CHAPTER : 4

MANAGEMENT OF MUTUAL FUNDS
CONSTITUTION OF MUTUAL FUNDS

A mutual fund is a specialized type of financial institution which acts as an investment mediator for investors at large especially the small investors. As the authorities are more concerned about the safety of investors, the regulations are drafted to give a specific direction to the constitution of a mutual fund. In India the Securities Exchange Board of India (SEBI) regulates the Mutual Fund sector. The guidelines applicable to mutual funds are set out in the SEBI (Mutual Funds) Regulations, 1996. These provisions were designed to safeguard investor interests, check speculative activities expected of mutual funds and ensuring financial discipline through transparency and fair play. Regarding constitution, SEBI regulations require a four-tier system to organize mutual fund which include different independent agencies for various roles. They include a Sponsor, Trustees, Custodians and Asset Management Company. The four tier system has been provided to ensure arm's length distance between the 'sponsor' and 'the fund'. SEBI's guidelines have made it clear that sponsors will not be able to use the corpus of the funds for their own benefit.

(i) The Sponsor

The promoter of a mutual fund is referred as a Sponsor. The regulation states that a sponsor is "any person who, acting alone or in combination with another body corporate, establishes a mutual fund." SEBI also prescribes that a sponsor should have a sound track record and general reputation of fairness and integrity in all business transactions. Here the sound track record menas;

➢ Carrying on business in financial services for a period of not less than five years.
➢ Having a profit, after providing for depreciation, interest and tax, in three out of the immediately preceding five years, including in the fifth year.
➢ Having a positive net worth in all the immediately preceding five years.
In the immediately preceding year, having a net worth that is more than the capital contribution of the sponsor in the Asset Management Company (AMC).

The sponsor has to contribute at least 40% to the net worth of the AMC and he or any of its directors, or the principal officer to be employed by the mutual fund should not be guilty of fraud or convicted of an offense involving moral turpitude or found guilty of any economic offence.

(ii) Trustees

A trustee is a person who holds the property of the mutual fund in trust for the benefit of the unit holders. A trustee should observe and ensure that AMC is managing schemes in accordance with the trust deed. It is the duty of the trustees to provide information to unit holders as well as to SEBI about the mutual fund schemes. Trustees are to appoint AMC to float the schemes. Some important specifications about trusteeship are:

- Any mutual fund will have a minimum of four trustees.
- Two-thirds of the trustees need to be independent trustees, namely persons, who are not associates of the sponsors, or associated with them in any manner whatsoever.
- An asset management company, or any of its officers or employees, is not eligible to act as trustee of any mutual fund.

Trustees can dismiss the appointed AMC. It is the responsibility of trustees to supervise the collection of any income due to be paid to the scheme. Trustees for their service are paid trusteeship fee which is to be specified in the trust deed. Trustees are to present annual report to the investors. They can call a meeting of the unit holders if a requisition is filed by three-fourth of the unit holders or when majority of trustees decide to windup or prematurely redeem the units or modify any scheme.
(iii) Custodians

' Custodians' is an agency that keeps custody of the securities that are bought by the mutual fund managers under the various schemes. They ensure safe custody and ready availability of scripts. According to SEBI norms, the custodian who is appointed should in no way be associated with the AMC and cannot act as sponsor or trustees to and mutual fund. A custodian is supposed to act only for a single mutual fund unless otherwise approved by SEBI. Some of the important functions of the custodians are:

- Safe keeping of the securities.
- Participation in any clearing system on behalf of the client to effect deliveries of the securities.
- Collecting income or dividends on the securities depending on the terms of the agreement.
- Ensuring delivery of scripts only on receipt of payment and payment only up on receipt of scripts and carrying out regular valuation of assets and accounting records.
- Ensuring timely resolution of discrepancies and failures and Arranging for proper registration or recording of securities.

(iv) Asset Management Company

The investment manager of a mutual fund is technically called as the Asset management Company (AMC). An AMC is appointed by the sponsor or the trustees. It manages the affairs of the mutual fund. It is responsible for operating all the schemes of the fund and can act as the AMC of only one mutual fund. Only activities which are in the nature of management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis can be undertaken by the AMC. With the permission of SEBI, it can also operate as an underwriter. To ensure an efficient management, SEBI has put forward many requirements and mode of operation on the working of AMCs.
The working of an AMC revolves around the investment functions. Here the fund manager is responsible for managing the funds of an AMC. The fund manager should desirably be an independent agency, as is the practice in USA. But according to the practices in India, a single fund manager handles many schemes simultaneously. The basic function of a fund manager is to decide the rate, time, kind and quantum of securities to be bought or sold. It is the fund manager who ensures the success of the fund schemes. In the case of bank-sponsored funds, committees are created for the purpose of handling the investment exercise.

The research and planning cell of the AMC undertakes research activities relating to securities as well as prospective investors. The results of the study are analysed to draft future policy governing investment management. It is also possible that the research work is assigned to an outside agency. Creating dealers also comes under the functions of the AMC. They should have a deep understanding of stock market operations in order to execute the sale and purchase transactions in the capital market or money market.

**Chart : 4.1**

**Mutual Funds Operational Flowchart**

Pool their money with

- **Investors** ➔ **Fund Manager**
- **Passed back to**
- **Returns** ➔ **Securities**
- **Generates**
- **Invest in**
The following are some important SEBI regulations 14 to 27 as regards Constitution and Management of Mutual Funds and Operations of Trustees, etc.

**Trust Deed to be registered under the Registration Act (Regulation 14)**

A mutual fund shall be constituted in the form of a trust and the instrument of trust shall be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 (16 of 1908) executed by the sponsor in favour for the trustees named in such an instrument.

**Contents of the Trust Deed (Regulation 15)**

(1) The trust deed shall contain such clauses as are mentioned in the Third Schedule and such other clauses which are necessary for safeguarding the interests of the unit holders.

(2) No trust deed shall contain a clause which has the effect of:

(i) limiting or extinguishing the obligations and liabilities of the trust in relation to any mutual fund or the unit holders; or

(ii) indemnifying trustees or the asset management company for loss or damage caused to the unit holders by their acts of negligence or acts of commissions or omissions.

**Disqualification from being appointed as trustees (Regulation 16)**

(1) A mutual fund shall appoint trustees in accordance with these regulations.

(2) No person shall be eligible to be appointed as trustees unless:

(a) he is person of ability, integrity and standing; and

(b) has not been found guilty of moral turpitude; and

(c) has not been convicted of any economic offence or violation of any securities laws; and

(d) has furnished particulars as specified in Form C.
(3) An asset management company or any of its officers or employees shall not be eligible to act as a trustee or any mutual funds.

