EduTap

SUMMARY SHEET

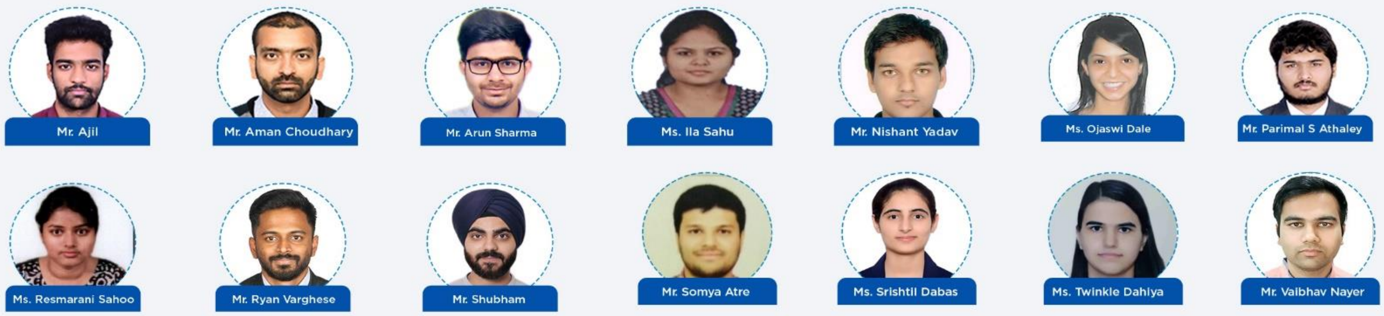
Mutual Funds

EduTap

EduTap Hall of Fame

RBI Grade B 2020 - 21

198 Selections Out of 257



SEBI Grade A 2020

63 Selections Out of 80

NABARD Grade A 2020

65 Selections Out of 69

Important Points

1. This Summary Sheet shall only be used for Quick Revision after you have read the Complete Notes

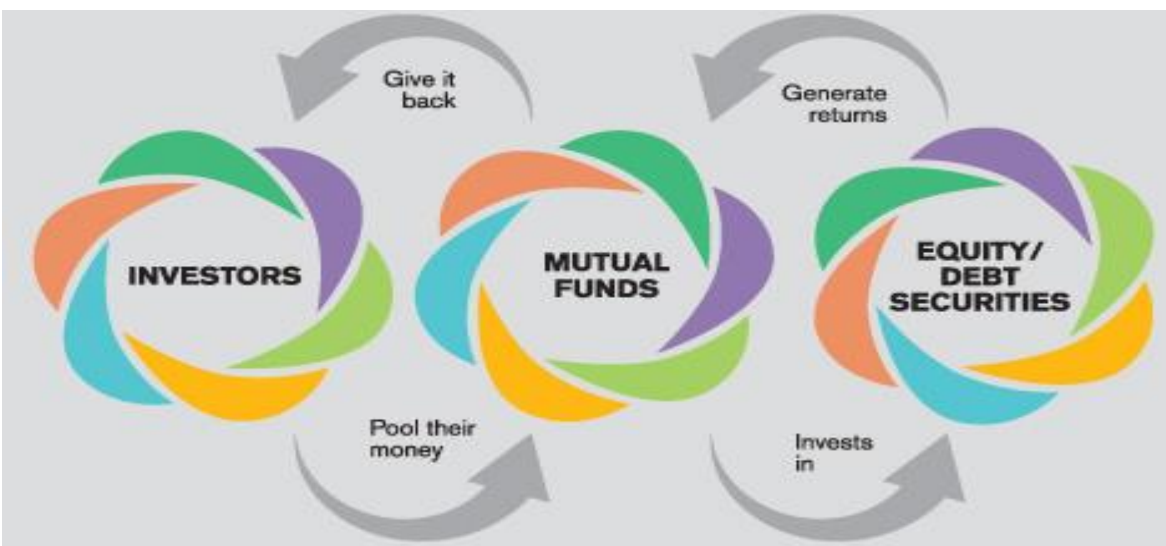
2. For Building Concepts along with examples/concept checks you should rely only on Complete Notes

3. It would be useful to go through this Summary sheet just before the exam or before any Mock Test

4. Questions in the exam are concept based and reading only summary sheets shall not be sufficient to answer all the questions

