CHAPTER I

MUTUAL FUNDS – AN OVERVIEW

1.1 INTRODUCTION

The Indian financial system based on four basic components like Financial Market, Financial Institutions, Financial Service, Financial Instruments. All are play important role for smooth activities for the transfer of the funds and allocation of the funds. The main aim of the Indian financial system is that providing the efficiently services to the capital market. The Indian capital market has been increasing tremendously during the second generation reforms. The first generation reforms started in 1991 the concept of LPG (Liberalization, privatization, Globalization).

Then after 1997 second generation reforms was started, still the it’s going on, its include reforms of industrial investment, reforms of fiscal policy, reforms of ex-imp policy, reforms of public sector, reforms of financial sector, reforms of foreign investment through the institutional investors, reforms banking sectors. The economic development model adopted by India in the post independence era has been characterized by mixed economy with the public sector playing a dominating role and the activities in private industrial sector control measures emanciated form time to time. The last two decades have been a phenomenal expansion in the geographical coverage and the financial spread of our financial system.
The spared of the banking system has been a major factor in promoting financial intermediation in the economy and in the growth of financial savings with progressive liberalization of economic policies, there has been a rapid growth of capital market, money market and financial services industry including merchant banking, leasing and venture capital, leasing, hire purchasing. Consistent with the growth of financial sector and second generation reforms its need to fruition of the financial sector. It also need to providing the efficient service to the investor mostly if the investors are supply small amount, in that point of view the mutual fund play vital for better service to the small investors.

Moreover, the mushrooming growth of the asset management companies and also the plethora of new schemes introduced by them make the choice of investors next to impossible. The ordinary investors may not be aware of the challenges involved and the required tools to select the schemes for his investment. Hence, it is relevant to analyse the investment strategies and performance of Indian mutual fund companies.

1.2 CONCEPT OF MUTUAL FUNDS

Mutual Fund is investment product that operates on the principle of “strength of numbers”. The concept of Mutual fund is based on “Drops make an ocean”. Mutual Funds are association or trusts of public members who wish to make investment in the financial assets or corporate sector for the mutual benefit of its members.
The fund collects the moneys of these members from their savings and invests them on the behalf of investors in a diversified portfolio of financial assets with a view to reduce risks and to maximize their income and capital appreciation for distribution to its members on a pro-rata basis. A portfolio of a mutual fund scheme is the basket of financial assets held by that particular scheme. It comprises of investment in a variety of securities and asset category. This collecting or pooling permits a number of investors to contribute to, according to their amount and capacity of investment, the performance of the fund that is managed with what is acknowledged to be expertise. Hence, the small investors enjoy collectively the benefits of expertise in investment by specialist in the trust, which no single individual by himself could enjoy. By means of the number of options in the form of stocks, bonds or other financial securities available in the fund's portfolio the investors gain access to wide range of securities, which otherwise would have been only a dream. Managers of mutual funds along with diversification and risk reduction, also endow with a variety of services not otherwise reachable to the small investors.

Mutual Fund is thus a concept of mutual help of subscribers for portfolio investment and management of these investments by specialist and expert in the field. Mutual funds play an imperative role in mobilizing the savings of small investors and then channelizing the same for productive ventures in the Indian economy. These funds are set up under the Indian Trusts Act (1882). UTI is governed by its own Act. From time to time Securities Exchange Board of India (SEBI) provides necessary guidelines to regulate mutual fund companies.
In these terms, a mutual fund is a financial intermediary that pools the savings of investors for collective investment in a diversified portfolio of securities. A fund is mutual as all of its returns, minus its expenses, are shared by the fund's investors.
The Securities and Exchange Board of India (Mutual Funds) Regulations, 1966 defines a mutual fund as “a fund established in the form of a trust to raise money through sale of units to the public under one or more schemes for investing in securities, including money market instruments”.

According to the above definition, a mutual fund in India can raise resources through sale of units the public. It can be setup in the form of a trust under the Indian Trust Act. The definition has further extended by allowing mutual funds to diversify their activities in following areas:

- Portfolio management services
- Management of offshore funds
- Providing advice to offshore funds
- Management of pension or provident funds
- Management of venture capital funds
- Management of money market funds
- Management of real estate funds

### 1.2.1 Characteristics of Mutual Funds

Some noteworthy distinctiveness of mutual funds which are considered to be universal in nature irrespective of the type of fund is summarized as under.

**Mobilization of funds**: Mutual fund helps to mobilize the savings of small investor by launching schemes which are specially designed to meet their investment preferences. In this way the scattered savings of small investors are accumulated into a common fund of considerable amount and then invested in a number of financial instruments available in the capital market. Hence the retail
investors get an opportunity to participate in the prosperity of a large number of companies.

**Diversification of risks:** Mutual funds with the collected funds from small investors can ensure diversification. The investment collected from various investors of a mutual fund scheme are invested in the scrip of a number of companies so as to make certain the diversification of the portfolio, which results in the diminution of magnitude of risk.

**Allocation of returns with fellow investors:** Returns earned on the plentiful of scrip of various companies, that constitute the portfolio of a mutual fund scheme are distributed among the investors after the deduction of administration expenditure. The degree of returns earned depends on the value of the underlying portfolio and as well on the proceeds earned on the various scripts that make up the portfolio of an individual investor.

**Expert services:** Mutual fund employs experts and professional managers to take the investment decision and to efficiently manage the portfolio of the individual investors. Thus the professional insight and the dynamic approach towards the investment of the resources provide these managers an edge over the individual investor in dealing with risk of capital market securities.

### 1.3 HISTORY OF MUTUAL FUND

The origin of today’s Mutual funds can be found in the early nineteenth century’s English Investment Trust and Investment Companies. The investment company concept dates back to Europe in the late 1700s, according to K. Geert Rouwenhorst in The origin of mutual funds “a Dutch merchant and broker …
invited subscription from investors to form a trust … to provide an opportunity to diversify for small investors with limited means”. A mutual fund is a type of Investment Company that gathers assets from investors and collectively invests those assets in stocks, bonds, or money market instruments.

Historians are uncertain of the origins of investment funds; some cite the closed-end investment companies launched in the Netherlands in 1822 by King William I formed “Societe Generale de Belique”, at Brussels, which appears to be the first mf, while others point to a Dutch merchant named Adriaan van Ketwich whose investment trust created in 1774 may have given the king the idea. Van Ketwich probably theorized that diversification would increase the appeal of investments to smaller investors with minimal capital. The name of van Ketwich's fund, Eendragt Maakt Magt, translates to "unity creates strength". The next wave of near-mutual funds included an investment trust launched in Switzerland in 1849, followed by similar vehicles created in Scotland in the 1880s.

The idea of pooling resources and spreading risk using closed-end investments soon took root in Great Britain and France, making its way to the United States in the 1890s. The Boston Personal Property Trust, formed in 1893, was the first closed-end fund in the U.S. The creation of the Alexander Fund in Philadelphia, Pennsylvania, in 1907 was an important step in the evolution toward what we know as the modern mutual fund. The Alexander Fund featured semi-annual issues and allowed investors to make withdrawals on demand. While the mutual fund had its origin in Belgium, it did not take firm root in continental soil but flourished when transplanted in UK and USA surroundings.
Collective Investment Vehicle

Historically, mf in UK and USA began as private enterprise, known as investment trust. An investment trust would be founded by a single individual who used his financial abilities and judgment for the benefit of a group and who, in turn for his advice and allowed to retain a percentage of profits made from the group’s joint investment.

Over a period of time, mf industry has undergone numerous changes. MF evolved in response to the market condition marking notable changes in their organization structure and the economics of the industry.

Mutual Fund Industry in UK

The first investment trust, Foreign and Colonial, set out its investment aims “to give investors of moderate means, the same advantage as the large capitalist” in its prospectus of 1868. 1880s was the period of boom for this innovative investment opportunity in UK. Though some investment trusts failed during the British crash of 1890, most of them survived. By 1900 there were more 100 investment trusts, many of them are still around. These investment trusts are close-ended funds.

The years from 1900 to 1914 were marked by an increasing tendency on the part of British investment manager to invest their clients” funds in American securities, especially in stocks and bonds of American railways. With advent of the First World War, this situation changed drastically. From 1914-1918, British mutual fund sold a large proportion of their American investment, and a large part of the money obtained from the sale of American stocks and bonds was promptly
invested in the war loans of the British government. Though less remunerative, yet this strategy enabled the survival of the industry.

**Emergence of Unit Trust**

In US, many small investors lost their fortunes in the years following the Wall street crash of 1929. But not even one investment trust failed during those troubled years (1890s) in UK. However, some structural changes started taking place in the industry. The most important one was the emergence of unit trust.

Unit trusts are created by trust deed. The first unit trust appeared in 1931, shortly after the Wall Street crash. It was a period when income was more important consideration than growth. Unit trusts conform to the basic pattern of open-ended investment funds in UK.

Investment trusts continued to be popular with private investor’s right up until the middle of 1960s. The unit trust industry expended rapidly till October 1987 crash. By January, 1998 there were almost 1200 unit trust managed by more than 160 groups. These trusts became popular mainly because of the range of investment opportunities they made available to the investors. The stock market crash at the end of 1987 brought significant changes in the unit trust industry. The other main event affecting the unit trust industry during and after post 1988 is the implementation of the financial services act. The Financial services Act brought the investors greater protection and large number of restriction on the industry.

By the end of 1997 there was $237 billion of asset managed by 1455 open-ended funds. In the last decade, a lot of changes have taken place in the industry. Increased investor sophistication, wealth and power have led to
significant influence on the growth of mf market. Investors are demanding better levels of services, transparency in prices and more product variety. On the political front there is a drive for lower costs and standardization to encourage saving. The competition in UK fund industry has increased due to low entry barriers encouraging new players. The increased level of competition is putting pressures on prices. There has been a trend in the industry to focus on core activities and outsource the rest.

The pace of change is very rapid, resulting in steep increase in volumes. New products are launched, and newer distribution methods are explored. The mf industry in UK is witnessing a restructuring wave and the outcome is powerful brand leaders.

**Mutual Fund Industry in USA**

The origin of mf in the USA could be traced to the private trustee system in Boston during the second half of 19th century. One of the first investment trusts, the Boston Personal Property Trust, was organized in 1893. It advertised that it “was organized for the purpose of giving persons of small means an opportunity to invest in diversified lists of securities held by a trust which was managed by professional trustees which is regular line of business in Boston”.

