," cross investing in other schemes of the same or another AMC, may not exceed 5 percent of the net asset value of the ***mutual fund*** Borrowing is limited to 20 percent of the net asset value of the scheme and may not exceed six months However, the meaning of these restrictions may need clarification

Mutual Funds may carry on activities as underwriters provided that the underwriting obligation does not at any time exceed the total net asset value of the scheme Underwriting risk is also somewhat circumscribed by restrictions on investments which prevent a mutual fund under all its schemes from owning more than 10 percent of any company's paid up capital carrying voting rights This could still leave funds dangerously exposed to underwriting risks

Rules such as those requiring open end funds to maintain 85 percent of their portfolios in liquid securities or that a fund may not change its investment objective without a shareholder vote protect the integrity of the mutual fund as a concept A more subtle threat to product integrity arises from attempts to graft features onto mutual funds to simulate bank accounts, guaranteed debentures or government securities These can only confuse investors as to what mutual funds are and will inevitably cause investor disenchantment leading to greater regulation and greater complexity

5. Clear disclosure of investment objectives and policies. Although there does not appear to be a specific instruction in any Schedule or Form saying so in a few succinct words, it would appear that funds would be required to disclose their investment objectives and policies in Offer Documents and advertisements and that any changes in them could be made only with the approval of three fourths of fund shareholders

6. Protection of the Physical Integrity of Assets. It is critically important that the integrity of fund assets be maintained An independent custodian can not only protect the physical safety of fund assets, but can also help to assure the efficient administration of the fund through the record keeping procedures built into its operations Protection of the interests of unitholders demands that this function be carried out in a thoroughly professional manner Under the circumstances, allowing a sponsor and its associates to hold almost 50 percent of the voting rights of the custodian and just under 50 percent of the directorships, allows the sponsor to cast a large shadow over the custodian's operations which may suggest a lack of independence and undermine trust and confidence

7. Fair Valuation of Investor Purchases and Redemptions. Establishing the correct NAV is central to almost every aspect of fund operations and materially effects unitholders Fairness requires that NAV be calculated on a uniform basis Thinly traded and unlisted securities are required to be valued "in good faith" by AMC based on principles approved by its board and reported on as "fair and reasonable" by the fund's auditors While the standards are appropriate, there is still room for discretion by the AMC's AMFI could make an important contribution by providing uniform valuation guidelines for the industry

"Historical pricing," which means that funds use the last quoted price rather than the next or "forward" price for all securities they own, can result in dilution of the interests of existing unitholders in rising markets It also allows investors to time their purchases in a rising market in order to receive a lower price (i e pay less) This potential for dilution is exacerbated by the interval permitted between valuations which may be as much as one week Forward pricing should be adopted for all funds and the interval between valuations should be narrowed

8. Accurate Periodic Reports About the Funds and Their Investments. Unitholders need continuous relevant information about their investments portfolios, costs and expenses, performance, portfolio turnover ratios, repurchase programs, and any changes in management or operational procedures The 1996 Mutual Fund Regulations establish the general principle that every mutual fund, AMC, trustee, custodian, sponsor of the mutual fund shall make such disclosures or submit such documents as they may be called upon to do by SEBI However, unitholders do not have access to all of the reports their funds file with SEBI

Mutual funds and their AMC's are required to publish an annual report, in a prescribed form, or abridged summary of it, in an advertisement within six months of the end of the fund's fiscal year The full report must be forwarded to SEBI and unitholders can have access to it and receive a copy at a nominal fee at the fund's Head Office Twice yearly, the fund and AMC are also required to publish unaudited financial results in a prescribed form "and such other details as are necessary for the purpose of providing a true and fair view of the operations of the mutual fund "

Unitholders and the markets would benefit from

- additional disclosures in annual reports, including portfolio turnover ratios and descriptions of any affiliated/associated transactions, the reasons for them and the amounts involved in each,
- more frequent disclosures, perhaps semi-annually at first and then quarterly, of the kinds of information required to be in Annual Reports (other than additional audits),
- making the information contained in these reports being more easily and freely accessible to unitholders,

- continually upgrading the reliability and comparability of the information provided to investors by agreeing upon and implementing generally accepted accounting standards for mutual funds, and

- SEBI making information distribution one of its principal functions, becoming an information clearing house, demanding and collecting reliable information and immediately providing the means for its quick and efficient recirculation to the market by establishing a Public Information Centre

9. Enforcement. Mutual funds and the entire securities industry have a strong stake in a comprehensive and well functioning system of regulation and enforcement

C. For Strengthening AMFI

FIRE recommends that AMFI

1 **Build a Professional Staff.** AMFI should immediately start the rapid build-up of a high quality professional staff with the capacity to play an appropriate role in helping create and facilitate the growth of the fund industry which lies ahead It will need to develop expertise in four areas Regulation, Media Relations, Economic and Statistical Research and Operations

2 **Influence the Regulatory Environment.** The industry should take a proactive stance in the regulatory process and in coping with industry problems not just on an *ad hoc* or individual fuhd basis, but through AMFI, its industry association AMFI should become a continuing point of contact between the regulator and the industry AMFI's Office of General Counsel must have the ability to consult closely with policy-making bodies regarding pending legislation and with SEBI to assure that it gets the benefit of the industry viewpoint and that the industry understands SEBI's views Nothing will be more important than this ability to influence the regulatory environment

3 **Promote High Professional Standards.** AMFI should also independently address questions which would otherwise be the subject of government action Examples of effective actions from the U S experience include development of a uniform yield formula for fund advertising and promotional literature, a model Code of Ethics, and Code dealing specifically with Insider Trading by fund personnel

4 **Provide Guidelines and Training.** AMFI might also wish to

- recommend guidelines such as compliance and procedures manuals and provide training seminars dealing with
  - compliance matters,
  - trustees' and directors' responsibilities, and
  - orientation of new AMC and fund employees, and
- develop procedures for the rapid and efficient settlement of mutual fund transactions and to create uniformity

It could also provide workshops, manuals and interactive videos at cost to the industry

5 **Take the Lead in Investor Education.** AMFI should continue to play a major role in investor education by providing press releases, media contacts and educational brochures, meeting public requests for information and members' needs for shipments in bulk of brochures on which they can imprint their names Such a programme can be a continuing significant source of free publicity for the industry As a sustaining part of its Investor Awareness Campaign, AMFI might wish to follow the example of the ICI which ten years ago created a special annual prize awarded by impartial experts to those reporters who have done the best job in writing financial stories of special interest to individuals and families about personal financial planning

6 **Build a Data Base and Create a Research Department.** The information that a Research Department accumulates and the studies it performs should be readily available to the industry The Department should be able to

- monitor the flow of funds in and out of the industry and observe which kinds of funds are selling and being redeemed
- classify funds by objective, load vs no-load, close-end or open, types of sales forces, among others
  - compile and maintain a comprehensive historical data base which may be derived from members' monthly reports to AMFI
  - cover the entire industry and serve as the source of AMFI's own research
  - be able to perform marketing studies or surveys directly for members, including furnishing the names of shareholders for personal interviews, and
  - continuously track demographic trends, such as aging population vs young people to guide promotional efforts by tracking changes in the composition of the industry and of fund unit holders

7 **Create an Operations Department.** An Operations Department can assist the industry and its transfer agents in introducing uniformity which is good for all investors and broker-dealers by investigating computer developments on a common basis This kind of information is useful on a technical level for the industry

IV. NEXT STEPS

The FIRE Project offers continuing assistance in each of the areas suggested in the comprehensive strategic plan which it earlier designed and recommended to AMFI Those directly involved with mutual funds and their regulatory environment are the focus of its direct assistance to AMFI, particularly in helping to provide direction, structure and expertise to various AMFI Committees Significant efforts must be directed at training trustees, AMC's and fund sellers, raising standards and in educating funds and the investing public

FIRE recommends that AMFI begin immediately to

1 Set up administrative functions Take immediate steps to

- hire a professional staff
- adopt a work plan, organizational chart and budget
- set goals priorities and dates
- assign Committees and independent contractors to begin working on achieving the programme recommended by Mr Silver

2 Formulate uniform

- accounting and valuation methods, and
- policies for segregation of assets

3 Complete AMFI Investor Education Brochures

- Investor's Guide
- Agent's Handbook and
- Understanding Fund Performance
- AMFI Membership Directory

Submit to Focus Groups, revise and publish these booklets

4 Train Fund Sellers (as Trainers) and conduct Investor Conferences

5 Complete, circulate and adopt AMFI's Code of Conduct, AMFI's Model Compliance and Operations Manual, and train trustees and AMC's officers, directors and employees

6 Set up groups to provide continuing liaison with regulators, policy makers and legislators and to promote legislative and regulatory changes which will enable the industry to

- develop new products such as Money Market Schemes, Municipal Bond Schemes (when such bonds become available), Index Schemes, Personal Equity Plans ("PEPS), Pension and other retirement benefit plans, and to permit funds to use hedging techniques and derivative securities], and

- suggest reforms to clarify and improve existing regulations

7 Draft a Model Advertising Code to ensure uniform definitions of yield, total return and indicative returns and provide standards for performance measurement, including benchmarks and periods of measurement

8 Undertake a market research study to evaluate the impact on the industry of marketing strategies featuring guaranteed redemption prices and assured or indicative returns and recommend actions to improve the industry's credibility with respect to such practices

9 Assign an outside agency to compile and maintain a data base of industry statistics and to conduct ongoing performance evaluations and marketing surveys and assist in producing "AMFacts" an Annual AMFI Factual Reference Book on the Fund Industry for members and the press

10 Designate a Media Relations Officer and Institute Annual Awards for best

- investment performance in various categories
- disclosures and
- published articles and/or telecasts on personal and family finance

11 Compare the characteristics that distinguish UTI's structure, operations and regulation from those of AMFI's other members Outline the steps necessary to bring UTI under the full regulation of SEBI and provide its unitholders the same protections as those who invest in funds which are fully regulated by SEBI

APPENDIX I DRAFT CODE OF CONDUCT FOR AMFI MEMBERS

DRAFT

AMFI CODE OF ETHICS (ACE)

Drawn up by

AMFI in association with
Price Waterhouse LLP/FIRE Project

1.0 INTEGRITY

1.1 Members and their employees, in the conduct of their business, shall observe high standards of integrity and fairness in all dealings with investors, issuers, market intermediaries and other members.

1.2 Mutual Fund Schemes shall not be organized, operated, managed or their portfolios of securities selected, in the interest of:

* sponsors
* directors of Members
* Members of Board of Trustees or directors of the Trustee company
* brokers
* affiliated persons of any of the above, or
* in the interests of a special class of unitholders

2.0 DUE DILIGENCE

2.1 Members in the conduct of their business shall at all times:

* render high standards of service,
* exercise due diligence,
* ensure proper care, and
* exercise independent professional judgement.

2.2 Members shall have and employ effectively the resources and procedures which are needed for the proper performance of their business activities.

3.0 DISCLOSURES

3.1 Members 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.

3.2 Members shall disclose to investors, possible sources of conflict of duties and interests.

3.3 Members shall disclose to unitholders and AMFI, for each scheme; its portfolio; its ratios of expenses to total income and to total assets and of portfolio turnover, on a half yearly basis.

3.4 When engaging on behalf of a scheme, directly or indirectly in:

* any joint venture with any affiliated persons or any significant unitholder;
* any transactions with affiliated schemes; or
* any purchases or sales with any affiliated companies or any affiliated persons or any significant unitholder;

Members shall:

* submit a detailed description of the transaction, justifying the transaction and its fairness to the scheme, at the immediate next meeting of the Board of Trustees; and
* disclose to the unitholders through half yearly and annual accounts, a brief description of the transaction.

3.5 All transactions in securities by

* Trustees and employees, officers and directors of the Trustee Company and
* employees, officers and directors of Members.

shall be disclosed to the Members' Compliance Officer, on a periodic standard basis and subsequently reported to the Board of Trustees.

4.0 PROFESSIONAL SELLING PRACTICES

4.1 Members must not use any unethical means to sell, market or induce any investor to buy their products.

4.2 Members shall not make any exaggerated statement.

4.3 Members shall always endeavor to ensure that at all times-

* investors are provided with true and adequate information without making any misguiding or exaggerated claims to investors either about their qualifications or their capability to render certain services or their achievement in regard to services rendered to other clients, and are made aware of attendant risks before any investment decision is made by them;

* copies of prospectuses, memoranda and related literature are made available to investors;

* adequate steps are taken for fair allotment of mutual fund units and refund of application moneys without delay; and

* complaints from investors are fairly and expeditiously dealt with.