1 Summary Points

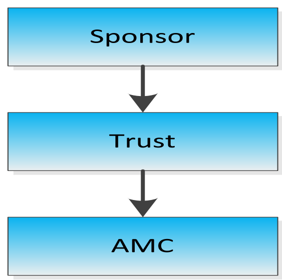
- **Mutual Funds: Professionally managed** type of collective investment scheme that **pools money** from many investors and **invests** it in stocks, bonds, short-term money market instruments and other securities



- **Features of Mutual Fund:**
    1. Managed by specialist investment management firms

2. Stating upfront the objectives with which the pooled money will be invested
3. Investors are allotted mutual fund units which represent their proportional participation
4. Money invested in accordance with the stated objective
5. Details about the securities and performance in terms of risk and return are periodically disclosed to the investors
6. The risk of the portfolio of securities is directly borne by the investors in a mutual fund(unit holders)
7. Mutual funds in India are not permitted to borrow to invest in a portfolio
8. The activities of a mutual fund including collecting money from investors, creating and managing the portfolio are subject to **SEBI Regulations**

➢ **Mutual Fund Structure in India (3-Tier Structure):**



1. **Sponsor (the First tier):** One(individual or group of people) who establishes a mutual fund and get it approved by SEBI. It is like a promotor of the company
2. **Trust:** As per the Indian Trusts Act, 1882, the trust is created through a document called the trust deed which is executed by the fund sponsor in favor of trustees. Once the Trust is created, it is registered with SEBI after which this trust is known as the mutual fund.

✓ **Trustees:** Manage the trust and are responsible to the investors. Acts as primary guardians of the unit-holders funds and assets

3. **Asset Management Company (AMC):** It is the investment manager of the trust. A company registered under the Companies Act, 1956. This is the entity which manages the funds of the mutual fund (trust) in return of fees which is borne by the investors. The AMC functions under the supervision of its Board of Directors, and also under the direction of the Trustees and SEBI. Trustees are vested with general powers of superintendence and direction over AMC

As per SEBI regulations, at least two-third directors on the board of Trustees must be independent directors i.e. they should not be associated with the sponsors. Moreover, 50 percent of directors of AMC must be independent

➢ **Role of Mutual Fund in Capital Markets**

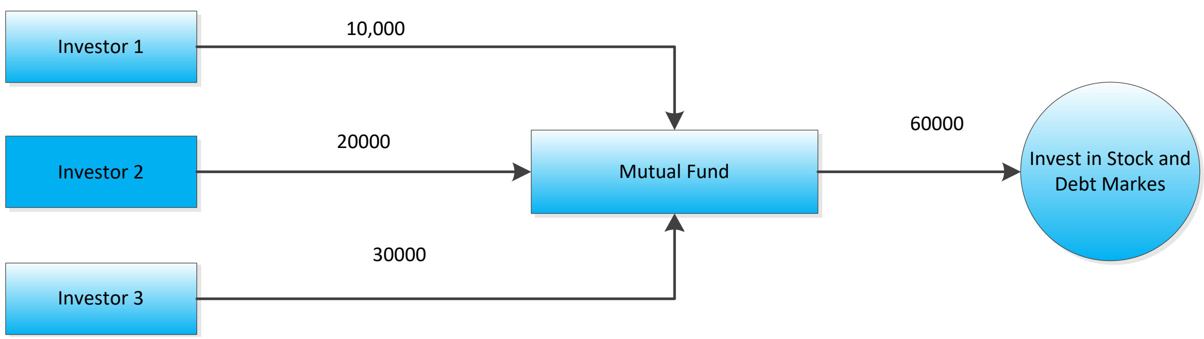
Mutual funds are fast emerging as an important financial intermediary for investing in public in India. Conceptually and Operationally they are different from banks. The key channel in bringing the mutual funds to a large number of investors all over the country is the network of intermediaries/distributors.

SEBI has made certain things mandatory for selling a marketing of mutual funds

1. Firm or corporates engaged in mutual fund business will have to obtain certificate of registration from Association of Mutual Funds in India (AMFI). **For example**, if banks are into mutual funds then they will have to obtain registration number form AMFI
2. It mandatory that any person/entity engaged in marketing and selling of mutual funds has to pass Association of Mutual Funds in India (AMFI) certification test (Advisor Module) and obtain a registration number from AMFI. **For example**, if an employee of the bank is selling mutual funds then he must pass this certification test

➢ **Calculations related to Mutual Fund Investment**

Investor 1, 2 and 3 invest 10000, 20000 and 30000 respectively. This pool of money is managed by Mutual Funds. The 60000 invested by Mutual Fund Company can be invested in different stocks, bonds and other schemes. Suppose each unit issued is at Rs 10. After some time, the shares in which the fund has invested appreciate in value and are now worth Rs. 72,000



