ICAI - WIRC

Recent Regulatory Changes in SEBI Regulations for Mutual Funds and Portfolio Managers

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SEBI (Mutual Fund) Regulations
(Post 2014)

MF Regulations – Investment

Changes in investment limits vide SEBI circular No. SEBI/HO/IMD/DF2/CIR/P/2016/35 dated February 15, 2016

- Restrictions on investments in debt instruments issued by a single issuer reduced to 10% of NAV from earlier limit of 15%. This limit can be extended only upto 12% of NAV with the prior approval of the trustees and Board of AMC instead of earlier limit of 20%.
- Investment in single industry sector not to exceed 25% of AUM of Debt Scheme instead of earlier limit of 30%. Additional exposure of only 5% is allowed for housing finance companies instead of earlier limit of 10%. This has been again re-instated to 10% vide SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/68 dated August 10, 2016. Additional exposure to such securities issued by HFCs only if these are rated AA and above and these HFCs are registered with National Housing Bank (NHB). However the total investment/ exposure in HFCs shall not exceed 25% of the net assets of the scheme.

MF Regulations – Investment…

- Circular also introduced group exposure i.e. total exposure of debt schemes in a group (excluding investments in securities issued by Public Sector Units, Public Financial Institutions and Public Sector Banks) shall not exceed 20% of the net assets of the scheme. Such investment limit may be extended to 25% of the net assets of the scheme with the prior approval of the Board of Trustees. Group means a group as defined under regulation 2 (mm) of SEBI (Mutual Funds) Regulations, 1996 (Regulations) and shall include an entity, its subsidiaries, fellow subsidiaries, its holding company and its associates. Regulation 2(mm) states that Group means group defined in MRTP Act.
- Revised circular is applicable to new schemes and new investments w.e.f. 15-02-2016 while existing schemes to comply with the same within a period of 1 year.
- Compliance with this Circular need to be monitored by trustees and confirm the same to SEBI in half-yearly report from trustees to SEBI.

MF Regulations – Investments…

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- SEBI Circular No. SEBI/IMD/CIR No 18 / 198647 /2010 dated March 15, 2010 allowed investment of NFO proceeds only after closure of NFO. Now, the new circular allows MFs to invest NFO proceeds in CBLO before closure of NFO. However, AMCs shall not charge management fees on funds deployed in CBLOs during the NFO period. The appreciation received from investment in CBLO shall be passed on to investors. If minimum subscription amount is not garnered by the scheme, the interest earned on CBLO shall be returned to investors along with refund of subscription amount.
- This provision is applicable since April 01, 2016

MF Regulations – MCR

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- MCR submission date has been revised as 3rd working day instead of 3rd calendar day.
- This provision is applicable since April 01, 2016

MF Regulations – Net worth

SEBI (Mutual Funds) (Amendment) Regulations, 2014

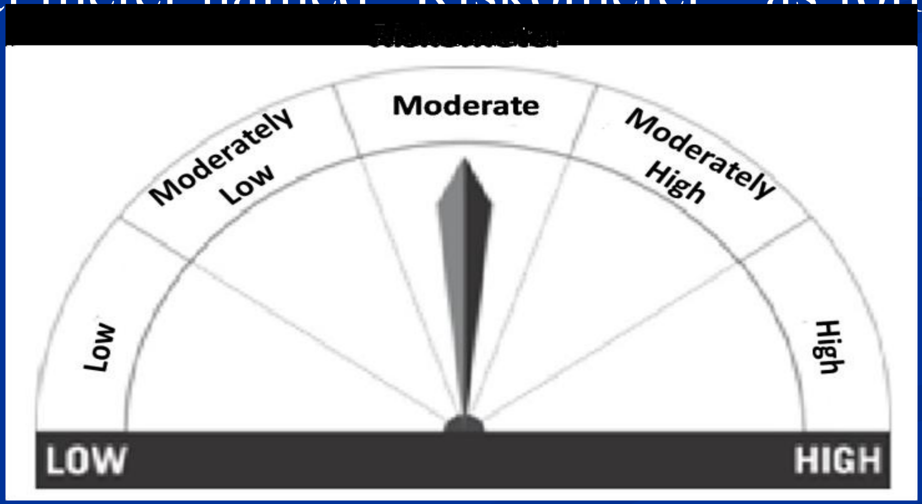
- Increase in net worth of AMC from 10 Crs. to 50 Crs. Existing AMCs have been given time period of 3 years to comply with the said Regulation i.e. May 2017. (Cost Inflation Index 281 (1996), 447(2003), 1125 (2016) makes value of 10 Cr. to 40 Cr.)
- Compulsory investment by sponsor or AMC in each scheme (other than close-ended schemes) 1% of amount raised in NFO or Rs. 50 lakhs whichever is less. Investment to be made in growth option and no redemption is possible till the scheme is wound up. In case of existing schemes investment is to be made within 1 year from the date of notification i.e. before May 2015