It was the Alexander Fund established in Philadelphia in 1907 by W. Wallace Alexander that seems to have originated many of the ideas adopted by mutual funds. Like 1924s M.I.T. and State Street Investors mutual fund, the Alexander fund began as an investment vehicle for a small circle of friends and eventually
expanded to include the general public. As the United States economy grew, investment companies were formed in Boston, New York and many other states. The creation of the Massachusetts Investors’ Trust in Boston, Massachusetts, heralded the arrival of the modern mutual fund in 1924. The fund went public in 1928, eventually spawning the mutual fund firm known today as MFS Investment Management. State Street Investors’ Trust was the custodian of the Massachusetts Investors’ Trust. Later, State Street Investors started its own fund in 1924 with Richard Paine, Richard Saltonstall and Paul Cabot at the helm. Saltonstall was also affiliated with Scudder, Stevens and Clark, an outfit that would launch the first no-load fund in 1928. A momentous year in the history of the mutual fund, 1928 also saw the launch of the Wellington Fund, which was the first mutual fund to include stocks and bonds, as opposed to direct merchant bank style of investments in business and trade.

**Regulation and Expansion**

By 1929, there were 19 open-end mutual funds challenging with nearly 700 closed-end funds. With the stock market crash of 1929, the dynamic began to change as highly-leveraged closed-end funds were wiped out and small open-end funds managed to survive.

Government regulators also began to take notice of the fledgling mutual fund industry. The creation of the Securities and Exchange Commission (SEC), the passage of the Securities Act of 1933 and the enactment of the Securities Exchange Act of 1934 put in place safeguards to protect investors: mutual funds were required to register with the SEC and to provide disclosure in the form of a
prospectus. The Investment Company Act of 1940 put in place additional regulations that required more disclosures and sought to minimize conflicts of interest.

The mutual fund industry continued to expand. At the beginning of the 1950s, the number of open-end funds topped 100. In 1954, the financial markets overcame their 1929 peak, and the mutual fund industry began to grow in earnest, adding some 50 new funds over the course of the decade. The 1960s saw the increase of aggressive growth funds, with more than 100 new funds established and billions of dollars in new asset inflows. Hundreds of new funds were launched throughout the 1960s until the bear market of 1969 cooled the public appetite for mutual funds. Money flowed out of mutual funds as quickly as investors could redeem their shares, but the industry's growth later resumed. In the USA, mutual fund industry evolved in three phases.

1. Pre 1940,
2. 1940-1970,
3. 1970 to the present.

The first stage that is the period before 1940 was the stage of infancy of the mutual fund industry. Mutual funds, in those days, were small and dissimilar to the extent that these entities were not even given the status of a separate industry. Close-ended funds were the dominant form of mutual funds to mobilize money (1929 assets mobilized under close ended schemes accounted for 95% of the total assets of the industry). However, by the end of 1940s the share of close-ended funds started shrinking in favor of open-ended fund.
In the second stage, assets managed by mutual funds witnessed rapid and steady growth and mutual fund evolved into an established industry. Assets under management were $450 million. In 1940, it rose to $47.6 billion by the end of 1970. During this phase open-ended funds became the dominant form of mutual funds.

The most striking feature of the phase (1970 to present) has been the innovation in the investment objective. Till this phase most of the money was mobilized under the objective of providing the benefit of diversification in equity investing. While there were five types of funds offered in 1970, there were 22 different types in 1987. The money market mutual fund is considered the most innovative launch of that time, as this product was quite different in contrast with the then existing equity product and was, in many respects very close to the products offered by banks. It widened the scope of competition for mf with banks on account of similarity in the product. Another important happening of that time was the innovative steps taken by the fund to improve the quality of investor servicing. An example can be given of the exchange privilege given to the investors to shift from one fund to another. Another significant development post-1970 has been the reduction or elimination of sales loads, thereby increasing the mobility of investors. In 1971, William Fouse and John McQuown of Wells Fargo Bank established the first index fund, a concept that John Bogle would use as a foundation on which to build The Vanguard Group, a mutual fund powerhouse renowned for low-cost index funds. The 1970s also saw the rise of the no-load fund. This new way of doing business had an enormous impact on the way
mutual funds were sold and would make a major contribution to the industry's success. The total assets under management by the end of 1997 were $4465 billion managed by 6900 funds.

The decade 1990-2000 was particularly favorable to mutual fund industry in USA as by the end of 2000 the asset managed by the industry increased to $7 trillion. The increased demand for mutual funds in the 1990s led to the creation of a large number of new mutual fund companies. The number rose from 2900 at the beginning of the decade to about 8200 by the end of 2000. As stocks and other financial assets earned relatively high returns in 1990s, households shifted their asset allocation away from real estates and other tangible assets to financial assets.

During this shift, households showed an increasing preference to investment through mf than buying securities directly. The number of households owing mf reached to 50.6 million in 2000 as against 23.4 million in 1990. World equity funds were also an important element in the growth of mf, as investors increasingly sought to diversify their financial assets through overseas investment. With the rising demand for mf in 1990s, fund companies and distribution companies developed new outlets for selling mf and expanded traditional sales channels. Many funds primarily marketed directly to investors turned increasingly to third parties and intermediaries for distribution. Funds that were traditionally sold through a sales force of brokers shifted increasingly to non-traditional sources of sales such as employee-sponsored pension plans, banks and life insurance companies in the 1990s.
With the 1980s and ‘90s came bull market mania and previously obscure fund managers became superstars; Max Heine, Michael Price and Peter Lynch, the mutual fund industry’s top gunslingers, became household names and money poured into the retail investment industry at a stunning pace. More recently, the burst of the tech bubble and a spate of scandals involving big names in the industry took much of the shine off of the industry’s reputation.

Shady dealings at major fund companies demonstrated that mutual funds aren’t always benign investments managed by folks who have their shareholders’ best interests in mind and who treat all investors equally.

Despite the 2003 mutual fund scandals, the story of the mutual fund is far from over. In fact, the industry is still growing, opening up new markets around the world. The first Korean mutual fund, the Mirae Asset Park Hyun-joo Fund, was launched in Dec 1998. Today there are 20 trillion Korean won (about US$19.32 billion) invested in Korea's funds. In the U.S. alone there are more than 10,000 mutual funds, and if one accounts for all share classes of similar funds, fund holdings are measured in the trillions of dollars. Despite the launch of separate accounts, exchange-traded funds and other competing products, the mutual fund industry remains healthy and fund ownership continues to grow.

**Mutual Funds Industry in India**

The mutual fund industry in India started in 1963 with the formation of Unit Trust of India, at the initiative of the Government of India and Reserve Bank India. The purpose of establishing the Unit Trust of India was to give a fillip to equity market.
In the wake of Indo-China war of 1961, there was shortage of savings going into industrial investment for economic development.

There was a need to mobilize adequate amount of risk capital for industrial enterprises. The household savings were sought to be channelized into the primary and secondary share market through units. However in the initial years, the emphasis in UTI was on income products.

The Indian mutual fund industry has evolved over distinct stages. The growth of mutual fund industry in India can be divided into four phases:

(1) Phase I (1964-87)
(2) Phase II (1987-92)
(3) Phase III (1992-97)
(4) Phase IV (beyond 1997)

1. Phase I: 1964 – 87

The mutual fund concept was introduced in India with setting up of UTI Act in 1963. The Unit Trust of India (UTI) was the first mutual fund set up under the UTI Act, 1963, a special act of the Parliament. Unit Trust of India (UTI) was established on 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Reserve Bank of India. It became operational in 1964 with a major objective of mobilizing savings through the sale of units and investing them in corporate securities for maximizing yield and capital appreciation. In 1978 UTI was delinked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. This phase commenced
with launch of unit scheme 1964 (US-64) the first open-ended and the most popular scheme. UTI's investible funds, at market value (and including the book value of fixed assets) grew as under:

Table 1.1
Growth of UTI's Investible Funds during Phase I (1964-87)

<table>
<thead>
<tr>
<th>Year</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1965</td>
<td>49 Crore</td>
</tr>
<tr>
<td>1970-71</td>
<td>219 Crore</td>
</tr>
<tr>
<td>1980-81</td>
<td>1126 Crore</td>
</tr>
<tr>
<td>1987</td>
<td>5068 Crore</td>
</tr>
</tbody>
</table>

Its investor base had also grown to about 2 million investors. It launched innovative schemes during this phase. Its fund family included five income oriented, open-ended schemes, which were sold largely through its gent network built up over the years. Master shares were the real close-ended scheme floated
by UTI. It launched Indian fund in 1986—the first Indian offshore fund for overseas investors, which was listed on the London Stock Exchange (LSE). UTI maintained its monopoly and experienced a consistent growth till 1987.

2. Phase II: 1987-92 (Entry of Public sector)

The second phase witnessed the entry of Mutual Fund Company sponsored by nationalized banks and insurance companies. In 1987, SBI Mutual fund and Canbank Mutual fund were set up as trusts under the Indian Trust Act, 1882. In 1988, UTI floated another offshore fund, namely The Indian Growth Fund which was listed on the New York Stock Exchange (NYSE). By 1990, the two nationalized insurance giants, LIC and GIC, and nationalized banks, namely, Indian bank, Bank of India, and Punjab National Bank had started operations of wholly-owned mutual fund subsidiaries. The assured return type of schemes floated by the mutual funds during this phase was perceived to be another banking product offered by the arms of sponsor banks.

In October 1989, the first regulatory guidelines were issued by the Reserve Bank of India, but they were applicable only to the mutual funds sponsored by banks. Subsequently, the Government of India issued comprehensive guidelines in June 1990 covering all mutual funds. These guidelines emphasized compulsory registration with SEBI and an arms length relationship be maintained between the sponsor and asset management company (AMC).

With the entry of public sector funds, there was a tremendous growth in the size of the mutual fund industry with investible funds, at market value, increasing to Rs 53,462 crore and the number of investors increasing to over 23 million. The
buoyant equity market in 1991-92 and tax benefits under equity linked saving schemes enhanced the attractiveness of equity funds.

