The Regulation and Governance of Mutual Funds in the UK in the Quest for Investor Protection: Lessons for Middle Eastern Countries

Mohammed Khair Alshaleel

A thesis submitted for the degree of Philosophy in Law

School of Law

University of Essex

December 2016

Dedication

This thesis is dedicated to my father’s soul, who encouraged me all the way through. I wish he was here to see his dream come true.

Acknowledgments

I would be pleased to express my appreciation to a number of people for their help, advice and encouragement in the course of completing this study. First and foremost, I would like to express my special appreciation and thanks to my supervisor Professor Agasha Mugasha, whose experience, wisdom, and constructive comments have been influential throughout the investigation and writing of this thesis. I have been extremely lucky to have a supervisor who cared so much about my research, and who responded to my countless questions so promptly.

I must express my gratitude to my wife Huda Jomaa for her constant support, encouragement, quiet patience and unwavering love. You have been a constant source of strength and inspiration. Along with her, I want to acknowledge my son Mohammed Alshaleel. Your charming smile gave me the power to finish my work.

Words cannot express how grateful I am to my mother Nawal Alshaleel for her endless concern, love and support. Your prayer for me was what sustained me thus far. It was your love that raised me up again when I became weary.

I owe special thanks to my brothers and sisters who supported me and helped me throughout my life.

Abstract

The mutual funds regulation in Middle Eastern countries is still insufficient and lacks the detailed rules that regulate all aspects of the mutual funds industry. Despite the fact that the current mutual fund regulation addresses different aspects of the fund industry, it is still far from the international standards applied in many countries such as the UK and the USA. The main purpose of this thesis is to investigate the possibility of exporting certain essential regulatory rules form the mutual funds regulation in the UK to the mutual funds regulation in Middle Eastern countries in order to enhance investors' protection. Enhancing the mutual funds regulations generally and investors protection particularly would accelerate the development of the mutual funds industry in those countries.

The first chapter of the thesis is an introduction. The second chapter defines mutual funds by showing their significant role in the financial market and showing their unique attributes which differentiate them from other financial institutions. The third chapter scrutinises the existing mutual funds laws and regulations and their amendments in the UK, namely the Financial Services and Markets Act 2000, the Open Ended Investments Companies Regulations 2001 and the Financial Conduct Authority Sourcebook. The fourth chapter examines the governance of mutual funds under the current legal framework in the UK. The fifth chapter focuses on how the features discussed in the previous chapters could be used in Middle Eastern countries. Finally, chapter six provides the general conclusion of the thesis and the contribution of this research.

The findings from the research show that the unique nature of mutual funds as useful financial institutions comes from the combination of the advantages offered to the investors by one financial institution. They also illustrate that mutual funds in the UK are governed by a robust legal framework that regulates nearly all aspects of the industry in detail. This legal framework adopts efficient governance mechanisms that provide investors with a high level of protection. The governance mechanisms ensure investors protection and play a key role in mitigating the potential conflicts of interests between the self-interests of the fund management and the interests of the investors.

Another important finding of the research is that the current mutual funds regulations in Middle Eastern countries lack the detailed rules, and they do not regulate all aspects of the fund industry. Therefore, mutual funds investors are not well protected.

Finally, the research shows that certain regulatory rules form the UK regulations are exportable to Syrian Mutual funds regulations and can be exportable to Middle Eastern countries. These rules will increase investors' protection and fill the gap between the international standard and those applied in Middle Eastern countries.

Table of Contents

Dedication.......i

Acknowledgments.......ii

Abstract.......iii

List of Abbreviations.......ix

CHAPTER 1.......1

Introduction.......1

1.1 Introduction.......1

1.2 Objectives and Aims of the Thesis.......4

1.3 Motivation and Rationale for the Study.......6

1.4 Research Methodology.......7

1.5 Literature Review.......9

1.5.1 Observations.......14

1.6 Structure and Outline of the Thesis.......15

CHAPTER 2.......21

Definition of Mutual Funds.......21

2.1 Introduction.......21

2.2 The Concept of Mutual Funds.......21

2.2.1 Why Invest in a Mutual Fund?.......26

2.2.2 Hedge Funds Versus Mutual Funds.......30

2.2.3 A Classification of Mutual Funds.......34

2.2.4 The Operation of a Mutual Fund.......40

2.2.5 Growth of the Mutual Funds Industry.......45

2.2.6 A Brief History of Mutual Funds.......51

2.2.6.1 Antecedents of Mutual Funds.......52

2.2.6.2 The History of the Mutual Funds in the Netherlands.......53

2.2.6.3 The History of Mutual Funds in the United Kingdom.......54

2.2.6.4 The History of Mutual Funds in the United States.......56

2.3 The Legal Nature of Open-Ended Investment Companies and Unit Trusts.......56

2.3.1 The Legal Nature of the Unit Trust.......57

2.3.2 The Legal nature of Open-Ended Investment Companies.......60

2.4 Mutual Funds Risk Management.......64

2.4.1 The Risk Management Function.......67

2.4.2 The Risk Management Process.......68

2.5 Conclusion 69
CHAPTER 3 70
A Critical Examination of the Regulatory Framework of Mutual Funds 70
3.1 Introduction 70
3.2 Objectives of Financial Regulation 71
3.3 The Existing legal Framework of Mutual Funds in the United Kingdom 73
3.3.1 Development of Mutual Funds Regulations in the UK 74
3.3.2 The Financial Services and Markets Act 2000 (FSMA): the Main Regulation of Mutual Funds in the UK 78
3.3.2.1 Authorised and Unauthorised Unit Trusts 79
3.3.2.1.1 Observations on Syrian Mutual Funds Act 2011 82
3.3.2.2 Restrictions on Investment and Borrowing Powers 83
3.3.2.2.1 Application to the Syrian Mutual Funds Act 2011 86
3.3.3 The Open Ended Investment Companies Regulations 2001(OEICs): the Impact of the European legislation 88
3.3.3.1 The Authorisation Process of OEICs 89
3.3.3.2 A Protected Cell Regime for Open-Ended Investment Companies 90
3.3.4 The Undertakings for Collective Investment in Transferable Securities (UCITS): the European Legislation 92
3.3.4.1 The Evolution of the UCITS 93
3.4 The Valuation and Pricing Regulations 102
3.4.1 Fair Value Valuation Method 105
3.4.2 Mutual Funds Valuation Obligations 107
3.5 Delegation of Functions under the Mutual Funds Regulations 109
3.6 Suspension of Redemptions and Winding up Mutual Funds 111
3.6.1 Suspension of Redemption: a Temporary Tool to Protect Investors 112
3.6.1.1 Potential Reasons for Suspension of Redemptions 112
3.6.1.2 The Consequences of Suspension of Redemption 113
3.6.1.3 Application to the Syrian Mutual Funds Act 2011 117
3.6.2 The Legal Methods of Winding up Mutual Funds under the Current Legal Framework in the UK 118
3.6.2.1 Winding up Open-Ended Investment Companies 118
3.6.2.2 Winding up an Authorised Unit Trust 121
3.6.2.1 Observations on the Syrian Legislation 122
3.7 Conclusion 123

CHAPTER 4 125

The Governance of mutual funds: A Comparative Perspective 125

4.1 Introduction 125

4.2 Definition and Scope of Governance 126

4.3 Competing Governance Models: Corporate Versus Contractual Model 128

4.3.1 The United States Corporate Model 128

4.3.1.1 The Pivotal Role of the Independent Directors in the American Mutual Funds Governance System 132

4.3.2 The United Kingdom Mutual Funds Governance Models 139

4.3.2.1 The Unit Trust Governance Structure 139

4.3.2.2 The Open Ended Investment Companies Governance Structure 143

4.3.3 Remarks on the USA's and the UK's Governance Structure 146

4.4 Agency Problems as a Challenge to Governance 147

4.4.1 Potential Types of Conflict of Interest in the Mutual Funds Schemes 148

4.4.2 Possible Regulatory Methods to Address Conflicts of Interest in the Mutual Funds Industry 150

4.5 Disclosure as a Regulatory Tool in Mutual Funds Governance 158

4.6 The Effectiveness of the Voting Right in Mutual Funds Governance 166

4.7 Conclusion 172

CHAPTER 5 173

Strengthening Mutual Funds Regulation and Governance in Middle Eastern Countries 173

5.1 Introduction 173

5.2 The International Organization of Securities Commissions (IOSCO) Principles for the Regulation of Collective Investment Schemes 174

5.3 Enhancing Mutual Funds Prudential Regulations 176

5.3.1 Risk Management: an Essential Tool for Investor Protection 177

5.3.1.1 Risk Management Principles under the Current Mutual Funds Regulations in the UK178

5.3.2 Restrictions on Investment and Borrowing Powers 182

5.3.2.1 Mutual Funds Investment Limitation: Prudent Spread of Risk 182

5.3.2.2 Restrictions on Mutual Funds' Borrowing Power 184

5.3.3 Suspension of Redemption: a Valuable Investor Protection Tool 186

5.3.4 Valuation and Pricing 189

5.4 Strengthening the Mutual Funds Governance Tools under the Syrian Mutual Funds Act 2011 193

5.4.1 Mutual Funds Authorisation: the Starting Point of Investor Protection 193

5.4.1.1 Revocation of the Authorisation Order 196
5.4.2 Conflicts of Interest: the Key Challenge of a Mutual Funds Governance System 197
5.4.3 Disclosure 201
5.4.4 The Concept of independence: the Cornerstone of Mutual Funds Governance . 204
5.5 External Supervision: the Fundamental Functions of the Supervisory and Regulatory Authorities 209
5.5.1 Supervision and Enforcement: the Challenge of Enforcement of Compliance 216
5.6 Conclusion 218
CHAPTER 6 220
Conclusion 220
6.1 Introduction 220
6.2 Summary of the Thesis and the Main Findings 220
6.3 Recommendations 232
Epilogue 241
Bibliography 243

List of Abbreviations

ACD	Authorised Corporate Director
AIFMD	Alternative Investment Fund Managers Directive
AUT	Authorised Unit Trust
CIS	Collective Investment Scheme
ESMA	European Securities and Markets Authority
FCA	Financial Conduct Authority
FSA	Financial Service Authority
FSB	Financial Stability Board
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act
ICI	Investment Company Institute
ICVC	Investment Company with Variable Capital
IFSC	International Finance Services Centre
IOSCO	International Organization of Securities Commissions
KIID	Key Investor Information Document
LSE	London Stock Exchange

NAV	Net Assets Value
OEIC	Open-Ended Investment Companies
SAI	Statement of Additional Information
SCFMS	Syrian Commission on Financial Markets and Securities
SEC	Securities and Exchange Commission
SMFA	Syrian Mutual Funds Act
UCITS	Undertakings for Collective Investment in Transferable Securities
UK	United Kingdom of Great Britain and Northern Ireland
USA	United States of America

CHAPTER 1

Introduction

1.1 Introduction

Generally, the concept of mutual funds is based on the notion of collecting money from a large number of investors to be managed by external professional management. Mutual funds as useful financial institutions play a fundamental role in the financial markets.[1] The mutual funds industry has grown dramatically in the last few decades to become a strong competitor to other financial institutions or even to banks in the financial markets. Some countries, such as the UK and the USA, realised early the significant role of mutual funds in the financial markets. Therefore, the mutual funds industry is developed in these countries. The development of the mutual funds industry in these countries can be attributed to different factors. While some countries exploited their strategic geographical location (such as Luxembourg), other countries, such the USA, the UK and France, benefited from their strong economy and legal environment to build a reputable funds industry.[2]

Moreover, the development of the mutual funds industry in these countries is coupled with the existence of regulations and laws that regulate different aspects of the industry almost comprehensively. This is to say that although each country has its specific reasons that support the development of the mutual funds industry, the existence of a robust legal framework of mutual funds is a common factor between these countries. The existing regulations in these countries have evolved to fit the creativity and development of the industry. Indeed, the existence of an effective legal framework is an essential element for the success of any type of financial institution in the financial markets. The mutual funds regulations in these countries have been established to suit the unique nature of mutual funds. The external professional management of the mutual fund is one of the key features of this industry. Thus, the mutual funds regulations concentrate precisely on the relationship between the management and the investors in order to provide investors with proper protection.

---

[1] J Haslem, Mutual Funds: *Risk and Performance Analysis for Decision Making* (Wiley-Blackwell Publishing Ltd, Oxford 2003) 2.

[2] See, American Investment Company Institute, '2015 Investment Company Fact Book' (55th Edition, 2015).

Moreover, during the development of the mutual funds regulations in these countries, the fund regulators established different governance mechanisms that provide investors with a high level of protection, which in turn encouraged investors to participate in the fund industry. For instance, in the USA, the Securities and Exchange Commission has mainly relied on the role of the independent directors to protect the interests of the mutual funds investors, while in the UK the concept of independence between the manager and the depositary is the key mechanism to protect investors. Mutual funds governance mechanisms aim to protect mutual funds investors and mitigate the potential conflict of interests between the mutual funds management self-interests and the interests of the investors. Some of these governance mechanisms are quite similar, irrespective of the form of the mutual funds structure. For instance, disclosure rules that require mutual funds to provide investors with clear and correct information are the same whether the mutual funds take the corporate form or the trust form. However, some governance mechanisms have been established to fit the specific mutual funds structure. For example, the voting right in the mutual funds that take the trust form is more restricted than in those that take the corporate form.

Unlike the development of the mutual funds in some countries, the mutual funds industry in many countries is still a nascent industry, such as in Latin American countries (with the exception of Brazil) and Middle Eastern countries. Nonetheless, these countries have recently noticed the effective role of mutual funds in the financial markets to attract local and foreign investments. As a result, they have begun enacting laws and regulations to encourage this industry. For instance, the Mutual Funds Act in Syria was enacted in 2011.

In addition, compared to the existing regulations in the developed countries such as the UK and the USA, some aspects of the existing regulations in Middle Eastern countries may not be sufficient to protect the investors and some aspects are not regulated at all. Hence, it is essential to enhance the existing regulations in these countries to support the growth of the industry. One possible effective solution that the research mainly examines to enhance the regulatory frameworks in Middle Eastern countries is to borrow certain regulatory lessons from countries where the mutual funds industry is developed, particularly the UK and the USA. This will help the mutual funds regulations to move rapidly toward international standards or even toward the standards applied in these countries.

In addition, borrowing lessons from the regulations applied in developed countries is very common in most of the financial industries, such as banking and company industries. Therefore, the thesis will extensively examine the possibility of exporting certain lessons from the mutual funds regulations in the UK to Middle Eastern countries such as Syria. However, while exporting lessons, the structures of the mutual funds in Middle Eastern countries and the financial market conditions there should be taken in to consideration. In other words, while some rules could be exportable and fit the mutual funds structures in these countries, some rules may not be exportable. Here, it is worth mentioning that studying the mutual funds regulations in the UK is very useful because the mutual funds in the UK can take either the corporate form with a depositary (open-ended investment companies) or the trust form (unit trusts). Thus, whether Middle Eastern countries adopt the corporate form or the trust structure they will benefit from the lessons that the thesis will recommend through the research.

Moreover, the study will mainly examine the existing regulations of mutual funds in the United Kingdom. That includes the Financial Services and Markets Act 2000, the Open Ended Investments Regulations 2001 and the Financial Conduct Authority (FCA) COLL Sourcebook. While the thesis will address different aspects of the regulations such as the authorisation of mutual funds, operation of a mutual fund and the winding up of mutual funds, the focus will be on the investor protection because most of the mutual funds investors are retail investors and they do not participate in the fund management, so their protection should be a priority for any legal framework.[3] The study will also examine the powers and duties of the main players under the existing mutual funds regulations in the UK and where it is necessary in the USA. That will include the powers and duties of the manager and trustee of the authorised unit trust and the authorities and obligations of the authorised corporate director and the depositary of the open-ended investment companies.

[3] In Europe, around 75% of the Undertakings for the Collective Investment of Transferable Securities (the European mutual funds form) investors are small investors. *See*, European Commission, 'Greater protection for retail investors: Commission welcomes European Parliament adoption of strengthened European rules on UCITS' 2 (2014) http://europa.eu/rapid/press-release_STATEMENT-14-121_en.htm accessed 13 March 2015.

The core part of the thesis will shed light on mutual funds governance because the main aim of mutual funds governance is to ensure that mutual funds are operated effectively in the best interests of the mutual funds investors and not in the interests of the mutual funds external services providers. The thesis will clarify the agency problem in the mutual funds industry and the possible situations of conflict of interests between the self-interests of the mutual funds management and the interests of the investors. The effectiveness of the disclosure to mitigate conflict of interests will also be addressed in this thesis. The study will highlight the fundamental information that should be disclosed in the prospectus and the time of disclosure. In addition, the research will study the voting right as a very important weapon to control the fund. Although the investors do not participate in the management of mutual funds, the regulations grant the investors the right to vote in certain situations. Therefore, the thesis will shed light on those situations. The research will also point out the importance of external supervision in mutual funds governance. External supervision is a key principle in the mutual funds industry to protect investors. Thus, the thesis will explain the role of external supervision in the mutual funds industry.

Further, the thesis will examine the weaknesses in the current mutual funds regulations in Middle Eastern countries and how the features mentioned above can apply to the regulations in those counties in order to strengthen the mutual funds regulations there. This examination will clearly show the need for enhancing the mutual funds regulations there.

It is necessary to point out that the thesis specifically addresses the Syrian mutual funds regulation, so the research findings and recommendations apply to Syria specifically, rather than the Middle East generally. However, since other Middle Eastern countries have similar but less detailed regulation, those findings and recommendations could be applied to these countries due to the similarities in terms of regulations, culture and market conditions. This will be the basis of the discussion and analysis throughout the thesis.

1.2 Objectives and Aims of the Thesis

The firm view that will be expressed in this thesis is that certain necessary rules of the existing mutual funds regulations in the UK and the USA may be exportable to the regulations in Middle Eastern countries such as Syria. This will strengthen the mutual funds regulations in Middle Eastern countries. Hence, the mutual funds industry would grow more quickly than the current growth in these countries. It is significant to mention that the analysis in the thesis is based on the assumption that regulation of the mutual funds industry is necessary for the protection of investors. Therefore, the thesis does not consider the broader question of whether mutual funds should be regulated per se. The mutual funds regulations in the UK and the USA are very developed and regulate nearly all aspects of the fund industry. As a result, the mutual funds industry is successful in these countries. The regulations adopt advanced governance mechanisms that ensure investors protection and mitigate conflict of interests between the main players of the industry. It is necessary to know that the UK and the USA are significant global players of the industry, and the international mutual funds standards established by the International Organization of Securities Commissions (IOSCO) are a reflection of the standards applied in the UK and the USA.[4] Further, borrowing lessons from the mutual funds regulations in the UK should consider the mutual funds structures and the financial market conditions in Middle Eastern countries because the financial market in the UK is one of the most developed markets in the world and the fund regulations are designed according to the market conditions. Therefore, the main objectives of the thesis are outlined next.

First, the thesis aims to comprehensively describe mutual funds by their function, social utility and legal attributes through scrutinising the existing legal framework governing the mutual funds industry mainly in the UK and secondarily in the USA. That includes studying the laws and regulations governing the two forms of mutual funds in the UK: open-ended investment companies and unit trusts. Studying the existing legal framework would help to define mutual funds by showing their unique characteristics that make these vehicles very attractive in the financial markets. Indeed, the concept of mutual funds is still not understood, either by the investors who are already involved in the industry or the other investors, so the research will attempt to clearly define mutual funds from different legal and practical aspects.

[4] The International Organization of Securities Commissions (IOSCO) 'Principles for the Regulation of Collective Investment Schemes' (1994) available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf accessed 17 April 2016.

Secondly, the thesis aims to examine the mutual funds governance mechanisms under the existing mutual funds laws and regulations in the UK to discover their effectiveness in enhancing investor protection. The governance mechanisms ensure investors protection and play a vital role in mitigating the potential conflicts of interests between the self-interests of the fund management and the interests of the investors. The concept of mutual funds is mainly based on the idea of pooling money from different investors to be invested by external professional management. The mutual fund assets must be invested for the primary benefit of the investors. Thus, the mutual funds governance should aim to protect the fund assets through ensuring that the fund management operates the fund in the investors' best interests. Further, the separation of the ownership of the mutual funds from its management carries a potential conflict of interests between the self-interests of the fund management and the interests of the fund’s investors. Therefore, the mutual funds governance should address any potential conflict of interests to protect the interests of the fund investors.

Thirdly, the research aims to assess the possibility of exporting certain lessons from the laws and regulations of mutual funds in the UK and the USA to Middle Eastern countries in order to strengthen the mutual funds regulations there. The research will examine the laws and the regulations of mutual funds in the UK and the USA, and thus the thesis will evaluate which rules could be exportable to Middle Eastern countries and which rules may not be exportable. Enhancing and increasing the mutual funds regulation will play a vital role in improving the mutual funds industry.

1.3 Motivation and Rationale for the Study

The thesis is motivated by two major considerations. The first consideration is to make a novel contribution to the legal literature of the mutual funds industry in the United Kingdom. The study will illustrate later that there is a gap in the legal literature of the mutual fund industry. The gap includes different key issues that help to understand the concept of mutual funds and enhance the industry. Hence the research will attempt to fill the gap and make a useful contribution by examining key aspects of the regulations and governance system of mutual funds.

In addition, the noticeable growth of the mutual funds industry around the world has motivated lawmakers in many countries to enact laws and regulations that regulate and encourage this industry. One of these countries is Syria, where the Mutual Funds Act was enacted in 2011. The growth of the industry in Syria is still very slow and the investors do not have a clear image concerning the concept of mutual funds. Since the fund industry is still new, there is no legal literature that could help investors and the mutual funds players to understand these vehicles. There is no doubt that legal literature plays a vital role in enhancing the laws and regulations in many countries, and lawmakers are more likely to be influenced by the ideas and suggestions of legal scholars. As a result, the thesis could be a useful guide that helps investors, academics, lawyers, judges and players of the industry to understand different aspects of the mutual funds industry. Here, it is worth mentioning that the development of the mutual funds industry in many emerging countries and especially Middle Eastern countries is similar to that in Syria. This can be concluded from the 2015 Investment Company Fact Book which shows the development of the mutual funds industry around the world.[5] The Fact Book does not show any marked growth of the mutual funds industry in any of the Middle Eastern countries. Thus, this thesis could possibly be a useful guide for these countries to strengthen their regulations which in turn would accelerate the growth of the fund industry. This aim is the second consideration of the thesis.

It is significant to note that the current situation in Syria is very bad due to the armed conflict. However, the mutual funds industry was a nascent industry that might flourish when the conflict ends (see the epilogue at the end of the thesis).

1.4 Research Methodology

In this thesis, a critical analysis will be made of the laws and regulations of the mutual funds industry in the UK. The research is essentially based on primary law resources: legislation (statutes and regulations) and case law, and other legal resources: textbooks and legal journals. The research will try to shed light on the most important court cases that address the mutual funds industry and its players such as the directors, managers, depositories and trustees. Depending on analysis of these decisions, possible ideas may be suggested to ensure stronger protection for local and foreign investors.

[5] American Investment Company Institute (n 2).

Examining the mutual funds regulation in the United Kingdom can be justified by the following key reasons. First, the United Kingdom is one of the leading countries in this industry. Secondly, the legal resources and law cases are accessible to achieve the objectives of the research. Finally, the mutual funds industry in the UK includes both forms of mutual funds: the corporate form and the trust form. Therefore, many countries could benefit from the research, whether they adopt the corporate form or the trust form.

However, since the USA has the biggest mutual funds market in the world and the UK mutual funds structural models are similar in form and functions to those in the USA (this will discussed later in chapter 4), the comparative methodology will be used to achieve the objectives of this study. The comparative methodology serves many overlapping purposes. It possibly facilitates a greater appreciation of similarities and differences among competing laws.[6] As for Middle Eastern countries, the focus will be on the mutual funds regulation in Syria, because the information regarding the mutual funds industry is accessible. Moreover, the investment environment in Syria is, to some extent, similar to most other Middle Eastern countries, so the results of the research could be applied to all of these countries. However, comparison with other Middle Eastern countries will be made where it is necessary.

In addition, one of the advantages of the comparative methodology is that it will "identify solutions to specific or novel legal problems already encountered in other jurisdictions".[7] Lawmakers around the world pay sufficient attention to the role of comparative methodology in enhancing laws because one of the objectives of comparative methodology is to enhance the development of laws.[8] Besides, another important aim of the comparative methodology is to criticise the existing laws and regulations, so that this may induce lawmakers to reform the laws.[9] Therefore, considering all these advantages of the comparative methodology with regard to

---

[6] M Siems, *Comparative Law* (Cambridge University Press, Cambridge 2014) 6.
[7] T Hutchinson, *Researching and Writing in Law* (2nd edn Lawbook Co, Sydney 2006) 106.
[8] J Hill, 'Comparative Law, Law Reform and Legal Theory' (1989) 9 Oxford Journal of Legal Studies 101-115.
[9] F Bignami and D Zaring, *Comparative Law and Regulation: Understanding the Global Regulatory Process* (Edward Elgar Publishing, Cheltenham 2016) 14.

achieving the objectives of the thesis, the comparative methodology will be used in this research.

Here, it is important to emphasise that along with comparing the regulations through the comparative methodology, doctrinal approach, the research will consider the wider internal attributes of Middle Eastern countries and specifically those is Syria. In other words, in deciding which rules could be exportable, the thesis will consider the culture, judicial system, language, market conditions in Middle Eastern countries generally and Syria particularly. For instance, when comparing the regulations in the UK and Syria the thesis will consider the culture in each country because the law is influenced by the culture of the home country. The research will also consider the sophistication and conditions of the financial market in Syria in order to ensure the appropriate application of the possible suggested rules.

1.5 Literature Review.

Mutual funds governance as a method of enhancing the protection of investors has largely been neglected by legal commentators in the United Kingdom. Although the mutual fund industry has grown dramatically in the UK and the number of investors involved in this industry has increased noticeably, the number of legal studies that address this industry is minimal. The available literature of mutual funds governance in the UK is minimal compared to the existing literature of corporate governance practices. The situation is different in the USA where legal scholars have addressed the mutual funds governance topics in detail. Moreover, the mutual funds industry in Syria is still new, as the Mutual Funds Act was enacted only in 2011. Thus, there is no legal literature regarding this industry and that is one of the main reasons for conducting this research.

In the UK, during the 1970s and 1980s, the legal literature regarding mutual funds was rare. In the 1990s, the trend changed slightly. The most important books addressing the mutual funds in the UK are as follows:

1- The Legal Nature of Unit Trust. In 1997, Kam Fan Sin wrote his book "The Legal Nature of Unit Trust".[10] This book is considered a comprehensive study that examines the history and nature of unit trusts. In his book, Sin attempted to cover

[10] K F Sin, *The Legal Nature of the Unit Trust* (Oxford University Press Inc, New York 1997).

different areas of unit trusts. The main issues addressed in this book can be summarised as follows:

A- The evolution of the unit trust. On this point, Sin drew a clear picture of the history of unit trusts. The study pointed out that the unit trust has close historical links with the law of corporations, markedly through the deed of settlement company;

B- The constitution of a unit trust;

C- The character of unit trust relationships. The author stated that the relationship between trust and contract as principal elements in the unit trusts is not only instructive, but also timely appropriate.

2- The Law on Investment Entities. In 2000, in his book "The Law on Investment Entities", Alastair Hudson wrote about the mutual funds industry in the UK.[11] Here, it is worth mentioning that the book talks about the investment entities and mutual funds is one of the topics addressed in this book. The book addressed the two forms of mutual funds: unit trusts and open-ended investment companies. The study focused on the comparison between the unit trust and open-ended investment companies. This comparison aimed to analyse the rights that the investors acquire in relation to such entities. Furthermore, the study shed light on the mutual funds players, highlighting their roles and main duties. Then, it compared the roles of the players of the two forms of mutual fund to show the similarities and differences between them.

3- Fundamentals of Fund Administration: A Guide. In 2006, David Loader wrote his book "Fundamentals of Fund Administration: A Guide".[12] The main topics discussed in this book are fairly similar to those in the previous books such as the advantages and disadvantages of unit trusts and open-ended investment companies, and the main bodies that operate the mutual funds together with their basic duties and responsibilities.

4- The Law of Finance. In 2009, Hudson addressed the mutual funds industry again, but this time Hudson decided to expand his previous study by emphasising some important issues such as disclosure and the role of the Financial Service Authority (now the Financial Conduct Authority) with respect to the process of

[11] A Hudson, *The Law on Investment Entities* (Sweet & Maxwell Limited, London 2000).

[12] D Loader, *Fundamentals of Fund Administration: A Guide* (Butterworth-Heinemann, Oxford 2006).

authorisation.[13] The author referred to the importance of the prospectus as a means that provides investors with material information about mutual funds. Hudson talked about the preparation of the prospectus, its issue and who was responsible for preparing the prospectus. Hudson also clarified the material provisions that should be included in the prospectus. Moreover, the book talked about the Financial Service Authority's role of authorising unit trusts and open-ended investment companies. The study also referred to criteria that should be met to grant such authorisation. Compared to previous books, this book is considered more comprehensive with respect to both types of mutual fund in the UK. Nonetheless, the book did not discuss key issues in the fund industry such as potential conflicts of interest between mutual funds investors and the fund management, valuation and pricing, delegation of function and suspension of dealings.

The regulatory framework of mutual funds in the UK was also addressed by some important journal articles. In 1997, in his article "UK Introduces Open-Ended Investment Companies", Cornick wrote about open-ended investment companies.[14] The article shed light on the reasons for enacting the open-ended investment companies regulation and the importance of the corporate structure, because the unit trust was the only form of mutual fund in the UK and there was a debate about adopting the corporate form before introducing the OEICs. Cornick also indicated to the powers and duties of the authorised corporate director and the depositary, and the division of responsibilities between them. However, this article focused only on the key features of OEICs in order to give a general and clear image regarding the new vehicles.

Another important article was written in 2000 by Gerard McCormack, entitled "OEICs and Trusts: The Changing Face of English Investment Law".[15] The article compared and contrasted unit trusts and open-ended investment companies. The analysis in this article was coupled with a critical consideration of the benefits that OEICs should bring. Though the article, compared to the previous article, addressed

[13] A Hudson, *The Law of Finance* (Thomson Reuters Limited, London 2009).
[14] T Cornick, 'UK Introduces Open-Ended Investment Companies' (1997) 29 Int'l Fin. L. Rev 29-32.
[15] G. McCormack, 'OEICs and trusts: the changing face of English investment law' (2000) 21 Co Law 2-13.

different aspects of the fund industry, the key focus was only on the structural differences between the two forms of mutual fund.

Unlike the UK, the legal literature of the mutual funds industry in the USA is sufficient. The following books have addressed mutual funds in the USA:

1- The Development and Regulation of Non-bank Financial Institutions. In 2002, Jeffrey Carmichael and Michael Pomerleano wrote their book "The Development and Regulation of Non-bank Financial Institutions".[16] The book examined the regulations that govern the mutual funds industry in the USA. However, the study focused on the general regulatory framework of mutual funds without addressing fundamental points regarding the operation of the fund such as the board of directors and the role of the independent directors. It also indicated the supervisory role of the Securities and Exchange Commission to protect investors.

2- Mutual Funds: Risk and Performance Analysis for Decision Making. In 2003, John Haslem wrote his book" Mutual Funds: Risk and Performance Analysis for Decision Making".[17] The author discussed the corporate structure of mutual funds in the USA. The mutual funds service providers and their fundamental roles in the operation of the fund were also addressed in this book. The author also indicated the advantages generally attributed to mutual funds, such as professional management and diversification.

3- How to Create and Manage a Mutual Fund or Exchange-Traded Fund: A Professional's Guide. In 2008, Melinda Gerber published her book "How to Create and Manage a Mutual Fund or Exchange-Traded Fund: A Professional's Guide".[18] Gerber shed light on the way mutual funds work. The author referred to the players of mutual funds and their powers and duties. Gerber emphasised the role of the board of directors in ensuring the best performance of the fund.

4- International Finance: Law and regulations. In 2012, Hal Scott and Anna Gelpern wrote their book "International Finance: Law and regulations".[19] The book addresses various topics of financial law, and the mutual funds industry was one

[16] J Carmichael and M Pomerleano, *The Development and Regulation of Non-bank Financial Institutions* (World Bank Publications, Washington 2002).
[17] Haslem, *Mutual Funds: Risk and Performance Analysis for Decision Making* (n 1).
[18] M Gerber, *How to Create and Manage a Mutual Fund or Exchange-Traded Fund: A Professional's Guide* (Wiley, Hoboken, NJ, USA 2008).
[19] H Scott and A Gelpern, *International Finance: Law and regulations* (3rd edn Sweet and Maxwell, London 2012).

of these topics. The operation of mutual funds was the main point of discussion in the book. The book discussed the effectiveness of the United States' regulation of offshore mutual funds and registration of foreign funds. They also pointed out the problems in mutual funds regulations in the USA and the possible solutions to these problems. Finally, the book raised a concern with respect to management fees in the mutual funds industry.

Legal scholars in the USA also wrote many important articles regarding mutual funds regulations. In 1964, in his article "Duties and Responsibilities of Directors of Mutual Funds", Alfred Jaretzki discussed the principal duties and responsibilities of directors of mutual funds.[20] In addition, Jaretzki examined the composition of the board of directors and their election.

The roles and duties of the independent directors were examined again in 1972 in the article "Duties of the Independent Director in Open-End Mutual Funds".[21] This study analysed the role of independent directors in mutual funds. The writer emphasised the role of independent directors in protecting investors and examining the management fee. The research considered the potential impact of certain decisions and statutory amendments on the fund industry. In addition, it attempted to explore the possibility of enhancing the role of the independent directors in the mutual funds protection system.

Since the independent directors are at the centre of mutual funds governance in the USA, their roles were again under examination in 1981 where William Greenbush and Peter Clapman wrote their article "Role of Independent Directors in Corporate Governance".[22] The article analysed the development of the role of independent directors from three interrelated forces, namely the role of the SEC, court decisions and directors' own perceptions of their role.

[20] A Jaretzki, 'Duties and Responsibilities of Directors of Mutual Funds' (1964) 29 Law & Contemp. Probs 777-794.
[21] 'Duties of the Independent Director in Open-End Mutual Funds' [1972] 70 Mich. L. Rev. http://0-heinonline.org.serlib0.essex.ac.uk/HOL/LuceneSearch?typea=title&termsa=%20Duties%20of%20the%20Independent%20Director%20in%20OpenEnd%20Mutual%20Funds&collection=journals&collection_true=journals&other_cols=yes&searchtype=field&submit=Search accessed 1 November 2013.
[22] W Greenough and P Clapman, 'Role of Independent Directors in Corporate Governance' (1981) 56 Notre Dame Law Review 916-925.

In 2000, Chris Tobe wrote his article "Mutual Fund Directors: Governance Changes Proposed for Independent Directors in the US".[23] The aim of this article was to emphasise the fact that the effective independent mutual fund director must be truly independent and qualified. Moreover, Tobe tried to highlight the fact that there is a growing lack of trust in mutual funds.

In 2006, in her article "Regulating the Mutual Fund Industry", Donna Nagy shed light on mutual funds regulations in the USA.[24] The key concern in this article was improvement of the existing laws and regulation of the mutual funds. This study indicated the development of mutual funds regulations and the reasons behind the development. In her article, Nagy insisted on the internal controls and especially the role of chief compliance officer. Furthermore, Nagy argued that the mutual fund governance system could be enhanced in two ways. The first way is expanding the role and authorities of the Securities and Exchange Commission, while the second is establishing clearer standards regarding the role of the independent directors as watchdogs.

In the same year, Robert Radin and William Stevenson wrote a very important article with respect to the USA's mutual funds governance.[25] This study compared mutual fund governance and corporate governance. The most important issue addressed in the article was the lessons that the public company sector can teach to the mutual fund sector. The study pointed out that mutual funds directors play a very important role in the mutual funds governance system. It also referred to the similarities and differences between corporates and mutual funds. In addition, the authors examined the obstacles that impede the mutual funds governance system.

1.5.1 Observations

After examining a significant related part of the mutual funds literature, whether in the UK or in the USA, the following conclusions can be drawn. In the UK, the existing literature focuses mainly on describing the mutual funds structure and the main players that control these vehicles. The scholars have attempted to discuss the

[23] C Tobe 'Mutual Fund Directors: Governance Changes Proposed for Independent Directors in the US' (2000) 8 Corporate Governance 25-31.
[24] D Nagy, 'Regulating the Mutual Fund Industry' (2006) 1 Journal of Corporate, Financial & Commercial Law 11-44.
[25] R Radin and W Stevenson, 'Comparing Mutual Fund Governance and Corporate Governance' (2006) 14 Corporate Governance: An International Review 367-376.

existing regulations of mutual funds in terms of the requirements that should be met to call an institution a mutual fund, the powers and duties of the main entities that control the fund, the authorisation process, disclosure and the role of the Financial Conduct Authority.

However, the existing literature missed certain important issues and especially those regarding mutual funds governance. Protection of investors is a fundamental issue that should be demonstrated in the mutual fund industry because the contributions of investors are the cornerstone of the mutual fund concept. The thesis will try to fill this gap by addressing certain important issues that would ensure investor protection. The research will scrutinise the existing regulations of mutual funds in the UK and shed light on the amendments and changes to the regulations.

Furthermore, the research will discuss key issues of mutual funds governance such as conflict of interests, transparency and disclosure, and the effectiveness of the voting right and governance structure in the UK. The thesis will also emphasise the supervisory role of the Financial Conduct Authority to ensure investor protection. Here, it is necessary to emphasise that the thesis will assess the possibility of exporting some important lessons from the UK to Middle Eastern countries such as Syria as long as these lessons fit the mutual funds structures in these countries. This will be one of the key contributions of the thesis.

Moreover, it is clear that the existing literature in the USA is abundant. It pays noticeable attention to investor protection. Thus, the thesis would benefit from that part of the literature as long as it is applicable to the UK and the Syrian mutual funds structures.

It is significant to mention that in some points of this research the financial literature of mutual funds could be used to clarify some issues. For instance, talking about the net asset value (NAV) cannot be understood without giving some examples from financial studies. However, using the financial literature will be only for the purpose of ensuring a better understanding of the legal aspects of mutual funds.

1.6 Structure and Outline of the Thesis

In order to achieve the objectives of the thesis, the research is structured into six chapters. The thesis will focus in chapters two, three and four on the UK and the US legal framework as an example of a completely developed mutual funds regulation. Nonetheless, the research will refer to the Syrian regulation in these chapters where it is appropriate. Chapter 5 will be devoted to examine the mutual funds regulation in Syria. This implies that the thesis does not directly compare the UK and the Syrian regulations in each chapter. The first chapter is an introduction. It discusses the objectives and aims of the thesis, the motivations of the research and rationale for the study, the research methodology, and the literature review. The last part of the first chapter indicates the structure and outline of the thesis.

The second chapter will focus on defining mutual funds. The chapter is divided into three main sections. The first section will examine the concept of mutual funds. It will examine the way in which the mutual funds are established and work. In other words, it studies how mutual funds investors pool their funds together to be managed by professional management. It will also investigate the reasons and the advantages that make mutual funds a preferred option in the financial markets despite strong competition from many other available investments in the financial markets. Comparing mutual funds to hedge funds, which are significant financial institutions in the financial markets, will be a key point to show the importance of mutual funds. This section will also explore types of mutual fund in terms of their objectives. The players involved in the operation of a mutual fund and the key role of each, such as fund managers and custodians, will also be studied in this section, which will also highlight the growth of the mutual funds industry and the leading countries in this industry. In order to give a clear image of the concept of mutual funds, this section will lastly explore the history of mutual funds in three countries, namely the UK, the USA and the Netherlands.

Since the thesis will examine the mutual funds regulations and governance in the UK, the second section of this chapter will shed light on the legal nature of open-ended investment companies and unit trust. The mutual funds in the UK take either the corporate form or the trust structure, so it is important to understand the structure of both. Further, the last section of this chapter will examine the mutual funds risk management. Definition of mutual funds would not be comprehensive without understanding the major risks associated with the fund industry and how the mutual funds managers respond to those potential risks in order to minimise their impacts on the mutual funds.

Chapter three reviews the mutual funds regulations in the United Kingdom. While the chapter provides general and pertinent information on mutual funds, it focuses on the protection of investors. In the UK, three fundamental laws and regulations govern the mutual fund sector. The first of these is the European legislation: the Undertakings for Collective Investment in Transferable Securities (UCITS), which is included in the FCA Sourcebook (COLL). The second regulation is the Financial Services and Markets Act 2000 (FSMA) and the last one is the Open Ended Investment Companies Regulations 2001 (OEICs).

The chapter is divided into five main sections. The first section investigates the objectives of the financial regulation generally and the mutual funds regulation particularly. The second section will examine the existing legal framework of mutual funds in the United Kingdom. In order to understand the existing mutual funds regulations in the UK, this section will investigate the evolution of the mutual funds regulations through the development of this industry in the UK. This section will also scrutinise the FSMA 2000 and its amendments with respect to the rules and provisions governing mutual funds. The FSMA is the main legislation governing mutual funds in the UK and sets out the basis under which the authorised unit trusts operate. This section will also scrutinise the OEICs Regulations 2001. In 2011, the Treasury issued an amendment to the OEICs Regulations relating to segregated liabilities of sub-funds of umbrella funds. Hence, the chapter will discuss the amendment to discover the reasons behind it and the impact thereof on the industry. Finally, this section will indicate the impact of UCITS on the mutual funds regulations in the UK. The UCITS directives set down common standards for funds wishing to be registered and offered to the public throughout the European Economic Area. The UCITS seeks to give members states a European passport to operate throughout the EU. Therefore, the research will highlight the role of UCITS in enhancing the legal framework of the mutual funds sector.

The third section will address the valuation and pricing regulations. The valuation of mutual funds assets is an essential part of the industry, which should be well regulated. Therefore, the implementation of comprehensive policies and procedures for valuation of mutual funds assets is a major principle supporting the core objective of protecting investors. This section will highlight the importance of regulating the fair valuation method where the determination of the net asset value may not be available or the prices are not reliable. It will also study the mutual funds managers' obligations with respect to valuation of the fund assets, such as establishing written accounting policies and procedures.

Section four will investigate delegation of functions under the mutual funds regulations. It will examine whether delegation of functions, by the manager or the depositary, is permitted under the existing regulations, and the conditions under which they can delegate their functions. The last section of this chapter will scrutinise suspension of redemptions and winding up mutual funds. During the life of a mutual fund, the manager of the fund could suspend the right of redemption in very specific circumstances. Thus, this section will consider the potential reasons for suspension of redemption and the consequences of the suspensions of redemption, whether on the fund itself or the fund investors. This section will also examine the legal methods of winding up mutual funds under the current legal framework. It will focus first on winding up open-ended investment companies and then winding up unit trusts.

Chapter four will scrutinise the governance of mutual funds. This chapter is divided into five main sections. The first section will define the governance of mutual funds and specify its scope, taking into account the unique characteristics of these vehicles. The research will try to benefit from corporate governance to define mutual funds governance. Section two will assess mutual funds models in the UK and the USA from a comparative structural and institutional perspective. Since the key aim of this section is the governance and structure of mutual funds, the discussion will focus on structural rules such as the rules that regulate the allocation of powers to make the funds' decisions among the service providers and the conditions of making such decisions such that the decisions comply with the fund objectives. It will highlight the role of the independent directors in the U.S governance system and the concept of independence in the UK governance structure.

Section three will study the agency problems in the mutual funds industry between the fund management and the fund's investors (conflict of interests). It will concentrate on potential types of conflicts of interest in the mutual funds schemes and the regulatory methods established to address those potential conflicts of interest. Due to the mutual funds' unique management structure, there are numerous potential conflicts of interest in the mutual funds industry. Thus, the research will try to explain the most significant types of potential conflicts of interest and their potential impacts on the fund and its investors. It will then discuss the regulatory responses to these potential conflicts of interest under the current mutual funds regulations in order to protect the fund investors.

Section four will consider the role of disclosure in the mutual funds governance system. This section will highlight the significance of disclosure in the mutual funds governance in order to ensure proper accountability of the mutual funds and to keep investors informed of all relevant details on an ongoing basis. The focus will be on the role of the prospectus, simplified prospectus and the periodic reports to achieve the objectives of disclosure. Further, the last section of this chapter will explore the effectiveness of the voting right in the mutual funds governance. It will examine whether the existence of the redemption right in the mutual funds industry reduces the significance of the voting right. It will also shed light on the situations where mutual funds investors can exercise the voting right.

Chapter five will focus on studying the possibility of exporting regulatory lessons from the UK mutual funds regulations to Middle Eastern countries, which would play a crucial role in enhancing investors' protections and promoting the mutual funds industry. The chapter will concentrate on the Syrian Mutual Funds Act (SMFA) 2011 and will attempt to show the weaknesses in the current mutual funds regulations, which threaten the protection of investors and the industry. Then, it will examine the possibility of applying some important rules of the mutual funds regulations in the UK to mutual funds regulations in Syria in order to strengthen the investors' protection and accelerate the growth of the industry. The chapter is divided into four main sections. The first section will concentrate on the international standards of mutual funds. It will particularly study the International Organization of Securities Commissions (IOSCO) Principles for the regulation of collective investment schemes in order to see how far the mutual funds regulations in Middle Eastern counties are from them.

The second section will investigate the ways of enhancing mutual funds prudential regulations in terms of risk management, restrictions on investment and borrowing powers, suspension of redemption and valuation and pricing. The mutual funds prudential regulations play a key role in ensuring the safety of the industry and protection of the investors. This section will show the weaknesses in the prudential regulations and it will then suggest the changes necessary to strengthen them.

Section three will scrutinise the tools that strengthen the mutual funds governance. It will specifically study the mutual funds authorisation, conflicts of interest, transparency in disclosure and the concept of independence between the fund manager and the custodian. It will examine these mutual funds governance tools under the SMFA 2011 and the degree of protection provided to the mutual funds investors by these tools. This examination aims to enhance these governance tools through suggesting certain significant rules from the UK mutual funds governance. Furthermore, section four will study the fundamental functions of the supervisory and regulatory authorities in protecting mutual funds investors and enhancing the mutual funds industry. This section will show the significance of the role of the supervisory authority in protecting investors and ensuring compliance of the mutual funds management with the fund regulations. It will also highlight the supervisory authority powers necessary to achieve these objectives.

Chapter six will summarise the main points and findings of the research. It will make some suggestions and recommendations believed to be vital for the improvement of the mutual funds industry in Middle Eastern countries generally, and Syria particularly.

CHAPTER 2

Definition of Mutual Funds

2.1 Introduction

Although the mutual funds industry is markedly widespread around the world, the concept of a mutual fund is still not understood, either by the investors who are looking for an effective investment to invest their funds or by the investors who are already involved in this industry. Mutual funds as financial vehicles have unique characteristics. One of the key characteristics of these vehicles is that they are externally managed by professional management. This implies that different parties are involved in the operation of the fund, such as the manager, custodian and promoters. Here, it is worth mentioning that although some financial institutions such as hedge funds share this characteristic with mutual funds, mutual funds differ from them in that they are an attractive investment to all types of investors, whether retail investors or sophisticated investors, while hedge funds are suitable only for sophisticated investors. Further, the mutual funds structure varies between countries, and may take either the corporate or the trust form.

The main aim of this chapter is to define mutual funds by showing their unique characteristics that distinguish them from other financial institutions. This chapter will be the cornerstone to other chapters of the thesis because understanding the concept of the mutual fund is fundamental to discussing the mutual funds regulations and governance issues.

The first section examines mutual funds in terms of their importance, classification, the mutual funds players, the growth of the mutual funds industry, and the history of mutual funds. The second section discusses the two forms of mutual fund in the UK, namely the open-ended investment companies and the unit trust. It will investigate the legal nature of both forms. Finally, the last section studies the importance of mutual funds risk management in ensuring the safety of the fund and protection of the investors.

2.2 The Concept of Mutual Funds

People usually attempt to save money to secure their future. However, they usually have big concerns regarding the way of investing these funds. Some people do not have enough funds to make their own investments. Likewise, most individuals lack the professional expertise and awareness of business and economic principles that enable them to make successful investments. Mutual funds as financial institutions offer an effective solution to those people by bridging expertise and inadequate investment funds.

A mutual fund is considered one of the most important ways of raising funds from the public in the financial sector.[26] The term *mutual fund* reflects the mutual relationship between the investors and the fund. These financial institutions give the small investors a chance to participate in the rapid and robust growth of capital markets we have witnessed over the past few decades. Mutual funds provide an effective way for small investors to obtain varied investment portfolios with professional management at a sensible cost. This is not to say that mutual funds are only designed for small investors, because financial institutions and sophisticated investors also invest their assets in mutual funds.[27] However, the majority of the investors are retail investors. For instance, in Europe around 75% of the Undertakings for Collective Investment in Transferable Securities (UCITS) investors are retail investors.[28] Thus, like other financial institutions, mutual funds have been influential in raising the financial sophistication of the population.[29] However, as will be seen later, the combination of the advantages offered by mutual funds such as liquidity based on net asset value (NAV) means they are a preferred option for the investors.

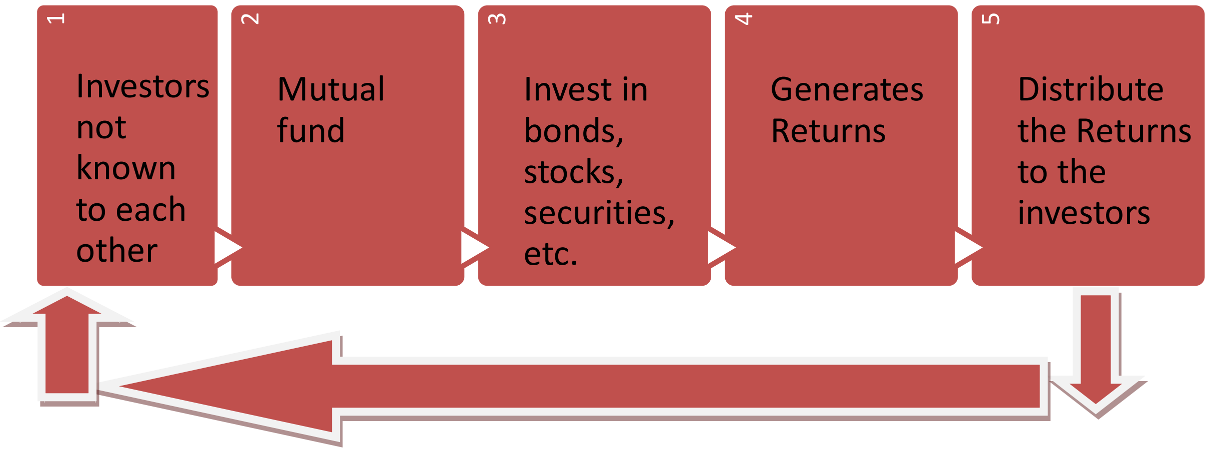
A mutual fund can be defined as a common pool of money into which investors put their funds, which will be invested in accordance with an agreed objective by professional management. It offers, in addition to diversification, liquidity by standing ready to redeem its shares at net asset value.[30] Generally, mutual funds invest their assets in bonds, stocks, short-term money market instruments, securities

---

[26] J Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (John Wiley & Sons, New Jersey 2009) xvii.
[27] H Kiymaz, H Baker and G Filbeck*, Mutual Funds and Exchange-Traded Funds Building Blocks to Wealth* (Oxford University Press, New York 2015) 10.
[28] European Commission, (n 3)
[29] OECD's Committee, 'White paper on Governance of Collective Investment schemes' (No. 88, March 2005) [P1].
[30] G. P. Mahoney, 'Manager-investor conflicts in mutual funds' (2004) 18 Journal of Economic Perspectives 161–182.

or a combination of these investments.[31] This definition, like most other definitions of mutual funds, attempts to show the main features of the mutual funds schemes (figure 2.1).

Figure (2.1): How mutual funds work.



Moreover, diversification, professional management, reductions of costs, liquidity and other significant features have made mutual funds competitive vehicles in the financial market, whether for the financial institutions that play a similar role to mutual funds in the financial market such as hedge funds and pension funds, or even for banks.[32]

Generally speaking, mutual funds around the world are created in different organisational forms. Firstly, the corporate form, where a mutual fund is usually treated as a separate entity. Secondly, the contractual form or the trust structure, where a mutual fund is established as a trust managed by a trustee for the benefit of the investors.[33]

In the UK, mutual funds are open-ended vehicles, which take one of two forms:

1- Unit Trust, which is an open-ended model and takes the trust form;

[31] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 8.
[32] Mahoney, (n 30).
[33] I.G. Sergeeva, 'Collective investment schemes regulations' (209) 3a Scientific journal NRU ITMO 1-13.

2- Open-Ended Investment Company (OEIC), which is an open-ended model and takes the corporate form.[34]

In addition, unit trusts and open-ended investment companies are open-ended vehicles and known in most of the countries around the world as mutual funds.[35] On the one hand, the OEIC takes the corporate form with a depositary and it is constituted under the instrument of incorporation. The OEIC is operated by the authorised corporate director (ACD) (or board of directors) and depositary. The role of the depositary, as will be seen later, is similar to the traditional role of the trustee of a unit trust, whereas the director (or board of directors) makes the investment decision on behalf of the OEIC. The shareholders in the OEICs are not the owners of the property that forms the subject matter of the fund, because OEICs have a separate legal personality. Further, the shares in OEICs are bought and sold at the same price which represents the mid-market price of the underlying assets (NAV).[36]

On the other hand, the legal basis of the unit trust is the trust and it is constituted under the trust deed.[37] There are two fiduciaries in the unit trust scheme, namely the manager and the trustee. The fund manager is responsible for making the investment decisions under the supervision of the trustee. In addition, the unitholders in unit trusts are the owners of the deposited property.[38] The units in the unit trusts are

[34] In the UK, the term *collective investment schemes* is wider than the term *mutual funds* because collective investment schemes include, in addition to open-ended investment companies and unit trusts, investment trusts. An investment trust is a closed-ended fund. This type of collective investment scheme is listed on the stock market. Investment trusts are actually not trusts as may be understood from the name, but are publicly quoted companies that invest in the shares of other companies. Like open-ended investment companies and unit trusts, investment trusts pool investors assets for investments, but investment trusts are closed-ended. They have a fixed amount of assets divided into shares for purchase. The investment trusts do not buy their shares back from shareholders. However, shareholders are entitled to the ordinary rights of a shareholder in relation to sale of shares and dividends. Investment trusts are registered under a company's legislation and the Financial Conduct Authority regulates their activities. The main differences between investment trusts and unit trusts were drawn in M&G Securities Ltd v Inland Revenue Commissioners, Chancery Division [1999] S.T.C. 315 case. For further information regarding investment trusts, see: B. J. Richardson, 'Ethical Finance in Britain: A Neglected Prerequisite for Sustainability' (2003) 5 Environmental Law Review 109-133.

[35] Sergeeva, (n 33).

[36] McCormack, (n 15).

[37] Ibid.

[38] See: Charles v. Federal Commission of Taxation (1954) 90 C.L.R. 598 at 609.

bought and sold at different prices. The price unitholders receive when selling units is generally less than the cost of purchasing units.[39]

While the mutual funds industry in the UK takes either the OEIC form or the unit trust form, most countries adopt only the corporate form because they do not recognise the trust concept. The trust is a well-developed common law concept adopted by common law countries.[40] However, whether mutual funds take the corporate form or the trust form, they are open-ended vehicles where investors can redeem their shares/units from the fund directly on demand and there is no limit to the number of shares/units offered.[41]

Mutual funds use the investors' contributions to buy assets stated with the specific investment objectives.[42] The investment objective defines the fund's fundamental investment aim. Generally, a wide range of mutual funds aims to increase the value of the basic amount invested (growth funds), while other mutual funds seek to provide investors with a regular income through the payment of dividends (fixed income funds). Further information regarding types of mutual fund will be discussed later.[43] The investment objective would often indicate the type of assets that would constitute a key part of the fund's investment portfolio. For instance, bond funds (fixed-income) would mainly buy debt instruments such as bonds, debentures or government securities.[44] The same principle applies to other types of mutual fund such as growth funds, balanced funds and money market funds where the managers must invest the assets according to the objectives of the funds, which the investors had already accepted when they bought shares/units of the funds. Here, it is worth mentioning that investors usually choose the mutual funds that match their personal investment objectives. For instance, a money market fund invests in short-term debt securities such as treasury bills and commercial paper because these instruments are

---

[39] For further information see, 3.4 (The Valuation and Pricing Regulations) 102.

[40] A trust is an equitable obligation binding a person (who is called a trustee) to deal with property over which he has control (which is called the trust property), for the benefit of persons (who are called beneficiaries). For further information see: D Hayton, P Matthews, C Christopher and J Mitchell, *Underhill and Hayton Law Relating to Trusts and Trustees* (18 edn, LexisNexis 2010).

[41] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 19.

[42] Collective Investment Schemes Sourcebook 2014, coll 4.2.5.

[43] A Northcott, The Mutual Funds Book: How to Invest in Mutual Funds & Earn High Rates of Returns Safely (Atlantic Publishing Company, Florida 2009) 51.

[44] Ibid.

forms of debt, which mature in a short period of time.[45] The manager of a money market fund cannot buy instruments that mature over a long period because that forms a breach of the stated objectives of the fund.[46]

2.2.1 Why Invest in a Mutual Fund?

Mutual funds have been successful financial institutions in the financial markets since the nineteenth century (see: A brief history of the mutual funds 2.2.6). One of the fundamental reasons for their phenomenal success in the developed markets such as the UK is the range of unique advantages they offer, which are difficult to duplicate by most other investment methods. It is important to know that some financial institutions may provide their investors with some of these advantages, but the unique thing in mutual funds is the combination of all those advantages in one vehicle. Those advantages can be summarised as follows:

1- Professional management

Professional management means that the assets of a mutual fund are invested and managed by professional fund managers with the experience, resources and expertise to manage the fund effectively.[47] Therefore, mutual funds provide access to professional investment skills, which would otherwise only be available to the sophisticated and wealthy investors. Making investment decisions is a complicated process, which requires comprehensive research and market analysis. Professional management usually has investment research teams, who have extensive access to research in different markets and sectors, to assess their prospects before making the investment decision. The opportunity for small investors to invest their funds by themselves is very limited. Thus, they delegate the task of making such investment decisions to specialist investment managers. Mutual funds provide such dedicated professional managers to those investors. It is worth noting that despite the criticisms of the professional managers that they obtain high fees compared to passive management such as tracker funds, the mutual fund managers provide the required services properly.[48] Unlike passive

---

[45] Kiymaz, Baker and Filbeck, (n 27) 270.

[46] Ibid.

[47] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 43.

[48] Trackers are known as passive investments because your fund manager does not make any 'active' decisions regarding markets or individual investments. In other words, when an index increases, the

management, mutual fund managers have a much greater level of freedom over the shape of their portfolios. Further, in bad times such as market fall, mutual fund managers can take a defensive stance to protect the investors, while passive management would have to follow the index.[49]

2- Diversification (Reduction of risk)

The term *diversification* indicates the process of spreading risk over a number of different investments, and probably across different markets ("do not put all your eggs in one basket").[50] Mutual funds introduce diversification to investors automatically by investing their assets in a wide range of bonds, stocks, securities and other investment vehicles.[51] While risk cannot be completely eliminated, the professional management of mutual funds can mitigate investment risks. In other words, if an investor invests his funds in a single investment holding, he would suffer markedly should the value of that holding suddenly decline.[52] On the contrary, if that investor invests his funds in several investments, the impact of a decline in the value of one of those holdings is offset by the other holdings. In addition, if an investor with a small amount of money invested directly into bonds or shares, it would be very difficult to him to achieve a meaningful level of diversification. Taking into account the cost of commission and bank charges on every single deal, his net investment funds would be reduced. Therefore, investing in a mutual fund enables small investors to avoid all those difficulties and obtain the required level of diversification.

3- Liquidity

One of the main concerns of investors in the financial markets is the relative length of time it takes to convert their units/shares into cash. This difficulty is overcome by investing in mutual funds. Liquidity is the ability of the investors to access their money in an investment. Generally, mutual funds are required by law

---

value of your fund rises with it and conversely, when the index falls, your investment in the fund falls with it.

[49] E Elton, M Gruber, S Brown and W Goetzmann, *Modern Portfolio Theory and Investment Analysis* (8th edn John Wiley & Sons, New Jersey 2009) 701.

[50] Haslem, Mutual Funds: *Risk and Performance Analysis for Decision Making* (n 1) 25.

[51] C Jones, *Mutual Funds: Your Money, Your Choice: Take Control Now and Build Wealth Wisely* (FT Press, New Jersey 2003) 47.

[52] Ibid.

to provide liquidity to investors. They are ready to buy back their shares/units every business day. In the UK, the mutual fund manager must redeem units/shares at a price determined no later than the end of the business day immediately following the receipt and acceptance of an instruction to do so, except for the deferred redemption situation.[53] The price per unit/share at which an investor can redeem shares/units is known as the mutual funds' net asset value (NAV). It is worth mentioning that in order to enhance liquidity, many mutual funds provide flexible rules by allowing investors to move between funds as long as they remain within the same mutual fund family. For example, Aberdeen Investment Funds ICVC entitles its shareholders to exchange shares of one class in a fund for the appropriate number of shares of another class, whether linked to the same or a different fund.[54]

4- Reduction of costs

When investors invest their funds in mutual funds, they get the advantage of economies of scale. This means that mutual funds pay lesser costs because of the large quantities in their transactions.[55] In fact, the costs of transactions in most financial markets are related to the size of the transaction. The costs of individual investors' transactions on small transactions are generally much higher than those transactions, which are carried out by institutional investors where they deal in large volumes.[56] The following example would clarify the idea. In the London Stock Exchange (LSE), investors buy and sell shares through a stockbroker. Brokers trade on behalf of their clients and profit by charging clients commission. If an investor wishes to invest in LSE, he should pay commission on every transaction. In order to reduce the risk of investment in the stock exchange, investors usually seek diversification. Therefore, the investor will make several transactions to minimise any potential loss. As a result, he will be charged for every transaction. Nonetheless, it should not be understood that the costs of

---

[53] Collective Investment Schemes Sourcebook 2014, coll 6, 6.2.16 (6).