(4) No person who is appointed as a trustee of a mutual fund can be appointed as a trustee of any other mutual funds unless;
   (a) such a person is an independent trustee referred to in subregulation (5); and
   (b) prior approval of the mutual fund of which he is trustee has been obtained for such an appointment.

(5) At least 50% of the trustees shall be independent person and no such trustees shall be an associate or a subsidiary or associated in any manner with the sponsor.

(6) In case a company is appointed as a trustee then its directors can act as trustees of any trust provided that the object of the trust is not in conflict with the object of the mutual fund.

Approval of the Board for appointment of trustee (Regulation 17)

(1) No trustee shall initially or any time thereafter be appointed without prior approval of the Board:
Provided further if any trustee resigns or retires, a new trustee shall be appointed with in a period of three months with the prior approval of the Board.

(2) The existing trustees of any mutual fund may form a trustee company to act as a trustee with the prior approval of the Board.

Rights and obligations of the trustees (Regulation 18)

(1) The trustees and the asset management company shall with the prior approval of the Board enter into an investment management agreement.

(2) The investment management agreement shall contain such clauses as are mentioned in the in the Fourth Schedule.
(3) The trustees shall have a right to obtain from the asset management company such information as is considered necessary by the trustees.

(4) The trustee shall ensure before the launch of any scheme that the asset management company has:

(a) systems in place for its back office, dealing room and accounting.

(b) appointed all key personnel including fund manager(s) for the scheme(s) and submitted their bio-data which shall contain the educational qualifications, past experience in the securities market with the trustees, within 15 days of their appointment;

(c) appointed auditors to audit its accounts;

(d) appointed a compliance officer to comply with regulatory requirement and to redress investor grievances;

(e) appointed registrars and laid down parameters for their supervision;

(f) prepared a compliance manual and designed internal control mechanisms including internal audit systems;

(g) specified norms for empanelment of brokers and marketing agents.

(5) The trustee shall ensure that an asset management company has been diligent in empanelling the brokers, in monitoring securities transactions with brokers and avoiding undue concentration of business with any broker.

(6) The trustee shall ensure that the asset management company has not given any undue or unfair advantage to any associates or dealt with any of the associates of the asset management company in any manner detrimental to interest of the unit-holders.

(7) The trustee shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme.
(8) The trustees shall ensure that the asset management company has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company.

(9) The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations.

(10) Where the trustees have reasons to believe that the conduct of business of the mutual fund is not in accordance with the regulations and the scheme that shall forthwith take such remedial steps as are necessary by them and shall immediately inform the Board of the violation and the action taken by them.

(11) Each trustee shall file the details of his holdings in securities on a half-yearly basis with the trust.

(12) The trustees shall be accountable for, and be the custodian of the funds and property of the respective schemes and shall hold the same in trust or the benefit of the unit holders in accordance with these regulations and the provisions of trust deed.

(13) The trustees shall take steps to ensure that the transactions of the mutual fund are in accordance with the provisions of the trust deed.

(14) The trustees shall be responsible for the calculation of any income due to be paid to the mutual fund and also of any income received in the mutual fund for the holders of the units of any scheme in accordance with these regulations and the trust deed.

(15) The trustees shall obtain the consent of the unit holders;

(a) whenever required to do so by Board in the interest of the unit holders; or

(b) whenever required to do so on the requisition made by three fourths of the unit holders of any scheme; or
(c) when the majority of the trustees decide to wind up or prematurely redeem the units; or
(d) when any change in the fundamental attributes of any scheme or the trust of fees and expenses payable or any other change which would modify the scheme or affect the interest of the unitholders is proposed to be carried out unless the consent of not less than three-fourths of the unit holders is obtained.

Provided that no such change shall be carried out unless three-fourths of the unit holders have given their consent and the unit holders who do not give their consent are allowed to redeem their holdings in the scheme.

(16) The trustees shall call for the detail of transactions in securities by the key personnel of the asset management company in his own name or on behalf of the asset management company and shall report to the Board, as and when required.

(17) The trustees shall quarterly review all transactions carried out between the mutual funds, asset management company and its associates.

(18) The trustees shall continuously review the networth of the asset management company and in case of any shortfall, ensure that the asset management company make up the shortfall as per clause (f) of sub-regulation (1) of regulation 21.

(19) The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that such contracts are executed in the interest of the unitholders.

(20) The trustees shall ensure that there is no conflict of interest between the manner of deployment of its networth by the asset management company and the interest of the unitholders.

(21) The trustees shall periodically review the investor complaints received and the redressal of the same by the asset management company.
(22) The trustees shall abide by the Code of Conduct as specified in the Fifth schedule.

(23) The trustee shall furnish to the Board on a half-yearly basis;
   a) a report on the activities of the mutual fund;
   b) a certificate stating that the trustees have satisfied themselves that there have been no instances of self-dealing or front running by any of the trustees, directors and key-personal of the asset management company;
   c) a certificate to the effect that the asset management company has been managing the schemes independently of any other activities and incase any activities of the nature referred to in sub-regulation (2) of regulation 24 have been undertaken by the asset management company and has taken adequate steps to ensure that the interest of the unit holders are protected.

Application by an asset management company (Regulation 19)

(1) The application for the approval of the asset management company shall be made in Form D.

(2) The provision of regulations 5, 6 and 8 shall, so far as may be, apply to the application made under sub-regulation (1) as they apply to the application for registration of a mutual fund.

Appointment of an asset management company (Regulation 20)

(1) The sponsor or, if so authorized by the trust deed, the trustee shall appoint an asset management company, which has been approved by the board under sub-regulation (2) of regulation 21.

(2) The appointment of an asset management company can be terminated by majority of the trustees or by seventy five percent of the unit holders of the scheme.

(3) Any change in the appointment of the asset management company shall be subject to prior approval of the Board and the unitholders.
Eligibility criteria for appointment of asset management company

(Regulation 21)

(1) For grant of approval of the asset management company the applicant has to fulfill the following;

(a) in case the asset management company is an existing asset management company it has a sound track record, general reputation and fairness in transactions;

(b) the directors of the asset management company are persons having adequate professional experience in finance and financial services related field and not found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws;

(c) the key personnel of the asset management company has not been working for any asset management company or mutual fund or any intermediary whose registration has been suspended or cancelled at any time by the board.

(d) the board of directors of such asset management company has at least fifty percent directors, who are not associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees;

(e) The chairman of the asset management company is not a trustee of any mutual fund;

(f) the asset management company has a networth of not less than rupees ten crores;

Provided that an asset management company already granted approval under the provision of Securities and Exchange Board of India(Mutual Funds) Regulations, 1993 shall with in a period of twelve months from the date of notification of these regulations increase its networth to rupees ten crores.
(2) The board may, after considering an application with reference to the matters specified in sub-regulation (1), grant approval to the asset management company.

