Mutual Fund Agents

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Student Reference Guide

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INTRODUCTION

A mutual fund agent is representative of a bank or similar financial institution, who offers mutual funds to prospective investors, maintains records of their investments and conducts regular market research to advice customers.

The mutual fund industry in India began in 1963 with the formation of the Unit Trust of India (UTI) as an initiative of the Government of India and the Reserve Bank of India. Much later, in 1987, SBI Mutual Fund became the first non-UTI mutual fund in India.

Subsequently, the year 1993 heralded a new era in the mutual fund industry. This was marked by the entry of private companies in the sector. After the Securities and Exchange Board of India (SEBI) Act was passed in 1992, the SEBI Mutual Fund Regulations came into being in 1996. Since then, the Mutual fund companies have continued to grow exponentially with foreign institutions setting shop in India, through joint ventures and acquisitions.

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.

As the affluence of Indians increase, the range of financial products to meet people's need will expand and with it the need for professional financial advice from the MF distributors will increase. There is going to be a huge demand for trained Mutual Funds agents to render professional advice to investor and reduce mis-selling of the Mutual Fund products. The Mutual Funds industry will need distributors who are able to inform the investors about the efficacy of the product for a particular risk profile and stage in their life cycle.

This module focuses on the various Mutual Fund products available in the Indian market. It also focuses on the regulatory guidelines, taxation and sales process related to Mutual Funds in India.

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Unit 1: Investment Basics

- After completing this unit, the student will be able to:
  - Understand the needs for investment
  - Identify the factors governing the interest rates
  - Recognise the various Investment Options available in India

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Investment Basics

What is *Investment*?

The money you earn is partly spent and the rest saved for meeting future expenses. Instead of keeping the savings idle you may like to use savings in order to get return on it in the future. This is called Investment.

Needs for Investment

One needs to invest to:

- earn return on your idle resources
- generate a specified sum of money for a specific goal in life
- make a provision for an uncertain future

One of the important reasons why one needs to invest wisely is to meet the cost of ***Inflation***. Inflation is the rate at which the cost of living increases.

The cost of living is simply what it costs to buy the goods and services you need to live. Inflation causes money to lose value because it will not buy the same amount of a good or a service in the future as it does now or did in the past. For example, if there was a 6% inflation rate for the next 20 years, a Rs. 100 purchase today would cost Rs. 321 in 20 years. This is why it is important to consider inflation as a factor in any long-term investment strategy.

Remember to look at an investment's 'real' rate of return, which is the return after inflation. The aim of investments should be to provide a return above the inflation rate to ensure that the investment does not decrease in value. For example, if the annual inflation rate is 6%, then the investment will need to earn more than 6% to ensure it increases in value.

If the after-tax return on your investment is less than the inflation rate, then your assets have actually decreased in value; that is, they won't buy as much today as they did last year.

Ideal Time to Start Investing

The sooner one starts investing the better. By investing early you allow your investments more time to grow, whereby the concept of compounding increases your income, by accumulating the principal and the interest or dividend earned on it, year after year. **The three golden rules** for all investors are:

1. Invest early
2. Invest regularly
3. Invest for long term and not short term

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Care one should one take while investing

Before making any investment, one must ensure to:

1. Obtain written documents explaining the investment
2. Read and understand such documents
3. Verify the legitimacy of the investment
4. Find out the costs and benefits associated with the investment
5. Assess the risk-return profile of the investment
6. Know the liquidity and safety aspects of the investment
7. Ascertain if it is appropriate for your specific goals
8. Compare these details with other investment opportunities available
9. Examine if it fits in with other investments you are considering or you have already made
10. Deal only through an authorised intermediary
11. Seek all clarifications about the intermediary and the investment
12. Explore the options available to you if something were to go wrong, and then, if satisfied, make the investment.

These are called the ***Twelve Important Steps to Investing.***

Interest

When we borrow money, we are expected to pay for using it – this is known as Interest. Interest is an amount charged to the borrower for the privilege of using the lender's money. Interest is usually calculated as a percentage of the principal balance (the amount of money borrowed). The percentage rate may be fixed for the life of the loan, or it may be variable, depending on the terms of the loan.

Factors determining interest rates

When we talk of interest rates, there are different types of interest rates:

- Rates that banks offer to their depositors
- Rates that they lend to their borrowers
- The rate at which the Government borrows in the Bond/Government Securities market
- Rates offered to investors in small savings schemes like NSC, PPF, etc.
- Rates at which companies issue fixed deposits, etc.

The factors which govern these interest rates are mostly economy related and are commonly referred to as macroeconomic factors. Some of these factors are:

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- Demand for money
- Level of Government borrowings
- Supply of money
- Inflation rate
- The Reserve Bank of India and the Government policies which determine some of the variables mentioned above

Various options available for investment

One may invest in:

- **Physical assets** like real estate, gold/jewellery, commodities etc.

and/or

- **Financial assets** such as fixed deposits with banks, small saving instruments with post offices, insurance/provident/pension fund etc. or securities market related instruments like shares, bonds, debentures etc.

Short-term investment options

Broadly speaking, savings bank account, money market/liquid funds and fixed deposits with banks may be considered as short-term financial investment options:

- **Savings Bank Account** is often the first banking product people use, which offers low interest (4%-5% p.a.), making them only marginally better than fixed deposits.
- **Money Market or Liquid Funds** are a specialized form of mutual funds that invest in extremely short-term fixed income instruments and thereby provide easy liquidity. Unlike most mutual funds, money market funds are primarily oriented towards protecting your capital and then, aim to maximise returns. Money market funds usually yield better returns than savings accounts, but lower than bank fixed deposits.
- **Fixed Deposits with Banks** are also referred to as term deposits and minimum investment period for bank FDs is 30 days. Fixed Deposits with banks are for investors with low risk appetite, and may be considered for 6-12 months investment period as normally interest on less than 6 months bank FDs is likely to be lower than money market fund returns.