[54] For more information see the Aberdeen Investment Funds ICVC Prospectus 2013 http://www.aberdeen-asset.co.uk/pdfupload.nsf/7DBCF3FACD680392802571BF002ABD54/$file/icvcprospectus.pdf?OpenElement accessed at 22 March 2015.

[55] See, Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 36.

[56] M Giles, E Alexeeva and S Buxton, *Managing Collective Investment Funds* (2nd edn John Wiley & Sons, 2005) 6.

investing in mutual funds might not be high because establishing, distributing and managing a mutual fund includes some costs such as management fees and custody costs.

5- Investor protection

Generally, mutual funds around the world are regulated by government regulations, which aim to protect investors. It is noticeable that the regulations of mutual funds, compared to other financial institutions such as hedge funds, are extensive.[57] Mutual funds must comply with a strict set of rules that are monitored by the legal authorities. These regulations include rules with respect to specific operating standards, transparency and disclosure. For instance, mutual funds must publish a prospectus, which contains specific relevant information such as the objectives of the fund and the management fees.[58] These regulations are designed to protect investors from fraud and conflicts of interest. This is supported by separation of the functions and supervision obligations of the service providers. Furthermore, mutual funds regulations require mutual funds to be transparent by enabling current or potential investors to access the important information regarding the financial situation and any changes in the main service providers of the fund or the investment objectives. Those extensive regulations may be justified on the basis that, compared to other financial institutions, most of the mutual funds investors are retail investors, and so the protection of investors is a key issue that should be considered by the mutual funds regulators.[59] However, the mutual funds regulations do not help investors to choose the proper fund. They also do not prevent mutual funds from losing their money.

Although mutual funds provide great advantages to the investors, there are a few disadvantages, including lack of control by investors and dilution. Regarding dilution, since mutual funds have small investments in so many different sectors, high returns from a few investments often do not make much difference to the overall return. However, the advantages of investing in mutual funds far outweigh the disadvantages.

[57] Haslem, Mutual Funds: *Risk and Performance Analysis for Decision Making* (n 1) 14.
[58] Collective Investment Schemes Sourcebook 2014, coll 4.2.5.
[59] European Commission, 'Greater protection for retail investors: Commission welcomes European Parliament adoption of strengthened European rules on UCITS' (n 3).

2.2.2 Hedge Funds Versus Mutual Funds

Defining mutual funds and demonstrating the importance of these financial institutions in the financial markets can be illustrated by comparing them with another significant financial institution in the financial markets: the hedge fund. Hedge funds play a significant role in the financial markets by increasing the number of participating investors and growing the pools of capital available. In its bi-annual Global Review, Hedge Fund Intelligence reported that assets in hedge funds of traditional types had reached nearly $2.337 trillion during the first half of 2013 compared to the banks' worldwide assets of $142 trillion by the end of 2014.[60] This shows the important role of these vehicles in the financial markets, and thus the research compares them with mutual funds.

Despite the growing attention that hedge funds have received recently by regulators, there is no common definition of what constitutes a hedge fund. Instead, hedge funds are usually defined by particular characteristics rather than by any specific legal structure.[61] As the European Central bank states:

> "*Although there is no common definition of what constitutes a Hedge Fund, it can be described as an unregulated or loosely regulated fund which can freely use various active investment strategies to achieve positive absolute returns*".[62]

In English law there is no regulatory, statutory or judicial definition of hedge funds. However, hedge funds are one of a category of funds known as alternative investment funds.[63] An alternative investment fund is a 'collective investment undertaking' that is not subject to the UCITS regime. It includes hedge funds, private equity funds, retail investment funds and real estate funds. Alternative investment funds invest in different types of global assets, including commodities and property.

[60] See, Statista: The Statistics Portal, available at http://www.statista.com/statistics/421215/banks-assets-globally/ accessed 31 May 2016. See also, Hedge Fund Intelligence, http://www.hedgefundintelligence.com/Article/3269985/Global-hedge-fund-assets-near-235-trillion-as-big-firms-drive-growth.html accessed 16 April 2015.

[61] L Tiffith, 'Hedge Fund Regulation: What the FSA Is Doing Right and Why the SEC Should Follow the FSA's Lead' (2007) 27 Nw. J. Int'l L. & Bus 497-532.

[62] T Garbaravicius and F Dierick, Hedge Funds and Their Implications for Financial Stability. European Central Bank Occasional paper series no. 34 (2005).

[63] M Sperlich, Alternative *Investments: Existing and Expected Legal Framework for the Operations of Hedge Funds in European and German Law* (Diplomica Verlag, Hamburg 2010) 10.

A UK hedge fund will normally be established as a corporate vehicle. Almost all of the UK managed hedge funds are domiciled in offshore zero-rated tax jurisdictions such as the Cayman Islands, where they enjoy light regulatory regimes.,[64]

Mutual funds and hedge funds as financial institutions have certain similarities. First, they pool their capital from investors, rather than bank loans or other sources of capital. Second, they invest their assets in publicly traded securities such as equities and bonds. Third, the capital collected from the investors is managed or invested by professional fund managers.[65]

Nonetheless, hedge funds differ from mutual funds in terms of the authorisation and transparency of all information, liquidity, oversight and systemic risks. Arguably, hedge funds were originally designed to circumvent regulations. When the first hedge funds came into existence in the US in the 1940s, they were designed to avoid the Securities and Exchange Commission regulations and fulfil versatility in their investments.[66] However, after enacting The Dodd-Frank Wall Street Reform and Consumer Protection Act in 2010, the Securities and Exchange Commission (SEC) has become increasingly active in monitoring the activities of hedge funds to ensure that investor interests were protected.[67] The Dodd-Frank Act has changed the scope of exemptions applicable to hedge fund managers. The Act requires hedge fund managers to maintain filed reports and records containing such information as the SEC deems necessary and appropriate in the public interest and for protecting the investors' interests or for the assessment of systemic risk by the Financial Stability Oversight Council.[68]

In the UK, despite the fact that hedge funds constitute unregulated schemes, those vehicles conducting investment business in the UK on behalf of that scheme such as the manager, promoter and prime broker, will be regulated by the FCA, such as the Conduct of Business Sourcebook, and, to this extent, investors are afforded a degree of regulatory protection. It is important to know that in 2013 the Alternative

[64] S Atiyah and A Walter, 'Hedge Funds - An Overview' (2004) 19 Butterworths Journal of International Banking and Financial Law 173-177.

[65] I Nelken*, Hedge Fund Investment Management* (Butterworth-Heinemann, Oxford 2005) 78.

[66] L Tiffith, (n 61).

[67] Available at http://www.sec.gov/about/laws/wallstreetreform-cpa.pdf.

[68] The Financial Stability Oversight Council is a United States federal government organisation, established by Title I of the Dodd-Frank Wall Street Reform and Consumer Protection Act to identify and monitor excessive risks to the USA's financial system.

Investment Fund Managers Regulations 2013 were enacted.[69] The Alternative Investment Fund Managers Regulations are applicable to alternative investment funds. Alternative investment fund managers are defined to mean legal persons whose regular business is managing one or more alternative investment funds (further information about these regulations will be discussed later).

Since the hedge funds are unregulated collective investment schemes, the main consequence of non-authorisation of hedge funds is that they cannot promote their products to the public. The Financial Services and Markets Act 2000 (Promotion of Collective Investment Schemes) (Exemptions) Order 2001 (SI 2001/1060) and The FCA's Conduct of Business Rules define the way that unregulated collective investment schemes, including hedge funds, may be marketed in the UK. According to the rules of these regulations, unregulated collective investment scheme products can only be marketed to intermediate or market counterparties, 'sophisticated investors', to specific categories of investors which meet particular net worth tests and to other private customers if the person marketing has taken reasonable steps to ensure that the product is suitable for the investor in question.[70]

A second important difference between hedge funds and mutual funds is the lack of transparency regarding the assets, strategy and leverage of a hedge fund. Transparency is related to the quality of being clear and understandable without any ambiguity. In contrast to hedge funds, transparency is a key issue in the mutual funds industry, where mutual funds are required by law to disclose specific information in the prospectus such as the fund objectives and management fees.[71] The consequence of lack of disclosure in hedge funds is so dangerous, to the investors or the market, because the lack of disclosure from hedge funds enables funds managers to engage in fraud and investors may not have any idea what a hedge fund manager is investing in until it is too late. In the USA between 1999 and 2004, the SEC brought fifty-one cases of hedge fund fraud totalling $1.1 billion in losses to investors.[72]

---

[69] Alternative Investment Fund Managers Regulations 2013.

[70] A certified high net worth investor is an individual who has signed, within the period of twelve months ending with the day on which the communication is made, a statement in specific terms. See, Conduct of Business Sourcebook, COBS 4.12.6.

[71] Collective Investment Schemes Sourcebook 2014, coll 4.2.5.

[72] G Sami, 'A Comparative Analysis of Hedge Fund Regulation in the United States and Europe' (2009) 29 Nw. J. Int'l L. & Bus 275-308.

In the UK, the Alternative Investment Fund Managers Directive (AIFMD) was transposed into UK law on 22 July 2013 by enacting The Alternative Investment Fund Managers Regulations 2013. The scope of the AIFMD regulations is broad since it covers the marketing and management of all 'collective investment undertakings' which are not subject to the Undertakings for Collective Investment in Transferable Securities Directives regime, including inter alia hedge funds, private equity funds and real estate funds.[73] The AIFMD regulations contain new rules relating to transparency of hedge funds. These rules require AIFMs to disclose to investors certain important information such as all associated risks, maximum leverage levels and a description of investment strategies.[74] It is clear that by establishing those rules, the AIFMD aims to avoid the consequences of a lack of transparency which could have negative effects on the financial markets.

Another difference between hedge funds and mutual funds is the lack of liquidity. Unlike mutual funds, hedge funds are not able to stand ready to repurchase shares on a daily basis. Rather, they impose some constraints on the investors such as liquidity dates and lock-up period. Liquidity dates indicate pre-specified times of the year when investors are allowed to redeem their shares. The lock-up period refers to the period of time for which the investors must keep their initial investment in the fund.[75]

Further, as was mentioned earlier, hedge funds in many jurisdictions are not strictly regulated as mutual funds. This lack of regulatory oversight might lead to potential conflicts of interest between the hedge fund management and investors. This does not mean that strict regulatory oversight in the mutual funds industry prevents conflicts of interest. While it is true that the regulatory oversight may not completely prevent conflicts of interest, clear and proper regulations might mitigate any potential conflict. For example, in the UK the mutual funds regulations require the mutual funds manager to disclose in the simplified prospectus any arrangements that may cause conflicts of interest and the way in which these conflicts will be resolved.[76]

---

[73] Parliament and Council Directive 2011/61/EU Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] oj L 174/1.
[74] Alternative Investment Fund Managers Regulations 2013, reg. 5.
[75] D Capocci, *The Complete Guide to Hedge Funds and Hedge Fund Strategies* (Palgrave Macmillan, New York 2013) 91.
[76] Collective Investment Schemes Sourcebook 2014, coll 4.6.8.

In addition, hedge funds can be highly levered asset management organisations. Systemic risk refers to “the risk that a major market participant’s losses in the financial markets may cause widespread loss to other firms in the market, or cause disruptions to other industries or to the entire worldwide financial system”.[77] An important drop in the hedge funds’ underlying assets might cause the hedge fund to fail. That could cause a significant loss to the financial markets. In contrast, mutual funds are much less levered, and so these funds would appear to be at little risk.[78] Transparency to regulators, through the information that needs to be provided on a regular basis with respect to both their asset positions and leverage levels, would reduce any potential systemic risk in the mutual funds industry.

To sum up, the fundamental difference between mutual funds and hedge funds lies in the degree of the regulations. Unlike mutual funds, hedge funds are not required to adhere to strict financial regulations. The idea that hedge funds are completely unregulated is not accurate; rather it would be more proper to say that these vehicles were originally structured to take advantage of exemptions in the regulations. As a result, investment in these funds would be more suitable to the sophisticated or professional investors who possess the knowledge, expertise and experience to make their own investment decisions and assess the potential risks that the investment incurs. In contrast, mutual funds are subject to comprehensive and strict regulations that govern the operation of the funds and the service providers. Those regulations are designed principally to protect investors and the industry.

2.2.3 A Classification of Mutual Funds

A wide variety of mutual funds exists worldwide to cater to the investors’ needs, such as risk tolerance and returns expectations. This flexibility makes mutual funds a preferred option in the financial markets. Though it is agreed that the definition of mutual funds excludes closed-ended funds, mutual funds may be classified, in a few jurisdictions, according to their capital structure into open-ended and closed-ended funds.[79] However, the term *mutual fund* in the leading countries of this industry such

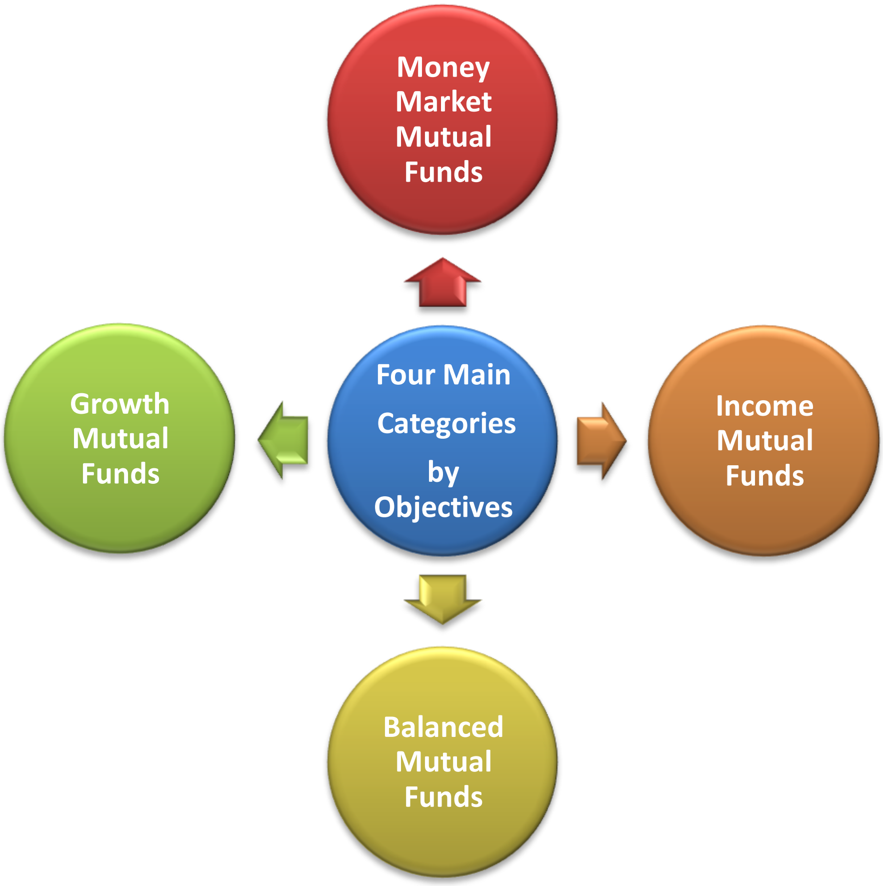
[77] A McClean, ‘The Extraterritorial Implications Of The SEC's New Rule Change To Regulate Hedge Funds’(2006) 38 Journal of International Law 105-122.
[78] For further information see, 2.4 (Mutual Funds Risk Management) 64.
[79] G Haight, G Ross and S Morrell, *How to Select Investment Managers & Evaluate Performance: A Guide for Pension Funds, Endowments, Foundations, and Trusts* (John Wiley & Sons, New Jersey 2008) 213.

as the UK, the USA and the Luxembourg refers only to the open-ended funds. The distinction between an open-ended and a closed-ended fund is very important in terms of the investors' rights and operation of the fund. On the one hand, open-ended mutual funds offer new shares/units to the public continuously.[80] Further, investors in open-ended funds can redeem their shares/units on demand at any time. This is to say that there is no specific duration for redemption. On the other hand, closed-ended funds issue a limited number of shares/units.[81] Closed-ended funds shares/units are not redeemable. That is, a closed-ended fund is not required to buy its shares back from investors upon request.[82] Closed-ended funds trade on a stock exchange. Therefore, the market price of a closed-ended fund is determined by the supply and demand for that fund.[83] For instance, J.P. Morgan Investment Trusts and Fidelity's Investment Trusts are closed-ended funds in the UK.

In addition, mutual funds can be classified into four types by objectives, namely those for growth alone, for income alone, those for both (balanced), and money market funds (figure 2.2). It is important to know that mutual funds with various investment objectives provide different investments returns and risk to the investors. Generally, the higher the potential returns, the bigger the risk of loss. Even though the level of risk in some mutual funds is smaller than in other funds, all mutual funds have some level of risk that cannot be avoided.[84]

Figure (2.2): Types of mutual fund by objectives.

[80] M P Fink, *The Rise of Mutual Funds: An Insider's View* (2nd edn Oxford University Press, New York 2011) 11.
[81] Haight, Ross and Morrell (n 79) 213.
[82] C. J. Stein, 'Why are most funds open-end? competition and the limits of arbitrage' (2005) 120 The Quarterly Journal of Economics 247-272.
[83] P Madlem and T Sykes, *The International Encyclopedia of Mutual Funds, Closed-end Funds and Real Estate Investment Trusts* (Taylor & Francis, London 2000) 235.
[84] For further information about the mutual funds risks, see 2. 4 (Mutual Funds Risk Management) 64.



1- Fixed Income Mutual Funds

The aim of fixed income mutual funds is to provide investors with a regular and steady income. Mainly, an income mutual fund invests its assets in fixed income securities, cash, money market instruments, and cash equivalents.[85] It is worth mentioning that the terms "*fixed income*" and "*income*" are synonymous regarding mutual funds. Generally, income mutual funds invest primarily in bonds issued by companies. Therefore, they are also referred to as bonds funds.[86] The net asset value of the fund is affected by the changes in interest rates. That is to say, if the interest rates increase, the net asset value is likely to fall in the short run and vice versa. Nonetheless, investors seeking long-term investment may not mind these fluctuations. Further, the level of risk in this type of fund is low to medium.

2- Growth Mutual Funds

[85] Northcott, (n 43) 51.
[86] Ibid.

The objective of growth mutual funds is to provide capital appreciation over the medium to long term with a small income.[87] Generally, these funds invest a main part of their assets in equities. The risk in this type of fund is higher than income mutual funds. Growth mutual funds are suitable for the investors who have a long-term outlook and are seeking appreciation over a long period. In the UK, the mutual funds regulations do not impose any obligation upon the growth funds regarding the length of period for which they can invest their assets.

3- Balanced Mutual funds

The objective of the balanced mutual funds is to provide both a regular income and growth as such mutual funds invest in equities and fixed income securities at the percentage referred to in the prospectus.[88] In fact, the balanced mutual funds have the freedom to specify the percentage of the assets, which will be invested in investments that provide a regular income and those which will be invested in growth investment. Normally, a typical balanced mutual fund may have a weighting of 50% equity and 50% fixed income. This kind of fund is ideal for investors seeking a mix of income and moderate growth. The level of risk in balanced mutual funds is medium to high depending on the split between equities and fixed income.

4- Money Market Mutual Funds

Money market mutual funds invest their assets in short term instruments such as certificates of deposit, commercial papers, treasury bills and government securities.[89] Therefore, the most important feature of money market funds is liquidity due to the short-term nature of their underlying investments. Liquidity refers to the extent to which the fund's holdings can be quickly converted into cash.[90] Money market funds pay incomes that commonly reflect short-term interest rates. Generally, the returns for money market funds are lower than for those in bond or equity funds. In addition, the short-term nature of money market

---

[87] M Mobius, Mutual Funds: An Introduction to the Core Concepts (John Wiley & Sons, New Jersey 2007) 21.

[88] C Turner, *International Funds: A Practical Guide to their establishment and operation* (Butterworth-Heinemann, Great Britain 2004)26.

[89] A Lyon, 'Money Market Funds and Shareholder Dilution' (1984) 39 the Journal of Finance, 1011-1020.

[90] Haslem, Mutual Funds: *Risk and Performance Analysis for Decision Making* (n 1) 38.

mutual funds makes them less risky than any other type of fund. This is not to say that money market mutual funds are not without risk.[91] In the UK, a money market mutual fund generally cannot invest in any instrument with a maturity greater than 397 days.[92] The global money market funds industry is dominated by the USA (around 61.5%).[93] The money market funds industry in the USA had approximately USD 3.1 trillion in assets under management as of the end of 2014. At the end of 2014, money market funds accounted for an estimated 16% of all mutual funds globally.[94]

In the UK, money market funds are currently subject to the European Securities and Markets Authority (ESMA) Guidelines on a common definition of European money market funds (CESR/10-049) of 19 May 2010. The ESMA Guidelines are implemented by the FCA in its Collective Investment Schemes Sourcebook (COLL 5.9). However, the money market funds regulations go much further than the ESMA Guidelines in a number of areas. Here, it is worth mentioning that as part of its shadow banking regulatory proposals, the European Commission has made a proposal for a new European framework for Money Market Funds. This includes a draft Regulation of the European Parliament and of the Council on money market funds 2013/0306(COD).[95] The proposal reflects the recommendations issued by the Financial Stability Board (FSB) in October 2012 regarding the need to apply floating NAV in the money markets industry.

It is clear now that the mutual funds industry has produced a wide range of funds that respond to the needs of the investors, whether they seek fixed and regular income, long or short-term investments or are looking for both. That is to say that mutual funds are flexible vehicles.

---

[91] See, Testimony on "Perspectives on Money Market Mutual Fund Reforms" by Chairman Mary L. Schapiro, USA. Securities and Exchange Commission available at http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489510 accessed 2 May 2008. It addresses the risks posed by money market funds to the financial system in the financial crisis of 2008.

[92] Collective Investment Schemes Sourcebook 2014, coll 5.2.7 G.

[93] International Organization of Securities Commissions, '*Peer Review of Regulation of Money Market Funds: Final Report'* (FR19, September 2015). Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD502.pdf accessed 15 February 2016.

[94] Ibid.

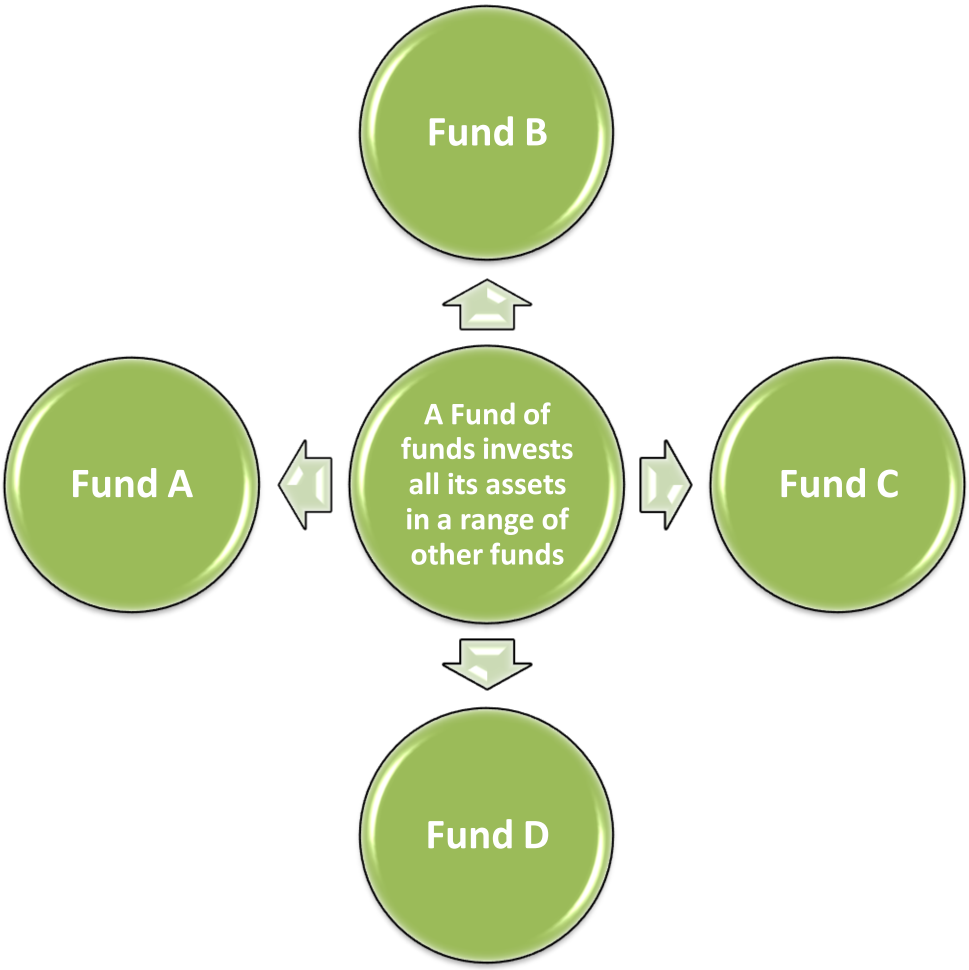
[95] The Proposal for a Regulation of the European Parliament And of the Council on Money Market Funds is available at: http://ec.europa.eu/internal_market/investment/docs/money-market-funds/130904_mmfs-regulation_en.pdf accessed 15 February 2016.

What is more, in the recent decades the mutual funds industry has focused on multiple vehicle structures such as funds of funds and umbrella funds.[96] An umbrella fund is a family of sub-funds established as a single legal entity.[97] Each sub-fund has its own discrete portfolio of underlying assets and its own investment objectives. In other words, each smaller fund is treated as if it were its own mutual fund.[98] Some sub-funds would mainly be based on investing in stocks, while others might be based on making investments in bonds or commodities. The umbrella fund structure provides favourable switching facilities between its sub-funds, and investors can easily move from one sub-fund to another.

In addition, a fund of funds is a fund that invests all its assets in other funds (figure 2.3). A fund of funds enables investors to obtain greater diversification through one vehicle.[99] Mutual funds regulations usually impose investment limits upon a fund of funds such that a fund of funds must not invest in a fund of funds or any sub-fund of an umbrella fund which is a fund of a fund. For instance, a UCITS fund of funds may not invest its assets in another fund which itself is allowed to invest more than ten per cent of its assets in funds. This is intended to avoid the potential consequences of levels of layering which could bear the risk of multiple charges.[100] A UCITS fund of funds is also not permitted to invest more than 30 per cent of its assets in non-UCITS funds.[101]

Figure (2.3): Fund of funds.

[96] Turner (n 88) 50.
[97] A Hall, *Getting Started in Mutual Funds* (2nd edn, John Wiley & Sons, New Jersey 2010) 20.
[98] Ibid.
[99] S Hodge, 'Open-Ended Investment Companies' (1995) 3 J.F.R. & C.321-328.
[100] Turner (n 88) 189.
[101] Ibid.



2.2.4 The Operation of a Mutual Fund

Unlike other business enterprises, a mutual fund is externally managed. In other words, it has no employees (full time staff) in the traditional sense. Rather, a mutual fund relies upon third parties' services to perform the mutual fund activities and invest its assets.[102] The following discussion addresses the various players involved in the operation of a mutual fund and the key role of each (figure 2.4).

Figure (2.4): Mutual fund main players

[102] Haslem, Mutual Funds: *Risk and Performance Analysis for Decision Making* (n 1) 2.

1- The mutual fund manager

The key aim of investing in a mutual fund is to leave the investment management to the professional mutual fund manager. The mutual fund manager is a professional financial expert who has investment skills. The mutual fund manager is responsible for the day-to-day management of the fund[103] and makes investment decisions that comply with the investment objectives.[104] It is also responsible for preparing the

[103] M&G Securities Ltd v Inland Revenue Commissioners; Schroder Unit Trusts Limited v Commissioners of Inland Revenue [1999] S.T.C. 315; [1999] B.T.C. 8003. P3.
[104] Collective Investment Schemes Sourcebook 2014, coll 6.6.3 (3).

mutual fund prospectus.[105] The fund manager also prepares the fund's short and long reports.[106] Although the mutual fund manager is usually entitled to delegate some of their functions to third parties, they remain responsible for the actions taken by delegates in case they fail to perform their functions properly.[107] It is important to know that in some jurisdictions, the mutual fund manager is replaced by other functionaries. For instance, the open-ended investment companies in the UK have an authorised corporate director (ACD). Here, it is worth mentioning that in the USA, the mutual fund manager is called the investment adviser.

2- The investment adviser

Though the fund manager is responsible for managing the fund and making the investment decisions, they are entitled to delegate some functions to third parties. A mutual fund manager may delegate specific functions to an investment adviser.[108] Generally, the key role of the investment adviser is to assess investment opportunities and adopt the most effective strategy complying with the fund's objectives.[109] Nonetheless, the investment adviser is not entitled to make decisions on behalf of the fund. It can only make recommendations to the fund manager who is responsible for making the investment decisions based on those recommendations. As a result, the manager will be responsible to the investors for any loss caused by those decisions. Furthermore, in some cases, the mutual fund manager may delegate specific functions to another manager rather than an investment adviser.[110] In this case, the external investment manager will be able to make decisions within their limits without approval from the mutual fund manager.

3- Administrator

While most mutual funds regulations do not require the appointment of an administrator, the mutual fund manager usually delegates the administration functions to an administrator. Essentially, the mutual fund administrator is responsible for coordinating the functions of the other service providers to perform

[105] Ibid, coll 4.4.2.
[106] Ibid, coll 4.5.2.
[107] Ibid, coll 6.6.15.
[108] Shepherds Investments Ltd v Walters [2006] EWHC 836 (Ch). [9].
[109] Ibid.
[110] Collective Investment Schemes Sourcebook 2014, coll 6.6. 15.

the business of the fund effectively.[111] For example, the administrator usually provides office space, preserving the mutual fund's records and publishing the NAV and other reports. It is important to know that, in some cases, the investment adviser may perform the activities of the mutual fund administrator.[112]

4- Custodian/Trustee/Depositary

A custodian is a person who holds the assets of the mutual fund in safe keeping. The custodian is typically a major financial institution such as a bank. Where the mutual fund takes the trust form, the custodian is known as the trustee, such as with the unit trust in the UK. A custodian of a mutual fund typically has a dual role: (1) to oversee the way in which the mutual fund is managed; (2) to safeguard the property of the mutual fund.[113] Therefore, the custodian provides independent oversight of the activities of the mutual fund in order to protect the interests of the investors. Further, in the UK, the OEICs' Regulations require OEICs to appoint a depositary who stands in place for a trustee of a unit trust.[114] The depositary role includes both the custodianship of the OEICs' property and supervision of the ACD and other service providers.[115]

5- Distributor

A mutual fund distributor is responsible for marketing the mutual fund shares/units to investors. The mechanism in which mutual funds shares/units are sold depends on the regulations and policies of the funds. A mutual fund may distribute its shares/units through independent professional intermediaries or it may distribute them directly to the public at a price equal to their current net asset value.[116] The distributors must provide the prospective investors with accurate and clear

---

[111] Kiymaz, Baker and Filbeck, (n 27) 405.
[112] D Riggs and C Park 'Mutual Funds: A Banker's Primer' (1995) 112 Banking L.J. 757-785.
[113] Abbey National Plc v Customs and Excise Commissioners [2006] S.T.C. 1136. [84].
[114] Open Ended Investment Company Regulations 2001, reg. 5.
[115] Collective Investment Schemes Sourcebook 2014, coll 6.6.4.
[116] D J Romanski, 'Role of Advertising in the Mutual Funds Industry' (1972) 13 Boston College Industrial and Commercial Law Review 959-1020.

information or any additional information that they may ask for.[117] Further, distributors must treat all prospective investors fairly.[118]

6- Auditors

In most jurisdictions, mutual funds regulations require mutual funds to appoint auditors. In the UK, regulation 69 of the OEICs regulations requires every open-ended investment company to appoint an auditor or auditors.[119] The main obligation of the auditors is to certify the mutual fund's financial statements and reports.[120] This ensures that the financial statements and reports comply with the requirements of the regulations. In addition, regulators usually place constraints on the type of audit firm that may audit the mutual funds.[121] It is worth mentioning that the audit fees are usually paid direct from the assets of the fund.[122]

7- Legal Counsel

The mutual fund legal counsel advises the mutual fund manager and other players on a wide range of matters. In fact, the role of the legal counsel begins before the mutual fund itself is established because the legal counsel usually reviews registration statements and other regulatory requirements. The legal counsel may also advise the fund on different matters such as taxation issues, permitted distribution methods and drafting of important contracts between the mutual fund and the third parties.[123]

In addition, it should be noted that the service providers involved in the operation of a mutual fund vary among jurisdictions. For instance, in the USA the Investment Company Act 1940 requires mutual funds to appoint a chief compliance officer to be responsible for administrating the fund's compliance policies and procedures,[124] whereas in the UK, the mutual funds regulations do not require mutual funds to appoint a chief compliance officer.

---

[117] Bernard L Madoff Investment Securities LLC, Re [2010] EWHC 1299 (Ch). [19].
[118] J Benjamin and D Rouc, 'Providers and Distributors: Responsibilities in Relation to Retail Structured Products' (2007) 1 Law and Financial Markets Review 413-421
[119] Open Ended Investment Company Regulations 2001, sched, 5 reg. 69. 4.
[120] Open Ended Investment Company Regulations 2001, reg. 67.
[121] Ibid, sched, 5 reg. 69. 1.
[122] Turner (n 88) 109.
[123] Ibid, 111.
[124] See, Kiymaz, Baker and Filbeck, (n 27) 75.

2.2.5 Growth of the Mutual Funds Industry

The worldwide mutual funds industry has grown dramatically in recent years. The American Investment Company Institute (ICI) publishes a Fact Book every year that updates the statistics of the mutual funds industry in the USA and around the world. In the 2015 Fact Book, the total worldwide net assets invested in mutual funds at the end of 2014 were a staggering $31.3 trillion, while the total worldwide net assets invested in mutual funds at the end of 2013 were $30 trillion (figure 2.5).[125] Here, it is important to compare the total mutual funds; worldwide assets with the total banks' worldwide assets. In fact, the banking industry is the biggest financial industry in the world in the financial markets. The banks worldwide assets reached $142 trillion by the end of 2014.[126] Further, the USA mutual fund net assets exceeded $15.8 trillion in 2014 compared to $15 trillion at the end of 2013,[127] whereas the USA banks' total assets reached $15.75 trillion by the second quarter of 2015.[128] This emphasises the significant role that mutual funds can play in the financial market. In the United Kingdom the total mutual fund net assets exceeded $1.18 trillion at the end of 2014 (figure 2.6) compared to $ 1.16 trillion at the end of 2013 (for the UK, funds of funds are not included).[129] These figures show the rapid growth of this industry around the world.

Furthermore, to demonstrate the significant role of the mutual funds industry, a comparison can also be made with pension funds. Pension funds are very important financial vehicles in the financial markets and attract a wide range of investors. According to a study made by the Towers Watson services company in 2013, the total assets of pension funds in the United Kingdom at the end of 2012 exceeded $2.736 billion, while it exceeded $16.851 billion in the USA at the end of the same year.[130] This comparison shows the significance of mutual funds as very attractive

[125] American Investment Company Institute, (n 2).
[126] Statista: The Statistics Portal, available at http://www.statista.com/statistics/421215/banks-assets-globally/ accessed 31 May 2016.
[127] Ibid.
[128] YCharts, available at https://ycharts.com/indicators/us_banks_total_assets accessed 1 June 2016.
[129] In the United Kingdom, the Investment Management Association (IMA), which represents the UK investment management industry, makes surveys in respect of the mutual funds industry which include statistics about this industry in the UK (www.investmentfunds.org.uk).
[130] Towers Watson, 'Global Pension Assets Study 2013' (2013). <http:// http://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2013/01/Global-Pensions-Asset-Study-2013 > accessed 19 September 2013.

financial institutions in the financial market because of the huge amount of assets invested in the mutual funds industry.

Along with other countries such as the USA, Luxembourg and Ireland, the United Kingdom is considered one of the leading countries in the mutual funds industry. The growth of this industry in these countries can be attributed to different factors such as economic, geographic and legal factors. However, the common factor between these countries is the existence of developed legal frameworks that attract local and foreign investors to invest in this industry. The regulations in these countries cover different areas of the industry and provide investors with a high level of protection. They adopt various governance mechanisms designed to fit the structure of the mutual funds industry.

Indeed, the existing regulations of mutual funds in these countries are a consequence of many developments and reforms. In other words, every time the mutual funds industry faces a crisis, scandal or developments, the legislators try to either amend the existing laws and regulations or enact new regulations to protect the investors and save the industry. As a result, these regulations cover different aspects of the industry and provide investors with a high level of protection.

Unlike the growth of the mutual funds industry in the UK and other countries, the development of this industry is still slow in many countries such as Latin American countries (except Brazil) and Middle Eastern countries. However, these countries have recently realised the significance of these vehicles in the financial markets to attract investments. As a result, legislators in these countries have recently started to enact laws and regulations that regulate this industry. One of these countries is Syria, where the Mutual Funds Act was enacted in 2011.

Though the regulations in these countries provide investors with some protection, they are still insufficient and do not cover some important legal aspects of the industry and epically those regarding investor protection. The most important outcome of this is that local and foreign investors are discouraged from investing their assets in these countries. One possible solution to enhance the legal framework of mutual funds in these countries could be that the lawmakers should benefit from the experience of the leading countries in a way that fits the legal structure of a mutual fund.

Figure (2.5).[131]

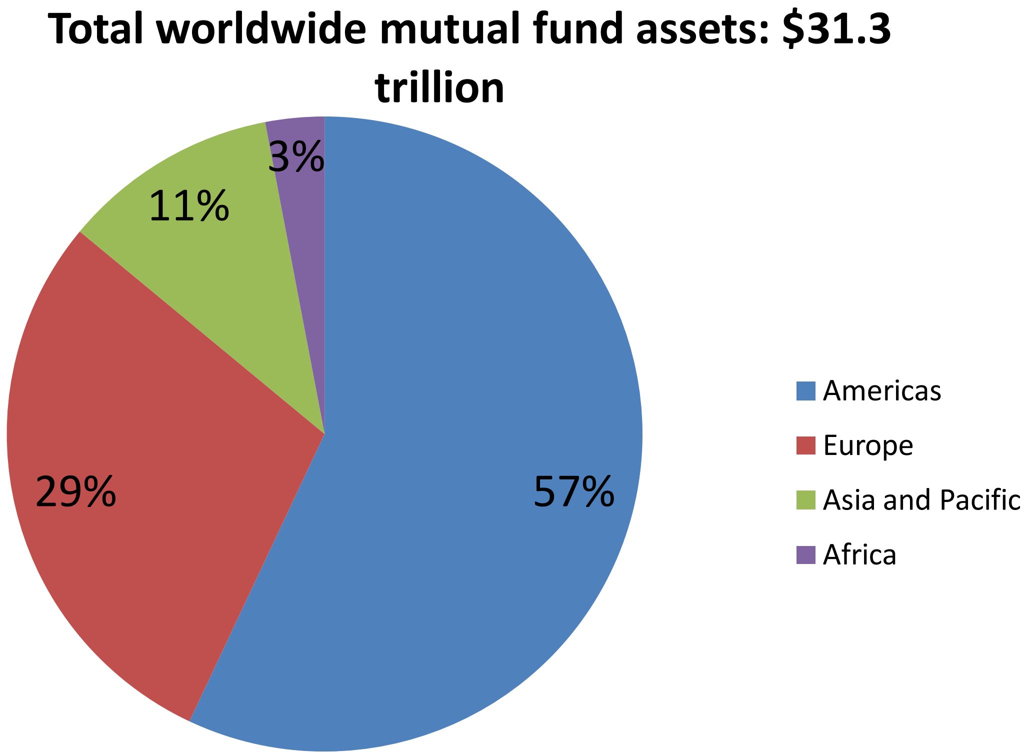


Figure (2.6).[132]

Figure 2 shows the leading countries regarding the total net assets of mutual funds at the end of 2014 in millions of US dollars according to the 2015 Investment Company Fact Book. However, it should be taken into consideration that funds of funds are not included, except for France and Luxembourg.

131 American Investment Company Institute, (n 2).
132 Ibid.

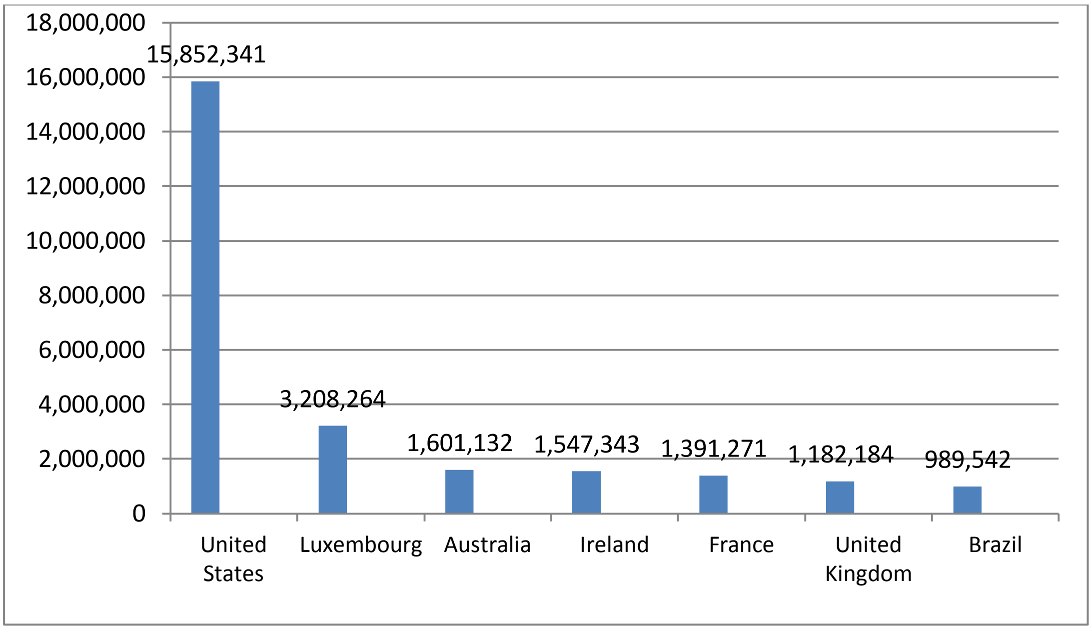


Figure (2.6) raises some important questions regarding the leading countries in this industry: why are some countries that have strong economies such as Germany not within these countries? Why are some countries such as Luxembourg, Australia, Ireland and Brazil leading countries in this industry? What are the reasons for this success? This study will try to find answers to all these questions in the following analysis.

As for the Brazilian mutual funds industry, this industry has grown rapidly in the last few decades in terms of its size and complexity. This growth can be attributed to economic factors such as liquidity, diversification, professional management and lower transaction costs provided by these products.[133] Furthermore, other possible reasons for this growth are the increasing Brazilian market sophistication, the marked growth of derivatives, and globalisation.[134] However, the changes and reforms in the mutual funds regulations may be the real reason for the growth. These changes have ensured stronger investor protection and sufficient information disclosure.[135] These

[133] G Varga and M Wenger 'The Growth and Size of the Brazilian Mutual Fund Industry' paper presented at the annual meeting of the BALAS Annual Conference, ESADE, Barcelona, Spain, Mar 24, 2010 < http://www.fce.com.br/gv/artigos/2010_BrazilianMutualFundIndustry.pdf> accessed 22 September 2013.
[134] Ibid.
[135] Ibid.

changes have also removed the restrictions on foreign investment, so the mutual funds industry in Brazil is no longer closed to other countries.[136]

The situation is different in Luxembourg and Ireland. Both countries are extremely important in the mutual funds industry. They attract a wide range of funds from across Europe. Regarding Luxembourg, this country has grown to be a European mutual fund axis fuelled by favourable bank secrecy and tax laws as well as its central location within Europe.[137] Luxembourg has direct access to the main European markets such as France and Germany. The general investment environment in Luxembourg, including a stable political environment, an effective financial platform and excellent information and communications technology infrastructure, attracts a wide range of investments from different countries. Luxembourg has become a major centre for offshore mutual funds. Favourable banking and tax laws have led Luxembourg to play this role. Moreover, in 1992, the German government decided to levy a 25% withholding tax on interest on investment assets and bank deposits. Hence, this decision led to a transfer of capital to Luxembourg-based fund management subsidiaries of German banks.[138] These movements fuelled the mutual funds industry in Luxembourg and were one of the major reasons for the growth of the industry.

In Ireland, different reasons have led to the remarkable growth. The most important reason for the growth is the establishment of an International Finance Services Centre (IFSC) in Dublin.[139] The International Finance Services Centre provides fund operators with great incentives in the form of a reduced tax of 10% on income earned from specific types of servicing and financing operations. Besides, the fund operators received a double tax deduction for rent. The growth may also be attributed to its educated workforce.[140] It should also be taken into consideration that the harmonisation of regulations permitting funds to be sold throughout European markets promoted the growth of the mutual funds industry in Ireland. The Undertakings for Collective Investment in Transferable Securities directives have

[136] Ibid.
[137] A Khorana, H Servaes and P Tufano, 'Explaining the Size of the Mutual Fund Industry Around the World' (2005) 78 Journal of Financial Economics 145-185.
[138] Ibid.
[139] Ibid.
[140] Ibid.

played a key role in the strong growth of mutual funds in Ireland. Within a few short years, Ireland has become a key pan-European domicile for fund products promoted by most of the world's largest investment management groups.[141]

In Australia, the growth of mutual funds would principally be attributed to the implementation of the mandatory pension plans (superannuation system) which operate on mutual funds principles. In 1992, the Australian government introduced the superannuation policy, which required employers to define contribution plans for their employees.[142] The system also encouraged the employees to make their own additional contributions. A significant part of these contributions ends up being managed by mutual funds managers.

After analysing the possible reasons of the growth of the mutual funds industry in Brazil, Luxembourg, Australia and Ireland, the following conclusions can be drawn with respect to the success of this industry in some countries more than others. The flexibility in laws and regulations has a significant impact on growing the mutual funds industry. In addition, excessive regulation could prevent or put brakes on the development of the industry. The impact of this could lead to the movement of funds management firms to less regulated financial markets. Moreover, another important factor might affect the mutual funds industry is the general legal environment. The character of the legal framework is significant for the enforcement of contracts. It also shows the government's general approach towards business and investments.[143] In fact, investors are usually more willing to invest their funds in a country where the overall legal system is robust.

In addition, the existence of mutual funds regulations that regulate different aspects of the industry is also key to developing the mutual funds industry. The countries that adopt mutual funds regulations with stronger investor protections are more likely to increase investors' willingness to invest in mutual funds.[144] Investors usually prefer mutual funds regulations that provide them with a high level of transparency rules and ensure they find procedures that prevent conflicts of interest between the mutual

---

[141] Ibid.

[142] L Gremillion, *Mutual Fund Industry Handbook: A Comprehensive Guide for Investment Professionals* (John Wiley & Sons, New Jersey 2012) 320.

[143] R La Porta, F Lopez-de-Silanes, A Shleifer and R Vishny, 'Law and finance' (1998) 106 J.Pol.Econ 1113-1155.

[144] Khorana, Servaes and Tufano, (n 137).

fund management and the investors. However, it should be taken into consideration that overregulation could cause high costs and form barriers that hinder the development of this industry.

Finally, there is no doubt that the relationship between the tax rules and investment decisions is also relevant in this regard.[145] The mutual funds industry would grow better when tax regulations provide facilities to the investments. In countries such as Ireland, where management companies receive favourable tax treatment of their income, the mutual funds industry would grow stronger.[146] Hence, each country willing to accelerate the growth of this industry should pay attention to all the above factors which make mutual funds attractive not only to local investors, but also to foreign investments.

2.2.6 A Brief History of Mutual Funds

Mutual funds have become a very attractive tool for a wide range of investors, whether individuals with insufficient experience to invest their money or sophisticated entities seeking to preserve their entities. Mutual funds are not a new invention. They have a varied and long history. The following discussion will address the history of mutual funds in three countries: the Netherlands, the US and the UK. The question here is; why will the study discuss the history of mutual funds in these countries? As for the Netherlands, most of the academics who have written about mutual funds pointed out that the first mutual fund was established in the Netherlands in 1774. Hence, this study will shed light on that investment, discuss its features, and discover whether it had the same characteristics as current mutual funds. In addition, the research will examine the history of mutual funds in the UK because the core focus of this thesis is the mutual funds industry and regulations in the UK, so it is essential to highlight the most important developments in the history of the industry in this country. Finally, the thesis will examine the history of mutual funds in the USA because the USA is the leader in this industry and more than half of the worldwide assets of this industry are invested in the US. However, before starting the discussion on the history of mutual funds in those countries, it is useful to mention briefly the antecedents of these financial institutions.

---

[145] See, J Poterba and A Samwick, 'Taxation and Household Portfolio Composition: USA. Evidence from the 1980s and 1990s' (2003) 87 Journal of Public Economics 5-38.

[146] Khorana, Servaes and Tufano, (n 137).

2.2.6.1 Antecedents of Mutual Funds

The idea of pooling money from different investors to create investments is not a new idea. Prior to the eighteenth century, when some of the modern mutual funds started to appear, a number of investment vehicles had been created. These vehicles aimed to pool financial or non-financial assets from a large number of investors into one big investment.[147] In fact, despite these investments not being identical to the current mutual funds, they showed many of the same features. The first basic type was a contract of survival. This included life annuities and tontines. The second type was plantation loans.[148]

Principally, life annuities are financial contracts whereby borrowers pay interest to lenders for the rest of the lenders' lives.[149] The lenders have the right to stipulate in the contract that the borrower should pay the interest to a third party named in the contract. This kind of investment probably dates back to as early as 205 B.C.[150] Life annuities spread and became significant vehicles for public finance in the seventeenth and eighteenth centuries.

In a tontine, a borrower undertakes to pay a group of individuals an annuity that will be divided among the surviving members. Every time one of the members dies, the payout to the rest increases. At the early stage of this industry, governments organised tontines. However, private tontines appeared and became popular in the seventeenth century.[151] To guarantee periodic payments to the members, the private tontines required some forms of collateral. This was achieved by using the members' initial contributions to buy financial securities.

The second type of securities that had some features of mutual funds were the plantation loans. This kind of investment spread in the eighteenth century. It securitised mortgages to planters in the West Indies.[152] Between 1753 and 1776, around two hundred plantation loans were brought to the Amsterdam market.[153] In addition, the plantation loans included some factors of investment trust. However,

---

[147] G Rouwenhorst, 'The Origins of Mutual Funds' (2004) Yale School of Management - International Centre for Finance 4-48. Available at SSRN: http://ssrn.com/abstract=636146.
[148] Ibid.
[149] Ibid.
[150] Turner (n 88) 9.
[151] Rouwenhorst, (n 147).
[152] Ibid.
[153] Ibid.

their investments, mortgages to planters, were not securities in themselves as mutual funds. Furthermore, the investments' objective was not to provide diversification to the public. Here, it is worth noting that many of the early mutual funds invested an important part of their portfolios in plantation loans.[154]

2.2.6.2 The History of the Mutual Funds in the Netherlands

The concept of mutual funds is a very old concept. Most of the academics and writers who wrote about mutual funds indicated that this concept was created in the Netherlands over 240 years ago.[155] In 1774, the Dutch merchant and broker Abraham van Ketwich established an investment trust named Eendragt Maakt Magt, which means 'Unity Creates Strength'.[156] The establishment of the trust followed the financial crisis of 1772–1773 and van Ketwich's aim was to provide small investors with limited means a chance to diversify. Abraham van Ketwich promised investors they would obtain a dividend of 4 percent with adjustments depending on the investment income of the project. The basic agreement was to dissolve the trust after twenty-five years, at which point the liquidation proceeds would be distributed among the remaining investors. Eendragt Maakt Magt issued 2,000 shares and subscription was open to the public. However, participation in the fund was only possible by purchasing shares from existing shareholders in the market.

The shares of the trust took two forms: registered shares and bearer shares. Based on these features, Eendragt Maakt Magt could possibly be categorised today as a closed-ended investment trust, which issues a fixed number of shares. Most of the information known about Eendragt Maakt Magt is based on a manuscript copy of its prospectus.[157] This prospectus includes seventeen articles illustrating the details of portfolio creation, management fees and payout policies. Here, it is worth noting that the prospectus required van Ketwich to provide an annual accounting report to the commissioners. Besides, it required van Ketwich, upon request, to provide an adequate disclosure to all interested parties to guarantee good and proper management at all times.

---

[154] Ibid.

[155] See: Rouwenhorst, '(n 147), and B D Fitzpatrick, 'Global Mutual Fund Industry Comparisons: Canada, the United Kingdom And the United States' (2010) 9 International Business & Economics Research Journal 11-24.

[156] Rouwenhorst, (n 147).

[157] Ibid.

After the successful experience in Eendragt Maakt Magt, Abraham van Ketwich established his second fund under the name of Concordia Res Parvae Crescunt in 1779, the name being the Latin equivalent of Eendragt Maakt Magt.[158] This fund was identical to the first one in terms of the name and structure. Nonetheless, Abraham van Ketwich adopted more freedom in the investment policy.

In 1782, the investment income decreased due to the Fourth Anglo-Dutch War of 1780-1784, so van Ketwich suspended the redemption of shares in Eendragt Maakt Magt and lowered dividend payments several years later.[159] By the end of the century, the two funds' prices disappeared from the official price record of the Amsterdam stock exchange, and share prices appeared in irregular private auctions by brokers.

During the 1780s and 1790s, more than thirty investment trusts were established with one aim: speculation on the future credit of the United States.[160] Between 1782 and 1791, an estimated 32 million guilders were raised in Amsterdam and Antwerp. In addition, in the eighteenth and nineteenth centuries, much of government borrowing occurred through a "book of public debt". Investors could obtain a receipt that could be presented at a treasury to collect periodic interest payments. Though depositary receipts were originally found to promote trade in foreign government debt, they became popular in the Amsterdam market in the second half of the nineteenth century.

2.2.6.3 The History of Mutual Funds in the United Kingdom

Some academics have pointed out that the mutual funds industry began in the United Kingdom in the mid-1800s, when the Foreign and Colonial Government Trust was created.[161] The Foreign and Colonial Government Trust was established in 1868 in London. It was the first investment trust outside of the Netherlands and invested its assets in foreign government bonds. According to its prospectus, the trust's aim was to provide "*the investors of moderate means the same advantages as the large capitalist….by spreading the investment over a number of different stocks.*"[162] By

[158] Ibid.
[159] Ibid.
[160] Ibid.
[161] Turner (n 88) 9.
[162] Rouwenhorst, (n 147).

1875, eighteen trusts had been formed in London.[163] Here, it is worth noting that the most significant feature of these trusts was not their legal features, but the high rate of return they offered.[164] However, after some initial success, some of the trusts were not able to pay the interest promised, for instance, the Share Investment Trust which went into partial default in 1876.[165]

In addition, in 1930 International Investment Deposit Certificates were invested in the UK. These certificates were units from a Swiss fixed unit trust.[166] Société Internationale de Placements was the manager of that trust and the Union Bank of Switzerland was the trustee. In 1931 the First British Fixed Trust was established with Municipal and General Securities Company Limited as the manager and Lloyds Bank as the trustee. In 1958 the Prevention of Fraud (investments) Act was enacted. This Act was very important because section 17 required authorisation from the Board of Trade. The Authorisation was required if the units were to be sold to the public.[167]

In 1986, the Financial Services Act was enacted. Section 76 of the Act provided the terms of authorisation of unit trusts. Under this section, the invitation to investors to become participants in a unit trust could only be issued by an authorised person. However, the government realised that the trust was not a widespread concept in Europe. As a result, the government decided to introduce open-ended investment companies to the financial market in the United Kingdom. The Open-Ended Investment Companies Regulations were enacted in 1996 and came into force in 1997. In 2000 the Financial Services and Markets Act was enacted and became the fundamental act that regulates the unit trusts in the UK. Moreover, the 1996 regulations regulating open-ended investment companies were replaced by Open Ended Investment Companies Regulations 2001. In other words, unit trusts are regulated by the Financial Services and Markets Act (FSMA) 2000, and open-ended investment companies are regulated by the FSMA 2000 and the Open Ended Investment Companies Regulations (OEIC) 2001.

---

[163] Ibid.
[164] Sin, (n 10) 25.
[165] For further information, see Skyes v. Beadon (1879) 11Ch. D 170.
[166] Sin, (n 10) 29.
[167] Khorana, Servaes and Tufano, (n 137).

2.2.6.4 The History of Mutual Funds in the United States

In the United States, the investment trust schemes were introduced to the financial market during the 1890s.[168] Like Eendragt Maakt Magt, most of those investment trusts were closed-ended funds issuing a fixed number of shares. This general trend was changed in 1924, when the Massachusetts Investors Trust became the first open-ended mutual fund in the US.[169] The fund launched with assets of $50,000 invested in about 45 stocks. In a short period of time, the Massachusetts fund had most of the basic features of today's mutual funds. It issued only redeemable securities, and it continuously offered new shares to investors.

In 1929, the stock market crash slowed mutual funds' growth. As a result, during the 1930s and 1940s, Congress passed laws and regulations to provide investors with the appropriate protection. Both the Securities Act of 1933 and the Stock Exchange Act of 1934 required mutual funds to be registered with the Securities and Exchange Commission. They required also that the mutual funds provide the prospective investors with a prospectus.

In 1936, the Revenue Act was enacted. This act is considered one of the most important events in the history of the mutual fund in the USA. It provided that if a mutual fund met a numbers of requirements, it would be exempt from tax. Furthermore, it provided that fund shareholders would be taxed on distributions they received.[170] Here, it is worth mentioning that the Revenue Act was the first time that mutual funds had been regulated by federal regulation.

In 1940, the Investment Company Act was enacted. This Act is the main legislation that regulates the mutual fund industry in the USA today. Following all these regulations, the mutual funds industry has grown rapidly, and today more than half of the world's mutual fund assets are invested in the USA.

2.3 The Legal Nature of Open-Ended Investment Companies and Unit Trusts

In the UK, the mutual funds take either the trust structure (unit trusts) or the corporate form (OEICs). Since the discussion in this thesis mainly addresses mutual funds in the UK, it is important to explore the legal nature of OEICs and unit trusts.

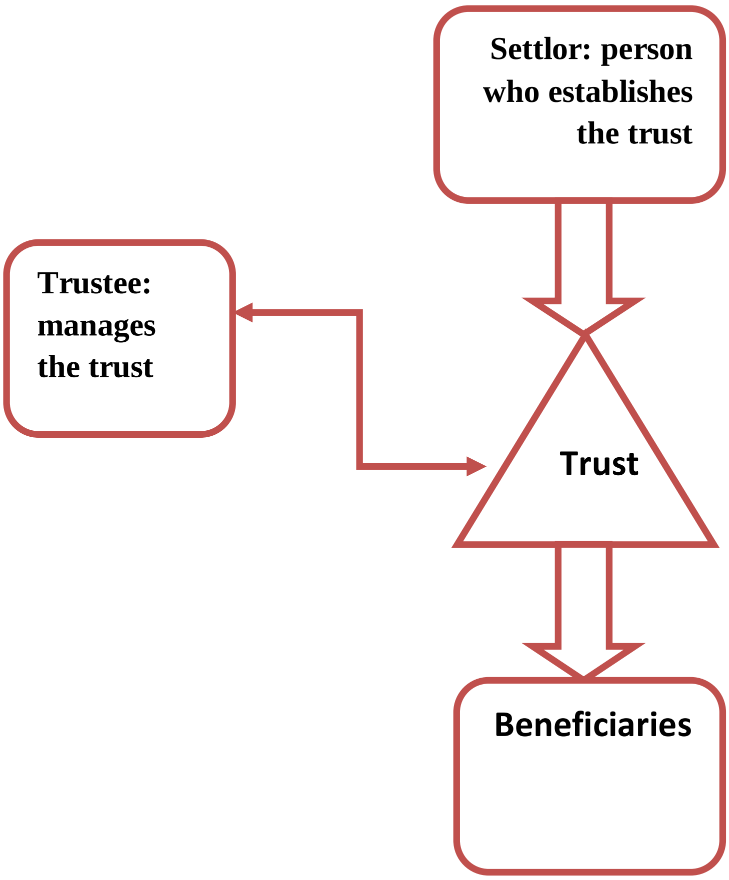
---

[168] Rouwenhorst, (n 147).
[169] Turner (n 88) 11.
[170] Fink, (n 80) 29.

2.3.1 The Legal Nature of the Unit Trust

The unit trust is the original form of mutual funds in the United Kingdom. This depends on the English common law concept of the trust. Generally, a trust is created by a settlor who signs the trust deed.[171] The trust deed defines the duties and powers of the trustee.[172] It also specifies the way in which the beneficiaries are to benefit (figure 2.7). The trustee holds the legal title of trust assets on behalf of the beneficiaries (in the case of the unit trust, the beneficiaries are investors or the unitholders).[173] The beneficiaries have a beneficial interest in the underlying assets.[174]

Figure (2.7): Trust structure



Further, trusts themselves do not have any legal personality under English law. Thus, they cannot make contracts in their own name. Instead, trusts are characterised by the

[171] A Hudson, *Equity and Trusts* (3rd edn, Cavendish Publishing, London 2014) 32.
[172] Ibid.
[173] Ibid.
[174] C Webb and T Akkouh, *Trusts Law* (3rd edn, Palgrave Macmillan London 2013) 39.

relevant document constituting the trust between the trustee and the beneficiaries (in the case of the unit trust, this is the trust deed).[175]

In addition, understanding the legal nature of the unit trust requires explaining the way in which unit trusts operate. Generally, unit trusts operate as follows. The unit trust is established under a deed of the trust between the manager and the trustee.[176] The trust deed defines the terms and provisions under which the trust is created. It defines the investment objectives and the products permitted. The trust deed also specifies the limitations of investments which the manager should consider when they choose the investment strategy of the scheme.[177] The manager of the unit trust must be a management company.[178] The manager will be empowered by the terms of the trust deed to acquire securities defined in the trust deed. The unit trust manager will be subject to a general duty to spread the risk of the total investment capital of the unit trust.

Then, the securities are transferred to the trustee appointed in the trust deed. The trustee must also be a company under the provisions of the FSMA 2000.[179] The trustee does not make any investment decisions. However, the efficient role of the trustee is to ensure the manager's compliance with the regulations and the fund objectives.[180] Further, the profits of the investment are then allocated proportionately between the units held. Each investor has the right to a pro-rata cash return for each unit held.

Furthermore, it is clear that the constitution and operation of the unit trust involves two steps. The first step is the accomplishment of the trust deed between the manager and the trustee. The second step is when the investors make the decision to subscribe units of the unit trust and become unitholders.

