NISM CERTIFICATION EXAMINATION WORK BOOK

V-B

Mutual Fund Foundation

National Institute of Securities Markets

A Capacity Building Initiative of SEBI

Workbook for

NISM-Series-V-B: Mutual Fund Foundation Certification Examination

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This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Mutual Fund Foundation.

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Foreword

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NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. The book covers all important topics to enhance the quality of sales, distribution and related support services in the mutual fund industry. It covers topics related to the basics of mutual funds, their role and structure, different kinds of mutual fund schemes and their features, accounting, valuation and taxation aspects underlying mutual funds and their distribution. It will be immensely useful to all those who want to have a better understanding of Indian mutual fund industry.

Sashi Krishnan
Director, NISM

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About NISM Certifications

National Institute of Securities Markets (NISM) is a capacity building initiative of Securities and Exchange Board of India (SEBI), the securities market regulator. The Institute was established in 2006 pursuant to the Union Budget of 2005-06.

NISM is engaged in developing and administering Certification Examinations and Continuing Professional Education (CPE) Programmes for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programmes are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

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These Certifications create quality market professionals and catalyzes greater investor participation in the markets. They also provide structured career paths to students and job aspirants in the securities markets.

Examination Objectives:

On successful completion of the examination the candidate should:

- Know the basics of mutual funds, their role and structure, different kinds of mutual fund schemes and their features
- Know how mutual funds are distributed in the market-place, how specified schemes are to be evaluated and how suitable schemes can be recommended by this cadre of distributors to prospective investors.
- Know the rules and regulations related to distribution of specified products.

Assessment Structure

The examination consists of 50 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 50%. There shall be no negative marking.

How to register and take the examination

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For any feedback and/or queries, please write back at certification@nism.ac.in.

Important

Please note that the Test Centre workstations are equipped with either Microsoft Excel or OpenOffice Calc. Therefore, candidates are advised to be well versed with both of these softwares for computation of numericals.

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8	Mutual fund Taxation	6%
9	Investor Services	20%
10	Legal and Regulatory Environment	8%
	Total Weightage	100%

CHAPTER 1: INVESTMENT LANDSCAPE

Learning Objectives:

After studying this chapter, you should understand about:

- Saving and investment
- Different Asset Classes
- Financial needs
- Different types of financial goals
- Short term needs versus Long Term Goals
- Role of mutual funds in achieving different financial goal

1.1 Saving or Investments?

Do the two words "saving" and "investment" mean the same thing? Or are they different words? If these are different things, which is better – saving or investing? Such a clarification is warranted since many individuals use the two terms interchangeably.

The word "saving" originates from the same root as "safe". The safety of money is of critical importance here. Whereas, when one invests money, the primary objective typically is to earn profits. The important point to note here is that there is a trade-off between risk and return.

The other difference is evident from the dictionary definition of "saving" – reduction in the amount of money used. This definition refers to reducing consumption so that some money is saved. It is this saved money that can be invested. In other words, saving and investing are not to be considered as two completely different things, but two steps of the same process – in order to invest money, one needs to save first. Thus, saving precedes investing.

1.1.1 Factors to evaluate savings and investment products

The three most important factors to evaluate investments are safety, liquidity, and returns. In addition to these, there are few more parameters such as convenience, ticket size (or the minimum investment required), taxability of earnings, tax deduction, etc. These factors have been discussed below:

Safety: This begins with the safety of capital invested. However, one could stretch that to also include the degree of surety of income from investment. In order to understand the safety of an investment, it is important to understand the risks involved.

Liquidity: How easily can one liquidate the investment and convert it to cash? The degree of ease is different across different categories, and even within the categories, the same could be different across products. Sometimes, the nature of the product could be such that selling it is difficult, whereas sometimes there could be some operational features, e.g. a lock-in for a certain period, after which one may be able to liquidate the investment; or a penalty for early exit. While such a penalty does not hamper liquidity, it only lowers the investment returns. Another aspect that one may also want to look at is the divisibility. Is it possible to liquidate part of the investment or is it necessary to sell the whole thing?

Returns: As seen earlier in the definition of investments, the major purpose is to get some returns from investment. Such returns may be in the form of regular (or periodic) income, also known as current income; and capital appreciation, or capital gains.

The current income is receivable periodically, without having to sell the investment, whereas the capital gains can be realized only when one sells the investment.

The exit charges, or penalty would bring down the returns, as seen earlier. Hence, whenever there are any such charges for withdrawals (including early withdrawals), the same must be considered as a trade-off between liquidity and returns.

Convenience: Any investment must be evaluated in terms of convenience with respect to investing, taking the money out – fully or partially, as well as the investor’s ability to conveniently check the value of the investment, as well as to receive the income.

