Chapter – 5

LIFE INSURANCE CORPORATION
AND MUTUAL FUNDS
Chapter – 5

LIFE INSURANCE CORPORATION AND MUTUAL FUNDS

5.1 THE BASIC CONCEPT OF MUTUAL FUNDS:

Basically Mutual Funds [MF's] are institutions which mobilize resources from the small investors. The savings of small investors are, therefore, utilized to purchase the securities of companies and corporations. It is, thus, an institutional arrangement for resource mobilization from small, marginal and household sector investors. Such accumulated funds are utilized to acquire shares and securities of reputed companies. Mutual Funds become a major vehicle for mobilization of savings, particularly from small and household sectors, for the investment in stock-market. The importance of mutual funds has been increasing in the capital market by expanding the investors' base. A mutual fund is an institutional device or an investment vehicle through which, the investors pool their funds under the direction of an investment manager. These funds are invested in a wide variety of portfolios of securities in such a way as to minimize risk, while ensuring safety and steady return. Mutual Fund is an institutional device to
bridge the gap between the supply and demand of capital in the market. A Mutual Fund is an investment company of a trust that pools the resources of thousands of its shares holders or unit-holders and invests on behalf of them in diversified securities and a cross-section of companies to attain the objectives of the investors, which in return achieve income or growth or both.

Mutual funds are the major types of investment companies. Investment companies are financial intermediaries [middlemen] that pool the funds of investors who are seeking some general investment objective and invest them in a number of frequently traded different types of securities, e.g., common stock, bonds and money market securities. These pooled funds provide thousands in investors with proportional ownership of diversified portfolios which are operated by professional investment managers. The management of funds and investment policy is entrusted to an experienced professional named "Portfolio Manager".

Thus, Mutual Fund offers:

(i) Professional Management,
(ii) Portfolio Management,

(iii) To Common Investing Group, diversified investment opportunities are available,

(iv) Collective sharing of burden out of Fund Management,

(v) Collective sharing of Profit Earned,

(vi) Less Transaction Cost, and

(vii) Port-folio contraction as per the objectives of individual mutual fund scheme.

"Mutual Funds exist to give small investors an alternative way to invest in capital markets and to provide an alternative source of money to finance industries by buying their securities. Mutual funds also allow small investors to have a measure of self-defence when investing in markets which have become increasingly dominated by giant financial institutions. By buying shares in a mutual fund, the individual becomes part of an institution and so can stand on more even terms. Mutual Funds are organized, operated and managed by companies that do the Practical Administrative things that allow the fund to function. They select the funds strategy, hire the managers, market the
shares to potential investors, and do the paper work (keeping records of share holders' holding, sending statements, proxies and other materials to the investors, redeeming shares of share owners who decide to cash out etc.)" From the very definition the function of Mutual Fund can be highlighted as:

Mutual Fund collects funds from small investors or unit-holders.

The Funds so collected are invested in buying shares of companies. Thus, MFs, provide funds to companies for business purposes.

(a) They act as indicators between investors and companies.

(b) By buying shares in a mutual fund, the individual investor becomes part of our institution and so can stand on even terms.

(c) Mutual funds are organized, operated and managed by companies that do the practical administrative things that allow the fund to function, and

(d) They select the fund's strategy, hire manages, market the shares to potential investors and do the paper work.
In the words of Joel Ross, Mutual Fund is "taking the 'pool' of money and investing it in the securities of wide range of companies, managers of mutual funds decide, when to buy, sell, or held in order to achieve the objective of the fund. This Policy removes the risk associated with putting all your eggs in one basket as the typical small investors tends to do." According to him, Mutual Funds are collective or pooling money from small investors. The Mutual Funds decide when to buy, sell or hold securities.

"Mutual funds are corporations which pool funds and reduce risk by diversification".

"Mutual funds are financial intermediaries which bring a wide varieties within the reach of the most modest of investors".

According to Regulation 2(3), "Mutual Fund means a fund established in the form of a Trust by a sponsor to raise monies by the Trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations."
The features are:

(i) Mutual Fund is established as a fund in the form of Trust,

(ii) It is established by a Sponsor,

(iii) It is created to raise monies through sale of units,

(iv) It sells one or more schemes and

(v) The funds raised are invested in securities in accordance with the regulations.

"Units" means the interest of the investors in a Mutual Fund Scheme, which consists of each unit representing one undivided share in the assets of a scheme. For instance, the amount of a particular scheme is Rs. 60 crores of which each unit is Rs. 10/- and therefore total units are 6 lakhs.

Sponsor means anybody corporate who, acting alone, or in combination with another body corporate, establishes mutual fund after completing formalities. Thus, sponsor can be either a single body corporate or a concern or in combination with another body corporate. It has powers to create mutual fund.
Now, henceforth, the money collected under any scheme of a Mutual Fund shall be invested only in transferable securities, whether in money market or in the capital market or in privately placed debentures or secured debts [Regulation 40(1)].

Mutual Funds in India are known by different names in different countries. In the United Kingdom, they are known as "Investment Trust" while in the USA and most of the other countries they are called "Investment Companies".