MF Regulations – Investor Protection

- To provide investors an easy understanding of the kind of product/scheme they are investing in and its suitability to them, product labeling to be carried out and disclosed on front page of application forms, KIM, SID and all advertisements as follows:
  - Blue – principal at low risk.
  - Yellow – principal at medium risk.
  - Brown – principal at high risk.
- MFs to mandatorily print all literature related to Investor Education and awareness in regional languages. These campaigns to be conducted in regional languages in print as well as in electronic media.

MF Regulations – Investor Protection…

- Changes in product labeling norms. Level of risks of mutual fund schemes increased from 3 to 5. Earlier risk levels were described as Low, Medium and High. Now the same needs to be described as Low, Moderately Low, Moderate, Moderately High and High.
- Depiction of risk using colour codes would be replaced by pictorial meter named "Riskometer", as follows:



MF Regulations – Investor Protection…

- Detailed guidelines for product labelling have been specified by AMFI in the best practice guidelines issued on May 18, 2015.
- AMFI circular has specified the risk parameter of the scheme on the basis of assets in which the scheme would invest. E.g. Sectoral Funds to be classified as High, Equity Arbitrage Funds with marginal net equity exposure upto 20% to be classified as Moderate etc.
- This has reduced the ambiguity in classification of schemes and have brought standardisation in the method of classification across mutual funds.

MF Regulations – Risk Management

Stress Testing of Liquid Fund and Money Market Mutual Fund Schemes

- As a part of the extant risk management framework, AMCs need to have stress testing policy which mandates them to conduct stress test on all Liquid Fund and MMMF Schemes
- The stress test should be carried out internally at least on a monthly basis, and if the market conditions require so, AMC should conduct more frequent stress test.
- The concerned schemes shall be tested on the following risk parameters, among others deemed necessary by the AMC:

    i. Interest rate risk

    ii. Credit risk

    iii. Liquidity & Redemption risk

MF Regulations – Risk Management…

- To review impact of various risks parameters on NAV. The parameters used and methodology adopted for conducting stress test needs to be detailed in the policy.
- Stress testing policy needs to be reviewed by trustees on yearly basis to cover:

  i. Adequacy of the documentation for various elements of the stress testing framework

  ii. Scope of coverage and the levels of stress applied

  iii. Integration of the stress testing framework in the day-to-day risk management processes

  iv. Adequacy of the corrective actions and the efficacy of the systems for their activation

MF Regulations – Risk Management…

- In the event of stress test revealing any vulnerability or early warning signal, it should be brought to the notice of the trustees and take corrective action.

- Documented guidelines need to be in place to deal with adverse situation effectively.

- Compliance with this circular needs to be reported in half yearly report from trustees to SEBI.

MF Regulations – Risk Management…

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- In order to ensure that MFs/AMCs are able to carry out their own credit assessment of assets and reduce reliance on credit rating agencies, all MFs/AMCs are required to have an appropriate policy and system in place to conduct an in-house credit risk assessment/due diligence before investing in fixed income products.

