

CHAPTER

12

MUTUAL FUNDS

Covering-

- ABC Analysis
- Overview of Mutual Funds Industry in India
- Mutual Funds - Meaning
- Mutual Funds – Advantage
- Risks Involved in Mutual Funds
- Administration of Mutual Fund
- Scheme of Mutual Funds
- Infrastructure Debt Fund Schemes
- Capital Protection Oriented Schemes
- Distinguish Between ‘Leverage Funds’ and ‘Hedge Funds’
- Calculation of Net Asset Value (NAV)
- Various Factors for Judging the Efficiency of Mutual Funds
- Mutual Fund Costs
- SEBI (Mutual Fund) Regulations, 1996
- SEBI listing Regulations, 2015
- Self Test Questions
 - From Past CS Examination Questions
 - From ICSI Module

**EXPECTED
MARKS COVERAGE
(5 to 10)**

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MUTUAL FUNDS

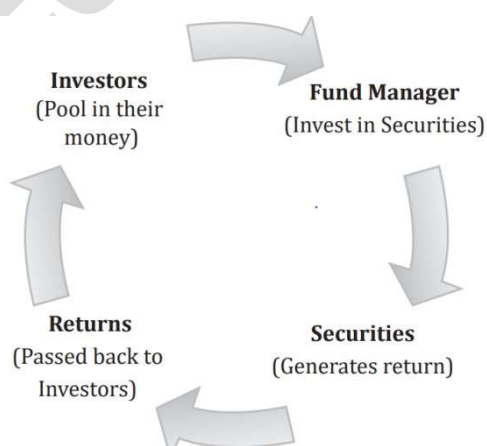
POOLED INVESTMENT VEHICLES ('PIVS')

SECTION 2 (da) OF SCRA, 1956

'Pooled Investment Vehicle' means a **fund** established in India in the **form of a trust or otherwise**, such as **mutual fund, alternative investment fund, collective investment scheme or a business trust** as defined in sub-section (13A) of section 2 of the Income tax Act, 1961 and **registered with the Securities and Exchange Board of India, or**

such other fund, which raises or collects monies from investors and invests such funds in accordance with such regulations as may be made by the Securities and Exchange Board of India in this behalf

MUTUAL FUNDS



The **small investors who generally lack expertise to invest on their own** in the securities market prefer some kind of collective investment vehicle like Mutual Funds (MFs), which pool their marginal resources, invest in securities and distribute the returns there from among them on cooperative principles.

This approach was conceived in the **USA in the 1930s**.

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WHAT IS A MUTUAL FUND ?

1. As the two words, **Mutual** connotes **getting together** and **Fund** connotes **money**.
2. a Mutual Fund is a **vehicle** for **investing money for investors** with a **common objective**. A Mutual Fund is a **trust** that collects money from investors who share a common financial goal, and invest the proceeds in different asset classes, as defined by the investment objective.
3. Simply put, mutual fund is a **financial intermediary**, set up with an objective to **professionally manage the money pooled from the investors at large**.
4. By pooling money together in a mutual fund, **investors can enjoy economies of scale** and can purchase stocks or bonds at a **much lower trading costs** *compared to direct investing in capital markets*.
5. Mutual Fund **means a fund established in the form of a trust to raise monies through the sale of units** to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments.

MUTUAL FUNDS- ADVANTAGES

The advantages of investing in a mutual fund are:

1. **Professional Management:** Investors avail the services of **experienced and skilled professionals** who are backed by a **dedicated investment research team** which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.
2. **Diversification:** Mutual funds invest in a **number of companies across a broad cross-section of industries and sectors**. This diversification reduces the risk *because seldom do all stocks decline at the same time and in the same proportion*. Investors achieve this diversification through a Mutual Fund with far less money than one can do on his own.
3. **Convenient Administration:** Investing in a mutual fund **reduces paper work** and helps investors to **avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies**. Mutual funds save investors time and make investing easy and convenient.
4. **Return Potential:** Over a **medium to long term**, Mutual funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.
5. **Low Costs:** Mutual funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the **benefits of scale in brokerage, custodial and other fees** translate into lower costs for investors.
6. **Liquidity:** In open ended schemes, **investors can get their money back** promptly at net asset value related prices **from the mutual fund itself**. With close ended schemes, investors can sell their units on a stock exchange at the **prevailing market price**.
7. **Transparency:** Investors get **regular information on the value of their investment** in addition to disclosure on the specific investments made by scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

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RISKS INVOLVED IN MUTUAL FUNDS

Mutual funds may face the following risks, leading to <u>non-satisfactory performance</u> :	1. Excessive diversification of portfolio, losing focus on the securities of the key segments .
	2. Too much concentration on blue-chip securities which are high priced and which do not offer more than average return.
	3. Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission .
	4. Poor planning of investment with minimum returns.
	5. Unresearched forecast on income, profits and Government policies.
	6. Fund managers being unaccountable for poor results.
	7. Failure to identify clearly the risk of the scheme as distinct from risk of the market .