5.2 MUTUAL FUND INDUSTRY—AN INDIAN PANORAMA:

The foundation for Mutual Fund Industry in India was laid by the Parliament in 1963. The idea of Mutual Fund took shape in India in 1963 with the set up and enactment of Unit Trust of India (UTI) by framing an Act titled UTI Act, 1963, to operate both as a financial institution and an Investment Trust, the then Finance Minister, Mr. T.T. Krishnamachari told the Parliament that. "UTI would provide an opportunity for the middle and lower income groups to acquire without much difficulty, property in the form of shares. This institution is intended to cater mainly to needs of individual investors whose means are small". In 1964, the Board of Trustees formulated an open – end scheme and launched in
July, 1964 at the nominal value of Rs. 10 each. Thus, the UTI came out with its first open-ended scheme in 1964. Till 1987, the UTI with a very few schemes was holding the key of the entire mutual fund industry.

Till 1986, there was only one Mutual Fund (MF) namely Unit Trust of India (UTI) operating in India. UTI is a public sector financial institution. As a public sector institution, UTI had a complete monopoly of the unit trust business. The scene has changed since 1986. Government of India amended the Banking Regulations Act to permit commercial banks in the public sector to set up mutual funds. The State Bank of India was the first bank to promote a mutual fund called "SBI Mutual Fund" in July, 1987. In December, 1987, Canara Bank established its subsidiary, Canbank Mutual Fund to enter mutual fund business. In the year 1987, Indian Bank, Bank of India and Punjab National Bank established mutual funds in the name of Ind-bank Mutual Funds, BOI Mutual Fund and PNB Mutual Fund respectively.

The Government permitted insurance corporations in the public sector to join the Mutual Funds band wagon which was till then being dominated by the commercial banks. LIC of India set
up LIC Mutual Fund in June 1989 with a view to targeting small investors particularly from the rural and semi-urban areas. The General Insurance Corporation of India (GIC) set up GIC Mutual Fund in 1991.

In 1992-93, the Mutual Funds industry was thrown open to private sector. Private sector Mutual Funds are allowed to take advantage of collaboration with foreign investment and fund managers. The Finance Minister, in his Budget, speech disclosed the Government's intention of allowing private sector to launch mutual funds. Thereafter, a ten member study group headed by Dr. S.A. Dave, Chairman of the UTI, was entrusted the task of evolving a frame work for legislation for the regulation of mutual funds that may be permitted in the joint/private sector. The Dave Panel Recommendations were submitted in September, 1991.

Private Sector mutual funds are Alliance Capital MF, Apple MF, Birla MF, Kothari Pioneer MF, Kotak Mahindra MF, Sri Ram MF and Tata MF. Chart 5.1 depicts the Mutual Fund Organisation in India.
Chart – 5.1

Mutual Fund Organisations in India

MUTUAL FUNDS

- Trusts (e.g. UTI)
  - Financial Institutions MF
    - 1. ICICI MF
    - 2. IDBI MF

- Public Sector
  - Public Sector Banks
    - 1. SBI MF
    - 2. Canara Bank
    - 3. Indian Bank
    - 4. BOI MF
    - 5. BOB MF
    - 6. PNB MF

- Private sector
  - Insurance Sector
    - 1. GIC MF
    - 2. LIC MF

- Private sector
  - 1. Alliance Capital
  - 2. Apple MF
  - 3. Birla MF
  - 4. CRB MF
  - 5. JM MF
  - 6. Kothari Piner MF
  - 7. Kotak Mahindra MF
  - 8. Morgan Stanley MF
  - 9. Sri Ram MF
  - 10. Sundaram MF
  - 11. Tata MF
  - 12. Taurus MF
  - 13. 20th Century MF
  - 14. Reliance MF
Reserve Bank of India Guidelines: The Reserve Bank of India (RBI) monitors the operations of nationalized banks, inter-alia, issued a set of guidelines in 1987. This set of guidelines was expected to be followed by the bank sponsored mutual funds. These are:

(i) Mutual Funds should be constituted as a trust under the Indian Trust Act. At least two outside trustees should be in the Trust.

(ii) Mutual Fund should have a full time executive for the day-to-day management.

(iii) Mutual Fund is separate from the sponsor bank. These should be an arm's length relationship between the mutual fund and the sponsor bank.

(iv) Every sponsor bank should contribute at least Rs. 25 lakhs.

(v) A Mutual Fund should have a clear statement of objectives and policies for the fund. It should be published.
(vi) Operations must be restricted to Capital Market Investments. Mutual Funds are not to undertake direct or indirect lending, underwriting and bill discounting.

(vii) Restrictions must be placed on the cost of managing any scheme.

(viii) A Management Information System (MIS) should be evolved maintain date and to submit various reports.

**Ministry of Finance Guidelines:** The Ministry of Finance issued guidelines in June, 1990 which are:

(i) All Mutual Funds, except the statutory ones, will now require the approval of the Controller of Capital Issues. Thereafter be registered with the Securities and Exchange Board of India (SEBI). The existing mutual funds must themselves be registered with SEBI within 90 days.

(ii) Sponsoring Institutions will have to contribute a minimum of Rs. 2 crores to the corpus of the funds. The contribution can be converted later in a subscription.

(iii) Such funds except those established with the declared objective of undertaking investment in immovable
property shall not undertake any activity relating to acquisition of immovable property except for their own use. The fund may, however, subscribe to the bonds and debentures issued by institutions dealing in housing finance.