Terms and conditions to be complied with (Regulation 22)

The approval granted under sub-regulation (2) of regulation 21 shall be subject to the following conditions, namely;

(a) any director of the asset management company shall not hold the office of the director in another asset management company unless such person is an independent director referred to in close (d) of sub-regulation (1) of regulation 21 and approval of the Board of asset management company of which such person is a director has been obtained;

(b) the asset management company shall forthwith inform the Board of any material change in the information or particulars previously furnished, which have a bearing on the approval granted by it;

(c) no appointment of a director of an asset management company shall be made without prior approval of the trustees;

(d) the asset management company undertakes to comply with these regulations;

(e) any change in controlling interest of the asset management company shall be only with prior approval of trustees, the Board and the unitholders;

(f) the asset management company shall furnish such information and documents to the trustees as and when required by the trustees.

Procedure where approval is not granted (Regulation 23)

Where an application made under regulation 19 for grant of approval does not satisfy the eligibility criteria laid down in regulation 21, the board may reject the application.
Restrictions on business activities of the asset management company

(Regulation 24)

The asset management company shall (1) not act as a trustee of any mutual fund; (2) not undertake any other business activities except activities in the nature of management and advisory services of offshore funds, pension funds, venture capital funds, management of insurance funds, financial consultancy and exchanges of research on commercial basis if any of such activities are not in conflict with the activities of the mutual fund:

Provided that the asset management company may itself or through its subsidiaries undertake such activities if it satisfies the Board that the key personnel of the asset management company, the system, back office, bank and securities account are segregated activity wise and their exist systems to prohibit access to inside information of various activities;

Provided further that asset management company shall meet capital adequacy requirement, if any, separately for each such activity and obtain separate approval, if necessary under the relevant regulations;

(3) the asset management company shall not invest in any of its scheme unless full disclosure of its intention to invest has been made in the offer documents:

Provided that an asset management company shall not be entitled to charge any fees on its investment in that scheme.

Asset Management Company and its obligations (Regulation 25)

(1) The asset management company shall take all responsible steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of the regulations and the trust deed.

(2) The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.
(3) The asset management company shall be responsible for the acts of commission or omissions by its employees or the persons whose services have been procured by the asset management company.

(4) The asset management company shall submit to the trustees quarterly reports of each year on its activities and the compliance with these regulations.

(5) The trustees at the request of the asset management company may terminate the assignment of the asset management company at any time:

Provided that such termination shall become effective only after the trustees have accepted the termination of assignment and communicated their decision in writing to the asset management company.

(6) Notwithstanding anything contained in any contract or agreement of termination, the asset management company to its directors or other officers shall not be absolved of liability to the mutual fund for their act of commission or omissions, while holding such position or office.

(7) No asset management company shall deal in securities through any broker associated with the sponsor or a firm which is an associate or a sponsor beyond 5% of the daily gross business of the mutual fund.

(8) An asset management company shall not utilize the services of the sponsor or any of its associates, employees or their relatives, for the purpose of any securities transaction and distribution and sale of securities:

Provided that an asset management company may utilize such services if disclosure to that effect is made to the unit holders and the brokerage on commission paid is also disclosed in the half-yearly annual accounts of the mutual fund.

(9) The asset management company shall file with trustees the details of transactions in securities by the key-personnel of the asset management company in their own name or on behalf of the asset
management company and shall also report to the Board as and when required by the Board.

(10) In case the asset management company enters into any securities transactions with any of its associates a report to that effect shall immediately be sent to the trustees.

(11) In case any company has invested more than 5% of the net asset value of a scheme, the investment made by the scheme or by any other scheme of the same mutual fund in that company or its subsidiaries shall be brought to the notice of the trustees by the asset management company and be disclosed on the half-yearly and annual accounts of the respective schemes with justification for such investment.

(12) The asset management company shall file with the trustees and the board;
   (a) detailed bio-data of all its directors along with their interest in other companies within fifteen days of their appointment; and
   (b) any change in the interest of directors every six months.

(13) A statement of holdings in securities of the directors of the asset management company shall be filed with the trustees with the dates of acquisition of such securities at the end of each financial year.

(14) The asset management company shall not appoint any person as key personal who has been found guilty of any economic offence or involved in violation of securities laws.

(15) The asset management company shall appoint registrars and share transfer agents who are registered with the Board.

Provided if the work relating to transfer of units is processed in house, the charges at competitive market rates may be debited to the scheme and for rates higher than the competitive market rates, prior approval of the trustees shall be obtained and reasons for charging higher rates shall be disclosed in the annual accounts.
(16) The asset management company shall abide by the Code of Conduct as specified in the Fifth schedule.

**Appointment of Custodian (Regulation 26)**

(1) The mutual fund shall appoint a custodian to carry out the custodial services for the scheme of the fund and sent information of the same to the Board with in fifteen days of the appointment of the custodian.

(2) No custodian in which the sponsor or its associates hold 50% or more of the voting rights of the share capital of the custodian or where 50% or more of the directors of the custodian represent the interest of the sponsor or its associates shall act as custodian for a mutual fund constituted by the same sponsor or any of its associate or subsidiary company.

**Agreement with custodian (Regulation 27)**

The mutual fund shall enter into a custodian agreement with the custodian, which contain the clauses which are necessary for the efficient and orderly conduct of the affairs of the custodian:

Provided that the agreement, the service contract, terms and appointment of the custodian shall be entered into with prior approval of the trustees.

**ORGANIZATION & MANAGEMENT OF MUTUAL FUNDS**

The organization and management of a mutual fund involves a broad range of activities which starts with the registration of a mutual fund. At first, the sponsor needs to apply to SEBI in the prescribed format for registering the mutual fund. With the application fee of Rs.25,000, drafts of the investment management agreement, trust deed and custodian agreement are to be sent along with the application. SEBI will review the application against the eligibility criteria. Based on this either a certificate of registration
would be granted or the application for registration would be rejected. The registration is subject to payment of a registration fee of Rs.25,00,000.

If this first step is over, the sponsor would setup the trust through the trust deed. If the sponsor has opted for the trustee company route, then this company would need to be incorporated. Then the sponsor would promote the AMC, if it is not already in existence. If the AMC already exists which is approved by SEBI, either the sponsor or (if permitted by the trust deed) the trustees will appoint the AMC for the mutual fund. Now the Investment Management Agreement would be executed between the trustees and the AMC.

In the next stage, the mutual fund should enter into a custodian agreement with the custodian for the securities in which its schemes would invest. Other than this, the trustees would appoint a statutory auditor for the mutual fund, who would audit the various schemes to be promoted by the mutual fund.

An Asset Management Company plays an important role in the organization and management of a mutual fund. It will have different sections to perform separate set of specified activities. These different sections can be General Administration, Accounts, Investment, Marketing, Research etc. Depending on the strategies they follow, some of the specified activities may be performed by some outside agencies.