---

175 J Garton, G Moffat, G Bean and R Probert, *Moffat's Trusts Law: Text and Materials* (Cambridge University Press, Cambridge 2015) 19.
176 McCormack, (n 15).
177 Loader, (n 12) 8.
178 Financial Services and Markets Act 2000 s.243 (5) (a).
179 Ibid.
180 For further information about the role of the trustee and the fund manager, see 4.3.2.1 (The Unit Trust Governance Structure) 139.

Unlike private trust inter vivos where the settlor is the creator,[181] the COLL Sourcebook (3.2.3) stipulates that the trust must be constituted by a trust deed made between the manager and the trustee.[182] This raises a significant question: who is the settlor in the unit trust? In an Australian case (the unit trust structure in Australia is similar to the unit trust in the UK regarding the dual structure: the manager and the trustee),[183] *Famel Pty. Ltd. V. Burswood Management Ltd.*, French J considered the manager as the settlor in the unit trust.[184] However, his Honour did not give any explanation to the meaning of the word "settlor".[185] If French J used the word settlor to mean creator of the trust, it is likely a correct discretion. If the word was used to mean a person settling property by way of gift, it is unlikely to be the right description of the manager.[186]

In addition, the role of the manager under the terms of the trust deed and the regulations is to manage the investment of unitholders' funds and make the investment decisions. In other words, the manager of the unit trust does not have any property to settle. Nonetheless, there is no trust without property. Here, the second step comes where the investors subscribe units and pay the subscription money, and so the unit trust comes into existence.

The question here is, every time an investor subscribes for units in the unit trusts, could the investor be considered a settlor establishing the unit trust? The concept of the unit trust is based on the idea of raising money from different investors to be managed by professional management. Therefore, when the investors make the decision to participate in the unit trust, the main intention of each investor is the same as others, which is pooling money with other investors to benefit from the professional management provided by the unit trust. Indeed, the unitholders are beneficiaries under a one unit trust scheme.[187]

---

[181] Garton, Moffat, Bean and Probert, (n 175) 153.

[182] Collective Investment Schemes Sourcebook 2014, coll 3.2.3.

[183] Sin, (n 10) 45.

[184] Famel Pty. Ltd. V. Burswood Management Ltd (1989) 15 Australian Company Law Reports (ACLR) 572.

[185] Sin, in his book *the Legal Nature of the Unit Trust,* interpreted the word settlor as the creator. See Sin, (n 10) 51.

[186] For further information see, Sin, (n 10) 51.

[187] In AEG Unit Trust (Managers) Ltd's Deed, Re, Midland Bank Executor and Trustee Co Ltd v AEG Unit Trust (Managers) Ltd, Wynn-Parry J held that a unitholder subscribing units in a unit trust is not settling his property for the purpose of the Law of Property Act provision related to restricting

To sum up, the unit trust purports to be a trust. However, the focal point is that the unit trust has no settlor. Instead, it involves capital contributions by different unitholders to an existing unit trust vehicle which was created by the trustee and the manager. The unitholders are regarded to be the beneficiaries under the terms of the trust deed. Each unitholder has the right to a pro-rata cash return for each unit held. In other words, the unit trust may be considered as a sui generis trust which is created to suit the investment purposes. However, it is important to note that everyone has accepted it and it is now in widespread use. That is to say, the legal anomaly does not affect business.

2.3.2 The Legal nature of Open-Ended Investment Companies

From the economic and legal respects, the functional similarities between the unit trusts and OEICs far outweigh the differences. The provisions that distinguish OEICs from unit trusts come from the corporate structure of OEICs. Further, to understand the legal nature of OEICs, it is essential to analyse the definition of OEIC. Analysing the definition will help in defining the criteria that should be considered to describe a body corporate as an OEIC.

An OEIC is defined in the Financial Services and Markets Act 2000 as: *"a collective investment scheme which satisfies both the property condition and the investment condition*."[188]

Therefore, for a body corporate to be an OEIC as defined in the FSMA 2000:

1- It must be a collective investment scheme (CIS);

2- It must satisfy the property condition in s. 236 (2); and

3- It must satisfy the investment condition in section 236 (3).

The first element of the definition is that OEICs are corporate structures of a collective investment scheme. This means that OEICs must have the features defined in section 235 of the FSMA 2000.[189]

accumulation of income. See AEG Unit Trust (Managers) Ltd's Deed, Re, Midland Bank Executor and Trustee Co Ltd v AEG Unit Trust (Managers) Ltd [1957] Ch 415 at 420.

[188] Financial Services and Markets Act 2000 s.36 (1).

In addition, if a body corporate comes within the definition of a CIS, the second element in the definition is whether the property to which the scheme relates meets the property element. The property condition is a requirement that:

> "*The property belongs beneficially to, and is managed by or on behalf of, a body corporate ("BC") having as its purpose the investment of its funds with the aim of— (a) spreading investment risk; and (b) giving its members the benefit of the results of the management of those funds by or on behalf of that body*."[190]

It is obvious from section 236 (2) that the OEIC itself will be the beneficial owner of the property, and the reference to body corporate is a reference to OEIC rather than to the authorised corporate director or to the depositary.[191] However, the shareholders of the body corporate may not have a beneficial interest in that property. They will only have rights against the body corporate. The term "*property*" is not defined in the FSMA, but it could be understood from the context that it refers to the investment assets held for the purpose of the CIS, whether including money or other forms of property. However, it must be possible to value the property if the requirements of the investment condition with respect to net asset value are to be met.

Furthermore, the property condition raises a very fundamental question which is whether the asset invested in by the body corporate with the objective of spreading risk is not affected by the levels of risk contained in specific investments. In fact, the value of each body corporate investment could be subject to a high level of risk. It could be said that this would not itself breach the property condition as long as the total of different investments affirmed that the aim was to spread investment risk.

Further, if the body corporate meets the requirements of the definition of a collective investment scheme, the third element that must be satisfied is the investment condition. The investment condition itself provides that:

---

[189] For more information about the definition of the CIS and its features, see Hudson, *The Law of Finance* (n 13) 1269.

[190] Financial Services and Markets Act 2000 s.36 (2).

[191] Hudson, *The Law of Finance* (n 13)1283.

> *"In relation to BC, a reasonable investor would, if he were to participate in the scheme— (a) expect that he would be able to realize, within a period appearing to him to be reasonable, his investment in the scheme (represented, at any given time, by the value of shares in, or securities of, BC held by him as a participant in the scheme); and (b) be satisfied that his investment would be realized on a basis calculated wholly or mainly by reference to the value of property in respect of which the scheme makes arrangements.*"[192]

Under the investment condition, the reasonable investor is looking to satisfy two aspects. These aspects are vital in making the investment decision. The first aspect is the expectation test and the second is the satisfaction test.

The Act used the term "reasonable investor" and not just a reasonable person. This means that the objective standard that must be applied is that of a reasonable investor. This creates a presumption that the reasonable investor has some knowledge of the characteristics of collective investment, and possesses judgement based on good sense.[193]

Moreover, the first aspect of the investment condition is the expectation test. This test provides that the reasonable investor contemplating investing in the fund must expect that he will be able to redeem his shares/units within a period that is reasonable to him. In making the assessment, different factors will be relevant, including the terms of the body corporate constitution, any public representations that have been made by the body corporate, the nature of the investment objectives or policy of the body corporate and the actual behaviour of the body corporate.[194]

In addition, it seems clear that the realisation of investment means converting an asset into cash or money. Thus, an expectation that securities or shares of the body corporate will be exchanged for other shares or securities will not consider redemption unless the process of replacing the shares and securities, and realising them, will be within a reasonable time.

---

[192] Financial Services and Markets Act 2000 s.36 (3).

[193] Meaning of open-ended investment company (AUTH App 2) 2004, 2.6.2. http://fshandbook.info/FS/html/handbook/AUTH/App/2 accessed 11 May 2014.

[194] Collective Investment Schemes Sourcebook 2014, coll 2.8.9.

The second aspect of the investment condition is the satisfaction test. The satisfaction test provides that the reasonable investor must be satisfied that his investment would be realised on a basis calculated wholly or mainly by reference to the net asset value. Generally, the investment condition concentrates on the manner in which the body corporate operates over time, and not by reference to specific issues of shares or securities.[195]

Further, in order that the reasonable investor is satisfied, many circumstances or a combination of circumstances should be taken into consideration, including the basis of net asset valuation stated in constitutional documents of the body corporate and any separate agreement or arrangement made outside the constitutional documents.

Furthermore, the satisfaction test will not be met if realisation is to happen through a secondary market because the market price of securities, which is determined by the rules of supply and demand, may not exactly reflect the net asset value of the company's assets. However, if the body corporate undertakes to take actions to ensure that the price of its securities is based on the net asset value, then this would satisfy the satisfaction test.[196] Here, it is worth mentioning that the FSMA uses the phrase 'wholly or mainly' to give some flexibility. Therefore, minor departures from the net asset value basis such as deduction of redemption charges, in some funds, are not fatal as long as the net asset value is the core basis of realisation.[197]

Now after analysing the factors of the OEIC definition, the following points can be concluded. First, the OEIC is a collective investment scheme and it takes the corporate form. Specifically, it is a property management institution through which investments are made by a financial vehicle on behalf of investors. The investment of the OEIC's assets is managed by a body corporate known as the authorised corporate director (ACD), while the property of the OEIC will be entrusted to the depositary.

Second, the requirements of the definition aim to provide investors with proper protection. Spreading risk and realisation of securities on the basis of net asset value within a reasonable period are the most important features of OEICs which distinguish them from traditional companies. Thus, the FSMA defined these features

[195] Ibid, coll 2.9.2.
[196] G Walker and M Blair, *Financial Services Law* (Oxford, New York 2006) 680.
[197] Meaning of open-ended investment company (AUTH App 2) 2004, 2.9.7.

in the definition of the OEIC to guarantee that any body corporate wishing to be an OEIC must fulfil these requirements.

2.4 Mutual Funds Risk Management

Risk management is key in protecting the mutual fund and the investors from potential risks to which mutual funds are exposed as a result of performing the fund's activities. The recent financial crisis (2008) and scandals in the financial markets have raised several questions regarding the efficiency of current risk management methods. They have confirmed the need for a comprehensive risk management process. Risk management could be defined as the comprehensive process of identifying an organisation's risk and making informed procedures in order to help it achieve its objectives, which would minimise the possibility of failure.[198] Therefore, managing risks requires finding a balance between the possibility that an investment of a mutual fund will go badly against the possibility that those investments will perform well.

In addition, in order to decide what types of risk to take, fund managers must understand what those risks are so that they can assess and manage them effectively. Failure to do so could result in an unanticipated risk which may harm the mutual funds investors. Generally, mutual funds' potential risks can be classified into two major areas: financial risks and non-financial risks.[199] On the one hand, financial risks generally include market risk, credit risk and liquidity risk. On the other hand, non-financial risks include operational risks, legal risks and integrity risks.

Further, understanding risk management principles and rules requires understanding those major risks. Therefore, the following discussion will be devoted to examining and describing those risks.

1- Market risk

Market risk indicates the risk of exposure to fluctuations in the value of the financial instruments due to changing market conditions.[200] Market risk generally includes

[198] See, J Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 154.

[199] See, E Fragnière and G Sullivan, *Risk Management: Safeguarding Company Assets* (George Sullivan, Boston 2007) 21.

[200] See, Kiymaz, Baker and Filbeck, (n 27) 154.

currency risk, interest rate risk and price risk.[201] Mutual funds regulations usually define the rules for how mutual funds must calculate market risk. The mutual funds prospectus usually indicates the market risk. For example, a mutual fund may invest most of its assets in specific markets, so the risk associated with those markets should be disclosed in the prospectus. In the UK, the mutual funds regulations require the mutual fund manager to ensure that the risk management policy includes such procedures as are necessary to enable the authorised fund manager to assess the exposure of each mutual fund it manages to market risk which might be material for that scheme.[202] In fact, a mutual fund may be prone to changing market conditions for different reasons, such as general movements in interest rates, development in the regulatory framework and global, regional or national economic developments.

2- Credit risk

Credit risk refers to the current and possible future risk to the assets and returns of the fund due to a counterparty default on its contractual or financial obligations.[203] Credit risk should also be stated in the prospectus. For instance, the risk of losing assets as a result of the insolvency or negligence on the part of the custodian constitutes a credit risk. It is important to know that the mutual fund manager performs daily reviews of portfolio attributes, such as credit quality and sector diversification. As a result, they make proper adjustments where necessary to ensure that the credit risk components of the mutual funds closely match those of the respective benchmarks.[204] Furthermore, the investment manager performs assessment of credit ratings of debt instruments as part of daily investment limitation monitoring. Counterparty credit risk is also evaluated periodically by the fund manager as part of the general credit risk assessment.[205]

3- Liquidity risk

Liquidity risk is the potential risk to the mutual funds' assets due to the fact that the fund is unable to meet its payment obligations.[206] In other words, the mutual fund

[201] Ibid.
[202] Collective Investment Schemes Sourcebook 2014, coll 6.12.5 (2).
[203] See, Kiymaz, Baker and Filbeck, (n 27) 185.
[204] Collective Investment Schemes Sourcebook 2014, coll 5.2.10A (2) (b) and 5.7.11 (7) (a).
[205] Ibid, coll 5.3.3c and 6.11.4 (b).
[206] P Lückoff, *Mutual Fund Performance and Performance Persistence: The Impact of Fund Flows and Manager Changes* (Springer Science & Business Media, Heidelberg 2011) 19.

cannot raise sufficient cash to meet its liabilities when due. Mutual funds are required to always have sufficient liquidity in order to meet their payment obligations. Therefore, mutual funds follow certain procedures including investment restrictions to maintain sufficient liquidity. In the UK, the mutual fund manager must employ an appropriate liquidity risk management process in order to ensure that each mutual fund manager is able to comply at any time with its sale and redemption obligations.[207] In fact, liquidity problems only take place in difficult market situations, so the possibility of them happening is small but the consequences might be great.[208] In the USA in 2015, the Securities and Exchange Commission proposed a comprehensive package of rule reforms designed to enhance effective liquidity risk management of mutual funds.[209] The main aim of this proposal was to ensure that investors could redeem their shares and receive their funds in a timely manner.

4- Operational risk

Operational risk is the risk of loss as a result of insufficient or failed internal procedures and systems or from external factors.[210] Operational risk also includes legal risk. An example of an internal event is internal fraud such as loss resulting from bribery. Further, the main difference between financial risks and operational risk is that there is no risk/return relationship in operational risk. Consequently, the fund cannot apply mathematical methods to mitigate risk. Legal risk includes the risk of not complying with regulations and laws. Mutual funds regulations usually avoid the consequences of operational risk by imposing strict obligations on the mutual fund service providers. The mutual fund manager must establish management policy which must comprise procedures to assess the potential operational risk and its consequences.[211]

5- Integrity risk

[207] Collective Investment Schemes Sourcebook 2014, coll 6.12.11 (1).
[208] For further information see, 3.3.2.2 (restrictions on the investment and borrowing powers) 83 and 3.5.1 (suspension of redemption) 111.
[209] Securities and Exchange Commission, '*SEC Proposes Liquidity Management Rules For Mutual Funds And ETFs*' (2015) available at https://www.sec.gov/news/pressrelease/2015-201.html accessed 3 June 2016.
[210] H Baker and G Filbeck, *Investment Risk Management* (Oxford University Press, New York 2015) 443.
[211] Collective Investment Schemes Sourcebook 2014, coll 6.12.5 (2).

Integrity risk includes conflicts of interest risk, money laundering risk and personnel risk. Mutual funds must have proper procedures to prevent any potential conflicts between investors and service providers (potential conflicts of interest and the regulatory methods to address conflicts of interest will be discussed later).[212] Further, mutual funds should adopt policies and procedures to assess the trustworthiness and positions of the third party providers.

It is important to know that mutual funds regulations usually do not classify risks, and they only define a few classes of risk. However, mutual funds should classify all types of risk to avoid their negative consequences.

2.4.1 The Risk Management Function

In order to protect investors and ensure effective operation of the fund, the mutual fund manager must establish a permanent risk management function. In the UK the risk management function must be hierarchically and functionally independent from operating units.[213] The function should be properly resourced and it should work according to suitable standards of efficiency and competence. That is to say, an effective risk management function should have the necessary personnel with the expertise, skills and knowledge required to perform the obligations that are imposed upon them.

Furthermore, the duties and responsibilities of the risk management function vary from one country to another depending on the size and form of the mutual fund. However, the key duties of the risk management function can be summarised as follows; firstly, it must implement risk management policy and procedures that fit the size and objectives of the fund.[214] Secondly, the function must provide the supervisory entity with regular reports.[215] Those reports must address different issues such as the conformity between the current level of risk incurred by the fund and the risk profile agreed for this fund, effectiveness of the risk management process and the compliance of the fund with the risk limit system. Thirdly, the function must advise the governing body on all necessary information with respect to identification

[212] See, 4.4 (Agency problems as challenge to governance) 147.
[213] Collective Investment Schemes Sourcebook 2014, coll 6.11.2.
[214] Ibid, coll 6.12.3.
[215] Ibid, coll 6.10.3.

of the risk profile.[216] To fulfil those duties, the risk management function must have access to all relevant information.

2.4.2 The Risk Management Process

The concept of the risk management process indicates the systematic operation of management procedures, policies and practices in the activities of evaluating, analysing, reviewing and monitoring risks.[217] The mutual fund manager must employ a risk management process that enables him to monitor and measure the scheme risk. The risk management process should consider the investment objectives and policies stated in the fund prospectus. In fact, the mutual fund manager should demonstrate more sophistication in the risk management process for funds with sophisticated risk profiles than he does for those with simple risk profiles.[218]

In addition, the manager must establish formal written policies that reflect the risk management objectives.[219] The risk management policy clarifies the fund's general intentions and its risk approach. The risk management policy should create an effective and transparent framework for managing risks. Further, the risk management policy should identify and define the allocation of the roles and responsibilities with the authorised fund manager.[220] It should also specify the reporting procedures and arrangements of the risk management function.[221]

Furthermore, the mutual fund manager must evaluate, monitor and regularly review the risk management process and policies to check whether the current control measures and procedures are effective. [222] The risk management function must define who is responsible for the assessment and monitoring process. The results of the monitoring and assessment process must be documented and reported.

In addition, the effectiveness and adequacy of the risk management process should be considered by the competent authorities. Those authorities should also supervise the process on an ongoing basis. The independent authorities should be informed of

[216] Ibid, coll 6.11.4.
[217] R Kumar, *Strategies of Banks and Other Financial Institutions: Theories and Cases* (Elsevier, USA 2014) 91.
[218] Collective Investment Schemes Sourcebook 2014, coll 6.12.3.
[219] Ibid, coll 6.12.5.
[220] Ibid, coll 6.12.5 (3).
[221] Ibid, coll 6.10.3.
[222] Ibid, coll 6.12.4 (6).

fundamental changes to the risk management process so that the competent authorities may intervene in appropriate cases.[223]

It is clear now that the risk management process is a key issue that should be considered by the mutual funds regulators. The risk management process should be dynamic. The process should be reviewed and changed when appropriate to respond to a changing environment. The risk management process is significant not only to the safety of the mutual funds but also to protecting the interests of the fund investors.

2.5 Conclusion

This chapter has focused on defining mutual funds. It demonstrated that mutual funds are one of the most important ways of raising funds from the public in the financial market .They have given small investors the opportunity to participate in the rapid and strong growth of capital markets in the past few decades. One of the key reasons for the success of this industry is the range of unique advantages they offer, such as professional management, liquidity, diversification, reduction of risk, and investor protection. Although some financial institutions offer some of these advantages such as hedge funds, which are managed by professional management, the unique feature of mutual funds is the combination of those advantages in one financial vehicle. Another significant reason that makes mutual funds attractive is flexibility. Flexibility means that there is a wide range of types of mutual fund which cater to the investors' needs, such as risk tolerance and returns expectations like growth funds, income funds, balanced funds, and money market funds. Further, the study also showed the importance of risk management in the mutual funds industry in order to protect the investors, the mutual fund and the financial market. Risk management plays a key role in protecting investors from potential risks to which mutual funds are exposed with respect to performance of the fund's activities. The research emphasised the significance of adopting the appropriate risk management policy which considers the fund investment's objectives and policies.

[223] Ibid, coll 6.12.7 (2).

CHAPTER 3

A Critical Examination of the Regulatory Framework of Mutual Funds

3.1 Introduction

Mutual funds have unique characteristics that affect the manner in which they are regulated. A distinct feature of these vehicles is the separation of the investment assets and management. Thus, the mutual funds regulations should take this fact into consideration to ensure the effectiveness of the legal framework. After defining mutual funds in the previous chapter, this chapter focuses on the mutual funds regulations in the UK. The main aim of this chapter is to examine how the mutual funds regulations in the UK address different aspects of the industry and especially with respect to investor protection. It is worth mentioning that examining and understanding the mutual funds regulations in the UK will help to understand the international principles for mutual funds because the UK is one of the significant global players of the industry and the international principles are a reflection of the principles that apply in the UK.[224] Nonetheless, the mutual funds regulations in the UK are more sophisticated than those principles.[225]

This chapter scrutinises the existing framework that governs the mutual funds industry in the United Kingdom. The chapter will shed light on the regulations of mutual funds during the stages of the mutual fund's life. The chapter will focus on the authorisation process of the mutual funds, the operation of the fund, and the winding up and termination of the fund. Here, it is significant to mention that the research will also highlight the mutual funds regulations in the USA, where it is necessary for comparative purposes and which will help to achieve the objectives of this chapter. Further, since the core objective of the research is to assess the possibility of exporting certain regulatory lessons to Middle Eastern countries, it is necessary at times to highlight some weaknesses in the existing mutual funds regulation in Syria.

---

[224] For further information about the international standards, see 5.2 (The International Organization of Securities Commissions (IOSCO) Principles for the Regulation of Collective Investment Schemes) 175.

[225] See International Organization of Securities Commissions, 'Objectives and Principles of Securities Regulation '(2010) available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf accessed 30 June 2016.

The first section investigates the objectives of the financial regulation generally and the mutual funds regulation particularly. The second section examines the existing legal framework of mutual funds in the United Kingdom. It particularly studies the development of the mutual funds regulations in the UK. The third section discusses the mutual funds valuation regulations. The fourth section examines the delegation of functions rules under the existing regulations. Finally, the last section studies the suspension of redemptions rules and the winding up methods. It is necessary to know that suspension of redemptions is an exceptional tool that fund managers can use in very limited situations, so it is necessary to examine the rules that regulate this tool in order to ensure that the interests of the investors are protected and the managers do not misuse this authority. Although winding up the mutual fund is the last stage in the life of the fund, it is significant to ensure the protection of the investors during this stage. Hence, the research will shed light on the rules governing the winding up of mutual funds under the current regulation.

3.2 Objectives of Financial Regulation

Globally, defining what the high level objectives of financial regulation should be is controversial. On the one hand, financial regulation is considered an effective tool of economic policy. Therefore, the core financial regulation objectives are determined by economic policy objectives. Economic growth and stability are generally the key aims of economic policy.[226] Financial regulation has a significant influence on economic growth and stability. Financial market failures might have serious impacts on a country’s potential growth and economic stability. They might also have a harsh consequence on public confidence. Thus, the key aim of financial regulation is to protect the economic integrity and to build public confidence in the financial system. On the other hand, financial regulation plays a key role in achieving consumer policy objectives and preventing financial crime.[227]

Generally, policy makers have established three major objectives of financial regulation.[228] The first objective is safeguarding the financial system’s stability.

---

[226] G Magone, *Regulating Europe* (2nd edn Routledge, New York 2003) 30.

[227] M Andenas and Chiu, *The Foundations and Future of Financial Regulation: Governance for Responsibility* (Routledge, London 2014) 245.

[228] International Organization of Securities Commissions, ‘Objectives and Principles of Securities Regulation ‘(2010) available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD323.pdf accessed 30 June 2016.

Stability of the financial system provides a favourable business system for effective investments which in turn supports economic growth.[229] The second objective is investor protection. This objective aims to protect investors from manipulative, misleading and fraudulent practices whether by the intermediaries who provide investors with professional services or by issuers of financial instruments.[230] The third objective is financial market integrity.[231] Transparency has a key role to play in achieving market integrity through contributing to the soundness and fairness of such a market. Further, supervision of the financial markets in order to identify market malpractice and take proper regulatory actions is also crucial to achieving market integrity.

In the UK, the Financial Services and Markets Act (FSMA) 2000 states the overall financial regulatory objectives.[232] The FSMA sets out four key objectives: (1) preserving confidence in the UK's financial system; (2) promoting public awareness and understanding of the financial system through helping the public to understand the risks and benefits associated with various types of investment; (3) providing consumers with the appropriate degree of protection; and (4) reducing financial crime in the financial sector.

Considering the fact that the FSMA is the main Act that regulates mutual funds in the UK, the mutual funds regulation in the UK reflects the objectives stated in this Act. The mutual funds regulation, as will be seen in chapter four (governance of mutual funds), adopts various governance mechanisms that aim to provide investors with a high level of protection. Due to the fact that mutual funds attract mainly unsophisticated investors, the protection of investors objective is very clear in the fund regulation. For instance, the regulation provides detailed rules regarding potential conflicts of interest situations between the investors and the fund managers in order to mitigate their consequences.[233]

---

[229] H Davies and D Green, *Global Financial Regulation: The Essential Guide* (Polity Press, Cambridge 2008) 16.

[230] See, Andenas and Chiu, (n 227) 133.

[231] Ibid, 16.

[232] Financial Services and Markets Act 2000 s.2 (2).

[233] The mutual funds conflicts of interest will be discussed in detail in chapter four (Governance of Mutual Funds) 146.

In addition, the mutual funds regulation aims to maintain confidence in the financial market through emphasising the safety of the mutual funds. The mutual funds industry plays a significant role in the financial market and any crisis in this industry will have negative impacts on the financial market which in turn will shatter the investors' confidence in the financial sector. Mutual funds regulation, for instance, requires mutual funds to establish a comprehensive risk management process to maintain the safety of the funds.[234]

Moreover, the mutual funds regulation also emphasises the integrity of the financial market and reduction of financial crimes. Mutual funds managers are required to disclose all relevant and necessary information with respect to the operation of the fund and its investments in the prospectus. They are also under obligation to prepare and publish periodic reports to the investors and the Financial Conduct Authority (FCA).[235]

It is clear that the mutual funds regulation objectives are a reflection of the overall financial regulation objectives in the UK, which in turn reflect the international financial objectives, and this is one of the main reasons for the success of this industry in the UK.

3.3 The Existing legal Framework of Mutual Funds in the United Kingdom

Managing a mutual fund is a complicated process involving different entities providing various services for the operation of the fund. Thus, for their efficient operation and development, mutual funds require an effective regulatory framework. Considering this fact, most countries have enacted regulations defining the terms under which mutual funds work.

Furthermore, both the USA and the UK have enacted detailed regimes for the regulations of mutual funds. In the USA, a mutual fund is one of the most regulated types of company. Mutual funds are regulated under each of the following principal laws: the Securities Act of 1933 (the Securities Act), the Securities Exchange Act of 1934 (the Exchange Act), the Investment Advisers Act of 1940 (the Advisers Act)

[234] For further information about the risk management process, see 2.4 (Mutual Funds Risk Management) 64.

[235] The effectiveness of disclosure in the fund industry will be discussed in chapter four (Governance of Mutual Funds) 157.

and the Investment Company Act of 1940 (the 1940 Act).[236] The Investment Company Act was enacted especially to regulate mutual funds and other types of investment company.

In the UK, the main framework for the regulation of mutual funds is contained in the FSMA 2000, and different instruments introduced under the provisions contained in the Act. Moreover, under the terms of the Financial Services and Markets Act, the Open Ended Investments Companies Regulations (OEICs) 2001 were enacted by the Treasury.[237] The OEICs regulations are almost entirely separate from the Companies Act 2006. The open-ended investments companies are regulated by the Financial Conduct Authority (FCA) under the provisions of the "COLL Sourcebook" contained in the FCA Sourcebook. The FCA Sourcebook sets appropriate standards of protection for investors by addressing fundamental issues of the industry such as operating duties and responsibilities, winding up, valuation rules, fees, disclosure, and investment powers. The FCA sourcebook also implements part of the requirements of the Undertakings for Collective Investment in Transferable Securities (UCITS) Directive to meet EU law obligations that are relevant to authorised funds and management companies. Here, it is worth mentioning that the FCA regulations refer to the open-ended investment companies as "Investment Companies with Variable Capital" (ICVCs).

3.3.1 Development of Mutual Funds Regulations in the UK

Mutual funds regulations in the UK have evolved to respond to the development and creativity of the industry in the local and international financial markets. In 1935, the Stock Exchange in London published a report on fixed trusts in the UK. The report recommended legislation to protect investors.[238] Further, in 1936 a Departmental Committee, under the chairmanship of Sir Alan Anderson, was appointed by the Board of Trade to enquire into Fixed Trusts in all their aspects, and to report what action, if any, would be desirable in the public interest.[239] The Committee adopted the term "*unit trust*" as comprehending both types of trust (fixed and flexible trusts). The report is universally admitted to be an admirable one as its recommendations

[236] Nagy, (n 24).
[237] The Financial Services and Markets Act 2000 s.262 (1) empowered the Treasury to make the regulations.
[238] Sin, (n 10) 33.
[239] Departmental Committee, Fixed Trust report, 1936 (Cmd. 5259) p.5.

became the cornerstone of the subsequent regulations in the UK and in the jurisdictions influenced by the English legislative model.[240]

In general, the Committee discussed fundamental issues regarding the operation and management of the unit trusts, such as: the dual role of management companies, service charge out of capital, excessive commission to brokers, the advertisement, taxation and voting rights. Generally, the Committee recommended that trusts should be registered on a public register. Further, the terms and provisions of the Companies Act protecting shareholders should be applied to trusts. It also recommended that provisions should be made to ensure that trustees have a definite and substantial financial standing. It was also recommended that the trust accounts should show the precise amount of assets in the portfolio at the end of the accounting period.

In 1939, the Prevention of Fraud (Investments) Act was enacted.[241] This Act was a consequence of the Fixed Trust Report 1936. Further, in 1958 the Prevention of Fraud Act 1939 was replaced by the Prevention of Fraud (Investments) Act 1958.[242] Under the provisions of the 1958 Act, a unit trust cannot offer its units to the public without authorisation. Section 17 provides that the Board of Trade may authorise unit trust schemes that comply with certain criteria.[243] As a condition of authorisation, the trustee and the manager should be incorporated under the law of the United Kingdom and have places of business in the UK. Further, the Prevention of Fraud (Investments) Act 1958 required the fund manager to provide investors with specific provisions contained in the first schedule of the Act. The 1958 Act also required the manager to be independent of the trustee.

Section 17 of the 1958 Act was important because it stated that the Board of Trade "may" authorise trusts when the specified conditions are satisfied. This implies that the Board of Trade may refuse to authorise a unit trust even though it complies with all the above conditions. These wide discretionary powers given to the Board of Trade might be justified on the grounds that it was very difficult at that early stage to establish clearly defined and limited statutory rules. Nonetheless, this system was

[240] The Modern Law Review, 'Reports of Committees: Fixed and Flexible Trusts' [2011] (1) Wiley Online Library http://onlinelibrary.wiley.com/doi/10.1111/j.1468-2230.1937.tb00008.x/pdf accessed 7 July 2014.
[241] Prevention of Fraud (Investments) Act 1939.
[242] Prevention of Fraud (Investments) Act 1958.
[243] Ibid, s.17.

criticised because these wide powers led the Board to involve themselves overly in the detailed arrangements of unit trusts.

In addition, proposals for more detailed and sophisticated regulations of the unit trusts had been made in the context of the report of the Company Law Committee in 1962. However, these proposals were never implemented.[244]

During the early 1980s, the Government asked Professor Gower, a lawyer and academic, to conduct a review of the protection of investors in the United Kingdom. The first part of Professor Gower's report was published on 18 January 1984.[245] Professor Gower recommended a new regulatory system for investment schemes, including unit trusts. A year later, the Government published its own White Paper: "Financial Services in the United Kingdom: A New Framework for Investor Protection".[246] In fact, the White Paper adopted the recommendations made in Gower's report. Further, part 2 of the Gower report was published in 1985, and emphasised the importance of finding a new regulatory system for the investment business.[247]

Furthermore, in 1986 the Financial Services Act was enacted.[248] This Act established a regulatory framework for the unit trusts. Even though the 1986 Act was passed in November 1986, it did not come into force until April 1988. The provisions and terms of the 1986 Act reflected the competition, technological developments and globalisation of the financial markets.[249] Section 76 (1) provides that making an invitation to the public to become or offer to become participants in a collective investment scheme can only be made by an authorised person if the scheme is either a recognised scheme under the Act or an authorised unit trust.[250] Section 81 empowered the Secretary of State (now the Treasury) to make regulations as to the constitution and management of authorised unit trusts. Therefore, a unit trust may be

[244] Board of Trade, Report of the Company Law Committee, 1962 (Cmnd.1749).
[245] L. C. B Gower, Review of Investor Protection: Report Part I, 1984 (Cmnd 9125).
[246] Department of Trade and Industry, 'White Paper Financial Services in the United Kingdom: A New Framework for Investor Protection' (Cmnd. 9432, 1985).
[247] L. C. B. Gower, Review of Investor Protection: Report: Part II, 1985.
[248] Financial Services Act 1986.
[249] Sin, (n 10) 35.
[250] Financial Services Act 1986, S.76 (1).

authorised under the 1986 Act if it complies with the regulations made under this section.[251]

Further, it was allowed under the provisions of the 1986 Act to constitute unauthorised unit trusts. Under section 76 (2), advertisement of an unauthorised unit trust may be issued to (1) an authorised person; (2) a person whose ordinary business involves the acquisition and disposal of property of the same kind as the property, or a substantial part of the property, to which the scheme relates. Here, it is worth mentioning that unauthorised unit trusts are not subject to the regulations made under section 81 of the 1986 Act.[252]

In 1996, open-ended investment companies were introduced into English law to provide mutual funds with corporate structure in the financial market. The open-ended investment companies were introduced by Open-Ended Investment Companies (Investment Companies with Variable Capital) Regulations 1996. The 1996 Regulations came into force after a long period of consultation.[253] One of the main reasons for the 1996 regulations was to enable British investment companies to compete with their offshore competitors in Europe. The 1996 regulation established the main elements of a separate corporate code for the new form of investment companies. Like the authorised unit trust, the Securities and Investments Board was responsible for authorisation and regulation of the OEICs. Further to open-ended regulations 1996, the Securities and Investments Board established the Financial Services (open-ended companies) Regulations 1997.[254]

In 2000, the Financial Services Act 1986 was replaced by the Financial Services and Markets Act 2000, which has become the fundamental framework of mutual funds regulation in the UK.

In 2001, under the provisions of the Financial Service and Markets Act 2000, the Open-Ended Investment Companies Regulations 1996 were replaced by the Open Ended Investment Regulations 2001.

[251] Ibid, s.81.
[252] Ibid, s.76 (2).
[253] The Treasury first consulted with policy proposals in 1994. Then, further consultations about draft regulations were followed in 1995.
[254] Hudson, *The Law of Finance* (n 13)1282.

It is clear now that the existing mutual funds regulations in the UK are a consequence of different changes and enhancements during the long history of the industry. The fundamental concepts and principles of the regulations are based on practical studies made by professional persons who have a clear image of the industry and its requirements. They are also built on general financial regulation principles. Further, the existing mutual funds regulations in the UK consider the development of mutual funds in the international financial markets to attract international investments. Therefore, two lessons could be learnt from the development of mutual funds regulations in the UK. First, mutual funds regulations should be reviewed from time to time by persons who have knowledge of the mutual funds industry and its requirements. Second, the development of the mutual funds industry should not be limited to the requirements of the local markets, but it should take into consideration developments in the international financial markets.

3.3.2 The Financial Services and Markets Act 2000 (FSMA): the Main Regulation of Mutual Funds in the UK

In the United Kingdom, the FSMA 2000 is considered as the cornerstone of the mutual funds regulatory regime. The FSMA imposes a special regulatory regime on unit trusts and open-ended investment companies which fall within its wide definition of “collective investment schemes” (CIS).[255] This regulatory regime was designed to fit the structure of these vehicles where the mutual funds hire professional management to operate the fund and the investors do not participate in the management. Further, the FSMA sets the basis under which authorised unit trusts (AUT) operate. It implements the fundamental provisions of the Undertakings for Collective Investment Schemes in Transferable Securities Directive. The FSMA grants the Financial Conduct Authority powers to make rules for OEIC and AUT.[256]

The following analysis will be devoted to discussing the unit trust schemes’ rules under the Financial Services and Markets Act 2000 and COLL Sourcebook.

[255] Financial Services and Markets Act 2000, Part XVII.

[256] The fundamental functions of the supervisory and regulatory authorities will be discussed in chapter five (Strengthening Mutual Funds Regulation and Governance in Middle Eastern Countries) 208.

3.3.2.1 Authorised and Unauthorised Unit Trusts

The unit trust regulations in the UK emphasise the importance of the authorisation process of unit trusts because they consider this process as the first step of the overall protection system that the regulations are seeking to achieve. Furthermore, the rules of this process are flexible, especially during determination of the applications. This can be found through the effective powers given to the authority, whether during the authorisation process or even after granting the authorisation order to the unit trust.

Generally, a unit trust is defined by section 237(1) of the FSMA 2000 as: *"a collective investment scheme under which the property is held on trust for the participants by the trustee".*[257]

Particularly, an authorised unit trust scheme or (AUT) is defined by section 237(3) of the FSMA 2000 as: *"a unit trust scheme which is authorised for the purposes of this Act by an authorisation order in force under section 243".*[258]

In order for the unit trust manager to be permitted to promote the unit trust to the public, the unit trust must have been authorised by the Financial Conduct Authority (FCA), hence becoming an authorised unit trust.[259]

The main requirements for obtaining an authorisation order from the FCA can be divided into three major categories specified in section 243 of the FSMA 2000. First, the requirements stipulated by the section itself. The manager and trustee must be independent of each other.[260] Further, the manager and trustee must be authorised persons with permission to act as manager and trustee respectively. They must each be a body corporate incorporated either in the UK or another EEA state, and have their affairs administrated in the country in which they are incorporated, with their place of business being in the UK.[261]

These requirements aim to ensure the best performance of the authorised unit trust and protect the fund investors. Being a body corporate, the manager and trustee will

---

[257] Financial Services and Markets Act 2000 s.237 (1).

[258] Ibid, s.237 (3).

[259] J Gray, 'Personal finance and corporate governance: The missing link: Product regulation and policy conflicts' (2004) 4 J. Corp. L. Stud 187-220.

[260] Financial Services and Markets Act 2000 s.243 (4).

[261] Ibid, s.243 (5) (a) (b) and (7).

have employees who are able to perform their duties properly. In addition, the independence of the manager and trustee creates a kind of supervision between them.

Moreover, the scheme's name must not be undesirable or misleading.[262] The purpose of the scheme must have a reasonable chance of being successfully effected.[263] Finally, the participants must be able to redeem their units at a price reflecting the net asset worth of the scheme.[264]

Second, the second category of requirements is those imposed by the FCA's Collective Investment Scheme Sourcebook (COLL).[265] For instance, the application for an authorisation order must be in writing in the method directed, and contain the information required in the application form.[266] Finally, the last requirement is a formal requirement: the FCA must have received a copy of the trust deed and a solicitor's certificate declaring that the fund complies with the trust deed requirements of section 243 and the rules of the COLL Sourcebook.[267]

The significance of the authorisation comes from the advantages that the authorised unit trust obtains that flow from the FCA authorisation order. Authorised unit trusts gain two major advantages. First, authorised unit trusts are entitled to make an invitation or financial promotion to participate in the scheme directly to the public.[268] Restricting the ability to make an invitation to the public to the authorised unit trusts is a necessary requirement to protect the prospective participants because this invitation could contain misleading or false information that would influence the investors' decisions and encourage them to participate in the scheme. Thus, it is essential to place this invitation under the supervision of FCA.

Here, it is worth mentioning that section 242(4) of the FSMA 2000 gives the FCA the power at any time after receiving the application and before determining it to ask the applicants to provide it with further information it considers necessary to make the decision and grant the authorisation order.[269] However, the FCA must determine

[262] Ibid, s.243 (8).
[263] Ibid, s.243 (9).
[264] Ibid, s.243 (10).
[265] Ibis s.234 (1) (b).
[266] Collective Investment Schemes Sourcebook 2014, coll 2, 2.1.4.
[267] Financial Services and Markets Act 2000, s.243 (1) (c).
[268] Ibid, s.238(4) (a).
[269] Ibid, s.242 (2).

whether or not to grant the authorisation order before the end of a period of six months beginning from the date on which it receives the completed application.[270]

Second, the second advantage of obtaining the authorisation order is included in the Taxation of Chargeable Gains Act 1992. Section 100 of the Taxation of Chargeable Gains Act 1992 states that: "*Gains accruing to an authorised unit trust, an investment trust or a court investment fund shall not be chargeable gains*".[271]

Thus, authorised unit trusts are not liable to pay UK tax on the chargeable gains realised on a disposal of assets in their investment portfolios.

Furthermore, the authorisation order may be revoked by an order made by the FCA. After granting the authorisation order, the FCA is entitled to revoke the authorisation otherwise than by consent in certain cases. First, if one or more of the requirements for the making of the authorisation order are no longer satisfied.[272] For example, if the unit trust appointed an unauthorised trustee to hold the unit trust property which contravenes the requirement that the trustee must be an authorised trustee.

Second, the manager or trustee of the authorised unit trust has breached one of the requirements imposed on him by or under the FSMA 2000 or has knowingly or recklessly given the FCA information which is misleading or false.[273] Third, no regulated activity is being carried out by the authorised unit trust for at least twelve months or earlier.[274] Finally, the FCA may revoke the authorisation order in order to protect the interests of the current unitholders or the potential participants in the authorised unit trust.

This authority given to the FCA to revoke the authorisation order is an effective tool to protect the unitholders' interests and to ensure that the requirements of the authorisation are satisfied during the authorised unit trust's life. The last situation that entitles the FCA to revoke the authorisation order is significant because it shows the key role of the supervisory authority in protecting the interests of the fund's investors.

---

[270] Ibid, s.244(1).
[271] Taxation of Chargeable Gains Act 1992, s. 100 (1).
[272] Financial Services and Markets Act 2000, s.254 (1) (a).
[273] Ibid, s.254 (1) (b) and(c).
[274] Ibid, s.254 (1) (d).

In addition, it is possible for unit trust schemes to be unauthorised.[275] This tends to mean that no FCA authorisation has been granted under section 243 of the FSMA 2000. Although the unauthorised unit trust schemes are not subject to the requirements contained in the COLL Sourcebook, they do not benefit from the exemption from the restrictions on making invitations to the public. Further, unauthorised unit trusts do not benefit from the exemption from the UK tax on capital gains realised on the disposal of their investment assets.

Generally, unauthorised unit trusts are attractive to a specialised group of investors.[276] As a result, unauthorised unit trust schemes are not suitable for use as retail investor schemes. Property unit trusts are the most common form of unauthorised unit trust that invest their assets in real property.[277] Such a unit trust cannot obtain the FCA authorisation because it contravenes the regulations on the allowed percentage of the scheme's property that can be invested in one type of property.[278] It is worth mentioning that unlike the unit trust schemes in the UK which could be either authorised or unauthorised, mutual funds in many countries are only authorised schemes, such as is the case in Syria.[279]

It is clear now that the authorisation system under the provisions of the FSMA 2000 and the rules of the COLL Sourcebook is a comprehensive system. The most important feature of the authorisation system is the role of the FCA, whether after receiving the application and before determining it or after making the decision and granting the authorisation order.

3.3.2.1.1 Observations on Syrian Mutual Funds Act (SMFA) 2011

Unlike the UK regulations, the SMFA 2011 does not confer the Syrian Commission on Financial Markets and Securities (SCFMS) any power to request any further information from the applicants after receiving the application.[280] Article 3 of the Act specifies the documents that must be submitted to the Syrian Commission on

[275] Sin, (n 10) 38.
[276] Ibid.
[277] Hudson, *The Law on Investment Entities* (n 11) 198.
[278] Collective Investment Schemes Sourcebook 2014, coll 5.6.19.
[279] Mutual Funds Act 2011, article 3.
[280] The Syrian Commission on Financial Markets and Securities (SCFMS) is the authority responsible for the mutual funds industry in Syria.

Financial Markets and Securities (SCFMA).[281] Although Article 3 gives the SCFMS the authority to request any document it considers important to make the authorisation decision, this can only happen before submitting the application.[282] However, this authority is not sufficient because during determination of the application, the SCFMS might need further information to make the proper decision.

In spite of the fact that the mutual funds industry in the UK is a wide and developed industry which would justify granting the FCA such authority to deal with various domestic and foreign mutual funds applications for authorisation, being a new industry would also justify granting the SCFMS the authority to request further information from the applicants after receiving the application because that would help the applicants avoid the consequences of having the application rejected. Having the application rejected prevents the applicant from re-submitting the application for three months as indicated by Article 4 (2). There is no doubt this rule has negative effects on the applicants because re-submitting the application after three months is too time consuming and too costly and might discourage the applicants from re-submitting their applications. Thus, it is advisable to grant the SCFMS such authority, as the FSMA 2000 grants it to the FCA, so the SCFMS will be able to determine the need for further information in each application on an individual basis.

Further, the SMFA 2011 does not give the SCFMS any power to revoke the authorisation order, so it is also advisable to specify some situations, otherwise than by consent, where the SCFMS will be able to revoke the authorisation order to protect the interests of the investors and the mutual funds industry. The importance of this authority comes from the fact that the mutual fund management will attempt to ensure that none of the situations specified in the act apply to the fund, so that the revocation will be avoided.

3.3.2.2 Restrictions on Investment and Borrowing Powers

At the outset, it is necessary to know that the restrictions on the investment and borrowing powers apply to open-ended investment companies and unit trusts. Further, protection of investors is a key objective of the mutual funds regulations.

---

[281] Mutual Funds Act 2011, article 3.
[282] Ibid, article 3(h).

The restrictions on the investment and borrowing power are one of the important issues that should be regulated carefully to ensure a high level of protection. This can be achieved by laying down minimum standards for the investments that may be held by a mutual fund. For instance, mutual funds are required to comply with a number of investment rules and procedures that require the spreading of risk.

Diversification is one of the fundamental advantages of investing in mutual funds. Unlike ordinary companies, which are not required by law to diversify their assets, mutual funds invest their assets in a wide range of options such as transferable securities, government and public securities and derivatives.[283] It is necessary to know that the aim of diversification is not to improve performance of the scheme; rather it can help to set the proper level of risk for mutual fund investments because a fall in the value of any sector is offset or mitigated by the stability or increasing value of other sectors unless there is a collapse in the entire financial market.[284]

Moreover, section 247 of the FSMA 2000 states: *"The Authority may make rules ("trust scheme rules") as to… (d) for restricting or regulating the investment and borrowing power exercisable in relation to the scheme".*[285]

Chapter 5 of the FCA COLL Sourcebook sets out the investment and borrowing powers of the authorised unit trust and OEIC. The COLL Sourcebook rules differentiate between the Undertakings for the Collective Investment of Transferable Securities (UCITS) and non-UCITS regarding investment and borrowing powers.[286] Further, subject to FCA Sourcebook rules, a manager of an authorised unit trust is required to ensure the authorised unit trust meets specific minimum standards regarding the type of property in which it may be invested. Here, it is worth mentioning that the trust deed constituting the authorised unit trust and the prospects influence the investment and borrowing powers within the regulatory restrictions.[287]

The investment restrictions are designed to ensure an appropriate level spread of risk through investing the fund assets over a number of various investments, and probably across different markets. Maximum proportions are set for various classes of

[283] Jones, (n 51) 47.
[284] Haslem, *Mutual Funds: Risk and Performance Analysis for Decision Making* (n 1) 25.
[285] Financial Services and Markets Act 2000 s.247 (1) (d).
[286] Collective Investment Schemes Sourcebook 2014, coll 5.1.4.
[287] Ibid, coll 5.2.4.

investment assets in the FCA COLL Sourcebook, such as transferable securities (shares, debentures, government and public securities, warrants, and certificates representing certain securities)[288], approved money market instruments, units in CIS, derivatives and forward transactions, and deposits.[289] For example, a UCITS authorised unit trust scheme is allowed to invest up to 10% of its assets in transferable securities that are not approved securities, while a non-UCITS authorised unit trust is permitted to invest up to 20% of its assets in transferable securities that are not approved securities.[290]

Furthermore, within the range of investment assets there are some detailed and concentration rules. For instance, no more than 20% in value of the UCITS authorised unit trust property is to consist of deposits with a single body, and no more than 5% in value of the UCITS authorised unit trust property is to consist of transferable securities by any single issuer.[291]

It is clear that these details defined in the FCA COLL Sourcebook help in achieving the fund regulations' aim of protecting investors by defining minimum standards for the investments that may be held by authorised unit trust schemes. These restrictions impose obligations upon the authorised unit trust managers. In order to fulfil these obligations, the fund managers of authorised unit trusts should take all reasonable procedures and exercise all due diligence to prevent the assets of the authorised unit trust being invested in breach of these restrictions.[292]

In order to ensure the compliance of the fund manager with the investment restrictions, the FCA regulations require the trustee to supervise the fund manager's investment policies and procedures.[293] This implies that the trustee should take all steps to exercise a proper degree of supervision over the manager's management of the authorised unit trust to ensure that the manager achieves the duties imposed thereon.

Borrowing Powers

[288] Ibid, coll 5.2.7.
[289] Ibid, coll 5.2.6A.
[290] Ibid, coll 5.1.4.
[291] Ibid, coll 5.2.11.
[292] Ibid, coll 5.2.3.
[293] Ibid, coll 6.6.4 (1) (a).

Chapter 5 of the FCA Sourcebook specifies the power of the authorised unit trust to borrow money and the restrictions on this power. The trustee of the authorised unit trust may, on the instruction of the manager, borrow money for the account of the scheme.[294] However, under the provisions of the COLL Sourcebook, the trustee may only borrow money from eligible institutions or approved banks.[295] The manager must take all reasonable steps to ensure that any borrowing is on a temporary basis.[296] The period of borrowing must not exceed three months without the prior consent of the trustee.[297] To give its consent, the trustee must ensure that borrowing does not cease to be on a temporary basis. The manager has a duty to ensure that the authorised unit trust's borrowing does not, on any day, exceed 10% of the value of the scheme property.[298] The intent of short term and 10 % restrictions on borrowing is to support liquidity for unit redemptions or to enable efficient management of the authorised unit trust in accordance with its investment objective.

In the USA, it is unlawful for mutual funds to issue any class of security or to sell any senior security of which it is the issuer. Mutual funds may only borrow from banks. Further, mutual funds are subject to a 300% asset coverage requirement on the amount of such borrowings.[299] In the event this coverage falls below 300%, the mutual fund should within 3 days reduce the amount of its borrowings to the extent that the coverage shall be at least 300%. In addition, it is common between the USA and the UK regulations that mutual funds can only borrow money from trustworthy institutions such as approved banks and eligible institutions (UK) and banks (USA), while they are not allowed to borrow money by way of issuing senior securities.

3.3.2.2.1 Application to the Syrian Mutual Funds Act 2011

In Syria, the SMFA 2011 imposes two restrictions upon the mutual funds managers regarding investment restrictions. The first restriction is that the manager of the scheme must not invest more than 10% of the fund assets in one issuer, while the second restriction is that the mutual fund must not own more than 10% of the assets

[294] Ibid, coll 5.5.4 (1).
[295] Ibid, coll 5.5.4 (3).
[296] Ibid, coll 5.5.4.4.
[297] Ibid.
[298] Ibid, coll 5.5.5.
[299] Investment Company Act of 1940, s.18, f (1).

of that body.[300] These restrictions do not apply to the investment in government and Central Bank of Syria securities. However, the Act does not specify the limits on the different types of scheme property. Thus, a mutual fund can invest all its assets, for example, in shares or units of other mutual funds. This might have serious impacts on the fund for instance, if a mutual fund invests all its assets in one sector. If that sector then suffers from financial difficulties, this will have a serious impact on the fund. Therefore, to avoid such potential risk, the rules adopted by the UK mutual funds regulations regarding the investment restrictions should be adopted to the extent that suits the types of investment property available in the Syrian financial market.

The investment restriction rules under the Syrian Mutual Funds Act 2001 might also have a negative effect on the fund's liquidity. In fact, the liquidity of some permitted types of scheme property is easier than others, so a mutual fund can obtain the required amount of cash to redeem shares at the request of shareholders. In situations such as financial crises or scandals in the mutual funds sector, most of the shareholders would prefer to redeem their shares, so a mutual fund must fulfil its obligation to redeem shares at the request of any shareholder. To fulfil its obligation, a mutual fund should be able to liquidate its assets into cash in a short period of time. Thus, it is advisable to define the proportions allowed to be invested in the different permitted types of scheme property, so a mutual fund can obtain cash from those that can be liquidated in a short period of time.

Regarding the borrowing powers, the SMFA 2011 does not contain any provision with respect to the ability of mutual funds to borrow money. The Act does not grant the SCFMS any power to make rules specifying the conditions under which mutual funds can borrow money. However, Article 110 of the Act states that the Company Act 2011 is applicable to the issues that are not included in this Act.[301] Article 121 of the Syrian Company Act gives corporations the right to borrow money by issuing bonds. The process of issuing bonds under the provisions of the Act is a complicated process and takes a long time.

[300] Mutual Funds Act 2011, article 68, 1 (c and d).
[301] Mutual Funds Act 2011, article 110.

Furthermore, bonds give the bondholders certain rights to intervene in the management of the company in order to protect their rights, and that may contradict the nature of mutual funds. Thus, it is advisable to limit the power of mutual funds to borrow money to approved banks and eligible institutions. It would also be useful to define the conditions under which mutual funds can borrow money. These conditions should consider the purpose of borrowing and the unique characteristics of mutual funds.

3.3.3 The Open Ended Investment Companies Regulations 2001(OEICs): the Impact of the European legislation

Prior to 1996, unit trusts were the only form of British mutual funds. In fact, the trust is a principally Anglo-American legal concept that is not popular in continental Europe.[302] Therefore, OEICs were introduced in the United Kingdom as a response to the unfamiliarity of foreign investors with the trust structure of the unit trust. Moreover, the success of corporate structures in the USA and many European countries was another motivation for the financial regulators to adopt the corporate structure of mutual funds in the UK.[303] Indeed, OEICs were established to promote the competitiveness of the UK financial services industry.[304]

In addition, in many aspects, OEICs are similar to authorised unit trusts where the regulatory provisions applying to both often use similar conditions and concepts. Nonetheless, OEICs are bodies corporate and thus have separate legal personality. Under the provisions of the existing UK company law, the creation of OEICs was not allowed because the capital maintenance doctrine restricted the extent to which regulated companies could be open-ended vehicles in buying and repurchasing their own shares.[305] Open-ended investment companies are regulated under part XVII of the Financial Services and Markets Act 2000, the FCA Sourcebook rules, and the Open Ended Investment Companies Regulations 2001 (OEICs Regulations).

---

302 It is worth mentioning that, recently, the application of the concept of trust has not been limited to the common law countries, and is also applicable in some civil law countries such as France. For more information, see M Graziadei, U Mattei and L Smith, *Commercial Trusts in European Private Law* (Cambridge University Press, New York 2005) 413.

303 Hodge, (n 99).

304 The first open-ended investment company was Threadneedle Asset Managements investment company with variable capital. For more information, see: R Millar, 'Open-ended investment companies: over two years on: where are they?' (1999) 1(4/5), 226-231.

305 J Warburton, 'Should Mutual Funds Be Corporations? A Legal & Econometric Analysis' (2008) 33 J. Corp. L 746-776.

As was mentioned above, the fundamental reason for the United Kingdom's adoption of the OEICs was marketability. In the 1980s, the European Union set forth a regulatory framework (UCITS Directive) for promoting mutual funds across borders. The aim of this regulatory framework was to impose minimum standards regulating mutual funds within the European Union.[306] The Directive defines minimum standards in terms of diversification, disclosure, permitted activities and authorisation of mutual funds.[307] The directive adopted the corporate form as the required structural form. As a result, OEICs could be sold throughout Europe, while unit trusts did not initially meet the requirements of the Directive regarding organisational form, so it was not possible for them to be marketed in Europe.

3.3.3.1 The Authorisation Process of OEICs

Unlike unit trusts, which can be established under the existing funds regulation as either authorised or unauthorised funds, OEICs can only be authorised vehicles.[308] This implies that OEICs cannot be established as unauthorised funds. The main requirements for obtaining an authorisation order are defined in the OEICs Regulations 2001.[309] These requirements mirror those of authorised unit trusts, but they reflect the fact that an OEIC has a separate legal personality, with an authorised corporate director instead of the authorised unit trust manager and with a depositary instead of the trustee.

In addition, an application for authorisation to act as an OEIC must be made to the FCA. The company must have at least one director.[310] The authorised corporate director (ACD) and depositary, who must both be authorised persons to act as ACD and depositary respectively, must be independent of each other.[311] The depositary must be a body corporate incorporated either in the UK or another EEA state and must have its affairs administrated in the country in which it is incorporated, with a place of business in the UK.[312] The OEIC must have its head office in England,

[306] Walker and Blair, (n 196) 660.
[307] Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [1985] ojL 375/3.
[308] Turner, (n 88) 177.
[309] Open Ended Investment Company Regulations 2001, reg.12.
[310] Ibid, reg. 15 (4).
[311] Ibid, reg. 15 (8) (f).
[312] Ibid, reg. 8.

Wales or Scotland.[313] The OEIC's name must not be undesirable or misleading.[314] The objectives of the OEIC must be reasonably capable of being fulfilled.[315] The shareholders must be able to realise their shares or securities at a price reflecting the net asset value of the scheme.[316]

Furthermore, OEICs must comply with the OEICs Regulations and the FCA rules (COLL Sourcebook).[317] There is also a formal requirement that the FCA must have received a copy of the proposed company's instrument of incorporation and certificate signed by a solicitor.[318]

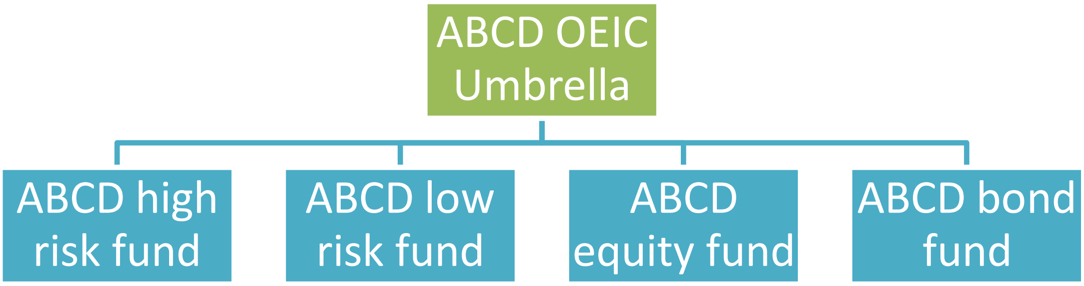
The OEICs Regulations granted the FCA the power to require any additional information to make the decision and give the authorisation order. Directions and requirements in regulation 12 (1) (2) may differ from one application to another.[319] Further, in case the FCA grants the authorisation order, an OEIC is incorporated despite the fact that at that time the body corporate has neither shareholders nor property.[320]

3.3.3.2 A Protected Cell Regime for Open-Ended Investment Companies

A protected cell regime is considered an efficient tool to protect shareholders. OEICs can be structured as umbrella companies with a number of sub-funds. The umbrella company would issue different classes of shares in respect of each sub-fund (figure 3.1). The sub-funds do not have separate legal personality, but they are separately charged, accounted, assessed for tax and managed. Prior to 2011, there was no segregation of liabilities between sub-funds. Therefore, creditors of one sub-fund could have a claim on the property of other sub-funds.

Figure (3.1): Umbrella fund.

[313] Ibid, reg. 3.
[314] Ibid, reg. 9.
[315] Ibid, reg. 10.
[316] Ibid, reg. 11 (a).
[317] Ibid, reg. 15 (2).
[318] Ibid, reg. 14 (1) (c).
[319] Ibid, reg. 12(1) (2).
[320] McCormack, (n 15).



In addition, to improve the competitiveness and attractiveness of the UK OEICs in the financial markets, and to increase the level of protection for shareholders, the Treasury introduced the protected cell regime (segregated liability) for OEICs in 2011.[321] Principally, the regulations provide that the assets of a sub-fund belong exclusively to that sub-fund. These assets cannot be used to discharge the liability of any sub-fund or the umbrella fund itself.[322] In case a liability is incurred on behalf of a sub-fund, it must be discharged solely out of the property of that sub-fund.[323] Further, the umbrella companies cannot enter into any contract, transaction, or agreement which is inconsistent with the protected cell regulations.

Moreover, in order to comply with the requirements of the regulations, the authorised corporate director must take certain necessary procedures. The ACD must amend policies, prospectus, procedures and internal control.[324] In order to ensure that all future transactions and contracts into which the umbrella company enters are consistent with the protected cell principles, the ACD must also amend the instrument of incorporation of the OEIC to include the prescribed wording on segregated liability. As for the existing contracts entered into by the OEIC, the ACD needs to review them to determine whether these contracts are consistent with the segregated liability principles. Further, the regulations provide that the compliance period is a period of 2 years for the standard OEICs and 3 years for micro businesses beginning from the date on which the regulations come into force (21st December 2011).[325]

---

[321] Open Ended Investment Companies (Amendment) Regulations 2011.
[322] Ibid, reg. 11A. (1).
[323] Ibid, reg. 11A. (2).
[324] Ibid, reg. 5.
[325] Ibid, reg. 4 (3) and reg. 6 (1).The reg. 7.includes the definition of the micro-business fund.

In addition, it seems clear that the Open Ended Investment Companies (amendment) Regulations 2011 represent the willingness of the Treasury to adopt the prevailing market conditions and demands of the international investment community in an effective and productive manner. The previous regulations, which did not allow sub-funds of umbrella funds within UK to avail of segregated liability, were unsatisfactory. The OEICs regulations 2011 provide a clear framework that will permit greater investor protection and encourage local and foreign investors to invest in the OEICs.