**3. Phase III: 1992-97 (Entry of Public Sector Funds)**

The year 1993 marked a turning point in the history of mutual funds in India. With the entry of private sector funds in 1993, a new era started in the Indian mutual fund industry, giving the Indian investors a wider choice of fund families. The Securities and Exchange Board of India (SEBI) issued the Mutual Fund Regulations in January 1993. SEBI notified regulations in bringing all mutual funds except UTI under a common regulatory framework. Private domestic and foreign players were allowed entry in the mutual fund industry. Kothari group of companies, in joint venture with Pioneer, a US fund company, set up the first private mutual fund the Kothari Pioneer Mutual Fund, in 1993. Kothari Pioneer introduced the first open-ended fund Prima in 1993. Several other private sector mutual funds were set up during this phase. UTI launched a new scheme, Master-gain, in May 1992, which was a phenomenal success with subscription of RS 4,700 crore from 63 lakh applicants. The industry’s investible funds at market value increased to Rs 78,655 crore and the number of investor accounts increased to 50 million. The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. However, the year 1995 was the beginning of the sluggish phase of the mutual fund industry. During 1995 and 1996, unit holders saw erosion in the value of their investment due to a decline in the NAVs of the equity funds.
Moreover, the service quality of mutual funds declined due to a rapid growth in the number of investor accounts, and the inadequacy of service infrastructure. A lack of performance of the public sector funds and miserable failure of foreign funds like Morgan Stanley eroded the confidence of investors in fund managers. Investor’s perception about mutual funds gradually turned negative. Mutual funds found it increasingly difficult to raise money. The average sales declined from about Rs 13,000 crore in 1991-94 to about Rs 9000 crore in 1995 and 1996.

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

**4. Phase IV: 1997 – 98**

During this phase, the flow of funds into the kitty of mutual funds sharply increased. This significant growth was aided by a more positive sentiment in the capital market, significant tax benefits, and 2000 to over Rs 1,10,000 crore with UTI having 68% of the market share. During 1999-2000 sales mobilization reached a record level of Rs 73000 crore as against Rs 31,420 crore in the preceding year. This trend was, however, sharply reversed in 2000-01. The UTI dropped a bombshell on the investing public by disclosing the NAV of US-64- its flagship scheme as on December 28, 2000, just at Rs 5.81 as against the face value Rs 10 and the last sale price of Rs 14.50. The disclosure of NAV of the country’s largest mutual fund scheme was the biggest shock of the year to
investors. Crumbling global equity markets, a sluggish economy coupled with bad investment decision made life tough for big funds across the world in 2001-02. The effect of these problems was felt strongly in India also. Pioneer ITI, JP Morgan and Newton Investment Management pulled out from the Indian market. Bank of India MF liquidated all its schemes in 2002.

The Indian MF industry has stagnated at around Rs 1, 00,000 crore assets since 2000-01. This stagnation is partly a result of stagnated equity markets and the indifferent performance by players. As against this, the aggregate deposit of Scheduled Commercial Banks (SCBs) as on May 3, 2002, stood at Rs 11,86,468 crore. Mutual fund assets under management (AUM) form just around 10 % of deposits of SCBs.

5. Phase V: 1999-2004 (Emergence of a large and uniform industry)

The other major development in the fund industry has been the creation of a level playing field for all mutual funds operating in India. This happened in February 2003, when the UTI Act was repealed. In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of Rs.29, 835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.
Second is the UTI Mutual Fund Ltd, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than Rs.76, 000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry entered in the fourth phase of consolidation and growth.

As at the end of September, 2004, there were 29 funds, which manage assets of Rs.153108 crores under 421 schemes.

Unit Trust of India no longer has a special legal status as a trust established by an Act of Parliament. Instead, it has also adopted the same structure as any other fund in India—a trust and an Asset Management Company. UTI Mutual Fund is the present name of the erstwhile Unit Trust of India. While UTI functioned under a separate law of Indian parliament earlier, UTI Mutual Fund is now under the SEBI’s (Mutual Funds) Regulations, 1996 like all other mutual funds in India. UTI Mutual Fund is still the largest player in the Indian fund industry. All SEBI compliant schemes of the erstwhile UTI are under its charge. All new schemes offered by UTI Mutual Fund are SEBI approved. Other schemes (US 64, Assured Return Schemes) of erstwhile UTI have been placed with a special undertaking administered by the Government of India. These schemes are being gradually wound up.

The emergence of uniform industry with the same structure, operation and regulations makes it easier for distributors and investors to deal with any fund
house in India. 1999 marked the beginning of a new phase in the history of the mutual fund industry in India, a phase of significant growth in terms of both amounts mobilized from investors and assets under management.

Between 1999 and 2005, the size of the industry has doubled in terms of assets under management which has gone from about Rs 68,000 crores to over Rs 150,000 crores. Within the growing industry, the relative market share of different players in terms of amount mobilized and assets under management have also undergone changes.


The industry has lately witnessed a spate of mergers and acquisitions, most recent ones being the acquisition of schemes of Alliance Mutual Fund by Birla Sun Life, Sun F&C Mutual Fund by Principal and PNB Mutual Fund by principal. At the same time, more international players continue to enter India, including Fidelity, one of the largest funds in the world. The stage is set now for growth through consolidation and entry of new international and private sector players.

Growth and Development of Mutual Fund Industry in India

The factors which can be largely attributed the impressive growth in the Indian Mutual fund industry are rising household savings, advantageous tax policies, and introduction of several new products, investor education and the role of distributors. The household’s income levels have grown significantly, in the last few years which ultimately leading to adequate increase in household’s savings. The Indian Mutual funds retail market, growing at a CAGR of about 30%, is
forecasted to reach US$ 300 Billion by 2015. Individual investors make up for 96.86% of the total number of investor accounts and contribute 36.9% of the net AUM. The Rs.7.2 trillion Indian Mutual fund industry is revisiting its business model to be in sync with the new norms put in place by the capital market regulator, the SEBI. India has 44 AMC’s in that, some of them are planning to start their own distribution business instead of selling funds through third-party distributors and they plan to cut the commission of the distributors by 25-30 basis points (bps) and shift their focus from frequent blending of funds to managing money for the longer term.

Besides, SEBI has introduced various regulatory measures in order to protect the interest of small investors that augurs well for the long term growth of the industry. The tax benefits allowed on Mutual fund schemes is qualified for tax deductions under section 80C of the Income Tax Act also have helped Mutual funds to evolve as the preferred form of investment among the salaried income earners. Further, the Indian Mutual fund industries which are started with equity fund, debt fund and balanced fund has significantly expanded its portfolio. And today, the industry has introduced an selection of products such as liquid/money market funds, sector funds, index funds, gilt funds, capital protection schemes, exchange traded funds, etc. The wide variety of schemes offered by the Indian Mutual fund industry provides numerous options of investment to common man.
1.4 CLASSIFICATION OF MUTUAL FUND SCHEMES

Henry Ford, founder of Ford Motor Company, has once quoted, “The customer can have any color he wants as long as it is black”. The Indian Mutual Fund investors in 1990s must have felt a bit like the American car buyer in the 1930s, which had as much freedom of choice in terms of car colors as Ford warranted. Previously, every mutual fund offering resembled the other in terms of kinds of schemes. Mutual funds schemes are allocated to a vast number of investors based on their individual needs and objectives. The requirement and the risk undertaking ability of a retired man will be certainly different from a young man of thirty years old. Hence, various types of mutual funds try to cater to the requirement and objective of investors. The selection of a fund will depend on an investor according to his income and risk taking capacity. Subject to SEBI regulations, a Mutual Fund Company is free to construct to its schemes or products to be offered to the potential investors. These schemes will cater to the vast requirements of the different types of investors. Mutual Funds in India presently offer more than 400 products across various categories. There are many types of mutual funds available to the investor. However, these different types of funds can be grouped into certain classification as follows under:
Types of Mutual Fund Schemes

Figure: 1.2

Structure of Investment
- Open Ended Funds
- Close ended Funds
- Interval Funds
- Load Funds
- No Load Funds
- Tax Exempt Funds

Nature /Objective of Investment
- Gilt Funds
- Diversified Debt Funds
- Focused Debt Funds
- High yield Debt Funds
- Assured Return Funds
- Fixed Term Plan
- Balanced Funds
- Growth and Income Fund
- Aggressive Growth Fund
- Growth Fund
- Specialty Fund
- Sector Fund
  - Foreign Securities Fund
  - Mid Cap/Small Cap Fund
  - Option Income Fund
- Diversified Equity Fund
- Equity linked Saving Scheme
- Equity Index Fund
- Value Funds
- Dividend Yield Funds

Others
- Commodity Fund
- Real Estate Fund
- Fund of Fund
- Domestic Fund
- Offshore Fund
- Ethical Funds
- Gold Exchange Traded Fund
- Leveraged Fund
- Hedge Funds
1.4.1 Functional Classification

a) Open-ended schemes
b) Close-ended schemes
c) Interval schemes
d) Load funds
e) No-Load funds
f) Tax-exempt funds

(a) Open-ended schemes: In open ended scheme, the mutual fund constantly offers to sell and repurchase its units at net asset value (NAV) or NAV related prices. Net Asset Value can be obtained by dividing the amount of the market value of the fund assets (plus accrued income minus the funds liabilities) by the number of units outstanding. Investors have the opportunity to enter and exit the scheme any time during the life of fund. The key feature of open-ended funds is degree of liquidity provided by such funds to the investors.

(b) Close-ended fund: The unit capital of a close-ended fund is fixed, the reason, as it makes one time sale of a fixed number of units. Close-ended funds have a predetermined maturity period ranging between 2 to 5 years. After the offer closes, these funds do not permit the investors to buy or redeem units directly from the funds. However, to present the much required liquidity to investors, close-ended funds are listed on a stock exchange. Investors are able to trade through a stock exchange, in the similar style as buying or selling shares of a company in direct investment.
(c) **Interval schemes:** Interval schemes are combination of both the features of open-ended and close-ended funds. Interval funds are available for sale or redemption during prearranged intervals at NAV-related prices.

(d) **Load funds:** Promotion of mutual funds involves preliminary expenses. The mutual fund company recovers such expenses from the investors in different ways at different times. The usual ways in which the expense can be recovered from the investors may be categorized as:

- At the time of investors entry into the fund, by deducting a specific amount from his contribution – **Entry load**
- By charging the fund with a fixed amount each year, during a specified number of years – **Deferred load**
- At the time of investors exit from the fund, by deducting specified amount from the redemption proceeds payable to the investor – **Exit load**

The fund that charges entry, exit, or deferred loads is called Load funds.