1. **Pooling and Representation in Proportion:**
   - ✓ The pooled sum is Rs. 60,000 and investors(1,2,& 3) proportionate holding is in the ratio 1:2:3
   - ✓ Thus, the value of the investors' holding in the mutual fund also goes up proportionately (in the ratio of 1:2:3) to Rs. 12,000, Rs. 24,000 and Rs. 36,000 respectively
2. **Units and Unit Capital:**
   - ✓ If the investors bought the units at the face value, the number of units that will be allotted to them is 1,000 units (Rs.10,000/Rs.10), 2000 units (Rs.20,000/Rs.10) and 3000 units (Rs.30,000/Rs.10) respectively
   - ✓ Total number of Units issued = 1000+2000+3000= **6000**

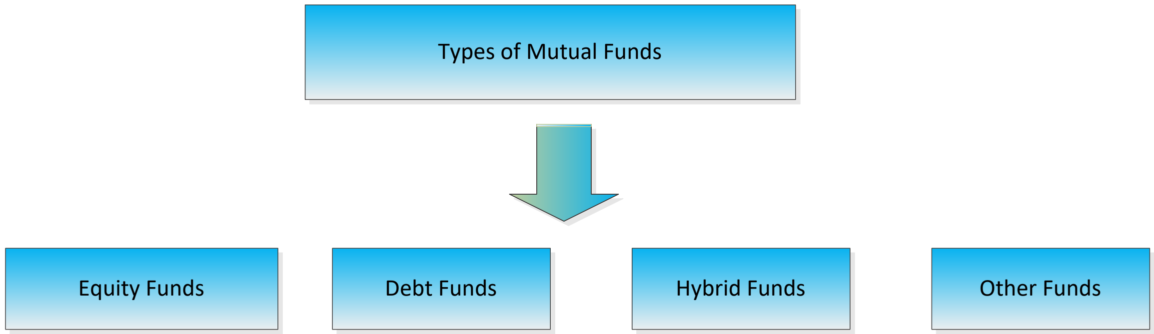
3. **Net Asset Value (NAV):** It is the current value of a mutual fund unit which is equal to current value of the securities held in the portfolio of the fund and any income earned such as dividend and interest less the costs and expenses charged for managing the fund
   - ✓ Assume dividend income of Rs.3000 and expenses of Rs.600
   - ✓ **Net Asset Value =** Market Value of Portfolio + Interest or Dividend Income – Expenses
   - ✓ the net assets would be 72000+3000-600 = 74400
   - ✓ The number of units is 600 (6000/10), so net asset value per unit would be 74400/6000 = **12.4.** That is, the NAV of the unit is 12.4
   - ✓ Since expenses can be also such that they are still to be paid though they have been incurred. Such expenses are called **liabilities**. For example, mutual fund has bought some shares though a broker and brokerage is Rs. 1000. The mutual fund has an understanding with the broker and will pay this brokerage after 1 month. So, though this Rs. 1000 has not been paid but since it has already been incurred, it is a liability for the mutual fund
   - ✓ Similarly, Mutual fund has invested in a company which has declared a dividend, but dividend will come next month. Then this income which has already accrued though still not received is an **Asset** for the Mutual fund
   - ✓ In the context of above points, the NAV of Mutual Fund can also be expressed as follows

$$\text{NAV} = \frac{\text{Market value of Schemes Investments + Current Assets – Current Liabilities}}{\text{Number of Units Outstanding under scheme}}$$