It is plain that the protected cell regime has become a necessary concept in the mutual funds industry. Hence, it is essential for the countries seeking to improve and encourage the industry to adopt this concept in the mutual funds regulations. That would attract foreign funds, which would come from countries that have already adopted the concept, to invest in these countries because the regulations in these countries require the managers to take into account the protected cell regime in their transactions and contracts.

3.3.4 The Undertakings for Collective Investment in Transferable Securities (UCITS): the European Legislation

The Undertakings for Collective Investment in Transferable Securities (UCITS) are a harmonised European open-ended retail fund product that can be marketed internationally and within the European Union on a European passport basis. Due to their high level of investor protection, the UCITS funds have been recognised globally, and many UCITS are registered in non-EU jurisdictions such as Switzerland, Hong Kong, Singapore, Taiwan, Chile, Peru, Bahrain, South Africa and Japan.[326] However, in this situation a UCITS must be registered under the national regime and comply with all local registration requirements.[327] The key role of the UCITS is to harmonise national rules in terms of authorisation, structure, supervision, disclosure and activities.[328] Further, the UCITS legal framework offers an attractive combination of transparency and liquidity for investors.

[326] R Pozen and T Hamacher, *The Fund Industry: How Your Money is Managed* (2nd edn John Wiley & Sons, New Jersey 2015) 467.
[327] Ibid.
[328] H Scott, *International Finance: Law and regulations* (2nd edn Sweet and Maxwell, London 2008)181.

Indeed, the UCITS schemes are not a separate brand of open-ended funds, but rather they are either authorised unit trusts or open-ended investment companies that meet the requirements laid down in the UCITS IV Directive. The United Kingdom has implemented the requirements of the UCITS Directive mainly through the FCA's COLL Sourcebook and the FSMA 2000. The UCITS schemes must comply with the legal criteria applicable to UCITS funds under the UCITS Directive.[329] The UCITS must also comply with specific rules on investment and borrowing powers.[330] As was discussed above, the UCITS investments limits have been incorporated into the UK COLL Sourcebook.[331] Furthermore, the investment and borrowing powers for the UCITS feeder funds are also included in COLL. These include a general duty that a feeder UCITS must invest at least 85% of its assets in the units of a single master UCITS.[332]

In addition, the COLL Sourcebook contains the UK rules on UCITS management company passport, both with respect to the European Economic Area (EEA) UCITS management companies operating a UK UCITS scheme and the UK UCITS management companies operating other EEA UCITS schemes.[333] The UK management companies are subject to general compliance and conduct rules incorporated in the COLL Sourcebook and in the FCA's conduct of business rules.

Rules allowing for the cross-border marketing of UCITS schemes of other EEA States are also included in the rules for recognised overseas schemes in Coll 9 and in section 264 of the FSMA 2000. The authorities of the home Member State of the relevant UCITS fund are required to notify the FCA that the fund has been authorised in that Member State. Thus, the fund will have the right to start marketing units/shares in the UK.

3.3.4.1 The Evolution of the UCITS

There is no doubt that the Undertakings for Collective Investment in Transferable Securities is a successful European story. It was created around 29 years ago, and it now represents the investment fund regulatory framework in Europe. Due to the different legal forms of funds and due to various regulatory approaches taken by

---

[329] Collective Investment Schemes Sourcebook 2014, colls 1.2.2 and 3.2.8.
[330] Ibid, chapter 5.
[331] Ibid, coll 5.2.
[332] Ibid, coll 5.8.
[333] Ibid, coll 12.

different European countries, the Members of the EEA realised the need to create a sort of uniformity. The regulations of collective investment schemes in each Member State are different from others, especially with regard to the obligations and controls imposed on the undertakings. Not only did these differences not provide comparable protection for investors, they also distorted the completion conditions between undertakings for different Member States. For these reasons, the Council, on 20 December 1985, issued a Directive on the coordination of regulations and laws regarding the Undertaking for Collective Investment Schemes in Transferable Securities (85/611/EEC).[334] This Directive was the original and first Directive "UCITS I".

The fundamental aim of the UCITS I was to harmonise and enhance investor protection among the EEA Members. It also aimed to ensure that the UCITS created in one Member State could be marketed in another, but with specific requirements which the host State was permitted to impose.[335] The United Kingdom adopted the UCITS I in 1989. However, the UCITS I did not achieve the EU's objective of a single market for financial services in Europe. The reality contradicted the expectations. This was principally for the reason that the marketing rules in the different Member States resulted in difficulties in cross border marketing of the UCITS. As a result, in the 1990s recommendations and proposals were put forward to amend the UCITS I and fulfil more practical harmonisation of regulations throughout the Member States. These proposals led to a draft UCITS II Directive. However, the UCITS II was abandoned because it was deemed to be too ambitious and the Member States failed to reach an agreement on its purpose and scope.

Moreover, after UCITS II was abandoned, the European Commission published proposals for UCITS III. UCITS III consisted of two Directives: the "Management Company" Directive and the "Product" Directive. These two Directives were adopted in 2001. The aim of the Management Directive was that the management companies should be authorised separately to the UCITS itself. It also aimed to adopt the concept of a "European Passport" with respect to the management companies,

[334] Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [1985] ojL 375/3.

[335] D Schubauer, 'Inadequacy of the UCITS Directive in a Global Marketplace' (2002) 21 N.Y.L. Sch. J. Int'l & Comp. L323-338.

similar to that which exists for other financial institutions such as banks, whereby an authorisation order in the home country enables it to work in other Member States without the need for further authorisation. Applying the concept of a European passport required the Directive to pay proper attention to two issues. The first point is investor protection while the second point is the cooperation between authorities in Member States.

The Directive found that the best way to ensure investor protection was to impose various obligations on the management companies. Further, the Directive gives a non-exhaustive list of functions which the management companies can perform such as investment, management, administration and marketing. Article 5d of the Management Directive provided that the home Member State of a management company is responsible for the supervision of management companies even when the management companies have established branches in other Member States.[336] In addition, Article 5f showed the legislator's concern to ensure investor protection and avoid fraud which could cause losses to investors. It provided rules for the supervision of management companies. These prudential rules aim to minimise investor risk.[337]

Moreover, Directive 2001/108/EC was adopted together with the Management Directive and it is generally referred to as the "product" Directive.[338] The fundamental aim of the Directive was to remove barriers to cross border marketing of units of collective investment schemes by allowing them to invest in a wider range of financial instruments. This Directive was so important because it allowed the possibility of establishing money market funds, which have become the most important type of UCITS, index tracking funds, derivatives funds and funds of funds as UCITS.

In addition, in 2009 the European Council took another step toward achieving the single market dream by adopting the UCITS IV. The UCITS IV is the fourth

---

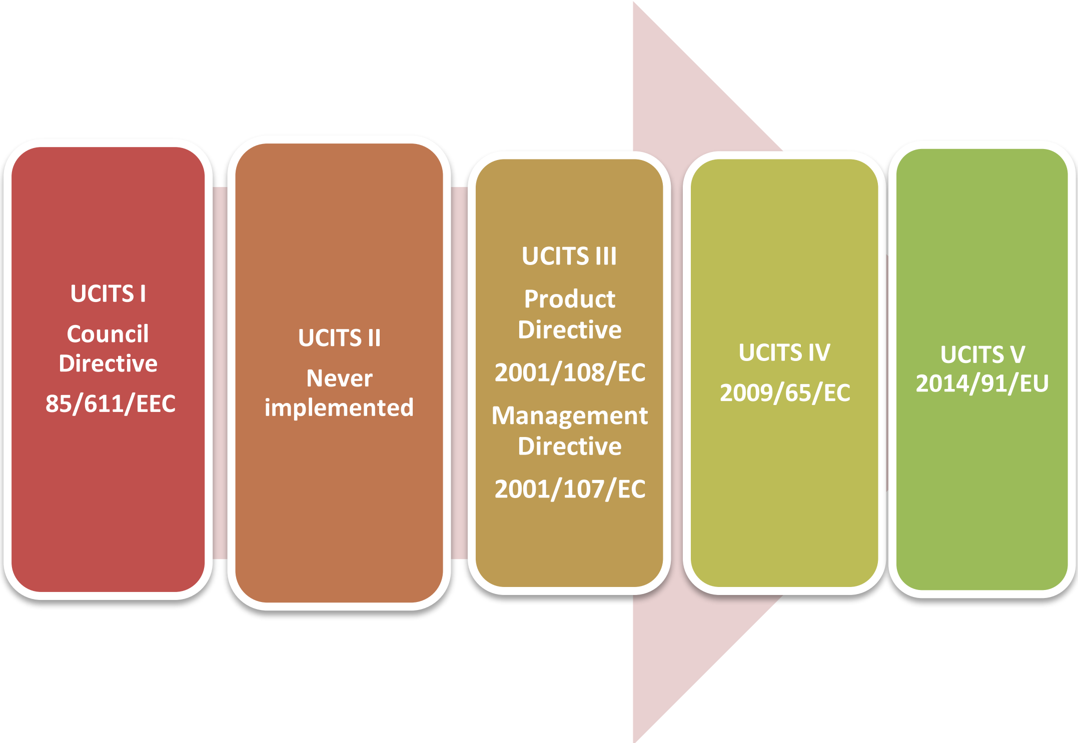
[336] Parliament and Council Directive 2001/107/EC amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses [2002] ojL 41/20.

[337] Ibid, article 5f.

[338] Parliament and Council Directive 2001/108/EC amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS [2002] ojL 41/35.

European Directive covering undertakings for collective investments in transferable securities (figure3.2). The main aim of the UCITS IV Directive is to modernise the regulatory framework of the UCITS.

Figure (3.2): The History of the UCITS Directive – From UCITS I to UCITS V

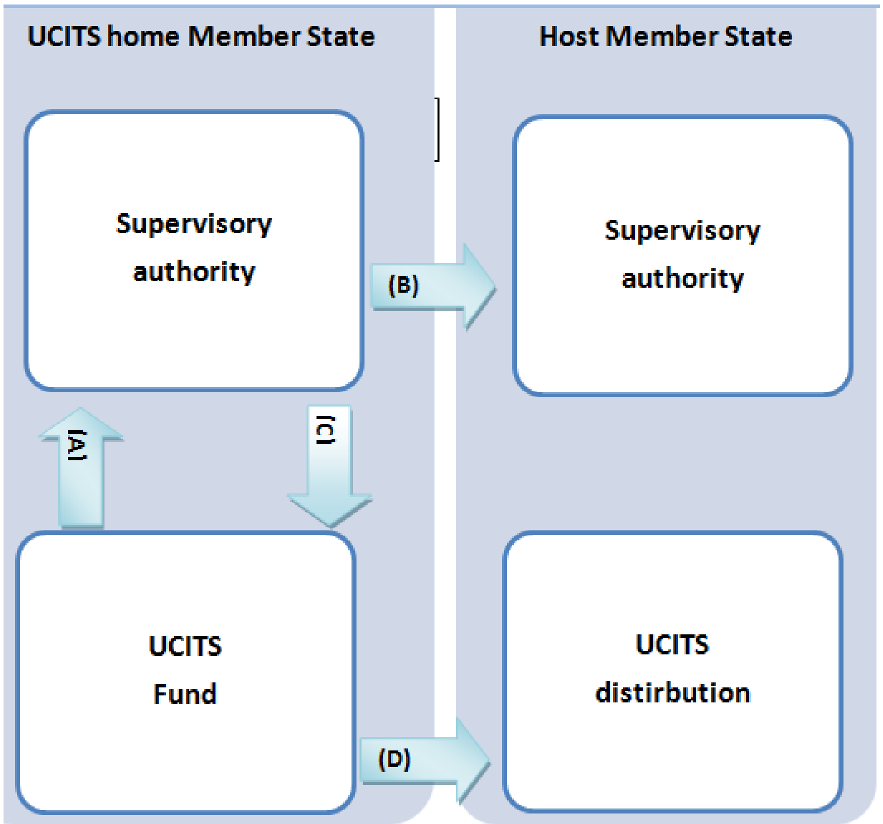


The UCITS IV Directive includes five core enhancements. Briefly, these enhancements are as follows:

1. Notification procedures. The UCITS IV Directive aims to accelerate and simplify the notification procedures. The shares/units of a fund established in one EU Member State may be distributed to investors in another. In order to market the shares/units in a Member State (host State), a UCITS should provide a notification letter to its home Member State authorities together with specific documents. Then, the home Member State authorities will transmit this documentation within ten working days to the host Member State authorities together with an attestation declaring that the UCITS meets all UCITS conditions.[339] After that, the UCITS will be permitted to market its shares/units in the host Member State starting from the date of the notification (Figure 3.3)

[339] Parliament and Council Directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] oj23/203L, art 93(3).

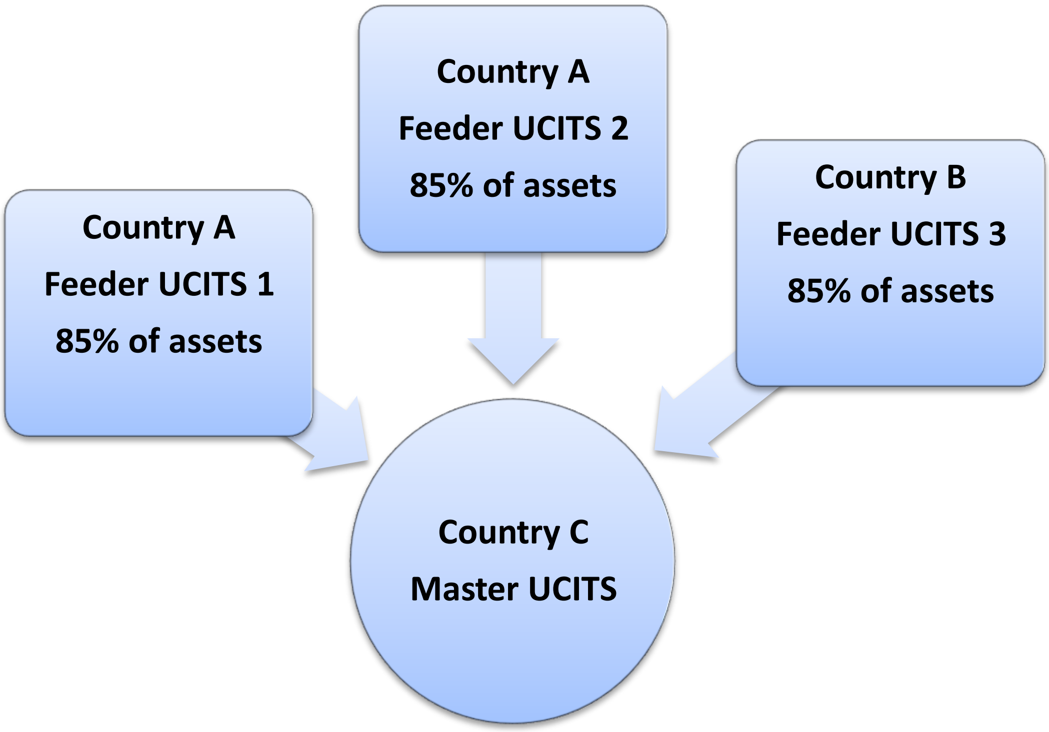
Figure (3.3): Notification procedures



2. Master-feeder structure. The master-feeder structure provides that the feeder UCITS invests most of its assets in a master UCITS. It could be considered that the management of most of the assets of the feeder fund is delegated to the manager of the master fund. Article 58 of the UCITS IV Directive stipulates that the feeder should invest at least 85% of its assets in a single Master.[340] Further, the feeder may invest up to 15% in liquid assets and financial derivative instruments. The master and the feeder funds could be located in different Member States. It is worth noting that a master cannot itself be a feeder or invest its assets in a feeder (figure 3.4).

Figure (3.4): Master-feeder structure

[340] Ibid, article 58.



3. Key investor information (KII) Disclosure is a very important element in the mutual funds industry. The UCITS introduces a new document replacing the simplified prospectus "key investor information" (KII) for every UCITS. The key investor information must contain clear, fair and understandable information about specific issues of UCITS. It is clear that the KII must be brief and contain non-technical information.[341]

4. Fund mergers. The UCITS IV Directive introduces an effective regime for cross border as well as domestic mergers of UCITS. A merger may happen between one or more UCITS or sub-funds (merging UCITS) and a receiving UCITS or sub-fund (receiving UCITS). A merger may take place in one of the three following possible scenarios:[342]

A. The first scenario may take place where the merging UCITS transfer not only their assets, but also their liabilities to an existing receiving UCITS (figure 3.5).[343]

[341] Ibid, article 78.
[342] Ibid, chapter VI.
[343] M K Alshaleel, 'Undertakings for the Collective Investment in Transferable Securities Directive V: Increased Protection for Investors' (2016) 13 European Company Law 14-22.

B. In this scenario, the merging UCITS transfers all of their assets and liabilities to a new receiving UCITS that they form (figure 3.6).[344]

C. In the last possible scenario, the merging UCITS transfers their net assets to a receiving UCITS which could be another investment (sub-fund) of the same UCITS, a UCITS that they form or another existing UCITS. Here, the merging UCITS continues to exist until their liabilities have been fully discharged (figure 3.7).[345]

Figure 3.5: Direct dissolution

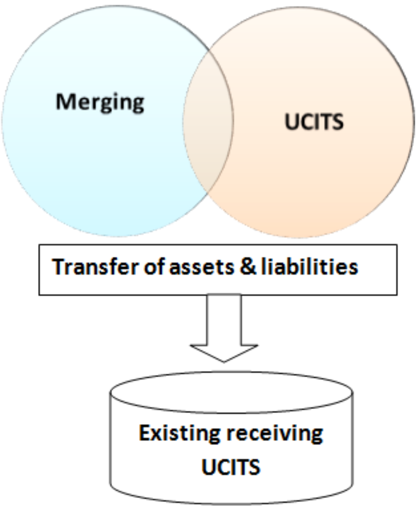


Figure 3.6: Direct dissolution

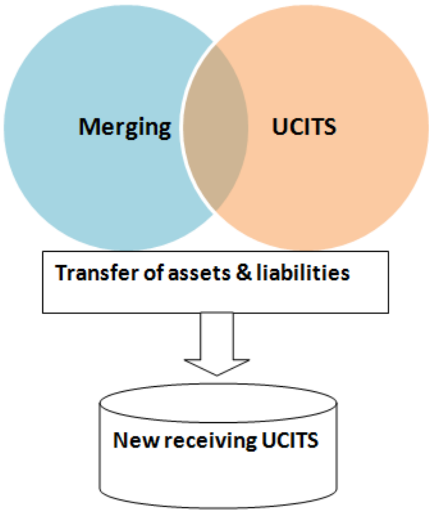
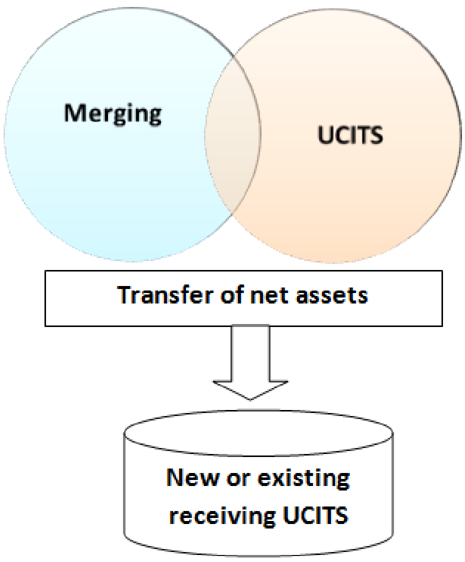


Figure 3.7: No direct dissolution



[344] Ibid.
[345] Ibid.

5. Management company passport. This amendment is related to the authorisation of the UCITS management company, which is different from the first amendment related to notification procedures for sale of the units of UCITS funds in other EU member states. A UCITS management company that has obtained authorisation in its home Member State authority will be allowed to perform the activities for which it has been authorised in another Member State.[346] Thus, the host State may not create a branch subject to any further authorisation. However, the management company intending to perform activities in another Member State must notify the home State authority of its intention to do this and provide some additional information. The home authority will communicate the information received to the host Member State authority. The management company may then commence business in the host State, providing cross border services subject to its home Member State's supervision.

Furthermore, the UCITS IV Directive was implemented in the UK on July 2011 by way of the Undertakings for Collective Investments Schemes in Transferable Securities Regulations 2011 and changes to the FCA Sourcebook.[347] There is no doubt that the implementation of the UCITS IV Directive by the UK authorities is useful in supporting and enhancing the mutual funds industry in the UK in terms of increasing the cross border industry and protecting investors. As was explained above, the UCITS IV enhancements were found to fit the development of the mutual funds industry and increase investor protection, so adopting the Directive would keep the UK mutual funds in the race to attract mutual funds investors in Europe and other areas.

On 3 July 2012, the European Commission released a proposal for a UCITS V Directive amending the UCITS IV Directive.[348] On 28 August 2014, Directive 2014/91/EU, a Directive to amend Directive 2009/65/EC, was published in the

[346] Parliament and Council Directive, (n 339) article 6.

[347] Undertakings for Collective Investment in Transferable Securities Regulations 2011 (S.I. 2011/1613).

[348] Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012PC0350, accessed 13 June 2014.

Official Journal of the European Union.[349] UCITS V entered into force on 17 September 2014. The core aim of the reform is to create uniform market conditions across the EU. The new rules are designed to essentially increase the level of protection enjoyed by UCITS investors. Those rules are also seen as a fundamental step towards restoring investor confidence in the wake of the financial crisis and scandals.[350] The UCITS V focuses on three key areas, namely: (i) clarification of the depositary role including a depositary's eligibility, its functions and its liability in circumstances where the assets in custody are lost; (ii) rules governing remuneration policies; and (iii) the harmonisation of the minimum administrative sanctions regime across the EU Member States.[351] In the UK, the FCA issued a policy statement with respect to implementation of the UCITS V Directive in February 2016.[352] In this policy statement, the FCA set out Sourcebook changes affecting managers and depositaries of UCITS. These changes fundamentally relate to final rules and guidance for implementing UCITS V.

It is worth mentioning that in 1988, Luxembourg became the first country to implement the UCITS I Directive. It gave its formal authorisation to the umbrella fund structure. Further, in 2002 Luxembourg implemented the UCITS III Directive (the Management and Product Directives). Again, Luxembourg was the first EU Member State to implement the UCITS IV into a national law by the "law of 17 December 2010". This precedent was one of the reasons that has made Luxembourg the leading domicile for UCITS distributed across borders, and more than 75% of the UCITS funds distributed internationally are based in Luxembourg.[353]

It is necessary to know that a referendum on the United Kingdom's membership of the European Union (EU) took place on Thursday 23 June 2016. The British people have voted to leave the EU. Leaving the EU might have potential consequences on

---

[349] The European Parliament and the Council Directive 2014/91/EU on amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions [2014] ojL 257/186

[350] Alshaleel, (n 343).

[351] Ibid.

[352] Financial Conduct Authority, Policy Statement PS 16/2 'Implementation of the UCITS V Directive' (February 2016). Available at https://www.fca.org.uk/static/documents/policy-statements/ps16-02.pdf accessed 1st May 2016.

[353] M Ferguson, UCITS IV Transforming the European Investment Fund Industry, available at: http://www.vaioe.at/fileadmin/user_upload/tax_legal/Klassische_Fonds/Allgemeine_Informationen/EY__UCITS_IV.pdf, accessed 16 June 2014.

the UCITS industry in the UK. Nonetheless, the scope of the research does not extend to those potential consequences and this could be an exciting topic for more research in the future.

3.4 The Valuation and Pricing Regulations

Mutual funds regulations should be a comprehensive framework that regulates all aspects of the industry. Ignoring any part of the industry would have serious effects on the investors' interests. The valuation of mutual funds assets is an essential part of the industry which should be well regulated. Therefore, the implementation of comprehensive policies and procedures for valuation of mutual funds assets is a major principle supporting the core objective of protecting investors.

One of the key advantages of mutual funds is the ease with which they can be bought, redeemed and sold on a daily basis.[354] This is fulfilled because of the requirement under the mutual funds regulations that a mutual fund can price and redeem its units/shares daily at their current net asset value (NAV). The per unit net asset value of a mutual fund is the aggregate value of the fund assets minus the aggregate liabilities of the fund divided by the number of units outstanding.[355] For instance:

The aggregate value of the assets	£3,000,000
The aggregate liabilities	£400,000
The aggregate NAV	£2,600,000
Number of units outstanding	£1,000,000
Net asset value per unit	£2.60

The FCA regulations require the mutual funds managers to pay due regard to the investors' interests and to treat them fairly.[356] Under the FCA regulations, the mutual funds managers are responsible for valuing the scheme property and calculating the price of units. The regulations impose a duty upon the managers to ensure the prices of units are calculated fairly and regularly.

[354] Jones, (n 51) 29.
[355] H B Mayo, *Financial Institutions Investments and Management* (8th edn Thomson South- Western USA 2004) 337.
[356] Collective Investment Schemes Sourcebook 2014, coll 6.2.2.

Generally, there are three pricing methods available to the mutual funds managers. The managers are required to select the most suitable pricing method. In determining the best method, the managers should take into account different factors such as objectives of the fund and the expectations of the funds' investors. However, shares in OEICs are always "single priced": there is only one price for the shares, whether one is buying or selling.[357]

The three pricing methods are dual pricing, single pricing with dilution levy and swinging single pricing. The dual pricing is the traditional methodology in the UK.[358] This method uses two pairs of prices: one pair is for issuing units and cancelling them, and the second for selling the fund units to the investors and thereafter redeeming them. The issue price is used to issue new fund units and is calculated using the offer prices plus notional dealing costs. The cancellation price uses the bid prices and the fund deducts the notional dealing costs.[359] The selling price cannot be more than the maximum issue price plus any initial charge if the fund applies it.[360] The fund manager must also ensure that the redemption price is not less than the cancellation price.[361] The fundamental advantage of this method is that the manager uses no discretion in determining the issue and cancellation prices. Therefore, the investors are protected from dilution by the pricing method itself.

The second method is the single pricing with dilution levy. It is the easy and simple method to price funds' units. This method requires the manager to calculate only one price at each valuation point. Then, this price will be used for both the creation and cancellation of units.[362] Applying this method implies that the fund uses a mid-market price. The mid-market price is a price between the actual bid and offer prices. The dilution levy is an adjustment that might be applied to an investor's transactions. The manager should set the criteria and the conditions under which it can use the levy and it should publish these in the prospectus.

---

[357] TC00946: J P Morgan Fleming Claverhouse Investment Trust plc and The Association of Investment Trust Companies [2011] UKFTT 68 (TC) [32].

[358] R Russell, *An Introduction to Mutual Funds Worldwide* (John Wiley & Sons, Sussex 2007) 128.

[359] M Buckle and J Thompson, *The UK Financial System Theory and Practice* (4th edn Manchester University Press, Manchester 2004) 137.

[360] Collective Investment Schemes Sourcebook 2014, coll 6.3.5B (1).

[361] Ibid, coll 6.3.5B (2).

[362] K Redhead, *Personal Finance and Investments: A Behavioural Finance Perspective* (Routledge Abingdon Oxon 2008) 193.

The last method is swinging single pricing. This method is also known as single pricing with a dilution adjustment.[363] The dilution adjustment is an adjustment made to the unit price. It includes the notional costs of dealing and the actual dealing spread. This method can be used in a similar way to dual pricing, but the pricing swings every day as appropriate to reflect unit dealing patterns.[364] Therefore, this method leaves the protection of investors against dilution as a matter of judgment for the manager. It is clear now that the three methods are effectively distinguished by their relative complexity and particularly by their ability to mitigate the consequences of dilution.

The Financial Conduct Authority Sourcebook sets forth the legal framework of the valuation rules. Under the provisions of the regulations, a mutual fund must have at least two regular valuation points in any month, but these two valuation points must be at least two weeks apart.[365] Nonetheless, this general rule does not apply to some mutual funds where the nature of the transactions in these funds requires the manager to make at least one valuation point every business day, such as higher volatility funds and qualifying money market funds. In higher volatility funds, a security's value can probably be spread over a short period of time in either direction. As a result, the manager should make a valuation point every business day to protect the interests of the investors. Money market funds invest in short term high quality money market instruments such as certificates of deposit, treasury bills and commercial papers.[366] The nature of these investments requires the manager to make one valuation point every business day. Here, it is worth mentioning that in the US, money market funds are regulated under rule 2a-7 of the 1940 Act. Unlike other mutual funds, money market funds seek to maintain a stable NAV, typically $1.00.[367] After the 2008 financial crisis, in March 2010, the SEC made a number of amendments to rule 2a-7.[368] The main aims of these amendments are to make money market funds more flexible by reducing the interest rate, credit and liquidity risks of

[363] Giles, Alexeeva and Buxton, (n 56) 167.
[364] Y Lustig, *Multi-Asset Investing: A Practical Guide to Modern Portfolio Management* (Harriman House Limited, Great Britain 2013) 325.
[365] Collective Investment Schemes Sourcebook 2014, coll 6.3.4.
[366] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 23.
[367] B Finkelstein, *The Politics of Public Fund Investing: How to Modify Wall Street to Fit Main Street* (Simon and Schuster, New York 2006) 61.
[368] Securities and Exchange Commission, Money Markets Funds Amendments, Final Rule (2010). Available at https://www.sec.gov/rules/final/2010/ic-29132.pdf accessed 2 May 2016.

fund portfolios. In 2013, the SEC proposed reforms to money market funds. These reforms concerned money markets' floating NAV. Under the floating NAV amendments, money market funds would be required to transact at a floating NAV, instead of at a $1.00 stable share price.

In Europe, the European Commission has made a proposal for a new European framework for Money Market Funds. This includes a draft Regulation of the European Parliament and of the Council on money market funds 2013/0306(COD).[369] The importance of this proposal comes from the fact that it reflects the recommendations issued by the Financial Stability Board (FSB) in October 2012. The key recommendation is that all constant redemption money market funds should float their NAV, where workable. Nonetheless, where conversion is not workable, the FSB proposed measures that are functionally equivalent in effect to liquidity, capital and other prudential requirements on banks that protect against runs on their deposits.

3.4.1 Fair Value Valuation Method

In some circumstances, the determination of the net asset value of mutual funds shares/units may not be available or the prices may not be reliable.[370] Thus, the manager is required to use the fair valuation method to determine the value of the assets. The fair value is the price that the mutual fund may reasonably expect to receive on a current sale. The FCA regulations impose a duty upon the mutual fund manager to pay due regard to the investors' interests and protect them from any potential loss. The manager may, after making the last valuation point, have reasonable grounds to believe that no reliable price exists for a security or the most recent price available does not reflect the fund manager's best estimate of a security.[371] Here, the manager should value those assets at a price that reflects the fair price for them. It is true that the manager has the authority to use the fair value method in certain circumstances, but using this authority should be justified. In making its decision, the manager should take into account different matters such as

[369] The Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds is available at: http://ec.europa.eu/internal_market/investment/docs/money-market-funds/130904_mmfs-regulation_en.pdf accessed 15 February 2016.

[370] Haslem, *Mutual Funds: Risk and Performance Analysis for Decision Making* (n 1) 123.

[371] Collective Investment Schemes Sourcebook 2014, coll 6.3.6 (5).

the type of mutual fund, the securities involved and the valuation policy disclosed in the prospectus.

In the USA, the definition of "value" in the Investment Company Act 1940 has two elements. The first element is securities for which market quotations are readily available. Those securities must be valued at the market value.[372] The second element is all other securities and other assets which should be valued fairly by the board of directors.[373]

The SEC has provided guidance over the years on the meaning of "fair value" and "readily available market quotations". The SEC requires the board of directors to monitor for circumstances that may require the use of fair value prices. In its guidance, the SEC has described varied events which would normally cause a fund to consider fair valuation of a portfolio security. Generally, the SEC indicates two concepts: the lack of current market quotation and the occurrence of a significant event.[374] In the first concept, the SEC refers to certain circumstances where there may not be a current market quotation such as events that unexpectedly close entire markets, scheduled market holidays and the absence of trading.[375]

Secondly, a significant event may be defined as an event that would have effects on the value of a mutual fund's securities, which has happened after closing prices have been established.[376] Here, it is worth noting that in 2001 the SEC stated that a significant fluctuation in domestic or foreign markets may constitute a significant event.[377] In fact, during the market fluctuations, the price of a security would rise or fall within a short period of time. These changes may be very dramatic and hence, the prices would not reflect the real value of the security. To protect the shareholders, the board of directors should use the fair value method. However, the SEC requires

---

[372] Haslem, *Mutual Funds: Risk and Performance Analysis for Decision Making* (n 1) 123.
[373] Investment Company Act of 1940, s.2 (a) (41).
[374] Ibid, s.22.
[375] Ibid, s.22 (e) (1).
[376] Haslem, *Mutual Funds: Risk and Performance Analysis for Decision Making* (n 1) 123.
[377] Securities and Exchange Commission 'Letter to the ICI Regarding Valuation Issues: Division of Investment Management' (April 2001) available at: http://www.sec.gov/divisions/investment/guidance/tyle043001.htm, accessed 16 October 2014.

the fluctuation to be significant in order for it to be considered as a significant event, so slight fluctuations are not considered as significant events.[378]

In addition, valuation and pricing is a technical process that requires good understanding of the market rules. The mutual funds manager may delegate the pricing function to a third party. The FCA regulations enable the managers to delegate the valuation and pricing to a third party, which is usually a valuation committee.[379] The committee has day to day responsibility for the valuation process. Nonetheless, the manager must oversee the committee and retain ultimate responsibility for valuation matters. The regulations do not mention the structure of the committee, but such a committee may consist of management personnel such as treasury, legal and investment professionals.

3.4.2 Mutual Funds Valuation Obligations

Valuation is one of the most important areas of potential risks for mutual funds. To mitigate those risks, the FCA regulations impose obligations upon the mutual funds managers. Those obligations may be outlined in four key points:

1. Adopt written accounting policies and procedures;[380]
2. Create a suitable methodology and written policies to determine the current fair value of a security;[381]
3. Regularly review the accuracy and usefulness of the methods and policies used in the valuation;[382]
4. Disclose the valuation policies to the investors in the prospectus.[383]

Further, establishing appropriate valuation policies and procedures is significant to protect investors because these policies define the roles and responsibilities of the parties involved in the valuation process, such as the role of the manager or in the case of delegating the valuation functions to a third party, the duties and obligations of that party. The valuation policies also monitor the circumstances of using the fair value method.

---

[378] Ibid.
[379] Collective Investment Schemes Sourcebook 2014, coll 6.3.6 (2) (6).
[380] Ibid, coll 6.3.3A.
[381] Ibid, coll 6.3.6.
[382] Ibid, coll 6.3.6 (1).
[383] Ibid, coll 6.3.3 A.

Moreover, the FCA regulations require mutual funds to regularly review the accuracy and suitability of the policies used in the valuation process. The regular review permits the mutual funds to assess the operation of the valuation methods and the policies. Therefore, those methods can be adjusted in light of changing conditions and experience.[384]

Finally, the regulations require the mutual funds to disclose the valuation policies or any changes in the prospectus.[385] The valuation methods may be complex and include financial information that may be difficult for investors to understand. As a result, it is desirable that the disclosure should be brief and laid out in simple words.

In the USA, the Morgan Keegan case is the clearest indication of the SEC's view towards valuation obligations and practices. Although the issues raised in this case are not the only consideration that the valuation parties in a mutual fund need to consider when it comes to the valuation process, the breaches identified by the SEC in the case should be considered as guidance to the valuation parties with respect to the regulatory exam. The SEC order was issued on December 10, 2012.[386]

The Morgan Keegan case involved five mutual funds that were heavily invested in securities backed by subprime mortgages. The main allegation was that the directors failed to satisfy their pricing and valuation obligations under the federal securities law.[387] The obligations under the securities laws are: (a) determining the fair value of portfolio securities where the market quotations are not readily available; (b) determining the methodologies to be used to fairly value securities; (c) regularly reviewing the appropriateness of those methodologies.

The SEC order found that the eight directors had failed to fulfil those obligations. Specifically, they had failed to provide the delegated valuation committee with sufficient substantive guidance on how fair value determinations should be made. The order found that the valuation committee to whom the valuation obligations were delegated by the directors did not utilise reasonable procedures. Therefore, the

[384] Ibid, coll 6.3.6 (1).
[385] Ibid, coll 6.3.3 A.
[386] Available at: http://www.sec.gov/litigation/admin/2012/ic-30300.pdf, accessed 16 October 2014.
[387] E Dartley, 'Lessons Learned from the Morgan Keegan Case,' [2013] (17) Wall Street Lawyerhttp://www.pepperlaw.com/publications_update.aspx?ArticleKey=2692 accessed 16 October 2014.

order found that the funds overstated the value of their securities. Further, the order found that the funds directors violated Rule 38a 1 under the Investment Company Act 1940, which requires mutual funds to adopt written policies and procedures reasonably created to prevent the violation of federal securities laws.

It is clear that the SEC order in the Morgan Keegan case emphasises the responsibility of the mutual funds directors to closely oversee the process of valuing securities held by their mutual funds. It also shows the SEC's willingness to hold the mutual funds directors accountable for funds' valuation policies and procedures.

Finally, the obligations of the mutual funds managers in the UK and the directors in the USA with respect to the valuation process are very similar. They emphasise three major issues: establishing appropriate valuation policies, regularly reviewing the accuracy of these policies and disclosure of the valuation policies to the investors. Therefore, these obligations could be considered as essential requirements to ensure the effectiveness of the valuations rules

3.5 Delegation of Functions under the Mutual Funds Regulations

Delegation of functions has become a common and necessary practice in the mutual funds industry. It happens when the manager or depositary of a mutual fund delegates certain tasks to a third party. As for the mutual funds managers, the desire to improve the services provided to investors may require them to delegate certain functions to a third party which may be able to perform those functions in a manner considered appropriate for the financial markets' development. In fact, the financial markets are becoming more and more sophisticated. The delegation of functions is an effective way to obtain specialised management in those sectors that the fund managers do not possess themselves. However, the delegation of functions must not be at the expense of the investors, because delegation of functions may contradict the rules of investor protection. Therefore, the mutual funds regulations should regulate all aspects of this authority to protect the interests of the investors.

The FCA Sourcebook enables the mutual funds managers to delegate functions to other persons.[388] Generally, the regulations empower the managers to delegate any function without restriction, so the managers can delegate the complaint handling,

[388] Collective Investment Schemes Sourcebook 2014, coll 6.3.1 (2).

risk management and internal audit functions. Nonetheless, the regulations do not mention whether or not the monitoring of delegated activities can itself be delegated. Monitoring illustrates the process of assuring the delegated function is being completed safely and competently in the way that is required.[389] Monitoring of the delegated activities by the manager itself is more effective than a third person monitoring because it allows the manager to ensure that the function is carried out appropriately and in compliance with the directions. Hence, the manager may modify the instructions as required or may even withdraw the delegation mandate from that person when this is in the interests of the investors. Therefore, it would be better to restrict the power of the manager to delegate the monitoring of the delegated functions to a third party, or the manager might be allowed to delegate this function, but in specific circumstances defined in the regulations.

In addition, the manager of a mutual fund has the power to retain the services of any person to assist it in the performance of its functions provided that a mandate with respect to managing investments of the fund is not given to specific persons.[390] The manager cannot delegate any function to the depositary because the core duty of the depositary is to ensure the effective supervision of the management of the mutual fund, so it would be difficult for it to monitor any of the activities which it may have been delegated by the managers. Further, the manager cannot delegate its functions to any person whose interests may conflict with those of the investors or the fund manager. For example, the manager cannot delegate its functions to the delegatee of the depositary.

Furthermore, the FCA Sourcebook requires the manager to delegate its functions to a qualified person capable of undertaking those functions.[391] Generally, the fundamental aim of the delegation of the manager's functions is to improve the services provided to the investors. This imposes a duty upon the manager to exercise due care in selection of the delegatee. The manager must ensure that the delegatee has sufficient resources such as human, technical and financial resources to perform

[389] Kiymaz, Baker and Filbeck, (n 27) 323.
[390] Collective Investment Schemes Sourcebook 2014, coll 6.6.15A (2) (a).
[391] Ibid, coll 6.6.15A (2) (d).

the delegated tasks. Further, the manager is also required to inform the FCA before it delegates one of its duties to a third person.[392]

Regarding the delegation of the depositary functions, the FCA Sourcebook, like the manager, gives the depositary the power to delegate its functions to a third party.[393] Nevertheless, the depositary must not delegate any function to the mutual fund manager, any other OEIC directors or an associate of the OEIC. The depositary may delegate the oversight function or any function of custody or control of the fund property. It is common that mutual funds invest part of their assets in international financial markets. This requires the depositary to delegate some functions to a third party in those markets.

The conditions under which the depositary can delegate its functions are similar to those regarding the delegation of the manager's functions where the depositary should exercise due care in the selection of any third party. The depositary must also keep exercising all due care and diligence in the regular review and ongoing monitoring of any delegatee to whom it has delegated parts of its functions.[394] The depositary must also ensure that the delegatee has sufficient financial and human resources to carry out the functions delegated. It must also ensure that the delegatee has structures appropriate to the nature and complexity of the assets entrusted.

Finally, the delegation of functions has become a necessary and common practice in the mutual funds sector. The regulators cannot ignore this practice. In order to protect the investors and avoid a conflict of interests, the regulators should establish a clear regulatory framework that regulates this practice.

3.6 Suspension of Redemptions and Winding up Mutual Funds

This section examines two important topics regulated under the mutual funds regulations in the UK. The first part of the section studies the suspension of redemptions, while the second part explains the winding up rules under the current legal framework. Winding up the mutual fund is the last stage in the life of the fund and the protection of investors should continue in this stage. Thus, it is significant to examine the rules that regulate the winding up process. Suspension of redemptions is

[392] Ibid, coll 6.6.16 (2).
[393] Ibid, coll 6.6.15 (4).
[394] Ibid, Annex 1 (3) (c).

an exceptional tool that the fund managers can use in very exceptional situations. Hence, the study will scrutinise these situations and the rules applying in this process. Regulating the authority of the managers to suspend the right of redemption is necessary in order to avoid misuse of this authority by the fund managers.

3.6.1 Suspension of Redemption: a Temporary Tool to Protect Investors

During the life of a mutual fund, the manager of the fund may suspend the right of redemption in very specific circumstances. The decision to suspend must be regularly and formally reviewed by the manager and trustee or depositary.[395] The supervisory authority must also be kept informed.[396] The most important point in this regard is how to protect the investors before, during and after the suspension.

The redemption of units/shares is a key right for the investors in the mutual funds industry. When investors invest their assets in mutual funds, they expect to be able to redeem their units/shares on a continuous and regular basis. Suspensions of redemptions prohibit investors from having access to their funds. This could cause serious problems for investors, especially if the mutual funds did not inform the investors of the possibility of a suspension. Further, suspensions could be fulfilled in unfair conditions leading to inequitable treatment of investors. For example, if the service providers of a mutual fund informed some of the fund investors about the fund's intention to suspend dealings, those investors may request the redemption of their units/shares before the suspension decision becomes effective. Therefore, the suspension of redemptions process should be regulated clearly to protect investors and ensure that all investors are treated fairly.

3.6.1.1 Potential Reasons for Suspension of Redemptions

Why would a mutual fund suspend redemptions of units/shares? Principally, suspensions of redemption are only justified in exceptional circumstances. These suspensions should be a temporary tool. Further, possible reasons for suspensions are as follows. The first possible reason is market failures and exchange closures.[397] Market failures and exchange closures might lead to an inability to price a

---

[395] Collective Investment Schemes Sourcebook 2014, coll 7.2.1 (4A).
[396] Ibid, coll 7.2.1 (2).
[397] The Investment Management Association, 'Authorised Funds: A Regulatory Guide' (March 2012). Available at http://www.investmentfunds.org.uk/policy-and-publications/industry-guidance/ accessed 24 July 2014.

fundamental portion of the fund assets precisely. Therefore, to protect investors, the mutual funds managers should ensure that the investors do not buy or redeem units/shares at a price that cannot be calculated accurately. The 11th September 2001 attack on the USA is the best example of this reason for suspension, where the attack caused market failures. The second potential reason is some other independent or emergency events out of the mutual funds manager's control, such as natural catastrophes or disasters. These events make it impossible to price the mutual funds' assets.[398]

The third possible reason is issues related to the mutual fund's structure. Operation of a mutual fund involves different entities which are responsible for ensuring the best performance of the fund. The failure of one of the main entities could result in the suspension of redemption because it is in the interests of all investors to temporarily suspend dealings. For instance, due to unforeseen circumstances, the manager of a mutual fund may cease to perform its functions and therefore the depositary would be required to replace this manager with an appropriate one.[399] That could take a long time, so the depositary of the fund may consider that it is in the interest of investors to suspend dealings.

The fourth potential reason is that the fund manager might suspend the redemption due to lack of liquidity.[400] The manager of a mutual fund is responsible for the management of the fund. The manager should ensure that units/shares can be redeemed on a regular basis. To meet this obligation, the manager should have in place sound liquidity arrangements. Suspensions of redemption as a consequence of a lack of liquidity would only be justified where, despite the good liquidity arrangements, the liquidity of the fund is in a position that makes the manager believe that it is in the interest of investors that all dealings in the mutual fund should be suspended temporarily.

3.6.1.2 The Consequences of Suspension of Redemption

The suspension of redemption might have serious impacts on the investors, the mutual funds industry and the financial market. One of the core features of mutual funds, which distinguishes them from other financial vehicles such as hedge funds, is

398 Investment Company Act of 1940, s.22 (e) (2).
399 Collective Investment Schemes Sourcebook 2014, coll 6.5.6.
400 Ibid, coll 7.2.2.

liquidity where investors are entitled to redeem their shares/units at any time.[401] Therefore, investors prefer to invest their money in the mutual funds. Suspension of redemption prohibits investors from redeeming their shares/units and having access to their funds. To limit the direct impact of suspension on investors, the mutual funds should alert the investors, whether before making their decision to invest in the mutual fund or after the investment, to the possibility of a suspension. In the case of Arch Financial Products, the manager and the depositary voluntarily agreed to establish a hardship fund for the affected investors to mitigate the serious impact of the suspension.[402]

Moreover, suspension of redemption does not only have an impact upon the investors, but would also have a serious impact on the mutual funds industry. In fact, suspension of redemption in a mutual fund might have certain effects on the confidence of investors in the mutual funds industry. Suspensions of redemption in mutual funds would, especially if the fund is a large fund, increase the investors' concern about other mutual funds, and this would make them run to the mutual funds with their share/units to redeem them. These redemptions in other mutual funds would lead to further mutual funds suspensions.

Further, as was mentioned above, the suspension of redemption in one or more mutual funds would increase the requests of the investors in other mutual funds to redeem their shares/units. The huge number of requests for redemptions may cause liquidity problems within the mutual funds. To overcome these problems, the mutual funds managers will attempt to sell the mutual funds assets to obtain cash. A forced sale to the mutual funds assets might lead to further price declines in the market or a particular sector. Price declines would result in lower mutual funds prices and this could lead to further redemptions. Thus, the mutual funds manager would suspend redemption to protect investors' interests.

In addition, in the UK the suspension of redemption regulations are included in the FCA Sourcebook.[403] These regulations apply to the authorised unit trust and open-

---

[401] Ibid, coll 6, 6.2.16 (6).
[402] Arch Financial Products LLP and others v Financial Services Authority - [2013] All ER (D) 67 (Jan).
[403] Collective Investment Schemes Sourcebook 2014, coll 7.

ended investment companies.[404] The regulations provide that the authorised fund manager may, with the prior agreement of the depositary, suspend redemptions. The suspension should be on a temporary basis and include suspensions of issue, cancellation, sale and redemption of units/share.[405] The regulations emphasise the fact that suspension of redemption is an exceptional tool and its aim is to protect investors.

Once the manager has made the decision of suspension, it is obliged under the regulations to fulfil two core duties. First, it must immediately inform the FCA, stating the reasons for its action.[406] Second, it must as soon as practicable give written confirmation of the suspension and the reason for it to the FCA and the Home State in each EEA State in which the authorised fund manager holds itself out as willing to redeem or sell units of authorised funds concerned.[407] It is obvious that the regulations do not require any pre-approval from the FCA to suspend redemptions. It is only required to inform it with the reasons for the suspension immediately after the suspension has taken place. However, before making the decision of suspension, the manager and the depositary should consider any possible alternative courses of action. Furthermore, throughout the period of suspension, the manager must ensure that sufficient details regarding the exceptional circumstances that resulted in the suspension are published to keep investors informed.[408] Further, during suspensions, none of the obligations in Coll 6.2 regarding dealing with units/shares apply.[409] Therefore, it is the manager’s duty to inform any person who requests a redemption or sale of units/shares during the suspension period that all dealings have been suspended, so the investors can either withdraw their requests or have their requests executed at the first possible opportunity after the end of the suspension.[410] Here, it is worth mentioning that the manager might agree to deal in units/shares. In such a case, all deals accepted during the suspension, and those outstanding before the

[404] In the authorised unit trust, the manager and the trustee are responsible for making the suspension decision, while in the OEIC the authorised corporate director and the depositary are responsible for making the decision.
[405] Collective Investment Schemes Sourcebook 2014, coll 7.2.1 (1).
[406] Ibid, coll 7.2.1 (2) (a).
[407] Ibid, coll 7.2.1 (2) (b).
[408] Ibid, coll 2.7.1 (2B) (a).
[409] Ibid, coll 2.7.1 (3) (a).
[410] Ibid, coll 7.2.1 (3) (b).

suspension will be calculated according to the first valuation point after the resumption of dealings.[411]

In addition, the suspensions should be formally reviewed by the authorised fund manager and the depositary every 28 days. The FCA should be informed of the results of the review and any change to the information originally submitted to the FCA with respect to the suspension.[412] This obligation ensures that the FCA will be informed of any new information in the fund, so it can undertake any necessary procedures to protect the interests of investors. The authorised fund manager and the depositary should stop the suspensions of redemption as soon as the exceptional circumstances have ceased. The manager must inform the FCA of the proposed restart of dealings in units/shares, and immediately after the restart must confirm this by notifying the FCA.[413]

In the United States, the ability of open-ended investment companies to suspend redemptions under the Investment Company Act 1940 is extremely restricted. Under the terms of the Investment Company Act, a mutual fund cannot suspend the right of redemption or delay the date of payment more than 7 days after the tender of the security, except: (1) during any period that the New York Stock Exchange (NYSE) is closed (except for customary weekend and holiday closings); (2) any period in which an emergency exists, as specified by the rules found by the USA Securities and Exchange Commission (SEC), as a result of which disposal by a fund of portfolio securities is not reasonably practicable or it is not reasonably practicable for the fund to determine fairly the value of its assets;[414] (3) such other periods as the SEC may by order permit to protect a fund's investors.[415]

Further, it is clear that the approach under US law allows for suspensions of redemption in an extremely limited way. Nonetheless, the 1940 Act empowers the SEC with the authority to grant an order that allows the fund to suspend the redemption for a period considered suitable to protect investors. This authority is an effective means for the SEC to protect investors.

---

[411] Ibid, coll 7.2.1 (6).
[412] Ibid, coll 7.2.1 (4A).
[413] Ibid, coll 7.2.1 (5).
[414] An example of such an exception would be an emergency that affects markets or funds, such as earthquakes.
[415] Investment Company Act of 1940, s.23 (e).

3.6.1.3 Application to the Syrian Mutual Funds Act 2011

In Syria, the SMFA 2011 allows mutual funds to suspend redemption in exceptional circumstances and according to the instrument of incorporation and the prospectus.[416] However, unlike the UK, the manager of a mutual fund cannot suspend the redemption without pre-approval by the SCFMS. This can be justified on the basis that the mutual funds industry in Syria is a new industry, and the suspension of redemption is an exception to the core rule of liquidity that allows investors to redeem their shares at any time. Therefore, the pre-approval of the SCFMS is a very necessary procedure to protect investors and the industry.

Further, the Act defines the exceptional circumstances where it is allowed to suspend the redemptions as: (1) the extraordinary requests of redemptions where the mutual funds will not be able to respond to all these requests; (2) where the assets of the mutual funds cannot be liquidated due to unforeseen circumstances; (3) the decline in the value of the securities comprising the portfolio of the fund as a result of the unexpected decline in the prices of these securities, leading to a significant decline in the value of the fund's assets; (4) the case of force majeure.[417]

However, the Act does not indicate the duties of the manager during the suspension of redemption. As with the mutual funds regulations in the UK that define the key duties of the manager, the mutual funds regulations in Syria should specify the manager's obligations and specifically the duty of the manager to ensure that sufficient details with respect to the exceptional circumstances that resulted in the suspension are published to keep investors informed. Further, the Act does not indicate whether it is allowed to accept dealings during the suspensions. Moreover, the Act does not refer to the duties and powers of the SCFMS during the suspensions. The supervisory role of the SCFMS is the main guarantee to protect the investors and especially during the exceptional circumstances the fund is facing. Therefore, the Act should grant the authority sufficient powers that fit such exceptional circumstances. Further, the Act provides that the suspension should cease as soon as the reason of suspension has ceased. It is advisable to define the period where the suspension is allowed or to impose a duty upon the manager to

[416] Mutual Funds Act 2011, article 83 (2).
[417] Ibid.

review the suspension and inform SCFMS of the results as is required by the mutual funds regulations in the UK.

3.6.2 The Legal Methods of Winding up Mutual Funds under the Current Legal Framework in the UK

Winding up a mutual fund would be defined as a process by which the life of a mutual fund is brought to an end. The aim of the rules for winding up a mutual fund and termination of sub-funds is to help with achieving the regulatory objective of protecting investors, by providing a cost effective and appropriate way of winding up mutual funds and termination sub-funds. The methods and procedures of winding up mutual funds are included in the FSMA 2000, the Open Ended Investment Companies Regulations 2001 and the FCA Sourcebook.

Further, the rules consider the fact that open-ended investment companies are corporate vehicles, while the authorised unit trusts are trust vehicles.[418] Therefore, the methods and the procedures are not the same for both forms. In fact, the rules and procedures of winding up emphasise two core principles; first, the importance of the supervisory role of the FCA during the winding up or termination process to protect investors.[419] Second, the mutual fund should inform the investors of any important information before, during and after a winding up or termination.

3.6.2.1 Winding up Open-Ended Investment Companies

The winding up rules of OEICs are included in the OEICs Regulations 2001 and the FCA Sourcebook. The regulations differentiate between two types of winding up; winding up by the court and winding up a solvent OEIC and terminating a sub-fund of an OEIC under section 7.3 of the Sourcebook.

On the one hand, OEICs as corporate vehicles may be wound up by the court as unregistered companies under part V of the Insolvency Act 1986.[420] Winding up an OEIC by the court begins by the presenting of a petition to the court by the depositary or by any person authorised under section 124 of the Insolvency Act

[418] Collective Investment Schemes Sourcebook 2014, coll 7.3.
[419] Ibid, 7.3.7 (9).
[420] Insolvency Act 1986. Section 220 defines the unregistered company as “For the purposes of this Part “unregistered company” includes any association and any company, with the exception of a company registered under the Companies Act 2006 in any part of the United Kingdom”.

1986.[421] Furthermore, section 124A (a) of the 1986 Act gives the Secretary of State the power to present a petition to the court on the grounds of public interest. This authority raises a fundamental question; can the Secretary of State use this power even though the OEIC is not involved in any illegal activity? In *Re Senator Hanseatische* Millett LJ stated:

> *"I reject Mr. Bannister's submission that the Secretary of State has no business to intervene in a case where no illegal activity is being carried on. The expression "expedient in the public interest" is of the widest import; it means what it says. The Secretary of State has a right, and some would say a duty, to apply to the court to protect members of the public who deal with the company from suffering inevitable loss, whether this derives from illegal activity or not*".[422]

This means that the court may order that the OEIC be wound up on the grounds of public interest even though the company is not involved in any unlawful activity.[423]

In addition, in case a petition for winding up an OEIC is presented by a person other than the authority, the regulations impose a duty upon that person to serve a copy of that petition to the authority. Here, the authority is entitled to be heard on the petition.[424]

On the other hand, the winding up of an OEIC may be achieved under section 7.3 of the FCA Sourcebook provided the OEIC is solvent and the requirements under regulations 21 of the OEICs Regulations are fulfilled. These requirements are related to the FCA approval for certain changes in respect to an OEIC. Mainly, section 7.3 lays down the procedures of a winding up and the obligations of the ACD and any other directors of the OEIC before, during, after the winding up process. Generally, the winding up procedure involves realising the OEIC assets, discharging its

---

[421] Under section 124 the authorised persons are: the company, or the directors, creditors, the Secretary of State and the FCA.
[422] Re Senator Hanseatische Verwaltungs Mbh [1997] 1 W.L.R. 515 at p 526 B-D.
[423] See A Lidbetter, Company investigations by the DTI' in J Lacy, *The Reform of United Kingdom Company law* (Cavendish, London 2002) P 317.
[424] Open Ended Investment Company Regulations 2001, reg. 31 (3).

outstanding liabilities and distributing the remaining realised proceeds to the investors.

The process of winding up is very precise, with every step requiring FCA approval. The ACD plays a key role in this process. Therefore, an OEIC must not be wound up or a sub-fund terminated if there is a vacancy in the position of the ACD.[425] Under the terms and provisions of the FCA Sourcebook, the winding up process is commenced when the directors make a full enquiry into the OEIC's business and property in order to determine whether the OEIC will be able to meet all its liabilities. Here, the ACD must prepare a statement either confirming the ability of the OEIC or the sub-fund to meet all its liabilities within 12 months of the date of the statement or declare that such confirmation cannot be given.[426] After that, an effect must be given under regulation 21 of the OEICs Regulations for proposals to wind up the affairs of the OEIC or to make alterations to the OEIC instrument of incorporation and prospectus.

In addition, section 7.3 defines the situations where an OEIC may be wound up.[427] OEICs will commonly be wound up following the expiry of their specified life or the occurrence of certain events specified in the OEIC instrument of incorporation, such as a failure to find a replacement for the depositary. Further, the shareholders may make a decision to wind up the OEIC by passing an extraordinary resolution.

Furthermore, commencing the winding up process has significant consequences for the operation of the fund. Once the OEIC has commenced the winding up procedures, the valuation and pricing process of the fund's shares cease to apply to the OEIC.[428] Further, the OEIC must cease to issue and cancel units (except the final cancellation). The ACD must also cease to sell or redeem shares.[429] This means the OEIC must cease to carry on its business, except for its beneficial winding up. These procedures are necessary to protect the investors' interests because commencing the winding up process could cause substantial harm to the commercial reputation of the OEIC. Therefore, any dealing with the OEIC assets would results in a loss to the shareholders.

[425] Collective Investment Schemes Sourcebook 2014, coll 7.3.4 (2).
[426] Ibid, coll 7.3.5.
[427] Ibid, coll, 7.3.4 (4).
[428] Ibid, coll 7.3.6.
[429] Ibid.

Then, it is the duty of the director and depositary to perform the fundamental steps of the winding up. The ACD must realise the scheme property and make sufficient provision to cover the expenses relating to the winding up or termination and all liabilities of the scheme.[430] The ACD must then arrange for all units in issue to be cancelled and the depositary must make the final distribution to the shareholders proportionately to the right of their respective units to participate in the scheme property at the commencement of the winding up or termination.[431]

It is clear that the same entities, the ACD and depositary, which operate the OEIC before commencing the winding up procedures, are responsible for performing the winding up process. No external entities are involved in the process. As was mentioned above, it is not permitted for the OEIC to commence a winding up or termination if there is a vacancy in the ACD position. The law does not give the OEIC the power to appoint an external entity for the sole purpose of winding up the fund, so it must appoint a new ACD to commence the process. The external professional management is the key feature of the mutual funds. This management operates the fund for the benefit of the investors. Therefore, it has a comprehensive knowledge of the fund's financial position, its liabilities and the investors' rights. This knowledge means it is in a better position to wind up the fund than any external entity. However, the law imposes a duty upon the ACD, and in some situations the depositary, to notify the FCA of every step in the winding up process. This supervision provides investors with proper protection during the winding up procedures.

3.6.2.2 Winding up an Authorised Unit Trust

The rules of winding up AUTs are included in the Financial Services and Markets Act 2000 and the FCA Sourcebook. The winding up procedures are very similar to the OEIC winding up procedures, but they are designed to fit the trust structure. The manager and trustee are responsible for performing the winding up process under the supervision of the FCA.

---

[430] Ibid, coll 7.3.7 (2).
[431] Ibid, coll 7.3.7 (3).

Further, under section 256 of the FSMA 2000, the manager or trustee of an AUT may request the FCA to revoke the authorisation order in respect of that AUT.[432] The FCA may refuse that request if it considers that revocation would not be in the interests of the investors. In addition, section 257 of the FSMA 2000 gives the FCA the power to make certain directions. The FCA might direct the manager and trustee of the AUT to wind it up.[433]

The consequences of winding up an AUT are similar to those explained in the winding up of an OEIC. The valuation and pricing rules cease to apply to the AUT. The trustee ceases to cancel or issue units. Further, the manager must cease to redeem and sell units.[434] Moreover, once the AUT falls to be wound up or a sub-fund is terminated, the scheme property must be realised. The trustee must make payment or sufficient provisions to cover the expenses relating to the winding up and all liabilities of the AUT.[435] Then, the trustee must distribute the proceeds of the realisation to the unitholders proportionately to their respective interests in the AUT before commencing the winding up.

Finally, it is obvious that the winding up process of the mutual funds under English law is well-regulated. Even though the process involves many steps and procedures, it provides the investors with a high level of protection. The laws define the methods of the winding up and the reasons for the winding up and termination. The laws also specify the obligations and liabilities of the mutual funds management. Further, the consequences of the winding up process are also clear. The laws also require FCA approval at every step during the process. As a result, the protection of the investors continues during the last stage in the fund's life. Without any of these steps and procedures, the investors' interests may not be protected.