(iv) A mutual fund shall not invest more than 5 per cent of its assets in the shares of any company. It shall not also invest more than 5 percent of the shares of any company under any one scheme.

(v) A mutual fund should not normally invest in another Mutual Fund. It should not normally keep deposits with companies and other bodies corporate.

(vi) A Mutual Fund should maintain separate accounts in respect of each scheme.

However, these guidelines are not applicable to country funds established abroad as India Fund, Indian Growth Fund which are governed by their own schemes. They get approval from Finance Ministry of Government of India.
Role of Securities & Exchange Board of India (SEBI):

In March 1991, the Government, in principle handed over the function of Regulating Mutual Funds to SEBI. From 31st March, 1991, the SEBI directed all the existing Mutual Funds by its guidelines. SEBI is an autonomous body. The Government has accorded statutory status to SEBI on 31st January, 1991 for the promotion and regulation of the Capital Market.

Chart-5.2 shows the Regulatory Framework of Investors:

Chart – 5.2

SPONSOR COMPANY

Mutual Fund Trust Managed by Board of Trustees

Asset Management Company

Custodian appointed by the Trustees for Custodia Services

Bankers appointed by Trustees

Registrars and Transfer Agents appointed by Trustees
In the interest of Investor protection, SEBI has been given wide ranging powers to oversee the constitution as well as operations of Mutual Funds. It is also empowered to impose quality on Mutual Funds should they fail to comply with its guidelines.

In October, 1991, SEBI issued guidelines for the formation of Asset Management Companies (AMCs) for Mutual Funds. According to Regulation 2(d) of SEBI (Mutual Funds) Regulations, 1993, an "Asset Management Company" means a company formed and registered under the companies Act 1956 and approved by the Board under Regulation 20.

(i) An Asset Management Company is a Joint Stock Company.

(ii) It is promoted and sponsored by financial institution or bank or LIC, GIC or any others.

(iii) Such AMC should be approved by the SEBI under Regulation 20.

(iv) The application for the approval of the AMC should be made in Form A.
(v) Memorandum and Articles of Association of the AMC should be submitted to the Board approval.

Every sponsor shall appoint AMC. It is approved by the Board. It is created to manage the affairs of the MF, and operate the schemes of such fund. According to Regulation 19(1) of SEBI Regulations the objectives of AMC are to manage the assets of the MF and other activities it can carry out, such as, financial services consultancy which do not conflict with the fund management activity and are only secondary and incidental.

According to Regulation 19(2), the appointment of an AMC can be terminated by majority of the Trustees or by 75% of the limit of the unit holders of the scheme.

According to Reg. 19(3) any change in the appointment of the AMC shall be subject to prior approval of the Board.

Directors of AMC are persons having professional experience in the relevant fields, such as portfolio management, investment analysis and financial administration. The Chairman of the AMC should not be the director of a Trustee company or Trustee of Board of Trustees.
The following chart 5.3 shows the structure of a Mutual Fund:

**Chart – 5.3**

**STRUCTURE OF A MUTUAL FUND**

- Mutual Funds
  - MF's approved as per SEBI
  - UTI as per U11 Act 1963
  - Money Market MF's as per RBI guidelines
  - Offshore MF's as in the form of FII's as per SEBI & RBI guidelines

1. Mutual Funds
2. Pension Funds
3. Investment Trusts
4. Asset Management Companies (AMCs)
5. Nominee Companies
6. Institutional Incorporated Portfolio Managers

AMC should have a minimum net worth of Rs. 5 crores. Net worth means paid-up capital of the company and free reserves. Any material change in AMC should be informed to the
Board. Under Regulation 23(1) No AMC shall act as a Trustee of any Mutual Fund, (2) It can undertaken activities like Financial Services, Consultancy, Exchange of Research on commercial basis.

**Trustee:** According to Regulation 2, trustee means a person who holds the property of the mutual fund in trust for the benefit of the unit holders.

**Unit-holder:** Means a participant in a scheme of a Mutual Fund.

**Custodian:** A custodian is appointed by the trustees of Mutual Fund to provide necessary custodial services.

From the above chart, the structure of a Mutual Fund can be explained in a way that "A Mutual Fund is established in the form of a trust by the sponsor. It is managed by the Board of Trustees and trust deed is executed by a sponsor. Trust deed lays down guidelines for the management of funds. The trust appoints and establishes "Asset Management Company (AMC)". It is the job of the trustees to ensure that the schemes floated and managed by AMC as per the Trust Deed. There is an arm's length relationship between Trustees and AMC. Trustees are the
principal controller of the Capital Property of the Mutual Fund schemes. They are required to act in their interest."

The Rights of Trustees Are:

(i) They have the right to obtain from AMC relevant information as well as quarterly report on its activities.

(ii) They are vested with powers to dismiss the AMC under specific conditions as per SEBI's Regulations and with its approval.

(iii) They have the right to appoint a custodian and supervise its activities.

(iv) They have the right to get auditor's report of AMC.

(v) They have the right to appoint bankers.

(vi) They have the right to appoint Registrars and Transfer Agents.

Trustees are required to submit a six monthly report to SEBI on the activities of Mutual Fund.