In a broader sense, mutual fund risk can be categorized as – **systematic risk and unsystematic risk**

Types of Risks	Cause of Risk
Volatility risk	The value of such funds is based on companies' performance , which often gets affected due to the prevalent microeconomic factors .
Credit risk	Credit risk in mutual fund investment often results from a situation, wherein, the issuer of the scheme fails to pay the promised interest
Liquidity risk	Such a risk signifies that investors often find it challenging to redeem their investments without incurring a loss .
Concentrated risk	It can be described as the situation when investors tend to put all their money into a single investment scheme or in one sector .
Inflation risk	It can be best described as the risk of losing one's purchasing power , mainly due to the rising inflation rate

OVERVIEW OF MUTUAL FUNDS INDUSTRY IN INDIA

(a) Started with the introduction of Unit Trust of India (UTI) – in 1963.
(b) Public sector companies started setting up mutual funds, beginning with SBI Mutual Fund in 1987 . This was followed by Canbank Mutual Fund, Punjab National Bank Mutual Fund, Bank of Baroda Mutual Fund, etc.
(c) Private sector mutual funds started in 1993 ; Franklin Templeton (erstwhile Kothari Pioneer) was the first of its kind.
(d) After the Securities and Exchange Board of India (SEBI) Act was passed in 1992, the SEBI Mutual Fund Regulations came into being in 1996 .
(e) As the industry expanded, a non-profit organization, the Association of Mutual Funds in India (AMFI) , was established on 1995. Its objective is to promote healthy and ethical marketing practices in the Indian mutual fund Industry. SEBI has made AMFI certification mandatory for all those engaged in selling or marketing mutual fund products

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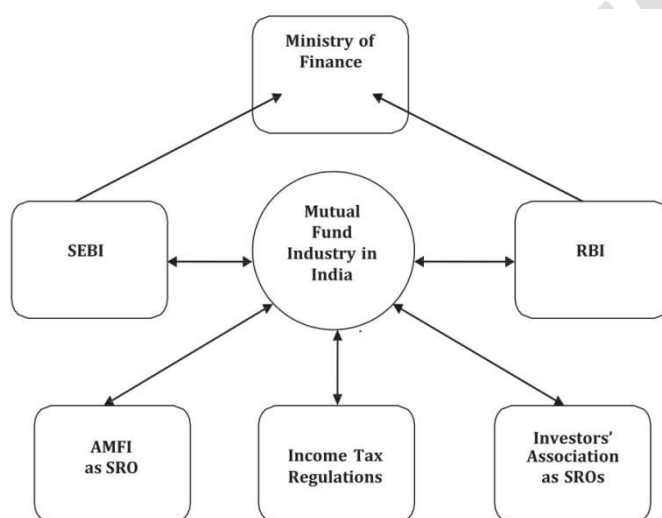


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STAKEHOLDERS IN INDIAN MUTUAL FUND INDUSTRY

List of all stakeholders in Indian mutual fund industry is as follows:

(a) Ministry of Finance
(b) Securities and Exchange Board of India (SEBI)
(c) Reserve Bank of India (RBI)
(d) Association of Mutual Funds in India (AMFI)
(e) Self Regulatory Organisation (SROs)
(f) Investors' Associations
(g) Income Tax Regulations



REGULATOR & INDUSTRY BODY

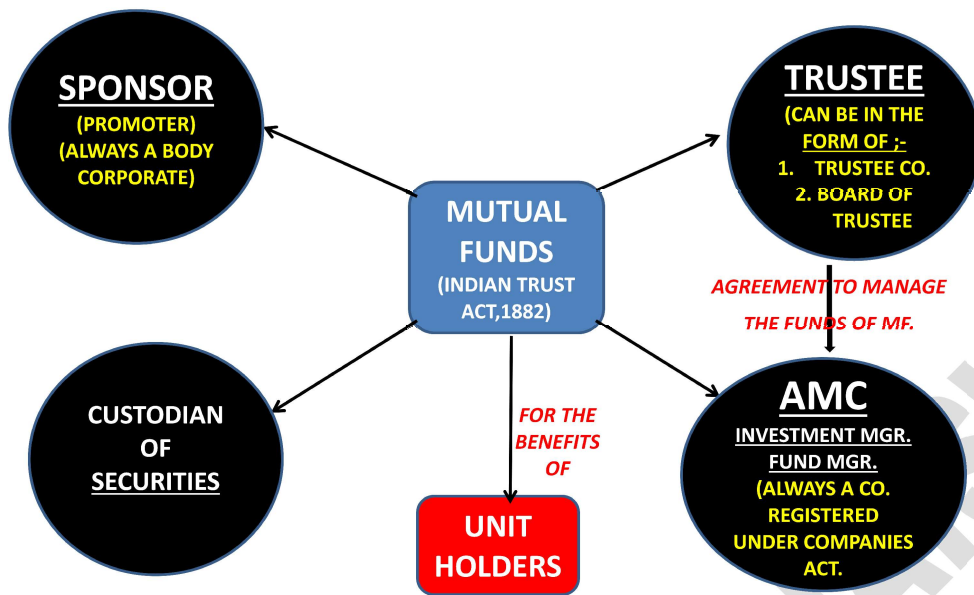
Regulator: Securities and Exchange Board of India (SEBI)

