BUILT ON TRUST

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GROUP

CHAPTER 1

INVESTMENT LANDSCAPE

- The discussion of investments must start with the purpose of investment. “Why is one investing?”
- When we assign **amounts** and **timeliness** to dreams or objectives, we convert them into financial goals.
- After identifying the events, one needs to assign priorities to each goal.
- Goals should be categorized on the basis of “**responsibilities**” and “**good-to-have**” goals.
- Prioritization can also be done by classifying the goals in terms of the timeline. (i.e. time left for the goals)
- The current cost of the financial goals should be adjusted for inflation. (The cost of education has been going up at a very fast pace over the last few decades.)
- Inflation has more impact on long-term goals, rather than short-term goals.
- The main objective of “**savings**” is to save money, while the main objective of “investments” is to earn a return.
- *Saving precedes investing*.
- The three most important factors to evaluate investments are **safety, liquidity, and returns**. In addition to these, there are a few more parameters such as convenience, ticket size, taxability of earnings, tax deduction, etc.
- **Safety** means safety of capital invested along with the degree of surety of income from investment.
- **Liquidity** means how easily one can liquidate the investment and convert it to cash.
- **Returns** may be in the form of regular (or periodic) income, also known as current income; and capital appreciation, or capital gains.
- **Ticket size** is the amount of money you put in the investment.
- **Tax deduction** is the deduction available to eligible investors on taxable income.
- In majority of the cases individuals purchase real estate for self occupation, hence it is considered as expense and not investment.
- In case of real estate, the transaction costs like brokerage and registration charges, etc. are high which brings down the ROI.
- Real estate is classified into various categories, such as **residential** real estate, **land**, **commercial** real estate, etc.
- Gold and silver (**bullion**) are the most common commodities in which the investors invest.
- Generally investors do not prefer to invest in commodities derivatives, this is because

  1. These are **leveraged contracts**, i.e. one can take large exposure with a small of money making it highly risky and

  2. These are normally **short term contracts**, whereas the investors’ needs may be for longer periods.
- **Fixed income securities** are marketable instruments like bonds and debentures.
- Many bonds pay regular interest; thus investors can expect current income.

- **Bonds** can be classified into subcategories on the basis of issuer type i.e. issued by the **government** or **corporates** or on the basis of the maturity date: **short term bonds** (ideal for liquidity needs), **medium term bonds**, and **long term bonds** (income generation needs).
- Someone who buys shares in a company becomes a part-owner in the business.
- **Sensex** is BSE's benchmark index representing shares of 30 large-sized companies. It is also considered to be one of the **bellwether indices**, a barometer of what is happening in the stock market in India.
- **Equity** has given **highest real returns** to the investor, i.e returns in excess of inflation. It also carries **high risk** in the business as the owner's capital is linked to the earnings of the business.
- Investments in **equity and bonds** can be done only in **financial form**, while **real estate and commodities** can be bought either in **financial or in physical form**.
- Real estate and commodities can either be bought as investment or for consumption purposes.
- **Inflation**, or **price inflation** is the general rise in the prices of various commodities, products, and services that we consume. It erodes the purchasing power of the money.
- When one seeks total safety of invested capital, along with liquidity at any time, the investment returns are usually lower than inflation.
- The returns on investment without factoring inflation is known as "**nominal rate**". However, when this number is adjusted for inflation, one gets the "**real rate of return**". If the investment returns are higher than inflation, the investor is earning a positive real rate, and vice versa.
- **Liquidity risk** means that it is difficult to sell an investment when desired, or it has to be sold below its fair value, or cannot be sold partially.
- Liquidity risk is **high** in real-estate investment.
- **Credit risk** is when the issuer does not pay principal and the interest on time or even defaults. There is no credit risk in government bonds.
- **Market risk** is a type of risk associated with the market as a whole rather than with individual stocks or business sectors. It is the risk that the market overall will lose value, rather than that one or more stocks or sector.
- **Price risk** is the risk that the value of a security or investment will decrease.
- The risk **specific** to security can be reduced through diversification while one that is **market-wide cannot** be reduced through diversification.
- **Interest rate risk** is the risk that an investment's value will change as a result of a change in interest rates. Bonds/debt instruments are more affected by interest rate risk than the stocks.
- The relationship between **interest rates** and **bond prices** is **inverse**.
- Bonds with **longer maturity** would witness **higher price fluctuation**s in comparison to those with shorter maturities.
- Strategies for management of the investment risks are:

  1. Avoid

  2. Take a position to benefit from some event / development.

3. Diversify.

- The ***availability heuristic*** *is a bias that* describes our tendency to use information that comes to mind quickly and easily when making decisions about the future.
- **Confirmation bias** is the tendency of people to favour information that confirms from their existing beliefs or hypotheses.
- **Familiarity Bias** is the preference of the individuals to remain confined to what is familiar to them.
- **Herd mentality bias** refers to investors' tendency to follow and copy what other investors are doing.
- **Loss aversion** is a tendency in behavioral finance where investors are so fearful of losses that they focus on trying to avoid a loss more so than on making gains. The more one experiences losses, the more likely they are to become prone to loss aversion.
- **Overconfidence bias** is a tendency to hold a false and misleading assessment of our skills, intellect, or talent. In short, it's an egotistical belief that we're better than we actually are.
- **Recency bias** is a cognitive bias that favours recent events over historic ones.
- To detach emotions from investments, it is better to take the opinion of a third person i.e. **Registered Investment Advisor (RIA) or Mutual Fund Distributor (MFD)**.
- Risk Profiling is the process to identify,
    - The need to take risks.
    - The ability to take risks
    - The willingness to take risks
- **Asset Allocation** is a process of allocating money across various asset categories in line with a stated objective.
- **Strategic Asset Allocation** is allocation aligned to the financial goals of the individual.
- **Tactical asset allocation** is an active management portfolio strategy that shifts the percentage of *assets* held in various categories to take advantage of market pricing anomalies or strong market sectors.
- The portfolio should be rebalanced to restore the target asset allocation. The **rebalancing approach** can work very well over the years, when the various asset categories go through many market cycles of ups and downs.
- If one does not have the ability and willingness to take risk and one can afford to outsource, it is better to invest the fund through a mutual fund.

CHAPTER 2

CONCEPT AND ROLE OF A MUTUAL FUND

- The ownership is in the hands of the investors (Unit holders) who have pooled in their funds, so ownership is '**Joint and Mutual**'.
- In India, Mutual Funds are constituted as a **TRUST**.
- Mutual Funds are **not allowed** to invest in '**Art**' and '**commodities except gold**' in India.
- Mutual fund is a vehicle to mobilize money from investors, to invest in different markets and securities, in line with the investment objectives
- **Primary role of a mutual fund** is to assist investors in earning an income or building their wealth, by participating in the opportunities available in various securities and markets.
- The money that is raised from investors, ultimately benefits governments, companies and other entities, directly or indirectly, to raise money for investing in various projects or paying for various expenses.
- Every Mutual Fund scheme has a pre-announced or pre-defined investment objective. For example,

Investment Objective	Type of MF Scheme
Long-term capital appreciation with equity related instruments across market-capitalisation spectrum along with investment in debt and money-market instruments for regular income.	Hybrid Fund
Generate steady stream of income through fixed income securities	Long Duration Fund

- The investment that an investor makes in a scheme is translated into a certain number of '**Units**' in the scheme. Thus, an investor in a scheme is issued units of the scheme.
- The number of units issued by a scheme multiplied by its face value (Rs. 10) is the capital of the scheme (**Unit Capital**).
- The true worth of a unit of the mutual fund scheme is called **Net Asset Value (NAV)** of the scheme.
- The sum of all investments made by investors in the mutual fund scheme is the entire mutual fund scheme's size, also known as **Assets Under Management** (**AUM**).
- The unit holder earns through "**interest income**" or "**dividend income**" or through "**capital gains"**.
- If the scheme is open to receiving money from investors even post-NFO, then such contributions from investors **boost the AUM**. Conversely, if the scheme pays any money to the investors, either as a dividend or as consideration for buying back the units of investors, the **AUM falls.**
- The process of valuing each security in the investment portfolio of the scheme at its current market value is called **Mark to Market (MTM)**.
- **Advantages** of Mutual Funds for Investors
    - Professional Management

- Affordable Portfolio Diversification
- Economies of Scale
- Liquidity
- Tax Deferral
- Tax benefits
- Convenient Options
- Investment Comfort
- Regulatory Comfort
- Systematic Approach to Investments

■ **Limitations** of a Mutual Fund

- Lack of portfolio customization
- No control over costs
- Choice overload

■ **SIP** (**Systematic Investment Plan**) is an approach where the investor invests constant amounts at regular intervals. A benefit of such an approach is, it gives **Rupee Cost Averaging**.

■ Mutual funds make it convenient for investors to manage their **SWP**s (**Systematic Withdrawal Plan**) by indicating the amount, periodicity (generally monthly) and period for their SWP.

■ In a **STP** (**Systematic Transfer Plan**), the amount that is withdrawn from a scheme is re-invested in some other scheme of the same mutual fund.

■ **Classification** of Mutual Funds can also be done on the basis of

- Its **Structure** (Open Ended or Closed Ended or Interval Fund)
- How the **management of the portfolio** (Active fund or Passive Fund)
- **Investment universe** (Equity, Debt, Gold etc.)

■ **ETF**s (**Exchange Traded Funds**) are those mutual fund schemes that are traded on a stock exchange just like any other stock.

■ ETFs generally track an index or have a fixed portfolio strategy based on some index. Hence, are categorized as passive funds.

■ NAV of an open ended scheme does not fluctuate during a day, while the traded price of an ETF changes throughout the day like any other stock.

■ ETFs provide additional liquidity for investors

SEBI CATEGORIZATION OF EQUITY SCHEMES

■ **Multi Cap Fund:** Invests across large cap, mid cap, small cap stocks. The minimum investment in equity and equity related instruments shall be **75%** of total assets. (Minimum investment in each category will be 25%)

■ **Large Cap Funds:** Predominantly invests in large cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be **80%** of total assets.

- **Large and Mid Cap Fund:** Invests in both Large & Mid Cap stocks, The minimum investment in equity and equity related instruments of large cap and Mid Cap Companies shall be **35%** and **35%** respectively of total assets.
- **Mid Cap Fund:** Predominantly invests in mid cap stocks. The minimum investment in equity and equity related instruments of mid cap companies shall be **65%** of total assets.
- **Small Cap Funds:** Invest in Small Cap stocks The minimum investment in equity and equity related instruments of small cap companies shall be **65%** of total assets.
- **Dividend Yield Fund:** An open-ended equity scheme predominantly investing in dividend yielding stocks. The minimum investment in equity shall be **65%** of total assets.
- **Value Fund or Contra Fund:** Follows a value investment strategy. Minimum investment in equity & equity related instruments shall be **65%** of total assets. A contra fund follows contrarian investment strategy. Mutual Funds will be permitted to offer either Value fund or Contra fund.
- **Focused Fund:** Can invest in maximum 30 stocks (the scheme needs to mention where it intends to focus, viz., multi cap, large cap, mid cap, small cap). Minimum investment in equity & equity related instruments shall be **65%** of total assets.
- **Sectoral/Thematic:** Invests in a specific sector/theme. The minimum investment in equity & equity related instruments of a particular sector/ particular theme shall be **80%** of total assets.
- **Flexi-cap Fund:** This would be a dynamic fund where there can be investment across large cap, mid cap as well as small cap stocks. The minimum investment in equity and equity related assets are **65%** of the total assets.
- **Equity Linked Savings Scheme (ELSS):**
    - 3 year lock-in period
    - The minimum investment in equity and equity related instruments shall be **80%** of total assets (in accordance with Equity Linked Saving Scheme, 2005 notified by the Ministry of Finance).
    - Maximum tax benefit under section 80C is Rs. 1,50,000.