To conclude, Mutual Funds in India comprise of various sectors such as, Public Sector Banks, Public Sector financial
institutions, MF sponsored by UTI and private sector. All these are playing an important role in mobilizing resources. The entry of Private Sector mutual funds imparted competitive atmosphere in the mutual Fund industry. It helped the investors to choose from the schemes with different maturity periods and various risk-return trade offs.

6.3 SIGNIFICANCE OF MUTUAL FUNDS:

(1) The MFs have been functioning like financial intermediaries to mobilise savings of public, invest them in a variety of securities and in those avenues where there is a demand of funds.

(2) These institutions employ experts who possess professional knowledge and expertise for the selection and supervision of their investment portfolios.

(3) The diversification and expert investment knowledge ensure steady and regular earning to the funds and a share in the general property to the investor.

(4) The Mutual Funds will relieve the investors from the problem of investing their savings and dealing with them
effectively. Further these will ensure a low risk, steady return, liquidity and capital appreciation.

(5) These funds make available relatively bigger lots of funds to needy industrial concerns and thereby reduce their burden and botheration involved in raising finance directly from individual savers.

(6) The MFs have been opening off-shore funds in various foreign countries, in order to attract foreign capital flow into the country and to secure profitable investment avenues abroad for domestic savings.

(7) The income levels of urban and rural middle class people are increasing and these people are part of their income to invest in profitable and safe avenues, since they are aware of the time benefits if they invest their money in capital market. The MFs are channelising such savings to the needy industrial undertakings.

(8) In this context the Mutual Funds have tremendous scope for growth in the country in nineties and thereafter.
(9) In view of liberalized economic and industrial policies and concessions for the growth of industrial sector, the capital market—both primary issue market and secondary market—have been witnessing unprecedented booming trends. Hence, MFs, have been able to speed their wings by spreading their funds in various industrial sectors.

(10) Investors' confidence: MFs are playing significant role in mobilizing savings from public and in the process it has provided stability to the Indian Capital Market. They have proved to be the mainstay in the market in times of high degree of volatility. They have garnered investors' confidence as a large section of savers are willing to put their savings in the MFs.

(11) Saver's attitude – Savers are more interested in the MFs and are willing to put their savings into MFs because of low risk, reasonable return guarantee to get back their investments with adequate appreciation.

(12) Income-tax Relief (U/s 88) – There are several Mutual Fund schemes to tax-paying class who get rebate on investment in these schemes. They get a high relief due to these schemes.
(13) High liquidity – Wherever investor feels like withdrawing the scheme, he can get immediately on repurchase price or Net Asset Value (NAV) price.

(14) Government Control – There is a great deal of control by the Government through SEBI on Mutual Fund industry because there is a vast corpus invested by household sector of India.

(15) Good Portfolio Management – There are expert and specialized professional managers appointed by Mutual Fund organizations. Therefore, good portfolio management is possible which results high benefits to Mutual Fund holders.

(16) Risk of loss due to ill informed and misinformed purchases/sales is reduced as the managers of MFs have better access to information. Risk is reduced due to diversification of Portfolio in terms of companies and industries. Even a small investor of Rs. 1,000 in MF gets the benefit of diversification. As the savings and investments are pooled, there are advantages of economics of scale. Even a small investor of Rs. 100 can reap the benefits of large size funds
of Rs. 50-100 crores. The funds are handled by professional experts, who are specially trained, and have considerable experience. The returns are automatically reinvested. The investor need not be bothered about paper work and the trauma associated with frequent switch over of stocks.

(17) Returns and capital appreciation are higher than that from bank deposits. Investors in MFs enjoy tax benefits under Sec. 80C and in some cases Sec. 80L and 88 of the Income-tax Act of 1961.

(18) MFs are ideally suited to a developing economy like India. This is because there is a large number and they have also shown their willingness to enter the capital market. MFs are more useful kind helpful to the investors who are shy of capital market. The claim to offer professional management of funds to diversify and thus reduce the unsystematic risk, while offering good returns.

The major disadvantage of investing in the mutual fund is that the investor has to bear the expenses of running a mutual fund. These expense are of two types – initial and recurring. To understand the implication of these, let us assume that the initial
expenses are 6% and recurring expenses are 2%. This means that if an investor contributes Rs. 100 to a mutual fund scheme, the net amount available for investment is only Rs. 94 [100-6]. Further on this net investment there is recurring expenses of $2^0$, hence if an investor can earn a rate of return of, say 18% by investing on his own, the mutual fund must earn a rate of return of 21.15% to provide the same return to the investor.

In spite of this disadvantage, Mutual Funds can serve the investors at large in a better way by providing them good returns and it is also an effective agency for the mobilization of resources for the economy.

5.4 REGULATION OF MUTUAL FUNDS:

5.4.1 Investment norms for mutual funds:

(i) No mutual fund under all its schemes can own more than 5% of any company's paid-up capital carrying voting rights.

(ii) No mutual funds under all its schemes taken together can invest more than 10% of its funds in shares and debentures or other instruments of any single company.

(iii) No mutual funds under all its schemes taken together can invest more than 15% of its funds in shares and debentures
of any specific industry, except in case of those schemes which are specifically floated for investment in one or more specified industries in respect of which a declaration has been in the offer letter.

(iv) No individual scheme of mutual funds can invest more than five percent of its corpus in any one company's shares.