Ticket size: What is the minimum amount required for investment? There are some avenues where an investor can start investing amounts as small as Rs. 50 or Rs. 100, whereas some require more than Rs. 1 lakh, and sometimes more than Rs. 1 crore. This becomes an important factor while taking a decision about selection of investment options. At the same time, this must not be the only option. Some investors (though a very small number) have started considering certain investments (requiring large amounts), only because they could afford the same, without checking whether they needed it, or if that was appropriate for their situation and goals.

Taxability of income: What one retains after taxes is what matters, and hence, taxation of the earnings is another important factor that one must consider. While looking at the taxability of income, it is critical to evaluate various other factors, too, and not look at taxation in isolation. For example, some products may offer lower tax on investment returns, but the safety also may be low. At the same time, there could be some products that may offer low tax on investment returns, only if the investor stays invested for a certain term, or till the maturity of the product. In other words, if the investor sells the investment before maturity (or a certain minimum period), the investment returns may be taxable.

Tax deduction: A related matter is the tax deduction that may be available in case of certain products. Such a deduction effectively increases the return on investment, since the same is calculated after factoring the net amount invested.

However, where a deduction is available, the product may have a lock-in period of certain years. Once again, this is a trade-off between liquidity and tax deduction.

The above discussion offers a good framework for evaluation of savings and investment products. However, as mentioned earlier, no factor should be seen in isolation. One also must consider the investor's situation while evaluating the avenues.

1.2 Different Asset Classes

Various investment avenues can be grouped in various categories, called asset classes. An asset class is a grouping of investments that exhibit similar characteristics. There are four broad asset categories or asset classes, and then there are various subcategories, within each of these. The four broad categories— Real estate, Commodities, Equity and Fixed income.

Out of these, real estate and commodities are also called real assets, whereas equity and debt are called financial assets. The real assets are available in physical form, whereas the other two would only be available in financial form.

Below is a discussion on the characteristics of each of the four asset categories, along with the pros and cons.

1.2.1 Real estate

Real estate is considered as the most important and popular among all the asset classes. However, the popularity of this asset category is largely because of a reason not related to investment. For those who have bought their own houses, it is the largest expense in life. The word used here is "expense", and not "investment". This would be elaborated later, but it is pertinent to mention here that in majority of cases, individuals purchase for self-occupation. This should not be considered as investment, since selling the same may have a negative impact on one's lifestyle.

Real estate could be further classified into various categories, viz., residential real estate, land, commercial real estate, etc.

As an asset category, real estate exhibits certain traits, some of which are listed as under:

- Location is the most important factor impacting the performance of investment in real estate
- Real estate is illiquid
- It is not a divisible asset
- One can invest in physical real estate, as well as in financial form
- Apart from capital appreciation, it can also generate current income in form of rents
- In case of real estate, the transaction costs, e.g. brokerage charges, registration charges, etc. are quite high. This would bring down the return on investment.

- The cost of maintenance of the property, as well as any taxes payable must be adjusted before calculating the return on investment, something that many individual investors do not. These expenses are also quite high, and cannot be ignored.

1.2.2 Commodities

This is another asset category that people at large are familiar in various ways. On a regular basis, people consume many commodities, e.g. agricultural commodities like spices; petroleum products such as petrol and diesel; or metals like gold and silver. However, it is not possible to invest in most of these, as many of these are either perishable and hence cannot be stored for long, or storage of the same could take a lot of space, creating different kind of difficulties.

Though, there are commodities derivatives available on many commodities, it may not be wise to call these "investments" for two reasons, (1) these are leveraged contracts, i.e. one can take large exposure with a small of money making it highly risky and (2) these are normally short term contracts, whereas the investors' needs may be for a long term.

On the other hand, there are at least two commodities that many investors are quite familiar with as investment avenues, viz., gold, and silver.

When someone invests in these commodities, the prices are almost in sync across the world. It is easy to understand the prices of gold and silver across countries by simply looking at the foreign exchange rate between the two countries' currencies, and making adjustments for various costs and restrictions imposed by any of the countries. In this manner, these two are globally accepted assets.

Both these commodities have been used as investments or storage of value for long. In fact, the history of currency would be incomplete without mention of these two. Gold has also been considered by many as a safe haven asset. In case of failure of an economy, or a currency, gold is considered to be the final shelter. However, the opposite camp also comes with very strong arguments. Many currencies across the world were pegged to the gold reserves available with the central bank of the country for long. However, this so-called gold standard has been done away with few decades ago. And still, most of the central banks hold gold in their reserves.

An investor in these commodities would have to count only on capital appreciation, since these do not generate any current income.

Gold and silver come in varying degrees of purity. Each one can be bought at different prices from the market. However, for a large majority of investors it is almost impossible to make out the level of purity. If we opt for purity certificate, the cost goes up and without one, the risk of getting lower quality metal is high.

1.2.3 Fixed income

When someone borrows money, one has to return the principal borrowed to the lender in the future. There could also be some interest payable on the amount borrowed. There are various forms of borrowing, some of which are through marketable instruments like bonds and debentures[2].