3.6.2.1 Observations on the Syrian Legislation

The SMFA 2011 specifies two methods of winding up mutual funds; voluntary and compulsory. The voluntary winding up gives the mutual fund the authority to define the situations where the fund may be wound up in the instrument of incorporation. The second method is the compulsory winding up where the SCFMS is entitled to

[432] Financial Services and Markets Act 2000 s.256.
[433] Ibid, s.257.
[434] Collective Investment Schemes Sourcebook 2014, coll, 7.4.3 (1).
[435] Ibid, coll 7.4.4.

wind up the mutual funds in specific situations.[436] For instance, the SCFMS is permitted to wind up a mutual fund if no regulated activity has been carried out by that fund during the last three months without any valid reason. The entity responsible for commencing the voluntary and compulsory winding up procedures is the custodian. However, since the manager is responsible for the everyday business of the fund and making the investment decisions, it would be better to make it responsible for commencing the winding up procedures alone or with the custodian, similarly to the mutual funds rules in the UK. Unlike the mutual funds regulations in the UK, the Syrian Mutual Funds Act entitles mutual funds to appoint an external entity to commence the winding up procedures in case there is a vacancy in the position of the custodian. That could be justified on the basis that the number of authorised custodians in Syria is limited, and so appointing a new custodian could take a long time. Therefore, this rule is more suitable for the mutual funds market circumstances than the rule that applies in the UK.

Further, the SMFA does not mention the consequences of the winding up on the operation of the fund in terms of valuation and pricing rules, cancellation or issue of the fund shares and redemption of the shares. Furthermore, the SMFA 2011 does not mention the obligations and liabilities of the management during the process. What is more, the SMFA 2011 does not specify the period of time for every step or procedure, which might lead to a very long process. As a result, the SMFA 2011 does not provide the investors with the proper protection during the winding up. Since the protection of the investor should continue in the last stage of the mutual fund's life, it is advisable that the SCFMS clarifies all of those issues to ensure the protection of the investors.

3.7 Conclusion

The discussion and analysis above demonstrate that due to the significant role of the mutual funds in the financial market, the mutual funds industry in the UK is subject to an extensive regulatory framework. The mutual funds regulation is part of the general financial regulation. The objectives of the mutual funds regulation reflect the overall financial regulation objectives, namely investor protection, financial stability and market integrity, and this is one of the key reasons for the success of this

[436] Mutual Funds Act 2011, article 86.

industry in the UK. The existing mutual funds regulation in the UK is a consequence of the evolution of the legal framework throughout the long history of the industry. The development of the legal framework is based on practical studies made by professional persons who have a clear image of the industry and its requirements, and the general financial regulation principles. Here, it is significant to emphasise the fact that the UK is a major contributor to the international regime and its impact is very obvious on all international financial standards. Therefore, the international legal framework of the mutual funds industry (IOSCO principles) reflects the principles applied in the UK. Nonetheless, the UK regulations are more sophisticated and detailed. As a result, the interests of the investors are well protected. The regulation provides detailed rules that regulate mutual funds from the first stage in the life of the fund (establishing the fund and the authorisation process) to the last stage in the life of the fund (winding up the fund).

CHAPTER 4

The Governance of mutual funds: A Comparative Perspective

4.1 Introduction

The mutual funds philosophy is based on the idea of pooling funds from a large number of investors to be invested by professional management without the participation of those investors in the management.[437] Those funds must be invested for the primary benefit of the investors. Therefore, the legal framework of mutual funds governance should principally reflect that unique nature of mutual funds. This intends to say that an effective mutual funds governance framework should aim to protect the fund assets through ensuring that the fund management operates the fund in the investors' best interests. Further, this concern comes from the fact that operation of mutual funds involves potential conflicts of interest between the mutual funds and the service providers such as the management fee. Unlike ordinary corporations, mutual funds are externally managed. The separation of the ownership of the mutual funds from its management carries a potential conflict of interest between the self-interests of the fund management and the interests of the fund's investors. Therefore, the framework of the mutual funds governance should address any potential conflict of interest to protect the interests of the investors. It is important to know that although some financial institutions such as hedge funds are externally managed, the governance system of mutual funds is different due to the fact that most of the mutual funds investors are retail investors. Thus, they should be provided with a high level of protection.

This chapter examines the governance of mutual funds in the UK and the USA. Nevertheless, it sometimes highlights weaknesses in the governance of mutual funds in Syria which affect investor protection. The first section tries to define the governance of mutual funds and specify its scope, taking into account the unique characteristics of these vehicles. Section two assesses mutual funds models in the UK and the USA from a comparative structural and institutional perspective. Since the key point of this section is the governance and structure of mutual funds, the discussion focuses on structural rules such as the rules that regulate the allocation of

[437] Russell, (n 358) 3.

the powers to make the funds' decisions among the service providers and the conditions of making such decisions. For instance, the decisions should comply with the fund's objectives. Section three studies the agency problems in the mutual funds industry between the self-interests of the fund management and the interests of the fund's investors (conflict of interest). It concentrates on potential types of conflict of interest in the mutual funds schemes and the regulatory methods to address those potential conflicts of interest. Section four scrutinises the role of disclosure in the mutual funds governance system. It studies the regulatory tools of disclosure, namely the prospectus and the periodic reports, and their role in helping investors make informed decisions. The last section explores the effectiveness of the voting right in mutual funds governance, and whether it plays the same role in other financial institutions and traditional corporations.

4.2 Definition and Scope of Governance

In order to examine the definition and scope of mutual funds governance, it is important to understand the core of the concept of corporate governance because it has been significantly developed. Corporate governance can be defined as the system by which business corporations are directed and controlled. Corporate governance defines the distribution of rights and obligations among different participants in the corporation, such as managers, shareholders, the board and other stakeholders.[438] It involves a set of relationships among a company's management, its board and its shareholders.[439] Board structures are an integral part of corporate governance. The organisational framework categorises Board structures into two types (i) A unitary or single tier board system where the governing body is comprised of a single board. This system is prevalent in Anglo-Saxon countries such as the UK and US; and (b) A two tier board system where the governing body is comprised of two separate boards, namely a supervisory board and a management board, and is found is countries such as Germany and the Netherlands.[440] It is important to know that, in most countries, the directors are subject to periodic (often annual) re-election by the company

[438] S Bloomfield, *Theory and Practice of Corporate Governance: An Integrated Approach* (Cambridge University Press, New York 2013) 10.
[439] Ibid.
[440] L van den Berghe, *Corporate Governance in a Globalising World: Convergence or Divergence?: A European Perspective* (Springer Science & Business Media, Dordrecht 2007) 71.

shareholders. This would appear to grant the shareholders ultimate power.[441] In addition, corporate governance specifies the structure through which corporate main objectives are set. It also provides the means of achieving those objectives and monitoring performance.[442] In fact, good corporate governance is just a part of larger scale economic conditions in which companies operate such as market condition and macroeconomic policies. Further, the corporate governance system depends on the regulatory and legal framework.

The concept of corporate governance might provide a useful guide for improving and developing the concept of mutual funds governance. However, the definition of mutual funds governance should take into account the key differences between the nature of the mutual funds and the traditional companies. Further, the definition of the mutual funds governance should also consider the fact that mutual funds around the world take on different structures. Therefore, the definition should be comprehensive and applicable to all different mutual funds structures.

Mutual funds governance might be defined as the system for the operation and organisation of mutual funds which aims to ensure that mutual funds are operated effectively in the best interests of the mutual funds investors and not in the interests of the mutual funds external services providers. Further, mutual funds are financial vehicles that pool their funds from individuals to obtain professional management to execute the investment strategy efficiently.[443] The fundamental aim of mutual funds is to invest the pooled funds in the interests of the investors. Thus, an effective mutual funds governance system should protect those assets from any potential loss by reason of the misconduct and negligence of the external services providers or a conflict of interest between the self-interests of the management and investors. Nonetheless, it should not be understood that the mutual funds governance system eradicates losses to investors because such losses may occur due to investment conditions such as market conditions. This is to say that when investors make their decisions to invest in any mutual fund, they must bear all inherent risks in their investment decisions.

---

[441] It will be seen later that in the USA, the independent directors who play the central role in the American mutual funds governance are elected by the independent directors.

[442] J Solomon, *Corporate Governance and Accountability (*2nd edn John Wiley & Sons, New York 2007) 12.

[443] Russell, (n 358) 3.

4.3 Competing Governance Models: Corporate Versus Contractual Model

Regarding the mutual funds structure and governance, two major models have arisen in the global financial markets: the corporate model and the contractual model. As for the corporate model, the oversight and safekeeping duties can be entrusted to either the board of directors or to the depositary. In the United States, the mutual funds governance system takes the corporate form with a board of directors.[444] In the United Kingdom, the mutual funds governance system takes either the contractual structure (the trust structure) or the corporate form with a depositary.[445] In fact, within each of these forms it is possible to define different oversight and review structures that can be applied to ensure investor protection. The following analysis will be devoted to evaluating the mutual funds models in the UK and the USA from a comparative structural and institutional perspective. Since the focal point is the governance and structure of mutual funds, the discussion concentrates on structural rules such as the rules that regulate the distribution of powers to make the funds' decisions among the service providers and the conditions of making such decisions. Further, after examining the different models, the research will attempt to shed light on the key differences among those models.

4.3.1 The United States Corporate Model

Mutual funds in the United States are structured pursuant to a corporate model.[446] Even though the law does not expressly require the mutual funds to be structured as corporations, it does impose specific requirements that presume the standard structure of corporate form.[447] The Investment Company Act 1940 requires mutual funds to have a board of directors whose main duty is to oversee the operations of the mutual fund and review the contract of the investment adviser and other service providers.[448] Like ordinary corporations, a mutual fund is an independent legal entity that has the capacity to make contracts, sue and be sued. US mutual funds are externally managed. That is to say that mutual funds do not have their own employees. Rather, the mutual fund enters into a contract with an investment adviser

---

[444] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 4.

[445] Buckle and Thompson, (n 359) 136.

[446] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 4.

[447] Investment Company Act of 1940, s.7 (a) and s.10 (a).

[448] A Pichhadze, 'Mutual Fund Governance Reforms: A Commentary' (2001) 17 Banking and Finance Law Review 67-98.

to operate the fund's investments for a fee.[449] In fact, the decision to create the mutual fund is usually initiated by the investment adviser. The investment adviser is a separate entity from the mutual fund. The 1940 Act defines the investment adviser as an affiliate of the investment company who, pursuant to contract with the fund, regularly furnishes advice to the fund with respect to the desirability of investing in, purchasing or selling securities or other property, or is empowered to determine what securities or other property shall be purchased or sold by the fund.[450]

In addition, the 1940 Act requires at least forty percent of the mutual fund's Board of directors to be independent (disinterested) directors. In other words, the 1940 Act requires that no more than 60 % of the board of directors be interested persons of the mutual fund.[451] It is important to know that most mutual funds rely on specific "Exemptive Rules" that efficiently require a higher percentage of the mutual fund's Board of directors to be independent. Therefore, each fund relying on any Exemptive Rule must have a board of directors whose independent directors constitute at least 75 percent of the Board or, if the fund has only three directors, all but one of the directors must be independent. A key purpose of that requirement (75%) is to strengthen the independent directors' control of the fund board and its agenda, so that the interests of shareholders are effectively protected.

Briefly, the Exemptive Rules are: (1) Rule 10f-3: this rule permits mutual funds to purchase securities in a primary offering when an affiliated broker-dealer is a member of the underwriting syndicate); (2) Rule 12b-1: the rule permits funds to use their own assets to pay distribution expenses; (3) Rule 15a-4: the rule permits fund boards to approve interim advisory contracts for up to 150 days without shareholder approval; (4) Rule 17a-7: the rule permits securities transactions between a fund and an affiliate of the fund's adviser; (5) Rule 17a-8: the rule permits mergers between certain affiliated funds; (6) Rule 17d-1(d)(7): the rule permits funds and their affiliates to purchase joint liability insurance policies; (7) Rule 17e-1: the rule specifies conditions under which funds may pay commissions to affiliated brokers in connection with the purchase or sale of securities on an exchange; (8) Rule 17g-1(j): the rule permits funds to maintain joint insured bonds; (9) Rule 18f-3: the rule

[449] In the USA, the mutual fund manager is called the investment adviser.
[450] Investment Company Act of 1940, s.2 (a) (20).
[451] Ibid, s.10 (a).

permits funds to issue multiple classes of voting stock; and (10) Rule 23c-3: the rule permits the operation of "interval funds" by enabling closed-ended funds to repurchase their shares from investors.[452]

Furthermore, section 16 of the 1940 Act gives the mutual fund's shareholders the right to elect the mutual fund directors at an annual meeting or a special meeting duly called for that purpose. In case there are some vacancies in the board that occur between meetings of shareholders, those vacancies might be filled by the board of directors itself.[453] Nonetheless, the 1940 Act puts a limit, which is one third, on the number of directors who might be elected by the board. Candidates for directors are sometimes nominated by a nominating committee of the board, but more usually they are nominated by the existing management.[454] It is clear that the board of directors not only in the case of filling vacancies, but also in nominating directors to shareholders at the annual meeting, holds responsibilities regarding the composition of the board of directors.

Further, if a mutual fund relies on the Exemptive Rules under the terms and conditions of the 1940 Act, the fund's independent directors must select and nominate other independent directors.[455] The reason for adopting this method is to enhance the independence of the directors because independent directors who are nominated and selected by other independent directors, rather than by the mutual fund's investment adviser, are more likely to be loyal to the shareholders rather than the fund's adviser. That is to say that when independent directors are nominated and selected by other independent directors, they are less likely to feel grateful to the investment adviser. Therefore, when the interests of the investment adviser conflict with those of the shareholders, they would be more willing to challenge the adviser's recommendations.

It is important to know that the 1940 Act does not contain any legal requirements with respect to the qualifications of a director.[456] The board of directors is commonly composed of directors with varied backgrounds in law, investment management,

[452] Available at https://www.sec.gov/news/studies/indchair.pdf accessed 14 December 2016.
[453] Investment Company Act of 1940, s16.
[454] Jaretzki, (n 20).
[455] R Robertson, *Fund Governance: Legal Duties of Investment Company Directors* (Law Journal Press, New York 2001) 4-30.2.
[456] Investment Company Act of 1940, s.56.

general business, accounting, academia, and other fields and professions. The mutual funds documents usually include the background and other related information about each director.

In addition, The 1940 Act explicitly imposes significant responsibilities on the mutual fund directors generally and on the independent directors particularly.[457] Directors of the mutual funds are also subject to traditional standards of obligations imposed by common law and statute. Mutual funds directors have the fiduciary duty to represent the interests of the fund's shareholders and are subject to the duties of loyalty and care (the fiduciary duties of the board of directors will be discussed in detail later).[458] Generally, like the directors of an ordinary corporate board, mutual funds directors oversee the management and operations of the fund. However, due to the structure of mutual funds, where the funds have no employees and rely on the investment advisers and other service providers to operate the fund's day to day operations, the nature of the directors' duties is different from the ordinary companies. The mutual funds directors focus on the performance of those external service providers under the provisions of their contracts in order to monitor any potential conflicts of interest.

It is important to note that directors of mutual funds occupy a principally different position than do ordinary corporate directors, and their authority to make investment decisions is considerably restricted in comparison to that of their ordinary corporate counterparts.[459] This is not accidental; rather it is the inevitable outcome of the structure and nature of mutual funds, where the fund investment adviser has the primacy of making the investment decisions. In other words, in ordinary corporations, the decision-making authority and supervision of all aspects of a company's business rest directly with the Board of directors.[460] This is the cornerstone of corporate governance in the USA. Another important difference is that corporate directors might sit on two or three boards, while mutual funds directors may sit on the boards of 50 funds.[461]

---

[457] Ibid, s 36.
[458] Ibid.
[459] See, D Kershaw, *Company Law in Context: Text and Materials* (2nd edn OUP, Oxford 2012) 410.
[460] E D Roiter, 'Disentangling Mutual Fund Governance from Corporate Governance' (2015) 5 Harvard Business Law Review, paper number 15-18.
[461] Ibid.

4.3.1.1 The Pivotal Role of the Independent Directors in the American Mutual Funds Governance System

In view of the mutual fund legal framework and of the Securities and Exchange Commission (SEC), the independent directors play a central role in the US mutual funds governance system. The regulators of the mutual funds industry have given noticeable attention to the role of the independent directors in protecting the interests of the shareholders. The focal point of the recent proposals and amendments to strengthen the governance system for the mutual funds industry has involved the role and duties of the independent directors because their key role is to ensure that the mutual fund acts in the interests of the shareholders rather than of any service providers.

In *Burks v. Lasker*, the USA Supreme Court stated that:

> *"The structure and purpose of the ICA [(Investment Company Act)] indicate that Congress entrusted to the independent directors of investment companies, exercising the authority granted to them by state law, the primary responsibility for looking after the interests of the funds' shareholders".*[462]

In order to understand the pivotal role of the independent directors in protecting the interests of the mutual fund's shareholders, it is important to scrutinise the key duties of the independent directors under the 1940 Act. The core duties of the independent directors are as follows:

1- Duty to evaluate the investment advisory contract.

Generally, a mutual fund contracts with an investment adviser to operate the fund's day to day activities for a fee.[463] The fees paid from a mutual fund's assets to the investment adviser and its affiliates affect the shareholders' investment return. The fee that the investment adviser receives is commonly a fixed annual percentage of the mutual fund's average daily assets.[464] Due to the dominance of the investment adviser over the negotiation process and operation of the mutual funds, shareholders

[462] BURKS v. LASKER, 441 USA. 471 (1979).
[463] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 329.
[464] M Radmer, 'Duties of the Directors of Investment Companies' (1977) 3 Journal of Corporation Law 61-111.

have a concern regarding the method of controlling the contracting and compensation process. The mutual funds regulators' response to this challenge was through imposing some requirements to protect the interests of the shareholders. In 1970, the Congress imposed an explicit fiduciary duty upon the investment adviser regarding the contractual compensation it receives. Section 36(b) of the 1940 Act provides in part:

> *"The investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser".*[465]

Gartenberg v. Merrill Lynch Asset Mgmt., Inc was the first case that gave a comprehensive analysis of the standards which courts should apply when examining excessive fee claims under Section 36(b).[466] In this case, two shareholders of a money market fund brought a derivative action claiming that the fees paid to the adviser were excessive, so the adviser was in breach of fiduciary duty under Section 36(b). Plaintiffs did not claim that the investors of the fund were not getting their money's worth, but rather, that the investment adviser, because of the size of the fund, was making too much money. The District Court found that Congress was imprecise in defining the fiduciary duty imposed by Section 36(b), but maintained that the standard was one of fairness. The court dismissed the complaint after applying a three-prong test that examined: (1) whether the fee was within the range prevailing in the marketplace; (2) whether the fee was adequately disclosed and the services sufficiently performed; and (3) whether the scope of the scheme was sufficiently disclosed to directors and investors.

Further, in a recent case, *Reso v. Artisan Partners L.P*, an investor in several funds managed by Artisan claimed that Artisan's advisory fees violated Section 36(b) of the Act. The court rejected Artisan's motion to dismiss. The court then examined the

[465] Investment Company Act of 1940, s.36 (b).
[466] Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982)

plaintiff's claims applying the Gartenberg factors as a framework. The Court denied Artisan's motion to:

> "*dismiss even if [plaintiff] has failed to allege certain of the Gartenberg factors, so long as [plaintiff's] complaint, taken as a whole, alleges facts that demonstrate a plausible claim for relief under Section 36(b)".*[467]

In fact, courts have issued various decisions involving Section 36(b) since the mutual fund industry scandal broke in 2003. However, most of the decisions continue to restrict the scope of cases brought under Section 36(b) of the Act. It is clear this approach to protect investors with respect to the investment contract is not enough. Therefore, the 1940 Act requires approval of the investment contract and renewals by the shareholders or the independent directors.

Section 15(c) of the 1940 Act provides in part that:

> *"It shall be unlawful for any registered investment company having a board of directors to enter into, renew, or perform any contract or agreement, written or oral..... unless the terms of such contract or agreement and any renewal thereof have been approved by the vote of a majority of directors, who are not parties to such contract or agreement or interested persons of any such party".*[468]

Section 15 (c) aims to make the independent directors the eyes of the SEC through the negotiations process to protect the interests of the shareholders. While the 1940 Act requires one annual meeting for the purpose of approving the investment contract, the preparation for that meeting might take several months and sometimes the entire year. Independent directors spend a significant amount of time preparing for the meeting. They may also participate in other meetings in order to determine the appropriateness of the fee. For instance, the independent directors might consider and review hundreds of pages of detailed information before making their decision. It is important to know that if the independent directors find that the mutual fund's

[467] Reso v. Artisan Partners L.P., No. 11-CV-873, 2011 WL 5826034 (E.D. Wis. Nov. 18, 2011).
[468] Investment Company Act of 1940, s.15 (c).

performance has been satisfactory and that the management fee proposed is reasonable in view of the quality of the investment adviser's service, they have no fiduciary obligation to request a lower advisory fee.[469]

In addition, in *Meiselman v. Eberstad*, the plaintiff brought a claim to the court that the affiliated directors of the mutual fund, who were at the same time shareholders of the investment management company, had paid themselves excessive fees through the management company.[470] The plaintiff also claimed that the independent directors had acquiesced in the illegal fee arrangement regarding the advisory contract. The Court dismissed the plaintiff's claim against the independent directors, concluding that there was "no possibility of liability on their part". Therefore, the court dismissed the entire claim, stating that the advisory contract fee was not legally excessive. In fact, the court in this case took into consideration two facts. Firstly, the shareholders of the mutual funds had twice approved the fees' arrangement. Secondly, the investment contract fee was lower than the industry average.

Another important case in this regard is *Saxe v. Brady*, where the plaintiff brought a claim against the independent directors and the investment adviser.[471] The plaintiff claimed that the independent directors had breached the fiduciary duty through approving the investment adviser's contract. The court found that independent directors had a duty to protect the mutual fund against the types of abuse claimed. However, the court concluded that the investment adviser's fees were reasonable, and so dismissed the plaintiff's claim. It is important to know that the court pointed out that the fees may be considered unreasonable when the net profits of the investment adviser become excessive or shocking. Further, two fundamental tests were suggested to be considered. The first test is comparing the investment adviser's net profits with those of similar advisers in the marketplace. The second test is comparing the adviser's ratio of expenses to fees with that of other advisers.

It is clear that in the two cases, *Meiselman and Saxe*, the courts came to the same conclusion that the independent directors had a duty to control the fees of the investment adviser. Nonetheless, both cases demonstrated the courts' reluctance to consider possible responsibility for failure to perform that duty. Therefore, Congress

[469] Jaretzki, (n 20).
[470] Meiselman v. Eberstadt, 170 A.2d 720 (Del. Ch. 1961).
[471] Saxe v. Brady, 184 A.2d 602 (Del. Ch. 1962).

passed the 1970 amendments (s15(c)) to the 1940 Act. By passing this amendment, Congress intended that the independent directors would play a key role in the investment adviser's fees' arrangement.

It could be argued that the investment adviser may take advantage of this amendment. That is to say that in case of bringing an action against the investment adviser with respect to the excessive fee, the court would consider the fact that the management contract was reviewed by the independent directors impartially. When the independent directors approve the management contract they compare the investment adviser's fee with similar mutual funds. Therefore, if they approved the management contract, this approval should be justifiable and that would reduce the possibility of paying the adviser excessive fees. Section 15 (c) would be more effective if it required the independent directors to provide the investors and the SEC with a detailed report regarding the approval of the management contract. The aim of this report is to justify the reasons for approving the management contract by showing that this approval is based on a comprehensive study of the current management fees of similar funds, the performance of the investment adviser and of the actions that have been carried out by them to reduce the fee.

2- Duty to monitor the mutual fund investments (the watchdog function).

Another fundamental responsibility for the independent directors is to oversee the operations of the mutual funds. Generally, this duty includes the general operation of the fund, the adherence of the investment adviser to the stated objectives and policies, and choosing some main service providers of the mutual fund. In *Burks v. Lasker*, the Supreme Court stated that:

> *"Congress' purpose in structuring the Act as it did is clear. It "was designed to place the unaffiliated directors in the role of 'independent watchdogs,' " Tannenbaum v. Zeller, 552 F. 2d, at 406, who would "furnish an independent check upon the management" of investment companies".*[472]

In addition, the mutual fund's instrument of incorporation contains the fund's main objectives and the investment policies. Those investment policies cannot be amended

[472] Burks v. Lasker, 441 USA. 471 (1979).

or changed without the authorisation of a majority of the outstanding voting securities.[473] Since the investment adviser is responsible for the day to day operations of the mutual fund, the independent directors have a duty to ensure that the investment adviser's performance is complying with the stated objectives and policies. The leading case of breach of duty in this context is *Aldred Investment Trust v. SEC*.[474] In this case, the investment adviser departed from the fund's stated policy. The Securities and Exchange Commission obtained injunctions against any possible steps by the management and the independent directors. The fund was managed by receivers appointed for that purpose. The Court of Appeals found that the directors had breached their fiduciary obligations because they had acquiesced to the investment adviser's plans and arrangements.

In *Taussig v. Wellington Fund, Inc*, the court expanded the scope of the duty of the independent directors to protect the fund's investment policies.[475] The court found that the independent directors were responsible not only for protecting the fund stated policy, but also for protecting the right of the shareholders to amend and change the fund's investment policy.

Furthermore, the independent directors' watchdog function includes their responsibility to ensure the best fulfilment of the fund's transactions. In *Moses v. Burgin,* one of the main issues addressed by the court was the best execution. The court indicated, with approval, that the independent directors had received and assessed reports from the investment adviser with respect to allocation of brokerage. The court found that the investment adviser's policy of placing brokerage as a reward for dealing with shares and providing the fund with investment advice was to be applied only if the best fulfilment could be obtained by the broker.[476] It is important to note that allocation of brokerage to the broker is a fundamental element in evaluating whether or not the advisory fee is fair and determining whether the best execution had been obtained. In other words, the brokerage rewards would encourage the broker to exert great efforts to perform more transactions. As a result, the fund's net assets value will be increased. Growth of the fund's net assets value increases the investment adviser's fees. This indirect advantage to the investment adviser should

[473] Investment Company Act of 1940, s.13.
[474] Aldred Investment Trust v. SEC 151 F.2d 254 (Ist Cir. 1945).
[475] Taussig v. Wellington Fund, Inc., 187 F. Supp. 179 (D. Del. 1960).
[476] Ibid, 37-39.

be considered by the independent directors, and the court in case of there being any claim, in determining the best execution of the fund's transactions.

Further, as with any other corporate director, the mutual fund independent directors are responsible for overseeing and controlling the general fund operations.[477] This includes controlling various expenses of the fund such as registration fees, taxes, administrative and safekeeping expenses, custodian fees and transfer fees.[478]

Another important duty of the independent directors is the appointment and approval of the mutual fund's accountants. Section 31 of the 1940 Act requires the mutual fund's independent accountants to be selected for each fiscal year in a meeting attended by a majority of the independent directors.[479] The Act further requires that the selection of the fund's independent accountant be submitted to the fund shareholders for ratification or rejection at their next annual meeting. However, Rule 32a-4 under the 1940 Act exempts mutual funds from this shareholders' approval requirement if the fund has established an audit committee composed solely of independent directors which has responsibility for overseeing the fund's accounting and auditing processes.

It is clear now that the pivotal role of the independent directors of the mutual funds is necessitated by the unique structure of the mutual funds. Therefore, the 1940 Act requires the majority of a mutual fund's independent directors to (1) approve the fund's contracts with its investment adviser and principal underwriter; (2) select and nominate candidates to fill independent directors' vacancies; select the independent accountant of the mutual fund; (3) oversee and approve affiliated securities transactions and (4) oversee the general operations of the mutual funds. Each of these obligations and responsibilities is vital to protecting the interests of the shareholders. The development of the regulatory framework of the mutual funds industry demonstrates the fact that enhancing the role of the independent directors is the cornerstone to improve the mutual funds governance system. Hence, the roles of the independent directors and proposals to improve their independence have been the subject of many initiatives since the Investment Company Act was enacted in 1940,

[477] Kiymaz, Baker and Filbeck, (n 27) 73.
[478] Ibid.
[479] Investment Company Act of 1940, s.32.

such as the 1970 amendments which restricted the categories of persons who could serve as independent directors for the mutual fund.[480]

4.3.2 The United Kingdom Mutual Funds Governance Models

Unlike the American mutual funds which take only the corporate form, the mutual funds in the UK take either the trust form (unit trust) or the corporate structure (open-ended investment companies). In fact, the governance structure of an open-ended investment company (OEIC) does not differ much from that of unit trusts. While the unit trust has a trustee and the OEIC does not, the difference is not substantive. The following discussion examines the governance structure of the unit trusts and OEICs.

4.3.2.1 The Unit Trust Governance Structure

Prior to establishing the corporate structure of mutual funds in the UK, mutual funds were structured exclusively as trusts (unit trusts). In a unit trust, the fund manager creates the unit trust by entering into a trust agreement (trust deed) with a trustee (see figure 4.1).[481] The fund manager is responsible for the daily management and promotion of the unit trust,[482] whereas the trustee is responsible for safeguarding the assets of the unit trust. Furthermore, the trustee is responsible for overseeing and monitoring the fund's manager's activities in order to ensure that the manager complies with the fund's objectives and policies, and with the requirements of the regulations.[483] Therefore, the unit trust governance structure is built on the basis of the segregation of duties between the fund manager and the trustee.[484] The governance system is built on applying the balances and checks rules, with a clear definition of the obligations and responsibilities of the manager and the trustee. That is to say that there should not be any confusion between the responsibilities of the trustee, which is the oversight entity, and the fund manager. In order to ensure the independence of the main parties of the unit trust, the manager and the trustee must be persons who are independent of each other.[485]

480 Ibid, s.2 (a) (19).
481 Collective Investment Schemes Sourcebook 2014, coll 3.2.3.
482 Ibid, coll 6.6.4.
483 Ibid, coll 6.1.3 (3).
484 Financial Services and Markets Act 2000 s.243 (4)-(5).
485 Ibid, s243 (4).

Since the main role of the fund trustee is to protect fund investors, it must act solely in the interests of the unitholders.[486] The duties of the trustee in the governance system of the unit trusts can be categorised into two key groups, namely safekeeping and monitoring. On the one hand, the trustee is responsible for the safekeeping of all of the trust property entrusted to it.[487] The trustee must also take into its custody or under its control documents of title to the scheme property.[488] Further, the trustee is responsible for the collection of income due to be paid for the account of the authorised fund. On the other hand, the trustee is responsible for overseeing the fund manager's activities.[489] The trustee must take reasonable care to ensure that the fund is managed by the fund manager in accordance with the trust deed and the existing regulations.[490] The trustee must also take reasonable care to ensure on a continuing basis that the fund manager is applying the appropriate procedures to ensure that the price of a unit is calculated for each valuation point in accordance with the regulations.[491] It is important to know that although the trustee can delegate certain functions to a third party, the trustee must not delegate any function to the mutual fund manager or to any associate of the fund manager because this could lead to a compromise of investor protection. That is to say that in case the trustee delegates its functions to the manager, the manager's activities will not be subject to any supervision. It is clear that the oversight duty of the unit trust trustee is a new duty for the trustees. This duty is not exercised by a trustee of a private trust. It is created to fit the dual investment structure of the unit trusts (the manager and trustee) in order to impose a strict oversight over the manager's activities. Thus, the interests of the unitholders will be protected.

While the trustee has a responsibility for protecting the unitholders by overseeing the activities of the fund manager, the Financial Services and Markets Act (FSMA) 2000 entitles the manager to replace the trustee.[492] This authority might restrict the ability of the trustee to perform its oversight duty on the manager's activities. This might then affect the investor protection because trustee oversight is the key pillar of

[486] Collective Investment Schemes Sourcebook 2014, coll 6.6.4 (3).
[487] Ibid, coll 6.6.12 (1).
[488] Ibid, coll 6.6.12 (1)(c) .
[489] Ibid, coll 6.6.4.
[490] Ibid.
[491] Ibid, coll 6.6.4 (2).
[492] Financial Services and Markets Act 2000 s.251.

investor protection. Nonetheless, the manager must give written notice to the Financial Conduct Authority (FCA) of any proposal to replace the trustee.[493] The fund manager might make the decision to replace the trustee on the basis of commercial reasons, such as competitiveness of fees. However, the real reason for making the replacement might be that the manager is uncomfortable with the trustee's strict enforcement of the regulations. Furthermore, in order to ensure that the manager will not misuse this authority, the FSMA 2000 imposes a key responsibility upon the FCA by providing that:

> "*The Authority must not approve a proposal to replace the manager or the trustee of an authorised unit trust scheme unless it is satisfied that, if the proposed replacement is made, the scheme will continue to comply with the requirements of section 243(4) to (7)".*[494]

The requirements of section 243 are that (1) the manager and the trustee must be persons who are independent of each other; (2) the manager and the trustee must each be a body corporate incorporated in the United Kingdom or another European Economic Area (EEA) State; and (3) the manager and the trustee must each be an authorised person.[495]

In addition, the fund manager has the right to appoint a new trustee in case of the retirement of the current trustee.[496] The trustee of a unit trust may not retire voluntarily except upon the appointment of a new trustee. Nonetheless, to ensure the continuing oversight of the manager's activities, the trustee of the unit trust must not retire voluntarily unless, before its retirement, it has ensured that the new trustee has been informed of any circumstance of which the retiring trustee has informed the FCA. Although the appointment of the new trustee in this situation is subject to the same conditions as replacement of the trustee, it is uncommon for the supervisory entity to be appointed by the entity that will be under supervision. In other words, since the manager has the right to appoint the new trustee, it will not appoint a trustee that may impose a strict oversight on its activities.

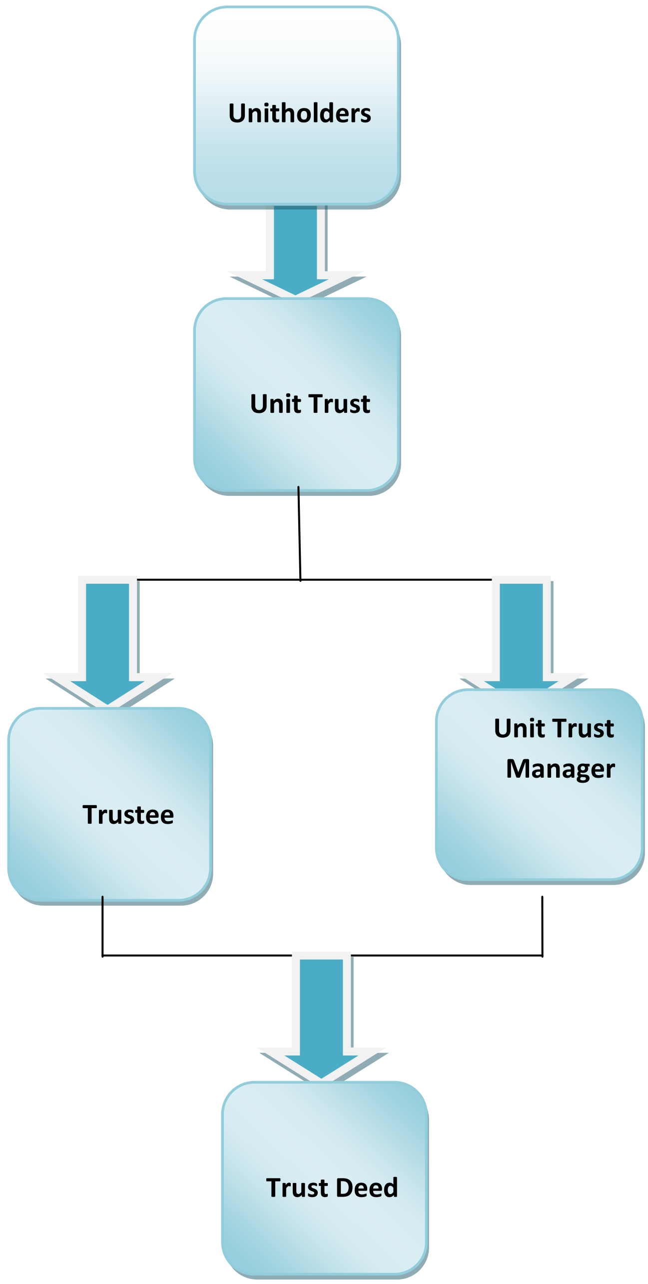
---

[493] Ibid.
[494] Ibid, s.251 (5).
[495] Ibid, s.243.
[496] Collective Investment Schemes Sourcebook 2014, coll 6.5.10.

Regarding the replacement of the fund manager, the FCA Sourcebook gives the trustee the power to replace the manager in exceptional circumstances such as winding up the fund manager and the appointment of a receiver to the authorised fund manager.[497] The trustee is also entitled to replace the manager if it is found that a change of the fund manager is desirable in the interest of the unitholders. However, this decision should be justifiable and the trustee should state the reasons in writing.[498] The replacement of the manager is subject to FCA approval. Therefore, the trustee of the unit trust scheme must give written notice to the FCA of any proposal to replace the manager of the scheme.[499] Similar to the provisions of replacement of the trustee, the Authority must not approve a proposal to replace the manager unless it is satisfied that the scheme will continue to comply with the requirements of section 243(4) to (7). It is clear that the role of the FCA is critical in protecting the investors through ensuring that the replacement authority is not misused, either by the manager or the trustee.

Figure (4.1): Unit trust governance structure

[497] Ibid, coll 6.5.7.
[498] Ibid, coll 6.5.7 (1) (g).
[499] Financial Services and Markets Act 2000 s.251 (3).



4.3.2.2 The Open Ended Investment Companies Governance Structure

Since 1997, mutual funds have been organised in both corporate structure (OEICs) and trust form (the unit trusts). OEICs are incorporated vehicles, governed by an instrument of incorporation, and unlike the unit trust have a separate legal existence. Unlike the unit trust structure, OEICs may have a board of directors, and must have at least one authorised corporate director (ACD).[500] In practice, OEICs appoint only one director to operate the fund. The ACD acts in the same manner as the manager of

[500] Open Ended Investment Company Regulations 2001, reg. 15 (4).

the unit trust. Further, the ACD must be an authorised body corporate. OEICs must also have a depositary to oversee the ACD's activities. The depositary must also be an authorised body corporate.[501] The depositary and the ACD must be persons who are independent of each other.[502]

The governance structure of OEICs does not differ much, in practice, from that of unit trusts. Like the unit trust governance structure, the OEICs governance structure is built on the basis of the segregation of duties between the ACD and the depositary. The ACD is responsible for the daily management of the fund. The ACD must perform its duties in accordance with the investment objectives and the existing regulations. The depositary has the duty of overseeing and monitoring the activities of the ACD to ensure the scheme is managed in accordance with its objectives and the existing regulations.[503] The depositary is also responsible for the safekeeping of the company's assets.[504]

In addition, the manner of appointing the depositary is similar to the manner of appointing the unit trust's trustee. The appointment of the depositary of a company must be made by the directors of the company.[505] However, OEICs must give written notice to the FCA in case of replacement of the depositary.[506] Further, the depositary of an OEIC may retire voluntarily. Nonetheless, the depositary may not retire voluntarily except upon the appointment of a new depositary.[507] In case of the depositary's retirement, the ACD is entitled to appoint another person eligible to be the depositary in its place pending the approval of the FCA.[508]

Unlike the unit trusts, where the trustee has the right to replace the fund manager, the appointment of the OEIC's directors must be made by the company in a general meeting.[509] Nevertheless, the directors of the OEIC may appoint a person to act as director to fill any vacancy until such time as the next annual general meeting of the

[501] Ibid, reg. 15 (8).
[502] Ibid, reg. 15 (8) (f).
[503] Collective Investment Schemes Sourcebook 2014, coll, 6.6.4.
[504] Ibid, coll 6.6.12 (1).
[505] Open Ended Investment Company Regulations 2001, reg. 5.
[506] Ibid, reg. 21.
[507] Collective Investment Schemes Sourcebook 2014, coll 6.5.10.
[508] Ibid, coll 6.5.10 (3).
[509] Open Ended Investment Company Regulations 2001, reg. 34 (2).

company takes place.[510] This difference between the unit trusts and OEICs can be justified on the basis that OEICs are corporate vehicles and have a board of directors, while unit trusts are trusts and have a trustee.

As for termination of appointment of the ACD, two situations should be differentiated. The first situation is where the ACD is not the sole director of the OEIC. In this situation the appointment of an ACD terminates if a notice of termination of that appointment is given to the ACD by a resolution of the board of directors.[511] The second situation is where the ACD is the only director of the OEIC. Here, the appointment of the ACD terminates if a notice of termination of that appointment is given by the depositary to the ACD and to the OEICS, following any of the events specified in the FCA Sourcebook such as the presentation of a petition for the winding up of the ACD.[512] The OEIC prospectus might give the investors the right to remove the ACD. For instance, the Alliance Trust Investment Fund prospectus provides that:

> *"The Company may by ordinary resolution remove the ACD before the expiration of its period of office, notwithstanding anything in the Instrument of Incorporation or in any agreement between the Company and the ACD, but the removal will not take effect until the FCA has approved it and a new ACD approved by the FCA has been appointed*".[513]

It is clear now that the governance structure of OEICs is substantially similar to the unit trust structure with the one notable exception that unit trusts are subject to trust law while OEICs are subject to corporate law. OEIC regulations follow unit trust regulations and where practicable use similar language. This aims to enable the unit trusts' regulatory concepts and procedures to operate in a similar way to those of OEICs. Levels of investor protection between OEIC and a unit trust are very similar. This protection is fundamentally achieved by the independence of the fund manager and the trustee or the depositary. Regulation 15(8) (f) of the OEIC Regulations (requirements for authorisation) requires independence between the depositary and

[510] Ibid, reg. 34.
[511] Collective Investment Schemes Sourcebook 2014, coll6.5.4 (2).
[512] Collective Investment Schemes Sourcebook 2014, coll 6.5.4 (3).
[513] Available at: http://www.alliancetrustinvestments.com/global/documents/8012/full-prospectus.pdf accessed 28 July 2015.

the ACD, as does section 243(4) of the Act (Authorisation orders) for the trustee and manager of a unit trust.

Even though OEICs take the corporate form, the governance structure is fundamentally different from ordinary companies in the UK. In ordinary companies, directors are appointed to manage and control the company's activities. The key responsibility of the board is, through its senior management, to support the success of the company over the long-term. In practice, the board of directors is composed of executive and non-executive directors.[514] Executive directors are responsible for running the business on a day-to-day basis. They are also responsible for developing the company strategy, specifying clear objectives and identifying the key potential risks that might face the business.[515] Non-executive directors are the independent representatives of shareholders on the board. They should take responsibility for monitoring the performance of executive management, particularly with respect to the progress made toward fulfilling the specified company strategy and objectives. Non-executive directors are also responsible for determining the appropriate levels of remuneration of executive directors.[516] Nonetheless, under the company law there is no distinction between the position of executive and non-executive directors.[517] Therefore, in the UK unitary board structure, non-executive directors have the same legal duties and potential liabilities as their executive counterparts. That is to say, if a breach of any duty is to be attributed to a board on the grounds that all of its members were present at a meeting, then each director will be liable irrespective of whether they are executive or non-executive.

4.3.3 Remarks on the USA's and the UK's Governance Structure

Although at first glance the UK's mutual funds governance structure looks quite different from the USA's governance structure, both structures share certain similarities in terms of their form and function. Both governance systems aim to provide strict separation between supervision and management functions. That is to

[514] Solomon, (n 442) 78.
[515] Ibid.
[516] The UK Corporate Governance Code, Financial Reporting Council (2014) available at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf accessed 4 August 2015.
[517] D French, S Mayson and C L. Ryan, *Mayson, French and Ryan on Company Law* (31st Oxford University Press, Oxford 2014) 420.

say that the supervisory entity should be able to perform its obligations without any potential conflict of interest with the manager, and the manager must not have any possibility to control the supervisory entity's decisions. Further, both systems specify clearly the responsibilities of supervisory and managing entities. This aims to provide a sufficient separation between the supervisory functions and asset management. The supervisory entity should not be involved with any activity of the management because there is a fundamental incompatibility between performing one function and then overseeing it. Another important similarity is that the appointment and replacement of the supervisory entity is made in such a way that the independence of that entity is ensured. As was mentioned above, in the USA the independent directors are nominated and appointed by the independent directors. In the UK, although the appointment of the trustee/depositary is made by the manager/ACD, the approval of the FCA is required in order for it to be valid.

However, the US mutual funds governance system grants the independent directors significant discretionary power to make business judgments. For example, the independent directors must approve the investment adviser's contract, the distributor's contract and the administrator's contract. The 1940 Act does not provide any guidance or criteria with which the independent directors should comply when they exercise that discretion. In contrast, the UK mutual funds regulations rely more on rules and giving guidance to the supervisory entity than discretion. That is to say that the UK governance system relies on supervisory entity oversight to monitor the manager's compliance with specified rules, and in performing the function the supervisory entity is given little discretion. For instance, the mutual funds regulations give the unit trust's trustee the right to remove the fund manager in exceptional circumstances, such as winding up the authorised fund manager and appointment of a receiver to the authorised fund manager.[518]

4.4 Agency Problems as a Challenge to Governance

When investors invest their funds in a mutual fund, they place their trust in the mutual fund's management to act in their best interests. Their confidence and trust in the mutual fund's management can be threatened if they believe that this management is not acting in their best interests. In fact, the concept of separation of

[518] Collective Investment Schemes Sourcebook 2014, coll 6.5.7.

the ownership of the mutual funds from their management carries a potential divergence of interests between the interests of the fund management and the interests of the fund's investors, and this might create a potential conflict of interest between the self-interests of the management and the interests of the investors.[519] This implies that the mutual fund management might manage the fund's assets in its own interests rather than in the interests of the investors. This potential conflict of interest, in the absence of clear and suitable control tools, has a negative effect on the interests of the investors. It would also have negative consequences on the investors' trust and confidence in the mutual funds as useful investment schemes. Therefore, the mutual funds regulations should respond to those potential effects by establishing detailed regulations designed to monitor any potential conflict of interest. The following discussion will analyse potential types of conflict of interest that might arise in the course of operating the mutual funds. It will also explore the regulatory responses adopted by the UK and US regulators in the mutual funds regulations to address those potential conflicts of interest.

4.4.1 Potential Types of Conflict of Interest in the Mutual Funds Schemes

Due to the mutual funds' unique management structure, there are numerous potential conflicts of interest in the mutual funds industry. The most apparent form of conflict of interest is the conflict of interest with respect to the management fee. Mutual funds do not operate like normal businesses.[520] They are operated by external management which aims to earn high returns for the mutual fund's investors. However, this external management seeks, at the same time, to acquire the highest possible earnings for itself. In the UK, the mutual fund manager must be a body corporate incorporated in the United Kingdom or another EEA State.[521] This management company could be a publicly-held corporate in which case its shares are held by investors who buy those shares in order to earn high returns. Therefore, the conflict of interest occurs between the self-interests of the management company and the interests of the investors because the fund manager seeks to maximise its return and is at the same time under a duty to maximise the investors' return. Further discussion regarding the conflict of interest regarding the management fee will be

[519] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 43.
[520] Russell, (n 358) 3.
[521] Financial Services and Markets Act 2000 s.243 (5) (a).

discussed later when the research addresses the fiduciary duties of the mutual funds managers.[522]

Another potential conflict of interest could take place where a mutual fund enters into a transaction with an affiliated party (associated party) as a principal.[523] Generally, the term *affiliated party* refers to those parties who might be associated with the mutual funds such as the manager, the custodian and their affiliates. The mutual fund manager might buy securities from the affiliated party at an inappropriate price that is higher than the real market value.[524] Conversely, the fund manager could sell the mutual fund securities or any investments at an inappropriate price that is lower than the actual price in the market. Further, the mutual fund manager could buy securities underwritten by an affiliated party at a price that is higher than the market price.

In addition, another potential conflict of interest could arise where a mutual fund enters into deals with a party that is not an affiliated party to the mutual fund, but those deals are entered into through agents or brokers who are considered affiliated parties to the mutual funds' affiliated parties, such as the fund manager or the fund custodian.[525] The mutual fund could pay excessive fees or commission to an affiliated party's broker or agent used for selling or buying securities to the benefit of the fund. Further, a mutual fund affiliated party might agree with its broker or agent to share commission or other profits derived from transactions carried out by that broker. The mutual fund might also enter into transactions through the affiliated party's broker or agent and this broker may receive kickbacks or payments from the other party to the transactions.

Furthermore, a conflict of interest might arise where a mutual fund and its affiliates jointly enter into deals with a third party.[526] The affiliated party of the mutual fund could take advantage of this situation by negotiating the terms and conditions of the deals with that third party in its own interests, even if those deals are not in favour of

[522] R Hubbard, *The Mutual Fund Industry: Competition and Investor Welfare* (Columbia University Press, New York 2010) 131.
[523] Jaretzki (n 20).
[524] Ibid.
[525] The World Bank, *Financial Access and Stability: A Road Map for the Middle East and North Africa MENA Development Report* (World Bank Publications, Washington 2011) 257.
[526] G Ferrarini, K Hopt and E Wymeerscj, *Capitalmarkets in the Age of the Euro* (Kluwer Law International, the Hague 2002) 119.

the mutual fund. Further, the mutual fund and its affiliates might jointly acquire shares or holdings in a specific company. This may allow the mutual fund affiliate to have a degree of control over that company which it could use in its own interests rather than the interests of the mutual fund. It is worth mentioning that the potential conflicts of interest situations are countless, but the situations addressed above are the most common and important forms of conflict of interest.

4.4.2 Possible Regulatory Methods to Address Conflicts of Interest in the Mutual Funds Industry

The mutual funds regulations should recognise that the mutual fund management might have interests which if exercised without restrictions would diverge in a substantial way from the interests of the fund investors. The regulatory responses to address the potential conflicts of interest are not the same in different jurisdictions. However, irrespective of the methods adopted to address the conflicts of interest, those methods should be built on a common rule that ensures investor protection by minimising the negative impact of any potential conflict of interest between the fund management and its affiliates and the mutual fund and its investors. It is important to know that even though it is possible to classify specific types of conflicts of interest and their potential impacts on the mutual fund and its investors, it is difficult to specify in relation to each distinct type of conflict of interest the exact regulatory method used to address it, because regulators usually use different methods to address particular types of conflict of interest. Therefore, the following analysis will scrutinise the possible regulatory methods to address potential conflicts of interest.

1- The general obligation imposed upon the mutual fund management to act in the best interests of the fund investors.

In order to avoid potential conflicts of interest, mutual funds regulations usually impose an obligation upon the mutual fund management to act in the best interests of the fund investors. This obligation is used in some countries as the premise upon which the mutual fund management is required to adopt appropriate procedures and policies to prevent or minimise potential conflicts of interest. It also requires the fund management to make sure that the mutual fund’s investors are treated fairly. In the UK, the mutual fund manager must be able to demonstrate that appropriate procedures and safeguards against conflicts of interest have been adopted to protect the interests of the investors.[527]

Furthermore, it is important to know that, under English law, mutual fund management has fiduciary obligations to act in the best interests of the fund investors. A fiduciary obligation is an ethical or legal relationship of trust and confidence between the fiduciary and principal in which the fiduciary is under a duty to act with good faith for the benefit of the principal.[528] In *Bristol & West Building Society v Mothew*, it was said by Millett LJ, regarding investment management, that

> *"a fiduciary is someone who has undertaken to act for or on behalf of another in a particular matter in circumstances which give rise to a relationship of trust and confidence*."[529]

The fiduciary must act solely in the interests of the beneficiaries. Essentially, a fiduciary must always act to ensure the beneficiaries' best interests. In *Pilmer v Duke Group Ltd*, it was stated that:

> *"the fiduciary is under an obligation, without informed consent, not to promote the personal interests of the fiduciary by making or pursuing a gain in circumstances in which there is 'a conflict or a real or substantial possibility of a conflict' between personal interests of the fiduciary and those to whom the duty is owed*".[530]

Further, the fiduciary must not allow his own interests to affect his performance in a manner that might conflict with the best interests of the beneficiaries. Thus, the fiduciary duty of the investment management provides an effective way to protect the investors against conflicts of interest.

---

[527] Collective Investment Schemes Sourcebook 2014, coll 6.11.2 (3).
[528] D Glusman and G Ciociola, *Fiduciary Duties and Liabilities: Tax and Trust Accountant's Guide* (CCH, Chicago 2006) 3-3.
[529] Bristol & West Building Society v Mothew [1998] Ch 1 CA.
[530] Pilmer v The Duke Group Limited (in liq) [2001) HCA 31.

Regarding the unit trust, both the manager and the trustee have fiduciary duties.[531] Further, the collective investment scheme Sourcebook states that:

> "*The duties and powers of the authorised fund manager, the directors of an ICVC and the depositary under the rules in this sourcebook and under the instrument constituting the fund are in addition to the powers and duties under the general law*".[532]

In fact, the mutual fund manager is responsible for performing all the management functions of the unit trust scheme. This raises a significant question which is whether the manager of a unit trust is considered a trustee by analogy to the statutory scheme included in the Public Trustee Act 1906. Section 4 of the Public Trustee Act 1906 allows the simultaneous appointment of a managing trustee and a custodian trustee.[533] The custodian trustee is responsible for the custody of all securities and documents of title with respect to the trust property.[534] Further, the custodian trustee should perform all acts necessary to enable the managing trustees to exercise their powers of management or any other power or discretion vested in them. The managing trustee is responsible for the management of the trust property. Thus, one could conclude that the unit trust manager is a managing trustee as the fund manager performs the same duties. Indeed, the position of a managing trustee is a creation of specific statutory provisions. That is to say that in order to say that the fund manager is a managing trustee, all the conditions of the relevant statutes should be complied with.[535] In *Arning v James* it was concluded that the positions of managing trustee and custodian trustee were statutory creations. Therefore, any appointment that does not strictly comply with the statutory provisions will be void.[536] It is clear now that a manager of a unit trust cannot be considered as a trustee.

---

[531] Review of the Governance Arrangements of United Kingdom Authorised Collective Investment Schemes, report by the Investment Management Association (November 2004) 16. Available at http://www.theinvestmentassociation.org/assets/files/press/2004/20041104-01.pdf accessed 5 May 2015.

[532] Collective Investment Schemes Sourcebook 2014, coll 6.6.5 (1).

[533] Public Trustee Act 1906, s (4).

[534] Ibid.

[535] Sin, (n 10) 171.

[536] Arning v James [1936] ch.158.

As for the OEICs schemes, the Open-Ended Investment Companies Regulations state that:

> "*The duty imposed by this regulation on a director is owed by him to the company (and the company alone) and is enforceable in the same way as any other fiduciary duty owed to a company by its directors*".[537]

It is clear that the fiduciary duties of company directors are owed to the fund as a whole, not to shareholders, because OEICs, unlike unit trusts, have separate legal personality. By contrast, the directors of ordinary companies have a fiduciary duty to their company. Under Section 175 of the Companies Act 2006, directors must avoid a situation in which they have, or could have, a direct or indirect interest that conflicts, or will probably conflict, with the interests of the company.[538] It is clear that the scope of Section 175's duty is very broad. It applies to both actual and potential conflicts. Further, Section 175 of the 2006 Act grants directors a new authority to authorise situational conflicts of interest. The duty to avoid conflicts of interest is not breached if the relevant matter has been authorised in advance by the directors, provided that; (1) in the case of a public company, the company's constitution allows the directors to give the authorisation; (2) in the case of a private company, the company's constitution does not contain anything that invalidates the authorisation.[539] It is important to know that most of the mutual funds regulations give the board of directors the authority to authorise certain situations of conflict of interest. For example the Syrian Mutual Fund Act (SMFA) 2011 requires the mutual fund manager to disclose to the board of directors the situations that could include potential conflicts of interest, and the board of directors has the authority to authorise those situations.[540]

In addition, the depositary of an OEIC is a fiduciary.[541] The depositary is responsible for safekeeping the scheme property.[542] The question that arises with respect to the

[537] Open Ended Investment Company Regulations 2001, reg. 35 (2).
[538] Companies Act 2006, s. 175 (1).
[539] Ibid, s. 175 (5).
[540] Mutual Funds Act 2011, article 74 (3).
[541] Review of the Governance Arrangements of United Kingdom Authorised Collective Investment Schemes (n 437).
[542] Open Ended Investment Company Regulations 2001, reg. 5 (1).

depositary of an OEIC is whether the depositary could be considered a trustee. Under the OEICs regulations, the depositary has a right to access such information and other communications relating to any general meeting of the company as a shareholder of the company is entitled to receive.[543] The depositary also has the right to attend any general meeting of the company[544] and is also entitled to require from the company's officers such information and explanations as it thinks necessary for the performance of its functions as depositary.[545] In fact, these rights are not enough to consider the fund depositary as an active trustee by themselves. It is important to know that the UCITS regulations require OEICs to appoint a depositary. Hence, it cannot be intended that the depositary would inevitably be a trustee because European jurisprudence does not recognise the trust.[546] Those reasons lead to the conclusion that the OEICs depositary is a fiduciary and not a trustee.

In the USA, the Investment Company Act of 1940 creates both general and specific fiduciary duties for the mutual fund investment manager and directors.[547] Section 36(b) of the Investment Company Act of 1940 imposes a fiduciary duty upon the mutual fund manager with respect to the management fee. Section 36 (b) provides that:

> "*For the purposes of this subsection, the investment adviser of a registered investment company shall be deemed to have a fiduciary duty with respect to the receipt of compensation for services, or of payments of a material nature, paid by such registered investment company, or by the security holders thereof, to such investment adviser or any affiliated person of such investment adviser".*[548]

Further, Section 36(b) was enacted in 1970 because the 1940 Act did not provide any clear mechanism by which the fairness of the manager's contracts could be examined by courts. Section 36 (b) provides an explicit private right of action regarding

[543] Ibid, Sched 1, reg. 4 (a).
[544] Ibid, Sched 1, reg. 4 (b).
[545] Ibid, Sched 1, reg. 4 (e).
[546] Hudson, *The Law on Investment Entities* (n 11) 220.
[547] H Knickle, 'The Mutual Fund's Section 15(C) Process: Jones V. Harris, the Sec And Fiduciary Duties of Directors' (2011) 31 Review of Banking & Financial Law 265-340.
[548] Investment Company Act of 1940, s.36 (b).

breaches of fiduciary duty including the receipt of compensation for services paid by the fund or its shareholders to the fund manager or any affiliated person of the manager. Section 36 (b) also enables the SEC to bring a suit against the fund manager for the same reason that the shareholder can perform such an action. However, it is important to know that the SEC has never brought suit against a fund manager for breach of fiduciary duty regarding its compensation, and shareholders have never won any suit they have brought.[549] In *Krinsk v Fund Asset Management Inc*, the United States Court of Appeal held that section 36(b) of the Investment Company Act of 1940 "*places on the investment adviser .. "a fiduciary duty with respect to the receipt of compensation for services paid by the investment company"*.[550] In this case a shareholder brought a derivative action against the fund manager for negotiating excessive management fees. The court found that there had been no breach of fiduciary duty.

In addition, as with directors of traditional corporations, mutual funds directors have the fiduciary duty to present the interests of the fund's shareholders and they are subject to the duties of loyalty and care. The duty of care requires the fund's directors to be informed, reach reasonable judgement and apply their business judgement.[551]

2- Direct prohibitions on certain types of transactions

Mutual funds regulators might address potential conflicts of interests in the mutual funds industry by imposing direct prohibitions on certain transactions that might give rise to potential conflicts of interest. In the UK, the mutual fund regulations require the mutual funds managers and depositaries to take reasonable care to ensure that certain transactions are not carried out on behalf of the fund.[552] These transactions are: (1) putting cash in deposit with an affected person, unless that person is an eligible institution or an approved bank; (2) lending money by an affected person to, or for the account of, the scheme, unless that person is an eligible institution or an approved bank; (3) the dealing in property by an affected person, to, or with, the

[549] E Johnson, 'The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination' (2009) 59 Duke Law Journal 145-181.
[550] Krinsk v. Fund Asset Management, Inc., 875 F.2d 404, 414 (2d Cir. 1989).
[551] See, SEC Interpretation: Matters Concerning Independent Directors of Investment Companies available at https://www.sec.gov/rules/interp/ic-24083.htm accessed 9 June 2015.
[552] Collective Investment Schemes Sourcebook 2014, coll 6.6. 17.

scheme, unless that person is an eligible institution or an approved bank; (4) the vesting of property (other than cash) by an affected person in the scheme or the depositary for the account of the scheme against the issue of units in the scheme; (5) the acquisition of scheme property by an affected person from the scheme; (6) transactions within COLL 5.4 (stock lending) by an affected person with, or in relation to, the scheme.[553]

Moreover, regulation (44) of the Open Ended Investment Companies Regulations 2001 prohibits certain transactions involving directors.[554] In case a fund director, or any person who is an associate of such a director, enters into a transaction with the OEIC and the director of the company exceeds any limitation on their powers under the company's constitution, the transaction is voidable at the instance of the OEIC.[555] Nonetheless, whether or not the transaction is voided, the director is liable to account to the fund for any gain that he has made directly or indirectly by the transaction and the director must indemnify the OEIC for any loss or damage resulting from the transaction.[556] The regulations also provide that the transaction ceases to be voidable in four situations, when: (1) restitution of any money or other asset is no longer possible; (2) the fund is indemnified for any loss or damage resulting from the transaction; (3) rights that are acquired by a person who is not a party to the transaction would be affected by the avoidance; and (4) the transaction is ratified by resolution of the OEIC in a general meeting.[557] It is clear that the regulations do not give the FCA any power to approve the transaction involving the fund directors.

In the USA, section 17 of the Investment Company Act of 1940 prohibits certain transactions involving self-dealing by affiliated persons of the mutual fund.[558] Section 2 of the 1940 Act defines broadly the term *affiliated person* which includes, among others, the fund manager.[559] Further, section 17 (a) makes it unlawful for any promoter or affiliated person, or any principal underwriter of a mutual fund, or any affiliated person of such a person, promoter, or principal underwriter, to effect

[553] Affected person" means (a) a company scheme; (b) its trustee; (c) a director of a company scheme; (d) the manager; (e) any investment adviser of a scheme; (f) any associate of any person in paragraph (a), (b), (c), (d) or (e); and (g) the auditor of the authorised scheme.
[554] Open Ended Investment Company Regulations 2001, reg. 44.
[555] Ibid, reg. 44 (2).
[556] Ibid, reg. 44 (3).
[557] Ibid, reg. 44 (5).
[558] Investment Company Act of 1940, s.17.
[559] Ibid, s.2 (3).

certain transactions with the mutual fund or a company controlled by the fund. It is important to know that if neither the mutual fund nor a controlled company is a party, section 17 does not apply. For instance, if Company S owns 7% of the voting securities of a mutual fund (and is thereby its affiliate) and the mutual fund owns 6% of the voting securities of Company D (and is thereby an affiliate), section 17 does not apply to a transaction by Company S to Company D. Nonetheless, if Company D is controlled by the mutual fund, section 17 applies. Further, the 1940 Act, unlike the mutual funds regulations in the UK, grants the SEC an exemptive power in section 17 (b). The SEC should grant an exemptive order if evidence establishes that the terms of the proposed transaction are reasonable and fair and do not involve overreaching on the part of any person concerned, and the proposed transaction is consistent with the policy of each registered investment company concerned.