4.4 Members in all their communications to investors and selling agents shall:

i. Not present a mutual fund as if it were a new share issue

ii. Not create unrealistic expectations

iii. Not guarantee returns except as stated in the Offer document of the scheme approved by SEBI; and in such cases, the Members shall ensure that adequate resources will be made available and maintained..

iv. Convey in clear terms the market risk and the investment risks of any scheme being offered by the Members.

v. Not induce investors by offering benefits which are extraneous.

vi. Not misrepresent either by stating information that would carry misleading implications or by omitting to state information which is material to making an informed investment decision.

5.0 INVESTMENT PRACTICES

5.1 Members shall for any scheme managed by them, carry out the business and invest in accordance with the fundamental investment policies and investment objectives stated in the prospectus and take investment decisions solely in the interest of the unitholders.

5.2 In any joint venture between a scheme managed by the Members and any affiliated persons or schemes or significant unitholders, the scheme shall not be treated less advantageously or less fairly Also for any purchases or sales to any affiliated entities, the price received or paid by the scheme, shall be fair to the scheme.

5.3 No member shall engage directly or indirectly in any transaction in any of its schemes in securities of any significant unitholder, without the prior approval of the Trustees.

5.4 After the expiry of the period of three months from the date of the said investment a member may engage in transactions in securities of the significant unitholder and its subsidiaries, subject to the disclosures and with the justifications required in Section 4 (e) above.

5.5 No member shall engage in any direct transactions on behalf of any scheme managed by the member with

* any officer, director, partner, or employee of the member
* any trustee or any officer, director, partner or employee of the Trustee Company

6.0 OPERATIONS

6.1 Members and/ or any affiliated persons shall not indulge in front running (buying or selling of any securities ahead of a transaction of the fund, with access to non public information regarding the transaction, material to making an investment decision, so as to derive unfair advantage).

6.2 Members, and/ or any affiliated persons shall not engage in any act, practice, or course of business in connection with the purchase or sale, directly or indirectly, of any security held or to be acquired by any scheme managed by the Members, and in purchase, sale and redemption of units of schemes managed by the Members, which is fraudulent, deceptive or manipulative

6.3 Members and/ or any affiliated persons shall not, in respect of any securities, be party to-

* creating a false market;
* price rigging or manipulation;
* passing of price sensitive information to brokers, Members of stock exchanges and other players in the capital markets or take action which is unethical or unfair to investors.

6.4 Employees, officers and directors of the Members shall not work as agents/ brokers for selling of the schemes of the Members, except in their capacity as employees of the member or the Trustee Company.

6.5 Members shall not make any change in the fundamental investment policies of a scheme, the portfolio mix necessary to achieve them and the fee and expenses structure affecting the unitholders, without the prior approval of unitholders.

6.6 Members shall avoid excessive concentration of business with broking firms, affiliates and also excessive holding of units in a scheme by few persons or entities.

7.0 REPORTING PRACTICES

7.1 Valuation:

Members and Trustees shall follow comparable and standardized valuation policies in accordance with the SEBI Mutual Fund Regulations.

7.2 Total Return.

Members shall follow uniform performance reporting on the basis of total return.

7.3 Segregation of cash and assets:

Members must ensure schemewise segregation of cash and securities accounts.

8.0 UNFAIR COMPETITION

Members shall not make any statement or become privy to any act, practice or unfair competition, which is likely to be harmful to the interests of other Members or is likely to place other Members in a disadvantageous position in relation to a market player or investors, while competing for investible funds.

9.0 CONFIDENTIALITY

Members shall not divulge to other clients, press or any other party any confidential information about their clients, which has come to their knowledge.

10.0 OBSERVANCE OF STATUTES, RULES AND REGULATIONS

Members shall abide by the letter and spirit of the provisions of the Statutes, Rules and Regulations which may be applicable and relevant to the activities carried on by the Members.

11.0 ENFORCEMENT

Members shall:

* widely disseminate the AMFI Code to all persons and entities covered by it

* make observance of the Code a condition of employment

* make violation of the provisions of the code, grounds for revocation of a contractual arrangement without redress or a cause for disciplinary action.

* require that each officer and employee of a Member sign a statement that he/she has received and read a copy of the Code.

* establish internal controls and compliance mechanisms, including assigning supervisory responsibility

* designate one person with primary responsibility for maintaining compliance and the power to fully investigate all possible violations

* file regular reports to the Trustees on a half yearly and annual basis regarding observance of the Code and special reports as circumstances require

* maintain records of all activities and transactions reviewed for at least three years which records shall be subject to review by the fund trustees

* dedicate adequate resources to carrying out the provisions of the Code.

12.0 DEFINITIONS

When used in this code, unless the context otherwise requires —

(a) *AMFI*

"AMFI" means the Association of Mutual Funds in India

(b). *Member*

A "member" means the member of the Association of Mutual Funds in India.

(c) *Trustee Company*

A "Trustee Company" is a company incorporated as a Trustee Company and set up for the purpose of managing a mutual fund.

(d) *Trustee*

A "trustee" means a member of the Board of Trustees or a director of the Trustee Company.

(e) *Affiliated Company*

An "Affiliated Company" means a company which is an affiliated person.

An affiliated company of the member includes the following:

- the sponsors of the mutual fund and their affiliates
- the trustee company and its affiliates

(f) *Affiliated Person*

An "Affiliated Person" of another person means

- any person directly or indirectly owning, controlling or holding with power to vote, 5% or more of the outstanding voting securities of such other person;
- any person 5% or more of whose outstanding voting securities are directly or indirectly owned, controlled or held by such other person,

An affiliated person of the member includes the following:

- any officer, director, partner, or employee of the member;
- any trustee or any officer, director, partner or employee of the Trustee Company;

(g) *Affiliated Scheme*

An "Affiliated Scheme" of a scheme managed by a member, means any other scheme that is managed by the member and includes any other clients' accounts managed by the member

(i) *Significant Unitholder*

A "Significant Unitholder" means any entity holding 5% or more of the total corpus of any scheme managed by the member and includes all entities directly or indirectly controlled by such a unitholder.

(j) *Joint Venture*

A "Joint Venture" means any written or oral arrangement, contract, agreement, authorization, practice or understanding of any kind that concerns a venture or enterprise whereby a member or any affiliated person have a joint participation or share in profits of such a venture or enterprise.

(k) *Fundamental investment policies*

The "fundamental investment policies" of a scheme managed by a member means the investment objectives, policies, and term of the scheme, that are considered fundamental attributes of the scheme and on the basis of which unitholders have invested in the scheme.

APPEDNIX II GUIDE TO INVESTING IN MUTUAL FUNDS

32

Ten Advantages Of Investing in Mutual Funds

- ▲ Professional Management
- ▲ Diversification
- ▲ Convenient Administration
- ▲ Return Potential
- ▲ Low costs
- ▲ Liquidity
- ▲ Transparency
- ▲ Flexibility
- ▲ Choice of Schemes
- ▲ Regulation

Back page

Creative Consultants:

Ogilvy & Mather
Financial & Business Communications

MAKING MUTUAL FUNDS WORK FOR YOU

The Investor's Concise Handbook

Cover page

AMFI

Dear Investor,

We at Association of Mutual Funds in India (AMFI) are devoted to a singular cause - making Mutual Funds help you achieve your investment goals But first a word about us

AMFI was incorporated in August 1995 as a non-profit organisation to promote and protect the interests of Mutual Funds and their unitholders, increase public awareness of Mutual Funds and define and maintain high ethical and professional standards in the industry

AMFI is governed by a Board of Directors who meet frequently to discuss various issues facing the Mutual Fund industry Recognising that proper investor understanding of Mutual Funds is crucial to the success of the industry, AMFI resolved to embark on a comprehensive investor awareness campaign This handbook is part of that effort. It has been produced by a a special committee of AMFI members consisting of Mr A P Kurian as Chairman and Mr Vivek Reddy, Mr K N Atmaramani, Mr S K Mitra, Mr Ajai Kaul and Mr A N Palwankar as members Price Waterhouse LLP/Financial Institutions Reform and Expansion (FIRE) Project funded by USAID, has also made a valuable contribution I take this opportunity to thank all of them for their time and effort.

This handbook on the concepts, operations and advantages of Mutual Funds does not solicit investment in any specific Mutual Fund and is intended purely as a guide It is not a legal or regulatory document It is recommended that you read the relevant offer document and if necessary, consult your investment advisor before making an investment decision

I hope this handbook helps you to understand Mutual Funds and how you can make them work for you I wish you all success in your future investments

Yours sincerely,

G A Shenai
Chairman

[illegible] Mutual Fund members of AMFI [illegible] Association of Mutual Funds in India [illegible] 400 005 Tel fax 2181496

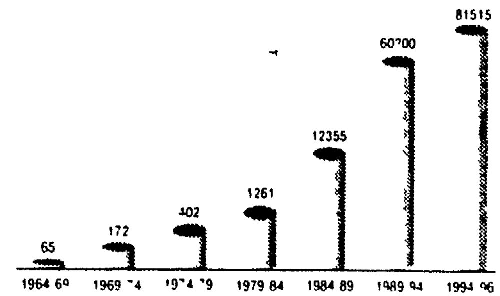
[illegible] with Price Waterhouse LLP FIRE Project funded [illegible] Mathur Financial & Business Communications

MUTUAL FUND - A GLOBALLY PROVEN INVESTMENT

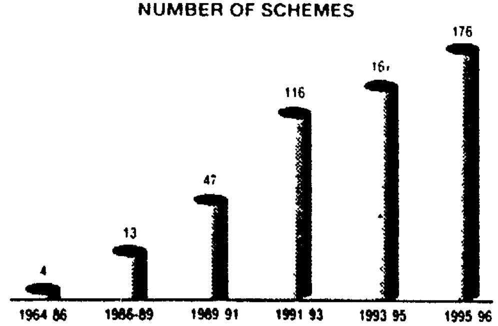
Worldwide, The Mutual Fund, or Unit Trust as it is called in some parts of the world, has a history of over a century [illegible] The popularity of the Mutual Fund has increased manifold In developed financial market like the United States, Mutual Funds have overtaken bank deposits and insurance funds As of date, in the US alone [illegible] Mutual Funds have assets of over US $ 3 trillion (Rs 100 lakh crores)

The Mutual Fund industry started with the setting up of Unit Trust of India in 1964 This was followed by the Public Sector banks and financial institutions establishing Mutual Funds in 1987 The private sector and foreign institutions were allowed to set up Mutual Funds in 1993 As of today, there are 36 Mutual Funds and over [illegible]96 schemes with total assets of around Rs [illegible],000 crores This fast growing industry is regulated by the Securities and Exchange Board of India (SEBI)

GROWTH IN CORPUS



NUMBER OF SCHEMES



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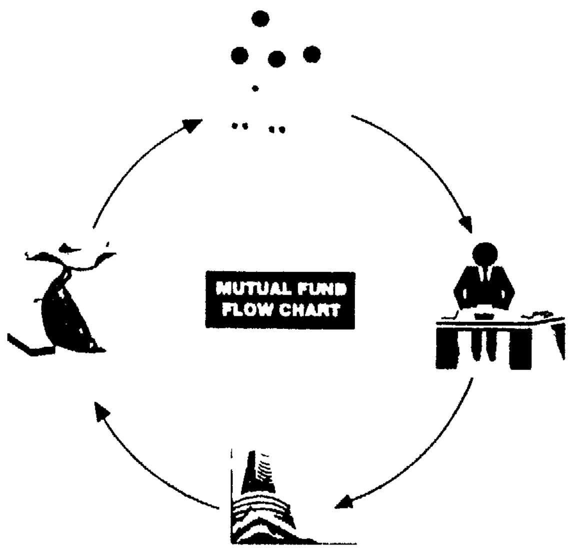
WHAT IS A MUTUAL FUND?

A Mutual Fund is a Trust that pools the savings of a number of investors who share a common financial goal. Anybody with an investible surplus of as little as a few thousand rupees can invest in Mutual Funds. These investors buy units of a particular Mutual Fund scheme that has a defined investment objective and strategy.

The money thus collected is then invested by the fund manager in different types of securities. These could range from shares, debentures to money market instruments, depending upon the scheme's stated objectives. The income thus earned through these investments and the capital appreciation realised by the scheme are shared by its unit holders in proportion to the number of units owned by them. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost.

THE MUTUAL FUND OPERATION FLOW CHART



TYPES OF MUTUAL FUND SCHEMES

There are a wide variety of Mutual Fund schemes that can cater to your needs, whatever your age, financial position, risk tolerance and return expectations. Whether as the foundation of your investment program or as a supplement, Mutual Funds schemes can help you meet your financial goals.

(A) By Structure

Open-Ended Schemes

Do not have a fixed maturity. You deal directly with the Mutual Fund for your investments and redemptions. The key feature is its liquidity. You can conveniently buy and sell your units at net asset value related prices.