Long-term investment options

Post Office Savings Schemes, Public Provident Fund, Company Fixed Deposits, Bonds and Debentures, Mutual Funds etc. are considered as long term investment options.

- **Post Office Savings:** Post Office Monthly Income Scheme is a low risk saving instrument, which can be availed through any post office. It provides an interest rate of around 8.40% per annum, which is paid monthly. The amount, which can be invested, is to be multiples of Rs.1,500/-. Maximum amount is Rs. 4,50,000/- (if Single) or Rs. 9,00,000/- (if held Jointly) during a year. It has a maturity period of 5 years. Premature withdrawal is permitted if deposit is more than one year old. The MIS can be prematurely en-cashed after one year but before 3 years at the discount of 2% of the deposit and after 3 years at the discount of 1% of the deposit. (Discount means deduction from the deposit.)
- **Public Provident Fund:** A long term savings instrument with a maturity of 15 years and interest payable at 8.7% per annum compounded annually. A PPF account can be opened through a nationalized bank any time during the year and is open all through the year for depositing money. Tax benefits can be availed for the amount invested and interest accrued is tax-free. A withdrawal is permissible every year from the seventh financial year of the date of opening of the account and the amount of withdrawal will be limited to 50% of the balance at credit at the end of the 4th year immediately preceding the year in which the amount is withdrawn or at the end of the preceding year whichever is lower the amount of loan if any.
- **Company Fixed Deposits:** These are short-term (six months) to medium-term (three to five years) borrowings by companies at a fixed rate of interest which is payable monthly, quarterly, semi-annually or annually. They can also be cumulative fixed deposits where the entire principal along with the interest is paid at the end of the loan period. The rate of interest varies between 8-12% per annum for company FDs. The interest received is after deduction of taxes.
- **Bonds:** It is a fixed income (debt) instrument issued for a period of more than one year with the purpose of raising capital. The central or state government, corporations and similar institutions sell bonds. A bond is generally a promise to repay the principal along with a fixed rate of interest on a specified date, called *the Maturity Date*.
- **Equity Investment:** One or more shares in the ownership of a business or corporation that are purchased by investors who are then entitled to shares of the firm's assets in the case of liquidation. These shares of stock may be bought and sold among stockholders in response to changes in market price.

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- **Mutual Funds:** A mutual fund is a professionally managed collective investment scheme that pools money from many investors and invests it in stocks, bonds, short-term money market instruments and other securities. Mutual funds have a fund manager who invests the money on behalf of the investors by buying / selling stocks, bonds etc. Currently, the worldwide value of all mutual funds totals more than $US 26 trillion.

Instrument	Tax Benefit	Return	Duration
EPF	√	8.75%	Long Term
PPF	√	8.70%	Long Term
NSC-10 Years	√	8.80%	Long Term
FD's – Banks & Post Office	√	5.70 to 8.50%	Short Term
Senior Citizen Savings Scheme	√	9.3%	Long Term
Mutual Funds	√	**Market Linked**	**Long Term & Short Term**
ULIP	√	Market Linked	Long Term
NPS	√	Market Linked	Long Term
Direct Equity	√	Market Linked	Long Term
Gold	√	Market Linked	Short Term
Real Estate	√	Market Linked	Long Term

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Summary

- The money you earn is partly spent and the rest saved for meeting future expenses. Instead of keeping the savings idle you may like to use savings in order to get return on it in the future. This is called Investment.
- One needs to invest to:
  - earn return on your idle resources
  - generate a specified sum of money for a specific goal in life
  - make a provision for an uncertain future
- One of the important reasons why one needs to invest wisely is to meet the cost of *Inflation.*
- The three golden rules for all investors are:
  - Invest early
  - Invest regularly
  - Invest for long term and not short term
- When we borrow money, we are expected to pay for using it – this is known as Interest.
- There are different types of interest rates:
  - Rates that banks offer to their depositors
  - Rates that they lend to their borrowers
  - The rate at which the Government borrows in the Bond/Government Securities market
  - Rates offered to investors in small savings schemes like NSC, PPF, etc.
  - Rates at which companies issue fixed deposits, etc.
- One may invest in:
  - Physical assets and/or
  - Financial assets
- Short-term investment options are:
  - Savings Bank Account
  - Money Market or Liquid Funds
  - Fixed Deposits with Banks
- Long-term investment options are:
  - Post Office Savings
  - Public Provident Fund
  - Company Fixed Deposits
  - Bonds
  - Equity Investment
  - Mutual Funds

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Knowledge Check:

1. State whether the following statements are true or false:
    a) Interest is usually calculated as a percentage of the principal balance.
    b) Gold is one of the prominent financial assets.
    c) The maximum limit of investing in Post Office Monthly Income Scheme by a single holder is Rs.400,000/-
    d) Liquid Funds are a specialized form of mutual funds that invest in extremely short-term fixed income instruments.
2. Choose the most appropriate alternative among the followings:
    a) ________________ is the rate at which the cost of living increases.
        i. Index
        ii. Sensex
        iii. Inflation
        iv. Interest
    b) There are _______________ Important Steps to Investing
        i. Ten
        ii. Twelve
        iii. Fifteen
        iv. Six
    c) Fixed deposits with banks and small saving instruments with post offices are considered as ________________ assets.
        i. Physical
        ii. Financial
        iii. Fixed
        iv. Variable
    d) A withdrawal from the Public Provident Fund is permissible every year from the ______________ financial year of the date of opening of the account
        i. Fifth
        ii. Sixth
        iii. Seventh
        iv. Tenth
3. Write short note on Public Provident Fund.
4. What are the *Twelve Important Steps to Investing*?
5. Discuss the various short term investment options available to the investors.