3- Disclosure of information with respect to potential conflicts of interest

Disclosure is a very common mechanism used by mutual funds regulators to minimise the effects of potential conflicts of interest. Disclosure is a very useful tool that helps regulators to monitor the activities of the fund that could give rise to conflicts of interest. Disclosure also keeps investors informed with information relating to conflicts of interest. For example, in the UK, the mutual fund manager should disclose to the investors all information with respect to the management fee and other expenses. Disclosure as an effective tool in mutual funds governance will be discussed later in this chapter.[560]

In addition, mutual funds regulators could use other mechanisms to minimise the adverse effects of potential conflicts of interest. Mutual funds regulators might require mutual funds to adopt conduct standards, policies and procedures to address conflicts of interest. Mutual funds regulators could also establish codes of conduct that must be followed by mutual funds service providers.

The above analysis draws the following conclusions. Firstly, conflict of interest is a very important issue in the mutual funds industry that should be addressed clearly by the funds regulators. Secondly, investors' interests are threatened and their protection is incomplete without addressing conflict of interest and its adverse effects. Thirdly,

[560] Collective Investment Schemes Sourcebook 2014, coll 6.7.6 (2).

mutual funds regulators do not use only one method to respond to a specific potential conflict of interest. Rather, they rely on a combination of mechanisms to protect investors because conflicts of interest take different forms in the mutual funds industry. Finally, the role of the mutual fund authorities is very important in addressing conflicts of interest.

4.5 Disclosure as a Regulatory Tool in Mutual Funds Governance

Discussion of any financial institution's governance regime, and traditional corporations, is not complete, and nor is it clear or comprehensive without examining the importance of disclosure as an effective regulatory tool to protect investors. In fact, disclosure is found to be almost without doubt the desired tool of regulation. A strict and clear system to require high levels of disclosure is fundamental to the sound functioning of the mutual funds industry. Further, the emphasis on the importance of the role of disclosure has its origin in Justice Louis Brandeis' famous conclusion, "*Sunlight is said to be the best of disinfectants*," and his admonition:

> *"To be effective, knowledge of the facts must be actually brought home to the investor, and this can best be done by requiring the facts to be stated in good, large type in every notice, circular, letter and advertisement inviting the investor to purchase. Compliance with this requirement should also be obligatory and not something which the investor could waive."*[561]

In addition, disclosure plays mainly a very important role in assisting investors to make investment decisions to join a mutual fund because when investors make their investment decisions, they should be afforded the accurate, clear and complete information necessary to choose the right mutual fund. When the investors are provided with the relevant information, they compare the available mutual funds in terms of past returns, past performance, risk levels, fees, service providers and the fund's objectives. Nonetheless, this does not mean to say that disclosure will prevent investors from making incorrect decisions, but it will at least improve their potential for making informed investment decisions. Therefore, the key objectives of disclosure should be to: (1) provide investors with sufficient information in order to

[561] Fink, *(*n 80) 160.

assess whether and to what extent the mutual fund is an appropriate investment scheme for them; and (2) furnish information on a timely basis, in a clear and simple format, taking into account the type of investors.[562]

Generally, mutual funds regulations in many countries, such as the UK and the USA, require mutual funds to provide investors with specific documents. Principally, the main documentary requirements are: (1) full prospectus; (2) simplified prospectus; and (3) periodic reports such as short reports and long reports (annual and half-yearly reports). In the UK, the cornerstone of the disclosure system for mutual funds is the prospectus.[563] A mutual fund prospectus can be defined as a lengthy and comprehensive document that describes in detail a mutual fund's fees, investment objectives, investment strategy expenses, management and risks.[564] This definition is consistent with the core purpose of the prospectus, which is describing the mutual funds to the prospective investors and providing the current investors with up- to-date information regarding the fund. The FCA expects a mutual fund's prospectus to be an investor's principal source of information. Thus, the main aim of the prospectus is to provide core information about the mutual fund in a manner that will help investors to make informed decisions with respect to purchasing the mutual fund's units/shares defined in the prospectus. Further, the information required by the mutual funds regulation must be in English.[565] The mutual fund manager is responsible for preparing the prospectus.[566] This responsibility requires the manager to ensure that the prospectus contains the information specified by the regulations.[567] The fund manager must also make sure that the prospectus does not contain any provision that conflicts with any rule in the mutual fund regulations, and that the prospectus is kept up to date.[568]

In the UK, mutual funds managers have never been sued with respect to false statements in the prospectus. However, some cases in this regard can be found in

[562] See, Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 324.
[563] Collective Investment Schemes Sourcebook 2014, coll 4.2.2.
[564] Romanski, (n 116).
[565] Collective Investment Schemes Sourcebook 2014, coll 4.2.2(1).
[566] Ibid.
[567] Ibid, coll 4.2.2(2).
[568] Ibid.

company law. One of the leading cases is *Derry v Peek*.[569] In this case Derry and other directors of the company issued a prospectus, inviting the public to apply for shares in it, stating that they had the power to run trams by steam power. They promised that they would soon be granted permission from the authorities. Nonetheless, the permission was rejected except for some parts of the tramway. The directors were sued for fraud by the investor. The court decided that the directors were not fraudulent but honestly believed that the statement in the prospectus was true. This affirms the difficulty of proving the directors' liability of a false or untrue statement in the prospectus. That is to say, in order to establish the directors' liability, the investors must prove that the director knows that there is untrue information with regard to the prospectus and ignores it.

In addition, in order to ensure that the prospectus is prepared and that it contains all the required information under the provisions of the mutual fund regulations, the mutual fund manager must provide the FCA with the original prospectus and all its revisions.[570] It is obvious that this duty aims to provide investors with a high level of protection. In fact, investors usually do not pay attention to the relevant regulations and their requirements, so they do not know whether or not the fund's prospectus complies with regulatory provisions. Therefore, it is essential to place this duty upon the FCA as a regulatory entity to ensure that the prospectus satisfies the regulatory requirements. Since the fund manager is aware that the prospectus will be examined by the FCA, it will take reasonable care during the preparation and publishing process.

Further, in case the prospectus contains an untrue or misleading statement or omission of any matter required by the mutual fund regulations, the manager will be liable to pay compensation to any person who has bought any units/shares in the mutual fund and suffered a loss in respect of them as a result of such omission or false statement.[571] Nonetheless, the fund manager is not liable to pay compensation if it proves that at the time the prospectus was made, it had taken reasonable care to determine that the statement was true and not misleading.[572] Here, it is worth mentioning that in the USA, in *Janus Capital Group, Inc. v. First Derivative Trader,*

[569] Derry v Peek (1889) LR 14 App Cas 337.
[570] Collective Investment Schemes Sourcebook 2014, coll 4.2.3.
[571] Ibid, coll 4.2.4 (1) (b).
[572] Ibid, coll 4.2.4 (2).

the Supreme Court of the United States held that an investment adviser to a mutual fund did not "make" the statements contained in that fund's prospectus for the purposes of Rule 10b-5 under the Securities Exchange Act of 1934. Instead, the court ruled that false statements in a mutual fund's prospectus are made by the fund and not the adviser and that the adviser and its parent company cannot be held primarily liable and subject to a private action by the parent's shareholders under Rule 10b-5.[573] It is clear that the ruling eliminates liability in private suits for the investment manager and other service providers who draft and often insist on the language contained in a fund's prospectus.

In the UK, COLL 4.2.5 of the FCA Sourcebook specifies the contents of a mutual fund prospectus.[574] Principally, the prospectus should contain the following points: (1) description of the mutual fund such as its name and whether it is an OEIC or unit trust; (2) the investment objectives and policy such as an indication of any limitations on that investment policy; (3) the fund reports, distribution and accounting dates such as date of sending the short report to investors; (4) characteristics of the units/shares such as how unitholders may exercise their voting rights; (5) the service providers, namely the fund manager, directors, depositary/trustee, investment adviser and auditors; (6) payment out of scheme property; (7) fund dealings such as the circumstances in which the redemption of units may be suspended; (8) redemption and (9) any other general information.[575] The prospectus must describe each of the previous points in detail. Here, it is worth mentioning that the mutual funds regulations indicate that, except where an investor requests a paper copy, delivery of the prospectus might be satisfied by electronic means.[576]

It is important to know that most of the mutual funds investors are not sophisticated with regard to financial and legal issues. The full prospectus might be legalistic and contain too much technical information for those investors. Most investors are less likely to read a prospectus that is difficult for them to understand. Thus, the FCA has tried to simplify prospectus disclosure requirements to concentrate more on essential information to make the prospectus less technical, so it will be easier for the investors to read. Mutual funds must publish a simplified prospectus which must be

[573] Janus Capital Group Inc. v. First Derivative Traders, 564 USA. n. 8 (2011).
[574] Collective Investment Schemes Sourcebook 2014, coll 4.2.5.
[575] Ibid.
[576] Ibid, coll 4.2.3 (1A).

incorporated in a written document.[577] Further, to achieve its objectives, the fund manager must ensure that the prospectus includes the necessary information that enables the investors to make an informed decision regarding whether to become a shareholder/unitholder in the fund.[578] The simplified prospectus, wherever possible, should also be written in plain language that avoids technical language and jargon.[579] However, it should not be understood that the simplified prospectus might substitute the full prospectus. Rather, it helps the investors to understand the full prospectus. Therefore, the simplified prospectus might be attached to the full prospectus as a removable part thereof.[580]

In addition, since the main aim of the simplified prospectus is to help investors to make an informed decision, the mutual fund manager must keep the simplified prospectus up-to-date and must immediately make proper revisions on the occurrence of any material change. That is to say that any material change to the simplified prospectus would influence the investors in determining whether or not to invest in the mutual fund.[581] For example, a mutual fund may change its objectives or investment policies.

Furthermore, the UK mutual funds that are Undertakings for the Collective Investment of Transferable Securities (UCITS) schemes must prepare and publish a short document in English containing a key investor information document (KIID) and the words “key investor information must be clearly stated in the document”.[582] The KIID must provide information to the investors with respect to description of the scheme, the investment objectives and policies, past performance, cost and charges, and risks associated with the investment.[583] It is important to know that the KIID might be translated into any language for the purpose of marketing units/shares of the UCITS fund in the UK.[584] Generally, the same rules of the simplified prospectus apply to the KIID in terms of the need to be revised and kept up to date.

[577] Ibid, coll 4.6.2 (1).
[578] Ibid, coll 4.6.2 (1)(a).
[579] Ibid, coll 4.6.2 (1)(c).
[580] Ibid, coll 4.6.2 (1).
[581] Ibid, coll 4.6.3.
[582] Ibid, coll 4.7.2.
[583] Ibid, coll 4.7.2 (4).
[584] Ibid, coll 4.7.4.

In addition, in order to provide investors with regular and relevant information about the progress and performance of the mutual funds on an ongoing basis, mutual funds regulations require investors to be provided with short and long reports.[585] While the fund manager must send the short report to all investors, it must only make the long report available to investors on request.[586] The main focus of those reports is the performance of the fund and this can be noted from the contents of those reports. In short reports, the key information that should be stated is (1) a review of the fund activities and investment performance; (2) a statement that the latest long report is available on request and (3) sufficient information to enable investors to know where the portfolio is invested.[587] The short report must also indicate any fundamental changes in the fund and the total expense ratio.[588]

Unlike the short reports, the long reports (half-yearly and annual reports) are technical and the information contained within might be hard to understand for most of the investors. For instance, the annual long report must contain a comparative table that must set out a performance record over the last five calendar years.[589] It is worth mentioning that the fund manager must ensure that long reports are supplied free of charge to any person upon request.[590]

In the USA, similar to the UK, the mutual fund prospectus is considered a keystone that helps investors to make informed decisions to choose the proper mutual fund that meets their investment objectives.[591] The Investment Company Act requires investment companies to be registered according to section 8 of the Act.[592] Principally, mutual funds register using Form N-1A.[593] The importance of this form comes from the fact that it serves a dual aim by allowing a fund to register itself pursuant to the Investment Company Act and its securities under the Securities Act.[594] Form N-1A is divided into three parts. Part A contains information required

[585] Ibid, coll 4.5.
[586] Ibid, coll 4.5.2.
[587] Ibid, coll 4.5.5.
[588] Ibid, coll 4.5.6.
[589] Ibid, coll 4.5.10.
[590] Ibid, coll 4.5.14 (2).
[591] A Palmiter and A Taha, 'Mutual Fund Investors: Divergent Profiles' (2008) 1 Columbia Business Law Review 934-1020.
[592] Investment Company Act of 1940, s8.
[593] It is important to know that the mutual funds registration is required in addition to registration under the Securities Act of 1933 of the securities that an investment company publicly offers.
[594] Form N-1A is available at: http://www.sec.gov/about/forms/formn-1a.pdf.

by section 10(a) of the Securities Act 1933.[595] This consists of the return/risk summary, which covers performance, risks, fees and investments. Further, principal investment, related risks, strategy of a fund's investment objectives, and a disclosure of the portfolio holdings are described in detail in this section.[596] It is significant to know that Form N-1A explicitly lists the required information and the order in which it must appear. As a result, a mutual fund manager has little discretion in formulating this part of the prospectus.

In addition, Part B of Form N-1A includes the information required in a fund's Statement of Additional Information (SAI). The key objective of the SAI is:

> *"To provide additional information about the Fund that the commission has concluded is not necessary or appropriate in the public interest or for the protection of investors to be in the prospectus, but that some investors may find useful".*[597]

Generally, the SAI includes information such as portfolio managers, the history of the fund's management of the fund, a description of the fund and its investments and risks, brokerage allocation and other practices, and taxation of the fund. The last part of Form N-1A includes other information required in a mutual fund's registration statement such as indemnification and principal underwriters.[598]

In 2009, the SEC issued amendments to Form N-1A.[599] The new rules permit mutual funds to send a summary prospectus to satisfy prospectus delivery requirements provided that the mutual fund's summary prospectus, statutory prospectus, and other specified information are available online.[600] Further, the mutual funds must ensure that the summary prospectus has the same information in the same order as the summary at the front of the statutory prospectus and the investors are able to download and retain an electronic version of the information contained therein.

---

[595] Securities Act of 1933, s.10 (a).
[596] Ibid.
[597] Form N-1A, c. 2 (a).
[598] Ibid, c.2 (c).
[599] See Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 R 4546 (Jan. 26, 2009)] ("Adopting Release"), available at: http://www.sec.gov/rules/final/2009/33-8998.pdf.
[600] S Zimmer, 'Securities And Exchange Commission's Enhanced Disclosure and New Prospectus delivery Option for Registered Mutual Funds' (2009) 83 St. John's Law Review 1431-1468.

Moreover, the Investment Company Act 1940 requires mutual funds to provide investors with annual and semi-annual reports 60 days after the end of the mutual fund's fiscal year and 60 days after the fund's fiscal mid-year.[601] Basically, these reports include updated financial information, a list of the mutual fund's portfolio securities and any other important information. The SEC has the authority to ask mutual funds to include in the semi-annual reports any other information as the Commission deems necessary or appropriate in the public interest or for the protection of investors.[602]

It is clear that, whether in the USA or the UK, the mutual funds disclosure regulations focus on two key areas, namely the substance and the format. The philosophy of the mutual funds regulators is that not only is the substance of information of the disclosure important, but also the format of information is essential to help the investors to understand the prospectus and make informed decisions. That is to say that mutual funds investors are most likely to understand obvious, concise and standardised disclosure of information in clear language. Therefore, mutual funds regulations require mutual funds to use tables and charts in their prospectus because tables and charts can be understood easily by investors, and consequently this facilitates comparison of funds. Another important point is that mutual funds regulators pay great attention to the issue that not all mutual funds investors are sophisticated in legal and financial matters. Thus, they try to simplify the prospectus by moving more detailed and complicated information to another document. In this way the investors will be able to understand the prospectus and make their informed decisions. Further, in order to make disclosure available and accessible to all investors, mutual funds regulations allow mutual funds to take advantage of technology and the internet. Therefore, mutual funds can provide their prospectus and reports by electronic means. Nonetheless, using technology can be restricted pending satisfaction of certain conditions. For example, mutual funds regulations might allow mutual funds to deliver the prospectus by electronic means provided the investors accept it. This will mean that investors experience greater confidence in receiving the prospectus.

[601] Investment Company Act of 1940, s.30 (f).
[602] Ibid.

It is worth mentioning that in deciding the extent of mandatory disclosure the financial regulators should pay considerable attention to the limits on mandatory disclosure. This will be helpful to understand better to what extent more disclosure will be beneficial. The financial regulators should consider the cost of mandatory disclosure. The costs of mandatory disclosure come from various sources such as the costs of printing and drafting the documents. They should also pay attention to the impacts of mandatory disclosure on market competition. Mandatory disclosure, especially when too detailed, makes a mutual fund's investment decisions more observable by the market competitors.[603]

4.6 The Effectiveness of the Voting Right in Mutual Funds Governance

In ordinary companies, ownership of shares confers on shareholders various fundamental rights. The most important legal right they have is the right to vote on significant corporate matters, such as amendments to the company charter, liquidation, merger and elections of boards of directors.[604] In fact, shareholder voting is a means for investors to participate in corporate governance. The exercise of voting rights is a principal tool for allowing shareholders' voices to be heard by the company's directors. Unlike shareholders of ordinary companies, mutual funds investors do not sell their shares/units, but rather they redeem them from the mutual fund for cash based on the net asset value.[605] The right of mutual funds investors to redeem their shares/units is known as the right to exit. It is argued that the existence of the unique right of exit in the mutual funds industry makes the voting rights ineffective. In other words, mutual funds investors usually prefer to exit the fund rather than to use the voting right in case the fund faces serious issues such as alteration of the fund's main objectives.

To understand the exit right in the mutual funds industry, it is important to compare it with the exit right in ordinary companies. In ordinary companies, shareholders can exit the company, but the assets cannot. This is to say that when a shareholder sells his shares, the assets that underlie those shares remain existent inside the company and the size of the company is not reduced. In contrast, mutual funds investors do not

[603] For further information about limits of mandatory disclosure see, L Enriques and S Gilotta 'Disclosure and Financial Market Regulation' in E Ferran, N Moloney and J Payne (eds), The Oxford Handbook of Financial Regulation (Oxford University Press, Oxford 2015).
[604] C Mallin, *Corporate Governance* (4th edn OUP, Oxford 2013) 118.
[605] Collective Investment Schemes Sourcebook 2014, coll 6.2.2.

sell their shares/units; rather they redeem them from the fund for cash calculated according to the NAV of the fund.[606] The main consequence of the redemption process is that the fund declines in size when those units/shares are extinguished. Further, mutual funds' share/unit prices equal the NAV of the fund.[607] Indeed, the expectations with respect to the future portfolio changes or returns do not affect the fund NAV. Thus, it is likely to find shares/units in two different funds with different possible returns that have the same NAV. If we assume that we have two mutual funds with the same NAV and different expected future returns, one could argue that the investors in the mutual fund with lower expected future returns might improve those returns by voting. Nonetheless, the investors would prefer to redeem their shares in the lower expected return fund and switch to the higher expected return fund. Switching between the two funds will not cost the investors anything because the two mutual funds have the same price.

On the contrary, the shareholders of ordinary companies cannot switch easily between companies with different expected cash flows. Imagine we have two companies with different expected cash flows. If the investors in the company with the lower expected cash flow wish to switch to the one with the higher expected cash flow, they shall bear the price difference between the two companies, which is usually costly.[608] The shareholders of the company with the lower expected cash flow can sell their shares at low prices that reflect the company's low expectation. If they wish to switch to the company with higher expected cash flow, they should buy its shares at higher prices that reflect the high expectation. However, the shareholders' activism is likely to improve the company's future returns.[609] Therefore, ordinary company shareholders prefer to use the voting rights to improve the company's returns and raise the share price in the stock rather than selling their shares at the current price.

In addition, it is important to know that mutual fund shares are widespread. Unlike ordinary companies, there are no great blocks of mutual funds units/shares held by certain individuals. In other words, a mutual fund might have thousands of investors,

[606] Ibid.
[607] Mayo, (n 355) 337.
[608] J Morley and Q Curtis, 'Taking Exit Rights Seriously: Why Governance and Fee Litigation Don't Work in Mutual Funds' (2010) 120 Yale Law Journal 84-142.
[609] See Kershaw, (n 416) 183.

each holding only a small portion of the total number of units/shares.[610] As compared with ordinary companies, some shareholders might hold large fractions of shares, so they use their voting right to pass certain decisions, such as Bill Gates in Microsoft.

Moreover, the relation between the ability of the mutual funds investors to redeem their shares/units and the ineffectiveness of voting is affirmed by certain cases. In those cases, mutual funds investors have preferred to redeem their shares rather than using their voting right. One of those cases is *Navellier v. Sletten*.[611] Navellier Management, Inc was an investment adviser to a family of funds, which included the Navellier Aggressive Small Cap Equity Fund. Navellier Management made a proposal to merge the fund, which was a low-load fund, into the Navellier Performance Fund, which was a separate no-load fund. In response to this proposal, the independent directors requested information from Navellier Management with respect to the management of the fund. Navellier Management completely refused to provide any information to the independent directors, claiming that it was irrelevant to the board's consideration of the merger proposal. In response to the Navellier Management's refusal, the independent directors refused to approve the merger. Meanwhile, the board was to consider the renewal of the advisory contract between Navellier Management and the fund. In considering the problem with Navellier Management, the independent directors voted to replace Navellier Management as the fund investment adviser with Massachusetts Financial Services. Navellier Management was aware that the independent directors would need the approval of Massachusetts Financial Services by the shareholders, so it campaigned to block the approval. At the shareholders meeting, Massachusetts Financial Services did not receive a sufficient number of votes. As a result, Navellier Management was reinstated as the investment adviser. Subsequently, Navellier Management brought a derivative suit against the independent directors. It claimed that the independent directors were personally liable for wasting fund money, and had thus breached their fiduciary duties. The dispute between the independent directors and the investment adviser caused a huge number of redemptions. Before the beginning of the dispute, the fund was valued at $250 million. However, by the end of the dispute, the fund

[610] See, J Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 274.
[611] Navellier v. Sletten, 262 F.3d 923 (9th Cir. 2001)

assets had decreased to $60 million.[612] Mutual fund shareholders clearly decided to move their money elsewhere rather than become involved in the dispute. That is to say they were able to vote to provide the board with sufficient power over the fund's investment adviser.

Another important case is *Yacktman v Carlson*.[613] Don Yacktman was investment adviser to the Yacktman Fund and the Yacktman Focused Fund. In 1998, the relationship between Yacktman and the directors of the Yacktman Fund became tense due to the changes in the investment preferences. The board of Yacktman refused the changes and questioned Yacktman about those changes. In response to the board's action, Yacktman threatened to replace the independent directors if they did not resign voluntarily. The independent directors refused to resign. Therefore, the investment adviser called the shareholders to a special meeting to remove the independent directors. The board fired the investment adviser and cancelled the shareholders meeting. In order to force the shareholders meeting, the investment adviser brought suit against the fund. Interestingly, the shareholders received letters from both the independent directors and Yacktman accusing each other of acting improperly. The fundamental consequence of this dispute was that the majority of the shareholders began to redeem their shares in the fund. In 1997, before the dispute, the Yacktman Fund had assets of $1.2 billion. In 1999, the total of the fund assets had declined to $280 million.[614] This means that around 64 percent of the shareholders chose to redeem their investments during the dispute. It is important to know that the remaining shareholders supported Yacktman. Thus, Yacktman continued to serve as the fund's investment adviser and the independent directors of the fund were replaced.

It is clear that the Navellier and Yacktman cases emphasise the importance of the redemption as a more favourable option for the mutual funds shareholder. In both cases, the shareholders had three options. The first option was that the shareholders could do nothing. The second option was that the shareholders could attempt to be

[612] See D Carter, Mutual Fund Boards and Shareholder Action available at http://cyber.law.harvard.edu/rfi/papers/mutualboards.PDF accessed 26 June 2015.
[613] Yacktman v. Carlson, No. 98-278177 (Cir. Ct. Baltimore, Md. filed Oct. 5, 1998)
[614] Available at http://ibd.morningstar.com/article/article.asp?id=605717&CN=brf295,http://ibd.morningstar.com/archive/archive.asp?inputs=days=14;frmtId=12,%20brf295 accessed 15 December 2016.

active and use the voting right. This option is what we call shareholder activism. The third possible option was to redeem their shares and exit the mutual fund. In fact, the shareholders would only choose the activism option if it was better than the other options. That is to say the shareholders will choose activism if its benefits exceed the benefits of other options and particularly the exit option. Generally, most of the mutual funds investors are retail investors who do not have investment skills or knowledge of the investment process and its procedures. Further, some mutual funds investors do not have enough time to make their own investments. Therefore, those investors, whether not possessing investment skills or having insufficient time, are more likely not to attend the fund meetings and use their voting rights.

In case the fund has some difficulties, the shareholders would not hesitate to exit from the fund and avoid any potential consequences. The redemption process will not take long because shareholders can usually redeem their shares at less than twenty-four hours' notice.[615] Even though redemption fees may have been a fundamental obstacle in the past, they are not a serious problem presently.[616] Investors can easily avoid those fees simply by choosing mutual funds that do not charge redemption fees. It is important to know that although Navellier and Yacktman are American cases, their implications are applicable to UK mutual funds because mutual funds investors' classes are almost the same throughout the world in the mutual funds industry.

However, the previous discussion does not intend to say that the voting right in the mutual funds industry is a completely ineffective tool. Mutual funds regulations require investors to vote on key issues with respect to the operation of the mutual funds. In the UK, the mutual funds regulations provide that every unitholder/shareholder has one vote.[617] Mutual funds investors can give their votes either personally or by proxy or by any other way allowed by the instrument constituting the mutual fund.[618] This means that, as with ordinary companies, a mutual fund investor might appoint another person to attend a general meeting and vote in his place. Further, the regulations require the mutual fund manager, by way of an extraordinary resolution, to obtain prior approval from the investor for any

[615] Jones, (n 51) 29.
[616] Ibid.
[617] Collective Investment Schemes Sourcebook 2014, coll 4.4.8 (1).
[618] Ibid, coll 4.4.8 (2) (a).

fundamental change in the fund.[619] A fundamental change is a change or event that (1) changes the purpose or nature of the fund; (2) might materially prejudice an investor; (3) alters the risk profile of the fund or (4) introduces any new payment out of the fund's property.[620]

The mutual fund regulations do not require the approval of the fund investors with respect to the significant changes. The mutual funds manager must only give prior written notice to the fund's investors regarding those changes.[621] A significant change is a change or event that is not classed as a fundamental change.[622] Furthermore, the authorised fund manager of the unit trust is subject to removal by resolution of the unitholders of the scheme.[623] Similarly, the OEICs directors are subject to removal by resolution of the shareholders.[624] Further, the unitholders of a unit trust can wind up the scheme by the passing of an extraordinary resolution.[625] The regulations also require the approval of the mutual fund investors for any arrangement for the merger of the scheme with another body or scheme.[626] It is clear that the investors have some limited voting rights which are restricted on essential matters concerning the operation of the fund and its service providers.

In the United States, the Investment Company Act of 1940 grants shareholders certain voting rights. Section 18 (i) of the 1940 Act requires that every share of stock issued by an investment company "shall be a voting stock and have equal voting rights with every other outstanding voting stock".[627] Mutual fund shareholders must approve the investment advisory contract.[628] They must also approve the underwriting contracts which include the amount of fees paid to the underwriter.[629] Further, a mutual fund's fundamental investment policies must be approved by the shareholders.[630] The shareholders must also elect the fund directors. It is obvious that the American mutual funds investors also have some limited voting rights. Here, it is

[619] Ibid, coll 4.3.4.
[620] Ibid.
[621] Ibid, coll 4.3.6.
[622] Ibid.
[623] Ibid, coll 6.5.7 (h).
[624] Ibid, coll 3.2.6.20.
[625] Ibid, coll 7.4.3 (2) (c).
[626] Ibid, coll 7.7.13 (4) (c).
[627] Investment Company Act of 1940, s.18 (i).
[628] Ibid, s.15 (a) (2).
[629] Ibid, s.15 (b) (1).
[630] Ibid, s.13 (a).

worth mentioning that mutual funds investors have nearly the same voting rights in many countries. For instance, in Syria mutual funds cannot change the instrument of the constitution or the fund polices and main objectives without the approval of the shareholders.[631]

4.7 Conclusion

This chapter has examined the governance of mutual funds. It focused on the governance mechanisms adopted by the UK and US mutual funds regulations which aim to protect the fund investors and mitigate potential conflicts of interest between the self-interests of the management and the interests of the investors. The research attempted to benefit from the literature on corporate governance to define mutual funds governance. However, it took into consideration the external management structure of mutual funds to set an appropriate definition. Mutual funds governance might be defined as the system for the operation and organisation of mutual funds which aims to ensure that mutual funds are operated effectively in the best interests of the mutual funds investors and not in the interests of the mutual funds' external management. The research then conducted an in-depth analysis of the corporate (US) and contractual (UK) models of mutual funds. The analysis demonstrated that neither the US mutual funds governance system nor the UK governance structure is accepted to be superior to any other system. Rather, each system adopts various governance mechanisms that suit the mutual funds structure and the general financial and investment culture in the country.

Further, the research showed that separation of the fund ownership and management carries the potential for the interests of the fund investors and the interests of management to diverge, which in turn gives rise to a possible conflict of interest between the self-interests of the manager and the interests of the mutual funds investors. Thus, it is necessary that the mutual funds regulation responds to potential conflict of interest situations in order to protect investors. The research examined some possible regulatory methods to address those situations. Finally, the roles of disclosure and voting rights in the mutual funds governance to protect investors were examined.

[631] Mutual Funds Act 2011, article 15.

CHAPTER 5

Strengthening Mutual Funds Regulation and Governance in Middle Eastern Countries

5.1 Introduction

In order for the mutual funds industry to flourish in a particular country, there must be a robust and effective legal framework that ensures investor protection, a transparent fund market, and reduction of systemic risk. This regulatory framework will encourage investors to invest their savings in the mutual funds. As was discussed throughout this thesis, in the United Kingdom and the United States, the mutual funds are subject to detailed regulation. They provide investors with a high degree of protection. This protection is one of the core reasons for the development of this industry in those countries. In Middle Eastern countries, the mutual funds industry is still a small industry. Some of those countries are still looking at the mutual funds regulations as an addendum to the other main financial regulations, such as securities regulations. For example, the mutual funds regulations in Jordan, Kuwait and Palestine are part of the Securities Act.[632] The same thing is found in Oman, where mutual funds regulations are part of the Capital Market Law.[633] Even the countries where mutual funds are regulated by special regulations suffer from poor adaptation of high standards of investor protection.

After studying the mutual funds regulations and governance, mainly in the UK and secondarily in the USA in the previous chapters, this chapter principally focuses on studying the possibility of exporting lessons from the UK mutual funds regulations to Middle Eastern countries, which can play a crucial role in enhancing investor protection and promoting the mutual funds industry. Since the mutual funds industry and its regulations are very similar across Middle Eastern countries, the chapter will concentrate, as did the previous chapters, on the SMFA 2011. The chapter will try to

[632] The Jordanian mutual funds and investment companies' regulation available at http://www.jsc.gov.jo/Public/English.aspx?Site_ID=1&Page_ID=708 accessed 28 March 2016. In Kuwait available at http://www.kuwaitchamber.org.kw/echamber/docfiles/website/CMS/trlawc17.pdfat accessed 28 March 2016. In Palestine available at http://muqtafi.birzeit.edu/pg/getleg.asp?id=14739 accessed 28 March 2016.

[633] Available at http://www.fiu.gov.om/files/english/Capital%20Market%20Law/Capital%20Market%20Law.pdf accessed 28 March 2016.

show the weaknesses in the current mutual funds regulations that threaten the protection of investors and the industry. Then, it will examine the possibility of applying the current mutual funds regulations in the UK to the mutual funds regulations in Syria in order to strengthen investor protection. The different economic and financial circumstances will be considered when applying those lessons in Syria. It is significant to mention, as was discussed in previous chapters, that some areas of mutual funds regulation in the USA are more developed and detailed than those in the UK. For instance, the fair valuation rules in the USA are more developed than the UK rules. Therefore, when exporting some regulatory rules to Syria the thesis, where it is necessary, will suggest a combination of the UK and the US rules. The first section of the chapter investigates the international principles that apply to the mutual funds industry. Particularly, it studies the International Organization of Securities Commissions (IOSCO) Principles for the regulation of collective investment schemes. The aim of this section is to assess whether those principles are applied in the UK and in Middle Eastern countries. The second section examines the methods of enhancing mutual funds prudential regulations in terms of risk management, restrictions on the investment and borrowing powers, suspension of redemption and valuation and pricing. Mutual funds prudential regulations are important to the safety of the industry and protection of the investors. Section three scrutinises the tools that strengthen mutual funds governance. It particular, it studies the mutual funds' authorisation, conflicts of interest, transparency in disclosure and the concept of independence between the fund manager and the custodian. Section four studies the fundamental functions of the supervisory and regulatory authorities in protecting mutual funds investors and enhancing the mutual funds industry.

5.2 The International Organization of Securities Commissions (IOSCO) Principles for the Regulation of Collective Investment Schemes

In October 1994, the International Organization of Securities Commissions (IOSCO) published a report on investment management.[634] The report discussed the principles for the regulation of collective investment schemes. IOSCO is the international body that brings together the world's securities regulators. It is recognised as the international standard setter for the securities sector. It develops, implements and

[634] The report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf accessed 27 March 2016.

promotes adherence to globally recognised standards for securities regulation. Further, the IOSCO principles provide guidance to the IOSCO member countries in their regulation of collective investment schemes, which is especially significant in the context of the globalisation of securities markets and investment advisory services. The principles also provide guidance for industry participants on the standards to be accomplished by collective investment schemes seeking to access international markets.

Moreover, the principles defined a collective investment scheme (CIS) as:

> "*an open end collective investment scheme that issues redeemable units and invests primarily in transferable securities or money market instruments. For the purposes of these Principles, it excludes schemes investing in property/real estate, mortgages or venture capital*".[635]

The report highlighted ten key principles that address different aspects of the collective investment scheme industry. Those aspects are (1) legal form and structure of CIS; (2) custodian, depositary and trustee; (3) eligibility to act as an operator; (4) delegation; (5) supervision; (6) conflicts of interest; (7) asset valuation and pricing; (8) investment and borrowing limitations; (9) investors' rights; and (10) marketing and disclosure. It is necessary to know that those principles are general principles and the member countries should implement them practically according to their legal framework.[636]

In September 1997, IOSCO published another report about the supervision of operators of collective investment schemes.[637] The report contained 10 principles for the supervision of operators of CIS. The supervision principles did not attempt to specify which entity is responsible for any particular supervisory activity. The principles also did not specify which regulatory techniques should be employed to attain effective supervision. They highlighted the general supervisory techniques such as registration and authorisation, and the power of the supervisory authority.

[635] Ibid.
[636] Ibid.
[637] Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf accessed 27 March 2016.

Another important paper, which addresses the objectives and principles of securities regulation, was published by IOSCO in 1998.[638] This document included 30 principles of securities regulation. Principles 17 to 20 addressed collective investment schemes. These four principles are similar to those contained in the 1994 report. Here, it is necessary to mention that in this paper, the term *collective investment scheme* includes the open-ended and closed-ended funds.

Undoubtedly, the IOSCO principles are the key global standard for financial industries, whose main objectives are to protect investors, to ensure fair, efficient and transparent securities markets, and to reduce systemic risk. It is important to know that the UK is a major contributor to laying down the international principles. Middle Eastern countries should explicitly exhibit a high level of compliance with the IOSCO principles. Although Middle Eastern countries apply some of those principles, they do not emphasise the other principles. For instance, the mutual funds regulations in Middle Eastern countries do not regulate the risk management process adequately, although the importance of risk management in the mutual funds industry is to protect investors and the industry itself. Therefore, the main problem with the mutual funds industry in Middle Eastern countries is the need to bridge the gap between their own principles and those of international mutual funds. However, the IOSCO principles are only general principles and these principles should be implemented using very detailed regulation. This implies that they provide only a general guide to the countries. As was previously mentioned, mutual funds regulation in the UK is very detailed because the fund industry is developed and the regulators always try to enhance this regulation in order to provide investors with a high level of protection. As a result, when the research attempts to take regulatory lessons from the current mutual funds regulation in the UK, it also takes into account the international principles and other developed rules applied there. Here, it is significant to mention that most Middle Eastern counties are members of the IOSCO, such as Syria, Qatar, Oman, Palestine and Saudi Arabia.

5.3 Enhancing Mutual Funds Prudential Regulations

The mutual funds prudential regulations are not only significant for the safety of the mutual funds industry, but they are also fundamental to protect the interests of the

[638] Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf accessed 27 March 2016.

mutual funds investors. This section will shed light on improving the prudential mutual funds regulations.

5.3.1 Risk Management: an Essential Tool for Investor Protection

Like other financial institutions such as banks, risk management is a key part of mutual funds' strategic management. Mutual fund risk management is a process whereby mutual funds systemically address all potential risks or problems before they occur in order to establish proper policies to avoid those risks or minimise their impacts.[639] That is to say, the aim of risk management is not the elimination of risk, but rather to adopt a process that ensures that risks are understood and consistent with the mutual fund's objectives. For instance, in liquidity risk, if a mutual fund is unable to meet its obligation to redeem the shares or units, this might force the fund manager to make a decision to suspend the fund dealings, which in turn might lead to the winding up of the fund.[640] By applying a proper liquidity risk policy, a mutual fund might alleviate the potential impacts of this risk. Risk management plays a central role in controlling and ensuring proper operation of the fund management. Specifically, it ensures the compliance of the fund management with laws and regulations. Furthermore, the risk management process is the key to protecting investors from risks through ensuring that the fund management is acting in the interests of the investors.

As was discussed previously, due to the importance of the risk management process, the present regulations of mutual funds in the UK require mutual funds managers to have sufficient risk management procedures and internal control mechanisms to protect the funds and the interests of the investors.[641] The outcomes of ignoring regulation of the risk management process might be harmful not only to the fund and its investors, but also to the economy in general. It is necessary to know that the current mutual fund risk management rules in the UK reflect the IOSCO principles included in the "Risk Management and Control Guidance for Securities Firms and their Supervisors" document.[642] In addition, the Asian financial crisis of 1997, for

---

[639] For further information, see 2.4 (Mutual Funds Risk Management) 64.

[640] For further information, see 3.6 (Suspension of Redemptions and Winding up Mutual Funds) 111.

[641] Collective Investment Schemes Sourcebook 2014, coll 6.11.

[642] International Organization of Securities Commissions, 'Risk Management and Control Guidance for Securities Firms and their Supervisors' (May 1998) available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD78.pdf accessed 28 March 2016.

example, demonstrated that ignoring risk management principles could also lead to economy-wide difficulties.[643] The 1997 crisis showed the weaknesses in risk management at many financial institutions such as banks. For instance, the Asian financial crisis emphasised the need to enhance banks' internal risk assessment practices as well as counterparty risk exposures.[644]

Unlike the mutual funds regulations in the UK, the Syrian Mutual Funds Act (SMFA) 2011 does not contain rules that impose upon mutual funds managers a duty to establish clear risk management procedures that ensure the protection of the investors and the safety of the fund. The SMFA 2011 includes only a rule with respect to liquidity risk, which requires the mutual fund manager not to invest more than 10% of the fund assets in one place.[645] Further, in the United Arab Emirates, even though the Collective Investment Law 2010 requires fund managers to establish and maintain systems and risk controls in order to ensure sound management of the fund in accordance with the fund's constitution and 2010 Law, it does not specify the details or general principles of those systems and risk controls.[646] Similarly, the Investment Funds Regulations 2006 in Saudi Arabia do not impose any duty upon the fund manager to establish a risk management system. The fund manager is only required to disclose, in the fund prospectus, the risks of investing in the fund.[647] It is clear that the mutual funds regulations in those countries do not emphasize sufficiently through legislation a fundamental function in the mutual funds industry, which provides investors and the fund with appropriate protection. Therefore, the following discussion will attempt to elicit from the current mutual funds regulations in the UK, which reflect the international principles, the main principles of an effective risk management system.

5.3.1.1 Risk Management Principles under the Current Mutual Funds Regulations in the UK

1- Risk management is a continual process. It is not a one-time project or periodic assessment of potential risks, but rather an ongoing part of mutual funds

[643] J Choi and M Papaioannou, 'Financial Crisis and Risk Management: Reassessing the Asian Financial Crisis in Light of the American Financial Crisis' (2010) 5 East Asia Law Review 442-468. Available at: http://scholarship.law.upenn.edu/ealr/vol5/iss3/1.

[644] Ibid.

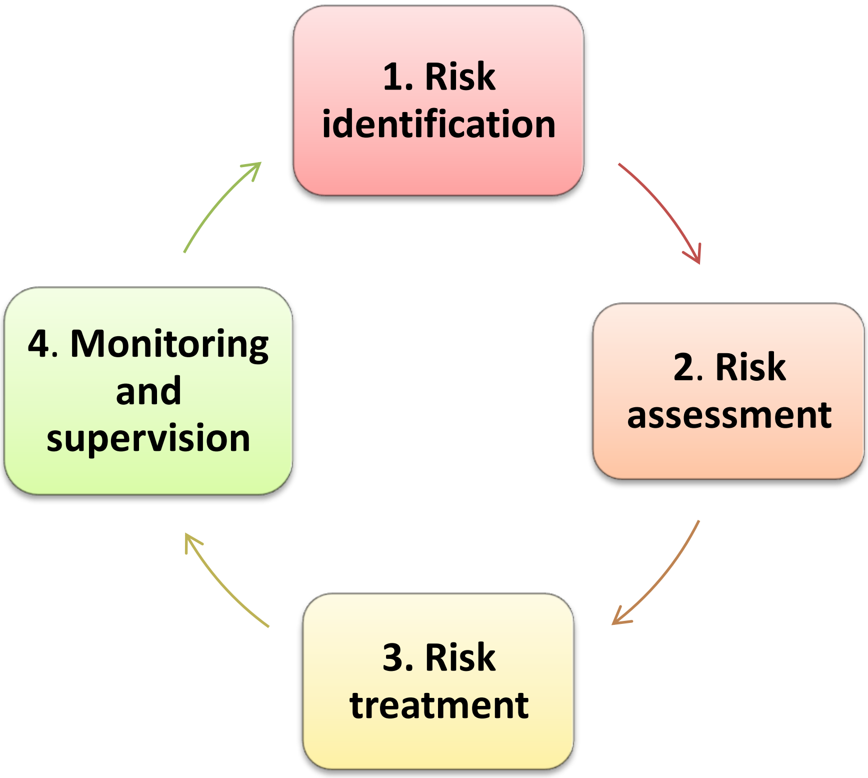
[645] Mutual Funds Act 2011, article 68, 1 (c and d).

[646] Collective Investment Law (DIFC LAW No. 2) 2010, part 5, chapter 1.

[647] Investment Funds Regulations 2006, article 14.

operations.[648] This process should comprise all the procedures necessary for (1) risk identification; (2) risk assessment; (3) risk treatment; and (4) monitoring and supervision (figure 5.1).

Figure (5.1): Risk management process



The mutual fund manager should identify potential risks and their description through analysing all potential sources of risk such as market risk, credit risk, operational risk, integrity risk and liquidity risk.[649] The mutual fund manager must establish, implement and maintain a sufficient risk management policy to identify the risks to which the fund is or might be exposed.[650] Here, it is worth mentioning that potential risks vary between countries. For example, market risk in Middle Eastern countries might be higher compared to other countries such as the UK because the political situation is not stable in most of those countries, which is likely to affect the financial markets there.

[648] Collective Investment Schemes Sourcebook 2014, coll 6.11.2.
[649] Collective Investment Schemes Sourcebook 2014, coll 6.11.4 (1) (c). For further information about types of potential risks, see 2.4 (Mutual Funds Risk Management) 64.
[650] Collective Investment Schemes Sourcebook 2014, coll 6.12.5.

In addition, after identifying the potential risks, the mutual fund manager should assess those risks.[651] In order to ensure the effectiveness of the assessment process, the fund manager should consider the possibility of the occurrence of the potential risk, and in case of the occurrence of that risk, the seriousness of its consequences on the mutual fund. The mutual fund manager might use available statistical data to assess the possibility of the occurrence of certain kinds of risk and their direct and indirect consequences on the fund. Further, the mutual fund manager should then identify the possible options for treating risk, assess their effectiveness, prepare suitable plans and implement them.[652] For instance, the market value of financial instruments might fluctuate due to changing market conditions. The fund manager might use the available data to assess the potential of the occurrence of fluctuation in the prices. It might then adopt a fair valuation policy to alleviate the consequences of this fluctuation.

Moreover, the mutual fund manager must assess, monitor and periodically review the adequacy and effectiveness of the risk management policy. The manager should report the results of the assessment and review to the supervisory function (board of directors or the depositary) and to the competent authority.[653] This works alongside the second principle of effective risk management, which is the importance of independent oversight in the risk management process.

2- Appropriate independent oversight. A process for independent supervision of the mutual fund risk management policies and procedures can help to confirm their effectiveness. The key purpose of the independent oversight is to ensure that risks are efficiently identified and assessed and that suitable controls and responses are in place. In the UK, the depositary of a mutual fund should take reasonable care to review the appropriateness of the risk management process.[654] In countries where the mutual funds take the corporate form, such as the USA, the board of directors is responsible for the independent oversight of the risk management process. Therefore, every director should be aware of the fund risks and the present risk management policies and procedures. However, the board of directors is not required to design and implement risk management policies and procedures because the board of

[651] Ibid, coll 6.12.4 (6).
[652] Ibid, coll 5.6.17.
[653] Ibid, coll 6.11.4 (1) (d).
[654] Ibid, coll 5.6.17.

directors is not responsible for managing the mutual fund investment or its business operations. Further, the board of directors should be satisfied that the mutual fund manager has implemented sufficient risk management policies and procedures.

To ensure the efficiency of the risk oversight function, the board of directors should ensure that the fund is applying a clear communication system. This means to say that the fund manager should periodically provide the board of directors with written reports regarding the adequacy and effectiveness of the risk management process, so the board of directors can check whether the fund manager has appropriate policies and procedures in place to identify and manage the fund risks.[655]

3- Supervision of the risk management process by the competent authority. In order to ensure the interests of investors are protected and to ensure the safety of the mutual funds industry, as a fundamental part of the financial market, the appropriateness and effectiveness of the risk management process should be considered by the competent authority. The competent authority can evaluate the compliance of the mutual funds with the applicable laws and regulatory requirements on risk management in two ways. First, the competent authority might assess the risk management process in the process for licensing the fund.[656] Secondly, it should also supervise the risk management process on a regular basis.[657] Therefore, the fund manager must notify the competent authority of any material changes to the risk management process, so the competent authority can intervene where necessary to protect the investors' interests and the fund.

Clearly, the risk management process is an essential tool in the mutual fund management organisation. Identifying and assessing the mutual fund potential risks and taking informed actions help to reduce the possibility of failure. The risk management process provides the fund investors, who put their trust in the fund management to invest their money, with proper protection. Therefore, mutual funds regulations in Middle Eastern countries such as Syria must explicitly regulate this fundamental part of the regulation. The mutual fund regulations should be amended to impose an obligation upon the fund manager to identify and assess all potential risks in order to prepare suitable plans and implement them. The regulations should

[655] Collective Investment Schemes Sourcebook 2014, coll 6.11.4 (1) (d).
[656] Ibid, coll 6.12.8.
[657] Ibid, coll 6.12.3.

also emphasise independent oversight of the risk management process. Finally, the regulations should give the supervisory authority explicit authority to supervise the risk management process adopted by mutual funds. The discussion above, which addressed the mutual funds risk management principles under the current regulations in the UK, might be a useful guide to those countries taking into consideration the degree of complexity of the fund industry there.

5.3.2 Restrictions on Investment and Borrowing Powers

The following analysis will address the restrictions on the investment and borrowing powers under the current mutual funds regulations in Syria, and whether those regulations provide investors with a high standard of protection similar to those applied in the UK. Here, it is necessary to know that the rules on restrictions on the investment and borrowing powers under the current mutual funds regulation in the UK reflect the IOSCO principle included in the "Principles for The Regulation of Collective Investment Schemes" report 1994.[658]

5.3.2.1 Mutual Funds Investment Limitation: Prudent Spread of Risk

Perhaps the most desirable attributes that attract investors to invest their savings in the mutual funds industry are diversification and liquidity.[659] Diversification is a vital tool for reducing risk and protecting investors. Since mutual funds are mainly designed to be suitable for retail investors, mutual funds regulations should impose upon mutual funds a duty to apply certain levels of diversification with the aim of reducing the risk of investing in a small number of assets.[660] In fact, the more different products and assets a mutual fund holds, the less the risk to investors of losing a fundamental portion of their portfolio if a certain asset falls in value due to market and economic conditions.

Further, another significant characteristic of mutual funds is that they allow investors to redeem their shares, generally on a daily basis.[661] This implies that the fund investors wishing to redeem their holdings in a fund, whether because they expect a fall in the value of their shares or for any other reasons, can ask the fund to redeem

[658] The report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf accessed 29 March 2016.
[659] S Gurusamy, *Financial Services* (2nd edn Tata McGraw-Hill Education, New Delhi 2009) 214.
[660] Jones, (n 51) 47.
[661] Collective Investment Schemes Sourcebook 2014, coll 6.2.16 (6).

them at any time. Therefore, mutual funds must maintain adequately liquid assets in order to meet the investor's redemption orders and reduce the impact of those redemption orders on the fund's remaining investors. As a result, it is necessary for mutual funds regulations to place investment limits on mutual funds to ensure liquidity and diversification of the fund assets. The Lehman Brothers' Bankruptcy in 2008 in the USA is a clear example of the importance of imposing investment restrictions on mutual funds to meet unexpected redemption requests. In less than one week, fund investors withdrew $169 billion from money market funds (around 5% of the total industry assets).[662]

It was discussed previously that in mutual funds regulation in the UK, chapter 5 of the Financial Conduct Authority (FCA) COLL Sourcebook sets out investment restrictions with which mutual funds must comply.[663] An Undertaking for the collective investment in transferable securities (UCITS) authorised unit trust scheme, for example, can invest up to 10% of its assets in transferable securities that are not approved securities, while it is permitted for a non-UCITS authorised unit trust to invest up to 20% of its assets in transferable securities that are not approved securities.[664] In addition, within the range of investment assets there are certain detailed rules. For instance, no more than 20% in value of the UCITS authorised unit trust property is to consist of deposits with a single body.[665]

In Syria, SMFA 2011 does not contain detailed rules that ensure liquidity and diversification of the fund assets. The SMFA 2011 defines only two restrictions: the first limitation is that the manager of the scheme must not invest more than 10% of the fund assets in one issuer, while the second prohibition is that the mutual fund must not own more than 10% of the voting rights of that body.[666] These restrictions do not apply to the investment in government and Central Bank of Syria securities.

Though the SMFA 2011 specifies the permitted types of fund property, it does not place limits on the different types of fund property. Thus, a mutual fund manager might make a decision to invest all the fund assets in shares. That would have a negative impact on the fund liquidity in case of a sharp fall in the value of the shares.

[662] G Dwyer, *Financial Crisis of 2008 in Fixed Income Markets* (Diane Publishing, Philadelphia 2010) 24.
[663] For further information, see 3.3.2.2 (Restrictions on the Investment and Borrowing Powers) 83.
[664] Collective Investment Schemes Sourcebook 2014, coll 5.1.4.
[665] Ibid, coll 5.2.11.
[666] Mutual Funds Act 2011, article 68, 1 (c and d).

The investment restrictions under the SMFA 2011 should be amended to explicitly define proportions allowed to be invested in the different permitted types of scheme property. For instance, mutual funds should not be allowed to invest more than 20% of their assets in transferable securities and not more than 15% of their assets in other mutual fund shares. Therefore, in case of increasing the number of redemption orders, a mutual fund can get cash from those that can be liquidated in a short period of time. It is important to know that the investment limitations should consider the available products in the financial market. In other words, in a country such as the UK, the financial sector is very developed where various types of financial instrument are available such as shares, debentures, government and public securities, warrants, money market instruments, units of collective investment schemes and derivatives. This implies that mutual funds regulations can impose wide investment limitations as the fund managers have a wide range of choices that suit the investment objectives and policies of the mutual fund. On the other hand, the financial market in Syria is relatively small and the available financial instruments are not numerous. Hence, the amendment should consider two key points: the first one is the available financial instruments in the Syrian financial market, and the second point is that the new rules should not place a heavy burden on the mutual funds managers when they make the investment decisions. Here, it is advisable that mutual funds regulations permit mutual funds managers to invest in offshore securities and funds, so the fund managers will have the freedom to invest the fund assets in different types of financial instrument.

5.3.2.2 Restrictions on Mutual Funds' Borrowing Power

The power of mutual funds to borrow money is another important topic that mutual funds regulations should regulate to ensure investor protection and prevent the mutual fund manager from misusing this authority.[667] Unlike the mutual funds regulations in the UK and the USA, the SMFA 2011 does not include any rule that regulates the ability of the fund manager to borrow money. Since mutual funds take the corporate form in Syria, Article 110 of the SMFA 2011 provides that the rules and provisions of the Syrian Company Act 2011 apply to the issues that are not regulated under this Act.[668] The Company Act 2011 entitles corporations to borrow

[667] For further information, see 3.3.2.2 (Restrictions on the Investment and Borrowing Powers) 83.
[668] Mutual Funds Act 2011, article 110.

money by issuing bonds.[669] The corporation should pay the bond-holders fixed interest at agreed times.[670] Further, the corporations can borrow an amount of money that equals their total assets.[671] To protect their interests, the bond-holders are entitled to constitute a committee that can attend the corporation meetings.[672]

It is obvious that the Company Act 2011 provisions contradict the nature of the mutual funds schemes because in the mutual funds industry, even the funds investors cannot intervene or participate in the fund management. Therefore, the mutual funds regulations should clearly specify the provisions under which the mutual funds can borrow money, considering the following two principles.

Two essential principles govern the mutual funds' ability to borrow money under the mutual funds regulations in the UK. The first principle is that the mutual fund manager must ensure that any borrowing is on a temporary basis. This means that the fund manager must have regard for the duration of any period of borrowing.[673] The mutual fund manager must ensure that no period of borrowing exceeds three months.[674] Since the main aim of the borrowing authority is to meet temporary liquidity needs, the borrowing must not be over a long period of time. The second principle is that the borrowing power should be limited. The mutual fund manager must ensure that the fund's borrowing does not, on any day, exceed 10% of the value of the fund property.[675] It is important to know that under the provisions of the COLL Sourcebook, the trustee may only borrow money from eligible institutions or approved banks.[676] These principles comply with the nature of mutual funds schemes. They also provide mutual funds investors with a high level of protection. Thus, it is advisable that the SMFA 2011 should be amended to reflect these two principles. The SMFA 2011 should also stipulate that mutual funds can only borrow money from trustworthy institutions such as approved banks and eligible institutions.

[669] Company Act 2011, article 121.
[670] Ibid, article 122.
[671] Ibid, article 123 (1).
[672] Ibid, article 131.
[673] Collective Investment Schemes Sourcebook 2014, coll 5.5.4 (4) (a).
[674] Ibid, coll 5.5.4 (4).
[675] Ibid, coll 5.5.5 (1).
[676] Ibid, coll 5.5.4 (3).

5.3.3 Suspension of Redemption: a Valuable Investor Protection Tool

Mutual funds are principally different from ordinary corporations owing to the right of redemption. The right of redemption is one of the fundamental principles of mutual funds where the fund investors can redeem their shares or units on a daily basis.[677] Therefore, investors prefer to invest their savings in mutual funds because they can get their money back when they need it. In fact, the right of redemption is not only a financial right, but is also essential to mutual fund governance. Mutual funds investors could impose responsibility on the fund managers for failing to fulfil fair investment returns.

In addition, redemption on the investors' demands is a crucial element of investor protection and should not, therefore, be suspended unless the mutual fund faces extraordinary circumstances.[678] In order to protect the mutual fund investors, mutual funds regulations should clearly regulate the process of suspension. In the UK, the mutual funds regulations regulate the suspension process comprehensively. The regulations recognise three stages in the process of suspension.[679] The first stage includes making the decision to suspend and identifying who is responsible for making it. The second stage defines the procedures that the fund manager must follow during the suspension. The last stage involves ceasing the suspension and resuming dealing of the fund. Regulating every stage is very important to protect the interests of the investors and ignoring any of the stages would threaten the interests of the investors or might lead to misuse of this authority.

In Syria, the SMFA 2011 allows mutual funds to suspend redemption in exceptional circumstances and according to the articles of association and the prospectus.[680] The mutual fund manager, unlike the UK, is required to obtain the Syrian Commission on Financial Markets and Securities' (SCFMS) pre-approval to be able to suspend the redemptions. Further, the Act specifies the exceptional circumstances where the fund manager can suspend the redemptions; (1) the extraordinary requests of redemption where the mutual funds will not be able to respond to all these requests; (2) where the assets of the mutual funds cannot be liquidated due to unforeseen circumstances;

[677] The Investment Management Association, (n 342).
[678] For further information, see 3.6 (Suspension of Redemptions and Winding up Mutual Funds) 111.
[679] For further information about the three stages in the process of suspension in the UK, see 3.6 (Suspension of Redemptions and Winding up Mutual Funds.) 111.
[680] Mutual Funds Act 2011, article 83 (2).

(3) where there is a decline in the value of the securities comprising the portfolio of the fund as a result of the unexpected decline in the prices of these securities, leading to a significant decline in the value of the fund's assets; and (4) the case of force majeure.[681] These rules are the only rules that cover the suspension of redemption process. It is obvious that these rules address only the first stage of the suspension process. The SMFA 2011 completely ignores the second and third stages. That means that the interests of investors are not protected. Even the first stage is not adequately regulated. The SMFA 2011 does not indicate the duty of the fund manager to inform the investors of the decision of the suspension. As a result, the SMFA 2011 should be amended to provide the investor with sufficient protection during the three stages of suspension of redemption. The following discussion will shed light on the possible rules that can be learned from the current mutual funds regulations in the UK in the second and third stages of the suspension of redemption process.

1- During the suspension of redemption. Every time a mutual fund suspends its redemption, the mutual funds investors must be kept appropriately informed about the suspension including, if known, its likely duration.[682] Thus, the mutual fund manager must publish sufficient details either on the fund website or by other general means. Further, during the suspension, none of the obligations with respect to the fund's dealing should apply.[683] Here, it is the fund manager's duty to inform any person who requests a redemption or sale of units/shares during the suspension period that all dealings have been suspended, so the investors can choose either to withdraw their requests or to have their requests executed at the first possible chance after the lifting of the suspension.[684]

Moreover, due to the temporary nature of suspension of redemption, the mutual fund manager should regularly review the suspension and inform the competent authority and the investors of the results of the review, so that the competent authority, if necessary, might intervene to protect the interests of the investors.[685] In the UK, under the COLL Sourcebook, the fund manager is required to formally review the

[681] Ibid.
[682] Collective Investment Schemes Sourcebook 2014, coll 2.7.1 (2B) (a).
[683] Ibid, coll 2.7.1 (3) (a).
[684] Ibid, coll 7.2.1 (3) (b).
[685] Ibid, coll 7.2.1 (4A).

suspension at least every 28 days and inform the FCA of the outcomes of this review and any change to the information provided previously.[686]

2- Resumption of redemption. The suspension of redemption is a temporary tool. Thus, the suspension of dealings in units must be lifted as soon as practicable after the exceptional circumstances have ceased, having regard for the interests of the fund investors. In the UK, the fund manager in this stage has two obligations. The fund manager must inform the FCA of the proposed restart of dealings in the fund units.[687] The manager must also send the FCA a notice that confirms resumption of dealings in the fund.[688] The fund investors should also be informed about the resumption of redemption.[689] Further, the common procedures among the three stages are that the competent authority and the mutual funds investors must be informed of any new circumstances, decisions or changes.

It is worth mentioning that in March 2009, Arch Cru investment funds (a UK mutual fund) were suspended due to liquidity problems. The Financial Services Compensation Scheme (FSCS) has paid over £58m compensation to CF Arch Cru claims since 2012.[690] The FSCS paid customers on an interim basis.[691] It is necessary to know that the FSCS is independent of the government and the financial industry. It was set up under the Financial Services and Markets Act 2000.[692] The FSCS is funded by levies on firms authorised by the Prudential Regulation Authority and the Financial Conduct Authority. The FSCS levy is split into eight broad classes.[693] Each firm's contribution to the FSCS is calculated on the tariff base applicable to the relevant class and each firm contributes proportionally. A threshold for each of these classes is set by the Prudential Regulation Authority and Financial Conduct Authority by reference to what a specific class can be expected to afford in a year.[694]

---

[686] Ibid.
[687] Ibid, coll 7.2.1 (2) (a).
[688] Ibid, coll 7.2.1 (2) (b).
[689] Ibid, coll 7.2.1 (5).
[690] For further information, see http://www.fscs.org.uk/news/2016/february/update-for-cf-arch-cru-customers-compensated-via-interim-payment-method/ accessed 15 February 2016.
[691] The Financial Services Compensation Scheme (FSCS) is the UK's statutory compensation scheme for customers of authorised financial services firms. The FSCS pays compensation if a firm is unable, or likely to be unable, to pay claims against it. This is usually because it has stopped trading or has been declared to be in default.
[692] Financial Services and Markets Act 2000 s.213.
[693] For further information see, http://www.fscs.org.uk/industry/funding/ accessed 29 March 2016.
[694] Ibid.