The different activities involved in the management of a mutual fund can be listed out under the following group of activities.²

**Pre-Issue**

- Designing of a scheme planning department in consultation with marketing department.
- Getting clearance from Board of Trustees.
- Sending the draft of the scheme to SEBI for approval.
- Follow-up with SEBI and getting green signal.
✓ Opening of new accounts and separate books of accounts for each scheme.
✓ Appointment of statutory auditors who would audit the accounts of the company.
✓ Appointment of Registrar to the scheme, Custodian and collecting bankers.
✓ Putting in place guidelines for empanelment of brokers for purchase and sale of securities by the mutual fund schemes, and distributors who would distribute the schemes of the mutual fund.
✓ Evolve marketing strategies and engaging services of advertising agencies.
✓ Printing of required stationary, offer documents, application forms, etc.
✓ Advertisement Campaign is launched.
✓ Distribution of offer document and application.
✓ Printing of unit certificates, allotment letters, etc. and sending these to registrar to the issue.
✓ Opening of schemes and collection by centres.
✓ Collection received by Head Office along with application forms which are passed on to the Registrar to the issue.
✓ Appointment of a compliance officer and key personnel including fund managers.

Post-Issue

Operating a Scheme

✓ Short-term call-money market investments start.
✓ Registrar prepares the records and sends allotment letters and or unit certificates to investors.
✓ Sending relevant records to investor centres.
✓ Payments of commission to agencies engaged.
✓ Settling customers complaints.
✓ Order for procuring investment from market by Investment Department as per investment plans.
✓ Payments released by Finance and Accounts department from respective accounts for investments made.
✓ Delivery of investment documents to the custodians.
✓ Sale of investments and payments received.
✓ Reconciliation of investments as per the books and as per the physical documents with custodians.
✓ Regular disclosures made at desired intervals.
✓ Subsequent sale of units.
✓ Repurchase of units from investors.
✓ Receiving incomes e.g. profits on sale of investments, dividends, interest, underwriting commission, etc. from companies.
✓ Compilation of expenses for operating the scheme.
✓ Final Accounts prepared by Accounts Department in consultation with department engaged in business development and marketing.
✓ Approval of dividend by Board of Trustees.
✓ Final Accounts audited and adopted.
✓ Dividend warrants sent to unit holders.
✓ Post-issue process continues for open-ended schemes.

Winding Up a Scheme
✓ Issue a notice for winding up of a scheme.
✓ Estimating value of investments on maturity date.
✓ Approval of the maturity rate.
✓ Announce the maturity rate.
✓ Investors surrender unit certificates.
✓ Investments are sold in the market.
✓ Maturity/ redemption cheques prepared and sent to investors.
✓ Books of accounts closed.

Some of the major operational activities of a mutual fund can be list out as:

(a) Designing a Scheme
(b) Launching a Scheme
(c) Marketing a Scheme  
(d) Portfolio Management  
(e) Fund Investment Strategies  

(a) Designing a Scheme  

It is an important decision taken by the mutual fund to float a scheme which is attractive and suitable for investors' need. Should it be an open ended or closed ended? Further should it be growth-oriented, income-oriented, balanced or industry specific scheme? To decide about all these, many aspects need to be analysed.  

- Investors' preference in case of the type of scheme should be taken into consideration. Those investors who are not interested in transacting at stock exchange may prefer open-ended scheme and investors preferring liquidity may also prefer open-ended schemes.  
- Decision relating to the nature of the scheme as income, growth, thematic etc.  
- Expertise available with the AMC should be taken into consideration. If a mutual fund wants to float a new industry specific scheme, it requires the expert in that specific field.  
- A detailed plan of assets allocation or investment plan relating to the scheme.  
- Should have the capacity to assess the strength and weakness of competitors to penetrate their segments.  
- Decision about the different options (like SWP, SIP, STP etc.) to attach to a scheme.  

Such factors may be considered differently by different mutual funds. That is why at one time different type of schemes may emerge in the market from different mutual funds. Innovation in the field of schemes which is suitable to the investor needs is always welcomed by the investors. It will be benefit to the investors as well as economy. Product variety in schemes will attract investors only if these are nearer to his need of financial assets. For the
economy, such innovations will activate ‘value discovery’ through professional fund management.

(b) Launching a Scheme

After designing a scheme, the AMC should submit it with SEBI for approval. The AMC should prepare the offer document which has to contain adequate disclosures to enable investors to make an informed investment decision. This also needs to be filed with SEBI, which has a period of 21 working days to stipulate modifications. The AMC can issue the offer document after this period.

Keeping in mind the profile of the prospective investors, the regulations provide that information in the offer document has to be presented in “simple language and in a clear, concise and easily understandable manner”. Minimum disclosure requirements are set out in SEBI’s “Standard Offer Document”. Besides, SEBI has also laid down certain “Standard Observations” that need to be incorporated in the offer document. The standard Offer Document prescribes the “nature of the disclosures” but not the “layout or the language”, except that Items I (cover page), II (definitions), and III (risk factors) must appear in the same numerical order in the Offer Document. A mutual fund is free to add any other disclosure provided such information is not presented in an “incomplete, inaccurate or misleading manner”.

Offer Document is issued only once in the case of closed-end schemes. Since open-end schemes sell units on an ongoing basis, mutual funds have to revise and update the Offer Document of such schemes regularly. A revised Offer Document needs to be printed at least once in two years. When an open-ended scheme has completed one year, and thereafter each year, the condensed financial information of the scheme has also to be included in the Offer Document.

Offer documents and sales literature are more informative and self-contained. They include not only information about the scheme, its
characteristics, buying, selling, redeeming, investment strategy, portfolio strategy, portfolio turnover etc., but also the rights of investors, duties of trustees, AMC and a well-defined due diligence. Due to these informative scripts, investors are able to take more informed decisions than a few years ago.

(c) Marketing a Scheme

One best designed scheme may fail to have a good investor backing in the absence of its systematic marketing. The launching time is a very important factor in the success of a scheme. There are two aspects of time of launching, one is from investor point of view, i.e. fund must ensure that prospective investors have surplus liquidity at the time of launching. Secondly time has a relevance from mutual fund point of view in the sense that collection of fund should be at such a time when capital market is at boom and its down trend is expected in a period by when collections are in hand of fund. This is so because it will give an ample opportunity to invest in a market at its lower ebb.

It is evident from the fact that more than a hundred mutual fund schemes were launched in the year 2005. It was on the backing of a securities market boom. There have been record fund collections from various equity schemes these times. Some are; Franklin India Flexi Cap (Rs. 1,950 Crore), Reliance Equity Opportunities (Rs. 1,761 Crore) HDFC Premier Multi-Cap (Rs. 1,328 Crore) Tata Infrastructure (Rs. 739 Crore).