- (a) Regulates mutual funds, custodians and registrars & transfer agents
- (b) The applicable guidelines for mutual funds are set out in SEBI (Mutual Funds) Regulations, 1996; updated periodically

Industry Body: Association of Mutual Funds in India (AMFI)

- (a) All 44 AMCs are members of AMFI (Source : www.amfiindia.com)
- (b) Recommends and promotes best business practices and code of conduct
- (c) Disseminates information and carries out studies/research on mutual fund industry

MUTUAL FUNDS - ADMINISTRATION



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ADMINISTRATION/CONSTITUENTS OF MUTUAL FUND

Five principal constituents

1. <u>MUTUAL FUND</u>
A mutual fund established under the Indian Trust Act to raise money through, the sale of units to the public for investing in the capital market . The funds thus collected as per the directions of asset Management Company for invested. The mutual fund has to be SEBI registered.
2. <u>ASSET MANAGEMENT COMPANY (AMC)-</u>
Under SEBI (Mutual Fund) Regulations, 1996 every mutual fund is required to have an Asset Management Company (AMC) incorporated in the Companies Act, 1956/2013 to manage the funds of the mutual fund.
The AMC should be approved by SEBI and should enter into an agreement with the trustees of the mutual fund. Appointment of AMC can be terminated by the majority of trustee or by not less than 75% of the unit holders of the scheme.
3. <u>SPONSOR-</u>
Sponsor means any person who, acting alone or in combination with another body corporate establishes a mutual fund.
4. <u>TRUSTEES –</u>
Trustees mean the Board of Trustees or the Trustee Company who hold the property of the mutual fund in trust for the benefit of the unit holders.
5. <u>UNIT HOLDERS–</u>
A unitholder is an investor who owns the units issued by a trust, like a real estate investment trust or a master limited partnership (MLP). The securities issued by trusts/MF are called units , and investors in units are called unitholders. The unit in turn reflect share of the investor in the Net Assets of the fund.

Three market intermediaries are:

1. <u>CUSTODIAN OF SECURITIES-</u>
Custodian means a person who has been granted a certificate of registration to carry on the business of custodian securities under SEBI (Custodian of Securities) Regulations, 1996.
2. <u>TRANSFER AGENTS</u>
A transfer agent is a person who has been granted a Certificate of Registration to conduct the business of transfer agent under SEBI Regulations Act 1993. Transfer agents' services include issue and redemption of mutual fund units, preparation of transfer documents and maintenance of updated investment records. They also record transfer of units between investors where depository does not function. They also facilitate investors to get customized reports.
3. <u>DEPOSITORY</u>
A depository facilitates the smooth flow of trading and ensure the investors about their investment in securities.

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ELIGIBILITY CRITERIA FOR REGISTRATION OF MUTUAL FUNDS

For the purpose of grant of a certificate of registration, the applicant has to fulfill the following, namely –

- (a) the sponsor should have a **sound track record and general reputation of fairness and integrity** in all his business transactions.

Explanation: For the purposes of this clause “**sound track record**” shall mean the sponsor should –

(i) be carrying on business in financial services for a period of not less than five years ; and
(ii) the networth is positive in all the immediately preceding five years ; and
(iii) the networth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company; and
(iv) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years , including the fifth year;

- (b) the applicant is a **fit and proper person**. in the case of an existing mutual fund, such fund is in the form of a **trust** and the **trust deed** has been approved by the Board.
- (c) the **sponsor** has **contributed or contributes at least 40% to the net worth** of the asset management company.
 Provided that **any person** who holds **40% or more of the net worth of an asset management company** shall be deemed to be a **sponsor** and will be required to fulfill the eligibility criteria specified in these regulations
- (d) the **sponsor** or **any of its directors** or the **principal officer** to be employed by the mutual fund should not have been **guilty of fraud** or has not been convicted of an offence **involving moral turpitude** or has not been found guilty of **any economic offence**
- (e) appointment of **trustees to act as trustees** for the mutual fund in accordance with the provisions of the regulations
- (f) appointment of **asset management company** to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations
- (g) appointment of **custodian** in order to keep custody of the securities or goods or gold and gold related instrument or other assets of the mutual fund held in terms of SEBI (Mutual Fund) Regulations, 1996 and provide such other custodial services as may be authorised by the trustees.

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ELIGIBILITY CRITERIA FOR APPOINTMENT OF ASSET MANAGEMENT COMPANY

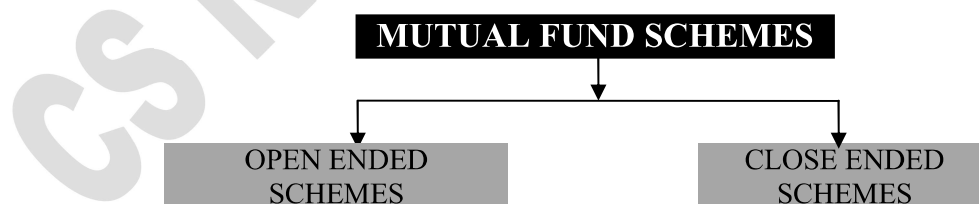
- (a) in case the asset management company is an existing asset management company **it has a sound track record, general reputation and fairness in transactions;**
- (b) the asset management company is a **fit and proper person;**
- (c) the **directors** of the asset management company are persons having **adequate professional experience** in finance and **financial services related field** and not **found guilty of moral turpitude** or convicted of any **economic offence** or violation of any **securities laws;**
- (d) the **key personnel** of the asset management company **have not been found guilty of moral turpitude** or convicted of **economic offence** or violation of **securities laws** or **worked for any** asset management company or mutual fund or any intermediary during the period when its registration has been **suspended or cancelled** at any time by the Board;
- (e) the **board of directors** of such asset management company has at least **fifty per cent directors, who are not associate of, or associated** in any manner with, the sponsor or any of its subsidiaries or the trustees;
- (f) the **Chairman** of the asset management company **is not a trustee of any mutual fund;**
- (g) the asset management company has a **networth of not less than rupees fifty crore;**