Further, the threshold determines the maximum that the FSCS can levy for compensation in any one year. The model operates on the basis that a class will meet the compensation claims from defaults in that class up to the threshold. For instance, the maximum level of compensation for claims against firms declared to be in default on or after 1 January 2010 is £50,000 per person per firm, while the maximum level of compensation for credit union claims is £75,000 per person per firm (for claims against firms declared to be in default from 3 July 2015).[695]

It is clear that the Financial Services Compensation Scheme provides investors, and especially small investors, with additional protection in cases where mutual funds face exceptional circumstances such as suspension of redemption. It also forces mutual funds to be careful in their operations to avoid paying high contributions. As a result, it is advisable that Middle Eastern countries should encourage the establishment of compensation schemes similar to the FSCS scheme in the UK, as that will make investors more confident to invest in the mutual funds industry.

Suspension of redemption is a significant regulatory tool that the mutual funds managers should use when it is in the collective interests of the fund investors to do so. This tool should only be used in exceptional circumstances.[696] During the life of the mutual fund, the fund manager could find itself obliged to suspend the fund's redemption. Even when the fund manager applies good liquidity management procedures, it might not be possible to avoid suspension due to exceptional circumstances such as the terrorist attacks in the USA in 2001. In a country such as Syria, where the mutual funds industry is still new, the fund managers do not have enough experience in situations such as the suspension of redemption. Therefore, the mutual funds regulations should regulate the entire process of suspension of redemption in order to keep the interests of the investors protected.

5.3.4 Valuation and Pricing

Valuation of mutual funds' assets and pricing of the schemes' shares or units are critical to the operation of the mutual funds. Given the importance of the valuation and pricing process, mutual funds in many countries such as the United Kingdom

[695] For further information, see http://www.fscs.org.uk/what-we-cover/compensation-limits/ accessed 29 March 2016.
[696] See 3.5.1.1 (Potential Reasons for Suspensions of Redemptions) 112.

and the USA provide detailed rules for mutual funds asset valuation and unit pricing.[697] In order to encourage investors to invest their funds in mutual funds, the investors must have confidence that the mechanism in which the investments owned by the funds are valued and priced is fair. Thus, mutual funds regulations should seek to ensure that all of the property of a mutual fund is fairly and accurately valued and that the net asset value (NAV) of the fund is correctly calculated. Under those UK and US regulations, mutual funds must have detailed policies and procedures designed to ensure that mutual fund assets are accurately valued and that the funds' NAV accurately reflects the funds' net asset value per share or unit.[698] The NAV represents a fund's per share/unit market value. However, as will be discussed later, the fund manager might use a fair valuation method to value the fund assets. Therefore, mutual funds managers should pay due regard when constructing and regulating valuation and pricing policies to ensure that the pricing and valuation are carried out correctly and that those investors are well protected. In the UK, a mutual fund must have at least two regular valuation points in any given month, but these two valuation points must be at least two weeks apart.[699] Nonetheless, in money market funds, the fund manager should make a valuation point every business day.

In Syria, the fund manager is responsible for valuing the fund property and for calculating the price of a share in the fund. The fund manager fund must have at least one regular valuation point each week.[700] The instrument constituting the mutual fund must contain information about its regular valuation points.[701] Further, the fund manager must ensure that the price of a share is calculated by reference to the net value of the scheme property and in accordance with the provisions of the instrument constituting the fund.[702] The per share net asset value of a mutual fund is the aggregate value of the fund assets minus the aggregate liabilities of the fund divided by the number of shares outstanding.[703] The fund manager must use the forward pricing mechanism to redeem or sell shares.[704] In a forward pricing mechanism, a mutual fund typically sets the price of its shares according to the net asset value of

[697] For further information, see 3.4 (The Valuation and Pricing Regulations) 102.
[698] Kiymaz, Baker and Filbeck, (n 27) 79.
[699] Collective Investment Schemes Sourcebook 2014, coll 6.3.4.
[700] Mutual Funds Act 2011, article 84.
[701] Ibid, article 8.
[702] Ibid, article 76.
[703] Mayo, (n 355) 337.
[704] Mutual Funds Act 2011, article 82.

the shares following the receipt of an order to redeem or sell the shares. The above rules are the only rules that regulate the valuation and pricing under the SMFA 2011. Nonetheless, the SMFA 2011 does not include any rule that addresses two key valuation and pricing principles, namely the fair value valuation method and supervision and review of the fund manager's valuation policies and procedures. In situations where market quotations are not readily available (for example market closings), fund managers are responsible for determining the fair value of the fund portfolio securities. These two principles are essential to protect the rights of the investors to redeem or buy the fund shares or units fairly and accurately. The following discussion will shed light on these two principles in order to improve the valuation rules under the SMFA 2011.

1- Fair value valuation. Mutual funds regulations must ensure that mutual funds assets are valued fairly and accurately in all circumstances.[705] Where the price of a security in the fund portfolio is not acceptable, the fund manager should apply fair value valuation to provide investors with proper protection because the price of that security will affect the fund NAV. The mutual funds regulations in the UK provide the fund managers with a clear guide on how and when to apply the fair value valuation method.[706] In circumstances where a security price is not reliable at a valuation point or the most recent price available does not reflect the mutual fund manager's best estimation of the value of a security, the fund manager, if it has reasonable grounds, should value a security at a price that reflects a fair and reasonable price for that security.[707] The regulations go further and indicate two circumstances where the fund manager might use the fair value valuation: (1) where there has been no recent trade in the investment concerned; or (2) the occurrence of a significant event since the most recent closure of the market where the price of the investment is taken.[708]

Even though the mutual funds regulations give the fund manager discretion to use the fair value valuation method where there is a necessity, they indicate certain factors

[705] Robertson, (n 455) 9-38.
[706] Collective Investment Schemes Sourcebook 2014, coll 6.3.6 (5).
[707] Ibid.
[708] Ibid, coll 6.3.6.1 (6). The Coll Sourcebook defines the significant event as "one that means the most recent price of a security or a basket of securities is materially different to the price that it is reasonably believed would exist at the valuation point had the relevant market been open".

that should be considered when determining to use this method.[709] The fund manager should consider the type of mutual fund concerned, the securities involved, the grounds and reliability of the alternative price used, and the policy of the valuation of fund property as disclosed in the prospectus.[710] It is worth mentioning that the regulations require the fund manager to document the basis of valuation, including any fair value pricing policy.

The regulations discussed above show the significance of regulating the fair valuation method; otherwise the interests of the mutual funds investors will not be well protected. Despite the fact that the mutual funds industry is developed in the UK and the fund managers have good experience and practices in this regard to deal with difficult and exceptional situations, the regulations clearly describe the essential rules that the fund manager should apply to value the fund assets fairly. This implies that it is not only important to give the fund manager the authority to use the fair valuation method, but it is also important to specify the circumstances and situations that enable the fund manager to use this method. Granting the fund manager this authority to use it without restrictions would result in its misuse and that would leave the fund investors vulnerable because the fund manager might use this method as a means to obtain certain benefits. Here, it is important to emphasise the role of the supervisory entity in the fund to supervise the fund manager's usage of this method to ensure that it is in the interests of the fund investors. Therefore, in order to protect the mutual funds investors through valuing the fund's assets fairly and accurately, the Syrian Mutual Funds Act 2011 should regulate the fair value valuation. The SMFA 2011 should impose a duty upon the fund manager to apply the fair value valuation where it is difficult to calculate the market value of the assets or where the market value is not reliable. Further, since the mutual funds industry in Syria is still new, it is advisable to define explicitly the factors the fund's managers should consider when determining whether to apply this method. It is also significant to specify the circumstances where the fund manager should apply this method. Nonetheless, the mutual funds managers should be given discretion to ensure that a high level of protection is provided to the investors in the valuation process.

[709] Ibid, coll 6.3.6.1 (7).
[710] Ibid.

2- Supervision and review of the fund manager's valuation systems. Another important principle that should be regulated by the mutual funds regulations is the supervision and review of the fund manager's valuation systems. This principle is essential to ensure that the fund manager complies with valuation regulations and the fund policies and procedures contained in the fund prospectus and the instrument constituting the fund. In the UK, the mutual funds regulations provide details of the kinds of checks a depositary should carry out to be satisfied that the mutual fund manager has adopted systems and controls that are appropriate to ensure that the prices of units are calculated in accordance with the fund regulations, and to ensure that the probability of incorrect prices is minimised. The depositary should perform the review when it is appointed.[711] However, subsequently, the law gives the depositary discretion to carry out a review where it realises or suspects that the fund manager's systems and controls are weak or are otherwise unsatisfactory.[712] Once the depositary has performed the review and identified certain improper issues, it must ensure that those issues are followed up on and resolved. Obviously, the depositary's review of the fund manager's compliance with the valuation rules is a keystone in the overall valuation process. Thus, the SMFA 2011 should provide detailed rules on the review of valuation to ensure that prices of shares are calculated correctly according to the regulations and the instrument constituting the fund.

5.4 Strengthening the Mutual Funds Governance Tools under the Syrian Mutual Funds Act 2011

This section examines the mutual funds governance tools under the SMFA 2011 and the degree of protection provided to the mutual funds investors by those tools. It also discusses the methods that might enhance those governance tools. The key tools that will be addressed in this section are mutual fund authorisation, conflicts of interest, disclosure and the concept of independence between that mutual fund manager and the fund's supervisory entity.

5.4.1 Mutual Funds Authorisation: the Starting Point of Investor Protection

Mutual funds are pooled investment vehicles that generally offer shares or units to the public on a continuous basis. The investors are able to ask the fund to redeem

[711] Collective Investment Schemes Sourcebook 2014, coll 6.3.6. 3 (3).
[712] Ibid, coll 6.3.6. 3 (4).

those shares/units at NAV. In order to pool their assets, mutual funds generally invite the public to participate in the fund. As with other financial institutions, only authorised persons can invite the public to invest their savings in the fund. In fact, a huge number of investors usually participate in the mutual funds, and a vast majority of them are small investors.[713] Therefore, restricting the ability to induce the public to invest their funds in the mutual funds to authorised persons is essential to protect those investors from any misleading or incorrect information that might be used to attract them to invest in a mutual fund.[714]

Authorisation of mutual funds can be considered as the first step in investor protection. Therefore, mutual funds regulations should carefully regulate the authorisation process. In Syria, Articles 3 and 4 of the SMFA 2011 provide the provisions of the authorisation process. Principally, the SMFA 2011 does not provide the Syrian Commission on Financial Markets and Securities with sufficient power to protect the prospective investors. Article 3 provides that the application for the authorisation of a mutual fund shall be made to the SCFMS by the fund promoters.[715] The application must be accompanied by the fund's constitution, the name of the fund manager, a notice from a bank that confirms the fund's promoters have deposited their contributions, the fund's promoters' personal details and any documents ordered by the SCFMS.[716] Providing the promoters and the manager's personal details is crucial to make sure that they are fit proper persons. In other words, the SCFMS must ensure that the promoters and the manager are financially competent, sound, reliable and reputable. It must also ensure that they have sufficient knowledge and expertise that fit the nature and scope of the investment fund proposed. Though the SMFA 2011 permits the SCFMS to ask the funds promoters to provide any relevant documents, it can only do so before submitting the application.[717] This is to say that the SCFMS cannot ask the fund's promoters to provide it with any document after receiving the application and before determining whether or not to accept the application.

[713] See, European Commission (n 3).
[714] For further information, see 3.3.2.1 (Authorised and unauthorised Unit Trusts) 79.
[715] Mutual Funds Act 2011, article 3.
[716] Ibid.
[717] Ibid.

The main consequence of this is that in case of the lack of any significant information, the SCFMS might reject the application. Rejecting the application prevents the applicant from re-submitting it again for three months according to Article 4 (2). There is no doubt that this rule has negative effects on the applicants because re-submitting the application after three months is too time consuming and costly. The main reason for this problem is that the SMFA 2011 does not grant the SCFMS the authority to make rules that clarify different aspects of the Act in detail. This authority would facilitate the work of the SCFMS (the importance of granting the SCFMS the authority to make rules will be discussed in the external supervision section).

In the UK, section 242(4) of the Financial Services and Markets Act (FSMA) 2000 entitles the FCA at any time after receiving the application and before determining it to ask the applicants to provide it with further information that it considers necessary to make the decision and grant the authorisation order.[718] Further, the FCA might give different directions and impose different requirements in relation to different applications. Therefore, it is advisable for the SCFMS to be granted the same authority. Giving the SCFMS this authority has two key advantages. First, it could help applicants to save time and money because, as was mentioned above, refusing the application means the applicant must resubmit it again after three months. Secondly, this authority also protects the prospective investors because the SCFMS will be able to ask the applicants to provide additional information to ensure that all documents provided are correct.

In addition, another important issue is the false or misleading information and documents provided by the fund promoters to the SCFMS which might be a reason for potential liability. The SMFA 2011 does not say anything about providing false or misleading information. To protect the prospective investors, the SMFA 2011 must consider providing false or misleading information an offence and impose strict punishments on the applicants. In the UK, Regulation 12 (5) of the Open Ended Investment Companies Regulations (OEICs) 2001 states that a person has committed an offence if for the purposes of or in connection with any application under the OEICs regulations he provides information that he knows to be false or misleading or

[718] Financial Services and Markets Act 2000, s.242 (2).

recklessly provides information that is misleading or false.[719] The consequences of breaching these regulations are that the person is liable (1) on conviction, to imprisonment for a period not exceeding two years or to a fine or to both; (2) on summary conviction, to imprisonment for a period not exceeding three months or to a fine not exceeding the statutory maximum or to both.[720] Obviously, this liability means the applicants are very careful when they furnish any information to the competent authority. Hence, it is advisable that the SMFA 2011 creates similar provisions to those included in the OEICs regulations.

Further, if the SCFMS is satisfied that the scheme complies with the requirements set out in the SMFA 2011, it may make an order declaring the scheme to be an authorised fund. However, this order should be ratified by the Prime Minster within 45 days. This procedure is not justified because that would discourage investors from establishing mutual funds. Here, it is worth mentioning that raising money in a given country should be in line with national policy and national interests. In fact, each country has a right to define what is necessary to protect its national policy and national interests. Countries usually use assessment techniques that reflect the country's circumstances, resources and institutions to protect the national policy and national interests.

5.4.1.1 Revocation of the Authorisation Order

The SMFA 2011 should give the SCFMS the authority to ensure that the authorisation requirements are still satisfied during the life of the fund. This can be achieved by granting the SCFMS the authority to revoke the authorisation. The SMFA 2011 does not provide the SCFMS with such authority to protect the investors at any time. In the UK, Section 254 (1) entitles the FCA to revoke the authorisation order by another order in certain circumstances.[721] The FCA may revoke the authorisation order if one of the requirements for the making of the order is no longer satisfied,[722] for instance, if the fund manager and the trustee are no longer independent of each other. The FCA may also revoke the authorisation order if the manager or the trustee of the scheme has knowingly or recklessly given the FCA

[719] Open Ended Investment Company Regulations 2001, reg. 12 (5).
[720] Ibid, reg. 12 (6).
[721] J Fisher, *The Law of Investor Protection* (2nd edn Sweet & Maxwell, London 2003) 145.
[722] Financial Services and Markets Act 2000, s.254 (1) (a).

information which is false or misleading.[723] The authorisation order might also be revoked if the manager or trustee of the fund concerned has contravened a requirement imposed on him by or under the 2000 Act.[724]

The authority to revoke the authorisation order is an effective means to protect investors because the mutual fund manager and the trustee will make sure that their activities comply with the mutual funds regulatory requirements to avoid revoking the authorisation order and in some cases the personal liability. Thus, the SMFA 2011 should give the SCFMS this authority to protect the investors and the industry. Again, giving the SCFMS the authority to make rules that regulate all mutual funds aspects might be the best solution to establish detailed mutual funds regulations.

The above discussion demonstrates the importance of the authorisation process to protect the current and prospective mutual funds investors. Two key points should be considered when regulating the authorisation process. The first point is that the authorisation regulations should not be inflexible, too costly and too time consuming because in some countries where the mutual funds industry is still under development, the most significant aim is to encourage and attract investors to invest in this industry and not to discourage them by the imposition of costly and complicated rules. The second point is that the first point should not compromise the protection of investors. That is to say, the regulations should protect the interests of the investors during the authorisation process and after granting of the authorisation order.

5.4.2 Conflicts of Interest: the Key Challenge of a Mutual Funds Governance System

Unlike ordinary corporations and banks, mutual funds have a unique management structure where mutual funds investors collectively pool their funds to be managed by external management.[725] This implies that mutual funds do not have employees; rather they are managed by external service providers. By contrast, in ordinary corporations, the decision-making authority and supervision of all aspects of a company's business rests directly with the board of directors.[726] The mutual fund

[723] Ibid, s.254 (1) (c).
[724] Ibid, s.254 (1) (b).
[725] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 43
[726] Roiter, 'Disentangling Mutual Fund Governance from Corporate Governance' (n 460).

investors' ownership of a fund is separate from the fund manager's management and monitoring of that mutual fund. Thus, the possibility exists for the interests of the investors and the interests of the fund manager to diverge. This gives rise to a possible conflict of interest between the self-interests of the management and the interests of the investors. While the fund manager is under a duty to make proper investment decisions in order to maximise the fund returns and minimise risks, it also seeks at the same time to maximise its fees or profits.[727] Therefore, in order to protect the interests of the mutual funds investors, mutual funds regulations should contain detailed rules that aim to minimise the negative impact of any potential conflicts of interest between the fund investors and the manager.

The regulatory responses to the potential conflict of interest are the core of the mutual funds governance system. Adopting appropriate regulatory mechanisms to address possible conflicts of interest increases investors' confidence in the mutual funds industry. It also protects the mutual funds industry from any scandal or crisis that might destroy the trust of the investors in this industry. The biggest challenge to the regulatory response to the potential conflicts of interest is that there is a broad range of transactions that are likely to produce some forms of conflict of interest.[728] For instance, the mutual fund manager might buy securities from an affiliated party at an inappropriate price that is higher than the real market value.[729] Therefore, the regulatory mechanisms that should be used to address potential conflicts of interest should consider this fact in order to provide investors with a high level of protection. This can be seen in the mutual funds regulations in the UK. The mutual funds regulations use varied regulatory tools to address conflicts of interest.[730] In brief, in the UK, the main regulatory tools to address conflicts of interest are: (1) the duty of the fund manager to act in the best interests of the fund investors (fiduciary duty);[731] (2) prohibition of certain transactions involving the fund directors;[732] (3) clear and detailed disclosure; and (4) oversight of the depositary to the mutual funds manager's

[727] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 43.
[728] P Lückoff, (n 206) 78.
[729] For more information, see 4.4.1 (Potential Types of Conflicts of Interests in the Mutual Funds Schemes) 148.
[730] For further information, see 4.4.2 (Possible Regulatory Methods to Addressing Conflicts of Interests in the Mutual Funds Industry) 150.
[731] Open Ended Investment Company Regulations 2001, reg. 35 (2).
[732] Ibid, reg. 44.

activities.[733] The mutual funds manager must be able to demonstrate that appropriate procedures and safeguards against conflicts of interest have been adopted to protect the interests of the investors.[734] Further, regulation (44) of the OEICs Regulations 2001 prohibits certain transactions involving directors.[735] The UK mutual fund regulations also use disclosure to monitor the fund's activities, which could give rise to conflicts of interest.[736]

In Syria, although the SMFA 2011 addresses the potential conflicts of interest, the rules are not sufficient. They do not provide investors with appropriate protection in case the mutual funds manager's interests conflicts with the investors' interests. Article 74 of the SMFA 2011 Act provides that the mutual funds manager must avoid any conflict of interest.[737] The mutual fund manager must not exercise any activity that involves conflicts between its interests and those of the funds or between the interests of the fund and any other fund it manages. Further, if any activity exercised by the fund manager involves conflicts of interest, the fund manager must immediately inform the board of directors in order to obtain its approval. The SMFA 2011 does not mention the consequences of breaching the duty to avoid conflicts of interest. In other words, if a mutual fund manager enters into a transaction, that is not in the interests of the fund, in order to obtain a commission from a third party, what is the legal position of this transaction?

The OEICs regulations in the UK provide a clear answer to this legal issue. Regulation 44 provides that such a transaction is voidable at the instance of the fund.[738] Further, in order to ensure that the interests of the fund's investors are well protected, the regulations go further and indicate that any director of the fund who has authorised the transaction, whether or not the transaction is voided, is liable to

---

[733] Collective Investment Schemes Sourcebook 2014, coll 6.6. 17.

[734] Ibid, coll 6.11.2 (3). For further information about the fund manager's fiduciary duty, see 4.4.2 (Possible Regulatory Methods to Addressing Conflicts of Interests in the Mutual Funds Industry) 150, (1) The general obligation imposed upon the mutual fund management to act in the best interests of the fund investors.

[735] Open Ended Investment Company Regulations 2001, reg. 44. For further information about the direct prohibitions on certain types of transactions, see 4.4.2 (Possible Regulatory Methods to Addressing Conflicts of Interests in the Mutual Funds Industry) 150, (2) Direct prohibitions on certain types of transaction.

[736] See 4.4.2 (Possible Regulatory Methods to Address Conflicts of Interest in the Mutual Funds Industry) 150, (3) Disclosure of information with respect to potential conflicts of interest.

[737] Mutual Funds Act 2011, article 74.

[738] Open Ended Investment Company Regulations 2001, reg. 44.

the fund for any profit or gain that he has made directly or indirectly by way of that transaction.[739] The fund director, therefore, must indemnify the fund for any loss or damage resulting from that transaction. Nonetheless, the transaction ceases to be voidable in specific situations. The transaction ceases to be voidable if (1) it is not possible to obtain restitution for any money or other asset that was the subject-matter of the transaction; (2) an indemnity is given to the fund for any loss or damage resulting from the transaction; (3) rights that are obtained, bona fide, by a person who is not a party to the transaction might be affected by the voidance; and (4) the transaction is ratified by resolution of the OEIC in a general meeting.[740] These rules clearly specify the right of the mutual funds in case the mutual funds manager misuses its position to make transactions that are not in the interests of the investors. Thus, it is necessary for the Syrian Mutual Funds Act to include similar rules that guarantee the protection of the fund's investors, because the mutual funds managers will be very careful before making any transaction involving conflicts of interest. Here, it is worth mentioning that when a mutual fund enters into a contract with a fund manager, it does so because the fund manager is a professional body. This means that the fund manager should exercise the duty of care and due diligence when performing its duties to manage the fund and this implies that the fund manager should not gain any illegal benefit from his job. Failing to exercise this duty might carry a potential liability under the general principles of law. Even though the mutual fund regulation does not directly mention the remedies of failing to exercise this duty, the general remedies under general law principles are still applied.

In addition, it is important to know that the previous conflict of interest rules apply not only on the transactions that involve the directors, but also to the transactions involving any director's associate. This implies that the protection of the investor will be broader to include a wide spectrum of the transactions. An associate means someone who is:

> *"in relation to any person who is a director of the company, means that person's spouse, child or stepchild (if under 18), employee, partner or anybody corporate of which that person is a director; and if that person is a body corporate, any*

[739] Ibid, reg. 44 (3).
[740] Ibid, reg. 44.

subsidiary undertaking or director of that body corporate (including any director or employee of such subsidiary undertaking)".[741]

Hence, it is recommended that the SMFA 2011 broaden its protection to include the transactions involving the fund manager's associates.

Furthermore, the SMFA 2011 does not contain any rule with respect to disclosure of information related to conflicts of interest to the mutual fund investors or to the authority. Disclosure is considered a significant tool that keeps the mutual funds investors informed of any potential conflicts of interest, so the fund manager might obtain the informed consent of the fund investors to transactions that could potentially raise conflicts of interest. In the UK, the mutual funds manager must adopt appropriate safeguards against conflicts of interest.[742] The simplified prospectus should point to the full prospectus for detailed information on these kinds of safeguards and how possible conflicts of interest will be resolved in their best interest.[743] Hence, it is necessary for the SMFA 2011 to adopt this tool to increase the investors' protection, because using different regulatory mechanisms to address conflicts of interest is essential in responding to the complex nature of conflicts of interest. However, it important to mention that although the SMFA 2011 does not explicitly impose any duty upon the fund manager to disclose potential conflicts of interest, it is in the interest of the fund manager to disclose any potential conflicts of interest with the fund to avoid any potential liability under general law principles.

5.4.3 Disclosure

Since mutual funds offer their shares or units to the public, the disclosure level should be sufficient to protect the interests of the fund investors. Even though mutual funds investors do not intervene in the management of the funds, this does not mean that they should not have access to fund information in order to monitor the performance of the management and protect their interests. Therefore, the mutual funds investors should, on an ongoing and regular basis, be informed of all relevant information. In fact, proper and timely issuance of information also play an

[741] Ibid, reg. 44 (8) (a).
[742] Collective Investment Schemes Sourcebook 2014, coll 6.11.2 (3) (a).
[743] Ibid, coll 4.6.8 (14) (a) (vi) 4.

important role in ensuring market efficiency and discipline. The mutual funds regulations must ensure that regular and accurate information is available to the fund investors so they can make their informed investment decisions.[744] All investors, whether sophisticated or small investors, should have access to specific key facts regarding the fund's investment and management prior to investing in the fund. They should also have appropriate information when they become the fund investors. Disclosure is considered an essential investor protection tool because it enhances the ability of investors to undertake independent examination.[745]

In the UK, as was discussed previously, the mutual funds regulations require full disclosure of information relating to the funds such as the investment objectives, fees, commission, characteristics of the units/shares, accounting reports, expenses risks, the fund service providers and performance of the funds.[746] The full prospectus, simplified prospectus and financial reports are the key documents that must be made available to the public and the fund investors. The mutual funds managers must be aware of their legal responsibilities for ensuring the topicality, reliability, and comprehensibility of the information included in the prospectus and the fund reports.

In Syria, as with mutual funds regulations in many countries, the prospectus is the key disclosure tool under the SMFA 2011. The SMFA 2011 requires the fund manager to include in the prospectus all material information that would assist an investor in making an informed decision.[747] For instance, the prospectus must contain the name of the fund, the type of fund, the net asset value, the name of the fund service providers, the method of valuation, the risk and the fund objectives.[748] Nonetheless, the SMFA 2011 does not specify the details that must be disclosed in the prospectus relating to activities of the fund. Rather, it gives the mutual fund manager discretion to adopt a mechanism to disclose the details provided and it must disclose that mechanism in the prospectus.[749] In other words, the SMFA 2011, for instance, requires the fund manager to disclose in the prospectus the investment

[744] Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 324.
[745] Romanski, (n 116).
[746] For further information, see 4.5 (Disclosure as a Regulatory Tool in Mutual Funds Governance) 158.
[747] Mutual Funds Act 2011, article 7.
[748] Ibid.
[749] Ibid.

objectives, but it does not specify the information that must be disclosed regarding the investment objectives. By contrast, the mutual funds manager in the UK must disclose specific information regarding the investment objectives, such as (1) the investment policy for achieving those investment objectives; (2) a reference to any limitations on that investment policy and (3) the description of assets of which the fund portfolio may consist.[750] The aim of including particular information in the prospectus is to help investors compare between mutual funds in order to make their investment decision. Therefore, it is necessary to specify the information that all mutual funds managers must disclose to achieve the aim of the prospectus. Otherwise, the mutual funds manager might disclose different information which may be insufficient or inappropriate. It is important to know that the mutual funds industry is still new in Syria, so there are no developed practices in the market with regard to disclosure, and thus it is essential to define all key information that the mutual funds managers must disclose.

Moreover, the SMFA Act 2011 does not impose any duty upon the mutual funds manager to issue a simplified prospectus. Generally, mutual funds regulations, in many countries such as the UK and the USA, impose a duty upon mutual funds to issue a simplified prospectus with the full prospectus in order to help investors make their investment decision.[751] Indeed, the full prospectus usually contains technical information which is very hard to read and understand for retail investors. Since most of the mutual funds investors are not sophisticated investors and do not have knowledge of the investment terms and technical issues, they should be provided with the simplified prospectus. This prospectus should contain only the essential information and be easy to read and understand for all investors. Here, it is important to emphasise that the simplified prospectus does not substitute the full prospectus. Rather, it helps the investors to understand the full prospectus. In the UK, the mutual funds managers are required to issue a simplified prospectus that does not contain technical information.[752] Thus, in order to help the mutual fund investors to understand the essential information of any fund and make the appropriate investment decisions, the SMFA 2011 should impose an obligation upon the fund

[750] Collective Investment Schemes Sourcebook 2014, coll 4.2.5.
[751] For further information, see 4.5 (Disclosure as a Regulatory Tool in Mutual Funds Governance) 158.
[752] Collective Investment Schemes Sourcebook 2014, coll 4.6.8.

manager to prepare and provide the investors with a simplified prospectus or to make the simplified prospectus available to the investors upon request.

In addition, mutual funds must provide information relating to investment performance on an ongoing basis. Financial reporting is a significant component of a good disclosure system because the regular reports and financial statements reflect the fund's financial position. Mutual funds reports are usually provided to investors at least once per year. However, semi-annual reports are also common in the mutual funds industry. The SMFA 2011 requires the mutual funds managers to issue annual and semi-annual reports to the investors, and these reports must be approved by the fund custodian.[753] The information and statements required to be included in the reports are similar to those required by the FCA Sourcebook in the UK, which reflect the real position of the fund and help the investors make their investment decisions.[754]

It is clear now that timely, appropriate, comprehensive, and accurate information is crucial to help investors make sound investment decisions. Where the information is inaccurate, unreliable, false or late, the investors will lose confidence in the mutual funds and their service providers. In fact, disclosure plays a critical role in ensuring proper accountability of the mutual funds. It is important to mention that the Mutual Funds Act 2011 should allow mutual funds to take advantage of technology and the internet to facilitate the delivery of information to investors. The simplified prospectus, and the annual and semi-annual reports should be available at the fund's website address specified in the full prospectus. Hence, the investors will be able to easily access all relevant information to help them make their decisions.

5.4.4 The Concept of independence: the Cornerstone of Mutual Funds Governance

One of the core mechanisms for investor protection and mitigating conflicts of interest is the oversight of independent entity. As was discussed previously, the concept of independence takes different forms among different mutual funds governance structures.[755] In the USA, where mutual funds take the corporate form

[753] Mutual Funds Act 2011, article 77.
[754] Collective Investment Schemes Sourcebook 2014, coll 4.5.7.
[755] For further information, see 4.3 (Competing Governance Models: Corporate Versus Contractual Model) 128.

with a board of directors, the independence indicates status and percentage of certain directors, known as the independent directors, on the mutual fund's board of directors. The 1940 Act requires that at least forty percent of the mutual fund's board of directors be independent (disinterested) directors.[756]

In the UK, the concept of independence is based on the idea of segregation of duties between the fund manager and the depositary.[757] The fund manager is responsible for operating the daily management and promotion of the mutual fund, while the depositary is responsible for safekeeping the fund's assets and overseeing the fund manager's activities in a number of main areas such as valuation of the fund assets. The aim of this supervision is to ensure that the manager complies with the fund's objectives and policies, and with the requirements of the mutual funds regulations.[758] Further, the independence concept is built on applying the balances and checks rules, with an obvious allocation of the obligations and responsibilities of the manager and the depositary. This implies that there should not be any confusion between the responsibilities of the depositary, which is the oversight entity, and the fund manager. In order to ensure the independence of the main parties of the mutual fund, the manager and the depositary must be persons who are independent of each other.[759]

In order to ensure the effectiveness of the supervisory entity, the mutual funds regulations in the UK emphasise essential rules that specify the relationship between the fund manager and the supervisory entity. The fund manager must not have any possibility to control the supervisory entity's decisions. The supervisory entity should not be involved with any activity of the management of assets because there is an essential incompatibility between performing one function and then overseeing it. Thus, the regulations define specifically the responsibilities of the supervisory and managing entities.[760] Further, the appointment and replacement of the supervisory entity is made in a way that ensures the independence of that entity.[761] These rules

[756] Investment Company Act of 1940, s.10 (a).
[757] Financial Services and Markets Act 2000 s.243 (4).
[758] I MacNeil, *An Introduction to the Law on Financial Investment* (Hart, Oxford and Portland 2005) 116.
[759] Financial Services and Markets Act 2000 s.243 (4).
[760] For further information, see 4.3.2.1 (The Unit Trust Governance Structure) 139.
[761] Ibid.

are necessary to any mutual funds governance system and ignoring any of them would have negative impacts on investor protection.

In Syria, mutual funds are corporate vehicles where each mutual fund must have a board of directors. The mutual fund must have at least three directors[762] but must not exceed seven directors. They must be appointed at the fund's general meeting by the shareholders.[763] The board of directors is responsible for appointing the fund manager and the custodian. In this way the SMFA 2011 ensures that the fund manager and the custodian will perform their duties effectively, because neither of them is responsible for appointing the other entity. In other words, since the appointment of the custodian is carried out by the board of directors, it is unlikely to feel grateful to the manager, so when the interests of the fund manager conflict with those of the shareholders, it would be more willing to challenge the fund manager's recommendations. Further, the board of directors is responsible for approval of the fund prospectus in order to ensure that the fund manager complies with the disclosure rules.[764] The board of directors is also responsible for ensuring that there is no conflict of interest in the mutual fund.[765] The SMFA 2011 grants the board of directors the authority to solve any potential conflict of interest in the fund.[766] It is clear that the mutual funds board of directors plays a different role than in an ordinary corporate board of directors. Specifically, the ordinary corporate board of directors is responsible for the decision-making authority and supervision of all aspects of a company's business,[767] while the mutual fund's board of directors can be considered as the eyes of the shareholders and the SCFMS on the fund manager and the custodian.

In addition, mutual funds must appoint a fund manager, which must be a body corporate.[768] This means that the fund manager must be licensed independently from the mutual fund itself. The main aim of this requirement is to ensure that the fund manager is competent and is able to perform its functions effectively. The Syrian regulatory system imposes high eligibility criteria upon management companies

[762] Mutual Funds Act 2011, article 43.
[763] Ibid.
[764] Ibid, article 51.
[765] Ibid.
[766] Ibid.
[767] Roiter, 'Disentangling Mutual Fund Governance from Corporate Governance' (n 460).
[768] Mutual Funds Act 2011, article 90.

wishing to be a licensed entity, such as capital adequacy, the integrity of the directors and financial resources. If the fund management company has met all those requirements, the interests of the fund shareholders will initially be protected. The fund manager should manage the mutual fund in accordance with the fund's constitution and its most recent prospectus and is responsible for preparation of the fund's prospectus,[769] the fund's reports and its financial statements. Further, the fund manager must value the fund assets and calculate the net asset value of the shares.[770] The duties of the fund manager are similar to their counterparts in the UK and the USA.

It is worth mentioning that the SMFA 2011 does not mention the ability of the fund manager to delegate its functions to a third party. Although the delegation of functions rules under general principles of law might apply to the delegation of functions of the mutual fund manager, some of these rules might not be suitable for mutual funds due to the unique nature of their structure. Investors might decide to invest in a specific fund because a particular manager is managing this fund which has the expertise, financial resources and competent staff that would guarantee the success of this fund. Thus, it is desirable to have specific delegation rules in the mutual fund regulation.

Further, in order to improve the services provided to the shareholders, the fund manager might delegate some functions to a third party which may be able to perform those functions in a manner considered suitable for the financial markets' development. In fact, the remarkable growth of the financial markets requires the fund managers to obtain specialised management in sectors that the managers do not possess themselves. Thus, the mutual funds regulations should not ignore this practice to protect the interests of the fund shareholders because delegation of functions may contradict the rules of shareholders' protection. In the UK, the mutual fund manager is entitled to delegate any function without restriction.[771] However, the fund manager cannot delegate any function to the depositary due to the independence concept between the fund manager and the depositary.[772] It is important to know that

[769] Ibid, article 91.
[770] Ibid.
[771] Collective Investment Schemes Sourcebook 2014, coll 6.3.1 (2).
[772] For further information, see 3.5 (Delegation of Functions under the Mutual Funds Regulations) 109.

the fund manager must delegate its function to a qualified person capable of undertaking those functions. The SMFA 2011 should adopt these rules to protect the shareholders and specifically ensure that the delegatee is a qualified entity, so it can perform the required function efficiently. The SMFA 2011 should also regulate the responsibility of the fund manager in case of delegation of certain functions to ensure shareholders' protection.

Another significant pillar in the Syrian mutual funds governance system is the custodian. In order to ensure the independence of the main parties of the mutual fund, the SMFA 2011 requires the manager and the custodian to be independent of each other.[773] The custodian of the mutual fund must take reasonable care to ensure that the fund is managed by the fund manager in accordance with the fund's objectives and policies and with the requirements of the regulations.[774] In case the fund manager fails in any of its duties; the custodian must immediately inform the SCFMS.[775] Hence, the SCFMS can take appropriate procedures to protect the interests of the shareholders. The custodian must also provide the SCFMS with regular reports with respect to the fund's performance. Further, the custodian is responsible for oversight of redemption of the fund shares.[776] Unlike the UK where the depositary is responsible for safekeeping the assets of the fund, all the mutual funds' assets must be deposited in the Clearing and Central Depositary Centre.[777] This implies that the core role of the custodian is the oversight. Therefore, the SMFA 2011 imposes an obligation upon the fund manager to provide the custodian with any document that facilitates exercise of the oversight function.[778]

It is plain that the SMFA 2011 relies on the concept of independence between the management and the oversight functions to ensure that the mutual funds service providers perform their duties adequately. As a result, the interests of the fund shareholders will be well protected. Giving the board of directors the authority to appoint the fund manager and the custodian is an efficient tool to ensure the independence of both entities. Further, placing the functions of the fund manager and

[773] Mutual Funds Act 2011, article 100.
[774] Ibid, article 98.
[775] Ibid.
[776] Ibid, article 99.
[777] Ibid, article 69.
[778] Ibid, article 95.

the custodian under the board of directors' oversight is also an additional mechanism to ensure their independence. This means that there are two levels of investor protection. The first is the supervision of the fund custodian of the fund manager's activities, and the second is the supervision of the board of directors of the manager's and custodian's functions.

5.5 External Supervision: the Fundamental Functions of the Supervisory and Regulatory Authorities

In order for the mutual funds industry to flourish in any country, there must be a robust supervisory and regulatory system that supervises the mutual funds operations and ensures that the interests of mutual funds investors are protected. This supervisory and regulatory system not only protects the mutual funds investors, but also promotes confidence in the mutual funds industry. The core purpose of this system is ensuring that mutual funds comply with mutual funds regulations. The compliance and monitoring process is carried out at two levels. The first level is the supervision and oversight function of the depositary/trustee in the UK, and the independent directors in the USA, which includes ensuring the compliance of the fund manager with the mutual funds regulations and the funds' policies and objectives. The second level of monitoring compliance is carried out by the regulatory authority through different regulatory tools such as inspections and receiving regular reports. In other words, the internal oversight of the mutual funds is accompanied by external oversight carried out by the regulatory authority.

In the UK, the Financial Conduct Authority, previously the Financial Services Authority (FSA), is the regulatory authority responsible for regulating and supervising the mutual funds industry. The FCA is tasked with monitoring and enforcing mutual funds' compliance with the mutual funds regulations. Section 247 of the FSMA 2000 gives the FCA the authority to make rules that regulate mutual funds such as the constitution, management, operation of the fund, the powers, duties, rights, liabilities of the fund operators, and the winding up of the funds.[779] Therefore, in order to meet its statutory objectives concerning the protection of consumers, the FCA has created the Collective Investment Schemes Sourcebook.

[779] Financial Services and Markets Act 2000, s.247.

The Sourcebook sets appropriate standards of protection for investors by specifying the rules that regulate the mutual funds' operation.[780]

In addition, the mutual funds regulations provide the FCA with several effective regulatory tools to protect mutual funds investors and enhance the funds industry. The FCA might use those tools during the authorisation process. Section 242(4) of the FSMA 2000 entitles the FCA at any time after receiving the application and before determining it to ask the applicants to provide it with any further information it considers necessary to make the decision and grant the authorisation order.[781] This authority enables the FCA to protect the prospective investors by ensuring that the information is correct and not false, so it will not grant the applicant the authorisation order unless it has received the necessary information. Further, the FCA is also entitled to revoke the authorisation order by another order in certain situations, such as if one or more of the requirements for the granting of the order are no longer satisfied or the manager or trustee of the mutual fund concerned has contravened a requirement imposed upon it by or under the fund regulations.[782] The FCA might also revoke the authorisation order in order to protect the interests of investors or potential investors in the fund.[783] This authority is an essential tool to protect the fund investors because the FCA can intervene at any time to protect the investors and the fund industry from any potential scandal.

Furthermore, the FCA might, on the application or with the consent of the manager and trustee of a particular scheme acting jointly, give directions that the COLL Sourcebook rules do not apply to the mutual fund or apply to the fund with such modifications as may be specified in the direction.[784] The financial market generally and mutual funds industry specifically are sophisticated in the UK, so the FCA must have the flexibility to deal with any difficulty that might obstruct the mutual funds' operation.[785]

Moreover, the FSMA 2000 requires mutual funds to obtain the FCA approval for any proposal to alter the fund or to replace its trustee/depositary or the

[780] Collective Investment Schemes Sourcebook 2014, coll 1.1.2 (1).
[781] Financial Services and Markets Act 2000, s.242 (2).
[782] Ibid, s.254 (1).
[783] Ibid, s.254 (1) (e).
[784] Ibid, s.250.
[785] Ibid, s.250.

manager/authorised corporate director (ACD).[786] The approval of the FCA is a guarantee to protect the fund investors because the majority of the fund investors do not have any knowledge or background of investment, so they would not know whether or not such an alteration is for their benefit. Therefore, the 2000 Act grants the FCA this authority because the FCA has professional staff and practitioners who are able to determine whether alterations are useful to the investors or against their interests. This authority is also necessary to protect the mutual fund service providers. For instance, the fund manager might attempt to change the depositary due to the strict oversight. Thus, to ensure that the depositary exercises its oversight function effectively and without any concern, the law requires the FCA's approval for any proposal to change the depositary.

The FCA might appoint one or more competent persons to commence investigation and report on the affairs of an open-ended investment company if it appears to the FCA that it is in the interests of shareholders or potential shareholders of the fund to do so or that the matter is of public concern.[787] The FCA is also entitled to investigate the affairs of the fund directors and the depositary to protect the fund investors and avoid any scandal in the mutual funds industry. In *Arch Financial Products LLP and others v Financial Services Authority*, trading in all the Arch Cru funds was suspended by their authorised corporate director, Capita Financial Managers Limited ("Capita"), as Capita considered that the funds had insufficient liquidity to meet expected redemption requests.[788] In order to discover the circumstances that led to the Arch Cru funds ceasing to operate, the Financial Services Authority (FSA) (the previous supervisory authority) commenced an investigation into the Applicants and the ACD. The FSA found that the applicants had breached various regulatory requirements, including the requirement to act with integrity, due skill, care and diligence. It is necessary to know that in determining whether a person is fit and proper to be an authorised person, financial regulators usually consider among other things the integrity, reputation and honesty of the applicant. It is clear that the FCA's authority to commence investigations is a fundamental tool because mutual funds operators will be careful before making any crucial decision that would affect the rights of the fund investors.

[786] Ibid, s.251 and Open Ended Investment Company Regulations 2001, reg. 21.
[787] Open Ended Investment Company Regulations 2001, reg. 30.
[788] Arch Financial Products LLP and others v Financial Services Authority [2013] All ER (D) 67 (Jan).

It is important to know that the FCA might apply to the court for an order removing the manager/ACD or the trustee/depositary, or both the manager and the trustee, of the fund. However, if the FCA has decided to apply to the court it must give written notice to the manager and trustee of the fund.[789]

In the USA, the Securities and Exchange Commission (SEC) has a similar role to the FCA. The SEC is responsible for monitoring and enforcing mutual funds' compliance with the Investment Company Act 1940 and all other applicable federal securities laws and regulations. This implies that in addition to its rulemaking authority, the SEC carries out supervision and oversight functions over the mutual funds. The SEC has authority from time to time to make, issue, amend, and rescind such rules and regulations as are necessary or appropriate to the mutual funds industry.[790] In *Chamber of Commerce of the U. S v. SEC* it was argued by the Chamber of Commerce of the United States that the SEC lacked authority as per the 1940 Act to publish a rule regulating the corporate governance of mutual funds.[791] A rule was enacted under the 1940 Act by the SEC that required mutual funds to have a board composed of at least 75% independent directors and an independent chairman. The DC Circuit Court stated that:

> "*We hold that the Commission did not exceed its authority in adopting the two conditions, and the Commission's rationales for the two conditions satisfy the Administrative Procedures Act*".[792]

Furthermore, the SEC may commence investigations as it deems necessary to determine whether any person has violated or is about to violate any provision of the mutual funds regulations.[793] If it appears to the SEC that any person has engaged or is about to engage in any act or practice constituting a violation of any provision of the mutual funds regulation, it may in its discretion bring an action to the court.[794] Further, the SEC may also conditionally or unconditionally exempt any person from

[789] Financial Services and Markets Act 2000, s.258, and Open Ended Investment Company Regulations 2001, reg. 26.
[790] Investment Company Act of 1940, s.38.
[791] Chamber of Commerce of the U. S, v. S.E.C., 412 F.3d 133 D.C. Cir. (2005).
[792] Ibid.
[793] Investment Company Act of 1940, s.42 (a).
[794] Ibid, s.42 (d).

any provision or provisions of regulations if such exemption is necessary or appropriate in the public interest and consistent with the protection of investors.[795]

In Syria, under the SMFA 2011, the Syrian Commission on Financial Markets and Securities (SCFMS), which is the capital markets regulator, is responsible for regulating and oversight of the mutual funds industry. The SMFA 2011 gives the SCFMS many powers of oversight and intervention. The SCFMS is responsible for reviewing and approving the mutual funds prospectus before publishing it to the public to ensure that the information included in the prospectus complies with regulations. This authority is very significant because the SCFMS will ensure that the information is clear, correct and not false or misleading.[796]

In addition, the SMFA 2011 requires SCFMS approval for certain changes in a mutual fund. A mutual fund cannot change or amend the fund instrument of incorporation without SCFMS approval. Any proposed alteration to the fund's prospectus such as the fund objectives must also be approved by the SCFMS.[797] Thus, the SCFMS will refuse any change that could prejudice the interests of the fund investors or reduce their protection.

The SMFA 2011 provides that if the fund manager or the custodian is no longer eligible to fill its position for any reason specified in the SMFA 2011, the board of directors must appoint a new one within 3 months. If the board of directors fail to appoint a new manager or a custodian, the SCFMS has the authority either to appoint a new manager or custodian, suspend the fund's dealings or wind up the fund.[798] There is no doubt that protection of investors requires providing the SCFMS with this authority because leaving the fund without a manager or custodian would result in the fund NAV of the fund shares being reduced, and that would cause a significant loss to the investors.

Further, the SCFMS can at any time ask mutual funds to provide it with any information or document. If the SCFMS discovers that there is any violation to any provision of the mutual funds regulation, it is empowered to take any proper procedure to stop that violation and protect the investors, such as winding up the

[795] Ibid, s.6 (c).
[796] Mutual Funds Act 2011, article 9.
[797] Ibid, article 15.
[798] Ibid, article 101 (3).

fund or asking the fund manager or the custodian to provide the fund with guarantees.[799] However, the SMFA 2011 does not explicitly empower the SCFMS, where it is necessary, to appoint one or more competent persons to commence an investigation and report on the affairs of the manager, custodian or the board of directors to protect the interests of the investors. In order to provide investors with a high degree of protection, the SCFMS should also be empowered to bring an action to the court where the investigation results indicate that the fund manager, custodian or any director has engaged or is about to engage in any act or practice constituting a violation of any provision of the mutual funds regulations. Mutual funds investors usually do not prefer to bring an action to the court against the fund service providers for two reasons. First, mutual funds investors usually prefer to use the exit right to leave the fund and invest in another fund. Second, bringing an action to the court is expensive. Thus, giving the SCFMS the authority to bring an action to the court would protect the investor and the mutual funds industry.

It is important to mention that since the SCFMS is the financial market regulator in Syria, it has general supervisory authorities to protect the financial market. Under article 16 of the Syrian Commission on Financial Markets and Securities Act 2005, the SCFMS has the general power to commence investigations, where necessary, against any entity that breaches the provisions of this law.[800] The SCFMS Law 2005 provides that the main aim of the SCFMS is to protect the investors and the financial market against any abuse or fraudulent acts.[801] This implies that the SCFMS might commence investigations against the mutual funds to protect the investors and the financial market. It is necessary to know that financial markets regulators around the world usually have investigative power. Nonetheless, the mutual funds regulations in the UK and the USA explicitly indicate the power of the FCA and the SEC to commence investigations against the mutual funds service providers to protect the interests of the investors. Thus, it would be desirable for the SMFA 2011 to explicitly grant the SCFMS the authority to commence investigations where necessary.

[799] Ibid, article 89.
[800] Syrian Commission on Financial Markets and Securities Act 2005, article 16.
[801] Ibid, article 3.

As was discussed above, the mutual funds regulations in the UK and the USA give the FCA and the SEC the authority to make rules that set appropriate standards of protection for investors and regulate the operation of the funds.[802] Mutual funds regulations impose upon mutual funds managers an obligation to provide the regulatory authority with regular reports and financial statements. Mutual funds managers are also required to provide the regulatory authority with the prospectus or any material changes in the funds. This implies that the regulatory authority has a clear image about the mutual funds practices and the difficulties that face the mutual funds industry. As a result, the regulatory authority should have the authority to make rules that correspond to the needs of the mutual funds industry. For instance, the SEC's efforts to increase the board of directors' independence broadly codify existing industry practices.[803] The SEC disclosure delivery guidelines that allow mutual funds to take advantage of technology are another example of the significance of giving this authority to the regulatory body.[804] Therefore, the SCFMS should be given the authority to make rules and especially because the mutual funds industry in Syria is still new, the industry could face certain challenges that require urgent regulatory intervention. Giving the SCFMS this authority might be the best alternative to amending the SMFA 2011 every time the fund industry needs certain rules because the SCFMS will have the flexibility to keep the fund industry up to date.

It is obvious that the role of the regulatory authority is crucial in the mutual funds industry. Though the SMFA 2011 provides the SCFMS with a certain degree of authority, there are still some key regulatory authorities such as commencing investigations, bringing actions to the courts and making rules that should be given to it in order that it can perform its external supervision efficiently, which would definitely improve investor protection. Thus, the SMFA 2011 should be amended to give the SCFMS those authorities.

[802] Financial Services and Markets Act 2000, s.247.
[803] A Palmiter, 'Mutual Fund Boards: A Failed Experiment in Regulatory Outsourcing' (2006) 1 Brooklyn Journal of Corporate, Financial & Commercial Law 165-208.
[804] Zimmer, (n 600).

5.5.1 Supervision and Enforcement: the Challenge of Enforcement of Compliance

Achieving the key objectives of any law or regulation cannot be done solely by having a robust regulation, but it should also be accompanied by an efficient enforcement system. This implies that creating an effective system of enforcement is a crucial element to the success of any legal framework. With around 50 billion US dollars undetected by the official authorities, the Bernard Madoff scandal has highlighted the significance of law enforcement because enforcement is a significant factor in the credibility of regulators.[805] Madoff was a fund manager who dipped into investor funds, and covered defaults in one investor's account by using other clients' accounts. He gradually built his notorious and gigantic Ponzi scheme, managing the fund for some 20 or so years.[806] In addition, regulatory supervision and enforcement are instruments to promote compliance with the legal framework. Compliance refers to adherence to the legal framework. On the one hand, the supervision functions aim to prevent any potential attempt at non-compliance with the laws and regulations.[807] On the other hand, enforcement aims to discover and impose punishments on non-compliance.[808] Regulators usually use different mechanisms to ensure compliance with laws and regulations such as periodic and regular reporting requirements, examinations and inspections and licensing standards.[809] Further, in order to establish an efficient enforcement system, the financial regulators must have sufficient legal authority to commence investigations. They must also have the authority to bring an action to court. As was discussed above, the mutual funds regulations in the UK and the USA give the FCA and the SEC the authority to commence investigations and bring actions to court. In Syria, the SMFA 2011 does not explicitly grant the SCFMS such power. It is necessary to note that the effectiveness of the court system is significant in supporting the enforcement system. In other words, where the process in the courts is very slow or the judges are corrupt, it will be very difficult to ensure compliance with the laws and regulations.

---

805 See, E Arvedlund, *Madoff: The Man Who Stole $65 Billion* (Penguin, London 2009).
806 Ibid.
807 See, Fink, (n 80) 196.
808 Ibid.
809 International Organization of Securities Commissions, 'Objectives and Principles of Securities Regulation' (May 2003) available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf accessed 4 April 2016.

Further, the FCA has the authority to intervene. This means that the FCA may give a direction under the mutual fund regulation if it appears to it that (1) one or more of the requirements for the making of an authorisation order are no longer satisfied; (2) the manager or trustee of a unit trust scheme has contravened, or is likely to contravene, a requirement imposed on him by or under the FSMA; (3) the manager or trustee of such a scheme has knowingly or recklessly given the FCA information which is false or misleading in a particular material and (4) it is desirable to give a direction in order to protect the interests of investors or potential investors.[810] The FCA direction might require the manager of the fund to cease the issue or redemption, or both. It might also require the manager and trustee of the fund to wind it up.[811] It is obvious that this authority is significant to ensure the compliance of the mutual funds service providers with the laws and regulations.

Moreover, an effective enforcement system must include dissuasive sanctions (penalties) to ensure compliance with the legal framework. In the UK, the FCA uses a wide range of enforcement powers (criminal, civil and regulatory) to protect investors. The FCA can (1) withdraw a firm's authorisation; (2) prohibit individuals from carrying out regulated activities; (3) suspend firms or individuals from undertaking regulated activities; (4) fine firms or individuals who breach rules or commit market abuse; (5) apply to the Court for injunctions and restitution orders; and (6) bring criminal prosecutions to tackle financial crime, such as insider dealing or unauthorised business.[812] The wide range of powers ensures that mutual funds meet the FCA standards and comply with existing fund regulations. Here, it is worth mentioning that section 253 of the FSMA 2000 provides that any provision of the trust deed of a unit trust scheme that exempts the manager or trustee from liability for any failure to exercise due care and diligence in the discharge of his functions in respect of the fund is void.[813]

There is no doubt that the main objective of the financial regulators in Middle Eastern countries is to develop the financial market and encourage investors to

[810] Financial Services and Markets Act 2000, s.257 (1).
[811] Ibid, s.257 (2)
[812] See *How we enforce the law*, available at http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law accessed 5 April 2016.
[813] Financial Services and Markets Act 2000, s.253. The same rule applies to the ACD and depositary of OEIC, Open Ended Investment Company Regulations 2001, reg. 62.

participate in different financial industries. A strong enforcement system might prevent the regulators from reaching this aim. In other words, when the regulators apply a severe enforcement system on market participants this might impede the development of the market through forcing those participants to exit the market. It might also discourage new participants from entering the market. Therefore, the regulators should strike a balance between enforcing the regulation and achieving the desirable development, and thus the regulator should be lenient without compromising the investors' rights.

Further, in order to ensure the effectiveness of the enforcement system, the financial regulators must have sufficient human resources to perform different functions quickly and efficiently. They need experienced staff to analyse, review and collect data. They also need skilled investigators to commence investigations without any influence from any other party. Legal counsel is also required to bring, where necessary, actions to court. The staff should have good knowledge of the financial market and its requirements. The main problem in recruiting skilled staff, and especially in countries such as those in the Middle East, is that those staff usually obtain high remuneration and the public sectors pay low remuneration compared to the private sectors. Therefore, it is crucial to find various financial resources to overcome this problem. It is also important to mention that using technology might help the regulators to overcome this problem. For instance, financial regulators might use electronic programmes to analyse and collect data.

It is clear that having a good regulatory framework is not enough to encourage investors and create confidence in the market. The robust legal framework should be supported by an effective enforcement system. Therefore, any reform to the mutual funds regulations in Middle Eastern countries should consider the importance of the enforcement system. Thus, the national and international investors will be encouraged to invest their funds in the mutual funds industry.

5.6 Conclusion

In this chapter, an attempt had been made to examine the possibility of exporting certain necessary regulatory rules from the mutual funds regulation in the UK to Syria particularly and Middle Eastern countries generally in order to strengthen the mutual funds regulation in those countries. The focus was on the SMFA 2011 as an illustration of Middle Eastern countries' laws. The study demonstrated that although the mutual funds regulation in Syria provides investors with some protection, the regulation there is still far from the international standards. It showed that the regulations there regulate different aspects of the industry. Nonetheless, they lack the detailed rules that ensure a high level of investor protection. The study highlighted the weaknesses in the current legal framework that threaten the protection of investors and the industry, and the possible rules that would enhance the legal framework. Enhancing the regulatory framework will encourage investors to participate in the industry, and it will accelerate the growth of the industry. The research emphasised that the best way to improve the existing legal framework of the Syrian mutual funds industry is to give the SCFMS the power to make rules and amend policies where it is necessary. Therefore, the thesis does not attempt to actually draft legislation for Syria. It is significant to mention that since other Middle Eastern countries have similar but less detailed regulation, the findings and recommendations of this chapter could be applied to those countries as well.

CHAPTER 6

Conclusion

6.1 Introduction

Mutual funds regulation in Syria is still insufficient and lacks the detailed rules that regulate all aspects of the industry. Although the current mutual funds regulation addresses different aspects of the fund industry and provides investors with certain protections, it is still far from the international standards applied in many countries such as the UK and the USA. In this thesis, an attempt has been made to explore the possibility of exporting certain essential regulatory rules from the mutual funds regulation in the UK to the mutual funds regulation in Middle Eastern countries in order to increase the investors' protection and enhance the mutual funds industry. Borrowing regulatory lessons from the UK mutual funds regulation will help the mutual funds regulation in Syria to move closer to the international standards or even to the mutual funds regulation in the UK, which provides a higher level of investor protection. In practice, academic suggestions for the improvement of different areas of the existing legal framework in Syria are accepted by the legislature. As a result, implementation of the findings of the thesis, whether before or after the armed conflict, is highly possible. Further, the fundamental challenge for this thesis was to define mutual funds because in spite of the significant role of mutual funds in the financial markets, the concept of mutual funds is still not clear and not known to the investors, academics and even practitioners. Therefore, it was necessary to define mutual funds and clarify all their aspects. In order to achieve the key objectives of the research, the thesis was divided into four major chapters.

This concluding chapter is divided into two sections. The first section will summarise the key points made in the research. It will also sum up the key findings of the thesis. Building on the key findings of the research, the thesis will, in the second section, make certain recommendations with respect to enhancing the mutual funds industry in Middle Eastern Countries.

6.2 Summary of the Thesis and the Main Findings

In order to achieve the aims and objectives of this research, the study had first to define mutual funds by showing their significant role in the financial market and showing the unique attributes that differentiate them from other financial institutions. There is no doubt that the financial sector is one of the most significant sectors that promote the development of a country's economy. The financial institutions have over an extensive period played a fundamental role in the financial sector through mobilisation of resources from investors to establish a pool of funds to be invested on their behalf. Mutual funds provide millions of investors with the ability to invest. By pooling the resources of millions of small investors together, they increase their participation in the financial markets, which in turn enhances the effective functioning of the financial markets themselves. In mid-2014 in the USA, the number of individuals who had invested in mutual funds was around 90.4 million, while the number of households was about 53.2 million.[814] Therefore, mutual funds offer a dynamic means to develop the financial sector in Middle Eastern countries through pooling the small investors' savings together. This can be confirmed by the fact that in Europe around 75% of the undertakings for the collective investment in transferable securities (UCITS) investors are small investors.[815] However, it is necessary to note that mutual funds accommodate different types of investor, whether retail investors or sophisticated investors. In other words, in a country such as Syria where the financial market is relatively small, the capacity of this market to establish many types of financial institution is limited. Thus, before establishing any type of financial institution in the financial market, the regulators should consider all types of investor. Unlike the most common financial institutions such as hedge funds, mutual funds offer an opportunity to all types of investors to participate in these vehicles, and for this reason the regulators, especially in the developing countries, have recently begun to pay great attention to this industry.

Further, in order to define mutual funds, the research then answered a principal question: why a mutual fund? When investors decide to invest their savings they find many options in the financial markets such as insurance companies, investment banks, hedge funds and mutual funds. Therefore, why might investors prefer to invest in mutual funds and ignore all other options? The thesis found three key reasons that make mutual funds an attractive financial institution. The first reason is the advantages that investors obtain by investing in mutual funds (Figure 6.1).

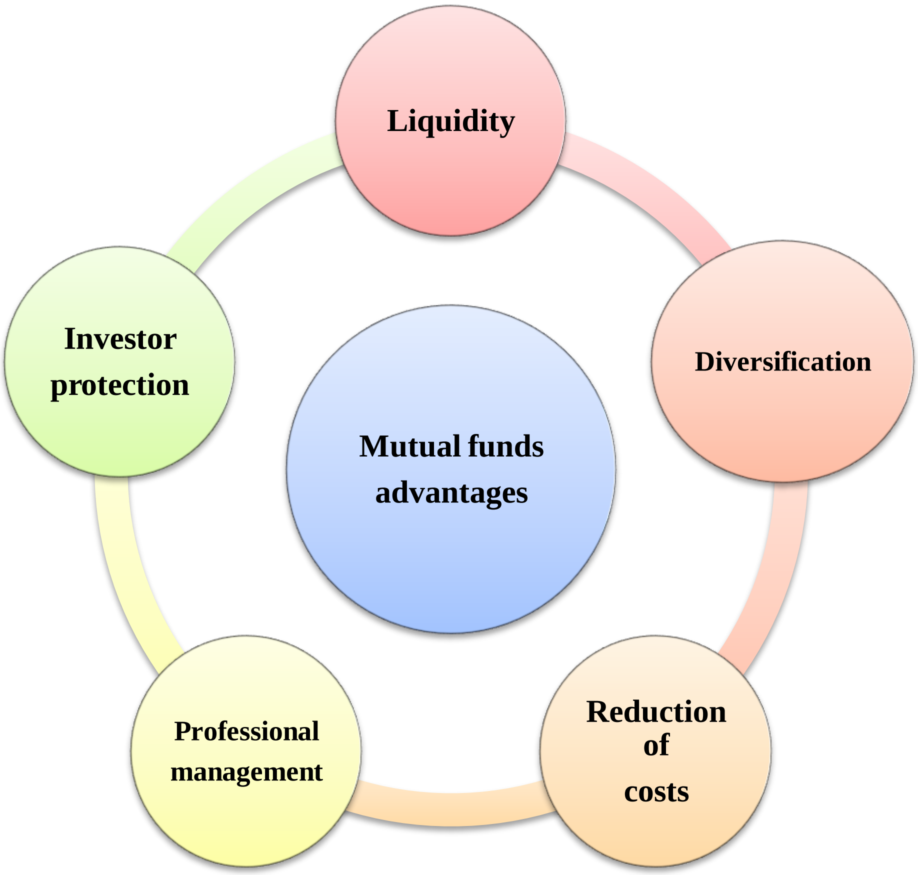
[814] American Investment Company Institute, (n 2).
[815] European Commission, (n 27).