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Unit 2: Basics of Mutual Funds

- After completing this unit, the student will be able to:

  - Understand the Mutual Fund Structure in India
  - Comprehend the Rights and obligation of the investors
  - Realise the benefits of Mutual Fund investments
  - Understand the risks involved with Mutual Funds
  - Identify the various styles of Fund Management.

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History of Mutual Funds

Mutual funds have become one of the most popular investment vehicles in the recent years all over the world. In fact, just before the beginning of 21st century, the number of securities listed in the New York Stock Exchange was less than the number of mutual funds registered in the United States. . This proves the popularity of mutual funds in one of the strongest economy of the world. Though this popularity is relatively a recent phenomenon, the origins of mutual funds can be traced to 18th century, when a Dutch merchant named Abraham van Ketwich formed trust named “Eendragt Maakt Magt” and invited subscription from investors. This trust was aimed towards small investors and the funds of this trust was invested in various securities, mostly in Government securities, thus resulting in diversification of the investors’ money.
In 1868 Foreign and Colonial Government Trust was founded in London, which was the first investment trust outside Netherlands. The trust also invested in foreign government bonds. By 1875, 18 trusts were established in London. During the 1890s, investment trusts were introduced into the United States and early U.S. investment trusts were mostly closed-end funds. Massachusetts Investors Trust was the first U.S. mutual fund to have an open-end capitalization in 1924. This gradually became the dominant models for the mutual funds in US as well as the world.

Mutual Funds History in India

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank of India. The history of mutual funds in India can be broadly divided into four distinct phases:

First Phase - 1964-1987

Unit Trust of India (UTI) was established in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. In 1978 UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had Rs. 6,700 crores of assets under management.

Second Phase - 1987-1993 (Entry of Public Sector Funds)

1987 marked the entry of non-UTI, public sector mutual funds set up by public sector banks and Life Insurance Corporation of India (LIC) and General Insurance Corporation of India

(GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Canbank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990.

At the end of 1993, the mutual fund industry had assets under management of Rs. 47,004 crores.

Third Phase - 1993-2003 (Entry of Private Sector Funds)

With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996.

The number of mutual fund houses went on increasing, with many foreign mutual funds setting up funds in India and also the industry has witnessed several mergers and acquisitions. As at the end of January 2003, there were 33 mutual funds with total assets of Rs. 1,21,805 crores. The Unit Trust of India with Rs. 44,541 crores of assets under management was way ahead of other mutual funds.

Fourth Phase - since February 2003

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs. 29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs. 76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual

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Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth.

(Source: AMFI)

Some of the developments in the Indian mutual funds history are:

Year	Developments
2002	• Franklin Templeton AMC acquired Pioneer ITI AMC
2004	• Birla Sun Life Mutual Fund acquired Alliance Capital Mutual Fund
2009	• L&T Mutual Fund is formed after acquiring DBS Cholamandalam Asset Management Ltd • Abolishing of 2.25% Entry Load in Equity Fund schemes by SEBI
2011	• Goldman Sachs Asset Management acquired Benchmark AMCg • KYC becomes mandatory for all categories of investors in Mutual Funds
2012	• Exit of Fidelity's mutual fund business in India with L&T Mutual Fund taking over
2014	• Birla Sun Life Mutual Fund acquired the assets of ING Investment Management India • HDFC AMC acquired Morgan Stanley • Kotak Mahindra AMC acquired PineBridge Mutual Fund

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Indians have been traditionally savers and invested money in traditional savings instruments such as bank deposits. Against this background, if we look at approximately Rs.12 lakh crores (As of June,2015 : AMFI) which Indian Mutual Funds are managing, then it is no mean an achievement. A country traditionally putting money in safe, risk-free investments like Bank

FDs, Post Office and Life Insurance, has started to invest in stocks, bonds and shares – thanks to the mutual fund industry.

However, there is still a lot to be done. The Rs.12 Lakh crores stated above, includes investments by the corporate sector as well. Going by various reports, not more than 5% of household savings are channelized into the markets, either directly or through the mutual fund route. Not all parts of the country are contributing equally into the mutual fund corpus. 8 cities account for over 60% of the total assets under management in mutual funds. These are issues which need to be addressed jointly by all concerned with the mutual fund industry. Market dynamics are making industry players to look at smaller cities to increase penetration. Competition is ensuring that costs incurred in managing the funds are kept low and fund houses are trying to give more value for money by increasing operational efficiencies and cutting expenses. As of June 2015 there were around 41 Mutual Funds in the country. Many more mutual funds are expected to enter India in the next few years.

All these developments will lead to far more participation by the retail investor and ample of job opportunities for young Indians in the mutual fund industry.

MUTUAL FUNDS: STRUCTURE IN INDIA

There are many entities involved in Mutual Funds. The structure of a Mutual Fund in India can be described below:

ORGANISATIONAL SET-UP OF A MUTUAL FUND

(Source: AMFI)

Mutual Funds in India follow a **3-tier structure**. There is a **Sponsor** (the First tier), who thinks of starting a mutual fund. The Sponsor approaches the Securities & Exchange Board of India (SEBI), which are the market regulator and also the regulator for mutual funds.

Not everyone can start a mutual fund. SEBI checks whether the person is of integrity, whether he has enough experience in the financial sector, his net worth etc. Once SEBI is convinced, the sponsor creates a Public Trust (the Second tier) as per the Indian Trusts Act, 1882. Trusts

have no legal identity in India and cannot enter into contracts, hence the **Trustees** are the people authorized to act on behalf of the Trust. Contracts are entered into in the name of the Trustees. Once the Trust is created, it is registered with SEBI ***after which this trust is known as the mutual fund.***

It is important to understand the difference between the Sponsor and the Trust. They are two separate entities. Sponsor is not the Trust; i.e. Sponsor is not the Mutual Fund. **It is the Trust which is the Mutual Fund.**

The Trustees role is not to manage the money. Their job is only to see, whether the money is being managed as per stated objectives. Trustees may be seen as the internal regulators of a mutual fund.