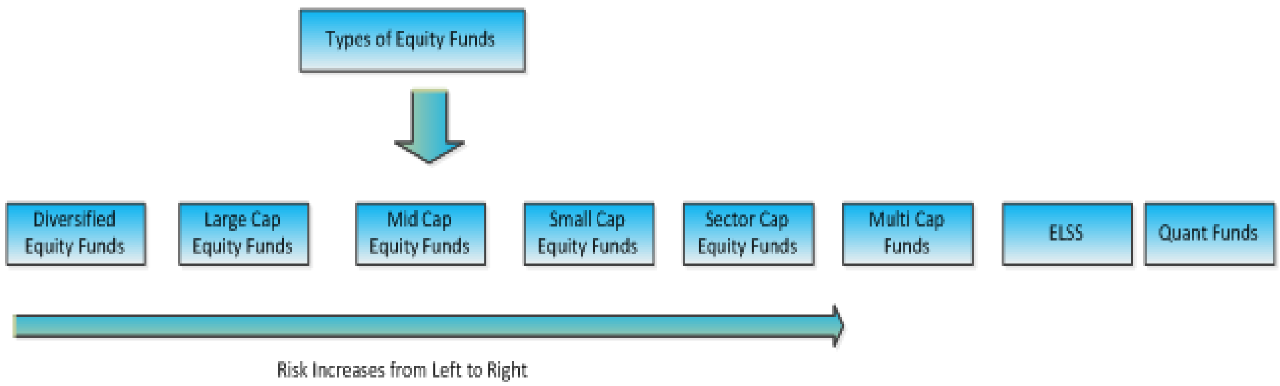
4. **Disclosure of NAV:**

- ✓ The NAV of schemes except fund of fund schemes need to be published on a daily basis by Mutual fund in at least two newspapers. NAVs of fund of fund schemes can be published in newspapers with a lag of one day i.e. Prices of Monday end of day will be published in newspapers on Wednesday. Such NAVs which are being published with delay shall have an asterisk(*) marked in front of them to indicate lag or delay
- ✓ NAV of all mutual fund's schemes except for Fund of Fund schemes are to be updated on AMFI's website and the Mutual fund's websites by 9 p.m. of the same day. Fund of Fund schemes shall have extended time up to 10 p.m. the following business day in this regard.
- ✓ **Rounding off of NAVs** : To ensure uniformity, Mutual funds have to round off NAV up to 4 decimal places for index funds, debt funds/Liquid or Money market funds. For all equity-oriented funds and balanced fund schemes, mutual funds will have to round off NAVs up to two decimal places.

➢ **Types of Mutual Funds (By Nature):**

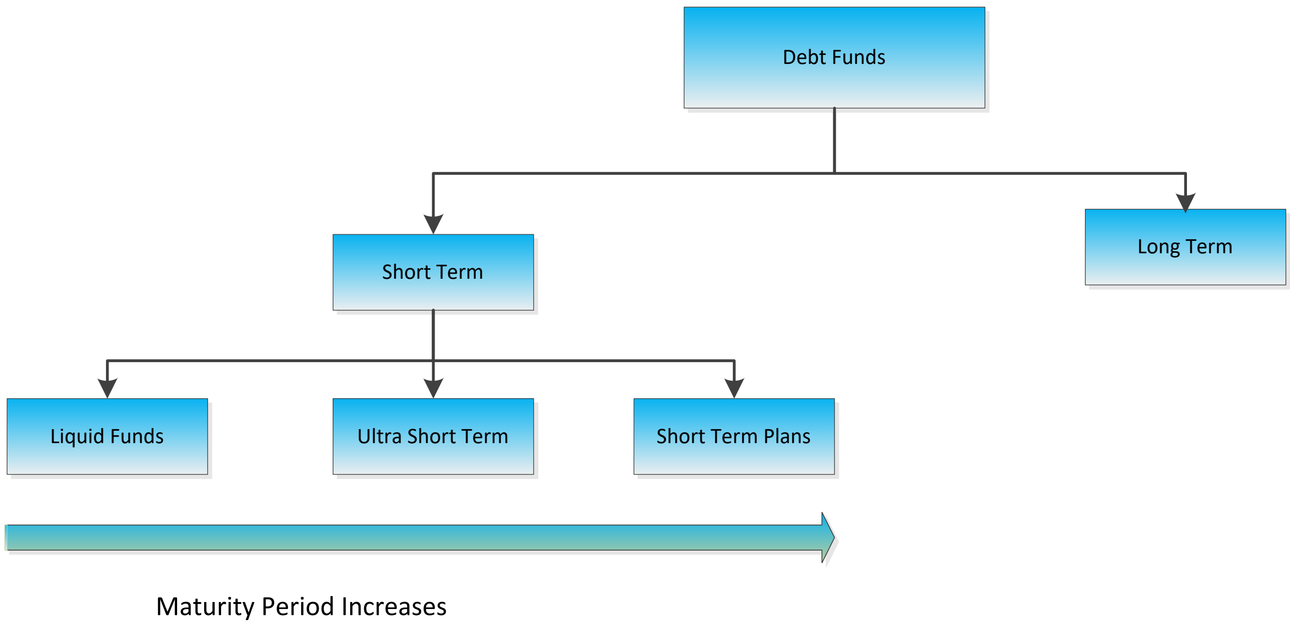


➢ **Equity Funds:** Invest in a portfolio of equity shares and equity related instruments. They can be classified as,



