



# ASSOCIATION OF MUTUAL FUNDS IN INDIA

135/BP/ 55 /2015-16

Date: April 20, 2015

## AMFI Best Practice Guidelines Circular No. 55 /2015-16

### Risk Mitigation Process Against Third-Party Cheques in Mutual Fund Subscriptions

We invite your reference to AMFI Best Practices Guidelines Circular No. 135/BP/16/2010-11 dated August 16, 2010 and revision thereto, vide circulars no. 135/BP/18/10-11 dated December 22, 2010, no. 35/BP/23/2011-12 dated April 29, 2011, no. 135/BP/24/2011-12 dated June 17, 2011 and 135/BP/25/11-12 January 16, 2012 on the captioned subject.

On a review, it has been decided to revise the clause 3(A) (b) as indicated below and insert a new clause "e" under Section 3 (A) as mentioned below:

- **Amendment of clause 3(A) (b) (text highlighted below)**
  - b. Payment by Employer on behalf of employee under Systematic Investment Plans or lump sum / one-time subscription, through Payroll deductions or deductions out of expense reimbursements. Asset management companies should exercise extra due diligence in terms of ensuring the authenticity of such arrangements from a fraud prevention and KYC perspectives.
- **Addition of clause 3 (A) (e)**
  - e. Payment by Corporate to its Agent/Distributor/Dealer (similar arrangement with Principal-agent relationship), on account of commission/incentive payable for sale of its goods/services, in the form of the Mutual Fund Units through Systematic Investment Plans or lump sum / one-time subscription, subject to compliance with SEBI Regulations and Guidelines issued by AMFI, from time to time. Asset management companies should exercise extra due diligence in terms of ensuring the authenticity of such arrangements from a fraud prevention and ensure compliance with provisions of PMLA Act regarding prevention of money laundering etc.

The revised Best Practice Guidelines on the subject incorporating abovementioned additions are annexed hereto, which shall supersede all the above referred circulars.

All members are requested to confirm having noted the contents of this circular for due compliance. They are also advised to place this circular for information of the Trustees of their Mutual Fund in their immediate next meeting.

With regards,

H. N. Sinor

Chief Executive



## **Annexure to AMFI Best Practices Guidelines Circular No. 55 / 2015-16**

### **Risk Mitigation Process Against Third-Party Cheques in Mutual Fund Subscriptions**

The Committee constituted by SEBI on 'Operational Risk Issues related to Investor Service processes in Mutual Funds' had given recommendations on select service processes which were not standardised across the industry or were ambiguous or involved high risk due to higher possibility of errors or frauds, including acceptance of third party cheques. The committee's report was circulated to all members, vide AMFI's email dated July 28, 2010. Pursuant to the above, SEBI had advised AMFI to take immediate steps to implement the committee's recommendations regarding third party cheques with a view to enhance compliance with AML/KYC requirements as well as to mitigate the risk associated with such transactions.

AMFI Working group, after examining the recommendations, has suggested the following implementation process.

#### **1. What is a Third-Party Cheque?**

- a) When payment is made through a cheque issued from a bank account of a person other than that of the beneficiary investor, the cheque is referred to as Third-Party cheque.
- b) It is clarified that in case of payments from a joint bank account, the first holder of the mutual fund folio has to be one of the joint holders of the bank account from which payment is made.

#### **2. Risks:**

There are primarily two inherent risks involved in accepting investment money from a person other than the beneficial owner of the investment (referred to as third party):

- a) Fraud risk (using one investor's cheque to fund a different investor's account)
- b) Non-Adherence to PMLA requirements

#### **3. Recommendations:**

##### **(A) Not to accept Third-Party cheques:**

Asset management Companies (AMCs) should not accept subscriptions with Third-Party payments, except in the following exceptional situations:

- a) Payment by Parents/Grand-Parents/related persons on behalf of a minor in consideration of natural love and affection or as gift for a value not exceeding ₹50,000 (each regular purchase or per SIP instalment). However, this restriction will not be applicable for payment made by a guardian whose name is registered in the records of Mutual Fund in that folio.<sup>1</sup>
- b) Payment by an Employer on behalf of employees under Systematic Investment Plans (SIP) or lump sum / one-time subscription, through Payroll deductions or deductions out of expense reimbursements<sup>2</sup>. Asset management companies should exercise extra due diligence in terms of ensuring the authenticity of such arrangements from a fraud prevention and KYC perspectives<sup>3</sup>.

<sup>1</sup> As amended vide circular 135/BP/23/2011-12 dated April 29, 2011.