MANAGING THE INVESTOR'S MONEY

This is the role of the **Asset Management Company** (the Third tier). Trustees appoint the Asset Management Company (AMC), to manage investor's money. The AMC in return charges a fee for the services provided and this fee is borne by the investors as it is deducted from the money collected from them. The AMC's Board of Directors must have at least 50% of Directors who are independent directors. The AMC has to be approved by SEBI. The AMC functions under the supervision of its Board of Directors, and also under the direction of the Trustees and SEBI. It is the AMC, which in the name of the Trust, floats new schemes and manages these schemes by buying and selling securities. In order to do this the AMC needs to follow all rules and regulations prescribed by SEBI and as per the Investment Management Agreement it signs with the Trustees.

If any fund manager, analyst intends to buy/ sell some securities, the permission of the **Compliance Officer** is a must. A compliance Officer is one of the most important persons in the AMC. Whenever the fund intends to launch a new scheme, the AMC has to submit a Draft Offer Document to SEBI. This draft offer document, after getting SEBI approval becomes the offer document of the scheme. **The Offer Document** (OD) is a legal document and investors rely upon the information provided in the OD for investing in the mutual fund scheme. The Compliance Officer has to sign the Due Diligence Certificate in the OD. This certificate says that all the information provided inside the OD is true and correct. This ensures that there is accountability and somebody is responsible for the OD. In case there is no compliance officer, then senior executives like CEO, Chairman of the AMC has to sign the due diligence certificate. The certificate ensures that the AMC takes responsibility of the OD and its contents.

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A CUSTODIAN

A custodian's role is safe keeping of physical securities and also keeping a tab on the corporate actions like rights, bonus and dividends declared by the companies in which the fund has invested. The Custodian is appointed by the Board of Trustees. The custodian also participates in a clearing and settlement system through approved depository companies on behalf of mutual funds, in case of dematerialized securities. In India today, securities (and units of mutual funds) are no longer held in physical form but mostly in dematerialized form with the Depositories. The holdings are held in the Depository through Depository Participants (DPs). Only the physical securities are held by the Custodian. The deliveries and receipt of units of a mutual fund are done by the custodian or a depository participant at the instruction of the AMC and under the overall direction and responsibility of the Trustees. Regulations provide that the Sponsor and the Custodian must be separate entities.

ROLE OF THE AMC

The role of the AMC is to manage investor's money on a day to day basis. Thus it is imperative that people with the highest integrity are involved with this activity. The AMC cannot deal with a single broker beyond a certain limit of transactions. The AMC cannot act as a Trustee for some other Mutual Fund. The responsibility of preparing the OD lies with the AMC. Appointments of intermediaries like independent financial advisors (IFAs), national and regional distributors, banks, etc. is also done by the AMC. Finally, it is the AMC which is responsible for the acts of its employees and service providers.

As can be seen, it is the AMC that does all the operations. All activities by the AMC are done under the name of the Trust, i.e. the mutual fund. The AMC charges a fee for providing its services. SEBI has prescribed limits for this. This fee is borne by the investor as the fee is charged to the scheme, in fact, the fee is charged as a percentage of the scheme's net assets. An important point to note here is that this fee is included in the overall expenses permitted by SEBI. There is a maximum limit to the amount that can be charged as expense to the scheme, and this fee has to be within that limit. Thus regulations ensure that beyond a certain limit, investor's money is not used for meeting expenses.

ROLE OF A REGISTRAR AND TRANSFER AGENTS

A Registrar & Transfer Agents (RTA) is a third-party engaged by a fund house and generally has a wide branch network throughout the country from where they can interact and assist the investors to execute their Mutual Fund transactions. The RTA acts a single window

communication system for the investors from where they can obtain the Mutual Fund application forms, Mutual Fund Statements and also submit the instruction or application forms. Investors also receive information on new fund offers from the RTAs.

Mutual fund houses have to maintain records of all the transaction that the investors make. However, since these are not the core jobs of an AMC, these are outsourced to an agency, who handles all these transactions on its behalf. The major three RTAs that are currently operating in India are Computer Age Management Services (CAMS), Karvy and Deutsche Investor Services.

The mutual fund pays fees for the services offered by the R&T agent, which depends on the volume of transactions done on behalf of the fund house.

The charges will depend on the volume of transactions done for the mutual fund. Registrars and Transfer Agents (RTAs) perform the important role of maintaining investor records. All the New Fund Offer (NFO) forms, redemption forms (i.e. when an investor wants to exit from a scheme, it requests for redemption) go to the RTA's office where the information is converted from physical to electronic form. How many units will the investor get, at what price, what is the applicable NAV, how much money will he get in case of redemption, exit loads, folio number, etc. is all taken care of by the RTA.

REGULATORY BODY FOR MUTUAL FUNDS

Securities Exchange Board of India (SEBI) is the regulatory body for all the mutual funds. All the mutual funds must get registered with SEBI. In the year 1992, Securities and exchange Board of India (SEBI) Act was passed. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market. As far as mutual funds are concerned, SEBI formulates policies and regulates the mutual funds to protect the interest of the investors. SEBI notified regulations for the mutual funds in 1993. Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market. The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines to the mutual funds from time to time to protect the interests of investors.

All mutual funds whether promoted by public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI. All mutual funds are required to be registered with SEBI before they launch any scheme.

If any complain of an investor is not redressed by the concerned Mutual Fund / Investor Service Centre of the Mutual Fund, the investors may approach SEBI for facilitating redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with it regularly.

AMFI (Association of Mutual Funds in India)

AMFI, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies, was incorporated on August 22, 1995, as a non-profit organisation. As of now, all the 44 Asset Management Companies that are registered with SEBI, are its members.