SEBI CATEGORIZATION OF OPEN ENDED DEBT SCHEMES

- **Overnight Fund:** The investment is in overnight securities having maturity of **1** day.
- **Liquid Fund:** Liquid scheme whose investment is into debt and money market securities with maturity of upto **91 days** only.
- **Ultra Short Duration Fund:** An ultra-short term debt scheme investing in debt and money market instruments with Macaulay duration between **3 months and 6 months**.
- **Low Duration Fund:** A low duration debt scheme investing in debt and money market instruments with Macaulay duration between **6 months and 12 months**.

- **Money Market Fund:** Invests in money market instruments having maturity upto **1 year**.
- **Short Duration Fund:** Invests in debt and money market instruments with Macaulay duration between **1 year and 3 years**.
- **Medium Duration Fund:** Invests in debt and money market instruments with Macaulay duration of the portfolio being between **3 years and 4 years**.
- **Medium to Long Duration Fund:** Invests in debt and money market instruments with Macaulay duration between **4 years and 7 years**.
- **Long Duration Fund:** Invests in debt and money market instruments with Macaulay duration greater than **7 years**.
- **Dynamic Bond:** An open ended dynamic debt scheme investing across duration.
- **Corporate Bond Fund:** Predominantly invests in **AA+** and **above** rated corporate bonds. The minimum investment in corporate bonds shall be **80** percent of total assets (only in AA+ and above rated corporate bonds).
- **Credit Risk Fund:** Invests in **below** highest rated corporate bonds. The minimum investment in corporate bonds shall be 65% of total assets (only in **AA** (excludes AA+ rated corporate bonds) and **below** rated corporate bonds).
- **Banking and PSU Fund:** Predominantly investing in debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds. The minimum investment in such instruments should be **80** percent of total assets.
- **Gilt Fund:** Invests in government securities across maturity. The minimum investment in G-secs is defined to be **80** percent of total assets (across maturity).
- **Gilt Fund with 10-year constant duration:** An open-ended debt scheme investing in government securities having a constant maturity of **10** years. Minimum investment in G-secs is **80** percent of total assets such that the Macaulay duration of the portfolio is equal to **10** years.
- **Floater Fund:** Predominantly invests in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives). Minimum investment in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives) shall be **65** percent of total assets.

SEBI CATEGORIZATION OF OPEN ENDED HYBRID SCHEMES

- **Conservative Hybrid Fund:** Predominantly invests in debt securities. Investment in debt instruments shall be between **75%** and **90%** of total assets while investment in equity and equity instruments shall be between **10%** and **25%** of total assets.
- **Balanced Hybrid Fund:** The investment in equity and equity related instruments shall be between **40% and 60%** of total assets while investment in debt shall be between **40% and 60%**.
- **Aggressive Hybrid Fund:** Predominantly invests in equity and equity related instruments. The investment in equity and equity related instruments shall be between **65% to 80%** of total assets while investment in debt instruments shall be between **20% and 35%.**
- Mutual funds in India are permitted to offer either Aggressive Hybrid Fund or Balanced Fund.

- **Dynamic Asset Allocation or Balanced Advantage:** Investment in equity/debt that is managed dynamically.
- **Multi Asset Allocation:** Investing in at least three asset classes with a minimum allocation of at **least 10%** each in all three asset classes. Foreign securities are not treated as a separate asset class in this kind of scheme.
- **Equity Savings Fund:** Invests in a combination of equity, arbitrage and debt. The minimum investment in equity and equity related instruments shall be **65%** (including arbitrage) and in debt **10%** of total assets.
- **Arbitrage Fund:** An open-ended scheme investing in arbitrage opportunities. The minimum investment in equity and equity related instruments shall be **65** percent of total assets.

SEBI CATEGORIZATION OF SOLUTION ORIENTED SCHEMES

- **Retirement Fund:** An open-ended retirement solution-oriented scheme having a **lock-in of 5 years** or till retirement age (whichever is earlier).
- **Children's Fund:** An open-ended fund for investment for children having a lock-in for at **least 5 years** or till the child attains age of **majority** (whichever is earlier).

SEBI CATEGORIZATION OF OTHER SCHEMES

- **Index Funds/Exchange Traded Fund:** An open-ended scheme replicating/tracking a specific index. This minimum investment in securities of a particular index (which is being replicated/ tracked) shall be **95** percent of total assets.
- **Fund of Funds (Overseas/Domestic):** An open-ended fund of fund scheme investing in an underlying fund. The minimum investment in the underlying fund shall be **95** percent of total assets.

OTHER FUNDS

- **Fixed Maturity Plans:** They are close-ended debt fund where the duration of the investment portfolio is closely aligned to the maturity of the scheme.
- **Floating Rate Funds:** Floating Rate Funds invest largely in floating rate debt securities i.e. debt securities where the interest rate payable by the issuer changes in line with the market.
- **Capital Protected Schemes:** Capital Protected Schemes are close-ended hybrid schemes, which are structured to ensure that investors get their principal back, irrespective of what happens to the market.
- **Infrastructure Debt Funds:** Infrastructure Debt Funds (IDFs) can be set up either as a "Trust" or as a "Company".
    - A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be an NBFC regulated by the Reserve Bank.
    - IDF offered by MFs are generally sponsored by banks and NBFCs, while IDF offered by NBFCs are sponsored by banks and Infrastructure Finance companies.
    - **Real Estate Mutual Fund:** It directly or indirectly invests in real estate assets or other permissible assets in accordance with the SEBI's regulations requiring at least 35% of the portfolio should be held in physical assets with not less than

75% of the net assets of the scheme shall be in real estate assets, mortgage backed securities, equity shares or debentures engaged in dealing with real estate development projects.

- **Environmental, Social and Governance ("ESG") Investing**

  SEBI has introduced a separate sub-category for ESG investments under the thematic category of Equity schemes. Any scheme under the ESG category can be launched with one of the following strategies:

  a. Exclusion

  b. Integration

  c. Best-in-class & Positive Screening

  d. Impact investing

  e. Sustainable objectives

  f. Transition or transition related investments

NEW TYPES OF FUNDS

- **Smart Beta Funds** are an extension of traditional investment options such as exchange-traded funds (ETFs) and index funds that track the benchmark indices in much the same way as traditional investment options.
- In traditional investment products (ETFs, Index Funds), the weightage to the stocks was based on market capitalisation, while smart-beta funds use additional parameters (low volatility, value, Quality) to select stocks.
- **Quant Funds** are a special kind of mutual funds whose asset allocation, including stock picking, is decided based on a predefined set of rules. These funds take out the human element in deciding on stock selection.
- **International REITs**, is a fund that invests in Real Estate Investment Trusts abroad gives an exposure to the investor both to international funds plus the commercial real estate sector.

GROWTH OF MUTUAL FUNDS IN INDIA

- Assets Under Management (AUM) of Indian Mutual Fund Industry as on June 2023, stood at Rs. 44.82 Lakh crore. The 10-year growth stands at 18.13% p.a. compounded annually.

CHAPTER 3

LEGAL STRUCTURE OF MUTUAL FUNDS IN INDIA

- **SEBI** has stipulated the legal structure under which mutual funds in India need to be constituted.
- Mutual funds are constituted in India as **Trusts**.
- Mutual Funds are governed by the **Indian Trusts Act, 1882**
- The mutual fund trust is **created by one or more Sponsors**, who are the main persons behind the mutual fund business.
- Every trust has **beneficiaries**. The beneficiaries, in the case of a mutual fund trust, are the **investors** who invest in various schemes of the mutual fund.
- The Trust acts through its **trustees.**
- **Day to day management** of the schemes is handled by an Asset Management Company (**AMC**) who are appointed by the sponsor or the Trustees.
- The **trustees execute** an "**investment management agreement**" with the AMC, setting out its responsibilities.
- Although the AMC manages the schemes, **custody of the assets of the scheme** (securities, gold, gold-related instruments & real estate assets) is with a **Custodian**, who is appointed by the Trustees.
- Investors invest in various schemes of the mutual fund. The **record of investors and their unit-holding** may be maintained by the AMC itself, or it can appoint a **Registrar & Transfer Agent** (RTA).
- The application to SEBI for registration of a mutual fund is made by the sponsor/s.
- The sponsor should have a sound track record and reputation of fairness and integrity in all business transactions. The requirements are:
  - **Sponsor** should be carrying on business in financial services for **not less than 5 years**
  - **Sponsor** should have **positive net worth** (share capital plus reserves minus accumulated losses) in all the immediately **preceding 5 years.**
  - **Liquid Net worth** should be more than the amount that the sponsor contributes to the capital of the AMC
  - The sponsor should have **earned profits**, after providing for depreciation and interest and tax, in each of the immediately preceding five years
  - The sponsor should have average net annual profits after depreciation, interest and tax during the immediately preceding five years of **at least rupees 10 crore**.
- The sponsor needs to **contribute a minimum 40 percent of the net worth of the AMC**.
- A person who is **guilty of moral turpitude** cannot be appointed as a trustee.
- A person convicted of any economic offence or violation of any securities laws cannot be appointed as trustee.
- No AMC and no director (including independent director), officer, employee of an AMC shall be eligible to be appointed as a trustee of a mutual fund.
- No person who is appointed as a trustee of a mutual fund shall be eligible to be appointed as trustee of any other mutual fund.

- **Prior approval of SEBI** needs to be taken, **before** a person is **appointed as a Trustee**.
- The sponsor will have to **appoint at least 4 trustees**. If a trustee company has been appointed, then that company would need to have **at least 4 directors** on the Board.
- At least **two-thirds** of the **trustees / directors** on the Board of the trustee company would need to be **independent trustees.**
- The **trustees** shall ensure that the **interests of the unit holders are not compromised** in any of the AMC's dealings with brokers, other associates and even unit holders of other schemes.
- On a quarterly basis the trustees shall review the transactions of the mutual fund with the AMC and its associates. They shall also review the net worth of the AMC on a quarterly basis.
- Day to day operations of asset management is handled by the AMC.
- Prior approval of the trustees is required, before a person is appointed as a director on the board of the AMC.
- **At least 50 percent of the directors should be independent directors** i.e. not associates of or associated with the sponsor or any of its subsidiaries or the trustees.
- The AMC needs to have a minimum **net worth of Rs. 50 crore**.
- AMC has five main functions:

  1. Compliance
  2. Fund management (Under Fund Management, there are analysts, fund managers, and dealers)
  3. Operations and customer services team. (Under Operations and customer services team there are R&T agents, custody, fund accountant, cash management)
  4. Sales and marketing (Under which there is distribution)
  5. Other functions (It includes, Finance and administration, HRD, technology)

- AMCs are required to invest seed capital of 1 percent of the amount raised subject to a **maximum of Rs. 50 lakh** in all growth options of the mutual fund schemes throughout the lifetime of the scheme.
- The custodian has custody of the assets of the fund.
- The Custodian is appointed by the **trustees.**
- A **custodial agreement** is signed between the trustees and the custodian.
- An independent custodian ensures that the securities are indeed held in the scheme for the benefit of investors.
- The custodian also tracks corporate actions such as dividends, bonus and rights in companies where the fund has invested.
- The **RTAs** maintain **investor records**. Examples are **CAMS** and **KARVY**.
- The functions of the RTAs include processing of purchase and redemption transactions of the investor.
- The appointment of RTA is done by the AMC.