(v) Mutual funds can invest only in transferable securities, either in money market or in capital market. Privately placed debentures, mortgaged debts and other unquoted debt instruments, holdings cannot exceed 10% in the case of growth funds and 40% in the case of income funds.

(vi) Mutual funds are required to distribute at least 90% of their annual profits in any given year.

Besides the above norms, there are guidelines governing the operations of mutual funds seeking to ensure greater investor protection through detailed disclosure and reporting by the mutual funds. SEBI has also been granted wide ranging powers to oversee the constitution as well as their operations, including a common advertising code. Further SEBI can impose penalties on mutual
funds after due investigation for their failure to comply with the guidelines.

### 5.4.2 Rights of investors:

(i) *Certificates*: Under a closed-end scheme, an investor is entitled to receive shares or unit certificates allotted to him within a period of 10 weeks from the date of disclosure of subscription. Under an open end scheme, this period is six weeks from the date of disclosure of initial offer.

(ii) *Transfer*: An investor is entitled to get the unit of share certificates transferred within a period of 30 days from the date of lodgment of the offer.

(iii) *Refund*: If the total collection of funds by mutual funds is less than the statutory minimum, the applicants are entitled to receive the entire application money as refund, within a period of six weeks from the date of disclosure of the subscription. Should the refund be delayed beyond this period, the applicants are entitled to receive, along with the application money, interest at the rate of 15% p.a. for the period of delay.
(iv) **Disclosure:** (a) An investor under a mutual fund scheme is entitled to receive information about the net asset value at the intervals not exceeding the months in the case of close-end schemes and one month in the case of open-end schemes. This information should be published in at least two daily newspapers. (b) Every mutual fund is required to publish the audited annual report and audited half-yearly report, through prominent newspapers in respect of each of its schemes, within six months and three months respectively, of the data of disclosure of accounts.

This set of guidelines will go a long way in providing a level playing field to all the mutual funds.

### 5.5 THE ENTRANCE OF LIC IN MUTUAL FUNDS:

Life Insurance industry was nationalized and consequently Life Insurance Corporation of India (LIC) came into existence on 1st September, 1956 by an Act of Parliament. Since then, it is doing Life Insurance business covering entire Indian Territory. LIC has today largest family of savers around 11 crores policyholders. It has nearly 2048 branches and 101 divisional offices. It has its Central Office in Mumbai and has 7 Zonal offices at
Mumbai, Delhi, Kanpur, Calcutta, Hyderabad and Chennai. It has more than 18000 development officers and more than 10 lakhs (10,41,737) agents. It renders multi-dimensional services, such as Life Insurance, Group Insurance, Pension plans, Annuity business etc.

Having such a track record in business activities, LIC established another new venture LIC Mutual Fund. The Board of LIC in its meeting held on November 21, 1988, approved the proposal of LIC setting up mutual fund, named LIC Mutual Fund. Eventually a trust deed setting up the LIC Mutual Fund as a trust was signed on April 20, 1989.

The LIC Mutual Fund was inaugurated on 19th June, 1989, at New Delhi by Hon. Finance Minister, Shri S.B. Chavan. Viewed in the context of the need to push up the savings rate in the country, LIC's decision to float a mutual fund was welcomed and it was hoped that it will be one more institution effective in tapping the savings potential to the country.

The basic objectives of setting up Mutual Fund are:
- to mobilize savings of people, especially from rural and semi-urban areas.

- to provide good returns on investment.

- to assure safety, security and liquidity of capital.

Other institutions under Mutual Funds offer some combination of liquidity, returns and safety. But LIC Mutual Fund will offer investment options with a fourth dimension – Insurance protection. Many of the specific schemes that will be offered by the LIC mutual fund will offer like cover. In concept, it works like this. The investor can set a goal to build a corpus of savings within a certain time frame. Contributions to the mutual funds are made to achieve this, should be unforeseen happens and the investor is no more during the specified time frame, the mutual fund will pay the investor's nominee the full amount originally set as the goal.

LIC MF has, therefore, been established as a catalytic agent between investors and capital market. LIC MF has been recognized under Section 10 (230) of the Income-tax Act, 1961 vide Gazette S.O. 477(E), Part II, Section 3, Sub-section (II) dated 22.6.1989. LIC sponsored the LIC MF. The trust deed was
executed by LIC as a settler. It contributed Rs. 2 crores in which it shall have no beneficial interest. It created a Board of Trustees. In terms of SEBI (Mutual Fund) Regulations, 1993, an Asset Management Company (AMC) called the Jeevan Bima Sahyog Asset Management Company Limited, with an authorized capital of Rs. 5 crores was formed on 20th April, 1994. It has separate Board of Directors.

The administration and the day-to-day operation of the MF is looked after by the AMC. AMC has the Chief Executive who looks after day-to-day affairs with the help of a dedicated team of employees drawn from LIC and some are directly recruited.

LIC MF has made an agreement with Central Bank of India for collection of subscriptions under its different schemes through designated branched. Funds collected are invested in the light of general guidelines of Government and SEBI and the predetermined objectives of the scheme.