(e) **No-Load funds:** Mutual funds that make no entry, exit, or deferred charges for sale expenses are known as no-load funds. It may be noted here that a no-load fund only means a fund that does not charge marketing expenses. All funds still charge the schemes for management fees and other recurring expenses; it is only that an investor in a no-load fund enters or exits at the net NAV of the fund, calculated after accounting for these expenses, but without paying any further marketing expenses from the particular NAV. Some funds charge only an entry
load and some only an exit loads. Such funds may be termed as **Partial load funds.**

(f) **Tax-exempt funds:** A mutual fund which invests in tax-exempt securities, are termed as a tax-exempt funds. In India, any income received by the mutual fund is tax-free. After the 1999 Union Government Budget, all the dividend income received from any mutual fund is tax-free in the hands of investors. On the other hand, funds other than open-ended equity oriented funds have to pay a distribution tax, before distributing income to investor.

1.4.2 **Nature / Objective of Investment**

   a) Money market mutual funds
   
   b) Debt funds
   
   c) Hybrid Funds
   
   d) Equity funds
   
   e) Other Funds

**a) Money market / Liquid funds:** Liquid funds are characterized as the lowest stair in the order of risk level as they invest in debt securities of short term nature. These investments are mainly done in the securities of less than one-year maturity. MMMFs offer diversification of short-term assets, in terms of issues, maturity, and size, thereby spreading the risk for the investors. Foundation of MMMF In India, Reserve Bank of India outlined the extensive framework for setting up MMMF in its credit policy in April 1991. The objective was “Providing an additional short-term avenue to investors and to bring money market instruments within the reach of individuals.” RBI allotted a task force to work out
the comprehensive effective guidelines and documentation for MMMFs with Mr. D Basu (Deputy MD, State Bank of India) as the chairman. Based on the recommendation presented by the task force under the chairmanship of Mr. D Basu, the Reserve Bank of India declared a detailed scheme for money market mutual funds on April 1992. Money market mutual funds invest in the following securities:

(a) *Treasury bills issued by Government*

(b) *Certificate of Deposits issued by banks*

(c) *Commercial paper issued by companies*

(d) *Call or Notice money*

**b) Debt funds:** Debt funds invest in debt instruments issued by Government as well as private companies, banks, financial institution and other entities such as infrastructure companies. The main objective of investing in debt funds is low risk and stable income for the investor. Though, these funds are more risky than liquid funds as they do have higher price fluctuation risk, since they invest in long term securities. Likewise, debt funds do have higher risk of default by their borrowers as compared to Gilt funds. Debt funds are basically considered as Income funds as they primarily invest in fixed income generating debt instrument. They do not target capital appreciation but look for current income, and therefore allocate a considerable part of their surplus to investor. Debt funds can be further classified according to the different investment objective and risk profile.

i) *Gilt funds*: In India, we have Government Securities or Gilt Funds that invest in government paper called dated securities. Gilt securities are the securities which
are meant for medium to long-term investments, typically of over one year. Since the issuer is the Government/s of India/States, these funds have little risk of default and consequently offer better safeguard of principal. Gilt securities are issued by Reserve Bank of India on behalf of the Government. These instruments form a part of the borrowing program approved by Parliament in the Finance Bill each year (Union Budget). Gilt funds have a maturity period of 1 year to 20 years. Gilts are issued through the auction route but RBI can sell or purchase in its Open Market Operation (OMO). OMO includes conducting repos as well and are used by RBI to manipulate short-term liquidity and thereby the interest rates to desired levels.

The other types of Government securities are as:

- Inflation linked securities
- Zero coupon bonds
- State Government Securities (State loans)

However, Gilt securities, like all debt securities, face interest rate risk. Debt securities prices fall when interest rate level increases and rises when interest rate level decreases. It is the responsibility of investors to realize the potential changes in NAV of guilt funds on account of changes in interest rates in the economy.

ii) Diversified Debt fund: Diversified Debt Fund can be explained as a debt funds that invest in all accessible types of debt securities, issued by entities across all industries and sectors. A diversified debt fund has the advantage of risk reduction through diversification. In addition, all debt mutual funds lead to risk
reduction for the individual investor as any losses by a debt issuer are shared by a huge number of investors in the fund.

iii) **Focused Debt Fund**: Focused debt funds are funds with less diversification in its investment. These funds invest in sector, specialized, and off-shore funds. They have a major part of their portfolio invested in debt instrument and are more income oriented and inherently less risky. Other example of focused funds includes those that invest only in **Corporate Debentures and Bonds or only in Tax Free Infrastructure or Municipal bonds**. But these funds may take some time to materialize as a real choice for the Indian investor. One category of specialized funds that invest in the housing sector, but offers greater security and safety than other debt instrument, is the **Mortgage Backed Bond Funds** that invest in distinctive securities created after securitization of (and thus secured by) loan receivables of housing finance companies. As the Indian financial markets observe the escalation of securitization, such funds may emerge on the mutual funds prospect soon.

iv) **High Yield Debt Funds**: Usually, Debt funds control the default risk by investing in securities issued by borrowers who are rated by credit rating agencies and are considered to be of “investment grade”. High Yield Debt Funds, however, seek to earn higher interest returns by investing in debt instrument that are considered “below investment grade”. High Yield debt funds invest in instruments with high yield, consistent with risk tolerance. In the U.S.A., funds that invest in debt instrument that are not backed by tangible assets and rated below investment grade (popularly known as junk bonds) are called **Junk Bond**
Funds. These funds tend to be more volatile than other debt funds, although they may earn at times higher returns as a result of the higher risks taken.

v) Assured Return Funds – an Indian Variant: In India, UTI and other funds had offered assured return schemes to investors. The most accepted variant of such schemes was the Monthly Income Plans (MIP) of UTI. Returns were indicated in advance for all the future years of these close-ended schemes. In assured return schemes the loss, if any, is borne by the sponsor or Asset Management Company. Assured return debt funds undoubtedly diminish the risk to the investor, but only to the degree that the guarantor has the required financial strength. Hence, the market regulator SEBI permits only those funds whose sponsors have sufficient net-worth to recommend assurance of returns. If Assured return scheme is offered, unambiguous guarantee is required from a guarantor whose name has to be specified in advance in the offer document of the scheme. The risk that the investor faces was clearly confirmed when the assured return schemes of UTI faced large shortfall in their payment obligations. In case of UTI, the Government bailed it out and took over the scheme obligation on itself. Assured return schemes are no longer offered by AMCs though possible. Despite the fact that Assured Return Schemes offer lowest risk to the investor, they are not to be termed as risk – free instrument, as the investors have to usually lock their funds for specified time such as three years. Because of such lock in, the investor may lose the chance to acquire higher returns in other debt or equity securities, as changes in financial market may take place. In
addition, the investor is likely to face the credit risk of the guarantor who must remain solvent enough to honor his guarantee throughout the lock in period.

vi) Fixed Term Plan Series – an Indian variant: A mutual fund scheme would generally be either open-end or close-end. However, in Indian context, mutual funds have developed an innovative middle option between the two, in response to investor requirements. If a scheme is open-ended scheme, the fund issues new units and redeems them at any time. The fund does not provide a stated maturity or fixed term of investment as such. Fixed Term Plan Series offer a combination of both these features to the respective investors, as a series of plans are offered and units are issued by the fund at frequent intervals for short plan duration. Fixed Term Plan are essentially close-ended in nature, in that case the AMC issues a fixed number of units for each series only once and closes the issue after an initial offering period, like a close-ended scheme. A close-ended scheme would normally make a one-time initial offering of units, for a fixed duration generally exceeding one year depending upon the policy of the particular scheme. The individual investors have to hold the units until the end of the stated time period, or sell them on a stock exchange if listed. Fixed Term Plan is close-ended, but usually for shorter period, they are also not listed on stock exchange. The scheme under which Fixed Term Plan Series are offered are likely to be an Income Scheme, since the objective is clear for the AMC to attempt to reward investors with an expected return within a short period.

c) Hybrid Funds – Quasi Equity/Quasi Debt: Hybrid securities are classic example of capital management tools, combining elements of debt and equity in
a flexible and cost-effective manner. Hybrid schemes invest in mix of equity and debt instruments. Hybrid funds do not specialize in a particular security. These funds are designed to meet individual objectives for example, rapid growth, matching a market index, or investing in any area of the economy. Hybrid funds thus use combination of securities to achieve their pre-determined goals.

Merits of Hybrid funds

- Hybrid funds plays the role of a catalyst as a risk diversification tool and fulfills the investors dream of making money without taking too much risk and provide a smooth sailing in the market that is low volatility.
- Hybrid funds prove advantageous to the investors who don’t have sufficient money to diversify into several funds.
- They prove beneficial in rupee-cost-averaging strategies where an investor wants to get both stock and bond in one easy monthly purchase.
- Investors who do not wish to take the trouble of allocating their respective funds in different investments options, with the help of Hybrid funds can avail the services of expert portfolio managers.
- Hybrid funds are also desired by the retired investors who are looking for income but still wish to have some stock market growth opportunities.

i) Balanced funds: A balanced fund comprises debt instruments, convertible securities, preference shares and equity shares in its portfolio. Balanced funds
invest in more or less equal proportions between debt/money market and equities. As a result of investing in combine nature, balanced funds seek to achieve the objectives of income, moderate capital appreciation and preservation of capital. These funds are more suitable for investors who are conservative and long-term players. The remarkable feature of such funds is that the investor is very much conscious of the need of diversification of their portfolios and they generally do not keep all the eggs in the same basket. That is why a combination of debt and equity has formed a major chunk of their portfolio.

ii) Growth-and-Income Funds: Growth-and-Income Funds endeavor to strike equilibrium between capital appreciation and income for the respective investor. The portfolios consist of a mix between companies with good dividend paying records and those with potential for capital appreciation.

iii) Asset allocation Funds: The percentage of money to be invested in a particular category of asset is predefined. Many funds permit variable asset allocation policies and move in and out of an asset class (equity, debt, money market, or even non-financial assets) depending upon their outlook for specific market. The fund manager is provided with the elasticity to transfer towards equity when equity market is estimated to do well and shift towards debt when the debt market is expected to do well.