- It is not compulsory to appoint an RTA. This activity can be managed in-house.
- **Auditors** are responsible for the **audit of accounts**.
- The auditor appointed to audit the scheme accounts needs to be different from the auditor of the AMC.
- The **scheme auditor** is appointed by the **Trustees**, the **AMC auditor** is appointed by the **AMC**.
- The fund accountant performs the role of calculating the NAV, by collecting information about the assets and liabilities of each scheme.
- Distributors have a key role in selling suitable types of units to their clients.
- The investors' money go into the bank account of the scheme in which they have invested in.
- To do away with multiple KYC formalities with various intermediaries, SEBI has mandated a unified KYC for the securities market through KYC Registration Agencies registered with SEBI.
- The **aim of Central KYC** (CKYC) is to have a structure in place which allows investors to complete their KYC only once before interacting with various entities across the financial sector.
- **Payment Aggregators** such as Tech Process, Bill Desk etc. are service providers that facilitate payment processing in the online marketplace.
- Distributors need to pass the **NISM Certification Examination** (NISM-Series- V-A: Mutual Fund Distributors (MFD) Certification Examination) and register with AMFI.
- SEBI has also allowed provisions for empanelment of a new cadre of mutual fund distributors, who are allowed to sell a **certain limited set of schemes**. This new cadre of distributors can be empaneled if they clear the **NISM-Series- V-B**: Mutual Fund Foundation Certification Examination and register with AMFI under the particular category of distributors.
- AMCs in India are members of AMFI. It is not an SRO. Examples of SRO: Institute of Chartered Accountants of India (ICAI), NSE, BSE
- AMFI is formed to define and maintain high professional and ethical standards. It recommends and promotes best business practices and code of conduct.
- AMFI has framed a set of guidelines and code of conduct for intermediaries, consisting of individual agents, brokers, distribution houses and banks.
- **Valuation agencies**: SEBI has issued guidelines for the purpose of arriving at fair valuation of debt securities that are non-traded or thinly traded. AMFI has appointed CRISIL Ltd. and ICRA Ltd. for the purpose
- Credit rating agencies rate debt securities issued by various issuers.
- A depository is an institution, which holds the securities in dematerialised or electronic form on behalf of the investors.
- Investors have the option of holding their mutual fund units in dematerialised form through a depository participant.
- The units of close-ended funds and ETFs are compulsorily listed on at least one stock exchange.

- Execution Only Platforms (EOP) is a digital or online platform which facilitates transactions such as subscription, redemption and switch transactions in direct plans of schemes of Mutual Funds.
- No entity shall operate as an EOP without obtaining registration from SEBI or the AMFI.

CHAPTER 4

LEGAL AND REGULATORY ENVIRONMENT

- Mutual Funds are regulated by SEBI, but they need to comply with regulations set by other regulators (like RBI) also.
- Anyone who is aggrieved by a ruling of SEBI, can file an appeal with the Securities Appellate Tribunal (SAT).
- During the 2018 credit crisis, SEBI laid down the provision for creating segregated portfolios for protecting the interests of the unit holders and giving fair treatment to all investors in case of a credit event and to deal with liquidity risk.
- Currently there are four regulators:

  1. **Reserve Bank of India (RBI)** regulates the banking system, money market and foreign exchange market in the country;

  2. **Securities and Exchange Board of India (SEBI)** that regulates securities markets;

  3. **Insurance Regulatory and Development Authority of India (IRDA)** that regulates insurance markets;

  4. **Pension Fund Regulatory and Development Authority of India (PFRDA)** that regulates the pension market.
- The applicable guidelines for mutual funds are set out in **SEBI (Mutual Funds) Regulations, 1996**, as amended from time to time.
- Anyone who is aggrieved by a ruling of SEBI, can file an appeal with the Securities Appellate Tribunal (SAT).
- The investors have **no control over** the investment management of the mutual fund.
- **General Rules and Restrictions:**

  1. The Mutual Fund will buy and sell securities **on delivery basis**. Securities purchased will be **transferred in the name of the Mutual Fund** on account of the respective scheme.

  2. The Mutual Fund shall not advance any loans.

  3. The scheme will not invest in any unlisted or privately placed securities of any associate or group company of the sponsor.

  4. Investment in **listed securities** of the group companies of the sponsor will be limited to **25 percent** of the net assets.

  5. The Scheme may invest in other schemes of the same Mutual Fund or other Mutual Funds. But, **not more than 5 percent** of the net asset value of the scheme. No fees will be charged on such investments. This does not apply to Fund of Funds.

  6. The Mutual Fund under all its schemes shall **not own more than 10 percent** of a company's **paid up capital** bearing voting rights
- **Restrictions in Debt Securities:**

  1. The Scheme shall **not invest more than 10 percent of its NAV** in investment grade debt instruments issued by a single issuer. This **can be extended to 12 percent with the approval** of the trustees. The limit shall not apply to Government Securities, Treasury Bills and CBLO.

  2. Investment in **unrated debt securities of a single issuer will be limited to 10 percent** of its net assets and the total investments in such securities shall not exceed

25 percent. These limits shall not apply to investments in Government securities, treasury bills and CBLO.

3. **Parking of funds in Short-term deposits** with all scheduled commercial banks shall be **limited to 15 percent** of the net assets of the scheme. This can be raised to 20 percent with the approval of the trustees.

4. All **investments by a mutual fund equity scheme** in equity shares and equity related instruments shall only be made provided such securities are **listed or to be listed**.

5. **No mutual fund** under all its schemes **shall own more than 10 percent** of units issued by a single issuer of REIT and InvIT.

6. **A mutual fund scheme shall not invest** – (i) more than 10 percent of its NAV in the units of REIT and InvIT; and (ii) more than 5 percent of its NAV in the units of REIT and InvIT issued by a single issuer.

7. The **ELSS notification requires that at least 80 percent** of ELSS funds should be invested in equity and equity-linked securities.

8. The **scheme shall not invest more than 10 percent** of its net assets in the equity shares and equity related instruments of one company.

9. **Not more than 5 percent** of the net assets of the scheme shall be invested in **unlisted equity shares** or equity related instruments in case of open ended scheme and 10% of its NAV in case of closed ended scheme.

10. **Open-ended debt funds** have to maintain a **minimum of 10 percent** of their corpus in liquid assets (not applicable to liquid and overnight funds where this limit is already being met). *Liquid assets have been defined as Cash, Government Securities, T-bills and Repo on Government Securities.*

- **SEBI Advertisement Code for Mutual Funds**

1. Advertisements shall be accurate, true, fair, clear, complete, unambiguous and concise.

2. Advertisements **shall not contain statements** which are false, misleading, biased or deceptive, based on assumption/projections and shall not contain any testimonials or any ranking based on any criteria.

3. **No celebrities** shall form part of the advertisement **to promote** a particular mutual fund or a scheme.

4. No advertisement shall directly or indirectly discredit other advertisements or make unfair comparisons.

5. Advertisements **shall be accompanied by a standard warning in legible fonts** which states ‘Mutual Fund investments are subject to market risks, read all scheme related documents carefully.’ No addition or deletion of words shall be made to the standard warning.

6. The **dividends declared or paid shall also be mentioned in Rupees per unit along with the face value of each unit** of that scheme and the prevailing NAV at the time of declaration of the dividend.

7. When the mutual fund scheme has been in **existence for more than three years**:

   - **Performance advertisement** of mutual fund schemes shall be provided in terms of CAGR for the past 1 year, 3 years, 5 years and since inception.

- **Point-to-point returns** on a standard investment of Rs. 10,000 shall also be shown in addition to CAGR for the scheme to provide ease of understanding to retail investors.

8. Where the scheme has been in **existence for less than one-year, past performance shall not** be provided.

9. Further, if the scheme has been in **existence for more than six months but less than one year**, then **simple annualized growth rate of the scheme** for the past 6 months from the last day of month-end preceding the date of advertisement shall be provided.

10. The **celebrity endorsements shall not promote a scheme of a particular Mutual Fund** or be used as a branding exercise of a Mutual Fund house/AMC.

11. **Expenses towards such celebrity endorsements shall be limited** to the amounts that are aggregated by Mutual Funds at industry level for the purpose of conducting investor education and awareness initiatives.

12. **Prior approval of SEBI** shall be required **for issuance of any endorsement of Mutual Funds** as a financial product, which features a celebrity for the purpose of increasing awareness of Mutual Funds.

- **Investors Rights & Obligations**

1. Unit-holders have a proportionate right to the beneficial ownership of the assets of the scheme.

2. Investors can **choose to change their distributor or opt for direct investing**.

3. Unit-holders **have the right to inspect key documents** such as the Trust Deed, Investment Management Agreement, Custodial Services Agreement, RTA agreement and Memorandum & Articles of Association of the AMC.

4. The investor/s **can appoint up to 3 nominees**, who will be entitled to the Units in the event of the demise of the investor/s.

5. Investors **can pledge their mutual fund units**. This is normally done to offer security to a financier.

6. 75 percent of the Unitholders of a Scheme **can pass a resolution to wind-up** a Scheme.

7. Parking of funds in Short-term deposits with all scheduled commercial banks shall be limited to **15 percent of the net assets** of the scheme.

8. SEBI has mandated that the **status of complaints redressed should be published by each AMC in their annual report**. **Pending investor complaints can be a ground for SEBI** to refuse to the AMC to launch new schemes.

9. If there is a **change in the fundamental attributes** of a mutual fund scheme, then the **unit-holders are provided the option to exit at the prevailing NAV without any exit load.** This exit window has to be open for at least 30 days.

10. 75 percent of unit holders can terminate the appointment of an AMC. The Trustees are **bound to obtain consent of the Unit-holders**:

- Whenever required to do so by SEBI, in the interest of the Unit-holders.
- Whenever required to do so by 75% of the Unit-holders (in practice, Unit-holding) of the scheme.
- When the trustees decide to wind-up or prematurely redeem the scheme.

11. AMC can recover investment management and advisory fee on management of these unclaimed amounts, at a **maximum rate of 0.50% p.a**.

12. Treatment of illiquid securities;

- If the amounts are substantial, and recovered within 2 years, then the amount is to be paid to the old investors.
- In other cases, the amount is to be transferred to the Investor Education Fund maintained by each fund.

■ **Recovery of such unclaimed amounts** by the investors is as follows:

1. If the investor claims the money within 3 years, then payment is based on prevailing NAV i.e. after adding the income earned on the unclaimed money.

2. If the investor claims the money after 3 years, then payment is based on the NAV at the end of 3 years.

■ **SEBI Complaint Redress System (SCORES)** is a web based centralized grievance redress system of SEBI.

■ Entities **against which complaints are handled by SEBI** include:

1. Listed companies/ Registrar & Transfer Agents

2. Brokers/ Stock Exchanges

3. Depository Participants/ Depository

4. Mutual Funds

5. Portfolio Managers

6. Other Entities (KRAs, Collective Investment Scheme, Merchant Banker, Credit Rating, Foreign Portfolio Investors, etc.)

■ **AMFI** has also framed a set of guidelines and code of conduct for intermediaries (known as **AMFI Guidelines & Norms for Intermediaries** (**AGNI**)).

■ The **AMFI Code of Ethics (ACE)** sets out the standards of good practices to be followed by the Asset Management Companies in their operations and in their dealings with investors, intermediaries and the public.