1. **Diversified equity funds** invest across different segments, sectors and sizes of companies
2. **Large- cap equity funds** invest in stocks of large, liquid blue-chip companies with stable performance and returns
3. **Mid-cap funds** invest in mid-cap companies that have the potential for greater growth and returns but slightly higher risk
4. **Small-cap funds** invest in companies with small market capitalization. They can offer higher returns but also mark higher risk
5. **Sector funds** invest in companies that belong to a particular sector such as technology or banking
6. **The risk increases in the order -> Diversified Fund, Large Cap Fund, Mid Cap Fund, Small Cap Fund and Sector Cap Fund**
7. **Multi Cap Funds**: Has a mixture of different types of funds(small, large, mid, etc) which changes frequently as per the investment objective
8. **Equity Linked Savings Scheme (ELSS)**: Open ended equity schemes with lock in period of 3 years, where investors get tax benefit up to Rs. 1.5 lacs under section 80C of the Income Tax Act
9. **Quant Funds**: An investment fund that selects securities based on quantitative analysis. In this, the managers build computer-based models to determine whether an investment is attractive

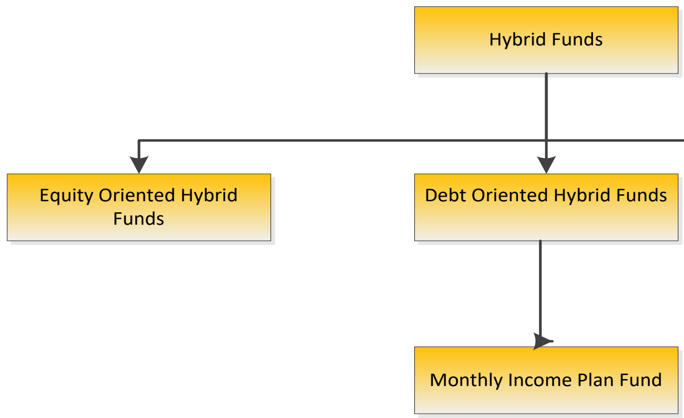
➢ **Debt Funds:** Debt funds invest in debt securities issued by the government, public sector units, banks and private limited companies



1. **Short-Term Debt Funds (Also called Money market funds) :** Types of Short Term Funds,
    a. **Liquid funds**: Invest in securities with not more than 91 days to maturity
    b. **Ultra-short-term funds:** slightly higher maturity than liquid funds to benefit from higher coupon income
    c. **Short-Term Plan:** Hold short-term debt securities but can also hold long-term debt securities
2. **Long-Term Debt Funds:** Invest in longer maturity securities. It earns interest income along with appreciation of the price of the Debt instrument itself

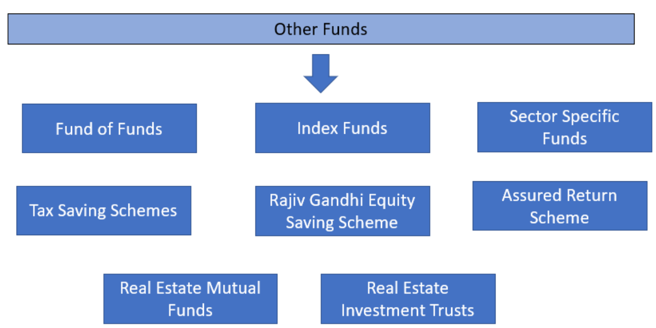
- **Other Debt Funds**
    - **a. Gilt Funds:** Invest only in government securities. These can be Short-term or Long-term Gilt Funds depending on the type of securities invested
    - **b. Income Funds:** Are longer term Funds and invest in combination of Government and Corporate Bonds
    - **c. Dynamic Funds:** Keep on shifting their focus between short and long term debt instruments

- **Hybrid Funds (Balanced Fund):** Hold a portfolio of equity and debt securities. Risk in this is dependent on the allocation between equity and debt. Types of Hybrid Funds,