however Where the sponsor does not fulfil the requirements of regulation 7 at the time of making application, the asset management company shall be required to have a networth of not less than rupees one hundred crore

TERMS AND CONDITIONS OF REGISTRATION

- (a) the trustees, the sponsor, the asset management company and the custodian **shall comply** with the provisions of **SEBI (Mutual Fund) Regulations, 1996.**
- (b) the mutual fund shall forthwith **inform the SEBI**, if any information or particulars previously submitted to the SEBI was **misleading or false** in any material respect.
- (c) the mutual fund **shall forthwith inform the SEBI, of any material change** in the information or particulars previously furnished, which have a bearing on the registration granted by it.
- (d) payment of **fees** as specified in the SEBI (Mutual Fund) Regulations, 1996 regulations.

SCHEMES OF MUTUAL FUNDS



- A. Open ended mutual funds:** An open ended mutual funds is a fund with a non-fixed number of outstanding shares/units, that stands ready at any time to redeem them on demand. The fund itself buys back the shares surrendered and is ready to sell new shares. Generally the transaction takes place at the net asset value which is calculated on a periodical basis.
- B. Close ended mutual funds:** It is the fund where mutual fund management sells a limited number of shares and does not stand ready to redeem them. The shares of such mutual funds are traded in the secondary markets. The requirement for listing is laid down to grant liquidity to the investors who have invested with the mutual fund. Therefore, close ended funds are more like equity shares.

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The main **differences** between close ended and open ended funds are:

CLOSE ENDED SCHEMES	OPEN ENDED SCHEMES
1. Can be purchased only during NFO (new fund offer)	1. Can be purchased on any transaction day
2. Fixed corpus: no new units can be offered beyond the limit	2. Variable corpus due to on going purchase and redemption
3. Listed on the stock exchange for buying and selling	3. No listing on exchange transactions done directly with the fund
4. Two values available namely NAV and the Market Trading Price	4. Only one price namely NAV
5. Mostly liquid	5. Highly Liquid

TYPES OF MUTUAL FUND PLANS

REGULAR PLANS	Direct PLANS
Sold through a distributor	Sold directly by the AMC
Higher Expense Ratio (Due to commissions paid to distributor)	Lower Expense Ratio (No commission paid to distributor)
Potentially lower returns to the investor (Due to higher expenses)	Potentially higher returns (Due to lower expenses)

TYPES OF MUTUAL FUNDS (MFs)- SCHEMES ACCORDING TO INVESTMENT OBJECTIVE

1. **Income Oriented MF/Schemes:** The fund primarily offer fixed income to investors Naturally enough, the main securities in which investments are made by such funds are the fixed income yielding ones like bonds.

2. **Growth Oriented MF/Schemes:** These funds offer growth potentialities associated with investment in capital market namely:

(i) high source of income by way of dividend and
(ii) rapid capital appreciation, both from holding of good quality scrips. These funds, with a view to satisfying the growth needs of investors, primarily concentrate on the low risk and high yielding spectrum of equity scrips of the corporate sector.

3. **Hybrid MF/ Schemes:** These funds cater to both the investment needs of the prospective investors - namely fixed income as well as growth orientation. Therefore, investment targets of these mutual funds are judicious mix of both the fixed income securities like bonds and debentures and also sound equity scrips. In fact, these funds utilise the concept of balanced investment management. These funds are, thus, also known as “balanced funds”.

4. **Money Market Mutual Funds:** These funds invest in short- term debt securities in the money market like certificates of deposits, commercial papers, government treasury bills etc. Owing to their large size, the funds normally get a higher yield on such short term investments than an individual investor.

5. **Tax Saving MF/ Schemes:** These schemes offer tax rebates to the investors under tax laws as prescribed from time to time. This is made possible because the Government offers tax incentive for investment in specified avenues. For example, Equity Linked Saving Schemes (ELSS) and pensions schemes.