The Association of Mutual Funds in India (AMFI) is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

Objectives of AMFI

The Principal objectives of AMFI are to:

1. To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
2. To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
3. To interact with the Securities and Exchange Board of India (SEBI) and to represent to SEBI on all matters concerning the mutual fund industry.
4. To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the Mutual Fund Industry.
5. To undertake nation-wide investor awareness programme so as to promote proper understanding of the concept and working of mutual funds.
6. To disseminate information on Mutual Fund Industry and to undertake studies and research directly and/or in association with other bodies.
7. To take regulate conduct of distributors including disciplinary actions (cancellation of ARN) for violations of Code of Conduct.
8. To protect the interest of investors/unit holders.

Benefits of investing in Mutual Funds:

There are several benefits from investing in a Mutual Fund which are discussed below::

Small investments: Mutual funds help you to reap the benefit of returns by a portfolio spread across a wide spectrum of companies with small investments.

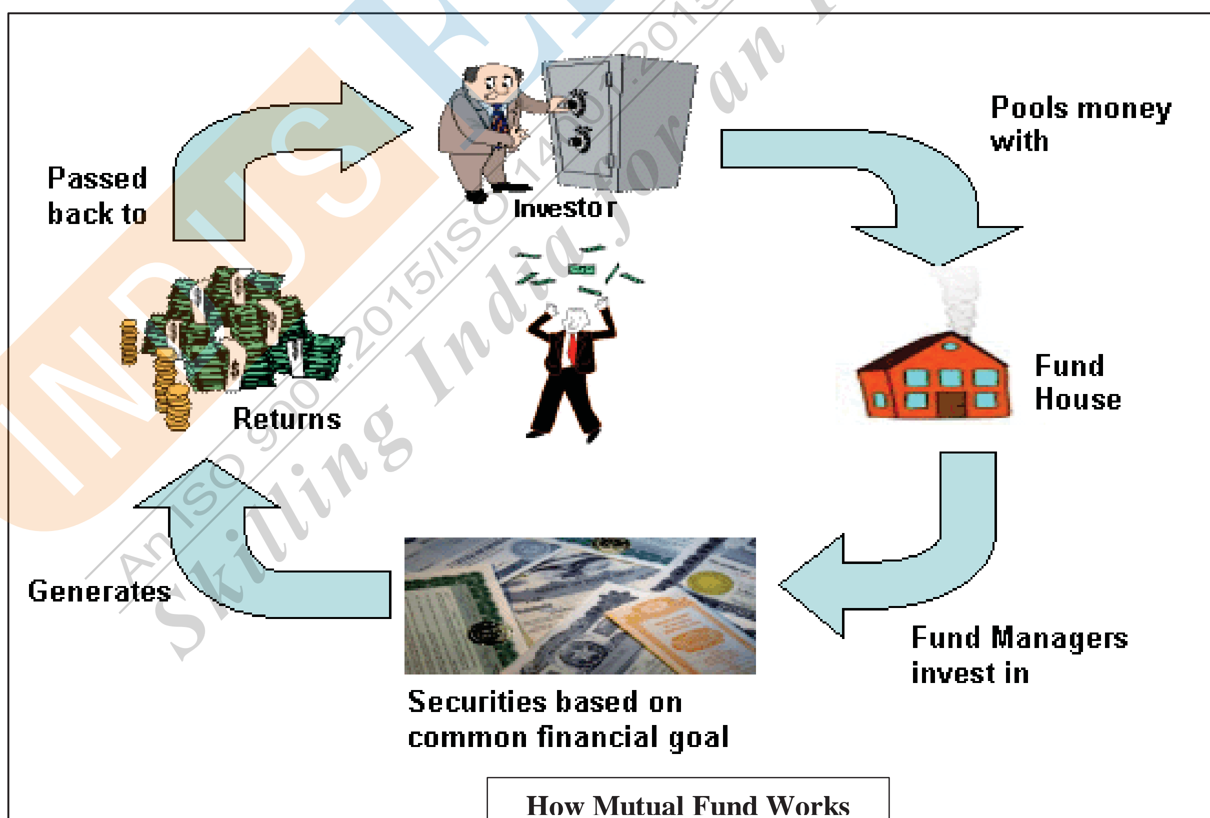
Professional Fund Management: Professionals having considerable expertise, experience and resources manage the pool of money collected by a mutual fund. They thoroughly analyse the markets and economy to pick good investment opportunities.

Spreading Risk: An investor with limited funds might be able to invest in only one or two stocks/bonds, thus increasing his or her risk. However, a mutual fund will spread its risk by investing a number of sound stocks or bonds. A fund normally invests in companies across a wide range of industries, so the risk is diversified.

Transparency: Mutual Funds regularly provide investors with information on the value of their investments. Mutual Funds also provide complete portfolio disclosure of the investments made by various schemes and also the proportion invested in each asset type.

Choice: The large amount of Mutual Funds offer the investor a wide variety to choose from. An investor can pick up a scheme depending upon his risk/ return profile.

Regulations: All the mutual funds are registered with SEBI and they function within the provisions of strict regulation designed to protect the interests of the investor.



How Mutual Fund Works

An Initiative of Indus Integrated Information Management Limited An ISO 9001:2008, ISO 14001:2004 Company