1. **Equity-Oriented Hybrid Funds:** Have a greater exposure to equity in their portfolio as compared to debt. Overall returns tend to fluctuate more due to maximum investment in equity
2. **Debt Oriented Hybrid Funds:** Have a higher proportion of their portfolio allotted to debt. Example, Monthly Income Plans
3. **Capital Protection Funds:** In this, **a portion** of the principal amount is invested in **debt instruments** so that it grows to the principal amount over the term of the fund(provides the protection to the capital invested) and the **remaining amount** is invested in **equity derivatives** to earn higher returns
4. **Monthly Income Plans:** Invest in debt papers as well as equities. Suitable for investors who want to generate regular income. Investment in debt portion provides monthly income and investment in equity provides higher returns

➢ **Other Funds:**



1. **Fund of Funds:** Funds those invest in units of other mutual funds

2. **Index Funds:** Index funds replicate the portfolio of particular index such as BSE sensitive index, Nifty index etc. These schemes invest in securities in the same weightage as their weightage in the index. NAV of such schemes would rise or fall in accordance with the rise or fall in the index though not exactly by the same percentage. There might be some difference. For example, in Nifty has increase by 10% then NAV of the fund might increase by 9.7%. This difference is called tracking error. The tracking error can come due change in the index which is not replicated by the fund manager in the index fund. The meaning of the

change in index is that some companies are moved out of the index and new companies are added in the index

3. **Sector Specific Funds:** Mutual funds which invest in a particular sector or industry as specified in the offer document e.g. Pharma, IT etc. are said to be sector-specific funds. Since the portfolio of such mutual funds consists mainly of investment in one particular type of sector, they offer less amount of diversification and are considered to be risky

4. **Tax Saving Schemes**: These funds offer tax rebates to the investors under some specific provisions of Income Tax Act, 1961. These schemes are mostly growth-oriented schemes and invest in equities. **ELSS scheme that we discussed earlier is an example of Tax-saving scheme**

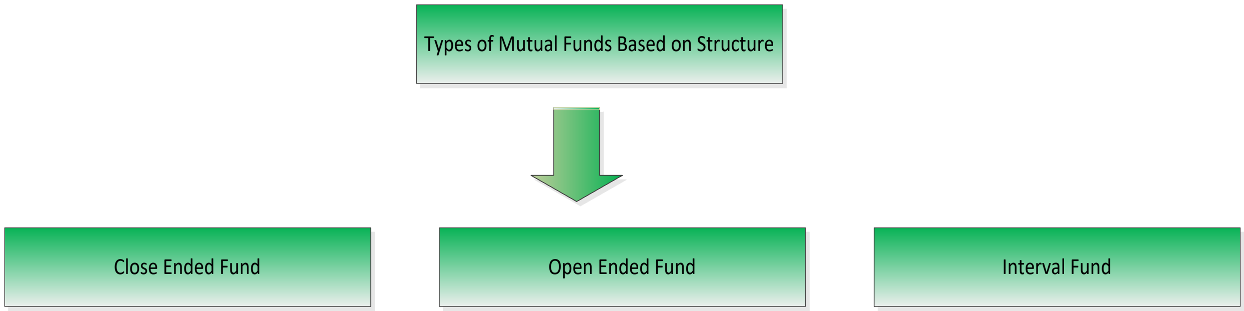
5. **Rajiv Gandhi Equity Saving Scheme**: Rajiv Gandhi Equity saving scheme is equity tax saving scheme with the objective of encouraging small investors to invest in domestic equity markets. It was announced in budget of 2012-13 and new section 80CCG was defined under which tax rebate was to be given for investing under this scheme. Under this scheme all New Retail Investors who have gross total income less than or equal to Rs. 12 lakhs. are eligible for tax benefits up to 50,000 i.e. investment up to 50,000 in this scheme is exempted from tax. The word 'New Retail Investor' means that those who have not opened a demat account and has not done any trading before investing in this scheme

6. **Assured Return scheme**: Assured return scheme is the one that ensure a specific return to the unit holders, irrespective of performance of the scheme. A scheme cannot promise assured return unless the returns are fully guaranteed by the sponsor or AMC and this is required to be disclosed in the offer document

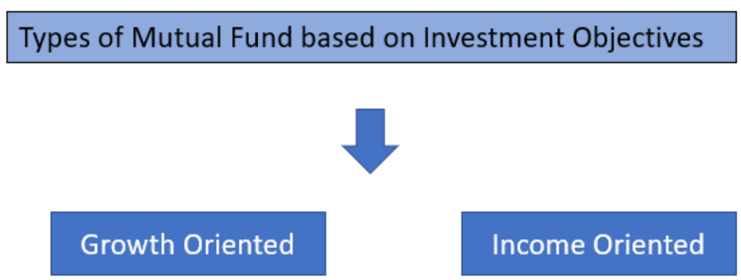
7. **Real Estate Funds:** Invest in real estate either in the form of physical property or in the form of securities of real estate companies