■ If the investor claims the money after 3 years, then payment is based on the NAV at the end of 3 years.

■ While the SEBI Code of Conduct lays down broad principles, the AMFI Code of Ethics (ACE) sets more explicit standards for AMCs and Trustees.

■ **AMFI has framed a set of guidelines and code of conduct** for intermediaries, consisting of individual agents, brokers, distribution houses and banks.

■ In the event of **breach of the Code of Conduct** by an intermediary, the following **sequence of steps** is provided for:

1. Write to the intermediary (enclosing copies of the complaint and other documentary evidence) and ask for an explanation within 3 weeks.

2. In case an explanation is not received within 3 weeks, or if the explanation is not satisfactory, AMFI will issue a warning letter indicating that any subsequent violation will result in cancellation of AMFI registration.

3. If there is a proven second violation by the intermediary, the registration will be cancelled, and intimation sent to all AMCs.

■ The **intermediary has a right of appeal to AMFI**, to revoke the decision.

CHAPTER 5

SCHEME RELATED INFORMATION

- The legal documents that provide the information that the investor requires are available in the scheme related documents (Scheme Information Document, Statement of Additional Information) and the Key Information Memorandum.
- Investors need to note that their investments are governed by the principle of **caveat emptor** i.e., let the buyer beware. An investor is presumed to have read and understood the scheme related documents before investing in a mutual fund scheme.
- The Offer Document is one of the most important sources of information on the scheme to help prospective investors evaluate the merits and demerits of investing in it. OD is the Operating Document and describes the product.
- There are primarily two important documents for understanding about mutual fund schemes: Scheme Information Document (SID) which has details of the scheme, and Statement of Additional Information (SAI) which has statutory information about the mutual fund that is offering the scheme.
- In practice, SID and SAI are two separate documents, though the legal technicality is that SAI is a part of the SID.
- SID and SAI together are the primary source of information for any investor—existing as well as prospective.
- The **Scheme Information Document (SID)** sets forth concisely the information about the scheme that a prospective investor ought to know before investing. An SID remains effective until a 'material change' (other than a change in fundamental attributes and within the purview of the SID) occurs and thereafter changes are filed with SEBI and communicated to the investors or publicly notified by advertisements in the newspapers, subject to the applicable Regulations.
- **SID** is **structured** in the following manner:

  1. Table of Contents

  2. Highlights

  3. Introduction (eligible investors, risk factors- standard and scheme-specific), provisions regarding the minimum number of investors in the scheme, any other special considerations, definitions, due diligence certificate (issued by the AMC)

  4. Information about the scheme (name and type of the scheme, investment objectives and policies, asset allocation pattern, where will the scheme invest?, investment strategy, fundamental attributes, benchmark, managers of the scheme, investment restrictions, performance track record of the scheme).

  5. Units and Offer

  6. Fees & Expenses

  7. Rights of Unit-holders

  8. General Unit-holder information
- **Updation of SID for 1st time (Post – NFO)**
- The **SID shall be updated within the next six months** from the end of the 1st half or 2nd half of the financial year in which schemes were launched. (For example, if the scheme was launched in October 2020 (i.e. in the 2nd half of the financial year) then the first update will be within the next six months from the end of that financial year. (i.e. before September 2021).

- **SID shall be updated regularly within one month from the end of the half-year** (September and March) and it should be based on the relevant data and information as at the end of September and March respectively.
- SID is regularly updated every year or whenever there is a change in a Fundamental attribute of the scheme.
- According to 18(15A) of SEBI (Mutual Funds) Regulations, 1996, the Trustees are required to ensure that no change in the fundamental attributes of the Scheme(s) or the trust or fee and expenses payable or any other change which would modify the scheme shall be carried out unless:
    - A written communication about the proposed change is sent to each Unit-holder and an advertisement is given in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of the region where the Head Office of the mutual fund is situated; and
    - The Unit-holders are given an option for a period of 30 days to exit at the prevailing Net Asset Value without any exit load.
- **Key Information Memorandum (KIM)** is a **summary of the SID and SAI**. It contains the key points of these documents that are essential for the investor to know to make a decision on the suitability of the investment for their needs. As per SEBI regulations, **every application form is to be accompanied by the KIM**.
- Some of the key items contained in the KIM are as follows: name of the AMC, mutual fund, trustee, fund manager and scheme, dates of issue opening, issue closing and re-opening for sale and re-purchase, investment objective, asset allocation pattern of the scheme, the risk profile of the scheme, plans and options, benchmark index, dividend policy, performance of scheme and benchmark, expenses of the scheme, information regarding registration of investor grievances.
- While the SID, SAI and KIM need to be updated periodically, the interim changes are updated through the issuance of such addendum. The **addendum** is considered to be a part of the scheme related documents and must accompany the KIM.
- **SAI contains every detail regarding the fund house** other than a particular scheme for which investors want to apply, So, it is obvious to understand that **single SAI is relevant for all** the schemes offered by a mutual fund.
- **SAI is regularly updated by the end of 3 months of every financial year** or any Material changes have to be updated on an ongoing basis and uploaded on the websites of the mutual fund and AMFI.
- Disclosure of Daily NAV, Total Expense Ratio, Portfolio disclosure, Financial results and Annual reports are other **Mandatory information/disclosure**.
- In case of open ended schemes, the **NAV is calculated for all business days** and released to the Press. In case of closed ended schemes, the NAV is calculated at least once a week. In Liquid and Overnight Funds, NAVs are declared on Sundays / holidays as well, which reflects the accrual for that day.
- The Mutual Fund declares the Net Asset Value of the scheme on every business day on AMFI's website www.amfiindia.com and also on their website.
- SEBI has mandated that the Asset Management Companies (AMCs) should prominently **disclose on a daily basis, the Total expense ratio** (scheme-wise,

date-wise) of all schemes under a separate head – “Total Expense Ratio of Mutual Fund Schemes” on their website.

- The notice of change in base TER should be updated on the AMC website at least **3 working days** prior to effecting such change.
- To enable investors to make informed decisions regarding their investments, a pictorial representation of the risk to the principal invested in a mutual fund product is depicted using a **‘Riskometer**’.
- **Current value of investments = Unit balance in the investor’s account X current NAV**
- The AMCs shall send a half yearly portfolio via email within 10 days from the end of each half year, if the email address is registered with the fund.
- Annual statement has to be sent by email to the investors who have registered their email id with the fund, no later than four months from the date of closure of the relevant financial year.
- The **mutual fund shall** before the expiry of one month from the close of each half year, (Mar 31st and Sep 30th) shall **display the unaudited financial results on AMC website**.
- It is **not mandatory to publish the monthly fact sheet**, it is a market practice followed by all the fund houses, on a voluntary basis.
- Factsheet is a marketing and information document, various SEBI regulations pertaining to information disclosure are applicable to it.
- **Portfolio** features such as the price-earnings ratio (PE), Beta and other risk measures such as standard deviation and Sharpe ratio (in case of equity funds), credit rating profile, average maturity and duration (in case of debt funds) **are also available in the factsheet**.

CHAPTER 6

FUND DISTRIBUTION AND CHANNEL MANAGEMENT PRACTICES

- The **mutual fund distributor's job** is to assess the needs, limitations, resources and financial goals of the investor.
- **Mutual funds are distributed** in India to the investors **through multiple channels**, viz., individual mutual fund distributors, bank branches, national distributors through their branches or their sub- agents, post offices, and directly by the AMCs.
- The **traditional non-institutional channels** generally operate through
  - Their own branch offices and employees
  - A network of sub-agents
- **Non-individual entities** include partnerships, regional distributors, national distributors, NBFCs, banks, stock brokers, etc.
- **NSE's platform** is called **NMF II Platform**. **BSE's platform** is **BSE STAR Mutual Funds Platform**. NMF II platform of NSE has two versions, one for trading members and one for distributors.
- The **stock exchanges only offer a transaction platform**, but they do not replace the RTAs.
- The **exchanges do not offer settlement guarantee**. **Responsibility for settlement is with the AMC**.
- **MF Utilities (MFU)** is a transaction aggregating platform that connects investors, RTAs, distributors, banks, AMCs and others. It offers a Common Transaction Form to transact in multiple schemes across participating mutual funds.
- Investors who register on the **MFU are allotted a Common Account Number (CAN)** under which all their mutual fund holdings are consolidated.
- **MFU allows a single payment for multiple subscriptions** made under a single form.
- The **bank and nomination details provided to the MFU** at the time of registering for the CAN will override the information provided in the folios.
- **Prerequisites to become Distributor** of a Mutual Fund

  a. Obtaining NISM Certification

  - The individual needs to pass the NISM certification examination mandated by SEBI.
  - Persons who have attained the age of 50 years or who have at least 10 years of experience in the securities markets in the sale and/ or distribution of mutual fund products as on May 31, 2010, can obtain the certification either by passing the NISM certification examination or qualifying for Continuing Professional Education (CPE) by obtaining such classroom credits as may be specified by NISM from time to time.

  b. **Know Your Distributor Requirements-** The KYD process consists of document verification and bio-metric process.

  c. **Obtaining AMFI Registration Number-** After obtaining the certification and completing KYD requirements, the next stage is to register with AMFI. On registration, AMFI allots an AMFI Registration Number (ARN). Minimum age for obtaining ARN is 18 years.

  d. **Empanelment with AMCs-** An ARN holder can become a distributor or can become agents of a distributor who is already empanelled with AMCs. The employees of the distributor need to obtain an Employee Unique Identification Number (EUIN) from AMFI apart from AMFI Registration Number (ARN).

- There are “no” SEBI regulations regarding the minimum or maximum commission that distributors can earn.
- As per SEBI circular dated October 2018, AMCs shall adopt full trail model of commission in all schemes, without payment of any upfront commission or upfronting of any trail commission, directly or indirectly, in cash or kind, through sponsorships, or any other route.
- **Upfronting of trail commission** is allowed only in case of inflows through Systematic Investment Plans (SIPs) of upto Rs. 3,000 per month for an investor investing in mutual fund schemes for the first time. In other cases, Upfront commission will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor.
- **Trail commission** is calculated as a percentage of the net assets attributable to the Units sold by the distributor. The commission payable is calculated on the daily balances and paid out periodically to the distributor as per the agreement entered into with AMC. (quarterly basis or monthly basis)

  Trail commission for the day = AUM X trail commission rate p.a./365

Type of Investor	Transaction Charges (Rs.) (for purchase/subscription of Rs. 10,000 and above)
First time mutual fund investor	Rs. 150/-
Investor other than first time mutual fund investor	Rs. 100/-

- Distributor is paid a commission for as long as the investor’s money is held in the fund.
- SEBI has mandated Mutual Funds / AMCs to disclose on their respective websites the **total commission and expenses paid to distributors who have**

  1. Multiple point presence (More than 20 locations)
  2. AUM raised over Rs. 100 crore across industry in the non-institutional category but including high net worth individuals (HNIs)
  3. Commission received of over Rs. 1 Crore p.a. across industry
  4. Commission received of over Rs. 50 Lakhs from a single mutual fund

- Mutual Fund distributors can claim commission on investments made through them by their clients. However, **no commission is payable on their own investments**.
- Distributors who have chosen the **‘opt-out’ option** i.e. decided not to charge transaction charges based on type of the product e.g. they can decide not to charge it for debt schemes.
- The distributor cannot choose to charge transaction charges from one investor and not from another.

