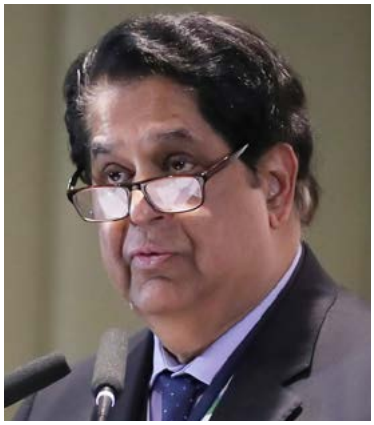
ARIA
Association of
Registered Investment Advisers

SPOTLIGHT ON
Mutual Funds

Foreword



Mr. K V Kamath
Former-President
New Development Bank

The Covid-19 pandemic has brought us face to face with mortality. Many of us have suffered the loss of loved ones which is truly saddening and stressful for spouses and families. At such times, engaging with and completing the formalities for transmission of assets to the rightful heirs translates into an unbearable experience.

The transmission process is neither centralised nor uniform, nor does it have defined turnaround times. As a result, the bereaved family has to deal separately with individual institutions, each with their own set of forms, processes and procedures. If nominations have been made by the deceased person, then the nominees can get control of the assets in a reasonable time frame. But in all cases such transmission needs to be validated through an overburdened court or legal process.

Some of the constraints and authentication requirements laid down in the nominations process may indeed have been required at a time when technology was not developed and KYC and other processes where not present. But today, India is at the leading edge of technology with the India Stack allowing everyone from governments to commercial enterprises to seamlessly provide benefits and services to the billion plus Indian population. The recent launch of the account aggregator framework also signals that a new era of interconnectedness and interoperability among financial institutions is here.

There is no reason why the same technology stack and these emerging platforms cannot be used to reduce the friction points and streamline nominations and transmission of assets on the death of a person.

All that this needs is a short and coordinated effort of say six months, from all the parties involved, and if required, facilitated by the Regulators who could consider modifying the regulations to enable the institutions to use these new approaches. Where necessary, in just a few areas, the government might need to modify the governing law to give primacy to the wishes of the deceased as expressed in her nominations.

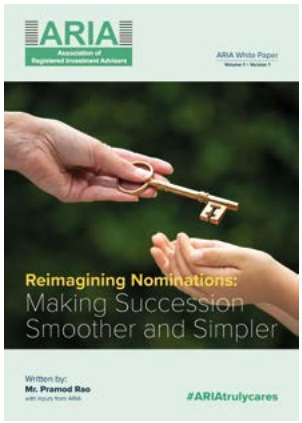
Pramod[1] had written a brilliant paper analysing nominations and joint ownership of financial assets and spelt out the need to make the whole succession process smoother and simpler. When Harsh[2] approached me for support for the #ARIATrulycares initiative, I requested him to work with Pramod to collaborate in this effort. Pramod has since written the white paper with inputs from ARIA and has also helped draw up spotlight papers on bank accounts, safe deposit lockers, dematerialised securities and mutual fund units. Specific recommendations on other assets such as NPS, provident funds, small saving schemes and immovable property are likely to be added soon.

A smoother and simpler succession process will provide quick transmission of assets. It will also relieve the courts of the unnecessary burden of uncontested and undisputed succession matters. Financial institutions will also get discharge from their liability and this will go a long way in mitigating the pain and sorrow of the family and heirs.

I hope and trust that financial institutions and supervisory bodies would consider the suggestions outlined in the White Paper on the nomination facilities and do a quick reset of the process.

1 Pramod Rao is the Group General Counsel of ICICI Bank and a leading thinker on legal and governance matters

2 Harsh Roongta runs an investment advisory firm and is the Vice chair of Association of Registered Investment Advisers (ARIA) – a section 8 not for profit company



Executive Summary of the White Paper

Reimagining Nominations:
Making Succession Smoother and Simpler

For multiple reasons as outlined in the paper, the process of claims by successors of deceased financial consumers remains difficult to navigate, especially at a time when the family and those surviving the individual are coping with the loss of a loved one and still grieving.