The marketing strategy of a fund should be designed by taking into account different factors like the reputation of the AMC, Fund Manager, innovative features of the scheme etc. Here it is also important that the targeted consumers are available with different other investment options like post office deposits, different debt market instruments, equities, life insurance Schemes etc. The marketing strategy should make the scheme more attractive than these options by using extensive advertising and consumer education programs.
(d) Portfolio Management

The portfolio management of a mutual fund involves four basic steps:

(i) Setting investment goal of scheme
(ii) Identification of specific securities
(iii) Portfolio designing
(iv) Reviewing the portfolio

The main aim of a new scheme is to earn good returns and thus serve the investor in a best possible way. A thorough study on prospective investors is needed for the sake by the mutual fund houses. Investors' expectations vary from individual to individual depending on their age, income, family structure, education, tax slab etc. No other investment form offers as much design flexibility to suit the investors' needs as mutual fund schemes. One can combine liquidity, risk, return etc. in number of ways to suit a particular category of prospective investors' needs. Thus the mutual fund manager has to evolve a portfolio and set investment goals through a process of compromising in a way which satisfies majority of clients which the scheme aims at.

Once the goal of a scheme clearly spelled out, the fund manager has to involve himself in a security analysis to identify securities which can be combined to meet the goal requirements. For each security, risk and return characteristics are evaluated in broader perspective. As institutional investors like mutual funds have to satisfy a variety of investors on different fronts special schemes are to be designed for different requirements of different investors. Accordingly investment strategies are to be evolved by the fund managers. For no two schemes same investment strategies can be followed. While launching a scheme, the fund managers have to do a lot of research work as the broad portfolio mix has to be specified by the fund manager. i.e., which shares, debentures etc. are to be bought, how much, when etc. Thus a fund manager should try to create a well-diversified portfolio of securities to reduce significantly unsystematic risk and associate expected returns on individual security and portfolio.
Once build up portfolio may not be continued for all times to come since the risk return characteristics of all securities go on changing with time. In a dynamic investment world it is natural that once designed portfolio may not perform desired. Further new securities may introduce in the market and old one may fade out. Thus, to stick to a portfolio is not desirable. To maximise the return on investment, all possible favourable opportunities are to be availed. Thus a turnover in the portfolio is a must.

(e) Fund Investment Strategies

Investment strategy, like portfolio management, is a crucial component of funds management. It has a significant influence on future risk-related returns, as well as major impact on the unit holders' decision-making process. Therefore, the investment policy of a fund and the style and strategy of the fund manager of a particular scheme need to be clearly outlined. So that prospective unit holders can take informed decision. Most of the funds remain silent on the specific strategies to be pursued by them. What they mention in very broad terms is their intention to conduct investment operations within the regulatory frame work to earn the maximum possible return. But such a practice is against the principle of disclosure and will affect the decision making process of the ultimate investors. For example, following are the 'investment objectives' provided of two well performing funds of UTI in its bulletin (September – October 2005 issue);

**UTI Master Share:** An open-end equity fund aiming to provide benefit of capital appreciation and income distribution through investment in equity.

**UTI Dynamic Equity Fund:** An open end fund which aims to generate capital appreciation by primary investing in equity / equity related investments. As a defensive strategy arising out of market conditions the scheme may also invest in debt/money market instruments.
Here in both the cases, any specific fund management strategy is not clearly mentioned. If a clear and specific strategy is not following in the investment management, the funds may suffer from bad performance mainly because the fund managers did not take a scientific and objective look at the investment options available and their personal biases also may affect the investment decision.

STATUTORY REGULATIONS – ROLE OF SEBI & AMFI
SECURITIES EXCHANGE BOARD OF INDIA (SEBI)

Securities Exchange Board of India (SEBI) is the apex body set up by the Government of India on April 12, 1988. To start with, SEBI was setup as a non-statutory body. By passing a separate legislation in the name of Securities Exchange Board of India Act, 1992, SEBI was charged with comprehensive powers over practically all aspects of capital market operations. According to the preamble of the SEBI Act, the primary objective of the SEBI is to promote healthy and orderly growth of the securities market and secure investor protection. For this purpose, the SEBI monitors the activities of not only stock exchanges but also merchant bankers, mutual funds and other intermediaries.

The SEBI Regulations of 1993 were the first direct attempt to bring mutual funds under the structured regulatory framework and give direction to their functioning. New regulations were passed in the year 1996 under Securities Exchange Board of India (Mutual Funds) Regulations 1996. SEBI now acts as an autonomous and powerful regulator of mutual funds in India. It was secured by passing the Securities Law (Amendment) Ordinance, 1995, which empowers SEBI to impose penalties for violation of its regulations. Under this amendment SEBI is also allowed to file complaints in court without prior approval of the Central Government.

SEBI regulations are quite comprehensive and qualitatively superior to those of many other countries. As a visionary, it had framed the regulations aimed at protecting the investor interests, putting measures to make checks
and balances for managers and systematic control over the overall working of mutual fund industry. These are reflected in the regulations like duties, rights and responsibilities of various parties like sponsor, trustees, custodians and asset management companies, the norms for disclosures, formation of audit committee etc. Apart from these, SEBI has taken measures for good corporate governance in mutual funds. These are mainly the guidelines on accounting policy, advertisements, investment restrictions, frequency of disclosure, formation of valuation committee etc. The SEBI (Mutual Funds) Regulations 1996 lay down different measures to protect the mutual funds investors. Some of the important measures can be listed as follows.

- Every mutual fund should be registered with SEBI and the registration will be granted on the fulfillment of certain conditions laid down in the regulations for 'efficient and orderly conduct of the affairs of a mutual fund'.

- The regulations stipulate that the sponsor must have a sound track record and experience in the field of financial services for a minimum period of five years.

- Strict conditions for the appointment of trustees and has specified their obligations, as well as detailed guidelines on the trust deed.

- The Asset Management Company (AMC) is to be approved by SEBI. Strict terms and conditions for the approval of the Asset Management Company. For e.g. AMC should have a net worth of not less than Rs.10 crore.

- The directors of the AMC should be of persons having adequate professional experience in finance and financial services-related fields. The key personnel of the AMC should not have been working for and AMC or mutual fund or any intermediary whose registration has been suspended or cancelled at any time by the board.

- Mutual fund must have a custodian who is to be approved by SEBI, and one of the precondition for approval is a 'sound track-record, general reputation and fairness in transaction'.
➢ No new schemes can be launched by any mutual fund unless the same is approved by the trustees and a copy of the document has been filed with the board.

➢ The AMC should stipulate the minimum amount it seeks to raise under a scheme and the extent of oversubscription to be retained.