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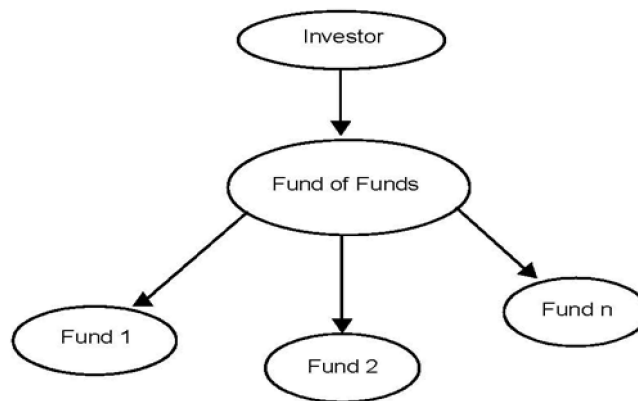
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6. **Real Estate Funds:** These are close ended mutual funds which invest predominantly in real estate and properties.
7. **Hedge Funds:** They employ their funds for speculative trading, i.e. for buying shares whose prices are likely to rise and for selling shares whose prices are likely to dip.
8. **Fund of Funds:** They invest only in units of other mutual funds. Such funds do not operate at present in India.



9. **Gold exchange traded funds**

Gold Exchange Traded Fund scheme shall mean a mutual fund scheme that invests primarily in gold or gold related instruments.

10. **Special Schemes**

This category includes **index schemes** that attempt to replicate the performance of particular index such as the **BSE, Sensex or the NSE-50** or **industry specific schemes** (which invest in specific industries) or **sectoral schemes** (which invest exclusively in segment such as **'A' Group or initial public offering**). Index fund schemes are ideal for investors who are satisfied with a return approximately equal to that of an index. Sectoral fund schemes are ideal for investors who have already decided to invest in particular sector or segment.

11. **Off-shore Funds**

Such funds invest in securities of **foreign companies** with RBI permission.

12. **New Direction Funds**

They invest in companies engaged in **scientific and technological research** such as birth control, anti-pollution, oceanography etc

13. **Exchange Trade Funds (ETFs)**

are a new variety of mutual funds that first introduced in 1993. ETFs are sometimes described as mere "tax efficient" than traditional equity mutual funds, since in recent years, some large ETFs have made smaller distribution of realized and taxable capital gains than most mutual funds.

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INFRASTRUCTURE DEBT FUNDS SCHEMES

They invest primarily in the debt securities or securitized debt investment of infrastructure companies.

CAPITAL PROTECTION ORIENTED SCHEMES

It is a scheme **which protects the capital invested in the mutual fund** through suitable orientation of its portfolio structure.

DISTINGUISH BETWEEN 'LEVERAGE FUNDS' AND 'HEDGE FUNDS'

<u>Basis of Difference</u>	<u>Leverage Funds</u>	<u>Hedge Funds</u>
1. Meaning	Leverage funds are also known as borrowed funds.	Hedge funds are not borrowed funds; they are used for speculative trading. Hedge funds employ their funds for speculative trading, i.e. for buying shares, whose price are likely to rise and for selling shares whose prices are likely to fall.
2. Increase in portfolio.	Leverage funds increase the size of portfolio.	Hedge funds don't increase the portfolio size and value.
3. Risk factor.	Leverage funds are less risky.	Hedge funds are more risky.

CALCULATION OF NET ASSET VALUE (NAV)

What is NAV?

- (a) The value of one unit of a mutual fund scheme on a given date
- (b) It has to be declared by fund houses on every business day – on AMC website and AMFI website
- (c) Mutual funds raise money by selling their shares to public and redeeming them at current net asset value.
Net asset value is the value of the assets of each unit of the scheme.

How is it calculated?

(Net Asset Value per share value of the fund's is total net assets after liabilities divided by the total number of shares outstanding on a given day)

$$\text{Net Asset Value} = \frac{\text{Net Asset of the Scheme}}{\text{Number of units outstanding}}$$

Net Asset of the Scheme = Market value of investments + Receivables + other accrued income + other assets – Accrued Expenses – Other Payables – Other Liabilities

Thus if the **NAV is the more than the face value of 10/-**, there is an **appreciation** for the investment. If the NAV is less than the face value, it indicates depreciation of the investment.

Every mutual fund shall compute the NAV of each scheme by dividing the net asset of the scheme by the number of units of that scheme outstanding on the date of valuation and 'disclosed in the manner specified by SEBI

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HOLDING PERIOD RETURN

Holding period return is the **total return received from holding an asset or portfolio of assets over a period of time**, generally expressed *as a percentage*. Holding period return is calculated on the basis of total returns from the asset or portfolio – i.e. income plus changes in value. It is particularly useful for comparing returns between investments held for different periods of time.

Calculation of HPR

$$\text{HPR} = \frac{\text{Income} + (\text{end of period value} - \text{original value}) \times 100}{\text{Original Value}}$$

Illustration

Calculate HPR for a unit holder who bought a unit at ₹ 17.60 and received a dividend of ₹ 2 per unit during the period. Face value of the unit is ₹ 10 and current unit price is ₹ 19.875

$$\text{HPR} = \frac{\text{Dividend} + (\text{NAV at present} - \text{NAV at purchase})}{\text{NAV at Purchase}} \times 100$$

$$= \frac{2 + (19.875 - 17.60)}{17.60}$$

$$\text{HPR} = 24.29\%$$

VARIOUS FACTORS FOR JUDGING THE EFFICIENCY OF MUTUAL FUNDS/ EVALUATING PERFORMANCE OF MUTUAL FUND

While looking at a mutual fund scheme's performance, one must not be led by the scheme's return in isolation.

One must compare the **scheme's return** as against its **benchmark return**.