Nomination facilities have provided a level of succour to the successors. However, these reflect an outdated point-of-view that was more relevant when the facilities were instituted and require a fresh review and update as per the needs of the financial consumers and citizenry. Both the level of unclaimed funds or the tedious and time-consuming legal process and the current situation brought on by Covid-19 signal that a deeper review and recast is all too necessary.

The white paper proposes the expectations for updated, revised and revamped nomination facilities in terms of three policy objectives:

- Convenience to financial consumers and to their successors
- Due discharge for financial services providers upon providing access to and an ability to transact in the financial assets or transmission of the financial assets to the successors
- Eliminating or reducing references to an overburdened judiciary, where litigants face considerable costs and delays

The white paper reimagines the nomination facilities keeping the three policy objectives paramount and also uses the lens of providing ease and convenience harnessing the technological advancements and frameworks which are available today.

The paper outlines 15 measures for financial services providers, financial sector regulators and lawmakers to consider in respect of nomination facilities, more succinctly captured in the Annexure.

Spotlight Papers in Volume 1:

1. Current Accounts, Savings Accounts and Fixed Deposits with Banks and Safe Deposit Lockers
2. Securities Held in Demat Accounts
3. Mutual Funds
4. Physical shares and securities issued by entities governed by the Companies Act, 2013 (and earlier versions of the Companies Act)
5. Employees' provident fund, Employees' Deposit Linked Insurance and Employees' Pension Scheme

   Provident funds governed by Employee Provident Funds Act, 1925

   Public Provident Funds

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SPOTLIGHT ON
Mutual Funds

Investments in mutual fund schemes have grown by leaps and bounds, and particularly post demonetisation. The current corpus under management of mutual funds is at ₹31.4 trillion as on March 31, 2021.

Nomination is possible for mutual fund holdings. Nomination made by a mutual fund investor is applicable for units held in all the schemes under the respective folio / account and gets rescinded on redemption of such units or its transfer.

There is flexibility to specify up to three nominees, and in case of multiple nominees, the mutual fund investor can specify the percentage of share of each nominee with such allocation / share being required to be in whole numbers without any decimal. In the event percentage allocation is not specified, the presumption of equal division among the nominees applies.

Individuals who are joint investors in mutual funds (irrespective of the mode of operation) are also permitted to make nominations, being required to do so jointly.

Nominations can be made only by individuals. Non-individuals including a Society, Trust, Body Corporate, Partnership Firm, Karta of Hindu undivided family, a Power of Attorney holder and / or Guardian of Minor mutual fund investor cannot nominate.

In the event of the nominee(s) predeceasing the mutual fund investor(s), the nomination is automatically cancelled.

Nominations can be in favour of individuals / natural persons, and also the Central Government, State Government, a local authority, any person designated by virtue of his / her office or a religious or charitable trust can be specified as nominees. This is an expanded set of eligible nominees (distinct from nominations permitted for bank accounts or demat accounts).

A minor can be a nominee, subject to the name and address of the guardian being provided.

Nominations can be varied or cancelled, and fresh nominations made.

Uniquely, there is a specification of consequences in case of death of a nominee. In the event of the nominee(s) predeceasing the mutual fund investor(s), the nomination is automatically cancelled. In case of multiple nominations, if any, if the nominee is deceased at the time of claim settlement, that nominee's share would be distributed equally amongst the surviving nominees. Upon successive nominations being implemented and being specified by the mutual fund investor, such successive nominations will become operative instead.

Table 3: **Mutual Fund folios/ accounts**

In the event of	Transmission in favour of	
	Nomination provided	Nomination not provided
Death of single holder	Nominee(s)	Legal heirs (as per succession certificate/ probate/ letters of administration)
Death of one of the joint holders	Surviving joint holder(s)	Surviving joint holder(s)
Death of all the joint holders	Nominee(s)	Legal heirs (as per succession certificate/ probate/ letters of administration)

Transmission of units in favour of the nominee(s) constitutes valid discharge of the asset management company, the trustee company and the mutual fund. It's important to note that while the nominee is legally entitled to receive the units, the nominee doesn't constitute the successor or inheritor of such units. The successors or legal heirs (either in terms of the will executed by the mutual fund investor, or as per the personal laws of succession governing the mutual fund investor who dies intestate) are entitled to claim their rightful share from the nominee[1].