➢ There are clear regulatory provisions regarding the listing of close-ended schemes, refunds, transfer and sending of unit certificates to investors.

➢ There are several provisions pre-launch and post-launch disclosure to ensure that investors can take informed decisions on the basis of factual information supplied by the mutual fund.

➢ The prospectus of the fund should disclose the names of the trustees, director of the AMC, investment objectives and strategies, approximate percentage share of investment to be made in various instruments etc.

➢ No guarantee of returns can be given by any scheme unless they are fully guaranteed by the sponsors or AMC, and a statement indicating the manner of guarantee and the name of the person who will guarantee the returns is to be made in the offer document.

➢ Detailed advertisement code is issued by SEBI which are to be followed by mutual funds in making any publicity regarding a scheme and its performance.

➢ All mutual funds are bound to publish a scheme-wise annual report or an abridged summery through an advertisement within six months of the closure of the financial year. A mutual fund is also to publish half-yearly unaudited financial results through an advertisement.

➢ SEBI has specified prescribed norms for investment management with a view to minimising/ reducing undue investment risks.

➢ SEBI has the right to inspect the books of accounts, records and documents of a mutual fund, the trustees, AMC and custodian.
The regulatory framework outlined above indicates that SEBI is a highly powerful regulator. It has the power to take penal actions for violation of the regulations. There is a strong emphasis on ex-post investigation and disciplining of mutual funds through financial penalties. There are enough provisions for disclosure also. Thus the regulatory mechanism and supervisory control are strong enough for protecting the interest of investors.

ASSOCIATION OF MUTUAL FUNDS IN INDIA (AMFI)

Association of Mutual Funds in India (AMFI) is a body which is established as a non-profit organisation on 22 August 1995, which represents the Asset Management Companies (AMCs) in India. It has been formed with the objective of promoting and protecting the interest of mutual funds and their unit holders, increasing public awareness of mutual funds and serving the investors’ interest by defining and maintaining high ethical and professional standards in the mutual funds industry.

AMFI is not a self regulatory organization (SRO). Its recommendations are not binding on the industry participants. AMFI recommendations become mandatory only if and when SEBI incorporates any of them in the regulatory framework it stipulates for mutual funds. It is also noteworthy that various regulatory measures taken by SEBI are on the basis of recommendations of different committees appointed by AMFI.

Within a very short span of time, AMFI has played a proactive role in identifying the steps that need to be taken to protect investors and promote the mutual fund sector. However, it still does not function as an SRO to any significant extent, which is what the mutual fund industry requires today.

AMFI functions under the committee system, the practice which is followed all over the world. Various committees including experts from the industry have been formed and have made very significant contributions in different areas in which mutual fund deals.

The various activities undertaken by AMFI are the following on the basis of its annual reports.
• AMFI has brought out publications on investor awareness, code of ethics, model compliance on mutual funds directory and a standard offer document.

• AMFI is also conducting a testing programme for intermediaries and employees.

• AMFI has formed several committees and submitted their reports to SEBI in order to promote high professional standards. Among the committees are:

  (a) The valuation committee- for valuation of securities, appropriate accounting standards, valuation of traded and non-traded equities and valuation of non-traded debt securities.

  (b) The committee on NPA – to identify and recommend norms for recognizing NPA of mutual funds, as well as the principles and system for provisioning such NPAs; and to suggest the standard and frequency of disclosures.

  (c) The Committee on compliance – to prepare a compliance manual

  (d) The Committee on inspection fees – to suggest the basis for the fees to be paid to the auditors appointed by SEBI

  (e) The committee on advertising guidelines- to finalise comprehensive guidelines for advertisement.

  (f) The committee on derivatives – to formulate guidelines for trading in derivatives

  (g) The committee on investors’ education and training; and

  (h) A committee which has devised the process of certification for intermediaries selling mutual fund products.
AMFI is working on the development of best practices in all areas of mutual funds operation. It is actively associated with SEBI in matters relating to regulations and compliance, among others. In many ways, AMFI, as an association of mutual funds, has played a significant role.

RATINGS OF MUTUAL FUNDS

Rating of mutual fund always helps the investors to make the best possible investment decision. The ratings are always based on an objective judgment of a team of expert from a rating agency. It is expressed in code numbers which can easily comprehended even by the layman investors. It is a common practice in the developed countries in the field of finance and nowadays in India, many research organizations in the field of investments are rating and presenting detailed and timely mutual fund statistics in an easy to use format.

All the rating agencies have designed their products and developed methodologies of rating. These agencies include Credit Rating and Investment Services India Ltd. (Crisil), Credit Analysis and Research Ltd. (CARE), Investment Information and Credit Rating Agency of India (ICRA) etc. Other than these rating agencies, Value Research of New Delhi and Credence of Mumbai are some of the prominent agencies conducting research on mutual funds in India. They are basically involved in post-issue analysis of fund performance. In fact their regular and detailed scanning of select portfolios and rating of performance of the schemes helps the investors keep track of the funds' portfolio and performance.

Some of the leading organizations in this field are;

Crisil (Credit Rating and Investment Services India Ltd.)

Crisil was formed in 1987 and was promoted by the Industrial Credit and Investment Corporation of India Ltd (ICICI) and UTI. Crisil has pioneered the concept of credit rating in India and developed a methodology for rating
corporate debt in the context of India's financial, monetary and regulatory system. Crisil has a tie-up with S&P of the US. Though it has been involved in rating since 1987, it entered the field of mutual funds rating only in 1998.

Rating Methodology:

Crisil's ratings evaluate the credit quality of the portfolio, the fund's systems and procedures, and the management. The agency describes its rating concepts as: 'Rating is an opinion on the credit quality of the funds underlying portfolio holding. The rating is not an opinion on the stability of the NAV of the fund or the timelines of payments to investors in the fund.' Only pure bond funds are rated, i.e., the fund's portfolio holdings should consist entirely of fixed income securities.

Crisil takes into account the various systems and procedures, including the execution of investment decisions, back-office system, various reconciliations and calculation of the NAV. Tracking interest payment and empanelment of brokers are also factored into the rating.

The track record of the management, the quality of key personnel, and the investment strategy are among the factors considered while evaluating the management.

CARE (Credit Rating and Investment Services India Ltd.)

It was established in April 1993, as a credit information and advisory services company. It was promoted by IDBI, UTI, Canara Bank and other leading banks. CARE has also started rating mutual funds, particularly bond funds. Initially it had a tie-up with the US rating agency, Fitch IBCA, but this was discontinued in July 2000.

Rating Methodology:

CARE's ratings are based on information provided by the company, its in-house database, and data obtained from other sources that it considers reliable. While rating a fund CARE also considers its investment objectives,
the experience of its managers and the track record of the AMC, among other things.