Close-Ended Schemes

Schemes that have a stipulated maturity period (ranging from 2 to 15 years) are called close ended schemes. You can invest directly in the scheme at the time of the initial issue and thereafter you can buy or sell the units of the scheme on the stock exchanges where it is listed. You should note that the market price at the stock exchange could vary from the scheme's NAV on account of demand and supply situation, unitholders expectations and other market factors. One of the characteristics of the close ended schemes is that they are generally traded at a discount to NAV, but closer to maturity, the discount narrows.

Some close ended schemes give you an additional option of selling your units directly to the Mutual Fund through periodic repurchase at NAV related prices. SEBI Regulations ensure that at least one of the two exit routes are provided to the investor.

Interval Schemes

These schemes combine the features of open ended and close ended schemes. They may be traded on the stock exchange or may be open for sale or redemption during pre determined intervals at NAV related prices.

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BEST AVAILABLE COPY

BEST AVAILABLE COPY

(B) By Investment Objective

Growth Schemes

Aim to provide capital appreciation over the medium to long term. These schemes normally invest a majority of their funds in equities and are willing to bear short term decline in value for possible future appreciation.

These schemes are not for investors seeking regular income or needing their money back in the short term.

Ideal For
Investors in their prime earning years
Investors seeking growth over the long term

Income Schemes

Aim at providing regular and steady income to investors. These schemes generally invest in fixed income securities such as bonds and corporate debentures.

Capital appreciation in such schemes may be limited.

Ideal For
Retired people and others with a need for capital stability and regular income
Investors who need some income to supplement their earnings

Balanced Schemes

Aim to provide both growth and income by periodically distributing a part of the income and capital gains they earn. They invest in both shares and fixed income securities in the proportion indicated. In a rising stock market the NAV of these schemes may not normally keep pace or fall equally when the market falls.

Ideal For
Investors looking for a combination of income and moderate growth
Anticipating investors

Money Market Schemes

Aim to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer short term instruments such as treasury bills, certificates of deposit, commercial paper and inter bank call money.

Returns on these schemes may fluctuate, depending upon the interest rates prevailing in the market.

Ideal For
Corporates and individual investors as a means to park their surplus funds for short periods or awaiting a more favourable investment alternative

Other Schemes

Tax Saving schemes

These schemes offer tax rebates to the investors under tax laws as prescribed from time to time. This is made possible because the Government offers tax incentives for investment in specified avenues. For e.g. Equity Linked Savings Schemes (ELSS) and Pension Schemes.

Recent amendments to the Income Tax Act provide further opportunities to investors to save capital gains by investing in Mutual Funds. The details of such tax savings are provided in the relevant offer documents.

Ideal For
Investors seeking tax rebates

Special Schemes

This category includes index schemes that attempt to replicate the performance of a particular index such as the BSE Sensex or the NSE 50, or industry specific schemes (which invest in specific industries) or sectoral schemes (which invest exclusively in segments such as 'A' Group shares or initial public offerings).

Indexed fund schemes are ideal for investors who are satisfied with a return approximately equal to that of an index.

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Sectoral fund schemes are ideal for investors who have already decided to invest in a particular sector or segment

Keep in mind that any one scheme may not meet all your requirements for all time You need to place your money judiciously in different schemes to be able to get the combination of growth income and stability that is right for you

Remember as always the higher the return you seek the higher the risk you should be prepared to take

A few frequently used terms are explained here below

Net Asset Value

Net Asset Value is the market value of the assets of the scheme minus its liabilities The per unit NAV is the net asset value of the scheme divided by the number of units outstanding on the Valuation Date

Sale Price

Is the price you pay when you invest in a scheme Also called Offer Price It may include a sales load, if any

Repurchase Price

Is the price at which the scheme repurchases the units and it may include a back-end load, if any This is also called Bid Price

Redemption Price

Is the price at which open-ended schemes repurchase their units and close-ended schemes redeem their units on maturity Such prices are NAV related

Sales Load

Is a charge collected by a scheme when it sells the units Also called, 'front-end' load Schemes that do not charge a load are called 'No Load' schemes

Repurchase Load

Is a charge collected by a scheme when it buys back the units from the unitholders Also called 'back-end' load

WHY SHOULD YOU INVEST IN MUTUAL FUNDS?

The advantages of investing in a Mutual Fund are

1 Professional Management You avail of the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the company performance and prospects and selects suitable investments to achieve the objectives of the scheme

2 Diversification Mutual Funds invest in a number of companies across a broad cross section of industries and sectors This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion You achieve this diversification through a Mutual Fund with far less money than you can do on your own

3 Convenient Administration Investing in a Mutual Fund reduces paperwork and helps you avoid many problems such as bad deliveries delayed payments and unnecessary follow up with brokers and companies Mutual Funds save you time and make investing easy and convenient

4 Return Potential Over a medium to long term Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities

5 Low Costs Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of scale in brokerage custodial and other fees translate into lower costs for investors

6 Liquidity In open ended schemes you can get your money back promptly at net asset value related prices from the Mutual Fund itself With close ended schemes you can sell your units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase which some close ended and interval schemes offer you periodically

7 Transparency You get regular information on the value of your investment in addition to disclosure on the specific investments made by your scheme the proportion invested in each class of assets and the fund manager's investment strategy and outlook

8 Flexibility Through features such as regular investment plans regular withdrawal plans and dividend reinvestment plans you can systematically invest or withdraw funds according to your needs and convenience

9 Choice of Schemes Mutual Funds offer a family of schemes to suit your varying needs over a lifetime

10 Regulation All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors The operations of Mutual Funds are regularly monitored by SEBI

HOW TO INVEST IN MUTUAL FUNDS

Step One Identify your investment needs

The financial goals of investors vary based upon their age lifestyle financial independence family commitments level of income and expenses among many other factors

The first step is to assess your needs

Begin by asking yourself these questions

1 What are my investment objectives and needs?

Probable Answers I need regular income or need to buy a home or finance a wedding or educate my children or a combination of all these needs

2 How much risk am I willing to take?

Probable Answers I can only take a minimum amount of risk or I am willing to accept the fact that my investment value may fluctuate or that there may be a short term loss in order to achieve a long term potential gain

3 What are my cash flow requirements?

Probable Answers I need a regular cash flow or I need a lump sum amount to meet a specific need after a certain period or I don't require a current cash flow but I want to build my assets for the future

By going through such an exercise you will know what you want out of your investment and can set the foundation for a sound Mutual Fund investment strategy

Step Two Choose the Right Mutual Fund

Once you have a clear strategy in mind you now have to choose which Mutual Fund and scheme you want to invest in The offer document of the scheme tells you its objectives and provides supplementary details like the track record of other schemes managed by the same Fund Manager

Some factors to evaluate before choosing a particular Mutual Fund are the

track record of performance over the last few years in relation to the appropriate yardstick and similar funds in the same category

how well the Mutual Fund is organised to provide efficient prompt and personalised service

degree of transparency as reflected in their frequency and quality of communications

Step Three Select the Ideal Mix of Schemes

Investing in just one Mutual Fund scheme may not meet all your investment needs You may consider investing in a combination of schemes to achieve your specific goals

The following charts might prove useful in selecting a combination of schemes that satisfy your needs

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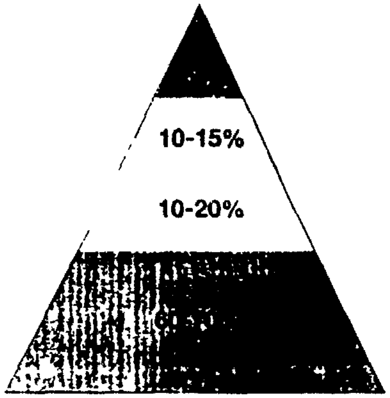
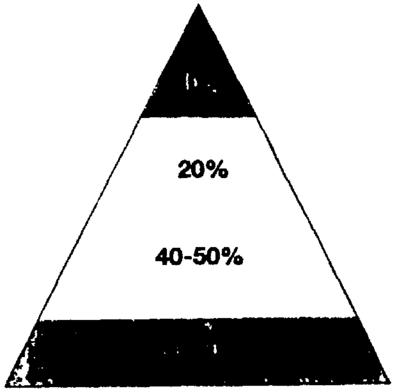
AGGRESSIVE INVESTORS



This plan may suit
- Investors in their prime earning years and willing to take more risk
- Investors seeking growth over a long term

GROWTH SCHEMES INCOME SCHEMES
BALANCED SCHEMES MONEY MARKET SCHEMES

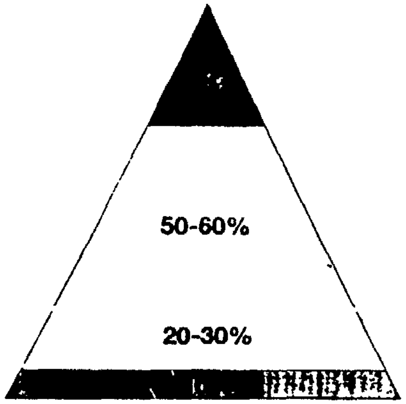
MODERATE INVESTORS



This plan may suit
- Investors seeking income and moderate growth
- Investors looking for growth and stability with moderate risk

GROWTH SCHEMES INCOME SCHEMES
BALANCED SCHEMES MONEY MARKET SCHEMES

CONSERVATIVE INVESTORS



This plan may suit
- Retired and other investors who need to preserve capital and earn regular income

GROWTH SCHEMES INCOME SCHEMES
BALANCED SCHEMES MONEY MARKET SCHEMES

Step Four Invest Regularly

For most of us, the approach that works best is to invest a fixed amount at specific intervals, say every month. By investing a fixed sum each month, you buy fewer units when the price is higher and more units when the price is low, thus bringing down your average cost per unit. This is called rupee cost averaging and is a disciplined investment strategy followed by investors all over the world. With many open ended schemes offering systematic investment plans, this regular investing habit is made easy for you.

Step Five Keep your Taxes in Mind

If you are in a high tax bracket and have utilised fully the exemptions under Section 80L of the Income Tax Act, investing in growth funds that do not pay dividends might be more tax efficient and improve your post tax return.

If you are in a low tax bracket and have not utilised fully the exemption available under Section 80L, selecting funds paying regular income could be more

tax efficient Further there are other benefits available for investment in Mutual Funds under the provision of the prevailing tax laws

You may therefore consult your tax ... or Chartered Accountant for specific advice ... investment

Step Six Start ...

It is desirable to start investing early and stick to a regular investment plan ... that if you start ... you will make more than if you ... and invest later This is because of the power of compounding where you earn income on income and your money multiplies at a compounded rate of return

Step Seven The Final Step

... it should be clear that Mutual Funds are suitable for every kind of investor whether ... a career or retiring conservative or risk taking growth oriented or income seeking All you need to do now is to get in touch with a Mutual Fund or your agent broker and start investing And reap the rewards in the years to come

A Word of Caution

As with everything in life and especially when you are planning to invest your hard earned investible surplus a cautious approach is always advisable Before investing in a Mutual Fund keep the following in mind

All investments in Mutual Funds are subject to market risks and the net asset value of schemes may go up or down depending on the factors that affect the securities market There is no guarantee that the stated objectives of the scheme will be achieved

Past performance of a Mutual Fund is not necessarily indicative of its future results

Investors are advised to study the offer document carefully before investing

Before investing it is best to consult your agent, financial advisor or portfolio manager

AMFI's DEDICATED TO

- Promoting and protecting the interests of Mutual Funds and their unitholders
- Increasing public awareness of Mutual Funds
- Serving the investors interest by defining and maintaining high ethical and professional standards in the Mutual Fund industry

APPENDIX III SELLING MUTUAL FUNDS MADE EASY

SELLING MUTUAL FUNDS MADE EASY

(A suitable picture or a flow chart
showing the sale process)

Association of Mutual Funds in India
An Agents Handbook

41

EIGHT KEYS TO SELLING MUTUAL FUNDS

1. Know Your Products
2. Know Your Clients
3. Priortitize Your Clients
4. Understand Your Clients Needs
5. Help Them Choose Their Investments
6. Encourage Regular Investment
7. Commit Them to Invest
8. Provide Personalised After Sales Service and Keep In Regular Touch With Your Clients

Give a professinal tocuh to your job. Remember always, a satisfied and well looked after client is an important asset of your profession.

Dear Agent,

It gives us at AMFI great pleasure to present this "Agents Handbook" as a guide to selling mutual funds

AMFI was incorporated in August 1995 as a non-profit organization. Its members are asset management companies registered with SEBI AMFI's principal objectives are to promote and protect the interests of Mutual Funds and their unitholders, increase public awareness of mutual funds and serve the interest of investors by defining and maintaining high ethical and professional standards in the mutual fund industry.

