CHAPTER : 7

CONCLUSION
&
SUGGESTIONS
Investor confidence in the mutual fund industry has been extremely low in India as compared to other developed countries. Majority of the investors are not ready to put their hard earned money in mutual funds as they are not confident enough with the Indian mutual fund industry. It is a big challenge for the mutual fund industry. There are many reasons behind this. When we study the history of Indian mutual funds, we can see that the investors in this sector have received nasty shocks repeatedly. Many fund houses could not honour their promises in the '90s. In some cases the sponsoring bank had to bailout the mutual funds and in other cases the investors had to grin and bear the loss. The biggest shock was caused in 2001 by the crisis in the UTI's US-64 Scheme. Some foreign-sponsored funds under world renowned management also flopped after creating great expectations.

MEASURES TO REVIVE INVESTOR CONFIDENCE IN THE MF INDUSTRY

Reviving investor confidence and maintaining their interest in mutual funds are the most important points to keep up the growth of this industry. The quality of service which the investors receive from the fund house should be standardized. The fund houses should give due care in the standards of services like promptness of receipt of dividends, accurate adherence to payment instructions, completing transfer formalities, promptness to response to queries, speeding redressal of grievances etc.

The fund houses should take initiative to boost the investor confidence in the Indian mutual fund sector. It is the basic fact that customers are the backbone of an industry. Good customer contacts always keep the industry alive. Satisfied customer backing is the strength of a mutual fund house. A good customer contact system will always keep the existing customers with the fund in the difficult situations they face. Such a good customer orientation system is not yet rooted in the Indian mutual fund industry. Unfortunately,
some of the fund houses are not even sending quarterly reports to their members in India.

Lack of proper disclosures and funding of financials by mutual funds is a problem identified with Indian mutual fund industry compared to foreign fund management system. SEBI is yet to take steps for matters regarding these problems. The lack of transparency in operation will always keep the investors away from investment. A very nominal percentage of the total population of India constitutes the mutual fund investors. Many are not yet ready to keep a portion of their savings in mutual funds. It is mainly due to the fact that the industry is not yet prepared to earn the investor confidence. Many of the disclosure requirements of SEBI are outdated and Indian mutual fund industry needs relevant guidelines. For example SEBI has laid down the guidelines that the NAV is to be declared at regular intervals but is yet to come out with regulations as to how to compute NAV. A monthly disclosure of portfolios at random will open the veil of actual numbers and strength of the asset allocation of different funds. Monthly disclosure of the number of investors in each scheme also will prevent the malpractice of disproportionate holding of the corpus of a fund.

Mutual fund is more safe as compared to other investment products like equities, bonds and fixed deposits because, the structural framework of mutual fund operations is sounder with in-built checks and balances. It is possible in mutual fund with the presence of Board of Trustees which supervises the operations of the AMC. In other cases, the investor funds go to an organization that uses the funds within the overall supervision of external regulatory authorities such as SEBI, RBI etc.

Association of Mutual Funds in India (AMFI) plays a proactive role in identifying the steps that need to be taken to protect investors, boost their confidence in the sector and promote the mutual fund industry. In 1997, AMFI brought out the AMFI Code of Ethics to promote investors' interest by defining and maintaining high ethical and professional standards in the mutual fund industry. It was produced by SEBI in association with Price
Waterhouse LLP / FIRE Project funded by US Agency for International Development (USAID). Some of the standards prescribed by the code are:

- Members and their key personnel in the conduct of their business shall observe high standards of integrity and fairness in all dealings with investors, issuers, market intermediaries, other members and regulatory and other government authorities.

- Mutual fund schemes shall be organized, operated, managed, and their portfolios of securities selected, in the interest of all classes of unit holders and not in the interest of:
  - Sponsors;
  - directors of members;
  - members of Board of Trustees or directors of the Trustee company;
  - associates of the members; and
  - a special class selected from out of unit holders.

- Members shall not use any unethical means to sell, market or induce any investor to buy their products and schemes.

- Members shall not make and exaggerated statement regarding performance of any product or scheme.

- Members, in all their communications to investors and selling agents shall:
  - Not present a mutual fund scheme as if it were a new share issue;
  - Not create unrealistic expectations;
  - Not guarantee returns except as stated in the Offer Document of the scheme approved by SEBI, and in such case, the Members shall ensure that adequate resources will be made available and maintained to meet the guaranteed returns;
  - Convey in clear terms the market risk and the investment risk of any scheme being offered by the members.
> Not induce investors by offering benefits which are extraneous to the scheme; and
> Not misrepresent either by stating information in a manner calculated to mislead or by omitting to state information which is material to making an informed investment decision.