**ICRA (Investment Information and Credit Rating Agency of India)**

It was setup in 1991 with the objective of providing rating, information and advisory services. It was promoted as a private limited company by 22 banks and financial institutions. The US rating agency, Moody’s subsequently entered into a partnership with ICRA.

**Rating Methodology:**

ICRA’s methodology of rating separately evaluates two major categories of risk, credit risk and market risk, through ‘Credit Risk Rating’ and ‘Market Risk Rating’ respectively. Both are based on quantitative and qualitative factors. The Credit Risk Rating covers the quality of the portfolio, quality of asset liability management, the risk management system, characteristics of the management, operational procedures and control, regulatory compliance, and so on. The Market Risk Rating covers the credit risk, historical price and total return performance, interest rate risk, liquidity, derivative risk, investment diversification and concentration etc.

**Value Research**

Value Research is an independent entity focused on mutual fund research. They provide a monthly ‘Score Card’ which rates different classes of funds on the basis of their risk and return.

**Rating Methodology:**

Value Research fund rating is a convenient and composite measure of a fund’s return and risk relative to its peers in the category. They measure risk by taking a fund’s return for each month since it was launched and comparing it to the returns given by ‘risk less’ investments. Risk less investments are like the ones backed by the government. A consequence of risk-adjusted ratings is that funds with high gains do not rate vary highly if
they have taken high risks in doing so. The rating is purely quantitative. For equity and hybrid funds, the fund rating for the two time periods (3 and 5 years) are combined. For debt funds, the fund ratings are based on 18-month weekly risk-adjusted performance. They rate an equity fund with a minimum performance history of three years and a debt fund with minimum history of 18 months.

Till now in India, only individual schemes from fund houses were being rated by rating agencies. It is mainly depends on the performance of the scheme. As the Indian financial markets align more and more with the ones around the globe, international best practices are catching up with the domestic mutual fund industry as well. Crisil, the Indian arm of the global rating major Standard & Poor's recently introduced 'Fund House Rating Service' in India. The first fund which was rated by Crisil is HDFC Mutual Fund (a joint venture between HDFC and UK-based Standard Life Investments). It received 'Fund House Level 1' rating, the highest rating.

INNOVATIONS IN THE MUTUAL FUND INDUSTRY

Mutual funds in India has shown a tremendous growth in the past two three years. It is an indicator of the fast development of our economy. Just like the consumption behaviour of a common Indian, the saving pattern too is changing significantly. The latest proof of this comes from figures for funds under management of all mutual fund schemes in India. On March 31, 2005, all the mutual fund schemes in India were managing a total corpus of Rs. 1,49,000 crore. By the end of September, that figure had climbed to Rs.2,00,000 crore. i.e, an addition of Rs. 50,000 crore in six months. It had taken over 40 years for the mutual fund industry to draw assets worth Rs.1,50,000 crore, but it took just six months to leap to Rs.2,00,000 crore. In other words, one-fourth of India's 40 year old mutual fund industry was created only in the past six months.

When we analyse the factors behind this extra growth, we can find that it is a combination of two factors; the inflow of fresh investments in
mutual fund schemes—both new and old and a rise in the value of investment. Indian mutual fund industry already has shown maturity in the past by rolling out dozens of pioneering products in active collaboration with foreign joint venture partners. In fact, a major part of our growth has come from innovations in products, services and new delivery channels. New fund offers of equity-based schemes alone has mobilized over Rs.20,000 crore since January 2005. The innovations in the Indian mutual fund industry were a need of the time in the growth period. Different funds have introduced many new innovative schemes in the market recently. If we analyse the debt-equity structure of new schemes, we can find that most of the schemes are highly equity oriented. It shows the change in the pattern of the choice of the ultimate investor. Data reveals that if one were to put money into any of the equity schemes in the last four years, even the worse performance could have given 22% return annually.

A new trend in the Indian mutual fund industry is a buzz with acronyms as it seeks to create branded funds. This branding strategy that many fund houses are resorting is to use easy to remember acronyms to brand their funds. For example, Sundaram Mutual Fund has launched SMILE (Small and Mid-Cap Indian Leading Equities) Fund; ING Vysya has launched LION (Large-Cap Intermediate-Cap, Opportunities and New Offerings) Fund; and SBI Mutual Fund has launched the Magnum COMMA (Commodities in Oil, Metals & minerals, Materials and Agriculture sectors) Fund. While these are all recent New Fund Offers(NFOs), DSP Merill Lynch had introduced a TIGER (The Infrastructure Growth and Economic Reforms) Fund and Prudential ICICI had introduced an emerging STAR fund last year.

It is the latest technique tested by some of the Funds which make money irrespective of stock prices go up or down. At least that is what a handful of mutual funds are hoping to do with their soon-to be launched near the end of the year 2005. They are going to exploit the price difference of stocks between spot and derivative markets. The Mutual funds which have
filed the draft prospectus with SEBI are UTI Spread Fund, JM Equity and Derivative Advantage Fund and SBI Arbitrage Opportunities Fund.

It works according to the fund manager's evaluation of the price difference of stock between the future and spot markets. If the price is higher in the future market than the spot market, the fund will buy the stock in the spot market and sell it in equal quantity in the future market. For Eg. If price of a stock is Rs.100 in the spot market and the month-end future price is Rs.115. The scheme would enter into the following trades: Purchase 1000 shares (Rs.100 per share) at the total cost of Rs.1,00,000 and sell 1,000 futures of the same stock (Rs.115 per share) at the sale proceeds of Rs.1,15,000. The trade is done to lock in profits of Rs. 15,000 irrespective of the movements in the stock price. If the price of the stock has gone down to Rs. 95 by the end of the month, it would mean a loss of Rs. 5,000 \(1000 \times (95-100)\) in the spot market and a profit of Rs. 20,000 \(1000 \times (115 - 95)\) in the future market. That means there is a net profit of 15,000 for the scheme.

In the recent years many Funds have launched new schemes in the mutual fund market which are supposed to cater to the needs of different types of investors. Some of the new generation schemes are discussed below;

**Mid-cap, Small-cap and Multi-cap funds**

The Mid-cap, Small-cap and Multi-cap funds really stole the show in the largest rallies in the history of Indian stock market in the past two years. Mid-cap, Small-cap and Multi-cap funds seem to have monopolized the equity mutual fund space. This is very evident from the number of new launched in recent times of these categories.

The fund houses defines Mid-cap companies as those having survived the highest risk part of their life cycle and have now entered a period of long-term growth. Therefore by investing in companies which are going to give above average returns and out perform the large-caps, investors can reap a good return.
A Multi-cap cap fund as the name suggests, will invest in companies of all sizes – large, mid and small. Thus the investable universe of a muti-cap fund will be the entire stock market rather than specific segments of the market. Then the difference between an equity diversified and a Multi-cap fund is that most diversified equity funds generally focus on large-caps or sometimes on mid-caps. But a multi-cap funds aims to bring in diversification by investing in a mix of large-caps, mid-caps and small caps.