Mutual funds float various types of schemes to cater to the requirements of different classes of people. Various types of schemes are:
(i) Open-ended schemes

(ii) Close-ended schemes

(iii) Income schemes

(iv) Growth schemes

(v) Equity-linked Savings Schemes (ELSS)

(vi) Value-added Schemes

(vii) Miscellaneous Schemes

- Unit linked Insurance Scheme

- Children's Gift Growth Plan

- UTI's Senior Citizen's Unit Plan

- Children's College and Career Fund Scheme

- LIC Mutual Fund's Dhanvidya etc.

The following Chart-5.4 depicts the various types of schemes floated by Mutual Fund:

(1) **Open-ended schemes**-

(a) These are available for subscription all the year round excluding the period of book-closing.
(b) Open-ended schemes may or may not have a specified redemption period.

(c) Sale and purchase prices are fixed by the mutual fund concerned from time to time.

(d) Repurchases are generally allowed at specified rates.

(e) Each open-ended scheme must have a minimum corpus of Rs. 50 crores. In case the fund manager is unable to raise this amount at the time of issue or 60% of the targeted amount, whichever is higher, the entire subscription must be returned to the investors.

Chart – 5.4

**MUTUAL FUND SCHEMES**

- Fundamental Basis
  - Open-End Schemes
  - Close-End Schemes

- Geographical Basis
  - Domestic Funds
  - Overseas Funds

- Income Schemes
  - Growth Schemes
  - Income-cum Growth Schemes

- Equity-linked Saving Schemes (ELSS)

- Tax-saving Schemes

- Regular Income Schemes
- Monthly Income Schemes
- Cumulative Income Schemes
(2) **Close-ended schemes**-

(a) Close-ended schemes are open for subscription only during a specified period.

(b) Usually the redemption period is also specified.

(c) The duration of the scheme varies, usually it is 5 to 7 years.

(d) Repurchase during the intervening period may or may not be allowed.

(e) Many of these schemes are listed on stock exchanges.

(f) Each open-end fund must have a minimum corpus of Rs. 20 crores. In case the fund manager is unable to raise this amount at the time of issue or 60% of the targeted amount, whichever is higher, the entire subscription must be returned to the investors.

(3) **Income schemes**-

(a) Income schemes provide returns in the forms of dividends.

(b) The returns may be cumulative.

(c) The returns may be non-cumulative on a monthly, quarterly, half-yearly or yearly basis.
(d) Mutual funds carry market risks and therefore they are prohibited by SEBI from declaring any guaranteed rate of returns.

(e) In addition to the regular returns, there is some marginal growth also as reflected in the bonus declared from time to time.

(f) In view of the regular, consistent and steady flow of returns to the investors, the corpus is invested predominantly in fixed income securities like debentures, bonds, government securities etc. of course, funds are invested in shares but relatively at lower percentage.

(4) **Growth funds**

(a) They are generally close-ended schemes.

(b) The objective of such schemes is to provide capital appreciation to their investors. Accordingly a substantial part of the corpus is invested in equities and convertible debentures.

(c) They are listed on stock exchanges.
(d) The capital appreciation is disclosed in their market quotations.

(e) They may or may not declare dividends.

(f) Growth schemes may be "Pure growth fund schemes" which mean they are not declaring dividends.

(g) Some of the growth schemes have provision for repurchase by the Mutual Fund after the expiry of a specified period.

(5) **Equity-Linked savings schemes (ELSS)**-

(a) They are popularly known as tax-planning schemes.

(b) They are essentially close-ended schemes.

(c) They are floated by almost all public sector mutual funds in the last quarter of each financial year.

(d) Investment up to a ceiling of Rs. 10,000 provide tax rebate to the extent of 20% (25% in case of artists, writers, dramatists etc.) under Sec. 88 of the Income-Tax Act, 1961.

(e) The duration of the scheme is 10 years.

(f) Repurchases are allowed after a specified period usually three years.
(g) They are listed on stock-exchanges.

(h) During the lock-in-period of three years these units cannot be traded, pledged or transferred.

(6) **Value added schemes**-

In addition to income/ growth schemes, some of the mutual funds schemes have the provision for 'Value addition'. This is usually in the nature of personal insurance cover for accidents etc.

(7) **Miscellaneous schemes**-

(a) They are designed to serve specific purpose like children's education, hospitalization expenses, schemes for senior citizens, insurance cover etc.

(b) Usually they are open-ended schemes.

(c) Investment matures after specified period or on fulfillment of the objective of the scheme.

(d) Dividend accrued each year is usually re-invested.

(e) These are neither traded nor transferable.

(f) They are not listed on Stock Exchanges.
5.6 INVESTMENT POLICY OF LIFE INSURANCE CORPORATION'S MUTUAL FUNDS:

The main objective is to discuss the investment policy as disclosed by the mutual fund offer documents and as reflected in the asset allocation at the end of the accounting year. This is of vital importance to the investor in determining the returns and it is this era that the expertise in fund management is put to test.

An Investment policy in concept may be regarded as a verbalized version of a definite course of action to be pursued by a mutual fund in regard to its investments. For implementing a policy so evolved, a decision or asset of decisions will have to be taken which may be regarded as policy decisions. For instance, a mutual fund or an income-oriented scheme may decide not to invest more than 30% of its funds in equity shares and for a growth scheme, not to invest more than 40% of its funds in debentures and bonds. In accordance with the investment objective of the scheme, mutual funds may select and invest in various types of securities such as equity shares, fixed income securities and money market securities. The allocation of securities in each scheme depends upon the investment objective.
of the scheme, subject to stipulations laid down by SEBI regulations.