It is important to identify **under-performers** over the longer time horizon.

In addition, one may also consider evaluating the '**category average returns**' as well

Even the **expense ratio** of some of the schemes that one could be holding may be high compared to others within the same category.

MUTUAL FUND COSTS

1. **Operating Expenses:** Costs incurred in operating mutual funds include advisory fees paid to investment managers, custodial fees, audit fees, transfer agent fees, trustee fees, agents commission etc.
2. **Sales Charges/Loads:** These are otherwise called as sales loads and are charged directly to the investors. Mutual funds use the sales loads for payment of agents commission and expenses for distribution and marketing. Sales charges have no impact on the performance of the scheme as these are collected from the investor.

There are 2 types of Sales Charges/Loads:-

- (a) **Front end load (entry load):** Front end load is a one time fixed fee which is paid by an investor while he buys into a scheme. Front end loads can be calculated as follows:-

$$\text{Public Offer (purchase) Price} = \frac{\text{Net Asset Value}}{(1 - \text{Front end load})}$$

- (b) **Back end Load (exit load):** This will be a fixed fee redemption load and is paid only at the time of redeeming or selling units of a load. This can be calculated as:

$$\text{Redemption price} = \frac{\text{Net Asset Value}}{(1 + \text{Back end load})}$$

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It may be noted that SEBI has decided **not to charge entry load for direct applications received by the Asset Management Company (AMC)** i.e. applications received through internet, submitted to AMC or collection centre/ Investor Service Centre that are **not routed through any distributor/agent/broker**.

Illustration

The redemption price of mutual fund unit is ₹ 48 while the front end load and back end load charges are 2% and 3% respectively. **Compute:**

(i) NAV per unit

(ii) Public offer price of the unit.

Solution:

$\text{Redemption Price} = \frac{\text{NAV}}{(1 + \text{Back Load})}$ $48 = \frac{\text{NAV}}{1 + 0.03}$ $= 48 \times 1.03$ $\text{NAV} = ₹ 49.44$	$\text{Public Offer Price} = \frac{\text{NAV}}{(1 - \text{Front End Load})}$ $= \frac{49.44}{1 - 0.02}$ $= \frac{49.44}{0.98}$ $\text{Public Offer Price} = ₹ 50.45$
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EXPENSE RATIO

The fees charged by the scheme to *manage investors' money*.

What does it contain?

(a) Fees paid to service providers like trustees, Registrar & Transfer Agents, Custodian, Auditor, etc.
(b) Asset management expenses
(c) Commissions paid to distributors
(d) Other selling expenses including advertising expenses
(e) Expenses on investor communication, account statements, dividend / redemption cheques / warrants
(f) Listing fees and Depository fees

Under SEBI (Mutual Funds) Regulations, 1996, Mutual Funds are permitted to incur / charge certain operating expenses for managing a mutual fund scheme – such as sales & marketing / advertising expenses, administrative expenses, transaction costs, investment management fees, registrar fees, custodian fees, audit fees – as a percentage of the fund's daily net assets.

This is commonly referred to as 'Expense Ratio'. In short, **Expense ratio is the cost of running and managing a mutual fund which is charged to the scheme.**

All expenses incurred by a Mutual Fund, AMC will have to be managed within the limits specified under Regulation 52(6) & (6A) of the SEBI Mutual Funds Regulations.

The expense ratio is calculated **as a percentage of the Scheme's average Net Asset Value (NAV)**. The daily NAV of a mutual fund is disclosed after deducting the expenses. **Thus, the TER has a direct bearing on a scheme's NAV – 'the lower the expense ratio of a scheme, the higher the NAV.'**

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SEBI (MUTUAL FUND) REGULATIONS, 1996

SEBI (Mutual Fund) Regulations, 1996 has been notified on December 09, 1996 *with objective to improve the working and regulation of the mutual fund industry*, so that mutual funds could provide a better performance and service to all categories of investors and offer a range of innovative products in a competitive manner to match investor needs and preferences across various investor segments. SEBI (Mutual Funds) Regulations, 1996 deals with **10 Chapters and 12 schedules**.

PROCEDURE FOR LAUNCHING OF SCHEMES

The key provisions of the SEBI Regulations, 1996 include:

- | |
|---|
| (a) All the schemes to be launched by the AMC needs to be approved by the Board of Trustees and copies of offer documents of such schemes are to be filed with SEBI . |
| (b) The offer documents shall contain adequate disclosures to enable the investors to make informed decisions. |
| (c) The listing of close-ended schemes is mandatory and they should be listed on a recognised stock exchange within six months from the closure of subscription . |

However, the **listing is not mandatory in case:**

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|--|
| (i) if the scheme provides for monthly income or caters to senior citizens, women, children and physically handicapped ; |
| (ii) if the scheme discloses details of repurchase in the offer document ; or |
| (iii) if the scheme opens for repurchase within six months of closure of subscription . |
| (iv) if the scheme is a capital protection oriented scheme . |