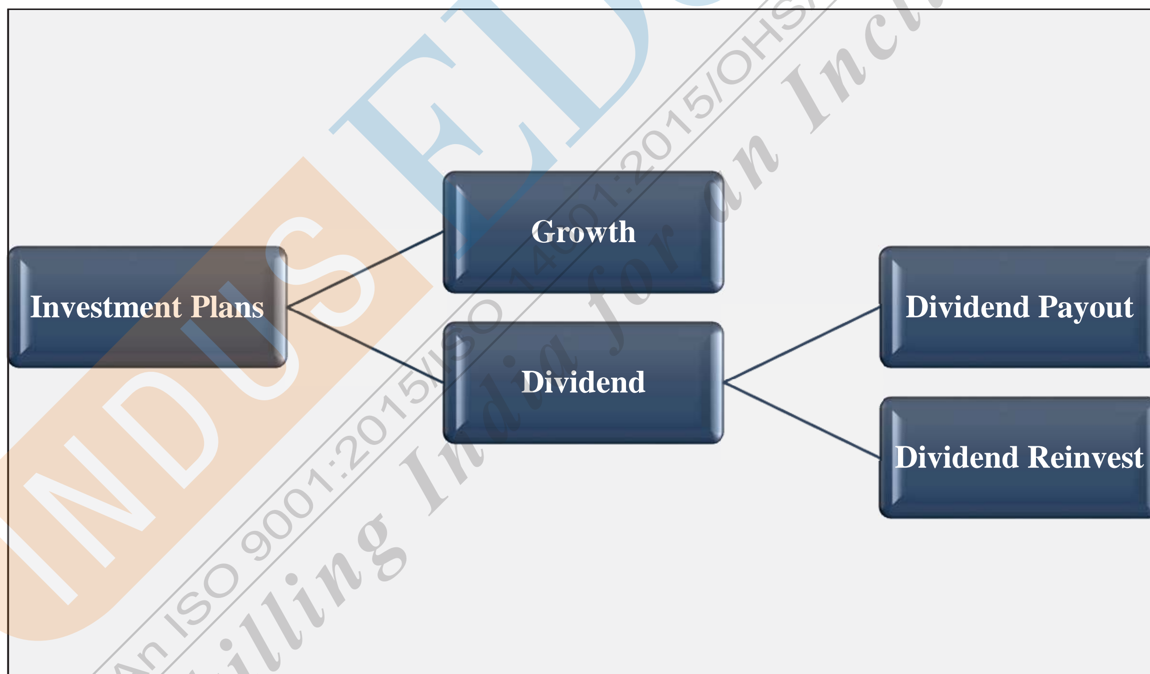
Net Asset Value (NAV)

NAV or Net Asset Value of the fund is the cumulative market value of the assets of the fund net of its liabilities. NAV per unit is simply the net value of assets divided by the number of units outstanding. Buying and selling into funds is done on the basis of NAV-related prices. The NAV of a mutual fund are required to be published in newspapers and also updated in the AMFI website. The NAV of an open end scheme should be disclosed on a daily basis and the NAV of a close end scheme should be disclosed at least on a weekly basis. The concept of the NAV has been described in details in the next Unit.

Different Investment Plans

The term 'investment plans' generally refers to the services that the funds provide to investors offering different ways to invest or reinvest. The different investment plans are an important consideration in the investment decision, because they determine the flexibility available to the investor.

Some of the investment plans offered by mutual funds in India are:



Growth Plan

A growth plan is a plan under a scheme wherein the returns from investments are reinvested and very few income distributions, if any, are made. The investor thus only realizes capital appreciation on the investment.

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Dividend Plan

Under the dividend plan, income is distributed from time to time. This plan is ideal to those investors requiring regular income.

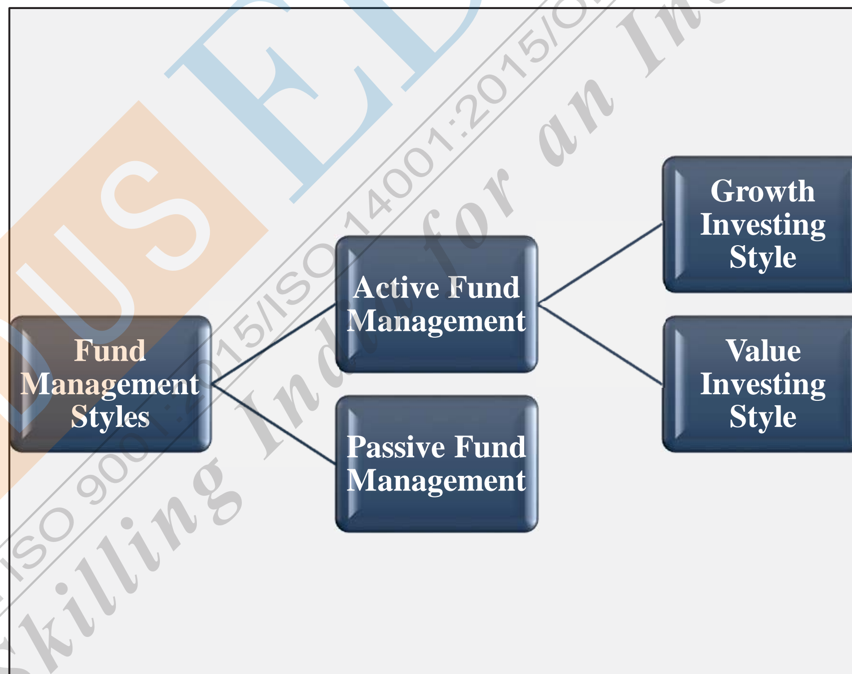
Dividend Reinvestment Plan

Dividend plans of schemes carry an additional option for reinvestment of income distribution. This is referred to as the dividend reinvestment plan. Under this plan, dividends declared by a fund are reinvested in the scheme on behalf of the investor, thus increasing the number of units held by the investors.

Fund Management Styles

The Fund Manager can take different approaches while constructing a portfolio for a mutual fund scheme. His approach depends on the investment philosophy of that particular scheme. These different approaches are known as Fund Management Styles which can broadly be categorized as *Active Fund Management* and *Passive Fund Management*. Active Fund Management can again be sub classified in two categories: *Growth Investing Style* and *Value Investing Style*.

Let us now understand each of these styles one by one.



Active Fund Management

When investment decisions of the fund are at the discretion of a fund manager(s) and he or she decides which company, instrument or class of assets the fund should invest in based on research, analysis, market news, etc. such a fund is called as an actively managed fund. The fund buys and sells securities actively based on changed perceptions of investment from time to time. Based on the classifications of shares with different characteristics, 'active' investment managers construct different portfolio.