- This provision is applicable since May 01, 2016

MF Regulations – Restrictions on redemptions

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/57 dated May 31, 2016

- SEBI Circular No. SEBI/IMD/CIR No.5/126096/08 dated May 23, 2008 allowed mutual funds to restrict redemptions on approval from BOD of AMC and trustees. But this circular did not lay down circumstances under which this restriction can be applied. The new circular has laid down these circumstances and requirements for laying down the restrictions on redemptions as follows:
- Restriction can be imposed in circumstances leading to systemic crisis or event that severely constricts market liquidity or the efficient functioning of markets such as
  - Liquidity issues: if market at large is illiquid affecting almost all securities. This is not a substitute for efficient management of liquidity. Importantly this restriction shall not be imposed due to illiquidity in specific security as it turns bad.

MF Regulations – Restrictions on redemptions…

- **Market failures, exchange closures:** When due to political, economical, military, monetary or other emergencies, markets are affected which impact functioning of exchanges
- **Operational issues:** When exceptional circumstances are caused by force majeure, unpredictable operational problems and technical failures then redemptions can be restricted. Such cases can only be considered if they are reasonably unpredictable and occur in spite of appropriate diligence of third parties, adequate and effective disaster recovery procedures and systems

- Restriction can be imposed for a specified period not exceeding 10 working days in any 90 days period. (rolling period)
- Any imposing of restriction can be with specific approval from Board of AMC and trustees.
- This provision is applicable since July 01, 2016

MF Regulations – Restrictions on redemptions…

- Procedure to be adopted while imposing restrictions:
  - No redemption requests upto INR 2 lakh shall be subject to such restriction.
  - If redemption request is more than Rs. 2 lakhs, redemption upto Rs. 2 lakhs should be processed and the excess amount will be subject to restriction.
- The above mentioned information should be disclosed to investors in SID/KIM.
- This provision is applicable since July 01, 2016.

MF Regulations – Investor Servicing

Investment of funds related to unclaimed redemption and dividends

- Earlier investment of these funds was allowed only in call money and money market securities (though there existed an industry practice to investment these funds in the Liquid scheme of he mutual fund.) SEBI vide circular No. SEBI/HO/IMD/DF2/CIR/P/2016/37 dated February 25, 2016 allowed investment in liquid scheme subject to following conditions:
  - Separate plan to be floated under existing scheme wherein these funds are to be invested.
  - No exit load to be charged in this plan and
  - TER of this plan can be only 50 bps

MF Regulations – Investor Servicing…

Steps to be taken by Mutual funds to trace rightful owners of unclaimed amounts:

- Provide list of names and addresses of investors on mutual fund website
- AMFI should also provide list on investors, across MFs, on their website
- This information can be viewed by investors only on providing his proper credentials
- Website should also provide information on processing of unclaimed amounts payment and necessary forms and documents required
- Information on unclaimed amount along-with its prevailing value shall be separately disclosed to investors through the periodic statement of accounts/Consolidated Account Statement sent to the investors.

MF Regulations – Distribution of units

- SEBI vide circular dated September 13, 2012 has allowed a new cadre of distributors, such as postal agents, retired government and semi-government officials (class III and above or equivalent) with a service of at least 10 years, retired teachers with a service of at least 10 years, retired bank officers with a service of at least 10 years, and other similar persons (such as Bank correspondents) as may be notified by AMFI/AMC from time to time, shall be allowed to sell units of simple and performing mutual fund schemes. Simple and performing mutual fund schemes comprised of diversified equity schemes, fixed maturity plans (FMPs) and index schemes having performance better than benchmark returns during last 3 years. Vide this new circular, SEBI allowed distribution of liquid and money market scheme and retirement schemes having tax benefits to be sold by these cadre of investors.