To claim the units after the death of a unitholder, the nominee has to complete the necessary formalities, such as completion of KYC process, along with proof of death of the unit holder, signature of the nominee duly attested, furnishing of proof of guardianship in case the nominee is a minor and other such document as may be required for transmitting the units in favour of the nominee(s)[2].

One key element, which appears to be excessive or contributing to avoidable friction is requirement of attestation of nominee's signatures.

One key element, which appears to be excessive or contributing to avoidable friction is requirement of attestation of nominee's signatures. When the transmission amount is up to ₹2 lac, the attestation by a bank manager is required in a prescribed form, and when the transmission amount is more than ₹2 lacs, the attestation by a Notary Public or a Judicial Magistrate First Class (JMFC) is required. Attestation requirements also extend to various documents including bank passbook / bank statement, death certificate and so on – all of which appear excessive and could be dispensed with.

A notable quirk is transferability of mutual fund units requires that the units be dematerialised and be in a demat account[3] only after can it be transferred. This can adversely impact estate or succession planning by individuals in their own lifetimes as it limits the making of settlements or gifts (without dematerialising the units). This re-emphasises the relevance of nomination facilities being upgraded to address succession issues and overcoming such constraints. It is also important to note that when units in mutual fund schemes are held in a depository or a demat account, the nomination details provided to the depository / depository participants will be applicable to such units and govern the transmission.

1 Specification in the will that the nominee/s is / are the beneficiary/ies can obviate challenges or issues from arising; one potential challenge that should be considered is that when more than one nominee has been specified, they could transform into joint holders, and if they get along (or don't) could impact operation of the mutual fund folios / accounts, and hence segregating the folio with one nominee for each folio could be a better approach

2 See here for a very useful resource: https://bit.ly/3AMiwIM

3 Transferability of units is worthy of comment: *Regulation 37 of SEBI (Mutual Fund) Regulations, 1996 permits free transferability of mutual fund units, however since units are held in non-demat form, specified only in account statement and without issuance of unit certificates, and the specification that scheme documents can restrict or prohibit transfers, has meant that transfer of mutual fund units including by way of gifts has been significantly constrained. Equally, from the mutual fund providers, the ease and speed of redemption of units has also meant signaling that transferability may not be necessary. However, SEBI could consider measures to facilitate transferability including gifting or at least specifically gifting, so that estate and succession planning by individuals in their own lifetime can be eased. This would also place mutual fund units on par with most other financial assets which permit transferability without dematerialisation, and not only on death as and by way of transmission.*
Regulation 37 of the SEBI (Mutual Fund) Regulations, 1996 specifies the following:
(1) A unit unless otherwise restricted or prohibited under the scheme, shall be freely transferable by act of parties or by operation of law.
(1A) A unitholder, in a close ended scheme listed on a recognised stock exchange, who desires to trade in units shall hold units in dematerialised form.
(2) The asset management company shall, on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production: Provided That if the units are with the depository such units will be transferable in accordance with the provisions of the Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996

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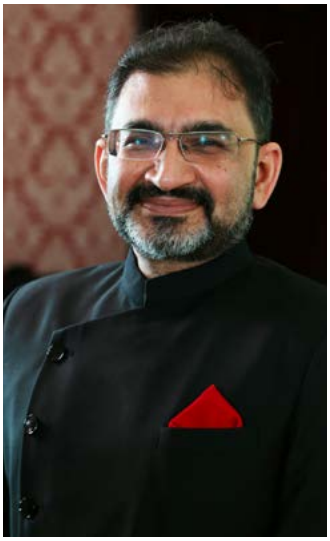
Assessment of Measures Recommended for Mutual Fund Investments