Recognizing that agents and intermediaries play a very important role not only in informing investors about the advantages in investing in Mutual Funds, but also in influencing their decesion, this handbook has been produced as a tool to help the agents in their profession. When used along with the Investor's Guide to Mutual Funds, this Handbook will assist you in selling Mutual Funds better and enhance the effectiveness of your profession

This handbook has been produced by a special committee of AMFI members consisting of Mr A.P Kurien as Chairman, Mr. Vivek Reddy, Mr. K.N. Atmaramani, Mr S K Mitra, Mr. Ajai Kaul and Mr A N Palwankar as members. Price Waterhouse LLP/Financial Institutions Reform and Expansion (FIRE) Project funded by USAID, has also made a valuable contribution. I take this opportunity to thank all of them for their time and effort.

G.A.Shenai
Chairman
AMFI

ROLE OF AN AGENT

As a mutual fund agent, you are an advisor and a financial intermediary representing the interests of your clients, as well as the mutual funds you sell. What is most important is that you see yourself not just as a distributor of forms, but more as a financial planner providing sound advice to your clients on how to manage their investments. Investors place a great deal of trust and confidence in you, and it is important that you deal with them in a professional manner

As a Mutual Fund agent you must:

- understand your clients' needs
- bring various products to their attention
- explain the opportunities and risks associated with those products
- recommend those that match the cl ient's requirements

Remember always that securities including mutual funds have to be sold with investors objectives in mind.

THE MUTUAL FUND INDUSTRY:

The Mutual Fund industry is in the midst of a significant growth with marked changes in its composition, product mix and identity. These changes coupled with fundamental market reforms and techonological advances will create new opportunities for investors and the securities markets

A decade ago, the "mutual fund industry" was Unit Trust of India (UTI). In 1987, the public sector commercial banks and the insurance companies were allowed to set up Mutual Funds. Not until the liberalisaton of the financial markets in 1993 did the private sector enter the field. However, UTI, a statutory corporation set up in 1964, continues to be the largest institution in the industry.

As of December 31, 1996, Mutual Funds managed Rs. 80,000 crores of assets spread over 190 schemes Until about 1995, most of the schemes were closed-end classified as growth, income or combination of both However, the benefits of the open-end form are now more recognised and the Mutual Funds are increasingly launching open-end schemes This has been made possible with improving standards of investor servicing

(pie charts/graphs on growth)

WHY SHOULD YOUR CLIENTS INVEST IN MUTUAL FUNDS

Having familiarized yourself with the industry, you need to know clearly the benefits that a Mutual Fund offers to your clients The information in this section should convince your clients that Mutual Funds can be part of every financial plan The advantages of investing in a Mutual Fund are·

1 **Professional Management** Your clients can avail of the services of experienced and skilled professionals who are backed by dedicated investment research team which analyses the company performance and prospects and selects suitable investments to acheive the objectives of the mutual fund scheme

2 **Diversification** Mutual funds invest in a number of companies across a broad cross-section of industries and sectors This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion Your clients can achieve this diversification through a Mutual Fund with far less money than they can do on their own.

3 **Convenient Administration** Investing in a mutual fund reduces paperwork and helps to avoid many problems as bad deliveries, delayed payments and unnecessary follow up with brokers and companies Mutual funds save time and make investing easy and convenient.

4 **Return Potential** Over a medium to long term Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities

5 **Low Costs** Mutual funds are a relatively less expensive way to invest compared to directly investing in the capital markets because their benefits of scale in brokerage, custodial and other fees translate into lower costs for investors

6 **Liquidity** In open-ended schemes, your clients can get their money back promptly at net asset value related prices from the Mutual Fund itself With close-ended schemes, you can sell your units on a stock exchange at the prevailing market price or avail of the facility of direct repurchase which some close-ended and interval schemes offer periodically

7 **Transparency** Your clients get regular information on the value of their investment in addition to disclosure on the specific investments made by the scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook

8 **Flexibility.** Through features such as regular investment plans, regular withdrawal plans and dividend reinvestment plans, you can systematically invest or withdraw funds according to investors needs and convenience

9 **Choice of Schemes.** Mutual funds offer a variety of schemes to enable investors to take advantage of opportunities not only in the equity, debt and money markets but also in specific industries and sectors

10 **Government Regulation** All mutual funds are registered with SEBI, and they function within the provisions of strict regulations designed to protect the interests of investors The operations of mutual funds are regularly monitored by SEBI

KEY TO SELLING MUTUAL FUNDS

The key to becoming a top class agent is to earn your clients' respect, trust and confidence by matching their financial needs with the right type of investments. Remember, selling is not just making your clients invest in a particular scheme, but it also involves building up a relationship that lasts for years and stands the test of time

Here are some keys to become a successful mutual fund agent

I. Know Your Products

To make a favourable impression, you need to have a thorough understanding about the mutual fund schemes you are selling. You must be able to explain the investments objectives, the risks, any special features and the specific advantages and disadvantages of the scheme to the investors Also, keep yourself upto date on the track record of the scheme as well as the overall performance of the Mutual Fund.

Before recommending an investment you must know

- the strengths of the asset management companies and sponsors of the Mutual Fund
- the choices/plans available and the advantages of such choices/plans
- the nature of the asset - i e., is it something that provides growth or a regular income or a balance of both (growth plus income)
- the potential for returns and the risks your client will have to assume to realise such returns
- tax benefits, if any
- operational details such as how to buy, how to sell or transfer to another scheme, etc.,

Remember, you must study carefully offer documents and related literature to acquaint yourself with th Fund.

II. Know Your Clients

Clients are different. Their financial needs and choice of investments vary depending upon their age, earning capacity, family commitments and ability to take on risks. Some broad types of clients are given below

- Young and accumulating Typically under 40, seeking to build capital for a long-term goal such as buying a house, children's education or a family wedding These clients may take higher risks for higher returns

- Middle-aged with family commitments: Typically between 40 and 60, in their prime earning years and with family commitments that require a large, periodic expenditures They may be willing to sacrifice a higher return for a stable investment and lower risks

- Retired Typically over 58 - 60, require seeking income to meet their regular expenses and are primarily concerned with safety of the principal

- Institutions and high networth individuals Corporates, banks, trusts and wealthy individual investors, who seek an appropriate combination of tax efficient growth and income depending upon their return expectations and risk tolerances

III. Prioritize Your Clients:

To make the most of your time, you must identify the clients with whom you can establish a good business relationship There are 3 types of clients - receptive, potential and independent minded The receptive clients are those who will work with you to develop a financial plan, have the discipline to invest regularly and believe in the merits of professional financial advisors.

The potential client is one who wishes to become a successful investor, but does not have the discipline or patience to do so. If you work closely with these investors, they could join the ranks of your good receptive clients The independent minded clients are those who do not use you financial intermediaries and prefer investing directly Such clients need to be cultivated over time.

IV Understand your Clients' Needs:

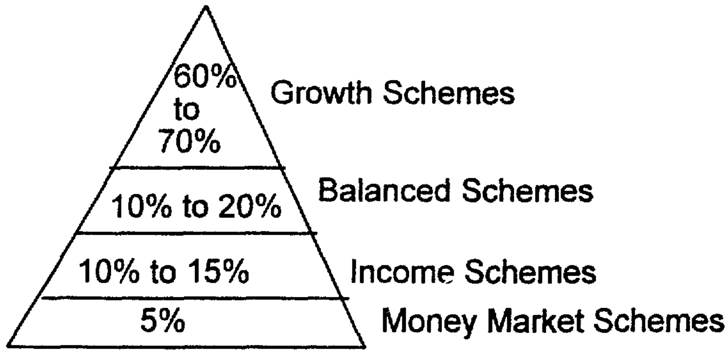
For you to be able to prescribe a sound financial plan to your clients, you must understand their needs and priorities Find out your clients'

- investment objectives Try to establish what your client's real need is "I need more money" is not a real need or goal On the other hand, something specific like "I need money to send my kids to college" or "I need money to retire by 58-60" is a real need or goal You must probe your client such that the real need comes out.
- risk tolerance Are they willing to take higher risks in anticipation of higher returns or would they prefer to play it safe and accept modest returns
- return expectations What kind of returns would the clients like from their investments, how long are they willing to wait and in what form do they want it i e capital appreciation or regular income.
- cash flow requirements How much liquidity your clients want and when do they want it.
- tax benefits Are your clients looking for any specific tax benefits on their investments? How important are tax concessions in choosing their investments?

V **Help them choose their Investments:**

Having understood your client's profile and needs, you now have to advise him on where to invest It might be a selection of only mutual funds or a combination of mutual funds and other investments A few indicative model portfolios are given below for your reference

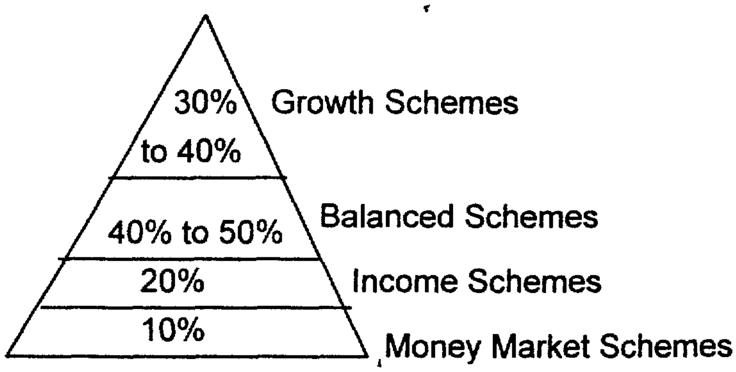
Aggressive Plan



This plan may suit·

- Younger investors in prime earning years and willing to take more risk
- Seeking growth over a long term

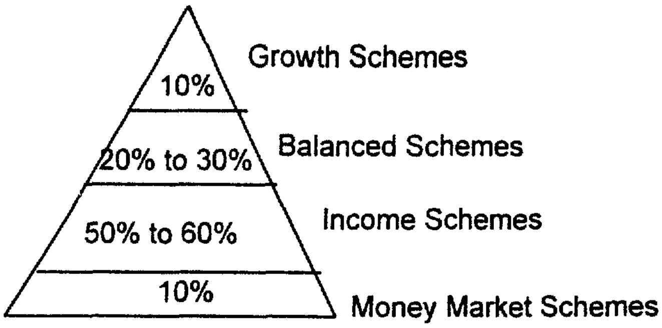
Moderate Plan



This plan may suit:

- Middle aged with many financial obligations
- Looking for growth and stability with moderate risk

Conservative Plan



This plan may suit.

- Retired investors with a need to preserve capital and earn regular income.

VI **Encourage regular Investment**

Advice your clients to invest early and stick to a regular investment plan. This will help them to make more moeny because of the power of compounding where your clients could earn income on income and their money multiplies at compounded rate

VII **Commit them to Invest:**

The best plans and the best choice of investments are of little use unless your client acts upon them and invests. Ensure that your clients give you the commitment for their investment. Be ready with application forms and other documents and if necessary, help them to complete the same

VIII. **Provide after Sales Service** :

One of the most important responsibilities of a professional agent is to provide prompt, efficient and courteous service to the clients You can build up lasting relationship by providing services that your clients most desire with respect to their investments·

- making periodic calls to see if they need any help with their investments
- getting in touch if there is a great deal of volatility which may be of concern to your clients
- assessing any change in their personal circumstances which may call for a review of the financial plan recommended by you
- informing them of new schemes and products that could be useful to them
- following up with the mutual fund if your clients have experienced a service related problem with their investment

By staying in touch with your clients on a regular basis, you not only get more investments from them but you also earn the business of their friends

- and relatives on account of the goodwill you have created and positive reference they receive from your clients

Following these eight basic steps will ensure that you attract and retain a loyal base of customers whose business you can depend upon

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SELLING TIPS TO MAKE YOUR BUSINESS GROW

The previous section dealt with what you need to know about mutual funds and how to deal with clients This section will outline to you some useful and practical tips for becoming a successful sales person These concepts are applicable not only to mutual funds, but also practised by sales people in all industries anywhere in the world.

1 Strengthen your prospecting skills to build a strong client base

To build a successful agency business you need to establish a strong client base - one that you can keep adding to This means that a lot of your effort should be directed at finding or prospecting for new clients.

As a first step in prospecting, you will need to generate a list of people who could become your potential cleints It could be based on membership of a club, association, professional group, etc for which lists are readily available Or you could select a particular locality in your town where you feel the residents may make good clients

Make contacts by either mailing or calling personally

- Direct Mailing - involves sending your potential clients a mailer describing how you can help them and then following-up with telephone calls to fix appointments

- Personal Calling - involves calling potential clients (telephonically/personally) with or without prior notice and explaining how you could be of use to them

As it is the first contact between you and the potential client, you must be prepared for a low success rate However, these methods are essential to build-up and expand your client base.