- To provide protection against loss of income to the mutual fund distributor's family, AMFI has advised its members (AMCs) to offer nomination facilities to the AMFI registered mutual fund distributors.
- A **nominee/legal heir need not be an ARN holder** to claim and receive the commission. Nominee shall receive the commissions only as trustee for the legal heirs of the deceased MFD.
- **In case of change of distributor code in a folio**, no commission would be payable to any distributor, neither the old one nor the new one.
- If the change of distributor code is initiated by the investor on account of voluntary cessation of business by the distributor, the new distributor would get the trail commission.
- **New age Technology-based platforms** allow investors to invest in mutual funds apart from other areas like stocks, bonds etc. (Groww, Kuvera, Paytm money, Coin etc).
- As per "SEBI" an "**Investment Advisor**" any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes any person who holds out himself as an investment adviser, by whatever name called.
- Investors can choose to change their distributor or go direct. This needs to be done through a written request by the investor. In such cases, AMCs will need to comply, without insisting on any kind of '**No Objection Certificate'** from the existing distributor.

CHAPTER 7

NET ASSET VALUE, TOTAL EXPENSE RATIO AND PRICING OF UNITS

- The 10 principles as laid out by SEBI are as under:

Principle 1:-	The **valuation shall be done in good faith and in true and fair** manner through appropriate valuation policies and procedures.
Principle 2:-	Investment in new type of securities/assets by the mutual fund scheme shall be made **only after establishment of the valuation methodologies** for such securities with the approval of the Board of the asset management company.
Principle 3:-	The **assets held by the mutual funds shall be consistently valued** according to the policies and procedures.
Principle 4:-	The asset management company **shall provide for the periodic review** of the valuation policies and procedures to ensure the appropriateness and accuracy of the methodologies used and its effective implementation in valuing the securities/assets.
Principle 5:-	The valuation policies and procedures approved by the Board of asset management company **should seek to address conflict of interest**.
Principle 6:-	**Disclosure of the valuation policy and procedures** approved by the Board of the asset management company shall be made in Statement of Additional Information, on the website of the asset management company/mutual fund and at any other place specified by the Board.
Principle 7:-	The **responsibility of true and fairness of valuation and correct NAV** shall be of the asset management company, irrespective of disclosure of the approved valuation policies and procedures.
Principle 8:-	The **asset management company shall have policies and procedures** to detect and prevent incorrect valuation.
Principle 9:-	**Documentation of rationale for valuation** including inter scheme transfers shall be maintained and preserved by the asset management company as per Regulation 50 of SEBI (Mutual Fund) Regulations, 1996 to enable audit trail.
Principle 10:-	The asset management company **shall take into consideration prices of trades of same security** or similar security reported at all available public platforms.

- Traded Securities other than money market and debt securities:
  - The securities shall be valued at the **last quoted closing price** on the stock exchange.
  - When the securities are traded on more than one recognised stock exchange, the securities shall be valued at the last quoted closing price on the stock exchange where the security is principally traded.

- On a particular valuation day, **if a security has not been traded** on the selected stock exchange, the value at which it is traded on another stock exchange may be used.
- **When a security is not traded on any stock exchange** on a particular valuation day, the value at which it was traded on the selected stock exchange or any other stock exchange, as the case may be, on the earliest previous day may be used provided such date is not more than thirty days prior to the valuation date.

■ Non-traded Securities' other than money market and debt securities:-

- When a security is not traded on any stock exchange for a period of thirty days prior to the valuation date, the **script must be treated as a 'non-traded' script**.
- **Non-traded securities shall be valued "in-good faith"** by the asset management company on the basis of appropriate valuation methods based on the principles approved by the Board of the asset management company.

■ The gold held by a gold exchange traded fund scheme shall be valued at the AM fixing price of London Bullion Market Association (LBMA) in US dollars per troy ounce for gold having a fineness of 995.0 parts per thousand.

■ **Net Assets of Scheme**

- Net assets include the amount originally invested, the profits booked in the scheme, as well as the appreciation in the investment portfolio.
- Net assets increase when the market prices of securities held in the portfolio increase, even if the investments have not been sold and profits realized.
- A scheme cannot show better profits by delaying payments. While calculating profits, all the expenses that relate to a period need to be considered, irrespective of whether or not the expense has been paid. In accounting language, this is called accrual principle.
- Similarly, any income that relates to the period will boost profits, irrespective of whether or not it has been actually received in the bank account. This again is in line with the accrual principle.

■ **Net Asset Value (NAV)** = (Current value of investments held + Income accrued + Current assets – Current liabilities – Accrued expenses) / No. of outstanding units. Income accrued is the dividend declared but not received. Expenses accrued include fees payable.

■ The process of valuing each security in the investment portfolio of the scheme at its current market value is called '**mark to market**'.

■ Investment and Advisory Fees are charged to the scheme by the AMC.

■ **Any expense other than investment advisory fee and recurring expenses** shall be borne by the asset management company or trustee or sponsors.

■ Expense limit in case of fund of funds scheme.

DETAILS (SCHEMES)	MAXIMUM EXPENSES CHARGED
Investment in liquid schemes, index fund schemes and exchange traded funds.	1.00 % of the daily net assets of the scheme.

Investment in Liquid Scheme	2.25% of the daily net assets of the scheme.
Other Schemes	2% of the daily net assets of the scheme.

- In case of an index fund scheme or exchange traded fund, **the total expense ratio** of the scheme including the investment and advisory fees shall not exceed 1.00 per cent of the daily net assets.
- In case of open ended schemes other than as specified for **fund-of-fund and index fund schemes**, the total expense ratio of the scheme shall not exceed the following limits:

NET ASSET	EQUITY SCHEME	DEBT SCHEME
Upto 500 cr	2.25%	2%
Next 250 cr	2%	1.75%
Next 1250 cr	1.75%	1.50%
Next 3000 cr	1.60%	1.35%
Next 5000 cr	1.50%	1.25%
Next 40000 cr	Total expense ratio reduction of 0.05% for every increase of Rs.5,000 crores of daily net assets or part thereof.	
On the Balance	1.05%	0.80%

- In case of **close ended and interval schemes**,

DETAILS (SCHEMES)	MAXIMUM EXPENSES CHARGED
Closed Ended Equity	1.25 % of the daily net assets of the scheme.
Other Schemes	1.00 % of the daily net assets of the scheme.

- AMC can charge **additional recurring expenses** if the new inflows from beyond top 30 cities are at least
  a. 30% of gross new inflows in the scheme or
  b. 15% of the average assets under management (year to date) of the scheme, whichever is higher

- Funds can charge additional expense of up to 30 basis points on daily net assets of the scheme.
- Daily net assets x 30 basis points x New inflows from beyond top 30 cities 365 X Higher of (a) or (b) above.

■ SEBI guidelines stipulate that dividends can be paid out of distributable reserves. In the calculation of distributable reserves:

a. All the profits earned (based on accrual of income and expenses as detailed above) are treated as available for distribution.

b. Valuation gains are ignored. But valuation losses need to be adjusted against the profits.

c. That portion of sale price on new units, which is attributable to valuation gains, is not available as a distributable reserve.

■ The difference between the NAV and re-purchase Price is called the "**exit load**".

■ No exit load will be charged on bonus units and units allotted on reinvestment of dividend.

■ **Exit loads have to be credited back to the scheme immediately** i.e. they are not available for the AMC to bear selling expenses.

■ **Key Accounting and Reporting Requirements**

a. The accounts of the schemes need to be maintained distinct from the accounts of the AMC. The auditor for the AMC has to be different from that of the schemes.

b. Norms are prescribed on when interest, dividend, bonus issues, rights issues etc. should be reflected in the accounts.

c. NAV is to be calculated upto 4 decimal places in the case of index funds, liquid funds and other debt funds.

d. NAV for equity and balanced funds is to be calculated upto at least decimal places.

e. Investors can hold their units even in a fraction of 1 unit. However, current stock exchange trading systems may restrict transacting on the exchange to whole units.

■ AMC **shall not charge investment and advisory fees** on the **segregated portfolio**. However, **TER** (excluding the investment and advisory fees) **can be charged**, on a pro-rata basis only upon recovery of the investments in a segregated portfolio.

■ Additional Tier 1(AT 1) and Tier 2(AT 2) bonds are issued by banks and are perpetual in nature. SEBI has imposed limits on the exposure that a fund can take to these bonds.

a. No mutual fund shall own more than 10% of such types of bonds issued by a single issuer.

b. Mutual fund scheme shall not invest more than 10% of its assets into such instruments.

c. The scheme should also not invest more than 5% of its assets in such instruments of a single investor.

d. These limits have to be within the overall limits of an issuer that are specified in the prudential guidelines issued by SEBI.

CHAPTER 8

TAXATION

- **Capital Gains Tax**

CAPITAL GAINS	EQUITY ORIENTED FUNDS	NON-EQUITY ORIENTED FUNDS EQUITY BETWEEN 35% TO 65% OF PORTFOLIO	NON-EQUITY ORIENTED FUNDS WITH EQUITY LESS THAN 35% OF PORTFOLIO
Short term capital gains	15%	Marginal tax rate, as applicable for the investor	Marginal tax rate, as applicable for the investor
Long term capital gains	10%	20% with indexation benefits	It is taxable as STCG irrespective of holding period

- In the Union Budget of the year 2018, there are two important provisions that are discussed here:

  1. Exemption upto Rs. 1 lakh: In case of long term capital gains arising out of equity shares and equity-oriented mutual funds, the tax is applicable only on the capital gains above Rs. 1 lakh.

  2. Grandfathering of capital gains: This meant that the capital gains earned till January 31, 2018 would not be taxable.

- The dividends would be taxable in the hands of the recipient at the applicable tax rate.
- In the Finance Act of 2023, applicable from the financial year 2023-24, growth option of debt funds was made taxable as short term capital gains (STCG) irrespective of holding period. It was defined as funds with exposure to domestic equity less than 35 percent of the portfolio.
- The new taxation structure applicable from 1 April 2023:

	DOMESTIC EQUITY 0% TO LESS THAN 35%	DOMESTIC EQUITY 35% TO 65%	DOMESTIC EQUITY MORE THAN 65%
STCG	Marginal slab rate. STCG irrespective of holding period.	Marginal slab rate. Holding period less than 3 years.	15% plus surcharge and cess as applicable. Holding period less than 12 months
LTCG	N.A.	Indexation benefit available. 20% plus surcharge and cess as applicable. Holding period more than 3 years.	10% plus surcharge and cess as applicable, beyond Rs 1 lakh per financial year. Holding period more than 1 year.

Examples of fund categories	All debt funds, Gold funds International funds, Conservative Hybrid funds, Fund of Funds	Multi Asset Funds with equity in the range of 35% to 65%	All domestic equity funds, Equity Savings funds, Arbitrage funds BAF, Aggressive Hybrid funds

- **Setting off of Capital Gains and Losses under Income Tax Act**
  - Capital loss, short term or long term, cannot be set off against any other head of income (e.g. salaries).
  - Short term capital loss is to be set off against short term capital gain or long term capital gain.
  - Long term capital loss can only be set off against long term capital gain.
- STT applicability for Investors in Equity oriented Mutual funds

PARTICULARS	RATES (IN PERCENT)	PAYABLE BY:
Purchase of units of equity oriented mutual fund	NIL	Purchaser
Sale of units of equity oriented mutual fund	0.001	Seller
Sale of units of equity oriented mutual fund (delivery based)	0.025	Seller
Sale of units of equity oriented mutual funds 0.025(non-delivery based)	0.001	Seller

- **Equity Linked Savings Schemes (ELSS)** are eligible for deduction under Section 80C of the Income Tax Act.
- There is **no TDS on re-purchase proceeds** to **resident investors**. The **TDS applicable for non-resident investors** is the lower of the rate specified in the income tax regulations or the tax specified in the DTAA of the country where the investor is resident.
- **Goods and Services Tax (GST) became applicable from the year 2017.** AMC(s) can charge GST, as per applicable Taxation Laws, to the schemes within the limits prescribed under SEBI (Mutual Fund) Regulations.