- Members shall not, in respect to any securities, be party to:
  > Creating a false market;
  > Price rigging or manipulation; and
  > Passing of price sensitive information to brokers, members of stock exchange and other players in the capital markets or take action that is unethical or unfair to investors.

Nowadays SEBI and other fund houses are conducting investor awareness programmes to educate the investors. It a good step towards the investor awareness and these movements will help in increasing their confidence in the mutual fund sector. Each and every mutual fund investor should aware of about his rights and duties. The general rights of a mutual fund unit holder are as follows;

- Unit holders are entitled to get the following disclosures;
  > Daily NAV of their schemes which are published in at least two newspapers.
  > Weekly disclosure of NAVs of closed-end schemes which are published in at least two newspapers.
  > Half yearly disclosure of unaudited financial results.
  > Abridged scheme-wise annual report which has to be mailed to all unit holders not later than 6 months from the date of closure of the relevant accounting year.

- Unit holders have a proportionate right in the beneficial ownership of the assets of any scheme and to the dividend declared, if any.

- Trustees are bound to make such disclosures to the unit holders as are essential in order to keep them informed about any relevant
information, especially which may have an adverse bearing on their investments.

- With the prior approval of SEBI, the appointment of the fund's AMC may be terminated by 75% of the unit holders, or by a majority of the Board of Trustees.

- Unit holders have the right to inspect all the documents listed under the heading "Documents available for inspection" in the Offer Document.

- 75% of its unit holders can pass a resolution to wind-up a mutual fund scheme.

- The Trustee should convene a meeting on a requisition of 75% of the unit holders of a scheme.

- The Trustee is obliged to obtain the consent of the unit holders:
  - Whenever required to do so by SEBI in the interest of the unit holders.
  - Whenever required to do so on the requisition made by three-fourth of the unit holders of any scheme.
  - When the majority of the Board of Trustees decides to wind up or prematurely redeem the units; and
  - When any change in the fundamental attributes (investment objectives and terms) of any scheme or the trust or the fees and expenses payable or any other change which would modify the scheme or affect the interest of the unit holders is proposed to be carried out.

No such changes can be carried out unless three-fourth 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 at the prevailing NAV.
Different Measures taken to stimulate the development of Mutual Fund Sector in the Union Budget 2006-'07

The Government has taken different innovative and liberal measures to increase the growth of Indian mutual fund sector year to year. These measures are really attracting more and more investors to this vibrant investment avenue. Different year's Budgets had announced new investment avenues and liberal measures which helped mutual fund industry at large. Though the Union Budget 2006-'07 has maintained status quo on most aspects relating to the Indian mutual fund industry, the changes related to investment limits and investments abroad are welcoming developments. Some of the main points relating to these are;

- The finance minister has raised the ceiling on aggregate investment by mutual funds in overseas instruments from $1 billion to $2 billion and has removed requirement of 10% reciprocal shareholding. While this will increase the investment universe for Indian mutual funds wanting to invest abroad, at present we have only one international equity fund.

- A limited number of qualified Indian mutual funds will also be allowed to invest cumulatively up to $1 billion in overseas exchange trade funds.

- Open-ended equity-oriented schemes will now be treated at par with close-ended equity oriented schemes for exemption from dividend distribution tax. Close-ended schemes have come back into mainstream after a low demand of almost 10 years and this move will help improve their popularity.

- The definition of equity-oriented schemes will be amended in order to provide exemption from dividend distribution tax. The finance minister
has increased the equity exposure to 65% from the existing 50% for equity oriented funds to be eligible for dividend distribution tax exemption under section 115R. This will have an impact on balanced funds that generally maintain an equity allocation of around 50%. These funds will now try and maintain an equity allocation of 65% in order to get the dividend distribution tax exemption.

- While dividends continue to be tax-free for investors, debt oriented mutual funds will continue to pay distribution tax amounting to 12.5% on the dividends declared while equity-oriented mutual fund schemes continue to enjoy the dividend distribution tax exemption. Similarly, long term capital gains tax continues to be nil for equity funds. Debt funds will continue to be taxed at 10% without indexation and 20% with indexation. Fund industry seems to be satisfied with the status quo maintained as regards dividend distribution tax and long-term capital gains.