d) Equity Funds: Equity funds are characterized as funds involving high risk as well as high returns. Equity funds invest a major portion of their corpus in equity shares issued by companies, acquired directly in initial public offerings or through the secondary market. Equity funds are exposed to the equity price fluctuation
risk at the market level, at the industry or sector level and at the company-specific level. Equity funds’ Net Asset Value fluctuates with all these price movements, which are caused by a number of external factors such as political, social and economic. Equity funds can appreciate in value in line with the issuer’s earning potential, and thus propose the greatest possibility for growth in capital. However, an investor should not overlook that Equity funds are considered at the higher end of the risk spectrum among all available funds in the financial market. But whenever the question of higher returns turn up it is the equity oriented Mutual fund which glitters more than debt investment.

i) **Aggressive Growth Funds:** As the name suggests, aggressive growth funds aim at obtaining maximum capital appreciation, invest in less researched or speculative shares and may adopt speculative investment strategies to accomplish their objective of high returns for the investor. Accordingly, they tend to be more unpredictable and riskier than other funds.

ii) **Growth Funds:** The key objective of Growth funds is capital appreciation over a three to five year span. To achieve this target the growth funds invest in companies whose earnings are estimated to rise at an above average rate. These companies may be operating in sectors like technology considered having a growth potential, but not completely unproven and speculative.

iii) **Specialty Funds:** Specialty Funds invest in only those companies that meet pre-defined criteria. For example, at the height of the South African apartheid regime, many funds in U.S. offered plans that promised not to invest in South African companies. Also, funds which exclude tobacco companies from their
portfolios come under this category. Funds which invest in particular area for example, Middle East or ASEAN countries are also examples of specialty funds. Specialty funds have a propensity to be more volatile as diversification is limited to one type of investment or they are more concentrated funds. Following are the kinds of specialty funds:

i) **Sector funds**: Portfolios of sector funds consist of investment in only one industry or sector of the market for example Information Technology, Pharmaceuticals or Fast Moving Consumer Goods. Sector funds carry a higher level of sector and company specific risk as these funds do not diversify into multiple sectors so that the risk could be spread out.

ii) **Foreign Securities Fund**: Foreign Securities Fund invests in foreign countries thereby achieving diversification across the national borders. However, they also have additional risks, for example, foreign exchange rate risk as well as their performance depends on the economic circumstances of the countries they invest in. Foreign Securities fund may invest in one foreign country than it becomes risky due to concentration and if investment is made in more than one country the funds becomes more diversified.

iii) **Mid-Cap or Small-Cap Fund**: Mid-Cap or Small-Cap Funds invest in the shares of the companies which have relatively lower market capitalization. These funds, therefore, prove to be more volatile, as mid-size or smaller companies shares are not very liquid in markets. While pointing about risk features, small company funds may be aggressive-growth or just growth
type. In terms of investment styles, some of these funds may also be value investor.

iv) **Option Income Fund:** Option Income funds do not yet exist in India, but option Income Funds write options on a significant part of their portfolio. Though these funds are risky instruments, they may in fact help out to control the volatility, if appropriately used. Conventional option funds invest in large, dividend paying companies, and then sell options against their stock positions. This ensures steady income stream in the form of premium through selling option and dividends. Now that option on individual shares has become obtainable in India, such funds possibly will be introduced.

e) **Diversified Equity Funds:** Diversified Equity Funds seeks to invest only in equities, except for a very small portion in liquid money market securities. These funds are not focused on any one particular sector or shares, hence termed as diversified equity funds. Though these types of funds are vulnerable to all equity price risk, these funds lessen the sector or stock specific risks through diversification. Diversified Equity Funds are also exposed to the equity market risk.

(a) **Equity Linked Saving Schemes: (ELSS) an Indian Variant:** In India, investors have been given tax concessions to encourage them to invest in equity market through these special schemes. The key feature of such schemes is that they entitles the holder to claim an income tax rebate, but
generally has a lock-in period. The ELSS has no specific constraint on the investment objective for the fund managers.

**f) Equity Index Funds:** An index fund tracks the performance of specific stock market index. The key feature of this fund is to match the performance of the stock market by tracking an index that represents the overall market. The Index funds invest in the shares that comprise the index and in the same percentage as the index. Main advantage of these funds are that they take only the overall market risk, while reducing the sector and stock specific risks through diversification. Some index funds have a narrow approach as they invest in sectoral index for example Pharma index or Bank index.

**g) Value Funds:** Value funds may be characterized as those funds which try to seek out basically sound companies whose shares are presently under-priced in the market, but are considered to have growth potential in future. Value funds will invest only in those shares to their portfolios that are selling at low price-earning ratios, low market to book value ratios and are assumed to be undervalued compared to their true potential. Value funds are subject to equity market risk. Value funds frequently come from cyclical industries, for example, Templeton fund, which includes Cement or aluminium company shares and other cyclical industry in its portfolio built-up. Prices of such shares may rise and fall more often than the overall market. Yet, proponents of the Value Investment propose it as a long term approach.

**h) Equity Income or Dividend Yield Funds:** Equity funds that are designed to give the investor a high level of current income along with some stable capital
appreciation, investing mainly in shares of companies with high dividend yields,
are categorized under equity funds. To accomplish the objective of steady
income and capital appreciation, the Equity income fund would invest in Power or
Utility company shares of established companies that pay higher dividends and
as well as the prices of such companies do not fluctuate as much as other
shares. Hence, these funds have the merits of stability and safety.

i) **Exchange Traded Funds:** An Exchange Traded Fund is the hybrid of open-
end index fund and close-end index funds. They are listed on stock exchanges,
just like a close ended fund and trade like individual stocks on the stock
exchange. ETF pricing is linked to the index and units can be bought/sold on the
Stock Exchange. ETFs do not sell their shares directly to investors for cash. The
shares are offered to investors over the stock exchange. Since they are listed on
stock exchanges, it is possible to buy and sell them throughout the day and their
price is determined by the demand-supply forces in the market.

1.4.3 Other Funds

a) **Commodity Funds:** A commodity fund specializes in investing in different
commodities directly or through shares of commodity companies or through
commodity future contracts. A most familiar example of such funds is the
**Precious Metals Funds.** Gold funds invest in gold, gold futures or shares of gold
mines. Platinum or silver are also available in other countries for investment. In
India, the Union Finance Minister recently announced a Gold Linked Unit
scheme- like a Gold fund. A large number of commodity futures contracts are
now available for trading on commodity exchange, popularizing the commodity funds.

**b) Real Estate Funds:** The latest entrant in the field of mutual fund is Real Estate Mutual Fund. Real estate funds invest in real estate directly, or may fund real estate developers, or lend to them, or buy shares of housing finance companies or may even buy their securitized assets. Real estate funds may have the objective of growth orientation or regular income. REIF (Real Estate Investment Fund) has three categories:

i) **Equity REIT:** own and operate real estate.

ii) **Mortgage REIT:** lend money directly or indirectly to real estate owners.

iii) **Hybrid REID:** own both property and lend money to real estate owners.

Securities and Exchange Board of India and Association of Mutual Funds in India together has set up a committee to recommend on the introduction of REMF so that such funds would be available for the investment purpose. After submission of the report prepared by SEBI and AMFI, on June 26, 2006 SEBI permitted the guidelines for dealing in REMF. Real Estate can be explained as land including the air above it and the ground below it and any piece of structure constructed on it. It includes residential house, commercial offices, trading areas for example shopping malls, hotels, etc. It also includes purchase, sale and development of land, building and structures. The players are landlords, developers, builders, tenants and buyers to name a few in this market. According to market regulator, SEBI has defined REMF as a scheme of mutual funds which has investment objective to invest directly or indirectly in the real estate property.
c) **Funds of Funds:** A regular Mutual fund invests in stocks, bonds, and fixed income securities depending upon the objectives as specified in offer document. A fund of fund scheme, instead of investing in a portfolio of securities such as debt, equity, invests in a portfolio of the units of other mutual funds scheme. The concept of diversification is applicable to Fund of funds. Fund of fund assist the respective investor to pick the right funds from a wide variety of schemes presented by various Asset Management Companies. As also investors in such funds have the benefit of diverse management styles. For example, Prudential ICICI Advisor series, the first Indian Fund of Fund scheme offers five plans:

1) *Very cautious (no equity, 100% debt)*

2) *Cautious (up to 35% equity)*

3) *Moderate (40-60% equity)*

4) *Aggressive (50-80% equity)*

5) *Very aggressive (90-100% equity)*

**Merits of Fund of Fund:**

(a) Fund of Fund schemes provides a high degree of diversification thereby reducing the risk factor.

(b) It is argued that fund of fund are more tax-efficient rather than investing in mutual funds directly.

(c) As far as risk is concerned, there will be lower level of risk in such holdings.

(d) The investor will benefit from the expertise and the skill of different leading fund managers.
(e) Convenience is another plus point. In the times when the market is performing well in one section and dull in the other one, the fund manager will take complete care of portfolio of the investors. However, these funds prove to be expensive as the expenses of AMC that manages the fund of funds get added to the expenses of other schemes it invests in. As also fund of fund schemes invests in solely in the schemes of the same mutual fund. This may not be in the interest of the investors, if the sister schemes are not the best of their kind.

d) **Domestic Funds:** A domestic fund mobilizes the resources only from a particular geographical locality like a country or region. The market is limited and confined to the national boundaries in which the fund operates. Hence, domestic funds can invest only in securities which are issued and traded within the market of national boundaries.

e) **Offshore Funds:** An offshore fund invests in securities of foreign countries. These funds are known to facilitate cross-border fund flow which leads to an augment in foreign currency and foreign exchange reserve. They open domestic capital market to international investors. In short, offshore funds attract the foreign capital for investment in the country of the issuing company.

f) **Ethical Funds:** Ethical funds are an innovative product which is introduced recently in mutual funds products. Ethical funds assimilate personal values and social concern with that of investment decision making process and performance. Investment management of ethical funds is popularly known as socially responsible investing. The Ethical funds take into account both the investors
financial requirements and an investments influence on society and surroundings. The most important objective of ethical funds is to confine the investment universe to such companies, which come under the purview of the ethical criteria. These criteria essentially concentrate on social, environmental and ethical concerns of the investors. Securities from companies that adhere to social, moral, religious and/or environmental beliefs are a few examples. Ethical funds generally do not invest in companies producing tobacco or liquor; some of them do not invest in companies whose chief action involves producing military products. In addition to basic quantitative analysis, a socially responsible portfolio manager takes into account a company's community investment, environmental responsibility, protection of human rights, employment diversity, animal testing and product offering. Some of the Ethical funds focus on environmental responsibilities such as non-polluting companies, organic farming etc. Ethical investors include individuals and institutions such as Trusts, Universities, Hospitals, Foundations, Non-profit organizations, Nongovernment organizations, Religious establishments, temple, Churches.