MF Regulations – Disclosures to Investors

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- This circular has amended the format of Consolidated Account statement (CAS) issued to investors on monthly and half-yearly basis.
  - Monthly CAS should contain total purchase value/cost of investment in addition to cost of investment of each transaction.
  - CAS to be sent on half-yearly basis as well and the same should include commission paid by AMC/MF to distributors during the half-year for the investments of that investor. Commission should include all monetary and non-monetary payments and the scheme's average TER for the half-year.
  - This circular is applicable from 1st October 2016.

MF Regulations – Disclosure to Investors…

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- Additional disclosures in KIM and SID:
  - The tenure for which the Fund Manager has been managing the scheme shall be disclosed, along with the name of scheme's fund manager(s)
  - Scheme's portfolio holdings (top 10 holdings by issuer and fund allocation towards various sectors), along with a website link to obtain scheme's latest monthly portfolio holding
  - In case of FoF schemes, expense ratio of underlying scheme(s)
  - Scheme's portfolio turnover ratio

MF Regulations – Disclosure to Investors…

- Additional disclosures in SID:

  a. The aggregate investment in the scheme under the following categories:

  i. AMC's Board of Directors

  ii. Concerned scheme's Fund Manager(s) and

  iii. Other key managerial personnel

  b. Illustration of impact of expense ratio on scheme's returns (by providing simple example).

- Separate SID/KIM for each MF scheme managed by AMC shall also be made available on MFs/AMCs website.
- Soft copy of SIDs along with printed final copy to be submitted to SEBI 7 working days prior to launch of the scheme instead of earlier provision of two working days in terms of SEBI circular No. SEBI/HO/IMD/DF2/CIR/P/2016/68 dated August 10, 2016

MF Regulations – Disclosure of Investors…

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- MF is required to have a dashboard on their website providing performance and key disclosures pertaining to each scheme managed by AMC. The information should inter alia include scheme’s AUM, investment objective, expense ratios, portfolio details, scheme’s past performance. Such information shall be provided in a comparable, downloadable (spreadsheet) and machine readable format
- This provision is applicable since May 01, 2016

MF Regulations – Additional Disclosures

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- With the underlying objective to promote transparency in remuneration policies so that executive remuneration is aligned with the interest of investors, MFs /AMCs shall make the following disclosures pertaining to a financial year on the MF/AMC website under a separate head – 'Remuneration'
  1. Name, designation and remuneration of Chief Executive Officer (CEO), Chief Investment Officer (CIO) and Chief Operations Officer (COO) or their corresponding equivalent by whatever name called.
  2. Name, designation and remuneration received by all employees of MF/AMC whose:
     a. Annual remuneration was equal to or above INR 60 lakh for that year.
     b. Monthly remuneration in the aggregate is not less than INR 5 lakh per month, if the employee is employed for a part of the

MF Regulations – Additional Disclosures

3. The ratio of CEO's remuneration to median remuneration of MF/AMC employees.
4. MF's total AAUM, debt AAUM and equity AAUM and rate of growth over last three years.

The AMCs/MFs shall disclose this information within one month from the end of the respective financial year (effective from FY 2015-16).

- This provision is applicable since April 01, 2016

MF Regulations – Additional Disclosures

SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

- In case there is an agreement with the broker by which broker provides free research, hardware, software or even non-research-related services along with deal execution, such arrangements between AMCs and brokers should be limited to only benefits that are in the interest of investors and the same should be suitably disclosed .
- This provision is applicable since April 01, 2016

SEBI (Portfolio Managers) Regulations (Post January 2012)

SEBI PMS Regulations

- In 2012, minimum investment amount was increased from Rs. 5 lakh to Rs. 25 lakh
  - All new PMS clients should bring minimum 25 lakh as corpus
  - Existing small investors can continue
  - This investment requirement needs to be met even on partial withdrawal.
- All listed as well as unlisted securities were required to be segregated and kept in separate client Account. Exception was made to investment in liquid schemes of mutual funds.