- However Securities Transaction Tax (STT) has been increased by 25% across the board. Equity markets seem to have taken this increase in STT in their stride. The reason probably is that investors don’t mind paying that little bit extra in a bull market but this increase may bother investors in a bear phase. Mutual fund investors will also have to bear the increase in STT rates.

- A move that might bother debt mutual funds is the fact that finance minister has allowed investments in fixed deposits in scheduled banks for a term for not less than five years to be included in section 80C. This may take a few risk averse investors away from debt mutual funds as fixed deposits will become more attractive due to the tax breaks.
➢ The limit on Foreign Institutional investment (FII) investment in government securities has been increased to $2 billion from the existing $1.75 billion and the limit on FII investment in corporate debt has been increased from $0.5 billion to $1.5 billion. This will help deepen the debt markets.

➢ In a move to bolster the confidence of retail investors, an investor protection fund will be formed under the aegis of SEBI.

CONCLUDING OBSERVATIONS ABOUT THE INVESTOR PERCEPTION ON MUTUAL FUNDS

The Indian Mutual Funds Industry is passing through a boom period these days. The Asset Under Management (AUM) of different fund houses are increasing day by day. The New Fund Offers (NFOs) cleared record collections ($4 billion in the first quarter of 2006) in the recent past. In April 2006, the possession of equities by domestic mutual funds exceed 1,00,000 crore. It is also important to mention here that the number of small investors participating in the field of mutual fund has also increased tremendously. These facts indicate the actual growth of mutual fund sector and the increased confidence level of small investors. The development in the investment fields like mutual fund is an indicator of the economic development of a country. The share of household savings in mutual fund investments in the developed countries like US is more than 25%. If we compare this proportion with India, it is near to 1% of the total household savings. Even though the recent developments in the capital market and the good prospects on Indian industry and service sector by the outside world has increased the scope of important financial sector segments like mutual funds. If the small investors are giving such a support, the industry also should be faithful to them by offering good return and service.
Nowadays many small investors are coming to invest in mutual funds by expecting a good return. If we evaluate the returns declared by fund house, we can see that mutual funds can offer higher returns than some conventional investment options. According to the analysis of Lipper¹, some equity funds like SBI Magnum Multiplier Plus Scheme, SBI Magnum Global Fund'94, Kotak Opportunities had made a growth of 111.43, 103.15, 102.84 respectively during the last 1 year. From the responses of the questionnaire administered, it has been observed that the investors have a positive approach towards mutual fund investment in many aspects.

According to the survey 17.1% investors have invested above 30% of their total investment in mutual funds. Another interesting fact is that among them 52.1% think that mutual funds is comparatively advantageous than other investment option and 45.6% believe still good scope exist for mutual funds as an investment avenue. It is an interesting fact only 2.3% investors responded negatively regarding the scope of mutual funds.

Another fact revealed by the survey is that many investors have selected mutual funds as an investment avenue for the first time on the recommendation of friends and on the recommendation of investment advisors. Tempted by advertisement has given only a minimal response. Here the expenses made by fund houses for the sake of advertisement and the net effect of that on investors is rethinkable fact.

It is a positive result that from among the investors, 44.9% of investors are ready to invest 1-3 years in mutual funds and 18.1% are ready to invest 3-5 years. Another group, 16.6% investors feel the best investment period is more than 5 years. These responses reflect the confidence shows by investors towards mutual fund investment. For the question about the performance of the fund the investors hold in terms of return, 28.2% of the investors evaluated good performance and 30.4% investors rated satisfactory for the return they earn.

Thus the different responses made by mutual fund investors show a positive approach towards mutual fund investment. The recent growth in the
mutual fund sector has also proved the same. During the financial year 2006, the domestic mutual funds have collectively collected close to Rs. 25,000-30,000 crore through their New Fund Offers (NFOs) only and the major portion of this money poured from the retail investors.