8. **Real Estate Investment Trusts (REITs):** Trusts **registered with SEBI** that invest in commercial real estate assets. The value of assets owned by REITs should be minimum **Rs.500 Crore** and minimum offer value must be **Rs. 250 Crore.** Its units must be listed on stock exchange. The minimum subscription amount per investor in an initial offer shall be Rs. 50 thousand

- **Types of Mutual Funds (By Structure):**



- **Open Ended Fund:** Does not have a fixed maturity date. Investors can buy/sell mutual fund units anytime from the mutual fund at **current NAV related prices** or if the fund is listed on stock exchange then they can trade among themselves at **market determined prices** on stock exchange
- **Close Ended Fund:** Mutual fund units are issued to investors at the time of launch and after this no additional subscription of units is done. Fund needs to be mandatorily listed on stock exchange to enable investors to trade units among themselves at market price. Funds can be sold to mutual fund only at maturity at current NAV related prices
- **Interval Funds:** Combines characteristics of both close and open ended funds where buy/sell of units directly from fund happens at specific periods and is registered on stock exchange for the trading of units
- **Types of Mutual Funds (By Investment Objectives):**



- **Growth Oriented Funds:** In growth-oriented plans, the profits made for investment are not distributed to the investors. They are invested further to make more gains. Growth Plan will have **more NAV** than Dividend Plan because profits are retained. **They provide capital appreciation. These schemes invest most of their corpus in equities and therefor risky**

- **Income Oriented Funds:** Income oriented funds are those which provide regular income to the investor. **Most of these are debt oriented** i.e. they invest in fixed income securities such as bonds, government securities or money market instruments. The interest earned from these investments is distributed among the investor on regular basis. These are less risky as the investment in fixed income securities provide stability. The NAVs of such funds are impacted by interest rates. If interest rate increases, then NAV of these funds is likely to fall and vice-versa. The relation between NAV and interest rates can be explained using the same logic as that between Bond prices and interest rates

Income oriented funds can be equity based also. In such cases Dividends are shared with investors at regular intervals. Income oriented funds based on equity are also called **dividend plans**

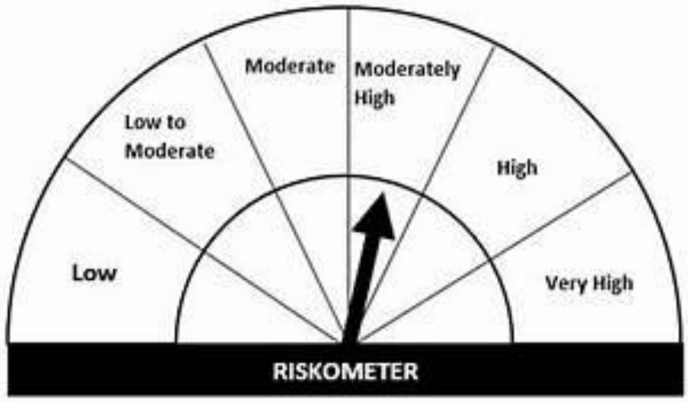
- **Mutual Fund Benefits:**
  1. **Professional Management:** Investors get help of qualified professionals who can research and analyse prospective of companies from investment objective
  2. **Diversification:** Enables lowering of risk of loss by spreading investor's money across various industries and geographic regions
  3. **Affordability:** Enables small investor to invest with minimal investment and earn returns on it
  4. **Tax benefits:** Also provides tax benefits for long term investments and indexation benefit
  5. **Liquidity:** Mutual funds market is highly liquid which enables trading units for the investors easy as per his needs
  6. **Transparency:** Available mutual funds schemes in the market get reviewed by various publications, rating agencies, analysts enabling investors to compare schemes and invest accordingly
  7. **Regulations:** All mutual funds are regulated by SEBI Regulations

- **NFO(New Fund Offer):** Any company who thinks of introducing a scheme has to come up with NFO in primary issue market mentioning Offer document and Key information memorandum for investors
- **Offer Document:** A legal document and investors rely upon the information provided in the OD for investing in the mutual fund scheme. It has two parts:
  1. **Scheme Information Document (SID):** Incorporates all information pertaining to a particular scheme
  2. **Statement of Additional Information (SAI):** Incorporates all statutory information on Mutual Fund
- **Key Information Memorandum (KIM): Summary** of scheme information document **(SID)** and statement of additional information **(SAI)**