The second approach which is even more effective is to gain referrals from your clients This means getting the names of their friends and relatives whom you could contact It could be voluntary on the part of your clients or you could specifically request that they help you with referrals. Here your chances of converting a "potential" to a regular client are higher, as your potential clients are reassured by the positive references on you received from someone they know

2 Ask Questions and Listen to the Answers

When you ask your prospective clients a lot of investment related questions, you are telling them that you are concerned about their financial well-being Investors give the right answers if they are asked the right questions However, asking questions is not enough You must listen to the responses and take notes if necessary because the clients' answers are a vital input for developing a proper investment plan for them.

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3 Prepare, Prepare, Prepare

The more time you spend on preparing, the more comfortable you will feel and the easier it will be for you to convince your investors Preparation should cover all possible aspects relating to your client and the potential investment opportunities.

Preparation should include a through understanding of specifics of the investments you are selling:

- refreshing your product knowledge
- trying to know more about your prospective clients
- preparing tables, charts, reports, etc. which help clients understand opportunities
- anticipating client questions and preparing your responses
- outlining or practicing what you are going to say to your client when you meet him

Or it could also include preparation on broader and more general subjects such as:

- the growth and status of the mutual fund industry
- fund concepts and new types of fund investments
- changes in the markets or government policies
- how market and regulatory reforms are helping to create increased efficiency, transparency and competition among mutual funds for the benefit of investor

Whatever you say, you must say with confidence and conviction, which requires lots of practice. Almost all successful people in any field attribute their success to preparation and practice.

4. Practice Basic Etiquette and Courtesies

In any relationship which depends on trust and confidence, being courteous and presenting yourself as thoroughly professional is very important. While building confidence in your clients through your knowledge and ability could take years, you could lose their faith in you, in minutes, through discourtesy or lack of professionalism Yet, etiquette and courtesy are often ignored aspects of selling. A well mannered smartly dressed agent is much more acceptable to a client. So keep the following in mind:

- Make a favorable first impression
- Don't barge in on a client Take an appointment
- Having taken an appointment, don't be late
- Spend a minute or so making polite enquiries about the client/his family
- Present yourself as warm, approachable and thoroughly professional
- Do not waste your client's time Finish your business quickly and leave

5 Get the most out of your Mutual Fund

To be able to sell a mutual fund schemes effectively, you need to insist on their total support Ensure that you ask for comprehensive information on product literature, their latest investment strategies and details of new products and initiatives And use this information to communicate to your clients and give them confidence In addition, you need to pass on any feedback obtained from your clients to the mutual fund to enable them to be responsive to the needs of your customers

6 Stay visible and keep in touch

Many times it may happen that the markets decline and your investors incur a short-term loss in the investments you have recommended At such a time, the tendency is to avoid calling on your clients because you are worried that they may have a negative reaction. But it is in such adverse circumstances that your clients need your reassurance most and this is when your visit or call will be most appreciated By staying in touch and communicating in difficult times, you build lasting relationships.

7. Set goals for yourself and determine to be successful

The first and most important step in becoming a successful agent is to have a desire for achievement. This involves setting specific goals such as "I want to increase my monthly commission from Rs.5,000 to Rs 8,000" or "I want to add 10 new clients every month" or "I want to have a new office by year end". Write these goals down and monitor your progress.

After you have decided what you want to accomplish, the next step is to work out your strategies to achieve these goals Strategies could include "Do 100 direct mailers each month" or "Call 3 new prospects everyday" or "Add on a new mutual fund to represent this year" or "Add 3 corporate clients in the next 3 months" Review your goals and action plans periodically to ensure you are on track and if necessary increase your efforts to achieve the level of success you desire.

Going through this Handbook should have given you enough ideas and knowledge to become a successful agent. Now it's time to get active and go out to start meeting potential customers. Remember, systematic and hard work leads to more and more sales.

Happy Selling!

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TIPS TO BECOME A SUCCESSFUL AGENT

- Present yourself as thorough professional and be courteous.
- Know your products well.
- Build relationships. Don't sell products.
- Know your clients. Understand their needs.
- Tell the truth. Your integrity will always be valued.
- Be a financial adviser, not a salesman.
- Be convinced yourself. If you are not convinced, your client will not be.
- Provide responsive and anticipatory after-sales service.
- Demand the best out of the mutual funds and companies you represent.
- Decide to become a successful agent and work hard.

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APPENDIX IV REFORMS THAT WILL IMPROVE THE SECURITIES MARKETS AND PROVIDE NEW OPPORTUNITIES FORINVESTORS

TECHNICAL SESSION VII

MUTUAL FUNDS THROUGH 2000

REFORMS THAT WILL IMPROVE THE SECURITIES MARKETS AND PROVIDE NEW OPPORTUNITIES FOR INVESTORS

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Mutual Fund Consultant

January 21, 1997

REFORMS THAT WILL IMPROVE THE SECURITIES MARKETS AND PROVIDE NEW OPPORTUNITIES FOR INVESTORS

Investors may look back upon the last years of the 20th Century as the period that gave birth to historic changes in India's capital market Every part of India's securities markets and their regulatory processes--from the scrips themselves to its stock exchanges, registrars, custodians and mutual funds-- is undergoing a huge transformation These changes will make tomorrow's markets almost unrecognizable to today's investors

The securities markets will become more attractive to investors as technological advances in communications, data entry and record keeping combine with regulatory reforms to introduce greater efficiency, transparency and integrity into the markets The transformation of the securities markets will accelerate developing changes in the composition, product mix, identity and regulation of the mutual fund industry to create greater flexibility and protections which will mean new opportunities for mutual fund investors

I strongly support the work of the Securities Exchange Board of India ("SEBI") I commend the thoughtful reports of the expert committees that laid the foundation for these reforms and the stock exchanges for the technological innovations and other reforms that they are initiating Good laws and fair, efficient and transparent markets mean better opportunities for mutual fund shareholders and good business for funds

A few fundamental market and regulatory changes will revolutionize the markets and the mutual fund industry and attract greater investment and new classes of investors The introduction of depositories will be a significant start toward quicker, cheaper, safer and more efficient transfers of securities The depository system should reduce problems associated with bad deliveries, delayed transfers, shares under objections and faked or forged certificates Far more significant, but less visible, changes will take place as the markets become more efficient

- Investors will immediately appreciate the increased certainty which the faster settlements and the reduced risks will bring about

- The markets will benefit by a decrease in opportunities for fraud and manipulations As the markets become fairer and more efficient, as transaction costs and risks decrease, they will become more attractive to investors

- Mutual funds will benefit immediately by not having to wrestle with piles of paper or worry about delays and bad scrip

- Mutual fund shareholders will benefit from the anticipated increased flow of investments into the market

- Closed end schemes that are listed on exchanges and their unitholders will be eligible to participate directly in the benefits the depository will provide

Caveat. The transformation will not be completed immediately Mechanically, the switch will take time To the extent that shareholders delay or choose not to surrender their scrip, our markets will operate on a two track system one relatively fast, efficient, safe and inexpensive, the other slower, less efficient, riskier and costlier Be assured that the mutual funds will be among the first to surrender their shares

Regulatory reforms should also lead to stronger safer markets Three recent landmark reports "The Report of the Expert Committee on the Accounting Policies, Net Asset Values and Pricing of Mutual Funds," "The Malegam Committee Report" and the SEBI Report "Mutual Funds 2000" point the way to improved disclosures which will benefit the markets generally and mutual fund investors specifically A basic premise of all three reports is that "Adequacy of disclosure is the corner-stone of a healthy capital market " Raising the general level of disclosure in the marketplace will benefit all investors As professional investors, mutual funds will be among the first to benefit The entire market should benefit because better disclosure should reassure all shareholders and attract new investors

These developments will not occur automatically For the Mutual Fund Industry to take full advantage of them it will have to change its image to emphasize aspects which to date have been underplayed It is my hope that the industry will heed the recommendations made at this Conference and that Mutual Funds will

- Expand their product mix to offer a wide variety of funds to meet all investors needs Stress the "family of funds" concept and by all means, with the cooperation of the regulatory authority, introduce "Money Market Funds "

- Lengthen their duration from short term to long term, from five years to a lifetime Equities have consistently outperformed other investments over time They do not always do so over the short term Mutual funds must be sold as a long term investment not a short term speculation

- Move from offering predominantly close end to predominantly open end funds The liquidity and simplicity of mutual funds are among their most attractive features Close end funds are much more sophisticated instruments than open end In a close end the investor must understand the relationship between two prices the net asset value per share of the portfolio which moves up and down with the market and market price which is often at a discount This can be confusing and, because close end funds generally sell at a discount, it can also be discouraging While close end funds have served specific needs and are useful for holding less liquid securities, open end funds have proven to be far simpler and more attractive to investors

- Sell on the basis of understanding and managing risk rather than assured or guaranteed returns When you invest in mutual funds you are investing in an underlying package of securities which can go up or down When investors understand that all funds involve risk, but depending upon their policies and portfolio mix the degree of risk can be lessened, will the fund industry sustain their loyalty and maintain its own credibility Attempts to guarantee rates of return or redemption prices will distort the product and the public's perception of it Failed guarantees or payments out of capital to meet assured returns erode public confidence and undermine the industry.

- Emphasize the advantages of regular investing over time through Rupee Cost Averaging to reduce risk of market fluctuations, to take advantage of compounding and improve chances for better returns

- Introduce standardized performance measurements to cover yield and total return over defined periods Require that the funds in their reports and advertisements adhere strictly to these standards without variation This will eliminate confusion and promote better understanding of fund performance, comparability of investment results and increased competition

- Create reasonable expectations This can be done if the product is explained well Essentially it provides the opportunity to own indirectly a professionally managed diversified portfolio of securities at relatively low cost It is not an IPO (initial Public offering), nor is it a bank account with an assured return

- Regulate salesmen All sellers of mutual funds should be trained, qualified and certified by their own self regulatory association or by SEBI This will go a long way toward raising professional standards in the industry and creating reasonable expectations

- Improve registrar services Fund registrars must provide rapid reliable services Technological changes, stronger regulation and competition should help to achieve a higher level of service which is essential to the success of the industry

An appropriate regulatory environment is critical to the success of the industry Investors will come to securities markets to the degree that they feel a high level of trust and confidence An appropriate regulatory framework and a vigorous, well-trained and effective regulator can add immeasurably to the level of confidence in the markets Let me share with you a short-hand way of analyzing the regulatory environment and particularly SEBI's new Mutual Fund Regulations It's called "SAFE T" and it stands for "Scope," "Accountability," "Fairness," "Enforceability" and "Transparency "

The scope of SEBI' s regulations depends upon the definition of Mutual Fund It is broad enough to include UTI which was created as a government institution with additional functions As such, it has operated under different rules than other funds It's important from the industry perspective that UTI be covered because capital market participants want to play on a level playing field where everyone abides by the same rules and no one receives an undue competitive advantage It's important from the investors' perspective that whichever fund they invest in offer the same high level of protections UTI should be subject to SEBI's full jurisdiction We must wait to learn how completely and quickly it can reorganize and readjust to meet SEBI's requirements SEBI's regulations have sent the right message

For accountability, SEBI deserves five stars for clearly defining the role and responsibilities of the trustees in managing the trust and protecting the interests of the unitholders The new mutual fund regulations not only set forth the trustees responsibilities, but also require certain reports and suggest other mechanisms for meeting those responsibilities Sponsors do not appear to be held to the same level of accountability, although trustees must ensure that they are "not given any undue or unfair advantage" or act in any manner " detrimental to the interests of unitholders " Sponsors' accountability may bear further watching as activities under the new rules unfold

On the question of fairness, at least three areas deserve mention--affiliated or associated transactions, valuation and calculation of net asset value, and cost to investors or compensation to Asset Management Companies

Affiliated or associated transactions involve transactions between schemes and related persons such as sponsors and others who control or are controlled by fund asset management companies Examples could include a sponsor who, perhaps as an underwriter has to place a security which is not selling well, uses the fund as a kind of garbage dump On the other hand, a sponsor might cause a fund holding a profitable security to sell it to the sponsor or another entity under its control at a bargain price or might arrange a joint venture where the fund bears most of the investment risk and the sponsor receives most of the profits