Two basic investment styles prevalent among the mutual funds are **Growth Investing** and **Value Investing.**

- **Growth Investing Style:** The primary objective of equity investment is to obtain capital appreciation. A growth manager looks for companies that are expected to give above average earnings growth, where the manager feels that the earning prospects and therefore the stock prices in future will be even higher. Identifying such growth sectors is the challenge before the growth investment manager.
- **Value investment Style:** A Value Manager looks to buy companies that they believe are currently undervalued in the market, but whose worth they estimate will be recognized in the market valuations eventually.

Passive Fund Management

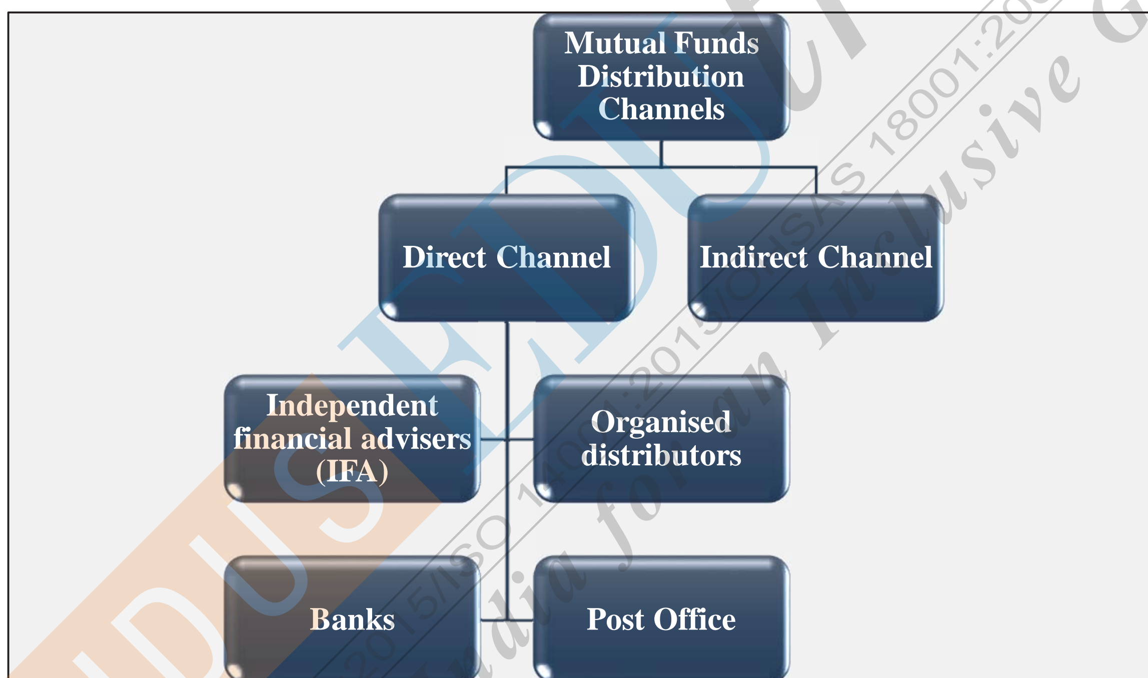
When an investor invests in an actively managed mutual fund, he or she leaves the decision of investing to the fund manager. The fund manager is the decision- maker as to which company or instrument to invest in. Sometimes such decisions may be right, rewarding the investor handsomely. However, chances are that the decisions might go wrong or may not be right all the time which can lead to substantial losses for the investor. There are mutual funds that offer Index funds whose objective is to equal the return given by a select market index. Such funds follow a passive investment style. They do not analyse companies, markets, economic factors and then narrow down on stocks to invest in. Instead they prefer to invest in a portfolio of stocks that reflect a market index, such as the Nifty index. The returns generated by the index are the returns given by the fund. No attempt is made to try and beat the index.

Research has shown that most fund managers are unable to constantly beat the market index year after year. Also it is not possible to identify which fund will beat the market index. Therefore, there is an element of going wrong in selecting a fund to invest in. Index Funds hold

a diversified basket of securities which represents the index while at the same time since there is not much active turnover of the portfolio the cost of managing the fund also remains low. This gives a dual advantage to the investor of having a diversified portfolio while at the same time having low expenses in fund.

Mutual Funds Distribution Channels in India:

Funds are bought and sold through distribution channels, which play a significant role in explaining to the investors the various schemes available, their investment style, costs and expenses. There are two types of distribution channels-direct and indirect. In case of the former, the investors buy units directly from the fund AMC, whereas indirect channels include the involvement of agents. The structure of the Mutual Funds distribution channels is graphically described below:



Let us consider these distribution channels in detail.

Direct channel

This is good for investors who do not need the advisory services of agents and are well-versed with the fundamentals of the fund industry. The channel provides the benefit of low cost, which significantly enhances the returns in the long run.

Indirect channel

This channel is widely prevalent in the fund industry. It involves the use of agents, who act as intermediaries between the fund and the investor. These agents are not exclusive for mutual funds and can deal in multiple financial instruments. They have an in-depth knowledge about

the functioning of financial instruments and are in a position to act as financial advisers. The players in the indirect channel assist investors in buying and redeeming fund units after understanding the risk profile of investors and suggest fund schemes that best suits their objectives. The indirect channel should be preferred over the direct channel when investors want to seek expert advice on the risk-return mix or need help in understanding the features of the financial securities in which the fund invests as well as other important attributes of mutual funds, such as benchmarking and tax treatment.