- **NFO time period:** For all open ended and close ended schemes (except ELSS schemes), the NFO should be open for up to 15 days. In case of ELSS schemes the maximum period of initial offering of Mutual Fund shall be 30 days

  The mutual fund (except ELSS and Rajiv Gandhi Equity Saving Scheme) shall allot units or refund money within 5 business days from closure of NFO. In case of ELSS and Rajiv Gandhi Equity Saving scheme, the mutual fund would have 15 days to allot units or refund the money deposited by applicants

- **Risk Indication in Mutual Funds –**



Risk Value	RISK LEVEL AS PER RISK-O-METER
≤ 1	Low
>1 to ≤ 2	Low to Moderate
>2 to ≤ 3	Moderate
>3 to ≤ 4	Moderately High
>4 to ≤ 5	High
>5	Very High

- **Trail Commission:** Paid by Mutual fund to institutional distributors such as banks and brokers, as well as independent financial advisors who distribute mutual fund units to investors on Fund's behalf. It is **paid periodically as a percentage of net assets sold by the distributor**
- **Registrar and Transfer Agents (RTA):** Are the trusts or institutions that register and maintain detailed records of the transactions of investors for the convenience of mutual fund houses
- **Custodians:** Custodian banks provides safekeeping of securities as well as funds of mutual fund but has no role in portfolio management
- **Investment Managers:** Are fund managers of AMC who manage the portfolio and are responsible for the returns and performance of the scheme
- Only entities registered with SEBI under **the SEBI (Mutual Fund) Regulations, 1996** can conduct the business of a mutual fund
- **SEBI Guidelines:**
  1. No scheme can invest more than 10% of its NAV in equity shares or equity related instruments of any company of a single company. Provided that, the limit of 10% shall not be applicable for investments in case of index fund or sector or industry specific scheme
  2. No scheme can invest more than 10% of its NAV in rated debt instruments of a single issuer
  3. If a scheme invests in another scheme of the same or different AMC, no fees will be charged. Aggregate inter scheme investment cannot exceed 5% of net asset value of the mutual fund.
  4. Schemes cannot invest in listed entities belonging to the sponsor group beyond 25% of its net assets.

- **Exchange Traded Funds (ETF):** A marketable security that **tracks an index, a commodity, bonds, or a basket of assets** like an index fund. Different from mutual fund in ways,
    1. **Trades like a common stock on a stock exchange**
    2. Can be bought or sold throughout the trading timings of exchange unlike mutual funds
    3. Enables to perform stock like strategies on them selling short, placing stop-loss or limit orders, even buying on margin unlike mutual funds

- **Expenses of the Fund:** Fees **charged by the fund and direct expenses** such as brokerage, stamp duty etc. on the transactions to buy and sell securities are levied on the fund

- **Loads:** Charges imposed on the investors at time of entering (**Front-end load**) or exiting a mutual fund (**Back-end load**). At present, SEBI has banned any charges on Mutual fund in form of entry load, only exit load is allowed
- **Redemption:** Withdrawing the investment made in a mutual fund by selling the units back to the mutual fund

- **Example:** Investor has 500 units to redeemed and current applicable NAV is 24 then what is the Redemption Amount for the Investor if exit load is 1%
  Solution:
  Units redeemed 500
  Applicable NAV: Rs. 24
  Exit load: 1%
  Price per unit for redemption: Rs. 24 x (1-1%) = Rs. 24- 0.24 = 23.76
  Redemption Amount: 500 x Rs. 23.76 = Rs. 11880
- **Systematic Investment Plan (SIP):** An investment strategy wherein an investor needs to invest the same amount of money in a particular mutual fund at every stipulated time period
- **Systematic Withdrawal Plan (SWP):** Allows an investor to withdraw a fixed or variable amount from his mutual fund scheme on a pre-set date every month, quarterly, semi-annually or annually as per his needs
- **Systematic Transfer Plan (STP):** An investor is able to invest lump sum amount in a scheme and regularly transfer a fixed or variable amount into another scheme. Example: From debt scheme to equity scheme. There are **two types**:
    1. **Fixed STP:** Fixed sum is transferred from the source to the target scheme
    2. **Capital Appreciation STP:** The sum transferred is the profit part of the investment of source scheme to the target scheme