

Structure of mutual funds in India:

Over the last couple of months we have been looking at various aspects mutual funds, whether it is about their portfolio or performance or how to compare them. We however did not discuss some fundamentals – on how a mutual fund house is structured. Here it comes, a bit late but hopefully useful for you to understand the product better. Mutual funds in India are regulated by the Securities and Exchange Board of India (SEBI). Since running of a mutual fund involves managing of investors' money, SEBI prescribes comprehensive set of guidelines in the functioning of a mutual fund through the "SEBI MF regulations 1996". These regulations stipulate that a mutual fund must be a three-tiered structure consisting of:

- i. A Sponsor
- ii. A Trustee
- iii. An asset management company (AMC)

While the above mentioned play the most important roles in creating and running a fund house, the custodian, registrar and transfer agent (RTA), auditors and the fund accountants play a vital supporting role in aiding the smooth functioning of a mutual fund.

Fund Sponsor – The Sponsor is the main body that establishes the Mutual fund. The Sponsor can be compared to a promoter of a company. The responsibility of the sponsor includes appointing the trustees with the approval of SEBI and setting up an AMC under the Companies act 1956 while getting the trust registered with SEBI. Since the Sponsors play the most important role in the functioning of a mutual fund, SEBI has a set of strict guidelines for the eligibility of a sponsor. Some of them are as follows: the sponsor should have a sound track record of carrying out business in the financial services space for not less than five years. A Sponsor also needs to have made profits in at least three of the five years including the latest year. During the same period, it is also important that the sponsor has had a positive net worth. It should be contributing a minimum of 40 per cent net worth of the AMC. It is also important that the sponsor has a good track record of fairness and integrity in all its transactions. For example ICICI Bank and Purdential Plc are sponsors for ICICI Mutual Fund. For Birla Sun Life Mutual Fund, Aditya Birla Financial Services and Sun Life (India) AMC Investments Inc. are sponsors.

Trustee – The main role of a trustee is to ensure that the interest of the unit holders is protected while making sure that the mutual fund complies with all the regulations of SEBI. Either, the sponsor should appoint four trustees or establish a trustee company with at least four independent directors. Additionally, at least two thirds of the trustees or the directors should be independent not associated with the sponsor in any way.

Some of the key responsibilities of the trustees include, entering into an investment management agreement with the AMC to define its functioning. They are also responsible for ensuring that the AMC has all the required process, procedures and systems in place while making sure that all the key personnel such as the CEO, CIO,

the fund managers and the analysts are appointed after through due diligence. All the schemes launched by the AMC have to be approved by the trustees prior to launch. The trustees will be reviewing all the transactions of the AMC on a quarterly basis while filing reports to SEBI on a half yearly basis.

Asset Management Company (AMC) – The AMC is the investment manager of the trust. It takes care of the day today operation of the mutual fund and managing the investors money as well. The AMC is appointed either by the trustee or the Sponsor after obtaining the approval of SEBI. The AMC consists of the Chief Investment Officer, the fund managers and analysts, who are together responsible for managing the various schemes launched. The compliance officer ensures compliance of all the activities of the AMC in line with SEBI's rules and regulations. For example; HDFC AMC is the Asset Management Company for HDFC Mutual Fund.

Custodian – The custodian has the custody of the all the shares and various other securities bought by the AMC. The custodian is responsible for the safe keeping of all the securities. The custodian is liable for keeping the investment account of the mutual fund.

Registrar and Transfer Agent (RTA) – The RTA maintains and updates all the investors records. The main function is investor servicing through its office and various other branches. Its functions includes processing of investor application, purchase and redemption transactions by investors in various schemes and plans.

The auditors are responsible for auditing of the AMC's accounts while ensuring that the accounts of schemes are maintained independently from that of AMC. The fund accountants are responsible for calculating the NAV of the schemes based on the information regarding the assets and liabilities of each scheme.

Thus we can note that the mutual funds in India are a well regulated entity with clearly defined structure comprising of several components whose roles and responsibilities are properly defined under the preview of SEBI.

The benefit of such a structure, especially the trust form, ensures that nobody, other than the sponsor or the AMC can mishandle your money. In the event of a fund house closing down, your money is safely returned to you. In many other cases, where a fund house does not want to run the business, it sells out to another AMC and investors are given a choice to exit or to stay with the new AMC. Thus, while your money does undergo market risks, there is no risk of losing money to the AMCs.