  1. GST on fees paid on investment management and advisory fees shall be charged to the scheme in addition to the overall limits specified as per the Total Expense Ratio (TER) provisions.

  2. GST on all the fees other than investment and advisory fees shall be charged to the scheme within the maximum limit of TER.

  3. GST on exit load, if any, shall be deducted from the exit load and the net amount shall be credited to the scheme.

  4. GST on brokerage and transaction cost paid for execution of trade, if any, shall be within the limit of TER.

5. The commission payable to the distributors of mutual funds may be subject to GST, as applicable in case of the ARN holder. Such tax cannot be charged to the scheme.

CHAPTER 9

INVESTOR SERVICES

- Units in a mutual fund scheme are offered to investors for the first time through a **New Fund Offer (NFO)**. The Asset Management Company (AMC) decides on a scheme to take to the market.
- NFO has to be in a category where the AMC does not already have a fund/scheme. Or, it has to be in a category where an AMC can have multiple funds/schemes e.g. Sector/Theme, Index or Fund of Funds.
- **AMC prepares the Scheme Information Document for the NFO**. It needs to be approved by the Trustees and the Board of Directors (BoD) of the AMC.
- Once the document is approved, it is then filed with SEBI. SEBI may make observations on the SID, which need to be incorporated. SEBI makes observations only and does not approve or disapprove the OD.
- The **AMC decides on a suitable time-table for the issue**, keeping in mind the market situation.
- The **AMC launches its advertising and public relations campaigns** to make investors aware of the NFO. These need to comply with SEBI's advertising code.
- The **AMC holds events for intermediaries and the press** to make them familiar with the scheme, its unique features, benefits for investors, etc.
- The **Scheme Documents and Application Forms are distributed to market intermediaries**, and circulated in the market, so that investors can apply in the NFO.
- **Important Points to Remember regarding NFO Process**
    - All NFOs can remain open for subscription for a minimum period of 3 working days.
    - NFOs except ELSS can remain open for a maximum of 15 days.
    - Allotment of units or refund of money, whatever the case may be, must be done within 5 business days of closure of the scheme.
    - Open-ended schemes have to re-open for sale or re-purchase within 5 business days of the allotment.
    - New Fund Offer (NFO) Price is the price per unit that the investors have to pay to invest during the NFO.
    - Ongoing price for purchase, redemption (sale) /switch outs (to other schemes/plans of the Mutual Fund) by investors is the price at which the investor purchases or receives redemptions/switch outs.
- Each mutual fund has to offer two plans to the investors, viz., **regular plan and direct plan**.
- The **direct plan** shall have a lower expense ratio excluding distribution expenses, commission, etc., and **no commission** shall be paid from such plans. Since the TER is different in both cases, the plans will have separate NAVs.

- The reduced NAV, after a dividend pay-out of Income Distribution cum capital withdrawal is called **ex-Dividend NAV**. After a dividend is announced, and until it is paid out, it is referred to as **cum-Dividend NAV**.
- In a **dividend re-investment option**, the investor does not receive the dividend in his bank account; the amount is reinvested in the same scheme and additional units are allotted to the investor.
- Subject to the receipt of the specified minimum subscription amount for the scheme, full allotment is made to all valid applications received during the New Fund Offer.
- Allotment of units and dispatch of allotment advice to FPIs (Foreign Portfolio Investors) is subject to RBI approval if required.
- The **price at which units are sold** to an investor as part of ongoing sales in an open-ended scheme is the sale price, which in turn is the applicable NAV.
- In a **rights issue**, the price at which the units are offered is clear at the time of investment.
- In a **bonus issue**, the investor does not pay anything. The fund allots new units for free.
- Mutual funds issue a monthly ***statement of account*** every month if there is a transaction during the month.
- Mutual Funds may issue the account statement annually to the unit-holders who have not transacted during the last six months.
- **Consolidated Account Statement (CAS)** is a single/combined account statement which shows the details of financial transactions made by an investor across all Mutual Funds and also other securities held in dematerialised (Demat) mode, over a given period of time under a PAN.
- The Depositories (NSDL or CDSL) issue CAS for each calendar month to the unit holders if there has been a financial transaction in the folio in the previous month.
- **Individual Investors are:**
    - **Resident Indian adult individuals, above the age of 18:** They can invest, either singly or jointly (not exceeding three names).
    - **Minors i.e. persons below the age of 18:** Since they are not legally eligible to enter into a contract, they need to invest through their guardians. SEBI has modified Investment in units of Mutual Funds in the name of minor through guardian stating that the payment for investment by any mode shall be accepted from the bank account of the minor, parent or legal guardian of the minor, or from a joint account of the minor with parent or legal guardian.
    - **Hindu Undivided Families (HUFs):** Here, family members pool the family money (inherited) for investments. The head of the family (called “Karta”) invests on behalf of the family. Against his name in the application, he would add the letters “HUF” to show that the investment belongs to the family.

- **Non-Resident Indians (NRIs)/Persons of Indian Origin (PIO) resident abroad:** Indian citizens, who are working abroad, and their family residing abroad, are typical NRIs who invest in India.
- **Foreign investors:** They can invest in equity schemes of MFs registered with SEBI after completing KYC process. Foreign nationals can invest in Indian mutual funds as Qualified Foreign Investors (QFIs). The QFI is sub-category of Foreign Portfolio Investor and refers to any foreign individuals, groups or associations, or resident. QFIs can purchase Indian mutual fund units through demat account mode (direct route) and unit confirmation receipt (UCR).

■ **Non-individual Investors are:**

- Companies / corporate bodies, registered in India
- Registered Societies and Co-operative Societies
- Trustees of Religious and Charitable Trusts
- Trustees of private trusts
- Partner(s) of Partnership Firms
- Association of Persons or Body of Individuals, whether incorporated or not
- Banks (including Co-operative Banks and Regional Rural Banks) and Financial Institutions and Investment Institutions
- Other Mutual Funds registered with SEBI, etc.

■ In **Direct Plan** Investors have the option to invest directly without routing the investment through a distributor.

■ **Dividend payout plan** is also called as income distribution cum capital withdrawal plan and dividend reinvestment plan is also called as income distribution cum capital withdrawal reinvestment plan

■ A mutual fund investment can have upto **three holders**.

■ An investment made for a minor (less than 18 years) is done through a guardian who complies with the KYC and PAN requirements and all other formalities as if the investment was for themselves.

■ In the case of investments by a Power of Attorney (PoA) holder on behalf of an investor (issuer), both the PoA holder and issuer should comply with the KYC and PAN requirements.

■ Along with the application form, each applicant should provide the KYC acknowledgement letter (as proof of compliance with the KYC norms). Also, additional KYC details relating to occupation, gross annual income or net-worth, etc. are mandatorily collected in the application form for both individual and non-individual applicants.

■ For applicants, including guardians, whose country of birth/citizenship/nationality/tax residency is other than India, the application requires additional information under **Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS)**.

■ It is mandatory for investors to provide the bank details of the sole/first holder of the folio in the application form.

- Investors have the option to hold the units in **physical mode or demat mode**. If the units are to be held in a demat account then the name and ID of the Depository Participant with whom the investor holds the account, and details of the beneficiary account has to be provided.
- The applicant can make a nomination in favour of a **maximum of three nominees** and indicate the percentage to each nominee.
- The Scheme Information Document (SID) and Key Information Memorandum (KIM) provides information on the minimum application amount.
- Fresh purchase or initial purchase of mutual fund units in a scheme can be made during the new fund offer (NFO) period or even subsequently in an open-ended scheme, during the open offer period.
- A **transaction slip** can be used to make additional purchases in an open-ended scheme in which the investor has already invested.
- Units held in de-materialized form have to be redeemed through the depository participant (DP).
- A **switch** is a redemption from one scheme and a purchase into another combined into one transaction.
- **Payment Mechanism** for mutual fund purchases:-

  1.) Internet Banking

  2.) M-Banking

  3.) Unified Payment Interface

  4.) Application Supported by Blocked Amount

  5.) Aadhaar Enabled Payment Service

  6.) National Unified USSD Platform

  7.) Debit Cards

  8.) E-Wallets

  9.) One-Time Mandate (OTM)

  10.) Cheque/Demand Draft

  11.) Cash Payments
- **RTGS** transfers are instantaneous. RTGS means Real time gross settlement.
- **NEFT** means National Electronic funds transfer.
- **SWIFT** used for international transfer
- **National Automated Clearing House (NACH)** is a centralized clearing system launched by the National Payments Corporation of India (NPCI).
- NACH aims to **replace** and consolidate multiple existing **Electronic Clearing Service (ECS)** systems across India and create a faster and more efficient clearing platform.

- The **Unified Payment Interface (UPI)** allows fund transfer between accounts through the mobile app.
- **Application Supported by Blocked Amount (ASBA)** is a facility where the investment application in a New Fund Offer (NFO) is accompanied by an authorization to the bank to block the amount of the application money in the investor's bank account.
- **Aadhaar Enabled Payment Service (AEPS)** allows bank to bank transactions using the Aadhaar number of the customer.
- **National Unified USSD Platform (NUUP)** based mobile banking allows transactions even without a smartphone and internet.
- **Mutual funds purchases using credit cards** are **not allowed**.
- Money is loaded to the **E-Wallet** and used as required to make payments and transfer funds to other E-Wallets. However, they cannot be used to transfer money to a bank account.
- **One-Time Mandate (OTM)** is a payment facility that investors can use to authorize their bank to process debits to their specified bank account raised by a specified mutual fund for purchase of units.
- **Demand Drafts (DDs)** are accepted only if the investor is from a location where there is no official collection centre for the application.
- **Small investors, who may not be tax payers** and may not have PAN/bank accounts, such as farmers, small traders/businessmen/workers are allowed cash transactions for purchase of units in mutual funds to the extent of Rs. 50,000/- per investor, per mutual fund, per financial year.
- Although investment can be made in cash, repayment in form of redemptions, dividend payments, etc. can be only through the banking channel.
- **Payment Mechanism for Repurchase of Units**
    - Cheque
    - Electronic Modes (Direct credit/RTGS/NEFT/NACH)
    - Instant Access Facility (IAF)
- An **individual investor can register up to five bank accounts** and a non-individual investor, ten.
- In case of **NRI investments,** if the payment for the investment was made through an NRO account, then the registered account should also be of the same type. If payment was routed through an NRE account, then the registered accounts can be an NRO or NRE account.
- **IAF facilitates** credit of redemption proceeds in the bank account of the investor on the same day of the redemption request.
- Points of acceptance have time stamping machines with tamper-proof seal. Opening the machine for repairs or maintenance is permitted only by vendors or nominated

persons of the mutual fund. Such opening of the machine has to be properly documented and reported to the Trustees.