Common directives issued to by SEBI to all SEBI Registered Intermediaries

Prevention of Money Laundering Act, PMLA and FATCA

SEBI circular No CIR/MIRSD/1/2014 dated March 12, 2014

- To designate a person as 'Designated Director' in addition to Principal Officer to comply with AML/CFT requirements.
- For record keeping requirement, the period is changed to 5 years from 10 years.
- Implementation of Foreign Accounts Tax Compliance Act (FATCA) due to agreement between US and Indian government India is now treated as having an IGA (Inter-governmental agreement) in effect from April 11, 2014. Indian Financial institutions have to register with US authorities and obtain Global Intermediary Identification No. (GIIN) by December 31, 2014.

SEBI KRA Regulations, 2011

- Vide circular no. LAD-NRO/GN/2013-14/46/522 dated March 13, 2014, intermediaries need to verify and download client details from KRA system and not to take fresh KYC.
- Circular No. LAD-NRO/GN/2014-15/05/23483 dated August 11, 2014 states that entities regulated by other regulators in the financial sectors, which are specified by SEBI from time to time, may access KRA to check KYC of their clients

Information regarding investor grievance redressal mechanism

SEBI Circular CIR/MIRSD/3/2014 dated August 28, 2014

- Applicable to all SEBI registered intermediaries
- Requirement to display basic information regarding grievance redressal mechanism available to investors.
- The information needs to be displayed at all offices of the intermediaries.
- Format of disclosure:
  - Annexure A of the circular : Stock Brokers (including registered sub brokers and Authorised Persons), Depository Participants
  - Annexure B of the circular: for other intermediaries

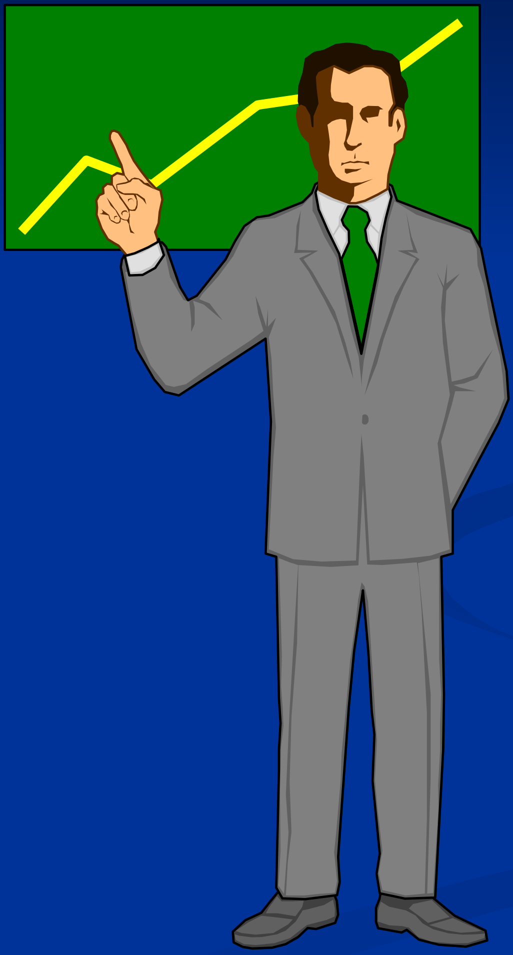
Information regarding investor redressal mechanism

- **Details to be disclosed:**
  - Name, email ID and contact numbers of the Compliance Officer
  - Name, email ID and contact numbers of the CEO/Partner/Proprietor
  - The website URLs, Contact numbers and email IDs of the relevant exchanges, in case the investor wishes to escalate the grievance
  - State that investor may also lodge their grievances with SEBI at http://scores.gov.in. Toll free helpline number of SEBI office to be mentioned

KYC norms applicable to all intermediaries

- Verification of PAN can be done through income tax website instead of insisting for original PAN card provided the client has also presented a proof of identity other than PAN card.
- SEBI has mandated all registered intermediaries to obtain sufficient information from their clients in order to identify and verify the identity of persons who beneficially own or control the securities account.
- The requirement for sending **original** KYC documents of the clients to the KRA has been removed.
- Format of KYC form modified to avoid duplication of information sought from the client.

Open House



Thank you!