Professional management, liquidity, diversification, investor protection and reduction of costs are the main advantages of investing in a mutual fund. Professional management means that the assets of a mutual fund are invested and managed by professional fund managers with the experience, resources and expertise to manage the fund effectively. Diversification refers to the process of spreading risk over a number of different investments, and probably across different markets (do not put all your eggs in one basket). Liquidity is the ability of the investors to access their money in the fund. Mutual funds are usually ready to buy back their shares/units every business day. Reduction of costs means that when investors invest their funds in mutual funds, they get the advantage of economies of scale. That is to say, mutual funds pay lesser costs because of large quantities. The protection of investors is achieved through the extensive regulation that governs the fund industry in most countries.[816] It could be argued that some other financial institutions share some of these advantages of mutual funds. It is true that some of the financial institutions might provide investors with some of these advantages, but the strong position of mutual funds comes from the combination of these advantages together in one financial institution. For instance, similar to mutual funds, hedge funds are managed by professional management. However, hedge funds are unregulated institutions, so they suit only sophisticated investors who can protect themselves.[817]

Figure (6.1)

[816] For further information about the advantages of mutual funds, see 2.2.1 (Why Invest in a Mutual Fund?) 26.

[817] See, 2.2.2 (Hedge Funds Versus Mutual Funds) 30.



The second fundamental reason is flexibility. The research also showed that the mutual funds industry has produced a wide range of funds, which respond to the needs of the investors, whether it be those seeking fixed and regular income, long or short-term investments or those looking for both. This also makes them an attractive option to all kinds of investor.

The third key reason is that mutual funds are less risky financial vehicles. When individuals decide to invest their funds, the main concern is the degree of risk carried by the investments. Some people prefer to invest in zero-risk investment such as banks. However, the return in this kind of investment is very low. Some people might decide to invest in high risk investment such as investing in stock markets in order to obtain high returns. Mutual funds provide investors with good returns with less risk. Diversification is considered a significant factor that makes mutual funds less risky. Diversification indicates the process of spreading risk over a number of different investments, and probably across different markets. This implies that investing in mutual funds reduces the risk but does not eliminate it. An important example that confirms this conclusion is that of the stock market difficulties in the

USA in 2001. In 2001, among publicly traded US companies, the stocks of twenty percent of those publicly traded companies lost more than sixty-six percent of their market value. On the contrary, among all US mutual funds investing primarily in stocks and other securities, only one percent lost sixty-six percent of their market value.[818]

The research, then, discussed a significant aspect of the concept of mutual funds, which is risk management. Defining mutual funds requires understanding the risks associated with the fund's investments and how the mutual funds deal with them. Mutual fund risk management is a process whereby mutual funds systemically address all potential risks or problems before they occur in order to establish proper policies to avoid those risks or minimise their impacts.[819] The research investigated different potential risks in the mutual funds industry. Nonetheless, market risk and liquidity are the two potential key risks in the fund industry.[820] The market risk indicates the risk of exposure to fluctuations in the value of the financial instruments due to changing market conditions, while the liquidity risk is the potential risk to the mutual funds assets due to the fund being unable to meet its payment obligations. In other words, the mutual fund cannot raise sufficient cash to meet its liabilities when due. The research emphasised the importance of the role of the fund manager in establishing, implementing and maintaining a sufficient risk management policy to identify the risks to which the fund is or might be exposed. After that, the mutual fund manager should assess those risks and their consequences for the fund. Finally, the research demonstrated the need to review the adequacy and effectiveness of the risk management policy.

The second major chapter of the thesis scrutinised the existing mutual funds laws and regulation in the UK, namely the Financial Services and Markets Act 2000 (FSMA), the Open Ended Investments Companies Regulations 2001 and the Financial Conduct Authority Sourcebook (COLL). It examined the mutual funds regulatory framework that governs mutual funds during their life, namely the authorisation process of the mutual funds, the operation of the fund, and the winding up and

[818] E Roiter, 'An Apology for Mutual Funds: Delivering Fiduciary Services to Middle and Working Class Investors' (2004) 23 Annual Review of Banking & Financial Law 851-862.
[819] See, J Haslem, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (n 26) 154.
[820] For more information about the types of risks, see 2.4 (Mutual Funds Risk Management) 64.

termination of the fund. In fact, the efficiency of laws and regulation determines the pace of development and success of any industry. In other words, in order for an industry to flourish in any country, there must be an effective legal and regulatory framework. This creates and maintains confidence in that industry and encourages investors to participate in it.

Mutual funds regulation promotes the main objectives of the financial regulation in the UK. Principally, protection of investors and market integrity are the most significant objectives of financial regulations.[821] Mutual funds regulation promotes the protection of investors. The thesis found that mutual funds regulation aims to protect investors from misleading, fraudulent practices and misuse of the investors' assets. Authorised mutual funds can only offer their shares or units to the public. Further, the fund regulation enhances market integrity. Clear, full and regular disclosure of information necessary for investors' decisions is the most important means for ensuring market integrity. Mutual funds regulation considers disclosure as a valuable tool to achieve market integrity and protection of investors.

The study examined the evolution of mutual funds regulation in the UK. This examination demonstrated the following findings. First, the current mutual funds regulation is a consequence of many changes and developments throughout the long history of the mutual funds industry in the UK. Second, in order to keep pace with the complexity and creativity of the mutual funds industry, the development of mutual funds regulation in the UK does not only consider the requirements of the local market but also considers the development in the international markets. This finding can be demonstrated by the adoption of the concept of the protected cell regime (segregated liability) for open-ended investment companies (OEICs) in 2011.[822] For the sake of improving the competitiveness and attractiveness of the UK OEICs in the financial markets and increasing investor protection for shareholders, the Treasury introduced the protected cell regime to mutual funds regulation. The new regulations protect investors by ensuring that the assets of a sub-fund belong

[821] See the FCA objectives available at http://www.fca.org.uk/about/what accessed 11 April 2016.
[822] Open Ended Investment Companies (Amendment) Regulations 2011.

exclusively to that sub-fund. These assets cannot be used to discharge the liability of any sub-fund or the umbrella fund itself.[823]

It is necessary to note that the mutual funds industry is one of the most regulated industries in the UK. Although the mutual funds industry is developed in the UK and the industry has many practices in the financial market, the funds regulators emphasise regulation of all aspects of the industry. They grant the mutual funds service providers only limited discretionary power. The core of the mutual funds industry, where a huge number of investors pool their money together to be managed by external management, justifies this regulatory emphasis. Since the mutual funds' managers invest the funds' assets in a wide range of sectors, any scandal or crisis in the funds industry might affect all those sectors. For instance, in the event of an occurrence of a crisis in the mutual funds industry, this would increase the requests of the investors to redeem their shares or units. The huge number of requests would force the mutual funds managers to sell the mutual funds' assets to get cash. A forced sale might lead to price declines in the market or a particular sector. Therefore, it is essential that this industry should be well regulated.

The third key chapter of the thesis investigated the governance of mutual funds. Indeed, the governance of mutual funds has not been addressed adequately by the legal literature in the UK. Thus, the thesis has attempted to fill this gap through examining different aspects of mutual funds governance. The importance of mutual funds governance springs from the need to protect the interests of the mutual funds investors. The concept of mutual funds is based on the idea of pooling funds from a large number of investors to be invested by professional management without the participation of those investors in the management. This implies that unlike ordinary companies, a mutual fund is typically externally managed. That is to say that it is not an operating company and it has no employees in the traditional sense. Instead, a mutual fund relies upon service providers in order to invest fund assets and perform other business activities. This nature carries the potential that the interests of the management and those of the investors might diverge. This gives rise to potential conflicts of interest between the self-interests of the fund management and the interests of the investors. For instance, the mutual fund manager might buy securities

[823] For further information, see 3.3.3.2 (A protected cell regime for open ended investment companies: an efficient regime to protect shareholders) 90.

from an affiliated party at an inappropriate price that is higher than the real market value. Therefore, it is essential for the mutual funds governance framework to ensure the fund management operates the fund in the investors' best interests. It is necessary to note that unlike some financial institutions such as hedge funds where investors are sophisticated and can protect themselves, the majority of the mutual funds investors are retail investors. Thus, those investors must be provided with a high degree of protection.[824]

In order to characterise the mutual funds governance and understand all its aspects, the study compared the mutual funds governance model in the UK (the contractual model) to the mutual funds governance model in the USA (the corporate model) from a comparative structural and institutional perspective. Mutual funds in the United States are structured pursuant to a corporate model with a board of directors, while in the UK, mutual funds can take either the trust structure or the corporate form with a depositary. The thesis scrutinised the structural rules of both models such as the rules that regulate the allocation of the powers to make the funds' decisions among the service providers and the conditions of making such decisions. The in-depth analysis of both models showed that although the governance structure of both systems seems quite different, both structures are substantially similar.

Principally, they rely on the same mechanism to protect the interests of the investors through ensuring strict separation between supervision and management functions. In other words, the mutual funds regulations must guarantee that the supervisory entity is able to perform its obligations without any potential conflict of interest with the manager. This separation must also ensure that the manager has no possibility to control the supervisory entity's decisions. Further, in order to provide a sufficient separation between the supervisory functions and asset management, the mutual funds regulations in both systems clearly specify the responsibilities of the supervisory and management entities. The fundamental role of the supervisory entity is to impose a comprehensive supervision upon the fund manager's activities, so it should not be involved in any activity of the management because there is an obvious incompatibility between performing a certain function and then overseeing the same function.

[824] European Commission, (n 27).

Another significant finding of the comparison is that in both systems, the appointment and replacement of the supervisory entity is made in a way that ensures the independence of that entity. In the USA, the independent directors are nominated and appointed by the independent directors. In the UK, although the appointment of the trustee/depositary is made by the manager/authorised corporate director (ACD), the approval of the Financial Conduct Authority (FCA) is required to be valid. This rule ensures that the supervisory entity performs its functions effectively, which results in greater investor protection.

The study also indicated that under the 1940 Act, the supervisory entity in the US has more discretionary powers than its peer in the UK. In the USA, the independent directors have significant discretionary power to make business judgments. For instance, the independent directors must approve the contracts of the fund service providers such as the investment adviser contract, the distributor contract and the administrator contract.[825] The 1940 Act does not contain any rules or criteria that the independent directors should apply when they exercise this discretion. On the contrary, the UK mutual funds regulations rely more on rules and giving guidance to the supervisory entity than discretion. For example, the mutual funds regulations give the unit trust's trustee the right to remove the fund manager in exceptional circumstances such as winding up the authorised fund manager and appointment of a receiver to the authorised fund manager.[826]

The comparison also showed that neither the US mutual funds governance system nor the UK governance structure is accepted to be superior to any other system. Rather, each system adopts different governance mechanisms that fit the mutual funds structure and the general financial and investment culture in the country. This can be seen through the discretionary powers that the independent directors have in performing their supervisory duties, which represent the general regulatory trend in US financial culture. However, regardless of the governance structure, both systems agree that protection of investors must be the core aim of the governance rules. The strict supervision exercised by the independent entity upon the fund manager's activities to manage the fund in the best interests of the investors in both systems is

[825] Investment Company Act of 1940, s.36 (b).
[826] Collective Investment Schemes Sourcebook 2014, coll 6.5.7.

clear evidence that investor protection should be the core of any mutual fund governance system.

The study also examined the role of disclosure in mutual funds governance. Since mutual funds investors do not participate in the management of the funds, they should have access to fund information in order to monitor the performance of the management and protect their interests. The thesis emphasised that timely, accurate and sufficient disclosure improves the capability of the fund investors to undertake independent scrutiny. Hence, disclosure is a key tool to protect the investor. Here, it is worth mentioning that in the UK it is a criminal offence under s.85 of the Financial Services and Markets Act 2000 either to offer transferable securities for sale to the public or to request the admission of securities to trading on a regulated market without publishing a prospectus in relation to that issue.[827] The prospectus must be submitted to, and approved by, the competent authority before it is published. Further, the study also illustrated that compared to other financial products, mutual funds are subject to extensive disclosure requirements. In other words, the UK mutual funds regulations require fund managers to issue a full prospectus, a simplified prospectus and financial reports.

The aim of these extensive disclosure requirements is to provide all types of investor with related information. In fact, most of the mutual funds investors are small and not sophisticated investors. As a result, mutual funds regulations should ensure that those investors are provided with essential, clear and untechnical information. This means that the mutual funds disclosure regulations should focus on two key areas, namely the substance and the format, because it is not only the substance of information of the disclosure that is important, but also the format of information is essential to help the investors understand the prospectus.

The last section of the chapter addressed the effectiveness of the voting right in mutual funds governance. In the mutual funds industry, the funds investors do not sell their shares/units, but rather they redeem them from the mutual fund for cash based on net asset value (NAV). The right of mutual funds investors to redeem their shares/units is known as the right to exit. The study investigated whether the existence of this right in the mutual funds industry makes the voting right ineffective.

[827] Financial Services and Markets Act 2000 s.85.

In order to answer this question, the study compared the exit right in the fund industry to the exit right in ordinary companies. This comparison showed that the redemption right is the most favourable option for mutual funds investors. This implies that mutual funds investors usually prefer to exit from the fund rather than use the voting right in case the fund faces serious issues such as changing its main objectives or the existence of disputes between the fund service providers. The fund investors would not hesitate to exit from the fund in order to avoid any potential consequences. Nonetheless, the study demonstrated that the voting right in the mutual funds industry is not a completely ineffective tool. Mutual funds regulations require investors to vote on key issues with respect to the operation of the mutual funds.

Chapter five of the thesis focused on how the above features could be used in Middle Eastern countries. The main aim of this chapter was to examine the possibility of exporting lessons from the UK mutual funds regulations to Middle Eastern countries, which would play a crucial role in enhancing investor protection and promoting the mutual funds industry. Due to the similarities in the mutual funds industry and regulations across Middle Eastern countries, the chapter, as did previous chapters, concentrated on the Syrian Mutual Funds Act (SMFA) 2011. In order to achieve the aim of this chapter, the study scrutinised the weaknesses in the current mutual funds regulations, which threaten the protection of investors and the industry. The main finding of this chapter was that regulation of mutual funds in Middle Eastern countries regulate the key aspects of the mutual funds industry and they provide investors with a certain kind of protection. Nonetheless, the regulations suffer from inadequate adaptation of high standards of investor protection and much is still needed to be done in this area to achieve a high degree of investor protection. Therefore, enhancing the current mutual funds regulations is essential to improve the mutual funds industry and attract investors. There is no doubt that the mutual funds industry is developed in countries that have strong regulations and especially where mutual fund investors' rights are well protected. Hence, when Middle Eastern countries borrow regulatory lessons from these countries, they promote the regulations to keep pace with the development of the industry and global standards.

The chapter, first, considered enhancement of mutual funds prudential regulations in Middle Eastern countries in terms of risk management, restrictions on investment and borrowing powers, suspension of redemption, and valuation and pricing. It shed light on the importance of risk management in the mutual funds industry. The study found that the fund regulations do not pay sufficient attention to the need for establishment of clear risk management procedures that ensure the protection of the investors and safety of the fund. The outcomes of the lack of adequate regulation governing the risk management process might be harmful not only to the mutual fund and its investors, but also to the economy in general. Thus, the research explained the risk management principles under the current mutual funds regulations in the UK for the sake of improving the risk management regulations in Middle Eastern countries.[828]

The study then addressed the restrictions on the investment and borrowing powers. Diversification is a vital tool for reducing risk and protecting investors, so mutual funds regulations should impose upon mutual funds a duty to apply certain levels of diversification with the aim of reducing the risk of investing in a small number of assets. The research highlighted that the mutual funds regulation does not contain sufficient rules that ensure liquidity and diversification of the fund assets. It also discussed the potential impacts of the lack of sufficient regulation. Since the mutual funds regulation in the UK regulates this aspect adequately, the study suggested some proper rules from the UK laws to enhance the current regulation. Further, the power of mutual funds to borrow money is another important topic that mutual funds regulations ignore in Middle Eastern countries. The unique nature of mutual funds' structure requires fund regulation to adopt rules that are suited to this nature. The fund regulations in the USA and the UK have similar rules that regulate this authority. Thus, the study recommended these rules to be adopted into Middle Eastern countries' regulations to protect investors and the fund industry.[829]

Another fundamental area addressed in enhancing the mutual funds prudential regulation is valuation and pricing. Mutual funds regulations should seek to ensure that all of the property of a mutual fund is fairly and accurately valued and that the net asset value of the fund is correctly calculated. The study indicated that mutual funds regulations in Middle Eastern countries do not regulate two key valuation and

[828] For further information, see 5.3.1.1 (Risk Management Principles under the Current Mutual Funds Regulations in the UK) 178.
[829] For further information, see 5.3.2 (Restrictions on the Investment and Borrowing Powers) 184.

pricing principles, namely fair value valuation method, and supervision and review of the fund manager's valuation policies and procedures. These two principles are essential to protect the rights of the investors to redeem or buy the fund shares or units fairly and accurately. They are well regulated under the UK mutual funds regulations. Thus, the research illustrated how these regulations would be suitable for the fund regulations in Middle Eastern countries.[830]

The research then discussed the possible rules that could be adopted to strengthen the mutual funds governance tools. The governance mechanisms ensure investors protection and play a vital role in mitigating the conflict of interest between the main players of the mutual funds. The key tools addressed in this section were mutual fund authorisation, conflicts of interest, disclosure and the concept of independence between the mutual fund manager and the fund supervisory entity. Protection of investors must be a key objective of mutual funds regulation. The number of investors who invest their funds in a mutual fund is usually extremely large. The majority of those investors are small investors who invest all they own in the fund. The investors do not participate in the fund management. Therefore, protecting them must be a priority for the mutual funds regulators. This study showed that mutual funds regulations in Middle Eastern countries regulate and adopt these mechanisms. Nonetheless, these regulations do not regulate all aspects of these mechanisms, so the fund investors are not well protected. This might discourage investors from investing their funds in the mutual funds vehicles. It might also discourage foreign investors from investing their assets in Middle Eastern countries because the investors' protection standards do not comply with those in the developed countries such as the UK and the USA. Consequently, the thesis examined the proper rules that can be learned from the UK mutual funds governance system to strengthen investor protection which in turn will develop the mutual funds industry.[831]

6.3 Recommendations

The thesis clearly showed that the current mutual funds regulations in Middle Eastern countries are inadequate and still far from international standards. Though the regulations regulate some key principles of the mutual funds industry, there are

[830] For further information see, 5.3.4 (Valuation and Pricing) 190.

[831] For further information, see 5.4 (Strengthening the Mutual Funds Governance tools Under the Syrian Mutual Funds Act 2011) 193.

certain fundamental principles that are still unregulated and threaten investor protection. Therefore, it is time now for the regulators in Middle Eastern countries to make essential reforms to the mutual funds regulations in order to increase investor protection, which will result in encouraging more investors, whether local or foreign, to participate in this industry. The SMFA 2011 regulates the key aspects of the mutual funds industry. Nonetheless, it lacks the details that make the mutual funds legal framework robust, and there are certain areas of the industry that should be regulated. Here, it is significant to mention that regarding the lack of detail of the regulation, the SMFA 2011 should contain a clear rule that empowers the SCFMS to make rules similar to those contained in the FCA Sourcebook (COLL) in the UK. As for the countries that are still looking at the mutual funds regulations as an addendum to the other main financial regulations such as securities regulations, they should enact a good common code that regulates the mutual funds industry. This section will highlight some of the key recommendations that enhance mutual funds regulations in Middle Eastern countries.

1- The need to define a clear risk management process

Risk management is one of the key areas that are not adequately regulated under the current mutual funds regulation in Middle Eastern counties, and in some of those countries, it is not regulated at all. Risk management has a crucial role in controlling and ensuring proper operation of the fund management. Principally, it ensures that the fund management complies with laws and regulations. Furthermore, the risk management process is key to protecting investors from risks through ensuring that the fund management is acting in the interests of the investors. Therefore, the mutual funds regulation in Middle Eastern countries should clearly regulate the risk management process. The new regulations should first impose a duty upon the fund managers to establish, implement and maintain an appropriate risk management policy to identify the risks to which the fund is or might be exposed. Second, the fund regulation should also require the fund manager to establish an assessment process to assess the potential risks in order to identify the possible options for mitigating them. Finally, the regulation should also impose upon the manager an obligation to periodically review the adequacy and effectiveness of the risk management policy and report the results of the assessment to the supervisory function in the fund and to the regulatory authority. It is also significant to emphasise that the risk management process should be under appropriate independent oversight, whether from the supervision function in the fund or from the competent authority.

2- Strengthening the restrictions on investment and borrowing powers rules

Mutual funds regulations in the UK emphasise the importance of diversification by imposing a duty upon the fund manager to apply certain levels of diversification with the aim of reducing the risk of investing in a small number of assets. Unlike the mutual funds regulations in the UK, the mutual funds regulations in Middle Eastern countries do not contain sufficient rules that ensure diversification of the fund assets. Although the fund regulations impose certain limits on investment with which the fund manager must comply, those limitations do not achieve the diversification objective. Hence, the mutual funds regulators should consider two key issues when they impose restrictions on the fund investment policy. The first issue is that the investment restrictions should minimise the impacts of decreasing the value of certain fund assets. The second issue is that the investment limitations should ensure that the fund has sufficient liquidity in case of an increase in redemption orders by the funds' investors in certain circumstances. However, it is necessary to note that the investment limitations should not restrict the fund manager because the available products in Middle Eastern countries' financial markets are not varied like those available in the developed financial markets. Thus, it is advisable that mutual funds regulation permits the funds' managers to invest in offshore securities and funds, so that they will have the freedom to invest the fund assets in different types of financial instrument.

Moreover, another important topic that is not regulated by mutual funds regulations in Middle Eastern countries is the authority of mutual funds to borrow money. Regulating the fund manager's ability to borrow money is significant in order to protect the mutual funds investors from misusing this authority. The fund regulators should consider two essential principles when they regulate this authority. The first principle is that the mutual fund manager must ensure that any borrowing is on a temporary basis. The second principle is that the borrowing power should be restricted. For instance, the fund regulations can stipulate that the mutual fund manager must ensure that the fund's borrowing does not, on any day, exceed 10% or 15% of the value of the fund property. It is also advisable to restrict the ability of the fund manager to borrow money to trustworthy institutions such as approved banks and eligible institutions.

3- The need to enhance the valuation system

Under the current mutual funds regulations in Middle Eastern countries, the fund managers are required to ensure that all of the property of a mutual fund is fairly and accurately valued and that the net asset value of the fund is correctly calculated. Nonetheless, those regulations do not contain rules that address the fair valuation method. The fair valuation method provides that where the price of a security of the fund is not acceptable, the fund manager should apply fair valuation to provide investors with proper protection. This implies that where a security price is not reliable at a particular valuation point, the fund manager should value a security at a price that reflects a fair and reasonable price for that security. Thus, the fund regulations should impose upon the funds' managers a duty to establish policies and procedures that define the fair valuation process. The regulations might also specify the situations where the managers should apply the fair valuation.

It is necessary to note that in order to ensure the compliance of the fund manager with the valuation regulations and the fund's policies and procedures, the fund's regulations should entitle the supervisory entity in the mutual fund to oversee and review the fund manager's valuation system. The supervisory entity might perform the review regularly or it might review the valuation system where it realises or suspects that the fund manager's systems and controls are weak or are otherwise unsatisfactory. This will result in investors being provided with high levels of protection.

4- The need to enhance rules on conflicts of interest to promote investor protection

Conflicts of interest are one of the core issues that should be regulated comprehensively to protect the interests of the fund investors, as they are inherent in mutual fund structures. The regulatory responses to the potential conflicts of interest are the essence of the mutual funds governance system. In Middle Eastern countries, although mutual funds regulations and laws regulate conflicts of interest, the rules are considered insufficient to provide investors with a high level of protection. They usually impose a duty upon the fund manager to avoid conflicts of interest. Nonetheless, this regulatory response is not enough and it should be accompanied by other effective regulatory mechanisms to alleviate the problem of conflicts of interest. The mutual fund regulation should prohibit certain types of transaction tainted by potential conflicts of interest. Here, it is significant to mention that mutual funds regulations might impose an obligation upon the fund manager to establish a review process to identify potential conflicts of interest to face any change in the circumstances of the fund manager, or the fund itself, such as the fund manager participating in new business. Further, it is also advisable to specify the legal consequences of breaching the conflicts of interest's obligations. For instance, if the fund manager enters into any transaction that results in a conflict of interest, this transaction should be voidable at the instance of the fund and it might be liable to the fund for any profit to account or gain that it has made directly or indirectly by way of that transaction.

In addition, in order to increase the degree of investor protection, the mutual funds regulations should extend the types of transaction that include potential conflicts of interest to those involving the fund managers' affiliates (associates).

Moreover, another significant regulatory response to the conflicts of interest problem that should be adopted by the mutual funds regulations in Middle Eastern countries is disclosure. Disclosure is an effective regulatory tool that keeps the mutual funds investors informed of any potential conflicts of interest. The fund manager should disclose the policies and procedures established to identify potential conflicts of interest. It should also disclose to the investors the types of safeguard adopted against conflicts of interest and how possible conflicts of interest will be resolved in their best interests.

5- The need to enhance the disclosure requirements

Disclosure is, and will continue to be, a fundamental tool that entitles the mutual funds investors to know all necessary information regarding the mutual fund on an ongoing basis. The mutual funds regulations must ensure that regular and accurate information is available to the fund investors. In Middle Eastern countries, the mutual funds regulations and laws require the fund's manager to disclose to the investors all necessary information, and they use the prospectus as a means to disclose this information. The types of information that should be disclosed vary from one country to another. However, those regulations do not consider the types of investor participating in the fund. In other words, mutual funds usually issue one lengthy and detailed prospectus to all investors. Hence, the small investors have difficulty reading and understanding the prospectus. It is advisable, therefore, to impose an obligation on the mutual funds manager to issue a simplified prospectus that enables the small investors to understand the information and make informed investment decisions. The simplified prospectus is intended to establish a disclosure system that is tailored to the unique nature of the fund investors in a way that ensures that they will make proper investment decisions. In order to achieve this objective, the fund regulations should clearly specify the information that should be included in the simplified prospectus or it might impose a limit on the number of pages, because too many pages would undermine its usefulness.

In addition, it is also recommended that mutual funds regulations in Middle Eastern countries should establish particular delivery guidelines to help mutual funds to take advantage of the internet and technology. Hence, the mutual funds investors will be able access the fund information easily. The regulations might limit electronic delivery to the simplified prospectus or it might require the investors' prior consent to use the electronic delivery. It is necessary to know that websites of the UK and the US mutual funds are rich mines of useful information that investors need to make wise investment decisions.

6- The need to increase the role and the powers of supervisory and regulatory authorities

The role of the supervisory authorities in Middle Eastern countries to enhance the mutual funds industry is crucial. They play a central role in ensuring that the interests of investors are protected and in increasing confidence in the mutual funds industry. In the UK, the Financial Conduct Authority, previously the Financial Services Authority (FSA), has noticeable impacts on the development of the mutual funds industry in the UK. The authority provided to the FCA under the current mutual funds regulations is the key reason for this remarkable role. Thus, to promote the role of the mutual funds' supervisory authorities in Middle Eastern countries in the development of the funds industry, the mutual funds regulations should provide them with a greater range of authority. The supervisory authority should be given investigation and inspection powers to protect the funds' investors and avoid any potential scandal or crisis that might destroy the funds industry and the financial market. The fund regulations should also entitle the supervisory authority to appoint competent personnel to commence investigations in case the authority does not have the expertise to carry out the investigations. It is necessary to note that this authority is important to ensure enforcement of the mutual funds regulations, simply having a good regulatory framework is not enough for any industry to flourish unless it is accompanied by an effective enforcement system.

Moreover, the mutual funds' regulatory authorities should also be empowered by the fund regulations to make regulations. This authority ensures that the mutual funds industry will keep pace with the complexity and creativity of the funds industry in the developed countries. In proposing necessary new regulations, the regulatory authorities might consult the funds industry's main players, such as the managers, custodians and investors. As mentioned previously, the mutual funds regulations in Middle Eastern countries lack detail, so by providing the regulatory authorities with this authority, they will be able formulate the detailed rules. The FCA Sourcebook (COLL) in the UK is a clear instance of the importance of this authority.

It is necessary to mention that in order to ensure the effectiveness of the role of the regulatory authorities, they should have a sufficient number of staff. This implies that the regulatory authority should build human resources capacity by appointing employees with sufficient knowledge of the funds industry and the capital market. It should also ensure that those staff are subject to regular education and training. Here, it is significant to emphasise the importance of joining regional and international organisations such as the International Organization of Securities Commissions (IOSCO), the International Monetary Fund (IMF), United Nations Capital Development Fund (UNCDF) and the Asian Development Bank (ADB) because these organisations usually provide the member countries with technical support, grants and loans to accelerate development in the developing countries. This will play a key role in the development of financial regulations generally and mutual funds regulations particularly. The regulatory authorities might also exchange their staff with developed countries such as the UK, France and Germany to develop their skills and benefit from their experience.

7- Promoting investor education

There is no doubt that investors education plays a substantial role in achieving investor protection. Investor education is considered a main objective for the financial regulators around the world. This can be seen in the Dodd-Frank Wall Street Reform and Consumer Protection Act 2010 in the USA. Section 917 of the Dodd-Frank Wall Street Reform and Consumer Protection Act states that:

> *"(a) IN GENERAL.—The Commission shall conduct a study to identify: (5) the most effective existing private and public efforts to educate investors; and (6) in consultation with the Financial Literacy and Education Commission, a strategy (including, to the extent practicable, measurable goals and objectives) to increase the financial literacy of investors in order to bring about a positive change in investor behaviour".*[832]

Section 17 of the Dodd-Frank Act emphasises the importance of investor education to promote any reform in the financial regulations.

In the UK, one of the main regulatory objectives of the FSMA 2000 is public awareness.[833] Section 4 of the FSMA 2000 provides that the public awareness objective intends to promote public understanding of the financial system through enhancing awareness of the benefits and risks associated with different types of investment or other financial dealings.[834] Therefore, the regulatory authorities in Middle Eastern countries should make more efforts to educate investors, which will in turn increase investor protection. They can use their websites to provide investors with basic information about mutual funds so that they can make informed decisions to invest in mutual funds. For instance, in order to warn mutual funds investors about past performance, the SEC published on its website a document "Invest Wisely: An Introduction to Mutual Funds".[835] This document gives fund investors a basic introduction to mutual funds and it also warns them about relying on past returns to make an investment decision. They might also educate investors about the basics of

[832] Dodd-Frank Wall Street Reform and Consumer Protection Act 2010, s (917).
[833] Financial Services and Markets Act 2000 s 2 (2) (c).
[834] Ibid, s 4.
[835] Available at https://www.sec.gov/investor/pubs/inwsmf.htm accessed 20 March 2016.

mutual funds by using a question and answer format. The regulatory authorities might also work with the Ministry of Education to have curricula containing compulsory courses on financial markets and basic investment principles in order to increase public awareness.

Here, it is worth mentioning that the education process might also address the mutual funds service providers and especially the fund managers. For instance, the regulatory authorities might make educational programmes that the fund managers must follow in order for them to become certified managers. These programmes might include attending sessions in different countries through partnership agreements with mutual funds organisations or associations. These programmes will provide managers with up-to-date skills that are universally applicable.

This research acknowledged its nature as a PhD thesis, which should be restricted to the extent of its scope and word limit. The outcomes of the thesis clearly demonstrate that exporting regulatory lessons from the current mutual funds regulation in the UK to the fund regulations in Middle Eastern countries is possible. It is true that the mutual funds industry in Middle Eastern countries is a nascent industry, but it could flourish and play a significant role in developing the financial markets. The existing regulations are a key obstacle that discourages investors from investing in this industry because they do not provide investors with a high level of protection. However, the analysis and recommendations based thereon in the thesis ensure enhancement of the legal framework of the funds industry. This will help to bridge the gap between the international standards and the current regulations, which in turn will encourage foreign and local investors to participate in this industry.

Number of words: 79,997

The law is stated as at 5 December 2016.

Epilogue

When I started my PhD study, the conflict in Syria was in its second year. No one expected that the conflict would continue for such a long time. Nonetheless, it is now five years and the catastrophic conflict continues. Prior to the conflict, the economy was stable and the growth was robust. In 2001, Syria requested to become a member of the World Trade Organization (WTO), and in 2007, it signed a free trade agreement with Turkey. The technical assistance from the International Monetary Fund (IMF) played a key role in its noticeable growth. The support included improving the financial market, modernising the monetary framework and enhancing the public financial management. However, the conflict has devastated the economy and the infrastructure.

Regarding the financial sector, the armed conflict and the international sanctions have negatively affected the financial system. Due to the international sanctions, banks, especially the central and state-owned banks, are isolated from the international banking market. The countries that have imposed sanctions on Syria froze its foreign assets. The stock exchange, which is located in Damascus, has continued to stay open during the conflict. However, only a small number of investors have continued trading on a regular basis.

When the conflict ends, many factors will be crucial in determining the speed with which the country is rebuilt. The external support and assistance will be significant in achieving a rapid recovery. International and regional organisations such as the World Bank, the International Monetary Fund and the World Trade Organization will provide financial and technical support to help the country overcome the impacts of the conflict. The developed countries, which have supported the Syrian people during the conflict, will also continue their support when the conflict is over. Another vital factor is the ability of the country to attract private investment. There is no doubt that in order to attract investors, the level of protection and facilities provided to them are essential. The mutual funds industry was a nascent industry before the conflict. This industry might flourish when the war ends and it may be an attractive investment to those investors. Therefore, the recommendations made in this research to enhance the mutual funds regulations are significant in order to make this industry attractive to investors and especially foreign investors. In other words, this research will be an effective contribution to rebuilding the country. Here, it is important to emphasise the idea demonstrated in the research that the results of the research are applicable to all Middle Eastern countries in order to bridge the gap with international standards.

Bibliography

Table of Statutes and Regulations:

A. The UK

- Alternative Investment Fund Managers Regulations 2013.
- Collective Investment Schemes Sourcebook 2014.
- Companies Act 2006.
- Conduct of Business Sourcebook 2016.
- Financial Services Act 1986.
- Financial Services and Markets Act 2000.
- Insolvency Act 1986.
- Open Ended Investment Company Regulations 2001.
- Open Ended Investment Companies (Amendment) Regulations 2011.
- Prevention of Fraud (Investments) Act 1939.
- Prevention of Fraud (Investments) Act 1958.
- Public Trustee Act 1906.
- Taxation of Chargeable Gains Act 1992.
- Undertakings for Collective Investment in Transferable Securities Regulations 2011 (S.I. 2011/1613).

B. The USA

- Dodd-Frank Wall Street Reform and Consumer Protection Act 2010.
- Investment Advisers Act of 1940.
- Investment Company Act of 1940.
- Securities Act of 1933.

- Securities Exchange Act of 1934.

C. Middle Eastern Countries

- Collective Investment Law (DIFC LAW No. 2) 2010 (United Arab Emirates).
- Company Act 2011 (Syria).
- Investment Funds Regulations 2006 (Saudi Arabia).
- Mutual Funds Act 2011(Syria).
- The Capital Market Law (Oman) Available at http://www.fiu.gov.om/files/english/Capital%20Market%20Law/Capital%20Market%20Law.pdf accessed 28 March 2016.
- The Mutual Funds and Investment Companies (Jordan) available at http://www.jsc.gov.jo/Public/English.aspx?Site_ID=1&Page_ID=708 accessed 28 March 2016. In Kuwait available at http://www.kuwaitchamber.org.kw/echamber/docfiles/website/CMS/trlawc17.pdf at accessed 28 March 2016.

D. European Directives

- Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [1985] ojL 375/3.
- Parliament and Council Directive 2001/107/EC amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) with a view to regulating management companies and simplified prospectuses [2002] ojL 41/20.
- Parliament and Council Directive 2001/108/EC amending Council Directive 85/611/EEC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS), with regard to investments of UCITS [2002] ojL 41/35.

- Parliament and Council Directive 2011/61/EU Alternative Investment Fund Managers and amending Directives 2003/41/EC and 2009/65/EC and Regulations (EC) No 1060/2009 and (EU) No 1095/2010 [2011] oj L 174/1.
- Parliament and Council Directive on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) [2009] oj23/203L.
- The European Parliament and the Council Directive 2014/91/EU on amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions [2014] ojL 257/186.

List of Cases

- Abbey National Plc v Customs and Excise Commissioners [2006] S.T.C. 1136. [84].
- AEG Unit Trust (Managers) Ltd's Deed, Re, Midland Bank Executor and Trustee Co Ltd v AEG Unit Trust (Managers) Ltd [1957] Ch 415 at 420.
- Aldred Investment Trust v. SEC 151 F.2d 254 (Ist Cir. 1945).
- Arch Financial Products LLP and others v Financial Services Authority - [2013] All ER (D) 67 (Jan).
- Arning v James [1936] ch.158.
- Bernard L Madoff Investment Securities LLC, Re [2010] EWHC 1299 (Ch). [19].
- Bristol & West Building Society v Mothew [1998] Ch 1 CA.
- Burks v. Lasker, 441 USA. 471 (1979).
- Chamber of Commerce of the U. S, v. S.E.C., 412 F.3d 133 D.C. Cir. (2005).
- Charles v. Federal Commission of Taxation (1954) 90 C.L.R. 598 at 609
- Derry v Peek (1889) LR 14 App Cas 337.

- Famel Pty. Ltd. V. Burswood Management Ltd (1989) 15 ACLR 572. (Australia).
- Gartenberg v. Merrill Lynch Asset Mgmt., Inc., 694 F.2d 923 (2d Cir. 1982).
- Krinsk v. Fund Asset Management, Inc., 875 F.2d 404, 414 (2d Cir. 1989).
- M&G Securities Ltd v Inland Revenue Commissioners; Schroder Unit Trusts Limited Commissioners of Inland Revenue [1999] S.T.C. 315; [1999] B.T.C. 8003. P3.
- Meiselman v. Eberstadt, 170 A.2d 720 (Del. Ch. 1961).
- Navellier v. Sletten, 262 F.3d 923 (9th Cir. 2001).
- Pilmer v The Duke Group Limited (in liq) [2001] HCA 31.
- Re Senator Hanseatische Verwaltungs Mbh [1997] 1 W.L.R. 515.
- Reso v. Artisan Partners L.P., No. 11-CV-873, 2011 WL 5826034 (E.D. Wis. Nov. 18, 2011).
- Saxe v. Brady, 184 A.2d 602 (Del. Ch. 1962).
- Shepherds Investments Ltd v Walters [2006] EWHC 836 (Ch). [9].
- Skyes v. Beadon (1879) 11Ch. D 170.
- Taussig v. Wellington Fund, Inc., 187 F. Supp. 179 (D. Del. 1960).
- TC00946: J P Morgan Fleming Claverhouse Investment Trust plc and The Association of Investment Trust Companies [2011] UKFTT 68 (TC) [32].
- Yacktman v. Carlson, No. 98-278177 (Cir. Ct. Baltimore, Md. filed Oct. 5, 1998).

Books

- Andenas M and Chiu I, *The Foundations and Future of Financial Regulation: Governance for Responsibility* (Routledge, London 2014).
- Arvedlund E, *Madoff: The Man Who Stole $65 Billion* (Penguin, London 2009).

- Baker H and Filbeck G, *Investment Risk Management* (Oxford University Press, New York 2015).

- Bignami F and Zaring D, *Comparative Law and Regulation: Understanding the Global Regulatory Process* (Edward Elgar Publishing, Cheltenham 2016).

- Buckle M and Thompson J, *The UK Financial System Theory and Practice* (4th edn Manchester University Press, Manchester 2004).

- Capocci D, *The Complete Guide to Hedge Funds and Hedge Fund Strategies* (Palgrave Macmillan, New York 2013).

- Carmichael J and Pomerleano, M, *The Development and Regulation of Non-bank Financial Institutions* (World Bank Publications, Washington 2002).

- Davies H and Green D, *Global Financial Regulation: The Essential Guide* (Polity Press, Cambridge 2008).

- Dwyer G, *Financial Crisis of 2008 in Fixed Income Markets* (Diane Publishing, Philadelphia 2010).

- Elton E , Gruber M, Brown S and Goetzmann W, *Modern Portfolio Theory and Investment Analysis* (8th edn John Wiley & Sons, New Jersey 2009).

- Enriques L and Gilotta S 'Disclosure and Financial Market Regulation' in E Ferran, N Moloney and J Payne (eds), *The Oxford Handbook of Financial Regulation* (Oxford University Press, Oxford 2015).

- Ferrarini G, Hopt K and Wymeersch E, *Capital markets in the Age of the Euro* (Kluwer Law International, The Hague 2002).

- Fink M, *The Rise of Mutual Funds: An Insider's View* (2nd edn Oxford University Press, New York 2011).

- Finkelstein B, *The Politics of Public Fund Investing: How to Modify Wall Street to Fit Main Street* (Simon and Schuster, New York 2006).

- Fisher J, *The Law of Investor Protection* (2nd edn Sweet & Maxwell, London 2003).

- Fragnière E and Sullivan G, *Risk Management: Safeguarding Company Assets* (George Sullivan, Boston 2007).
- French D, Mayson, S and Ryan, C, *Mayson, French and Ryan on Company Law* (31st Oxford University Press, Oxford 2014).
- Garton J, Moffat G, Bean G and Probert R, *Moffat's Trusts Law: Text and Materials* (Cambridge University Press, Cambridge 2015).
- Gerber M, *How to Create and Manage a Mutual Fund or Exchange-Traded Fund: A Professional's Guide* (Wiley, Hoboken, NJ, USA 2008).
- Giles M, Alexeeva, E, and Buxton, S, *Managing Collective Investment Funds* (2nd edn John Wiley & Sons, 2005).
- Glusman, D and Ciociola, G, *Fiduciary Duties and Liabilities: Tax and Trust Accountant's Guide* (CCH, Chicago 2006).
- Gremillion L, *Mutual Fund Industry Handbook: A Comprehensive Guide for Investment Professionals* (John Wiley & Sons, New Jersey 2012).
- Gurusamy, *Financial Services* (2nd edn Tata McGraw-Hill Education, New Delhi 2009).
- Haight T, Ross G and Morrell S, *How to Select Investment Managers & Evaluate Performance: A Guide for Pension Funds, Endowments, Foundations, and Trusts* (John Wiley & Sons, New Jersey 2008).
- Hall A, *Getting Started in Mutual Funds* (2nd edn, John Wiley & Sons, New Jersey 2010).
- Haslem J, *Mutual Funds: Portfolio Structures, Analysis, Management, and Stewardship* (John Wiley & Sons, New Jersey 2009).
- Haslem J, *Mutual Funds: Risk and Performance Analysis for Decision Making* (Wiley- Blackwell Publishing Ltd, Oxford 2003).
- Hayton D, Matthews P, Christopher C and Mitchell J, *Underhill and Hayton Law Relating to Trusts and Trustees* (18th edn, LexisNexis 2010).

- Hubbard G, *The Mutual Fund Industry: Competition and Investor Welfare* (Columbia University Press, New York 2010).
- Hudson A, *Equity and Trusts* (3rd edn, Cavendish Publishing, London 2014).
- Hudson A, *The Law of Finance* (Thomson Reuters Limited, London 2009).
- Hudson A, *The Law on Investment Entities* (Sweet & Maxwell Limited, London 2000).
- Hutchinson T, *Researching and Writing in Law* (2nd edn Lawbook Co, Sydney 2006).
- Jones C, *Mutual Funds: Your Money, Your Choice : Take Control Now and Build Wealth Wisely* (FT Press, New Jersey 2003).
- Kershaw D, *Company Law in Context: Text and Materials* (2nd edn OUP, Oxford 2012).
- Kiymaz H, Baker H and Filbeck G, *Mutual Funds and Exchange-Traded Funds: Building Blocks to Wealth* (Oxford University Press, New York 2015).
- Kumar R, *Strategies of Banks and Other Financial Institutions: Theories and Cases* (Elsevier, the USA 2014).
- Loader D, *Fundamentals of Fund Administration: A Guide* (Butterworth-Heinemann, Oxford 2006).
- Lückoff P, *Mutual Fund Performance and Performance Persistence: The Impact of Fund Flows and Manager Changes* (Springer Science & Business Media, Heidelberg 2011).
- Lustig Y, *Multi-Asset Investing: A Practical Guide to Modern Portfolio Management* (Harriman House Limited, Great Britain 2013).
- MacNeil I, *An Introduction to the Law on Financial Investment* (Hart, Oxford and Portland 2005).

- Madlem P and Sykes T, *The International Encyclopedia of Mutual Funds, Closed-end Funds and Real Estate Investment Trusts* (Taylor & Francis, London 2000).
- Magone G, *Regulating Europe* (2nd edn Routledge, New York 2003).
- Mallin C, *Corporate Governance* (4th edn OUP, Oxford 2013) 118.
- Mayo H, *Financial Institutions Investments and Management* (8th edn Thomson South-Western USA 2004).
- Mobius M, *Mutual Funds: An Introduction to the Core Concepts* (John Wiley & Sons, New Jersey 2007).
- Nelken I, *Hedge Fund Investment Management* (Butterworth-Heinemann, Oxford 2005).
- Northcott A, *The Mutual Funds Book: How to Invest in Mutual Funds & Earn High Rates of Returns Safely* (Atlantic Publishing Company, Florida 2009).
- Pozen R and Hamacher T, *The Fund Industry: How Your Money is Managed* (2nd edn John Wiley & Sons, New Jersey 2015).
- Redhead K, *Personal Finance and Investments: A Behavioural Finance Perspective* (Routledge Abingdon Oxon 2008).
- Robertson R, *Fund Governance: Legal Duties of Investment Company Directors* (Law Journal Press, New York 2001).
- Russell R, *An Introduction to Mutual Funds Worldwide* (John Wiley & Sons, Sussex 2007).
- Scott H and Gelpern A, *International Finance: Law and regulations* (3rd edn Sweet and Maxwell, London 2012).
- Scott H, *International Finance: Law and regulations* (2nd edn Sweet and Maxwell, London 2008).
- Siems M, *Comparative Law* (Cambridge University Press, Cambridge 2014).

- Sin F K, *The Legal Nature of the Unit Trust* (Oxford University Press Inc, New York 1997).
- Solomon J, *Corporate Governance and Accountability* (2nd John Wiley & Sons, West Sussex 2007).
- Sperlich M, *Alternative Investments: Existing and Expected Legal Framework for the Operations of Hedge Funds in European and German Law* (Diplomica Verlag, Hamburg 2010).
- The World Bank, *Financial Access and Stability: A Road Map for the Middle East and North Africa MENA Development Report* (World Bank Publications, Washington 2011).
- Turner C, *International Funds: A practical Guide to their establishment and operation* (Butterworth-Heinemann, Great Britain 2004).
- Walker G and Blair M, *Financial Services Law* (Oxford, New York 2006).
- Webb C and Akkouh T, *Trusts Law* (3rd edn, Palgrave Macmillan London 2013).

Journal Articles

- Alshaleel M K, 'Undertakings for the Collective Investment in Transferable Securities Directive V: Increased Protection for Investors' (2016) 13 European Company Law 14-22.
- Atiyah S and Walter A, 'Hedge Funds - An Overview' (2004) 19 Butterworths Journal of International Banking and Financial Law 173-177.
- Benjamin J and Rouch D, 'Providers and Distributors: Responsibilities in Relation to Retail Structured Products' (2007) 1Law and Financial Markets Review 413-421.
- Choi J and Papaioannou M, 'Financial Crisis and Risk Management: Reassessing the Asian Financial Crisis in Light of the American Financial Crisis' (2010) 5 East Asia Law Review 442-468. Available at: http://scholarship.law.upenn.edu/ealr/vol5/iss3/1.

- Cornick T, ‘UK Introduces Open-Ended Investment Companies’ (1997) 29 Int'l Fin. L. Rev 29-32.
- Duties of the Independent Director in Open-End Mutual Funds’ [1972] 70 Mich. L. Rev. http://0-heinonline.org.serlib0.essex.ac.uk/HOL/LuceneSearch?typea=title&termsa=%20Duties%20of%20the%20Independent%20Director%20in%20OpenEnd%20Mutual%20Funds&collection=journals&collection_true=journals&other_cols=yes&searchtype=field&submit=Search accessed 1 November 2013.
- Gray J, ‘Personal finance and corporate governance: The missing link: Product regulation and policy conflicts’ (2004) 4 J. Corp. L. Stud187-220.
- Greenough W and Clapman, P, ‘Role of Independent Directors in Corporate Governance’ (1981) 56 Notre Dame Law Review 916-925.
- Hodge S, ‘Open-Ended Investment Companies’ (1995) 3 J.F.R.& C.321-328.
- Jaretzki A, ‘Duties and Responsibilities of Directors of Mutual Funds’ (1964) 29 Law & Contemp. Probs 777-794.
- Johnson E, ‘The Fiduciary Duty in Mutual Fund Excessive Fee Cases: Ripe for Reexamination’ (2009) 59 Duke Law Journal 145-181.
- Khorana A, Servaes H and Tufano P, ‘Explaining the Size of the Mutual Fund Industry Around the World’ (2005) 78 Journal of Financial Economics 145-185.
- Knickle N, ‘The Mutual Fund’s Section 15(C) Process: Jones V. Harris, the Sec And Fiduciary Duties of Directors’ (2011) 31 Review of Banking & Financial Law 265-340.
- La Porta R, Lopez-de-Silanes F, Shleifer A and Vishny R, ‘Law and finance’ (1998) 106 J.Pol.Econ 1113-1155.
- Lyon A, ‘Money Market Funds and Shareholder Dilution’ (1984) 39 the Journal of Finance, 1011-1020.
- Mahoney P, ‘Manager-investor conflicts in mutual funds’ (2004) 18 Journal of Economic Perspectives 161–182.

- McClean A, ‘The Extraterritorial Implications Of The Sec's New Rule Change To Regulate Hedge Funds’(2006) 38 Journal of International Law 105-122.
- McCormack G, ‘OEICs and trusts: the changing face of English investment law’ (2000) 21 Co Law 2-13.
- Morley J and Curtis Q, ‘Taking Exit Rights Seriously: Why Governance and Fee Litigation Don’t Work in Mutual Funds’ (2010) 120 Yale Law Journal 84-142.
- Nagy D, ‘Regulating the Mutual Fund Industry’ (2006) 1 Journal of Corporate, Financial & Commercial Law11-44.
- Palmiter A and Taha A, ‘Mutual Fund Investors: Divergent Profiles’ (2008) 1 Columbia Business Law Review 934-1020.
- Poterba J and Samwick A, ‘Taxation and Household Portfolio Composition: USA. Evidence from the 1980s and 1990s’ (2003) 87 Journal of Public Economics 5-38.
- Radin R and Stevenson W, ‘Comparing Mutual Fund Governance and Corporate Governance’ (2006) Corporate Governance: An International Review 14 367-376.
- Radmer M, ‘Duties of the Directors of Investment Companies’ (1977) 3 Journal of Corporation Law 61-111.
- Richardson J B, ‘Ethical Finance in Britain: A Neglected Prerequisite for Sustainability’ (2003) 5 Environmental Law Review 109-133.
- Riggs D, and Park C, ‘Mutual Funds: A Banker's Primer’ (1995) 112 Banking L.J. 757-785.
- Roiter E, ‘An Apology for Mutual Funds: Delivering Fiduciary Services to Middle and Working Class Investors’ (2004) 23 Annual Review of Banking & Financial Law 851-862.
- Roiter E, ‘Disentangling Mutual Fund Governance from Corporate Governance’ (2015) 5 Harvard Business Law Review, paper number 15-18.
- Romanski D, ‘Role of Advertising in the Mutual Funds Industry’ (1972) 13 Boston College Industrial and Commercial Law Review 959-1020.

- Sami G, ‘A Comparative Analysis of Hedge Fund Regulation in the United States and Europe’ (2009) 29 Nw. J. Int'l L. & Bus 275-308.

- Schubauer D, ‘Inadequacy of the UCITS Directive in a Global Marketplace’ (2002) 21 N.Y.L. Sch. J. Int'l & Comp. L323-338.

- Sergeeva G, I, ‘Collective investment schemes regulations’ (209) 3a Scientific journal NRU ITMO 1-13.

- Stein J, ‘Why are most funds open-end? competition and the limits of arbitrage’ (2005) 120 The Quarterly Journal of Economics 247-272.

- Tiffith L, ‘Hedge Fund Regulation: What the FSA Is Doing Right and Why the SEC Should Follow the FSA's Lead’ (2007) 27 Nw. J. Int'l L. & Bus 497-532.

- Tobe C, ‘Mutual Fund Directors: Governance Changes Proposed for Independent Directors in the US’ (2000) 8 Corporate Governance 25-31.

- Warburton J, ‘Should Mutual Funds Be Corporations? A Legal & Econometric Analysis’ (2008) 33 J. Corp. L 746-776.

- Zimmer S, ‘Securities And Exchange Commission's Enhanced Disclosure and New Prospectus delivery Option for Registered Mutual Funds’ (2009) 83 St. John's Law Review 1431-1468.

Miscellaneous (General Publications, Reports, Papers, Online Articles and Online Sources)

- Aberdeen Investment Funds ICVC Prospectus 2013 http://www.aberdeen-asset.co.uk/pdfupload.nsf/7DBCF3FACD680392802571BF002ABD54/$file/icvc prospectus.pdf?OpenElement accessed at 22 March 2015.

- Alliance Trust Investment Funds ICVC Prospectus. Available at: http://www.alliancetrustinvestments.com/global/documents/8012/full-prospectus.pdf accessed 28 July 2015.

- American Investment Company Institute, '2015 Investment Company Fact Book' (55th Edition, 2015).

- Board of Trade, Report of the Company Law Committee, 1962 (cmnd.1749).
- Carter, D, Mutual Fund Boards and Shareholder Action available at http://cyber.law.harvard.edu/rfi/papers/mutualboards.PDF accessed 26 June 2015.
- Dartley, E, 'Lessons Learned from the Morgan Keegan Case,' [2013] (17) Wall Street Lawyerhttp://www.pepperlaw.com/publications_update.aspx?ArticleKey=2692 accessed 16 October 2014.
- Department of Trade and Industry, 'White Paper Financial Services in the United Kingdom: A New Framework for Investor Protection' (Cmnd. 9432, 1985).
- Departmental Committee, Fixed Trust report, 1936 (Cmd. 5259) p.5.
- Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management Investment Companies, Investment Company Act Release No. 28584 (Jan. 13, 2009) [74 R 4546 (Jan. 26, 2009)] ("Adopting Release"), available at: http://www.sec.gov/rules/final/2009/33-8998.pdf.
- European Commission, 'Greater protection for retail investors: Commission welcomes European Parliament adoption of strengthened European rules on UCITS' (2014) http://europa.eu/rapid/press-release_STATEMENT-14-121_en.htm accessed 13 March 2015.
- Ferguson, M, UCITS IV Transforming the European Investment Fund Industry, available at: http://www.vaioe.at/fileadmin/user_upload/tax_legal/Klassische_Fonds/Allgemeine_Informationen/EY__UCITS_IV.pdf, accessed 16 June 2014.
- Financial Conduct Authority, Policy Statement PS 16/2 'Implementation of the UCITS V Directive' (February 2016). Available at https://www.fca.org.uk/static/documents/policy-statements/ps16-02.pdf accessed 1st May 2016.
- Financial Services Compensation Scheme, Compensation Limits. Available at: http://www.fscs.org.uk/what-we-cover/compensation-limits/ accessed 29 March 2016.

- Financial Services Compensation Scheme, Funding. Available at: http://www.fscs.org.uk/industry/funding/ accessed 29 March 2016.
- Form N-1A is available at: http://www.sec.gov/about/forms/formn-1a.pdf.
- Garbaravicius, T and Dierick, F, Hedge Funds and Their Implications for Financial Stability. European Central Bank Occasional paper series no. 34 (2005).
- Gower, L C B, Review of Investor Protection: Report Part I, 1984 (Cmnd 9125).
- Gower, L C B, Review of Investor Protection: Report: Part II, 1985.
- Hedge Fund Intelligence, http://www.hedgefundintelligence.com/Article/3269985/Global-hedge-fund-assets-near-235-trillion-as-big-firms-drive-growth.html accessed 16 April 2015.
- How we enforce the law, available at http://www.fca.org.uk/firms/being-regulated/enforcement/how-we-enforce-the-law accessed 5 April 2016.
- International Organization of Securities Commissions, 'Objectives and Principles of Securities Regulation' (May 2003) available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf accessed 4 April 2016.
- International Organization of Securities Commissions, '*Peer Review of Regulation of Money Market Funds: Final Report'* (FR19, September 2015). Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD502.pdf accessed 15 February 2016.
- International Organization of Securities Commissions, 'Risk Management and Control Guidance for Securities Firms and their Supervisors' (May 1998) available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD78.pdf accessed 28 March 2016
- Meaning of open-ended investment company (AUTH App 2) 2004, 2.6.2. http://fshandbook.info/FS/html/handbook/AUTH/App/2 accessed 11 May 2014.

- Objectives and Principles of Securities Regulation, IOSCO. Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD82.pdf accessed 27 March 2016.

- OECD's Committee, 'White paper on Governance of Collective Investment schemes' (No. 88, March 2005) [P1].

- Principles for the Supervision of Operators of Collective Investment Schemes, IOSCO. Available at https://www.iosco.org/library/pubdocs/pdf/IOSCOPD69.pdf accessed 27 March 2016.

- Proposal for a Directive of the European Parliament and of the Council amending Directive 2009/65/EC on the coordination of laws, regulations and administrative provisions relating to undertakings for collective investment in transferable securities (UCITS) as regards depositary functions, remuneration policies and sanctions /* COM/2012/0350 final - 2012/0168 (COD). Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52012PC0350, accessed 13 June 2014.

- Report on Investment Management, IOSCO. The report is available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf accessed 27 March 2016.

- Review of the Governance Arrangements of United Kingdom Authorised Collective Investment Schemes, report by the Investment Management Association (November 2004) 16. Available at http://www.theinvestmentassociation.org/assets/files/press/2004/20041104-01.pdf accessed 5 May 2015.

- Rouwenhorst, G, 'The Origins of Mutual Funds' (2004) Yale School of Management - International Centre for Finance 4-48. Available at SSRN: http://ssrn.com/abstract=636146.

- SEC Interpretation: Matters Concerning Independent Directors of Investment Companies available at https://www.sec.gov/rules/interp/ic-24083.htm accessed 9 June 2015.

- Securities and Exchange Commission ‘Letter to the ICI Regarding Valuation Issues: Division of Investment Management’ (April 2001) available at: http://www.sec.gov/divisions/investment/guidance/tyle043001.htm, accessed 16 October 2014.

- Securities and Exchange Commission, Administrative Proceeding File No. 3-15127. Available at: http://www.sec.gov/litigation/admin/2012/ic-30300.pdf, accessed 16 October 2014.

- Securities and Exchange Commission, Money Markets Funds Amendments, Final Rule (2010). Available at https://www.sec.gov/rules/final/2010/ic-29132.pdf accessed 2 May 2016.

- Securities and Exchange Commission, 'SEC Proposes Liquidity Management Rules For Mutual Funds And ETFs' (2015) available at https://www.sec.gov/news/pressrelease/2015-201.html accessed 3 June 2016.

- Statista: The Statistics Portal, available at: http://www.statista.com/statistics/421215/banks-assets-globally/ accessed 31 May 2016.

- Testimony on “Perspectives on Money Market Mutual Fund Reforms” by Chairman Mary L. Schapiro, USA. Securities and Exchange Commission available at http://www.sec.gov/News/Testimony/Detail/Testimony/1365171489510 accessed 2 May 2008.

- The FCA objectives available at http://www.fca.org.uk/about/what accessed 11 April 2016.

- The International Organization of Securities Commissions (IOSCO) ‘Principles for the Regulation of Collective Investment Schemes’ (1994) available at http://www.iosco.org/library/pubdocs/pdf/IOSCOPD40.pdf accessed 17 April 2016.

- The Investment Management Association, ‘Authorised Funds: A Regulatory Guide’ (March 2012). Available at http://www.investmentfunds.org.uk/policy-and-publications/industry-guidance/ accessed 24 July 2014.

- The Investment Management Association, ‘Authorised Funds: A Regulatory Guide’ (March 2012). Available at http://www.investmentfunds.org.uk/policy-and-publications/industry-guidance/ accessed 24 July 2014.

- The Modern Law Review, ‘Reports of Committees: Fixed and Flexible Trusts’ [2011] (1) Wiley Online Libraryhttp://onlinelibrary.wiley.com/doi/10.1111/j.1468-2230.1937.tb00008.x/pdf accessed 7 July 2014.

- The Proposal for a Regulation of the European Parliament and of the Council on Money Market Funds, available at: http://ec.europa.eu/internal_market/investment/docs/money-market-funds/130904_mmfs-regulation_en.pdf accessed 15 February 2016.

- The UK Corporate Governance Code, Financial Reporting Council (2014) available at https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf accessed 4 August 2015.

- Towers Watson, 'Global Pension Assets Study 2013' (2013). <http:// http://www.towerswatson.com/en/Insights/IC-Types/Survey-Research-Results/2013/01/Global-Pensions-Asset-Study-2013 > accessed 19 September 2013.

- Update for CF Arch Cru customers compensated via interim payment method. Available at: http://www.fscs.org.uk/news/2016/february/update-for-cf-arch-cru-customers-compensated-via-interim-payment-method/ accessed 15 February 2016.

- Varga, G and Wengert, M, ‘The Growth and Size of the Brazilian Mutual Fund Industry’ paper presented at the annual meeting of the BALAS Annual Conference, ESADE, Barcelona, Spain, Mar 24, 2010 < http://www.fce.com.br/gv/artigos/2010_BrazilianMutualFundIndustry.pdf> accessed 22 September 2013.

- YCharts, available at https://ycharts.com/indicators/us_banks_total_assets accessed 1 June 2016.