**g) Gold Exchange Traded Funds:** It was Benchmark Asset Management Company in India, which conceptualized the idea of Gold Exchange Traded Funds (GETFs), in May 2002 when they filed a proposal with the Securities Exchange Board of India. The primary motive of Gold Bullion securities was to give financial and private investors the capability to have possession of gold and achieve exposure to price. With the launch of the GETFs in India, the investors can buy gold-linked units that would be traded on the stock exchange. One unit
of GETFs is equal to the value of one gram of gold. The daily price of each unit is linked to the prices of gold in the physical market. The investor is able to purchase and redeem the units GETF from the stock market. A Mutual fund house introducing a Gold ETF appoints Authorized Participants who at the outset buy the units of Gold ETF from the mutual fund by exchanging pure gold for the units of Gold ETF. These Authorized Participants facilitate secondary market trading of the Gold ETF units through the stock exchange where investors can buy or sell gold units on payment. The underlying asset is gold, which is held by Mutual fund house in a physical form through a gold receipt which provides the right of ownership. Authorized Participants are provided with the facility that they can go back to the mutual fund house to redeem the GETF units and can also demand the equivalent value of actual pure gold at any time. Gold, over the past years, has demonstrated to be a good hedge against inflation and has maintained a long term value. For this reason Gold ETF offer a well diversified option and reduction of overall risk and unpredictability of investments.

h) Leveraged Funds: Leveraged funds are the funds which increase the value of the portfolio and provide benefit to the unit holders by gains exceeding the cost of borrowed funds. The leveraged funds invest in speculative and risky instruments, like short sales to take the advantage of declining market. Leveraged funds are not common in India because of the risk associated with it.

i) Hedge Funds: The main objective of Hedge funds is to hedge risks in order to increase the value of the investors" portfolio. Hedge funds employ speculative trading principles while investing in financial instruments. These funds provide
hedge by purchasing shares whose prices are likely to rise and selling those shares whose prices are likely to fall. Hedge funds are not common in India.

1.5 STRUCTURE OF MUTUAL FUNDS IN INDIA

Mutual fund industry has shown remarkable growth in performance over the last few years and is still enduring to do so. It is considered to be the safest investment avenues because of its well-diversified portfolio and strict follow up by SEBI. SEBI, the market regulator, has outlined clearly the role, responsibilities and duties of each entity, which form a mutual fund. In India, the entities involved in a mutual fund operation are specified as under:

1. Sponsor
2. Trust
3. Asset Management Company
4. Custodian and Depositories
5. Bankers
6. Transfer agent
7. Distributors
8. Registrar
Entities Involved in a Mutual Fund Operation

Figure 1.3
1. Sponsor

What a promoter is to a company, a sponsor is to a mutual fund. In clear terms a sponsor is a person who initiates the idea of establishing a mutual fund company. The sponsor could be a financial services company, a bank or a financial institution. The sponsor will form a trust and appoint the board of trustees. The sponsor will also generally appoint an Asset Management Company as fund managers. The sponsor, either directly or through the trustees, will appoint a Custodian to hold the fund assets. All these appointments are made in accordance with SEBI Regulation. The sponsor takes big-picture decision related to the mf. In order to establish a mf in India, the sponsor is required to obtain a license from SEBI.

A. Eligibility norms for sponsor

1. The sponsor's contribution must be a minimum of 40% of the net worth of AMC.

2. The sponsor is also required to have carried on business in financial services for a period of not less than five years.

3. It is desirable that the sponsor should have positive net worth in all the immediate preceding five years of functioning.

4. The net worth of the immediately preceding year should more than the capital contribution of the sponsor in AMC and the sponsor should show profit after providing depreciation, interest, and tax for the three out of the immediate preceding five years.
5. The sponsor and any of the directors or principal officers to be employed by the mutual fund, should not have been found guilty of fraud or convicted of an offence involving moral turpitude or guilty of economic offences.

6. Those who qualify the above mentioned criteria are granted permission by the SEBI to establish a mutual fund.

2. Mutual fund as Trust

Mutual Fund Company is to be formed under the Indian Trust Act of 1882, and is registered with SEBI. The sponsor contributes towards the initial capital as well as appoints trustee to acquire the assets of the trust for the unit holders who are the beneficiaries of such trust. The instrument of trust is executed by the sponsor in favor of trustees and is registered under the Indian Registration Act, 1908. The fund thus established invites the prospective investors to contribute money in the common pool, by subscribing to units issued by various schemes established by the trust. The units acquired by the investor provide the proof of their beneficial interest in the fund. Under the Indian Trust Act, 1882 the fund has no independent legal capacity; it is the trustees who have the legal capacity.

3. Trustees

The MF Company should have board of trustees and trust deed. The trustees of the mutual fund are appointed by the sponsor. The mutual fund is managed by the Board of Trustees, who could be- a body of individuals, or a trust company- a corporate body. The trust is shaped through a document called the Trust Deed that is executed by the Fund Sponsor in favor of the trustees. It should be kept in
mind that the trustees do not manage the portfolio of securities directly. This function is performed by the Asset Management Company, appointed by the trustees or the sponsor, as per the authorization specified by the Trust Deed. The trustees are the primary guardian of the unit holder’s funds and assets, a trustee is required to be a person of high reputation and integrity. The trustees can be compared as internal regulator in a MF. The responsibility assigned to trustees is to protect the interests of unit holders. They ensure that the fund is managed by the AMC according to the defined objectives and in compilation with the Trust Deed and SEBI Regulation. It is made mandatory by the SEBI that out of the total number of trustees two-third of the trustees should be independent- that is, not have any association with the sponsor, to ensure they are impartial and fair in their dealings.

**A. Rights of Trustees**

- The trustees appoint the AMC with the prior approval of SEBI
- They also approve each of the schemes floated by the AMC
- They have the right to request any necessary information from the AMC concerning the operations of various schemes managed by the AMC as often as required, to ensure that the AMC is in compliance with the Trust Deed and the regulations.
- The trustees may take remedial action if they believe that the conduct of the fund’s business is not in accordance with SEBI Regulations. In certain specific events, the Trustees have the right to dismiss the AMC, with the approval of SEBI and in accordance with the regulations.
• The trustees have the right to ensure that, based on their quarterly review of the AMC’s networth, any shortfall in the networth is made up by the AMC.

**B. Obligations of Trustees**

• The trustees must enter into an investment management agreement with the AMC. This agreement must be in accordance with the Fourth Schedule of SEBI (MF) Regulations, 1996.

• They must ensure that the fund’s transactions are in accordance with the Trust Deed.

• The trustees are responsible for ensuring that the AMC has proper systems and procedures in place and has appointed key personnel including Fund Managers and a Compliance officer, besides other constituents such as the auditors and registrars.

• The trustees must ensure due diligence on the part of the AMC for empanelment of brokers.

• The trustees must ensure that the AMC is managing schemes independent of other activities and that the interests of unit-holders of one scheme are not compromised with those of other schemes/activities. For example, the trustees must ensure that AMC has not given any undue advantage to any associates.

• The trustees must furnish to SEBI on a half-yearly basis, a report on the fund’s activities and a certificate stating that the AMC has been managing the schemes independently of other activities.
4. Asset Management Company

An AMC is registered under the Companies Act, 1956, thus giving it a legal entity. The asset management company also known as Investment Manager is appointed by the Sponsor, or the trustees, if so authorized by the Trust Deed. To form an AMC the approval of SEBI is also required. It should have a certificate from SEBI to act as a portfolio manager under SEBI (portfolio managers) Rules and Regulations, 1993. It is the responsibility of AMC to recruit fund managers and analysts and other personnel to implement the decision taken by the sponsor. The AMC has to manage all operational matters which includes from designing schemes to launching schemes to efficient handling of investments to communicating with investors. AMC mobilizes the investment of the investors by making investment in various types of securities.

It acts as the investment manager to the trust under the supervision and guidance of the trustees.

Minimum required net worth for the AMC is Rs. 10 crores at all times and this net worth should be in the form of cash. At least 50% of the directors of the board should be independent, that is, they should not be associated with the sponsor or its subsidiaries or the trustees. The AMC cannot act as an AMC/Trustee to any other Mutual Fund. No person can be a director of more than one AMC or Director of Trust company operated by same AMC.

In return for rendering services, the AMC charges investment management fees and advisory fees, on an annual basis, according to the size of the scheme launched by the mutual fund.
5. **Custodian**

The custodian is appointed by the board of trustees. A custodian is responsible for the maintenance of back office of a mf. The custodian should be registered with SEBI, to be eligible to become a custodian of mf. The custodian of the mutual fund company holds the physical securities of various schemes of the fund in its custody. The duties performed by the custodian can be summed as receipt and delivery of securities, collection of income, distribution of dividends, and segregation of assets between schemes. It is important to note here that the sponsor of a MF cannot act as a custodian to the fund, so as to ensure that the assets of mutual fund are not in the hands of its sponsor.

**Custodian**

1. HDFC Bank
2. SHCIL
3. Citi Bank
4. Deutsche Bank
5. ABN AMRO
6. IIT Corporate Services
7. SBI India
8. Standard Chartered Bank

6. **Bankers**

Mutual funds activities involve dealing with money on a continuous basis primarily with respect to buying and selling of units, paying for investment made, receiving the proceeds on sale of investment and discharging its obligation
towards operating expenses. A fund’s banker therefore plays a crucial role with respect to its financial dealings by holding its bank accounts and providing it with remittance services.

7. **Distributor**

Mutual fund operates on the principle of accumulating funds from a large number of investors and then investing on a big scale. For a fund to sell units across a wide retail base of individual investors, an established network of distribution agents is essential. Distributors are given agency to sell the products of Mutual Fund Company in return of a commission.