Risk is an important characteristic of any investment avenue. A mutual fund scheme should state the risks involved in the scheme, essentially the market risk. A note regarding the level of market risk, and whether the level of risk is sustained or varied as market changes is essential.

In order to facilitate diversification and to restrict the mutual funds in the involvement of unfair practices, SEBI regulations impose certain restrictions on investments. Mutual Funds have to keep in mind these restrictions while formulating the investment policy.

For any mutual fund scheme, it is vital to have investment policy in writing. It is the explicit linkage between the scheme's long-term investment objectives and the daily work of the investment manager. The principal reason for articulating a long term investment policy in writing is to enable the investor and the manager to protect the portfolio from ad-hoc revisions. The usefulness of the investment policy depends upon the clarity and rigour with which the stated investment objectives are achieved.
A study of offer documents reveals that, in spite of the stated importance, the Indian mutual funds have ignored this aspect when they started mobilizing huge funds from the investors.

The offer documents of the schemes launched by LICMF in the year 1989 do not contain any information about the investment policy of the schemes. The funds were mobilized without stating where they are going to be invested. During 1990 and 1991 the offer documents contained a few words on investment policy of the schemes. Unfortunately, these are worded in such a style that an investor cannot get a fair idea about the actual deployment of his funds. For example, Dhanavarsha (2), (3) and (4), Dhanshree 91 and Dhanlakshmi Schemes of LIC Mutual Fund launched during the period 1990 and 1991 states:

"Efforts will be made to carry maximum rate of return by investing the funds in permitted instruments in capital market. There is also the possibility of reasonable capital appreciation by the end of the scheme period."

These are merely descriptive and generalizations cannot be drawn out of these statements. It can be stated that the offer
documents of the LIC MF schemes commenced during 1989 and 1991, do not contain neither the proposed development of funds nor the types of securities in terms of return and risk. Thus, the essential components of the investment policy are completely ignored by the LICMFs.

Since 1992, the LICMFs started disclosing about their investment policy by adding an element of objectivity. SEBI also made compulsory on the part of mutual funds to include the following statement in the offer documents:

"Mutual Funds and securities investments are subject to market risks and there can be no assurance or guarantee of returns by the trustees sponsoring institutions. The returns mentioned are not guaranteed but only indicative, based on the investment policy of the fund."

The above statement is a highly generalized one, which indicates the external realm of investments and markets, but each scheme should state about the risk factors more clearly.
The offer document of Dhanaraksha (5) of LIC Mutual Fund launched in June 1992, has specified about investment policy of the scheme as follows:

"The scheme being income and growth oriented, the proposed investment pattern of the funds collected would be as under:

- Debentures / Bonds 70% to 75%
- Equities 15% to 20%
- Money Market Instruments 10% to 15%

From the above, it is evident that the policy has clearly specified the types of investment and the proportion of investment to be made in each instrument. In September, 1994, LIC Mutual Fund launched Dhanaasamridhi, a pure growth oriented scheme. The investment policy, as stated in its offer document, contains the types of investment, their risk and the proportion of investment, the policy also contains in which Industries the funds are going to be invested. In the case of debt investments, LIC Mutual Fund has stated the quality of instrument in terms of rating. It is a welcome trend in the disclosure practice of the investment policy. However, the risk indicated in the offer documents is descriptive and provides only rough idea about the
risk. It is suggested that the LIC Mutual Fund should come to a consensus on the quantification of risk and its disclosure in the offer document.

The investment policy followed by LICMF is governed by the type of scheme. A growth scheme would have a predominant accent on equities. For an income scheme, high degree of investment in debt instruments is required to generate a steady flow of returns to investors. LICMF mobilizes funds from various mutual funds schemes. Those funds are invested in different categories such as equity shares, debentures and bonds, government securities, deposits and others. The funds are invested keeping in mind the safety, liquidity and yield. A detailed study on LICMF investment policy is given in the following table:
### Table 5.5