These kinds of self dealing transactions undercut the credibility and inhibited the growth of the mutual fund industry in the United States prior to the adoption of the Investment Company Act of 1940 That legislation, which was cosponsored by the industry, banned all affiliated transactions unless the parties could demonstrate their fairness in advance to the SEC and it then made a finding of fairness The definition of affiliate hinged on ownership of only 5 percent of the associate's voting securities and covered second tier affiliates as well as first The procedures adopted by the SEC included publication of a notice of the application which described the terms of the transaction and permitted interested parties to appear and protest any such transaction This has worked exceptionally well Many applications for such transactions are filed and granted every year, but they are untainted and the industry enjoys the highest level of public confidence

SEBI's approach in its 1996 Mutual Fund Regulations correctly identifies such transactions as a cause for concern and places the responsibility on the trustees to ensure against any undue or unfair advantage to associates and that such dealings are not detrimental to the interest of unit holders They require that the trustees quarterly review all transactions carried out between the mutual funds, AMC and its associates The definition hinges on 10 percent control rather than 5 percent and appears to cover only first tier associates Nor are there any procedures for advance approval by an independent body or advance notice or publication to interested persons

Were I a trustee responsible for ensuring the fairness of such transactions, I would be concerned over my possible liability and would try to introduce a number of internal safeguards including advance review procedures so that with my fellow trustees I could carefully screen the fairness of proposed transactions Even then, I might not be comfortable because I could still be second guessed after the fact Assuring the fairness of such transactions could still be a challenge

NAV (per unit) could be called the DNA of the mutual fund industry Establishing the correct NAV is central to almost every aspect of fund operations and materially effects unitholders First, it determines sale and redemption prices directly for open end funds, and influences market prices of close end funds Second, changes in NAV determine fund performance, affect investors' perceptions of the AMC's abilities and influence future sales and redemptions Finally, management compensation and fund expense limits are calculated as a percentage of total net assets

Fairness requires that NAV be calculated on a uniform basis One of the most difficult determinations lies in the valuation of thinly traded and unlisted securities The Eighth Schedule of the 1996 Mutual Fund Regulations sets forth an appropriate standard It requires such securities to be valued "in good faith" by the asset management company based on principles approved by its board and reported on as "fair and reasonable" by the fund's auditors While the standards are appropriate, there is still a lot of room for discretion by the AMC's For example, equities are to be valued on the basis of capitalization of earnings solely or in combination with net asset value, using for purposes of capitalization, the P/E ratios of comparable traded securities and with an appropriate discount for lower liquidity "

Another worrisome area, arises from the practice of historical pricing rather than forward pricing This means that funds use the last quoted price rather than their next for all securities they own Thus investors may time their purchases in a rising market and receive a lower price thus diluting the interests of existing shareholders Similarly, in a declining market, redeeming unit holders may time purchases to receive greater values and dilute the interests of remaining unitholders This potential for dilution is exacerbated by the interval permitted between valuations which may be as much as one week

A third consideration of fairness is the level of expenses to be borne by a scheme and by its AMC SEBI, in Mutual Funds 2000 called for clearly defining expenses and a fair fee structure Its regulations set limitations on maximum fees and total expenses graduated by size of assets and also limit the total selling commissions to be paid The levels of fees and expenses remain higher than those in more mature markets for schemes of comparable sizes, indicating a need for greater efficiencies Better disclosures leading to competition should result in lower fees and expenses

Enforceability is essential to an effective regulatory environment The credibility and effectiveness of SEBI's regulatory program will depend, to a large extent, on its ability to take effective actions to enforce the securities laws and its regulations SEBI's enforcement program must be able to detect and deter violations To do that the law's requirements must be clear and SEBI must have the authority and ability to assure

- that violations will be met with meaningful consequences
- that investors will be protected
- the marketplace will receive reliable information and
- that market mechanisms will not be corrupted

An effective, highly visible enforcement program can inspire public trust and confidence, essential to a successful capital market, and energize a regulatory agency A strong enforcement program should include clear standards, means of gathering information including, the power to conduct routine unannounced and for cause inspections, investigative authority, including the power to compel testimony and the production of documents, fair procedures, a broad range of sanctions, and a well-trained staff that not only understands substantive legal and accounting issues, finance and market operations, but is also expert in investigative techniques and procedures

SEBI's Division of Enforcement is developing the ability to carry out basic enforcement functions investigating possible violations of the securities laws and regulations and recommending enforcement activities Further efforts should be made to strengthen its ability to institute administrative proceedings and civil actions, to negotiate settlements and to review cases and refer matters to criminal authorities for prosecution

The 1996 Mutual Fund Regulations have introduced a number of meaningful steps to raise the level of transparency surrounding mutual funds However, SEBI could dramatically improve the transparency and fairness of the market, by making information distribution one of its principal functions Markets operate on information, the level of confidence and trust in a market is directly affected by the quality, quantity and freshness of the information available to the capital market SEBI, recognizing this principal, requires funds to adopt Codes of Conduct that would require

> "Trustees and AMC's and trustees (to) ensure the dissemination to all unitholders of adequate, accurate, explicit and timely information fairly presented in simple language about the investment policies, investment objectives financial position and general affairs of the scheme "

For such disclosure to be effective, SEBI must play a more significant role as an information clearing house, demanding and collecting reliable information and immediately providing the means for its quick and efficient recirculation to the market Only SEBI has the authority and power to require that market participants submit timely uniform information of high quality However, the information SEBI collects will be of little use if it is not immediately made widely available to the public SEBI could do this without greatly taxing its resources by establishing a Public Information Centre

As transparency increases and market forces supersede government controls, competition will become a driving force for higher standards and improved service throughout the mutual fund industry As investors and unitholders become more knowledgeable, they will choose fund schemes that provide the greatest transparency and best service We have just begun to witness the potential of this powerful combination With the implementation of SEBI's new Mutual Fund Regulations and the full support AMFI's membership, unitholders and the markets should begin to realize the increased benefits of transparency and competition

To the extent that the mutual fund industry can more fully realize its potential, it will not only bring more people and assets into the securities markets, provide sounder investments for unitholders and help to better educate investors, but it will play a more significant role in capital formation, in helping to build and maintain the liquidity of the capital markets and, as sophisticated, discriminating investors, in raising standards in the securities markets If mutual funds can earn the public's trust and confidence, they can make an enormous contribution to the growth, health and vitality of the capital markets and through them to the economy of India

APPENDIX V THE REGULATORY ENVIRONMENT FOR INDIA'S MUTUAL FUNDS

THE REGULATORY ENVIRONMENT FOR INDIA'S MUTUAL FUNDS

An Assessment
As of January 1997

By David Silver

(Transcribed by Lewis J. Mendelson)

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THE REGULATORY ENVIRONMENT FOR INDIA'S MUTUAL FUNDS

An Assessment
As of January 1997

By David Silver

In the competition for capital in the evolving global market, decision makers around the world increasingly are recognizing that the strength, integrity and fairness of a country's capital market can make a decisive difference in its economic development. Investors will come into India's securities markets to the degree that they feel a high level of trust and confidence An appropriate regulatory framework and a vigorous, well-trained and effective regulator can add immeasurably to the level of confidence necessary to tip the balance to broad based participation in the markets SEBI has made enormous progress toward these goals in the five years of its statutory existence.

All things considered, it is remarkable that SEBI in its 1996 Mutual Fund Regulations has addressed all of the significant areas in which pooled funds, such as mutual funds, can encounter problems Thus, I am very comfortable in stating that India now has a major league regulatory system which compares favorably with regulation anywhere

This does not mean that the present regulatory framework and the system that supports it are perfect In at least two respects SEBI has not had a clean slate on which to write. First, the operations and practices of the Unit Trust of India ("UTI") mutual funds and to a certain extent, public sector sponsored bank and insurance funds, were in some degree institutionalized before SEBI was created and are naturally resistant to change

Second, Mutual funds do not exist in a vacuum---they exist within a general social, financial and legal environment Mutual fund operations and the distribution of their units inevitably are affected by the operations of stock exchanges, investment banks, brokers, clearance and settlement procedures, depositories, and such overriding considerations as the attitude of the government towards economic innovation Too often I have seen government officials confuse deregulation with a mere lengthening of the leash But a longer leash leaves control in the hands that hold it and what has been lengthened can also be shortened

We cannot help but recognize that there are clear limits on what regulation by itself can accomplish. Since certain problems go beyond regulation, even if the system were perfect, there would still be room for further improvement in the operations of mutual funds Within the present legal an social environment, SEBI's 1996 Mutual Fund Regulations are both sensible and balanced responses to industry problems In only a very few instances would I question the desirability of a particular regulatory approach

It is widely accepted that mutual funds present a unique regulatory challenge They involve large amounts of highly liquid assets and may be managed by persons who often are not personally known to their shareholders and who may be associated with larger enterprises involved in other businesses In view of the possible conflicts of interests to which fund managers may be exposed, and considering the early history of investment companies in the United States, unitholders of mutual funds require special protections.

The first principle in fund regulation derives from the fact that mutual funds are trusts Under Trust Law trustees and similar fiduciaries must observe the highest duty of loyalty to the beneficiaries of the trust *"The trustee is under a duty to the beneficiary to administer the trust solely in the interest of the beneficiary "* That means *solely* in the interest of the unit holders Any business practice which is not totally consistent with this succinct and basic fiduciary duty should not be tolerated unless specifically authorized by carefully crafted laws or rules which are in accord with its spirit SEBI has recognized this principle by requiring each mutual fund to adopt a Code of Ethics which includes a version of it tailored to mutual funds and plainly states that "Trustees and AMCs must avoid conflicts of interest in managing the affairs of the schemes and keep the interest of all unitholders paramount in all matters "

I have reviewed the regulatory environment for India's Mutual Funds through a prism which applies to mutual fund regulation around the world Successful mutual fund regulation provides seven major areas of protection for investors It should

1 Prohibit various forms of self dealing
2 Provide for economic regulation of the remuneration of affiliates
3 Restrict unsound capital structures.
4 Require clear disclosure of investment objectives and policies.
5. Protect the physical integrity of assets
6 Assure fair valuation of investor purchases and redemptions.
7. Assure that investors receive accurate periodic reports about the funds and their investments.

Before I discuss those standards, there is a basic assumption that applies under most legal frameworks which for historic reasons does not yet fully apply here. It is that the protections which the law or regulatory framework provide should apply equally to all funds and investors in like financial products I was pleased to see that the definition of "Mutual Fund" in the Mutual Fund Regulations was broad enough to encompass the Unit Trust of India ("UTI") and that efforts are being made to bring UTI's mutual fund operations further under SEBI's regulatory aegis The complete integration and harmonization of UTI's mutual fund operations with those of the rest of the fund industry would strengthen the entire industry and rationalize the entire regulatory framework

1. Prohibit Self-dealing. SEBI in its 1996 Mutual Fund Regulations, correctly identified "associated transactions" as a cause for concern They are transactions between schemes and related persons such as sponsors and others who control or are controlled by fund asset management companies ("AMCs") Such transactions could include using the fund as a kind of burial ground for securities issued or owned by one of their associates or a joint venture in which the fund bears more than a fair share of the investment risk and the associate receives more than a fair share of the profits SEBI's regulations require that the trustees quarterly review the fairness of all transactions carried out between the mutual funds, AMC and its associates The definition of "associate" hinges on 10 percent control and appears to cover first tier associates. If an AMC enters into a securities transaction with any associate a report to that effect must immediately be sent to the trustees The standards set by the regulations set the proper direction

Self dealing transactions undercut the credibility and inhibited the growth of the mutual fund industry in the United States prior to the adoption of the Investment Company Act of 1940 That legislation, which was co-sponsored by the industry, banned all affiliated transactions unless the parties could demonstrate their fairness in advance to the SEC and it then made a finding of fairness The definition of "affiliate" hinged on ownership of only 5 percent of the associate's voting securities and covered second tier affiliates as well as first The procedures adopted by the SEC included publication of a notice of the application which described the terms of the transaction and permitted interested parties to appear and protest any such transaction. This has worked exceptionally well

Were I a trustee responsible for ensuring the fairness of such transactions, I would be concerned over my possible liability for transactions I did not specifically evaluate and authorize I would try to introduce a number of internal safeguards, including advance review procedures, so that with my fellow trustees and I could carefully screen the fairness of proposed transactions. Even then, I still might be uncomfortable because I could still be second guessed after the fact

Other conflicts of interest. In formulating rules dealing with conflicts of interest, there is one guideline I would especially commend Care should be taken not to permit any ancillary source of profit to those affiliated with mutual funds so significant that it detracts from the single minded loyalty demanded of fiduciaries. For example, permitting persons associated with a scheme, such as an AMC, to speculate in fund shares has been shown in other countries to undermine such loyalty

2. Economic Regulation of Remuneration of Affiliates. The 1996 Mutual Fund Regulations include comprehensive regulations setting maximum fees that may be charged by AMC's for advisory services, defining what expenses must be borne by the AMC, and limiting total fund expenses as a percentage of total assets The regulations also set parameters for selling expenses and sales loads that may be borne by unitholders.