SUGGESTIONS

Promotion of Self Regulatory Organisations

Securities market regulation in India is still evolving and has not yet taken any definite form. It cannot be wholly identified with any particular western model, but it is broadly of the statutory type, on the lines of SEC’s (Securities Exchange Commission of US) pattern of regulation. However, SEBI implicitly accepted the scope of promoting SROs in India way back in 1991. In its publication, ‘Agenda for Development and Reform’(1991), SEBI stated that once it is judicially fully empowered as the main regulator of all aspects of the securities market and investor protection in India, it will become possible to promote various SROs responsible for various segments of the securities industry. The SROs would function under the overall supervision and jurisdiction of SEBI. During the 1990s SEBI was legislatively empowered and emerged as the single most powerful regulator of the Indian securities markets. The Indian mutual funds industry is regulated by SEBI. However, regulation through SROs requires the delegation of supervisory powers, which has not yet taken place in the Indian mutual fund industry.

The SRO system has many advantages. Regulation through SROs has reported highly successful in the UK and Japan. Even in the US, there are demands for establishing SROs for the investment management industry. It will always help the healthy growth of mutual funds as the regulation through SRO means regulation through specialists, who understand the need for, and mechanism of, regulation better than government bureaucrats do. Regulation through SRO is often more flexible.
Moreover, they can minimise government intervention and regulate the industry in the interest of the investor.

It is argued that SROs reduce regulatory costs since their members are more cost-conscious than the government, mainly because they have to generate competitive returns for the investors. They also enable the industry, as a whole, to meet its social responsibilities. They oversee the marketplace, educate the public and industry regarding the market and inculcate ethical standards among the industry members.

In India, the Association of Mutual Funds in India (AMFI) is a body which plays the role of a SRO but it is not yet approved as a SRO and its recommendations are not binding on the industry participants. In order to evolve as an SRO, AMFI requires some regulatory back-up as well as restructuring of its organizational characteristics and business activities. SEBI should take steps to promote AMFI as an SRO and such a practical approach will accelerate the growth of the Indian mutual fund industry.

**Make Changes in the Amortisation Rule for New Fund Offers (NFOs)**

Under the current regulations, asset management companies floating a new fund can spend up to 6% of the income generated from a New Fund Offer (NFO) for expenses related to the issue like advertising, agency commission and so on. Expenses exceeding 6% are to be borne by the asset management company.

To encourage big investors to invest in the schemes, mutual funds spread out this liability over three to five years. This benefits the big investors. Suppose a mutual fund decides to amortise the initial issue expense of a scheme over five years equally. Then, a company investing in the scheme, and exiting after the first year, bears only a fifth of the total cost of amortisation. Small investors, who usually, stay invested for at least three years, and also those who invest in the scheme mid way, would have to therefore bear a disproportionate share of the amortisation expenses, as a result.
This practice encourages investors to instead churn their portfolio over a short term, to avoid the cost. In turn, fund managers also tend to look at a very short term investment horizon in the market to meet the expectations of the mutual fund investors in this small time span. The cycle therefore creates a reinforcing pull, which could damage the long term fortunes of the industry. So the fund houses should be ready to charge their initial issue expenses upfront instead of spreading it out over five to three years to save the small investors. The SEBI also should bring it into effect by amendments of the SEBI (MF) Regulations.

Reap benefits from new investment avenues

As a part of financial liberalization policies of the government, each year the Union Budget offers new investment avenues in the financial sector. As a part of that a new opportunity declared by the Finance Minister in the Union Budget 2005-'06 was the concept of Gold Funds. It has a good scope for the Indian mutual fund industry because through this new concept, over 800 crore worth of gold that Indians invest in annually can now be done in financial form rather than hold it in physical form. But till date, no such types of funds are introduced in the market. Some mutual fund companies are ready to start these types but the absence of clarifications is still creating a block.

The increase in the cap on overseas investment by individual mutual funds is another step in the liberalization process on mutual funds. Till the financial year 2005-'06, the limit of aggregate overseas investment was $1 billion. In the new budget proposal for 2006-'07, the finance minister has increased the limit from $1 billion to $2 billion. It is a good move which gives an additional option to those investors who want to diversify their asset allocation. The new budget has also taken away the restrictions on mutual funds to invest in foreign companies other than those that own at least 10% of its subsidiary in India. Here the real problem is to what extent, the fund houses utilize these liberal policies by formulating new schemes.
Another dynamic investment option which is not yet introduced in the Indian mutual fund industry is real estate mutual funds. Real Estate Mutual Funds (REMFs) or Real Estate Investment Trust (REITs) is popular in US and other developed countries. The REITs, like mutual funds collect money from individuals and institutions and deploy them in real estate. 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 and trade on major stock exchanges. Total assets of these listed REITs exceed $400 billion. 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.