	Who can implement the recommended measures	
	SEBI/AMFI	**Parliament**
Easy, uniform and simple process to check status of nominations and to make or change nominees	☑	
Simple, common nomination form/e-form across financial assets	☑	
Ability to specify any number of nominees	☑ Currently restricted to 3	
Ability to specify percentage allocation among nominees	☑	
Ability to specify successive nominees	☑	
Ability to make single scrip/folio/security level nominations	☑	.
Mandating comprehensive e-nomination facilities, especially within the website or mobile apps of such provider that facilitate financial transactions • Option for completing or updating KYC of nominees at any time	☑ ☑	
Extending nomination facilities for addressing situations of incapacitated financial consumer	☑	
Ability to specify minors as nominees (with or without specifying an adult or guardian during the minority of the nominees) • Ability to defer the age of vesting (as regards minor nominees)	☑ ☑	
Making nominations mandatory for all financial assets (including in respect of legacy financial assets in a time bound manner)	☑ Partial - as provides a choice to not nominate	
Centralised Reporting of demise or incapacitation of a financial consumer + reliance upon the information reported and documents uploaded + triggering proactive outreach by financial services providers to the nominees	☑	
Unclaimed funds and accumulations thereon that are earmarked for education, awareness or welfare of financial consumers should spread awareness and educate on advantages and benefits of nomination. On reimagined nomination facilities becoming operational, further awareness campaigns can also take place	☑	
Elevating or equating nominees to being legal and beneficial owners of the financial asset (up to the percentage allocation as specified) and doing away with concept of regarding nominees as trustees or custodians for legal heirs in respect of financial assets	☑	☑

Mr. Pramod Rao



Pramod is serving as an Executive Director at the Securities and Exchange Board of India, handling the Department of Debt and Hybrid Securities (DDHS), and Enquiries and Adjudication Department (EAD). The white paper — "Reimagining Nominations: Making Succession Smoother and Simpler" was written by Pramod in his personal capacity prior to joining the Securities and Exchange Board of India.

Pramod has extensive experience in the Indian financial services sector, having served as Group General Counsel at ICICI group, General Counsel for Citi South Asia cluster, as a partner at IndusLaw and as General Counsel of ICICI Bank, with many professional accomplishments in such roles.

He has also served as a member of the Board of Directors of ICICI Securities Ltd, ICICI Prudential Trust Ltd, ICICI Trusteeship Services Ltd, and as a member of the National Committee for Regulatory Affairs of the Confederation of Indian Industry (CII), of the Advisory Council of Sahamati & of the SEBI Subcommittee for Regulatory Sandbox.

Pramod has a deep interest in Fintech, LawTech & startups: He has co-founded a LawTech enterprise, & served as a Board member of 2 startups. He also advised & mentored startups under the aegis of ICICI Bank's Startup Engagement Team & its Innovation Lab, NSRCEL of IIM Bangalore, SINE of IIT Bombay & of No Changemaker Left Behind program by Agami. He has also led piloting and adoption of innovative approaches and technology-led solutions for various business, operational and legal requirements. He has collaborated on certain iSPIRT projects including Sahay-GeM and the Sahamati AA Ecosystem.

He has played a pivotal role in conceptualizing & adoption of online dispute resolution (ODR) at ICICI Bank & digital ecosystems such as Sahamati, Sahay GeM, Sahay GST and ONDC. He also engaged with policy makers, the government & the judiciary on ODR, which culminated in the Niti Aayog constituted committee report on Designing the Future of Dispute Resolution: The ODR Policy Plan for India, available at https://bit.ly/3AVS247, & in the launch of ODR Handbook, available at www.disputeresolution.online

Pramod has also been associated with IDIA – Increasing Diversity by Increasing Access – an NGO dedicated to assisting students from underprivileged backgrounds in attending premier law schools in India. He has served as a founding member of the Governing Board of the NLSIU Alumni Association from 2015-2020.

He has participated in & contributed to various law and regulatory reform initiatives of the government, regulators & industry forums, and written or contributed to several papers containing his personal view and opinions on matters of law and policy including for SCC Blog, IndiaCorplaw Blog, ARIA and for reputed digital business news platforms.

About ARIA

The Association of Registered Investment Advisers (ARIA) was born out of the need to support the development of the investment adviser community post the introduction of the investment adviser regulations by SEBI in 2013. ARIA was set up as a part of the inaugural RIA summit in 2017 from where an RIA Task force emerged to enable the development of the RIA profession, and bring it to the standards of other established professions that have been in existence since multiple decades. ARIA members come from different parts of the country and are a mix of individuals and corporates who are focussed on doing what is right for the investor without conflict of interest or high levels of disclosure.

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ARIA

Association of
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More Spotlight sections to follow soon

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