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|---|
| (d) Units of a close-ended scheme can be opened for sale or redemption at a predetermined fixed interval if the minimum and maximum amount of sale, redemption and periodicity is disclosed in the offer document. |
| (e) Units of a close-ended scheme can be converted into an open-ended scheme with the consent of a majority of the unit-holders and disclosure is made in the offer document about the option and period of conversion. |
| (f) Units of close-ended scheme may be rolled over by passing a resolution by a majority of the shareholders . |
| (g) No scheme other than equity-linked saving scheme can be opened for subscription for more than 15 days . Further, the minimum subscription and the extent of over subscription that is intended to be retained should be specified in the offer document . In the case of over-subscription, all applicants applying up to 5,000 units must be given full allotment subject to over subscription . |
| (h) The AMC is required to refund the application money if minimum subscription is not received, and also the excess over subscription within five working days of closure of subscription. |
| (i) close-ended scheme shall be wound up |

on redemption date, unless it is rolled over,

if 75% of the unit-holders of a scheme pass a resolution for winding up of the scheme;

if the trustees on the happening of any event require the scheme to be wound up;

if SEBI, so directs in the interest of investors.

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CODE OF CONDUCT OF MUTUAL FUNDS

(i) The schemes should not be organized, operated and managed in the interest of sponsors or the directors of AMC or special class of unit holders;
(ii) It shall ensure the adequate dissemination of adequate, fair, accurate and timely information of all the stake holders;
(iii) The excessive concentration of business with the broking firm or associates should be avoided;
(iv) The scheme - wise segregation of bank accounts and securities accounts must be ensured;
(v) The investment should be made in accordance with the investment objectives stated on the offer documents;
(vi) It must not use any unethical means to sell, market or induce any investor to buy their schemes.
(vii) The high standards of integrity and fairness in all the dealings should be maintained by the trustees and AMCs;
(viii) The AMCs shall not make any exaggerated statements

AVENUES AVAILABLE TO INDIAN MUTUAL FUNDS FOR INVESTMENT ABROAD

Indian Mutual Funds registered with SEBI **are permitted to invest in the following:**

(i) ADRs and GDRs;
(ii) Equity of overseas company;
(iii) Foreign debt securities;
(iv) Money market instruments;
(v) Government securities;
(vi) Derivative;
(vii) Short - term deposits;
(viii) Units issued by overseas mutual funds.

SEBI (LISTING OBLIGATIONS AND DISCLOSURE REQUIREMENTS) REGULATIONS, 2015

The provisions of **chapter IX** of the SEBI LODR Regulations, 2015 applies to the asset management company managing the mutual fund scheme whose units are listed on the recognised stock exchange(s).

Notwithstanding anything contained in this chapter, the provisions of the **Securities and Exchange Board of India (Mutual Funds) Regulations, 1996** and directions issued thereunder shall apply on the listed entity and to the schemes whose units are listed on the recognised stock exchange(s).

Submission of Documents

The listed entity **shall intimate to the recognised stock exchange(s)**, the information relating to **daily Net Asset Value, monthly portfolio, half yearly portfolio of those schemes whose units are listed on the recognised stock exchange(s)** in the format as specified under SEBI (Mutual Funds) Regulations, 1996 and directions issued there under.

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The listed entity **shall intimate to the recognised stock exchange(s)** in the manner specified by the recognized stock exchange(s) of:

(a) movement in unit capital of those schemes whose units are listed on the recognised stock exchange(s);
(b) rating of the scheme whose units are listed on the recognised stock exchange(s) and any changes in the rating thereof (wherever applicable);
(c) imposition of penalties and material litigations against the listed entity and Mutual Fund; and
(d) any prohibitory orders restraining the listed entity from transferring units registered in the name of the unit holders.

Dissemination on the website of stock exchange(s)

The listed entity shall submit such information and documents, which are required to be disseminated on the listed entity's website in terms of SEBI (Mutual Funds) Regulations, 1996 and directions issued there under, to the recognized stock exchange for dissemination.

MUTUAL FUND TERMINOLOGY

A. OFFER DOCUMENT

(a) AMC raises money in new schemes through New Fund Offer (NFO)
(b) Offer document contains key details about the NFO – open and close dates, scheme objective, nature of the scheme, etc.
(c) Filed with SEBI

Two parts:

- Scheme Information Document (SID)** - A document that contains the details of the scheme. SID has to be updated every year

Key Contents:

(a) Scheme name on the cover page, along with scheme structure (open / closed-ended) and expected scheme nature (equity / debt / balanced / liquid / ETF)
(b) Highlights of the scheme
(c) Risk factors <ol style="list-style-type: none"> Standard Scheme specific
(d) Due diligence certificate issued by the AMC
(e) Fees and expenses
(f) Rights of unit holders
(g) Penalties, litigations, etc.

2. Statement of Additional Information –

A document that contains statutory information about the fund house offering the scheme. SAI has to be **updated the end of every quarter**.