- The **daily time stamping of applications does not start with serial 1**.
- For **online transactions**, the time as per the web server to which the instruction goes, is used in determining the NAV for sale / re-purchase transactions.
- Applications of financial and non financial transactions are stamped with automatically generated Location Code, Machine identifier, Serial number, Date & Time.
- All investors, both individual and non-individual, including joint holders, NRIs, PoA holders and its issuers, and guardians in the case of minors have to be KYC compliant, irrespective of the investment value.
- Providing Permanent Account Number (PAN) is compulsory for all mutual fund investments. Exception has been made for Micro-SIPs i.e. SIPs where annual investment (12 month rolling or April-March financial year) does not exceed Rs. 50,000.
- SEBI has instituted a centralised KYC process for the capital market, including mutual funds.
- The Government of India authorised the Central Registry of Securitisation and Asset Reconstruction and Security Interest of India (CERSAI) to act as and to perform the functions of the Central KYC Record Registry. **e-KYC service launched by UIDAI** is also a valid process for KYC verification.
- If the investors choose to hold the units in demat form or for applicants who choose to invest through the stock exchange infrastructure, the KYC performed by the Depository Participant will be considered in compliance with the KYC norms.
- Where **investment is made by a minor**, **KYC requirements** have to be complied with by the Guardian.
- In the case of investments by a Power of Attorney (PoA) holder on behalf of an investor, KYC requirements have to be complied with, by both, investor and PoA holder.
- **For NRI investors PAN is the sole identification number for KYC compliance**. A copy of the passport/ PIO card/OCI card and overseas address proof is mandatory.
- **Additional Requirements applicable for Institutional Investors**
    - A proof should be submitted which shows that the institute is eligible to invest.
    - Authorization for the investing institution to invest.
    - Document which proves that an appointed person is authorised to sign the documents on behalf of the investing institution.
    - Details of the ‘Ultimate Beneficial Owner’ (UBO) of the investments.

Cut-Off Time for Purchases and Switch ins:

Type of Scheme	Transaction	Cut off time	Applicable NAV
Equity oriented funds and debt funds (except liquid funds) in respect of transaction of any amount	Purchases and Switch ins	3.00 pm	Irrespective of the time of receipt of application. NAV of the business day on which the funds are available for utilisation without before the cut-off time of that day is applicable.
Liquid fund	Purchases and Switch ins	1.30 pm	If application and funds are available for utilisation before the cut-off time. Closing NAV of the day immediately preceding the day of the receipt of application is applicable.
			If application received after cut off time and funds are available for utilisation on the same day. The closing NAV of the day immediately preceding the next business day is applicable.
			Irrespective of the time of receipt of applications, if funds are not available for utilisation before the cut-off time. The closing NAV of the day immediately preceding the day on which the funds are available for utilisation.

Cut-Off Time for Redemptions and Switch-outs:

Type of Scheme	Transaction	Cut off time	Applicable NAV
Equity Oriented Funds, Debt funds (Other than Liquid funds)	Redemptions and Switch outs	3.00pm	Same day NAV if received before cut off time.
			Next business day NAV for applications received after cut off time.
Liquid funds	Redemptions and Switch outs	3.00pm	NAV of day immediately preceding the next business day, if received before cut off time. If redemption request is received through Instant Access Facility (IAF) up to the cut off time, then the lower of: (a) NAV of previous calendar day and (b) NAV of calendar day on which application is received
			Next business day NAV for applications received after cut off time. If redemption request is received through Instant Access Facility (IAF) after the cut off time, then the lower of: (a) NAV of calendar day on which such application is received and (b) NAV of next calendar day

- SEBI has now eased the Know Your Client (KYC) Process by enabling Online KYC through the use of Technology / App by the registered intermediary.
- The use of technological innovations allows the investors to complete the KYC process without the requirement of physically visiting the office of the intermediary.
- **SEBI has enabled** the usage of e-Sign, Digi locker and electronic signature as it is permitted by the Government of India.
- It allows investors to submit their **Officially Valid Documents (OVDs)** through **e-mail or electronic means** to the SEBI registered intermediary's online/digital platform for the purpose of KYC.
- ***The online KYC process***

  Step 1: The investor visiting the app or the online website of the Registered Intermediary (RI).

  Step 2: Filling up the KYC form online along with the online submission of documents.

  Step 3: Verification of Information.

  Step 4: The investor has to take a printout of the KYC form and submit this along with their wet- signature through a scanned copy under e-Sign or affixing the online cropped signature and submitting the same to the RI by e-Sign.

- Under **Foreign Account Tax Compliance Act and Common Reporting Standards**, the application requires information to be provided if the citizenship/nationality/place of birth/tax residency are places other than India for all categories of investors.
- Through **SIP** investment, one can get the **benefit of rupee cost averaging**.
- Systematic investing allows investors to buy into a volatile market over time at an average price without having to predict market movements.
- In **SIP Top-Up facility**, investors have the option to increase the SIP amount at intervals chosen by them. The increase can be of a fixed amount or a percentage of the existing SIP amount.
- In **SWP,** a fixed amount of money is redeemed from a mutual fund scheme at a fixed interval and is credited in the bank account of the investor.
- In SWP, some schemes even offer the facility of transferring only the appreciation or the dividend.
- SWP helps to minimize the risk of redeeming all the units during a market trough.
- In a **STP**, the amount that is withdrawn from a scheme (called the source scheme) is re-invested in some other scheme (called the target scheme) of the same mutual fund.
- STP is used by investors to make periodic investments into a volatile market such as equity, or to rebalance a portfolio, or to book profits.
- **Dividend Transfer Plan (DTP)** is a facility that allows investors to invest the dividend earned in a mutual fund investment into another scheme of the same mutual fund.
- In case of systematic transactions, a default SIP date, frequency, end date may be specified by the scheme which will be applied in case the investor does not make a selection.
- To renew an SIP, a renewal form has to be submitted giving details of the scheme, plan and option, SIP amount, SIP date and period.
- An **SIP can be cancelled** by giving due notice of the same to the AMC by providing details of the SIP such as folio number, scheme name, option, bank details and mode of payment.
- The **nomination made in a folio** applies to all the investments held under the folio. Nomination can be made in favour of a maximum of three nominees.
- The **change or cancellation of a nominee** has to be made by all the unit-holders who made the original nomination, irrespective of the mode of holding.
- **Mutual fund units can be pledged** by unitholders to Banks, NBFCs and other financiers. Once Units are pledged, the Unit-holders cannot sell or transfer the pledged units, until the pledgee gives no objection to release the pledge.
- The **change in the status of an investor from minor to major** will require the PAN and KYC compliance of the investor to replace that of the guardian.
- Once the minor becomes major, financial transactions are disallowed in their account.

- Once an **NRI becomes a RI**, he cannot operate his NRO/NRE/FCNR (B) accounts
- **Schemes other than ELSS** can remain open for subscription for a maximum of Fifteen (15) days.
- Schemes other than ELSS need to allot units or refund money within 5 business days of closure of the NFO.
- **Unit certificate has to be issued within 5 working days** of the receipt of request for the certificate.

CHAPTER 10

RISK, RETURN AND PERFORMANCE OF FUNDS

- The **standard risk factors** are the risks that all mutual fund investments are exposed to whereas there are certain risks specific to individual asset categories.
- **Risk in dividend** is that, there is no assurance that a company may continue paying dividend in future.
- **Counterparty Risk** occurs when a counterparty fails to abide by its contractual obligations and therefore, the scheme is compelled to negotiate with another counter party, at the then prevailing (possibly unfavourable) market price.
- **Market Liquidity Risk** occurs where the derivatives cannot be transacted due to limited trading volumes and/or the transaction is completed with a severe price impact.
- This **re-investment risk** refers to the interest rate levels at which cash flows received from the securities in the Scheme are reinvested.
- Investments in mutual fund Units in India may be materially adversely impacted by Indian politics and changes in the political scenario in India either at the central, state or local level. It is called **Political Risk**.
- A slowdown in economic growth or macro-economic imbalances such as the increase in the central and state level fiscal deficits may adversely affect investments in the country. It is called **Economic Risk.**
- The Scheme may be denominated in Indian Rupees (INR) which is different from the home currency for Foreign Portfolio Investors in the mutual fund units. The INR value of investments when translated into home currency by Foreign Portfolio Investors could be lower because of the currency movements. It is called **Foreign Currency Risk**.
- The market capitalization spectrum has been defined as follows:
  - **Large-Cap Stocks**: 1st -100th company in terms of full market capitalization
  - **Mid-Cap Stocks**: 101st -250th company in terms of full market capitalization
  - **Small-Cap Stocks**: 251st company onwards in terms of full market capitalization
- **Basis Risk:** The underlying benchmark of a floating rate security or a swap might become less active or may cease to exist and thus may not be able to capture the exact interest rate movements, leading to loss of value of the portfolio.
- **Derivative products are leveraged instruments** and can provide disproportionate gains as well as disproportionate losses to the investor / unit-holder.
- One notch downgrade of a AAA rated issuer to AA+ will have an adverse impact on the price of the security and vice-versa for an upgrade of a AA+ issuer.
- Among corporate bonds, bonds which are rated **AAA are comparatively less risky** than bonds which are AA rated.
- **Investor holding units of segregated portfolio may not be able to liquidate** their holding till the time recovery of money from the issuer.
- The **purpose of credit enhancement** is to ensure timely payment to the investors, if the actual collection from the pool of receivables for a given period is short of the contractual pay-out on securitisation.
- **ReITs and InvITs are exposed to** price-risk, interest rate risk, credit risk, liquidity or marketability risk, reinvestment risk.

- The **liquidity risk is managed** by creating a portfolio which has adequate access to liquidity.
- **Fund managers cannot reduce the systematic risk** except by staying out of the market. Thus, some fund managers may tactically move between equity and cash depending on their view on the broader market.
- **Fundamental analysis** is a study of the business and financial statements of a firm in order to identify securities suitable for the strategy of the schemes as well as those with high potential for investment returns and where the risks are low.
- **Technical Analysis** is the study of price-volume charts of the company's shares to decide support levels, resistance levels, break outs, and other triggers to base their buy/sell/hold recommendations for a share.
- **Yield** = Interest Income + Capital Gain /Capital Loss
- **Earnings per Share (EPS):** Net profit after tax ÷ No. of equity shares outstanding
- **Price to Earnings Ratio (P/E Ratio):** Market Price per share ÷ EPS
- **Book Value per Share:** Net Worth ÷ No. of equity shares outstanding
- **Price to Book Value:** Market Price per share ÷ Book Value per Share
- **Dividend Yield:** Dividend per Share ÷ Market price per Share
- In a **top down approach**, the portfolio manager evaluates the impact of economic factors first and narrows down through the industry specific factors and then on to the companies that are suitable for investment.
- A **bottom-up approach,** on the other hand, analyses the company-specific factors first and then evaluates the industry factors and finally the macro-economic scenario and its impact on the companies that are being considered for investment.
- **Growth investment style** entails investing in high growth stocks i.e. stocks of companies that are likely to grow much faster than the market.
- **Value investment style** is an approach of picking up stocks, which are priced lower than their intrinsic value, based on fundamental analysis.
- Debt securities that are to mature within a year are called **money market securities**.
- **Yield to maturity (YTM)** is the return that the investor gets provided the security is held till maturity.
- The **holding period return (HPR)** is a combination of interest paid by the issuer and capital gain (if the sale proceeds are higher than the amount invested) or capital loss (if the sale proceeds are lower than the amount invested) relative to the price paid to buy the security.
- Securities issued by the Government are called **Government Securities or G-Secs or Gilts**.
- **Treasury Bills** are short term debt instruments issued by the Reserve Bank of India on behalf of the Government of India.
- **Certificates of Deposits** are issued by Banks (for 91 days to 1 year) or Financial Institutions (for 1 to 3 years)
- **Commercial Papers** are short term securities (up to 1 year) issued by Companies.