Here are some of the players in the indirect distribution channels.

a) **Independent financial advisers (IFA)**: These are individuals trained by AMCs for selling their products. They help investors in choosing the right fund schemes and assist them in financial planning. IFAs manage their costs through the commissions that they earn by selling funds.

b) **Organised distributors**: They are the backbone of the indirect distribution channel. They have the infrastructure and resources for managing administrative paperwork, purchases and redemptions. These distributors cater to the diverse nature of the investor community and the vast geographic spread of the country by establishing offices in rural and semi-urban locations.

c) **Banks:** They use their network to sell mutual funds. Their existing customer base serves as a captive prospective investor base for marketing funds. Banks also handle wealth management for their clients and manage portfolios where mutual funds are one of the asset classes.

d) **India Post:** The Post Office has traditionally been a distributor of financial services, from money orders to banking services. The Post Office Savings Bank is the largest retail bank in the country, operating from over 1, 50,000 branches. With an objective to leverage the strength of the postal network and skills Department of Posts had started retailing mutual funds and bonds.

   On 22nd January 2001, India Post in partnership with IDBI-Principal, launched a scheme for distribution of mutual funds through post offices. A pilot project was started from the four cities of Delhi, Mumbai, Kolkata and Patna. Thereafter from 15th June 2001 onwards, the scheme was extended to cover post offices in all major capital and other cities all across the country. At present select schemes of Principal, SBI, UTI, Franklin Templeton and Reliance Mutual Fund are retailed through designated post offices in the country.

Summary:

- **History of Mutual Funds**: Mutual funds have become one of the most popular investment vehicles in the recent years all over the world. In fact, just before the beginning of 21st century, the number of securities listed in the New York Stock Exchange was less than the number of mutual funds registered in the United States. The history of mutual funds in India can be broadly divided into four distinct phases:
    - First Phase - 1964-1987
    - Second Phase - 1987-1993 (Entry of Public Sector Funds)
    - Third Phase - 1993-2003 (Entry of Private Sector Funds)
    - Fourth Phase - since February 2003
- Mutual Funds in India follow a 3-tier structure. There is a Sponsor (the First tier), who thinks of starting a mutual fund. . Once SEBI is convinced, the sponsor creates a Public Trust (the Second tier) as per the Indian Trusts Act, 1882. Asset Management Company (the Third tier) carries the responsibility of managing the investor's money.
- A custodian's role is safe keeping of physical securities and also keeping a tab on the corporate actions like rights, bonus and dividends declared by the companies in which the fund has invested.
- A **Registrar & Transfer Agents (RTA)** is a third-party engaged by a fund house and generally has a wide branch network throughout the country from where they can interact and assist the investors to execute their Mutual Fund transactions.
- **Securities Exchange Board of India (SEBI)** is the regulatory body for all the mutual funds. All the mutual funds must get registered with SEBI. In the year 1992, Securities and exchange Board of India (SEBI) Act was passed. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market.
- **AMFI (Association of Mutual Funds in India)**, the association of SEBI registered mutual funds in India of all the registered Asset Management Companies, was incorporated on August 22, 1995, as a non-profit organisation. As of now, all the 44 Asset Management Companies that are registered with SEBI are its members. The Principal objectives of AMFI are to:
    - To define and maintain high professional and ethical standards in all areas of operation of mutual fund industry.
    - To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
- There are several benefits from investing in a Mutual Fund which are as follows:
    - Small investments
    - Professional Fund Management
    - Spreading Risk
    - Transparency
    - Choice
    - Regulations

- **NAV or Net Asset Value** of the fund is the cumulative market value of the assets of the fund net of its liabilities.
- Some of the investment plans offered by mutual funds in India are:
  - ***Growth Plan***: A growth plan is a plan under a scheme wherein the returns from investments are reinvested and very few income distributions, if any, are made.
  - ***Dividend Plan*****:** Under the dividend plan, income is distributed from time to time. This plan is ideal to those investors requiring regular income.
- **Fund Management Styles:** The Fund Manager can take different approaches while constructing a portfolio for a mutual fund scheme. Fund Management Styles can broadly be categorized as *Active Fund Management* and *Passive Fund Management*.
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- **Passive Fund Management:** When an investor invests in an actively managed mutual fund, he or she leaves the decision of investing to the fund manager. The fund manager is the decision- maker as to which company or instrument to invest in.
- There are two types of distribution channels - direct and indirect. Direct channel is good for investors who do not need the advisory services of agents and are well-versed with the fundamentals of the fund industry. Indirect channel is widely prevalent in the fund industry. It involves the use of agents, who act as intermediaries between the fund and the investor.

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Knowledge Check:

1. State whether the following statements are true or false:
    a) Market dynamics are making industry players to look at smaller cities to increase penetration.
    b) There are 42 mutual fund companies in India.
    c) The investor thus only realizes capital appreciation on the investment under a Dividend Plan
    d) Some of mutual funds provide assured returns.
2. Choose the most appropriate alternative among the followings:
    a) The role of the ___________ is to manage investor's money on a day to day basis.
        i. Custodian
        ii. SEBI
        iii. AMC
        iv. RTA
    b) The role of a _______________ is safe keeping of physical securities and also keeping a tab on the corporate actions like rights, bonus and dividends declared by the companies in which the fund has invested.
        i. RTA
        ii. Custodian
        iii. MFA
        iv. DRA
    c) The _____________ contains all the material information that the investor would require to make an informed decision.
        i. Offer Document
        ii. Prospectus
        iii. SEBI guidelines
        iv. Application Forms
    d) The NAV of a/an _______________ should be disclosed on a daily basis.
        i. Open-ended scheme
        ii. Close-ended scheme
        iii. Balanced scheme
        iv. None of the above
3. Write short note on Active Fund Management.
4. What are the objectives of AMFI? Discuss the benefits of investing in Mutual Funds.
5. Discuss the various investment plans available to the Indian investors.

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Unit 3: Equity Mutual Funds

- After completing this unit, the student will be able to:
  - Understand the salient features of Equity Funds
  - Identify the various types of Equity Funds
  - Understand Expense Ratio and Portfolio Turnover
  - Analyse Cash Levels in Portfolios.

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