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Key Contents:

(a) Information about sponsor, mutual fund, trustees, custodian and registrar & transfer agents
(b) Condensed financial information for schemes launched in the last three financial years
(c) Information on how to apply
(d) Rights of unit holders
(e) Details of the fund managers
(f) Tax, legal and other general information

B. KEY INFORMATION MEMORANDUM (KIM)

(a) Essentially a summary of SID & SAI
(b) As per SEBI regulations, every application form should be accompanied by the KIM
(c) The KIM has to be updated at least once a year

Contents

(a) Name of the AMC, Mutual Fund Trust, Trustee, Fund Manager(s) and Scheme details
(b) Open and close dates of the issue
(c) Issue price of the scheme
(d) Plans and options available in the scheme
(e) Risk profile of the scheme
(f) Benchmark
(g) Dividend policy
(h) Performance of the scheme and benchmark over last 1, 3, 5 years and since inception
(i) Loads and expenses
(j) Contact information and registrars

C. FACT SHEETS

Usually provided on a **monthly basis by AMCs**

Contains the following:

(a) NAV and AUM
(b) Expense ratio, exit loads, average maturity, YTM, modified duration
(c) Benchmark & Fund manager details
(d) Past performance
(e) Scheme's allocation & portfolios
(f) Style box
(g) Other scheme attributes – like risk category, minimum investment amount, scheme objective, etc.

D. ASSETS UNDER MANAGEMENT (AUM)

What is AUM?

It is the **total market value of the assets** managed by a mutual fund scheme as on a particular date

Periodic AUM Available

(a) Month-end
(b) Quarterly average

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E. KNOW YOUR CLIENT (KYC)

What is KYC?

- | |
|--|
| (a) A one-time process made mandatory to invest in mutual funds |
| (b) Key details required: PAN, Address proof, contact details, occupation and income details |

Where can it be done?

- | |
|--|
| (a) CDSL Ventures Limited KRA |
| (b) CAMS KRA |
| (c) Karvy KRA |
| (d) NDML KRA (wholly owned subsidiary of NSDL) |
| (e) DOTEX KRA (wholly owned subsidiary of NSE) |

F. FOREIGN ACCOUNT TAX COMPLIANCE ACT (FATCA)

What is FATCA?

- | |
|--|
| (a) Requires that all financial institutions (including Indian mutual funds) need to report financial transactions of US persons and entities in which US persons hold a substantial ownership. |
| (b) Enacted to prevent tax evasion through foreign investments. |
| (c) Key details required: Country of birth, Country of citizenship, country of tax residence, TIN from such country. |
| (d) Currently made mandatory for all investors (existing and new) in Indian mutual funds. |
| (e) For non-individual investors, Ultimate Beneficial Ownership (UBO) details have to be provided. |

G. MODES OF HOLDING

- | |
|--|
| (a) Single |
| (b) Either or Survivor |
| (i) Signature of any of the applicants is sufficient for making transactions |
| (c) Either or Survivor |
| (i) Joint |
| (d) Signature of all the applicants is required for making transactions |

H. NOMINATION

- | |
|---|
| (a) Up to 3 nominees can be registered for a folio |
| (b) Units get transferred to the nominees (in the proportion specified) in case of the investor's demise |
| (c) Nomination can be updated as and when required by the investor |
| (d) A minor can also be nominated , provided the guardian is specified |
| (e) If nomination is not registered , in case of death of the investor, the legal heir has to produce documents such as Will, Legal Heir Certificate, No-Objection Certificate from other legal heirs, etc. |

I. SYSTEMATIC INVESTMENT PLAN (SIP) IN MUTUAL FUND

An SIP allows an investor to **invest a fixed amount regularly in a mutual fund scheme**, typically an equity mutual fund scheme. An SIP helps investor to **stagger the investments in equity mutual fund schemes over a period**. Most mutual fund advisors do not recommend investing a lumpsum in equity mutual funds.

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SELF TEST QUESTIONS

FROM PAST CS EXAMS



1. Write short notes on the following :
 - (i) Hybrid instrument
 - (ii) Money market mutual funds.
2. Distinguish between of the following:
 - (i) 'Close ended schemes' and 'open schemes'.
 - (ii) 'Hedge funds' and 'leverage funds'.
3. What are the 'real estate mutual fund' schemes? Explain their features.
4. Describe briefly the risks involved in mutual funds.
5. Explain briefly the various factors for judging the efficiency of mutual funds.
6. What do you understand by infrastructure debt fund scheme? Discuss the eligibility criteria required to be fulfilled by a mutual fund for launching a scheme.
7. "The mutual funds have emerged as one of the important class of financial intermediaries which cater to the needs of retail investors."
8. Explain briefly the Infrastructure debt fund

FROM ICSI MODULE



Answer the following:

1. Discuss the various advantages, schemes and general obligations of Mutual Funds.
2. Describe various schemes of Mutual funds.
3. What are the risks involved in Mutual funds?
4. Write short notes on:
 - (a) Net Asset Value (NAV)
 - (b) Mutual Fund Cost
 - (c) Asset Management Company
 - (d) Gold Exchange Traded funds
 - (e) Capital Protection Oriented Schemes.
5. Briefly discuss the code of conduct to be followed by mutual funds.
6. What in Infrastructure Debt fund Scheme? Briefly explain the Eligibility criteria to launch such scheme.
7. Enumerate the salient features of Real Estate Mutual Fund Schemes.



Answers to be analysed in Classroom

Q. 1.

Answer to Question No. 1:-

CS NITESH KR. JAISWAL



Answers to be analysed in Classroom

Q. 2.

Answer to Question No. 2:-

CS NITESH KR. JAISWAL