Real estate investment has a good scope in India as there is really a boom in this sector from the last three to four years. In India this concept of Real Estate Mutual Funds (REMFs) or Real Estate Investment Trust (REITs) has not taken off although the AMFI (Association of Mutual Funds of India) and the SEBI (Securities Exchange Board of India) are working on a proposal. Some mutual fund houses are already considering this option. Recently the Kotak Group announced plans to float a real estate fund by 2006, once the regulator gives the green signal. If this proposal is agreed, it could be a boon to retail investors.
Introduce Financial Policies by the Government to Encourage Greater Retail Participation in MF

Mutual fund is one of the strategic investment avenues in a fast developing economy. It is a dynamic means to attract savings of a country into productive ventures. Such an investment route will be beneficial to the economy of a country at large. Steps should be taken on the part of the government to support such a means of investment. It is evident from the data that the retail investors have started allocating a large portion of their household savings towards equities. And since they don't have the potential to invest directly into the equity markets, they rely on financial products of different domestic and foreign mutual funds. The governments should provide further tax incentives particularly on the debt side to accelerate the growth of mutual funds. Though the Union Budget 2006-'07 has maintained status quo on most aspects relating to the Indian mutual fund industry, the changes related to investment limits and investments abroad are welcoming developments. The finance minister has raised the ceiling on aggregate investment by mutual funds in overseas instruments from $1 billion to $2 billion and has removed requirement of 10% reciprocal shareholding. In the new budget, while dividends continue to be tax-free for investors, debt oriented mutual funds will continue to pay dividend distribution tax amounting to 12.5% on the dividends declared while equity-oriented mutual fund schemes continue to enjoy the dividend distribution tax exemption. Similarly, long term capital gains tax continues to be nil for equity funds. Debt funds will continue to be taxed at 10% without indexation and 20% with indexation. Fund industry seems to be satisfied with the status quo maintained as regards dividend distribution tax and long-term capital gains.

More than declaring minor incentives every year, there is a need for stability in the tax regime. Such a policy will help the fund houses to generate new funds which may be suitable for a long term investment.
Further liberalization in investment restrictions and the overseas investment norms

In India, mutual fund industry faces many restrictions on investments. In India mutual funds are not allowed to participate in commodity futures and derivative markets which is one of the emerging dynamic investment options in a country like India. The logic of barring mutual funds in India from such hedging is unclear and needs to be changed. Internationally, mutual funds, banks and other financial intermediaries are allowed to hedge price risks in commodity futures market. It is also notable here that if banks and other financial institutions are allowed to participate in commodity futures and derivatives, it would make the entire commodity trade healthy, competitive and less risky.

Budget 2006 has eased the norms applicable to mutual fund investments in stocks listed on international bourses. The upper limit on such investments has been doubled and mutual funds have been allowed to invest in any type of stocks. There are indications that Fidelity is planning a new scheme to take advantage of the Government’s latest gift to investors. Not only will this new sop allow mutual funds to buy well-known global stocks like Google and PepsiCo, they will also be able to take advantage of the blazing rallies in the equity markets of a number of emerging markets. Stock prices in Brazil, Mexico, Russia and Korea have been on fire and Indian investors could benefit from these through the mutual fund route.

Introduce measures to penetrate Indian markets to tap more retail money

Nowadays Indian mutual fund industry is passing through the growth stage. In such a scenario, the fund houses should take steps to maximize its corpus from the retail investors. The best way to tap the retail money is by greater penetration of markets. In India still there exists a good scope of operation in its small towns. A survey by ADB (Asian Development Bank) mentioned about 2 crore people from the unorganized sector with investible
surplus, which can be tapped into. i.e. there is a greater need to penetrate smaller towns and villages.

If we target smaller towns in a big way, there are chances that it wouldn’t succeed, due to lower financial literacy level. The first steps the fund houses should take is to conduct investor education programmes. If we go to remote areas directly without awareness programmes, there is the risk of ‘mis-selling’. What the mutual fund agents does is that they sell only those schemes in which they can earn maximum commission. So what is needed is the right element of investor awareness, so that we can penetrate the remote areas.

It is a good move from the part of the government on such an issue. On 8th April 2006, RBI allowed Registered Urban Co-operative Banks (UCB) to market mutual fund products on certain conditions such that they should only act as an agent to customers and are prohibited from buying back units from customers. It is a good approach and will certainly help the penetration of mutual fund schemes.
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