I believe that regulation is only part of the answer for keeping costs and expenses reasonable Regulations set outside limits, they do not guarantee efficient rates Competition and economies of scale aided by good disclosures and informed investors are also part of the answer Consistently low expenses can make a significant difference in how well a fund performs *vis a vis* its competitors and in how well a fund meets its unitholders' expectations As unitholders come to realize this and focus on the impact of expenses on fund performance, the expense ratios

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of India's funds should decline

Those are the carrots Unitholders also need to carry a stick In the U S the job of the regulator has been immeasurably assisted by the inclusion within the Investment Company Act and other securities laws of the specific right of shareholders to bring lawsuits against mutual funds, defaulting trustees and other fiduciaries which misrepresent the truth or do not live up to representations they have made Shareholders in the U S can also sue if fund advisory fees are unreasonable This approach is worthy of further study in India

Fund sponsors should be accountable to fund investors Sponsors organize funds, appoint trustees, set up AMC's and directly or indirectly control their operations Often mutual fund schemes are bought on the basis of the sponsor's reputation Sponsors may "fully guarantee" returns promised in their fund schemes' offer documents if they state the manner in which such guarantees are to be met. Sponsors or their associates also may act as brokers, effecting transactions in securities of up to 5 percent of the daily gross business of a fund, or as distributors, so long as that fact and the brokerage or commission paid is disclosed semi-annually They may also own as much as 49 9 percent of their fund's custodian

The 1996 Mutual Fund Regulations contain a general requirement that sponsors, among others, "shall make such disclosures or submit such documents as they may be called upon to do so by (SEBI) " [Sec 58(1)] The inclusion of this principle in the regulations is very important First, it is a recognition of the need to assert jurisdiction over sponsors. Second, it points the way toward future reporting requirements if and as necessary The regulations also require trustees to ensure that the AMC has "not given any undue or unfair advantage" to any "associates" or dealt with any associate of the AMC "in any manner detrimental to the interests of unitholders " [Sec. 18(6)] The principle is correct, but the trustees' ability to exercise that kind of control over the sponsors needs to be reenforced The accountability of sponsors to unit holders is not yet commensurate with the sponsors' powers

3. Unsound Capital Structures. Mutual funds must make sense as an investment for the common man. Liquidity and simplicity should be among a fund's most attractive features That lesson was learned the hard way by the U S industry In the U S prior to the "Great Crash" of 1929, when closed-end companies predominated, they were a high stakes play A thin layer of equity ownership often controlled layers of different classes of investments. The companies were also highly leveraged and could and often did invest in other investment companies, creating pyramided schemes In those pre-Investment Company Act days putting money into an investment company with a complicated capital structure was too often the beginning of a dizzying roller coaster ride which left investors confused and at a loss and limited the credibility of the fund industry

The 1996 Mutual Fund Regulations are intended to guard against the worst features of complicated capital structures "Pyramiding," cross investing in other schemes of the same or another AMC, may not exceed 5 percent of the net asset value of the *mutual fund* (Seventh Schedule, Item 4) However, the meaning of this restriction may need clarification For example,

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it would appear that a small scheme which is part of a large mutual fund could invest more than 5 percent of its (the scheme's) net assets in another scheme or schemes if the aggregate investment by all the fund schemes does not exceed 5 percent

The regulations permit mutual funds to borrow only to meet temporary liquidity needs for the purpose of repurchase, redemption or the payment of interest or dividends. [Sec. 44(2)] Borrowing is limited to 20 percent of the net asset value of the scheme and may not exceed six months It is not clear whether this restriction would allow rolling six month periods which, in effect, would mean that schemes could be continually leveraged up to 20 percent. If so, this provision may require further tightening.

The Regulations allow Mutual Funds to carry on activities as underwriters provided that the underwriting obligation shall not at any time exceed the total net asset value of the scheme [Sec.46 (1) and (2)] The extent of the fund's underwriting risk is somewhat circumscribed by the Restrictions on Investments contained in the Seventh Schedule. Item 2 requires that "No mutual fund under all its schemes should own more than 10 percent of any company's paid up capital carrying voting rights " This could still leave funds dangerously exposed to underwriting risks

Rules designed to protect the integrity of mutual funds such as requiring open end funds to maintain 85 percent of their portfolios in liquid securities or that a fund may not change its investment objective without a shareholder vote protect the integrity of the mutual fund as a concept. There is another more subtle threat to product integrity which bears mention in this context Attempts to graft features onto mutual funds to simulate bank accounts, guaranteed debentures or government securities can only confuse investors as to what mutual funds are and will inevitably cause investor disenchantment leading to greater regulation and greater complexity.

4. Clear disclosure of investment objectives and policies. Although there does not appear to be a specific instruction in any Schedule or Form saying so in a few succinct words, it would appear that funds would be required to disclose their investment objectives and policies in Offer Documents and advertisements and that any changes in them could be made only with the approval of three fourths of fund shareholders

The 1996 Mutual Fund Regulations require that every fund adopt a Code of Conduct that requires the trustees and AMC to "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 " The Code of Conduct must also contain a requirement that trustees and AMCs "carry out the business and invest in accordance with the investment objectives stated in the offer documents and take investment decision(s) solely in the interest of unitholders." (Fifth Schedule, Items 2 and 6)

The Regulations also require that a mutual fund scheme's offer document "contain

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disclosures which are adequate in order to enable investors to make informed investment decision(s) " [Sec 58 (3)] Advertisements for any scheme must include its investment objectives [Sec 30(2)] The trustees are required to obtain the consent of three fourths of the unitholders "when any change in the fundamental attributes of any scheme or the trust or any other change would modify the scheme or affect the interest of the unitholders is proposed to be carried out " [Sec. 18(15)] Although terms like "investment policies," "investment objectives" or "fundamental attributes" are not defined, if questions arise as to their meaning, SEBI can define them in accordance with its power to issue clarifications and guidelines.

5. Protection of the Physical Integrity of Assets. It is critically important that the integrity of fund assets be maintained An independent custodian can not only protect the physical safety of fund assets, but can also help to assure the efficient administration of the fund through the record keeping procedures built into its operations It is very much in the interests of unit holders that this function be carried out in a thoroughly professional manner The 1996 Mutual Fund Regulations require every mutual fund to appoint a registered custodian to carry out the custodial services for the schemes of the fund and to notify SEBI within 15 days of the appointment. (Sec 26) The appointment must be entered into with the prior approval of the trustees and the "Custodian Agreement" must "contain clauses which are necessary for the efficient and orderly conduct of the affairs of the custodian "(Sec 27)

I question whether, in light of the importance of maintaining the independence of the custodian, allowing a sponsor and its associates to hold almost 50 percent of the voting rights of the custodian, and just under 50 percent of the directorships of the custodian (Sec 26) is the best course The ownership by a sponsor's of up to 49 9 percent and large representation on the custodian's Board of Directors allows the sponsor to cast a large shadow over the custodian's operations which may suggest a lack of independence

6. Fair Valuation of Investor Purchases and Redemptions. Establishing the correct NAV is central to almost every aspect of fund operations and materially effects unitholders. NAV determines sale and redemption prices directly for open end funds and influences market prices of closed end funds. Fund performance is measured in terms of changes in NAV per unit It affects investors' perceptions of the AMC's abilities and influences future sales and redemptions of a scheme Finally, the value of the scheme helps to determine management compensation and fund expense limits because they are calculated as a percentages of total net assets

Fairness requires that NAV be calculated on a uniform basis. One of the most difficult determinations lies in the valuation of thinly traded and unlisted securities. The Eighth Schedule of the 1996 Mutual Fund Regulations sets forth an appropriate standard. It requires such securities to be valued "in good faith" by the asset management company based on principles approved by its board and reported on as "fair and reasonable" by the fund's auditors While the standards are appropriate, there is still room for discretion by the AMC's. For example, equities are to be valued on the basis of capitalization of earnings solely or in combination with net asset value, using for purposes of capitalization, the P/E ratios of comparable traded securities and with an appropriate discount for lower liquidity " This is an area where the Assciation of Mutual

Funds in India ("AMFI") could make an important contribution by providing uniform valuation guidelines for the industry.

Another worrisome area, arises from the practice of historical pricing rather than forward pricing . "Historical pricing" means that funds use the last quoted price rather than the next or "forward" price for all securities they own Historical pricing can result in dilution of the interests of existing unitholders in rising markets It also allows investors to time their purchases in a rising market in order to receive a lower price (i e pay less) Similarly, in a declining market, redeeming unitholders may receive greater values and dilute the interests of remaining unitholders. This potential for dilution is exacerbated by the interval permitted between valuations which may be as much as one week I strongly recommend the adoption of forward pricing for all funds and that the interval between valuations be narrowed

7. Accurate Periodic Reports About the Funds and Their Investments. It is axiomatic that securities markets must be transparent If capital is the heart of the securities market, reliable current information is its lifeblood Both are necessary for the markets to work. Mutual fund investors need continuous relevant information about their investments portfolios, costs and expenses, performance, portfolio turnover ratios, repurchase programs, and any changes in management or operational procedures.

SEBI, recognizing this principal, requires funds to adopt Codes of Conduct that would require

> "Trustees and AMC's and trustees . (to) ensure the dissemination to all unitholders of adequate, accurate, explicit and timely information fairly presented in simple language about the investment policies, investment objectives financial position and general affairs of the scheme."

Reports to SEBI. The 1996 Mutual Fund Regulations establish the general principle that every mutual fund, AMC, trustee, custodian, sponsor of the mutual fund shall make such disclosures or submit such documents as they may be called upon to do by (SEBI) [Sec. 58(1)] More specifically, funds and AMCs are required to furnish SEBI.

(a) copies of annual audited statements of accounts, including a balance sheet and profit and loss account for the fund and in respect of each scheme, once a year;
(b) a copy of six monthly unaudited accounts;
(c) a quarterly statement of movements in net assets for each of the schemes of the fund, and
(d) a quarterly statement, including changes from the previous periods, for each scheme

Reports to which unitholders have access. Mutual funds and their AMC's are required to publish an annual report, in a prescribed form, or abridged summary of it, in an advertisement within six months of the end of the fund's fiscal year If a summary is published it must be accompanied by a note that the full report will be available for inspection at the fund's Head

Office and a copy made available to the unit holder at a nominal fee as specified by the fund (Sec 56) The Annual Report and details of investments and deposits revealing entire schemewise portfolios must also be forwarded to SEBI (Sec 57) The annual report must contain various kinds of information, which any investor would find highly useful, including

- the report of the Board of Trustees on operations of the schemes and the fund as a whole and the future outlook of the fund;
- Balance Sheet and Revenue Account,
- Auditor's Report,
- a brief statement of the Board of Trustees on

  -Liabilities and responsibilities of the Trustees and the Setlor;
  -Investment Objective of each scheme,
  -Basis and policy of investment underlying the scheme,
  -A prescribed statement on market value fluctuations, and
  -Trustees comments on the performance of the scheme, with full justification,

- Schemewise Historical per unit statistics for the past three years, including

  (a) NAV per unit,
  (b) gross income per unit broken into components;
  (c) aggregate of expenses, write off, amortisation and charges, per unit;
  (d) net income per unit,
  (e) unrealized appreciation/depreciation in value of investments, per unit;
  (f) if the units are traded or repurchased/resold, the highest and lowest prices per unit during the year and the price earnings ratio,
  (g) Per unit, ratio of expenses to average net assets by percentage,
  (h) Per unit, ratio of gross income to average net assets by percentage (excluding transfer to revenue account from past year's reserve but including unrealized appreciation on investments); and
  (I) per unit NAV

In addition, twice yearly, within two months of March 31 and September 30, the fund and AMC are required to publish unaudited financial results in a prescribed form "and such other details as are necessary for the purpose of providing a true and fair view of the operations of the mutual fund," in an English Daily Newspaper circulating in the whole of India and in a newspaper in the language of the region where the head office is located (Sec.59) "The trustees are also bound to make such disclosures to the unit holders as are essential in order to keep them informed about any information which may have an adverse bearing on their investments " (Sec 60)

The only additional disclosures I could suggest adding are portfolio turnover ratios and descriptions of any affiliated/associated transactions, the reasons for them and the amounts

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involved in each However, I would like to see the kinds of disclosures required to be in Annual Reports (other than additional audits) to be made more frequently, perhaps semi-annually at first and then quarterly I would also like to see the information become more easily and freely accessible to unit holders

The 1996 Mutual Fund Regulations have introduced a number of meaningful steps to raise the level of transparency surrounding mutual funds The reliability and comparability of the information provided to investors must also be continually upgraded. Further steps to agree upon and implement generally accepted accounting standards for mutual funds would be welcome

SEBI also could dramatically improve the transparency and fairness of the market, by making information distribution one of its principal functions, becoming an information clearing house, demanding and collecting reliable information and immediately providing the means for its quick and efficient recirculation to the market SEBI could do this without greatly taxing its resources by establishing a Public Information Centre

Enforcement. There is one theme which bears repeating in every market and which I stated in India in 1989 "(T)he adoption of new rules that remain unenforced is worse than futile All that is accomplished is increased disenchantment of the public Thus the securities industry has a strong stake in a comprehensive and well functioning system of regulation...and enforcement."