**Equity Linked Savings Schemes (ELSS) with Systematic Investment Plan (SIP)**

Equity Linked Savings Schemes are open-ended, diversified equity schemes offered by mutual funds. They become the hot favourite recently because of the tax benefit offer under the new section 80 C introduced in the Union Budget 2005-'06. According to the Union Budget 2005-'06, an investor could invest up to Rs.1,00,000 in ELSS to gain tax benefits. Besides offering the tax benefit, the scheme invests in shares of front-line companies and offers long term capital appreciation. Unlike other mutual fund schemes, there is a three year lock-in period for investments made in these schemes. Investors planning to build wealth over the long term and save on tax can use these schemes. Here it is also notable that there is no tax paid on capital gains as the long term capital gains tax does not apply to equity oriented schemes.

Most of the funds offer Systematic Investment Plan (SIP) with this scheme where an investor can put some amount every month. There is no entry load for these plans. However there is an entry load for lump sum investments. Minimum investment under a SIP is Rs. 500 while and for a lump sum, it is Rs.5000.

**Real Estate funds**

It is one of the variety of fund which is absent in the Indian mutual fund industry. Several developed countries have Real Estate Investment Trusts
(REIT) which are just like mutual funds but invest in property only. A REIT will either jointly develop a property with a developer or buyout property. Either way, returns would come by way of sale of property or lease rentals. Some REITs also finance real estate.

Depending on the strategy, REITs are classified into three. Equity REITs own and operate income-producing real estate. Equity REITs have increasingly become primarily real estate operating companies that engage in a range of activities including development of property and leasing. Mortgage REITs lend money directly to real estate owners, or indirectly through acquisition of loans or mortgage-backed securities. Hybrid REITs are companies that both own properties and make loans to owners and operators.

There are about 180 REITs registered with the US SEC (Securities Exchange Commission) and trade on major stock exchanges. Total assets of these listed REITs exceed $400 billion at the end of 2005. A large part of real estate investments in these countries are made by funds that have long-term investment horizons since returns on real estate take a relatively longer term.

In India, SEBI is also considering with the matter of allowing mutual funds to tap the real estate market. AMFI (Association of Mutual Funds of India) and SEBI are working on a proposal to allow fund houses to introduce real estate funds. Some mutual funds are already considering this option. Recently, the Kotak Group announced plans to float a real estate fund in 2006.

While it sounds like an attractive proposition, there are risks attached to investments in property. The most important is that prices are region specific. If development in the region is conducive to growth, property will flourish. Also, the property market in India is highly unorganized and there are several legal issues attached. It is probably due to these risks that the regulator is giving the issue a deep thought.
Gold Funds

Gold funds, a concept stuck before the RBI and SEBI for the past two years has been officially cleared by the Finance Minister in the Union Budget 2005-2006. This declaration actually opened a new investment avenue to the mutual fund investors. Through this new route over 800 crore worth of gold that Indians invest annually can now be done in financial form rather than hold it in physical form. This type of funds was launched in 2003 in London and Australia and only last year in New York and already made waves abroad. It is similar to index funds but traded more like stock. A Gold Exchange Traded Fund will represent gold as the underlying security. Through this scheme one can buy and sell gold in the form of units for as little as Rs.100. According to industry sources, UTI Asset Management Company and Benchmark Asset Management Company are ready to launch their gold funds in the first quarter of 2006. It has a good future in the land of the world’s most gold consuming country and the trend shows that India is catching up with the developed markets.

Though still called a blossoming industry, domestic mutual funds currently offer over 500 schemes for all type of investors, right from children to a working class executive to retired person or for large high net worth individuals. Indian mutual funds planning more and more new products like index warrants, covered warrants etc.

Exchange Traded Funds (ETFs)

Exchange Traded Funds is a relatively new concept in India. ETFs are open-ended investment fund that are listed on various stock exchanges. These funds are mainly index trackers and their returns more or less are in line with the performance of the underlying index since these funds follow an open-ended structure. All ETF products till available in the Indian markets are passive index funds. These funds are also efficient trading vehicles that offer intra-day liquidity and market depth.
ETFs are extremely popular in markets abroad but they haven’t really taken off in India, till now. Internationally there are 453 ETFs managing about $416 billion⁴. In India there are only 9 ETFs out of which 7 ETFs come from the Benchmark MF. These funds together manage around Rs.1,300 crore. This figure is very small when compared to the total assets been managed by ETFs in international markets. But as it is a relatively new concept in India, we have to give time to our investors to get used to such different products. The Finance Minister’s announcement in the budget 2005-06 which allow a limited number of qualified Indian mutual funds to invest cumulatively up to $ 1 billion in overseas exchange traded funds, will also boost the demand of this kind of funds.

Other New Generation Schemes with value additions

Increasing competition among mutual funds for New Fund Offers (NFOs) over the last two years amidst booming stock markets has resulted in some of the mutual funds launching new products with value added features. Mutual Funds such as Reliance Mutual Fund, Kotak Mutual Fund and DSP Merrill Lynch have tried to attract investors towards NFOs by offering them add-on features of life cover or accident insurance over up to a limit in some of their schemes, particularly those launched in the second quarter of the financial year 2005-06. Most of these schemes have offered such products by bearing the additional cost of insurance cover on themselves or by partially passing on the additional costs to investors through additional entry or exit loads.

Reliance Mutual Fund was the first one to have introduced additional features to attract investors towards its Reliance Mutual ELSS scheme, which was launched at the end of July 2005. It offered an additional accident insurance cover to the extent ranging from Rs. 50,000 to Rs. 5,00,000 depending on the subscription made. It also qualified as a tax saving scheme under section 80C of the Income Tax Act and carried a three year lock-in period. Another scheme which was launched by Kotak Mutual Fund offered
additional full life insurance cover and also allowed a benefit of accident insurance cover to the subscribers of the fund up to double the amount of limit of life cover.

This chapter mainly deals with the constitution and management of mutual funds. The constitution of mutual fund is a complicated procedure as it is a specialized type of financial institution. Under the SEBI guidelines, the constitution of a mutual fund requires four-tier systems which include different independent agencies for various roles. It is designed in such a way to check speculative activities, safeguard investor interests and ensuring financial discipline through transparency and fair play. The role of SEBI and AMFI regarding statutory regulations and guidance is the second area of discussion in this chapter. Rating of mutual fund schemes and rating of fund houses are some of the new trends which increase the confidence level of investors. Different rating agencies working in the field of mutual fund is also discussed in this chapter. At last, one of important matter relating to Indian mutual fund industry, which keeps the industry alive, 'innovations in this field' is discussed.
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