8. **Registrar / Transfer Agent**

The registrar is assigned with task of maintaining the accounts of investors for the purpose of investment as well as disinvestments. The responsibility undertaken by the registrar includes issuing and redeeming units, sending fact sheets and annual reports. It depend upon the respective fund house to manage such purpose in house or outsource it to SEBI- approved registrars and transfer agents for example Karvy, CAMS etc.

**R & TA**

1. CAMS
2. Karvy
3. MCS Limited
4. Datamatics
5. MN Dastoor & Co.
6. IIT Corporate Services
9. Investor

The people who invest in Mutual Fund Company are known as investors. The following persons are eligible to buy mf units:

1. Residents including:

   - Adult individuals (or minors through their parents or guardians) holding singly or jointly (not exceeding three in all);
   - Hindu Undivided Families through their respective Kartas;
   - Companies, corporate bodies, partnership, associations of persons or bodies of individuals, religious and charitable trusts and other societies registered under the Societies Registration Act, 1860 (so long as the purchase of units is permitted under their respective constituent documents);
   - Religious and charitable trust and private trusts, subject to receipt of necessary approvals as “public Securities” wherever required.
1. Association of persons or body of individuals.

2. Mutual funds registered with SEBI.

3. Army/Air Force/Navy other paramilitary units and bodies created by such institution besides other eligible institution.

2. Foreign Institutional Investors registered with SEBI.

3. Multilateral funding agencies/bodies corporate incorporated outside India with permission of Government of India/Reserve Bank of India.

4. Overseas financial organizations which have entered into an arrangement for investment in India, inter-alia with a Mutual fund registered with SEBI and which arrangements are approved by Central Government.

5. NRIs, OCBs, FIIs and persons of Indian origin residing abroad, on a full repatriation basis/non-repatriation basis.

6. Other schemes of same mutual fund subject to the conditions and limits prescribed by SEBI Regulations.

7. The Trustees/Trust, AMC or Sponsor or their affiliates, their associate companies and subsidiaries.

8. Provident / pension / Gratuity / Superannuation and such other retirement and employee benefit and other similar funds.

1.6 ADVANTAGES OF MUTUAL FUNDS

Mutual funds have designed to provide maximum benefits to investors, and fund manager have research team to achieve schemes objective. Assets Management Company has different type of sector funds, which need to proper planning for strategic investment and to achieve the market return.
Professional Management

Fund manager undergoes through various research works and has better investment management skills which ensure higher returns to the investor than what he can manage on his own.

Portfolio Diversification

Mutual Funds invest in a well-diversified portfolio of securities which enables investor to hold a diversified investment portfolio (whether the amount of investment is big or small).

Less Risk

Investors acquire a diversified portfolio of securities even with a small investment in a Mutual Fund. The risk in a diversified portfolio is lesser than investing in merely 2 or 3 securities.

Low Transaction Costs

Due to the economies of scale (benefits of larger volumes), mutual funds pay lesser transaction costs. These benefits are passed on to the investors.

Liquidity

An investor may not be able to sell some of the shares held by him very easily and quickly, whereas units of a mutual fund are far more liquid.

Choice of Schemes

Mutual funds provide investors with various schemes with different investment objectives. Investors have the option of investing in a scheme having a correlation between its investment objectives and their own financial goals. These schemes further have different plans/options
Transparency

Funds provide investors with updated information pertaining to the markets and the schemes. All material facts are disclosed to investors as required by the regulator.

Flexibility

Investors also benefit from the convenience and flexibility offered by Mutual Funds. Investors can switch their holdings from a debt scheme to an equity scheme and vice-versa. Option of systematic (at regular intervals) investment and withdrawal is also offered to the investors in most open-end schemes.

Safety

Mutual Fund industry is part of a well-regulated investment environment where the interests of the investors are protected by the regulator. All funds are registered with SEBI and complete transparency is forced.

1.7 DISADVANTAGES OF MUTUAL FUNDS

The mutual fund not just advantage of investor but also has disadvantages for the funds. The fund manager not always made profits but might creates loss for not properly managed. The fund have own strategy for investment to hold, to sell, to purchase unit at particular time period.

Costs Control Not in the Hands of an Investor

Investor has to pay investment management fees and fund distribution costs as a percentage of the value of his investments (as long as he holds the units), irrespective of the performance of the fund.
No Customized Portfolios

The portfolio of securities in which a fund invests is a decision taken by the fund manager. Investors have no right to interfere in the decision making process of a fund manager, which some investors find as a constraint in achieving their financial objectives.

Difficulty in Selecting a Suitable Fund Scheme

Many investors find it difficult to select one option from the plethora of funds/schemes/plans available. For this, they may have to take advice from financial planners in order to invest in the right fund to achieve their objectives.

1.8 RISK INVOLVED IN MUTUAL FUND

Mutual funds investment is subject to market risks. As mutual funds investment is made primarily in the capital market they are subject to various kinds of risks. The following are some of the risks associated with the investment in mutual funds.

Market Risk

The net asset values of mutual funds may rise and fall dramatically which may be due to prevailing market conditions. This is known as market risk.

Credit Risk

The debt servicing ability (may it be interest payments or repayment of principal) of a company through its cash flows determines the Credit Risk faced by the company. This credit risk is measured by independent rating agencies like CRISIL who rate companies and their paper. An AAA rating is considered the safest whereas a D rating is considered poor credit quality.
Inflation Risk

Inflation is the loss of purchasing power over time. Many times people make conservative investment decisions to protect their capital but end up with a sum of money that can buy less than what the principal could at the time of the investment. This happens when inflation grows faster than the return on investment.

Interest Rate Risk

In a free market economy interest rates are difficult if not impossible to predict. Changes in interest rates affect the prices of bonds as well as equities. If interest rates rises the prices of bonds fall and vice versa. Equity might be negatively affected in a rising interest rate environment.

Political/ Government Policy Risk

Changes in government policy and political decision can change the investment environment. They can create a positive environment for investment or vice versa. Thus the growth and development of mutual funds depends to a large extent on the policy of the government.

Liquidity Risk

Liquidity risk arises when it becomes difficult to sell the securities that one has purchased. Liquidity Risk can be partly mitigated by diversification, staggering of maturities as well as internal risk controls that lean towards purchase of liquid securities.
1.9 ROLE OF MUTUAL FUNDS IN INDIAN FINANCIAL MARKET

Since the year 2003 from which the present stage of bull run in the Indian capital markets began, the Mutual fund industry While the growth in terms of the AUM was subdued over the period from 2009-2013, it has gained unprecedented momentum over the four year period until March 2013. Over this latter period of four years, the assets under management have grown from Rs 417,300 crores to as high as 816,657 crores as at the end of March 2013. The compounded annual growth rate of the industry over this period is as high as 40%. This high level of growth has obviously been triggered by the stupendous growth of the Indian capital markets over this period. The NSE index of select 50 stocks over this period has been around 42.60 percent and the Nifty – 50 indexes grew from 2674.6 points to 5697.35 points over the same period.

According to AMFI, the growth of the capital markets in terms of BSE-30 share Sensex has been still higher, in absolute terms; this index grew from 3,301.67 points to 18,835.77 points. It is quite clear that the growth of the Mutual fund industry has been in tune with that of the capital market not only the quantitative growth, but also the Indian Mutual fund industry has shown qualitative growth as well. The regulatory environment, under the watchful eyes of the SEBI has been consistently improving. The frequency of reporting by the Mutual fund has increased. The media plays a powerful role for the developments of Mutual fund industry as the fund performance have been reported and evaluated constantly. The advanced growth prospect of the industry has attracted global players as well as splendid fund management talent. Awareness on investment dynamics
has become more among the investors. Below is Growth of the Indian Mutual fund industry over the period from 2003-2013 (in Crores).

**Growth of the Indian Mutual fund industry from 2004-2013**

Table: 1.2

<table>
<thead>
<tr>
<th>Year (As on 31 March)</th>
<th>Sales</th>
<th>Redemption</th>
<th>AUM</th>
</tr>
</thead>
<tbody>
<tr>
<td>2004</td>
<td>5,90,190</td>
<td>5,43,381</td>
<td>1,39,616</td>
</tr>
<tr>
<td>2005</td>
<td>8,39,662</td>
<td>8,37,508</td>
<td>1,49,554</td>
</tr>
<tr>
<td>2006</td>
<td>10,98,158</td>
<td>10,45,382</td>
<td>2,31,862</td>
</tr>
<tr>
<td>2007</td>
<td>19,38,592</td>
<td>18,44,512</td>
<td>3,26,388</td>
</tr>
<tr>
<td>2008</td>
<td>44,64,376</td>
<td>43,10,575</td>
<td>5,05,152</td>
</tr>
<tr>
<td>2009</td>
<td>54,26,353</td>
<td>5,454,650</td>
<td>4,17,300</td>
</tr>
<tr>
<td>2010</td>
<td>10,019,023</td>
<td>9,935,942</td>
<td>6,13,979</td>
</tr>
<tr>
<td>2011</td>
<td>8,859,515</td>
<td>8,908,921</td>
<td>7,00,538</td>
</tr>
<tr>
<td>2012</td>
<td>6,819,679</td>
<td>6,841,702</td>
<td>6,64,792</td>
</tr>
<tr>
<td>2013</td>
<td>7,267,885</td>
<td>7,191,346</td>
<td>8,16,657</td>
</tr>
</tbody>
</table>

According to the latest statistics from the Association of Mutual funds in India, the average AUM of the 44-member industry stood at a new high at Rs 8.16 lakh
crore for the quarter ended 31 March. This is a rise of 2.67% in the sequential quarter. According to Chandan Kishore Kant (2013), though the AUM growth of overall industry remained low, sector fund did better performance than industry’s average. The Mutual fund industry, besieged by net redemptions by investors and adverse global and local market conditions, shrank by 1.6% in terms of AUM during the year FY2011-2012.It was seen in 2006 that there was increased investor participation in the industry when market was Booming, was leading to fund inflows that enabling the AUM to grow at a pace greater than the Sensex. However, volatile market conditions in following two years have led to net withdrawals by investors to the tune of 22,023 crore in 2011-12, which was leading to a further drop in AUM, in addition to the drop caused by adverse market movements. The Mutual fund industry is primarily debt-oriented with debt funds forming 64% of the AUM. As in the past, increased equity participation is the need of the hour for the Mutual fund industry. The global economic crisis wherein the world flirted with a 1930s-style Great Depression pushed AUM down and the decline did not last more than a year. In 2009, AUM shot up by a whopping 61.6%. This was because of bond funds which experienced strong net inflows and equity markets rallied hard from their abysmal lows in February 2009. The below figure indicates the growth of assets over the years with BSE Sensex points.
Growth of Assets with BSE Sensex

Figure: 1.4

Asset Holding Investor-wise 2013

Figure: 1.5
The above figure 1.5 shows the investor-wise pattern of asset holding for year ended 2012. The investor-wise pattern of asset-holding as well as investor accounts that the individual investors accounted for 97.07 of total investors account and contribute 37.0% of the total net assets as on March 31, 2009. They were followed by NRIs, who constituted a meager 1.90 percent of the total number of investor accounts. On the other hand, the corporate/institutions accounted for 72.80 percent of the net assets of the Mutual fund industry in 2011–2012, followed by individuals, who accounted for 23.40 percent. The corporate/institutions saw the highest increase in net assets among the four categories, with a year-on-year improvement of 18.05 percent in 2011–2012. The chart reveals corporate holds maximum assets as on 2012 followed by Individual investors. NRIs and FIIs are holding 2% each who are the lowest among the categories.