**Investment Pattern of LIC Mutual Fund**

(Rs. in Crores) – Figures in Parenthesis indicate Percentage of the total

<table>
<thead>
<tr>
<th>Year</th>
<th>Equity share</th>
<th>Debentures bonds including private placed</th>
<th>Government securities including Treasuries bills</th>
<th>Public sector bonds</th>
<th>Other</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1990-91</td>
<td>48.94 (9.33)</td>
<td>100.56 (19.18)</td>
<td>29.31 (5.59)</td>
<td>71.34 (13.60)</td>
<td>274.30 (52.30)</td>
<td>524.45</td>
</tr>
<tr>
<td>1992-93</td>
<td>280.34 (21.98)</td>
<td>232.49 (26.07)</td>
<td>0.00 (0.00)</td>
<td>101.03 (7.92)</td>
<td>561.43 (44.03)</td>
<td>1275.29</td>
</tr>
<tr>
<td>1994-95</td>
<td>772.79 (48.06)</td>
<td>617.99 (38.43)</td>
<td>0.00 (0.00)</td>
<td>101.03 (6.28)</td>
<td>116.11 (7.23)</td>
<td>1607.92</td>
</tr>
<tr>
<td>1995-96</td>
<td>550.90 (57.42)</td>
<td>253.00 (26.37)</td>
<td>0.76 (0.08)</td>
<td>39.65 (4.13)</td>
<td>115.08 (12.00)</td>
<td>959.39</td>
</tr>
<tr>
<td>1998-99</td>
<td>238.34 (23.57)</td>
<td>645.91 (66.67)</td>
<td>0.00 (0.00)</td>
<td>92.53 (9.55)</td>
<td>2.00 (0.21)</td>
<td>968.78</td>
</tr>
<tr>
<td>2001-02</td>
<td>246.22 (21.69)</td>
<td>762.74 (67.19)</td>
<td>0.00 (0.00)</td>
<td>123.96 (10.92)</td>
<td>2.27 (0.20)</td>
<td>1135.19</td>
</tr>
<tr>
<td>2004-05</td>
<td>236.66 (17.41)</td>
<td>963.65 (70.89)</td>
<td>0.00 (0.00)</td>
<td>154.42 (11.36)</td>
<td>4.62 (0.34)</td>
<td>1359.36</td>
</tr>
</tbody>
</table>

Source: Various Annual Reports of LIC Mutual Funds.

From the above table, it is clear that the assets in LICMFs portfolio are equity shares debentures and bonds, government securities, public sector bonds and others totally spread.
Investment in equity shares has gone up from 9.33% in 1990-91 to 57.42% in 1995-96 showing increasing trend and after 1995-96, LICMF's investment in equity shares starts declining, i.e. from 57.42% in 1995-96, it came down to 17.41 in 2004-05.

Investment in debentures and bonds has gone up from 19.18% in 1990-91 to 66.67% in 1998-99 revealing an increasing trend. Investment in government securities has gone down from 5.59% in 1990-91 to zero in 2004-05. Investment in public sector bonds has gone down to 4.13% in 1995-96 from 13.60% in 1990-91. But after 1995-96, investment in Public Sector bonds starts increasing from 4.13% in 1995-96 to 11.36% in 2004-05. Similarly, investment in "others" category has gone down to only 0.34 in 2004-05 from 52.30% in 1990-91.

There is a shift in investment pattern due to slow down of investment in Government securities and public sector bonds to enhancing investment in equity and debentures. This shift might have necessitated owing to launch of, both growth schemes and income schemes.

The high investment in equity shares by LICMF till 1995-96 indicates that the funds exposed to higher risk, consequently
this has an impact on the performance. After 1995-96, by investing low proportion in equity shares LICMF has a relatively less risk than the other mutual funds, considering that the investment philosophy is safety, which is much ensured by LICMF schemes than the others. In other words LICMF has now become more cautious about the safety of the investment so that its investors can get the maximum benefit.

Now-a-days, LICMF has invested sizeable resources in debt instruments. It is expected that in the sluggish stock market conditions, the schemes of LICMF shall perform better than the others. The investment pattern and its impact on the performance is strongly associated with the investment objectives of the schemes rather than institutions.

The LICMF schemes have four major types of investment objectives – growth, income-cum-growth, income and tax planning. In growth schemes, major portion of fund is invested in equity sharcs. Since the performance of these schemes largely depends upon the stock market movements, the associated risks also are very high. Now-a-days the depressed market conditions affect the investors' interest in mutual funds. Growth oriented
equity schemes drew poor response from investors. When LICMF launched pure growth scheme 'Dhanasamridhi' in 1994, it was able to invest more than thirty-five crores of rupees in equities and debentures but in the year 2004-05, its investment has gone down. This is due to depressed market conditions which has negative effect on the market value of equity shares.

LICMF's income-cum-growth schemes are concentrated on the safety of the principal amount with a regular income and as the age of the schemes increase, they focused on capital appreciation by increasing the investment in equity shares. These are moderately risk-oriented schemes and hence, the returns are also moderate. Maximum number of schemes launched by LICMF are income-cum-growth type till 1992-93 but after 1992-93 LICMF shifts its concentration on other type of schemes because of depressed market conditions.

In income-oriented schemes, a higher proportion of funds is invested in debentures, bonds and other fixed income securities. Low percentage of equity investment indicates that these schemes are less risk oriented. In the state of sluggish stock markets, income schemes perform better than growth schemes. As these
schemes are required to distribute regular income as dividend, the proportion of investment in money market securities and deposits is higher than the schemes with other investment objectives. Till now LICMF has only one income scheme with two options i.e. Dhanavarsha (1) launched in May, 1990. After that most schemes launched by LICMF are of income-cum-growth types.

LICMF’s tax planning schemes provide two benefits and long-term capital growth. In these types of schemes, huge investment is in equity shares. The investment pattern indicates that similar to the growth schemes, these are highly risk-oriented and the performance would largely depends upon the state of the stock markets. LICMF has six tax-planning schemes but all the schemes are not very popular amongst the investors.

It can be concluded that, the growth and the tax-planning schemes are high return and risk oriented with less safety for principal amounts. Whereas the income schemes are low return and risk-oriented with higher safety for the principal amount. Income-cum-growth schemes constitute a balance between these two types with moderate return and risk and maximum number of schemes of LICMFs are of income-cum-growth type.