<sup>2</sup> The words "or deductions out of expense reimbursements" inserted vide 135/BP55/15-16 dated April 20, 2015

<sup>3</sup> As amended vide circular 135/BP/18/10-11 dated December 22, 2010.





- c) A Custodian on behalf of an Foreign Institutional Investor or a client.
- d) Payment by an AMC to an empanelled Distributor on account of commission/incentive etc. in the form of the Mutual Fund units of the schemes managed by such AMC through SIP or lump sum / one-time subscription, subject to compliance with SEBI Regulations and Guidelines issued by AMFI, from time to time. AMCs should exercise extra due diligence in terms of ensuring the authenticity of such arrangements from a fraud prevention and ensure compliance with provisions of Prevention of Money Laundering Act, 2002 (PMLA) regarding prevention of money laundering etc.
- e) Payment by a Corporate to its Agent/Distributor/Dealer (similar arrangement with Principal-agent relationship), on account of commission or incentive payable for sale of its goods/services, in the form of the Mutual Fund Units through SIP or lump sum / one-time subscription, subject to compliance with SEBI Regulations and Guidelines issued by AMFI, from time to time. AMCs should exercise extra due diligence in terms of ensuring the authenticity of such arrangements from a fraud prevention and ensure compliance with provisions of PMLA Act regarding prevention of money laundering etc<sup>4</sup>.

**(B) Documents to be obtained for exceptional cases:**

In case of exceptional situations as above, AMCs should have appropriate and adequate controls in place to carry out verification as required under the PMLA, which should, inter alia, include:

- a) Determining the identity of the Investor and the person making payment i.e. mandatory KYC for Investor and the person making the payment.
- b) Obtaining necessary declaration from the Investor and the person making the payment. Declaration by the person making the payment should give details of the bank account from which the payment is made and the relationship with the beneficiary.
- c) Verifying the source of funds to ensure that funds have come from the drawer's account only.

**(C) Investors to be cautioned to adopt safe mode of writing cheque:**

As a best practice and to avoid frauds, it is strongly recommended that AMCs should educate investors to make the payment instrument (cheque, demand draft, pay order, etc.) favouring "XYZ Scheme A/c First Investor name" or "XYZ Scheme A/c Permanent Account Number" or "XYZ Scheme A/c Folio number".

**4. Process to identify third party payments:**

The following process is recommended for identifying third party cheque:

- a) An investor at the time of his/her purchase must provide the details of his pay-in bank account (i.e. account from which a subscription payment is made) and his pay-out bank account (i.e. account into which redemption / dividend proceeds are to be paid). AMCs and R&TAs already have a process of capturing an investor's bank details mandatorily. These details are used for pay-out. It is recommended that the same details also be used for verifying pay-in (i.e. payment of the subscription money). This can leverage on existing processes which verify such bank accounts using a cancelled cheque leaf, bank statement, etc.

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<sup>4</sup> Inserted vide circular 135/BP55/15-16 dated April 20, 2015

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In case an investor has multiple bank accounts, he should be encouraged to register them with the AMC. Pay-in from such registered single or multiple accounts can be treated as 1st party payments.

- b) If the subscription is settled with pre-funded instruments such as Pay Order, Demand Draft, Banker's cheque, etc., a Certificate from the Issuing banker must accompany the purchase application, stating the Account holder's name and the Account number which has been debited for issue of the instrument. The AMC/RTA shall check that the funds have been debited from a pre-registered pay in account, or from the account of the first named unit holder.
- c) A pre-funded instrument issued by the Bank against Cash shall not be accepted for investments of ₹50,000/- or more. This also should be accompanied by a certificate from the banker giving name, address and PAN (if available) of the person who has requested for the demand draft. The AMC/R&TA shall check that the name as per the letter matches with the first named unit holder.
- d) If payment is made by RTGS, NEFT, ECS, bank transfer, etc., a copy of the instruction to the bank stating the account number debited must accompany the purchase application. The AMC/R&TA shall check that the account number mentioned on the transfer Instruction copy is a registered pay-in account or belonging to the first named unit holder.
- e) If aggregated payments are received via Channel distributors, AMCs shall ensure that the settlement model has satisfactory checks and balances against 3rd party payments.
- f) For payments through net banking and debit cards, AMCs shall endeavour to obtain the details of the bank account debited from the payment gateway service provider and match the same with the registered pay-in accounts. In case it is found that the payment is not made from a registered bank account or from an account not belonging to the first named unit holder, the AMC/R&TA shall reject the transaction with due intimation to the investor. Currently, where the investor account details are not made available by the payment gateway service provider, the AMCs shall obtain the name of the bank making the payment for the subscription.

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