To sum up, SEBI's 1996 Mutual Fund Regulations have significantly improved the regulatory environment for mutual funds and their unitholders They set the right tone and direction. Although there is more to be done, much can be accomplished by the industry through a pro-active stance in coping with industry problems SEBI has lent its encouragement to an expansion of the role of industry through the Association of Mutual Funds in India ("AMFI") the industry trade association. This development in itself must be viewed as highly positive.

AMFI is now in a position to improve the regulatory environment in which it operates by adopting and implementing Codes setting higher standards and filling gaps where greater clarity and uniformity are needed These could include formulating uniform accounting and valuation methods, and policies for segregating assets; adopting an AMFI Code of Ethics and a Model Compliance Manual, drafting an AMFI Model Advertising Code to ensure uniform definitions of key concepts and providing standards for performance measurement With SEBI's continued surveillance and enforcement behind them, AMFI standards could make a meaningful contribution to the quality of mutual fund regulation

APPENDIX VI ACTION MEMORANDUM

ACTION MEMORANDUM

TO : Mr G A Shenai
Chairman, Association of Mutual Funds in India ("AMFI")

FROM :Lewis J Mendelson
Mutual Fund Consultant, Price Waterhouse FIRE Project

RE :Implementation of David Silver's Recommendations
For Strengthening AMFI

RECOMMENDATION: That AMFI take immediate steps to

- hire a professional staff
- adopt a work plan, organizational chart and budget
- set goals, priorities and dates
- assign Committees and independent contractors to begin working on achieving the programme recommended by Mr. Silver

I. INTRODUCTION

The month of January may prove to be an extremely fortunate one for AMFI Mr Silver's appearance at the UTI-AMFI sponsored Third Annual Mutual Fund Seminar, the AMFI General Membership Meeting and the series of round table discussions with mutual fund and securities industry leaders were very well received His recommendations gave us all a lot to think about and act upon.

My forthcoming USAID Report will discuss in greater detail Mr Silver's assessment of the mutual fund industry and his recommendations for improving its products, services and regulation However, it will not be distributed for a few weeks To continue to ride the enthusiasm and momentum created by Mr Silver, this Memorandum attempts to summarize his recommendations for strengthening AMFI You may wish to use it as a Checklist and to help you and the AMFI Board of Directors take the decisions which will enable AMFI to develop the operations, structure, capacity and policies to become a strong, continuous, effective and respected voice for the fund industry

II. Mr. Silver's Recommendations for Strengthening AMFI

In his remarks before the AMFI General Membership Meeting and his Keynote Address before the AMFI - UTI Seminar, Mr Silver suggested that AMFI

1. **Build a Professional Staff.** AMFI should immediately start the rapid build-up of a high quality professional staff with the capacity to play an appropriate role in helping create and facilitate the growth of the fund industry which lies ahead It will need to develop expertise in four areas Regulation, Media Relations, Economic and Statistical Research and Operations

2. **Influence the Regulatory Environment.** The industry should take a proactive stance in the regulatory process and in coping with industry problems not just on an *ad hoc* or individual fund basis, but through AMFI, its industry association AMFI should become a continuing point of contact between the regulator and the industry AMFI's Office of General Counsel must have the ability to consult closely with policy-making bodies regarding pending legislation and with SEBI to assure that it gets the benefit of the industry viewpoint and that the industry understands SEBI's views Nothing will be more important than this ability to influence the regulatory environment

3. **Promote High Professional Standards.** AMFI should also independently address questions which would otherwise be the subject of government action Examples of effective actions from the U S experience include development of a uniform yield formula for fund advertising and promotional literature, a model Code of Ethics, and Code dealing specifically with Insider Trading by fund personnel

4 **Provide Guidelines and Training.** AMFI might also wish to

- recommend guidelines such as compliance and procedures manuals and
- provide training seminars dealing with.
  - compliance matters,
  - trustees' and directors' responsibilities, and
  - orientation of new AMC and fund employees, and
- develop procedures for the rapid and efficient settlement of mutual fund transactions and to create uniformity

It could also provide workshops, manuals and interactive videos at cost to the industry

5 **Take the Lead in Investor Education.** AMFI should continue to play a major role in investor education by providing press releases, media contacts and educational brochures, meeting public requests for information and members' needs for shipments in bulk of brochures on which they can imprint their names Such a programme can be a continuing significant source of free publicity for the industry As a sustaining part of its Investor Awareness Campaign, AMFI might wish to follow the example of the ICI which ten years ago created a special annual prize awarded by impartial experts to those reporters who have done the best job in writing financial stories of special interest to individuals and families about personal financial planning

6 **Build a Data Base and Create a Research Department.** The information that a Research Department accumulates and the studies it performs should be readily available to the industry The Department should be able to

- monitor the flow of funds in and out of the industry and observe which kinds of funds are selling and being redeemed
- classify funds by objective, load vs no-load, close-end or open, types of sales forces, among others
- compile and maintain a comprehensive historical data base which may be derived from members' monthly reports to AMFI
- cover the entire industry and serve as the source of AMFI's own research
- be able to perform marketing studies or surveys directly for members, including furnishing the names of shareholders for personal interviews, and
- continuously track demographic trends, such as aging population vs. young people to guide promotional efforts by tracking changes in the composition of the industry and of fund unit holders.

7. **Create an Operations Department.** An Operations Department can assist the industry and its transfer agents in introducing uniformity which is good for all investors and broker-dealers by investigating computer developments on a common basis. This kind of information is useful on a technical level for the industry

III. AMFI'S NEXT STEPS

Following the series of round table discussions hosted by PW on January 22, it was suggested that AMFI set up additional Committees to engage more members in its activities and enlist stronger support for the organization Below are listed eleven steps distilled from the suggestions of industry leaders and Mr Silver over the course of his visit They are organized and prioritized as suggested by Mr Silver and taking into account the concerns expressed by AMFI's leadership

1 Set up administrative functions Take immediate steps to

- hire a professional staff
- adopt a work plan, organizational chart and budget
- set goals priorities and dates
- assign Committees and independent contractors to begin working on achieving the programme recommended by Mr Silver

2 Formulate uniform

- accounting and valuation methods, and

- policies for segregation of assets

3 Complete AMFI Investor Education Brochures

- Investor's Guide
- Agent's Handbook and
- Understanding Fund Performance
- AMFI Membership Directory

Submit to Focus Groups, revise and publish

4 Train Fund Sellers (as Trainers) and conduct Investor Conferences

5 Complete, circulate and adopt AMFI's Code of Conduct. AMFI's Model Compliance and Operations Manual, and train trustees and AMC's officers, directors and employees

6. Set up groups to provide continuing liaison with regulators, policy makers and legislators and to promote legislative and regulatory changes which will enable the industry to

- develop new products such as Money Market Schemes, Municipal Bond Schemes, Index Schemes, Personal Equity Plans ("PEPS), Pension and other retirement benefit plans; and to permit funds to use hedging techniques and derivative securities] and
- suggest reforms to clarify and improve existing regulations

7 Draft a Model Advertising Code to ensure uniform definitions of yield, total return and indicative returns and provide standards for performance measurement, including benchmarks and periods of measurement.

8 Undertake a market research study to evaluate the impact on the industry of marketing strategies featuring guaranteed redemption prices and assured or indicative returns and recommend actions to improve the industry's credibility with respect to such practices

9 Assign an outside agency to compile and maintain a data base of industry statistics and to conduct ongoing performance evaluations and marketing surveys and assist in producing "AMFacts" an Annual AMFI Factual Reference Book on the Fund Industry for members and the press

10 Designate a Media Relations Officer and Institute Annual Awards for best

- investment performance in various categories
- disclosures and
- published articles and/or telecasts on personal and family finance

11 Compare the characteristics that distinguish UTI's structure, operations and regulation from those of AMFI's other members Outline the steps necessary to bring UTI under the full regulation of SEBI and provide its unitholders the same protections as those who invest in funds which are fully regulated by SEBI

IV. POSSIBLE AMFI COMMITTEES AND THEIR FUNCTIONS

Based upon subsequent discussions with your leadership, we have attempted to group the above steps and to suggest possible Committees through which to organize their activities consistent with AMFI's Comprehensive Plan and the ICI Model

1. AMFI Administration Committee. This Committee will hire a professional staff; adopt a work plan, organizational chart and budget; set goals, priorities and dates, and assign Committees and independent contractors to begin working on achieving the programme recommended by Mr Silver

2. Legislative and Regulatory (Government Relations) Committee. This Committee or several subcommittees within it could identify legislative goals and working with SEBI; the Ministry of Finance; the Reserve Bank of India; and other concerned Government Departments increase the industry's impact on legislative and regulatory matters that affect its vital interests and those of its unit holders, including:

(A) product development: preparing legislative strategies and regulatory changes for broadening the range of products and investment techniques offered by the fund industry to possibly include, among others

- money market schemes,
- municipal bond schemes;
- index schemes,
- tax benefitted retirement schemes, and
- allowing funds to use hedging techniques and derivative securities to minimize risk and/or seek possible enhanced returns;

(B) continuing regulatory liaison clarifying and improving regulations through Interpretive Letters and review of proposed and exiting regulations whether enunciated in the Mutual Fund Regulations, the Companies Act, the Indian Income Tax Act, the Indian Trust Act, or wherever, and

(C) restructuring and integration of UTI

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3. Research and Operations Committee: This Committee or several subcommittees within it could

(A) prepare an AMFI Model Advertising Code which would define uniform performance standards for advertising yield, total return, indicative returns, etc and provide uniform standards for measuring performance, including benchmarks, periods and consistency over time It would continuously monitor the advertisements of its members and those for competing products and recommend changes in the AMFI Code as necessary

(B) analyze and evaluate the history and impact on the industry of marketing strategies featuring "guaranteed" redemption schemes and "assured" and/or "indicative" returns; suggest reserve requirements for guarantors of such schemes; and recommend alternative marketing strategies and means of safeguarding the interests of investors and the credibility of the industry in the face of their continuing exposure to the possible failures of such funds to meet their stated goals

(C) maintain, initially with an outside source, the industry database, including statistics on performance and investor demographics, and conduct continuous performance studies

(D) immediately develop uniform methods of accounting, valuation and policies for segregation of assets, as well as determining appropriate reserve requirements for any entities which guarantee fund redemption prices or returns

(E) develop accounting standards for Mutual Funds over the longer term in coordination with the Institute of Chartered Accountants of India and SEBI

(F) assist the industry and its transfer agents in introducing uniformity by investigating computer developments on a common basis.

4. Professional Standards Committee. This Committee or several subcommittees within it could

(A) complete and implement the AMFI Code of Conduct and create other compliance mechanisms, such as an AMFI Model Compliance and Operations Manual and internal reporting forms, reports and schedules to help trustees, funds, AMC's and their employees understand and meet their responsibilities, including helping to define the role of Compliance Officer

(B) be responsible for structuring and planning initial training of fund trustees, directors, compliance officers and other employees of AMC's, including explaining SEBI's new regulations and the AMFI Code of Conduct and helping the funds to adapt to them.

(C) be responsible for setting standards for sellers of mutual fund schemes which would be observed by members in dealing with those who market their schemes

(D) establish "best practice" standards for various aspects of fund operations including swift and accurate processing of unit holder transactions, back office procedures, required disclosures and advertisements

5. Information Services Committee. This Committee or several subcommittees within it could play a major role in investor education by providing press releases, media contacts and educational brochures, meeting public requests for information For example by

(A) preparing and updating educational brochures such as the Investors' Guide , Agent's Handbook, Mutual Fund Performance Analysis and AMFI Directory

(B) structuring and planning training of fund sellers and conducting Investor Conferences

(C) maintaining media contacts, preparing press releases, public relations and collecting news abstracts

(D) creating a special annual prize to be awarded by impartial experts to those reporters or TV journalists who have done the best job in publishing or presenting financial stories of special interest to individuals and families about personal financial planning

* * * * *

I would be pleased to answer any questions you, the AMFI Board or any members might have or to explain or discuss further any of the suggested steps or possible AMFI Committees