- **Bonds / Debentures** are generally **issued for tenors beyond a year**.
- **Governments and public sector companies** tend to issue **bonds**, while **private sector companies issue debentures**.
- The difference between the yield on Gilt and the yield on a Non-Government Debt security (with highest safety, i.e. AAA or equivalent) is called its **Yield Spread**.
- Short maturity securities (lower modified duration) suffer lesser fluctuation in value, as compared to the ones with longer tenor (higher modified duration).
- The **returns in a debt portfolio** are largely driven by interest rates and credit spreads.
- When the **rupee becomes stronger**, it results in **lower returns in the gold fund**.
- When the **interest rate is low**, it results in **higher real estate prices**.
- **Total Risk** = Systematic Risk + Unsystematic Risk.
- **CAGR** = (Later Value / Initial Value)^(1/n) – 1
- A **Beta** is a measure of Systematic Risk. Beta of any Index will always be 1. Aggressive funds will have more than 1 beta.
- **Un-systematic risk / Specific Risk** can be reduced through diversification.
- The difference between an index fund's return and the market return is the **Tracking Error**.
- **Interest rates and Market price** of debt security are **inversely** related to each other.
- **Simple Return =** $\frac{(\textbf{LaterValue}\ \textit{minus}\ \textbf{InitialValue}) \times 100}{\textbf{InitialValue}}$
- **Annualized Return =** $\frac{\textbf{Simple Return} \times 12}{\textbf{Period of Simple Return}\ (\text{in months})}$
- **Variance** as a measure of risk is relevant for both debt and equity schemes. It is calculated as var(range of cells where the periodic returns are calculated)
- **Standard deviation** is a measure of total risk in an investment. Standard Deviation = stdev(range of cells where the periodic returns are calculated)
- **Modified duration** measures the sensitivity of value of a debt security to changes in interest rates. Higher the modified duration, higher is the interest sensitive risk in a debt portfolio.
- **In the debt markets**, the **credit risk** arises on account of three things, viz., default, delay in payments, or rating downgrade.
- The circumstances calling for restriction on redemption should be such that illiquidity is caused in almost all securities affecting the market at large, rather than in any issuer specific securities.
- When **restriction on redemption is imposed**, the following procedure shall be applied:
    - No redemption requests upto Rs. 2 lakhs shall be subject to such restriction;
    - When redemption requests are above Rs. 2 lakhs, AMCs shall redeem the first Rs. 2 lakhs without such restriction and remaining part, i.e. amounts over and above Rs. 2 lakhs shall be subject to the restriction.

- "**Segregated portfolio**" means a portfolio comprising of debt or money market instruments affected by a credit event, that has been segregated in a mutual fund scheme.
- "**Main portfolio**" means the scheme portfolio excluding the segregated portfolio.
- **Asset Management Company (AMC) were allowed to create a segregated portfolio** in a mutual fund scheme in case of a credit event at issuer level i.e. downgrade in credit rating by a SEBI registered Credit Rating Agency (CRA).
- **AMC will not charge investment and advisory fees on the segregated portfolio**. However, TER (excluding the investment and advisory fees) can be charged, on a pro-rata basis only upon recovery of the investments in a segregated portfolio.
- Longer the holding period in an equity fund, the lower is the volatility in your returns.

CHAPTER 11

MUTUAL FUND SCHEME PERFORMANCE

- The **benchmark for a scheme is decided by the AMC in consultation with the trustees**. The Scheme Information Document has to mention the benchmark.
- The **mutual fund schemes are benchmarked to the Total Return variant of an Index** (TRI). The Total Return variant of an index takes into account all dividends/interest payments that are generated from the basket of constituents that make up the index in addition to the capital gains.
- The **gap between the returns of PRI** (Price Return Index) **and TRI** is the amount of **dividend**.
- As per the SEBI guidelines, the **benchmark for debt** (and balanced schemes) should be **developed by research and rating agencies** recommended by AMFI, CRISIL, ICICI Securities and NSE have developed various such indices.
- **Standard Benchmarks**

Scheme Type	Benchmark
Equity Scheme	Sensex or Nifty
All Debt Schemes having duration / maturity up to 1 year and arbitrage Funds	1 year T-Bill
All Debt Schemes which are not covered in point 2	10 years dated GOI security
Conservative Hybrid Fund	10 years dated GOI security
Balanced Hybrid Fund / Aggressive Hybrid Fund / Dynamic Asset Allocation or Balanced Advantage/ Multi-Asset Allocation	Sensex or Nifty
Equity Savings	10 years dated GOI security
Retirement Fund / Children's Fund	Sensex or Nifty
Index Funds / ETFs & FoFs (Overseas/ Domestic)	Appropriate benchmark based on the underlying asset allocation as per above

- Risk adjusted returns are calculated by sharpe ratio, treynor ratio, Alpha
  - In Sharpe **Ratio**, Risk premium is divided by standard deviation
  - In **Treynor Ratio**, Risk premium is divided by Beta
  - The difference between a scheme’s actual return and its optimal return is its **Alpha**
- **Tracking error** is a measure of the consistency of the out-performance of the fund manager relative to the benchmark. It is used to measure how consistently a fund is able to out-perform its benchmark.
- A snapshot of the **suitability** of the product can be assessed from the product labels that have to be provided with any product literature.
- The **fund factsheets** are an official source of information of the fund’s objective, performance, portfolio and basic investment requirements issued by the fund house each month.
- The **Scheme Information Document** (SID) of each scheme needs to be updated once every year.

- The information and data found in SID is updated and current, and typically includes information about **suitability, returns and portfolio description.**
- **AMFI website** carries the performance data of all the mutual fund schemes.

CHAPTER 12

MUTUAL FUND SCHEME SELECTION

- The **investor's risk appetite** is a function of three things—the **need to take risks, the ability to take risks, and the willingness to take risks**.
- **Scheme selection depends upon**

  1.) Risk profile

  2.) Age

  3.) Asset Allocation

  4.) Investment Time Horizon
- **Asset allocation** generally **depends on the investor's needs**.
- **Risk-o-meter shall have the following six levels** of risk for mutual fund schemes
  - Low risk
  - Low to Moderate risk
  - Moderate risk
  - Moderately High risk
  - High risk
  - Very High risk
- In **Core portfolio**, the investment will be done according to the long term needs and goals of the investor.
- In **Satellite portfolio**, investment will be done to take advantage of expected short-term market movements.
- Investors who are more interested in investing in equity but less inclined to generate higher returns by beating the equity market benchmark, should invest in an index fund.
- **Aggressive investors** who **want to outperform the benchmark** should invest in **Active Fund**.
- Investors may choose the **close-ended funds only if they can keep the money locked-in** such schemes.
- Anyone who prefers a liquidity **option**, **may want to consider investing in open-ended funds**. Large and mid-cap funds are riskier than large cap funds, but less risky than mid-cap funds.
- **Fixed Maturity Plan** is ideal when the investor's investment horizon is in sync with the maturity of the scheme, and the investor is looking for a more predictable return than any conventional debt scheme. **Fixed Maturity Plans** are close-ended debt funds.
- **Target Maturity Funds** (TMFs): Portfolio comprises Government Securities / State Government Securities / AAA rated PSU companies i.e. top notch. **Target Maturity Funds** are open-ended debt funds. Liquidity is an advantage of TMFs over FMPs.
- The **performance of gold sector funds** is linked to the profitability of gold mining and processing companies. While the returns of Gold ETFs depend upon the price of gold.
- A **scheme should be selected based on** the following points:

  1.) Matching fund's portfolio with its investment objective

  2.) Fund Manager

3.) Fund Performance

4.) Fund Portfolio

5.) Fund Age

6.) Fund Size

7.) Portfolio Turnover

8.) Scheme Running Expenses

- The **dividend pay-out option seems attractive** for investors wanting a **regular income**.
- **Re-purchase transactions** are treated as a sale of units by the investor. Therefore, there can be an element of capital gain (or capital loss), if the re-purchase price is higher (or lower) than the cost of acquiring those units.
- **Growth option** has the benefit of letting the money grow in the fund on a gross basis (i.e. without annual taxation).
- Risk-Return Hierarchy of mutual funds, **Liquid funds – Debt funds – Hybrid funds – Equity funds**.
- Risk-Return Hierarchy of debt funds, **Overnight funds – Liquid funds – Ultra short duration funds – Low duration funds – Short duration funds – Medium duration funds – Medium to long duration funds – Long duration funds**
- Hierarchy of Credit risk in debt funds, **Gilt fund – Banking and PSU fund – Corporate bond fund – Credit risk fund.**
- Risk-Return Hierarchy of equity mutual funds, **Small cap funds – Mid-cap funds – Multi cap funds – Large and mid-cap funds – Large cap funds.**
- Risk-Return Hierarchy of Diversified to Concentrated funds, **Diversified funds – Focused funds – Thematic funds – Sector funds.**
- Risk Return Hierarchy of hybrid funds, **Arbitrage fund – Equity savings fund – Conservative hybrid fund – Dynamic asset allocation fund – Multi asset allocation fund – Balanced hybrid fund – Aggressive hybrid fund.**
- **Passive funds** are suitable for investors looking for exposure to an asset class without the risks associated with fund manager selection and strategies.
- An investor in an **active fund** is bearing a higher cost for the fund management, and a higher risk to earn returns better than the benchmark.
- A **growth fund** outperforms in a bull market, while the **value** orientation helps a value fund outperform in a falling market.
- The **sector funds** invest in stocks belonging to just one sector of the economy
- **Thematic funds** invest in stocks across a specific theme, and to that extent they fall between the diversified fund that can invest across the market and sector funds that invest only within one sector.
- **Short Duration Funds** invest in securities with maturities between 1 year and 3 years.
- **Liquid funds** have the feature of low volatility and high liquidity.

- **Floater funds,** invest in floating rate instruments. Since floating rate debt securities tend to hold their investment, even if interest rates fluctuate, the NAV of floaters tends to be steady.
- While selecting the mutual fund schemes, there are **few things that a mutual fund distributor must keep in mind:**

  A) Ensuring suitability

  B) Ensuring suitability

  C) Chasing past performance

  D) Understanding the investment objective and investment strategy of the scheme

  E) Keeping an eye on the taxes and loads

  F) Developing a consistent methodology for scheme selection
- **Dividend payout option** has the benefit of money flow to the investor; growth option has the benefit of letting the money grow in the fund on gross basis
- **Re-purchase transactions** are treated as a sale of units by the investor. Therefore, there can be an element of capital gain (or capital loss), if the re-purchase price is higher (or lower) than the cost of acquiring those units.
- **Risk, return and risk-adjusted returns** as parameters to evaluate schemes
- **Portfolio Turnover Ratio** is calculated as Value of Purchase and Sale of Securities during a period divided by the average size of net assets of the scheme during the period.
- A **large fund size** will allow better diversification and economies of scale. A **small sized fund** on the other hand is more flexible and better able to take advantage of market opportunities.
- While looking at **historical returns**, it would be important to note the following:

  1. Check the scheme's performance relative to the scheme's benchmark.

  2. Compare the scheme's performance with the peer group.

  3. Do both the above comparisons over multiple periods of time, e.g. over rolling periods. One may also consider comparing the scheme performance over various bull and bear market cycles.
- In case of **equity funds**, the performance should be seen for longer periods, at least last **5 years**. While for long-term **debt funds** at least **3 years** performance needs to be considered.