**Institution-wise Resource Mobilization**

*Figure: 1.6*
The resource mobilization through the route of Mutual funds is done broadly by three categories, namely, banks, private sector, and institutions. The structure of the institution-wise resource mobilization is depicted below gives the details of the sales, purchases and AUM. The private sector Mutual funds accounted for 79 percent of the resource mobilization (sales) by the Mutual fund industry in 2012–2013. These private sector Mutual funds witnessed a net outflow of 5,766,729 crore, compared to a net inflow of 5,622,189 crore in 2011–2012. In 2012–2013, bank-sponsored Mutual funds mobilized resources worth 1,465,565 crore, which was 24.22 percent higher than the resource mobilization in 2011-12 (1,179,842 Crore). The bank-sponsored schemes accounted for 20.16 percent of the gross resource mobilization in 2012–2013. In net terms, the bank-sponsored Mutual funds witnessed an outflow of 1,452,750 Crore in 2012–2013.

1.10 LEGAL FRAMEWORK OF MUTUAL FUNDS IN INDIA

The Indian mutual fund industry in terms of regulatory framework is believed to match up to the most developed markets globally. The regulator, Securities and Exchange Board of India (SEBI), has consistently introduced several regulatory measures and amendments aimed at protecting the interests of the small investor that augurs well for the long term growth of the industry.

The implementation of Prevention of Money Laundering (PMLA) Rules, the latest guidelines issued in December 2008, as part of the risk management practices and procedures is expected to gain further momentum. The current Anti Money Laundering (AML) and Combating Financing of Terrorism (CFT) measures cover
two main aspects of Know Your Customer (KYC) and ‘suspicious transaction monitoring and reporting’.

The regulatory and compliance ambit seeks to dwell on a range of issues including the financial capability of the players to ensure resilience and sustainability through increase in minimum networth and capital adequacy, investor protection and education through disclosure norms for more information to investors, distribution related regulations aimed at introducing more transparency in the distribution system by reducing the information gap between investors and distributors, and by improving the mechanism for distributor remuneration.

The success of the relatively nascent mutual fund industry in India, in its march forward, will be contingent on further evolving a robust regulatory and compliance framework that in supporting the growth needs of the industry ensures that only the fittest and the most prudent players survive.

**Regulations Regarding Establishment of a Mutual Fund:** In India mutual fund play the role as investment with trust, some of the formalities laid down by the SEBI to be establishment for setting up a mutual fund. As the part of trustee sponsor the mutual fund, under the Indian Trust Act, 1882, under the trustee company are represented by a board of directors. Board of Directors is appoints the AMC and custodians. The board of trustees made relevant agreement with AMC and custodian. The launch of each scheme involves inviting the public to invest in it, through an offer documents. Depending on the particular objective of scheme, it may open for further sale and repurchase of units, again in
accordance with the particular of the scheme, the scheme may be wound up after the particular time period.

1. The sponsor has to register the mutual fund with SEBI.

2. To be eligible to be a sponsor, the body corporate should have a sound track record and a general reputation of fairness and integrity in all his business transactions.

**Means of Sound Track Records**

- The body corporate being in the financial services business for at least five years
- Having a positive net worth in the five years immediately preceding the application of registration.
- Net worth in the immediately preceding year more than its contribution to the capital of the AMC.
- Earning a profit in the three out of the five preceding years, including the fifth year.
- The sponsor should hold at least 40% of the net worth of the AMC.
- A party which is not eligible to be a sponsor shall not hold 40% or more of the net worth of the AMC.
- The sponsor has to appoint the trustees, the AMC and the custodian.
- The trust deed and the appointment of the trustees have to be approved by SEBI.
- An AMC or its officers or employees cannot be appointed as trustees of the mutual fund.
At least two thirds of the business should be independent of the sponsor.

Only an independent trustee can be appointed as a trustee of more than one mutual fund, such appointment can be made only with the prior approval of the fund of which the person is already acting as a trustees.

**Launching of Schemes**

Before its launch, a scheme has to be approved by the trustees and a copy of its offer documents filed with the SEBI.

1. Every application form for units of a scheme is to be accompanies by a memorandum containing key information about the scheme.

2. The offer document needs to contain adequate information to enable the investors to make informed investments decisions.

3. All advertisements for a scheme have to be submitted to SEBI within seven days from the issue date.

4. The advertisements for a scheme have to disclose its investment objective.

5. The offer documents and advertisements should not contain any misleading information or any incorrect statement or opinion.

6. The initial offering period for any mutual fund schemes should not exceed 45 days, the only exception being the equity linked saving schemes.

7. No advertisements can contain information whose accuracy is dependent on assumption.
1.11 OPPORTUNITIES AND CHALLENGES

In any industry, innovation and improvements happen when the rules are changed. Large-scale environmental changes such as those that have taken place in the last years must lead to innovation and evolution.

1.11.1 Challenges for Mutual Fund in India

*No Guarantees*

No investment is risk free. If the entire stock market declines in value, the value of mutual fund shares will go down as well, no matter how balanced the portfolio. Investors encounter fewer risks when they invest in mutual funds than when they buy and sell stocks on their own. However, anyone who invests through a mutual fund runs the risk of losing money.

*Fees and Commissions*

All funds charge administrative fees to cover their day-to-day expenses. Some funds also charge sales commissions or "loads" to compensate brokers, financial consultants, or financial planners. Even if you don't use a broker or other financial adviser, you will pay a sales commission if you buy shares in a Load Fund.

*Taxes*

During a typical year, most actively managed mutual funds sell anywhere from 20 to 70 percent of the securities in their portfolios. If your fund makes a profit on its sales, you will pay taxes on the income you receive, even if you reinvest the money you made.
Management Risk

When you invest in a mutual fund, you depend on the fund's manager to make the right decisions regarding the fund's portfolio. If the manager does not perform as well as you had hoped, you might not make as much money on your investment as you expected. Of course, if you invest in Index Funds, you forego management risk, because these funds do not employ managers.

1.11.2 Opportunities for Mutual Fund in India

Mutual funds make saving and investing simple, accessible, and affordable. The advantages of mutual funds include professional management, diversification, variety, liquidity, affordability, convenience, and ease of recordkeeping—as well as strict government regulation and full disclosure.

Diversification

The best mutual funds design their portfolios so individual investments will react differently to the same economic conditions. For example, economic conditions like a rise in interest rates may cause certain securities in a diversified portfolio to decrease in value. Other securities in the portfolio will respond to the same economic conditions by increasing in value. When a portfolio is balanced in this way, the value of the overall portfolio should gradually increase over time, even if some securities lose value.

Professional Management

Most mutual funds pay topflight professionals to manage their investments. These managers decide what securities the fund will buy and sell.
Regulatory Oversight
Mutual funds are subject to many government regulations that protect investors from fraud.

Liquidity
It's easy to get your money out of a mutual fund. Write a check, make a call, and you've got the cash.

Convenience
You can usually buy mutual fund shares by mail, phone, or over the Internet.

Low Cost
Mutual fund expenses are often no more than 1.5 percent of your investment. Expenses for Index Funds are less than that, because index funds are not actively managed. Instead, they automatically buy stock in companies that are listed on a specific index.

1.11.3 Future of Mutual Fund
This section contains a summary of the expected drivers for future growth, expected industry growth projections and overall future outlook across various dimensions customers, markets, products, distribution channels and regulatory frameworks.

Growth Drivers
Although several macroeconomic and demographic factors affect the growth of the industry, the key underlying driver for all the categories of funds is the key economic indicator – the GDP growth rate.
Expected Impact

Retail Segment

- Increase in disposable incomes and household financial savings may result in households seeking alternate avenues for investments to yield higher returns with reasonable risk. Favorable demographics like urbanization and a relatively young population having an increased risk appetite are likely to save more and seek to invest a higher proportion of those savings in market-linked instruments such as mutual funds.

- Distribution innovations are expected to increased mutual fund penetration specifically in Tier 2 and Tier_3 towns thereby expanding the mutual fund customer base.

- Improved awareness levels and enhanced financial literacy is expected to aid the understanding of mutual fund products.

- Appropriate asset allocation and potential for wealth creation

Institutional Segment

- Increased demand for sophisticated treasury management products

- A better economic situation in the country is likely to ensure a steady fall in the interest rates.

- In the event of a quick economic revival and positive reinforcement of growth drivers identified, KPMG in India is of the view that the Indian mutual fund industry may grow at the rate of 22-25 percent
up to 2020, resulting in AUM of INR 16,000 to 20,000 billion in 2020.

However, lack of awareness still impedes the growth of the mutual fund industry. Unlike developed countries, most of the household savings still go to bank deposits in India. In the year 2004, the mutual fund industry in India was worth Rs 1,058,097 crores. The mutual fund industry is expected to grow at a rate of 13.4% over the next 10 years. The industry has grown in size and manages total assets of more than 1,058,097. Of the various sectors, the private sector accounts for nearly 91% of the resources mobilized showing their overwhelming dominance in the market.

The next chapter focuses on the study and findings of various research conducted on Mutual Funds by various authors at National and International level.