There are many issuers of such papers, e.g. Companies, Union Government, State Governments, Municipal Corporations, banks, financial institutions, public sector enterprises, etc.

Many bonds pay regular interest, thus the investors can expect current income. At the same time, if someone has invested at the time of issuance of the bond and hold the same till maturity, in almost all cases, there would be no capital gains. On the other hand, a transaction through secondary market – whether at the time of buying or at the time of selling, or both – may result into capital gains or losses.

Bonds are generally considered to be safer than equity, which we would discuss next. However, these are not totally free from risks. These risks will be discussed in detail later in the chapter.

Bonds can be classified into subcategories on the basis of issuer type i.e. issued by the government or corporates or on the basis of the maturity date (short term bonds (ideal for liquidity needs), medium term bonds, and long term bonds (income generation needs).

1.2.4 Equity

This is the owner's capital in a business. Someone who buys shares in a company becomes a part-owner in the business. In that sense, this is risk capital, since the owner's earnings from the business are linked to the fortunes, and hence the risks, of the business. When one buys the shares of a company through secondary market, the share price could be high or low in comparison to the fair price.

Historically, equity investing has generated returns in excess of inflation, which means the purchasing power of one's money has increased over the years. It has also delivered higher returns than other investment avenues, most of the times, if one considers long investment periods.

[2] We would use the two words bonds and debentures interchangeably in this discussion.

Apart from long term capital appreciation, equity share owners may also receive dividends from the company. Such dividends are shared out of the profit that the company has generated from its business operations. If the company does really well, the dividends tend to grow over the years.

To sum up, equity share prices generally fluctuate a lot, often without regard to the business fundamentals. However, over long periods of time, the share prices follow the fortunes of the firm. If the profits of the company continue to grow over the years, the share price follows.

There are similarities and differences between the various asset categories.

Investments in equity and bonds can be done only in financial form, whereas one can buy the other two assets, viz., real estate and commodities either in financial or in physical form. It is this physical form that gives a feeling of safety to many. Anything that is tangible is perceived to be safer than something intangible.

Real estate and commodities differ from equity and bonds in another way, too. These could be bought as investment or for consumption purposes. For example, one may invest in a residential property and give it on rent to generate income. This is investment. At the same time, one may also buy a flat to live in – for residential purpose. Such a self-occupied house may not be an investment. A similar logic may be applied to gold and silver by checking whether one has invested in the metal or bought the same for personal use.

When someone invests in equity shares, part of the profits made by the company may be shared with the investor. With a careful analysis of various equity shares, it is possible to receive a periodic income (though without any guarantee about how much would one receive, and whether one receives anything at all). Similarly, a real estate could be given on rent to generate intermittent cash flow. Bonds pay interest income. It is the commodities where such intermittent cash flow is not generated.

Investor in equity, real estate and commodities is an owner of the asset, whereas an investor in bonds has lent money to someone. In such a case, the lender's receipts—be it interest payments or return of principal amount invested – are agreed at the time of the issue of such instruments. In all the other three cases, the investor's cashflows (or receipts) are unknown. To that extent, the future returns from these assets, which may also be called ownership assets, would be highly uncertain in comparison to the lending assets like bonds or fixed deposits.

While the above discussion was about the characteristics of various asset classes, and certain differences across the asset categories, the same must be seen from another perspective, too. While one may buy equity shares listed in India in Indian Rupees, one can also invest in shares of various companies listed outside India. This provides exposure to another currency.

For example, an investor buying the shares of a company listed on the London Stock Exchange is exposed to the fortunes of the company, as well as the change in exchange rate between British Pound and Indian Rupee.

Similarly, one could also invest in bonds denominated in various currencies other than Indian Rupee, and one could also buy real estate abroad.

These are called International assets. However, one must understand the basic nature of the asset class as discussed earlier, and then try to assess the impact of currency fluctuation on these investments.

Different investment avenues can be categorized into different asset category as can be seen from the illustration in Table 1.1:

Table 1.1 Investment avenues classified under different asset categories

Equity	Fixed Income
• Bluechip Companies • Mid-sized companies • Small-sized companies • Unlisted Companies • Foreign Stocks • Equity Mutual Funds	• Fixed deposit with a bank • Recurring deposit with a bank • Endowment Policies • Moneyback Policies • Public Provident Fund • Sukanya Samriddhi Yojana (SSY) • Senior Citizens' Savings Scheme (SCSS) • Post office Monthly Income Scheme • Recurring deposit with a post office • Company fixed deposit • Debentures/bonds • Debt Mutual Funds
Real Estate/Infrastructure	Commodities
Physical Asset • Residential/ Commercial Financial Asset • Real Estate Mutual Funds (REMF) • Real Estate Investment Trusts (ReITs)	• Gold • Silver • Gold Funds

• Infrastructure Investment Trusts (InvITs)	
Hybrid asset classes	Others
• Hybrid Mutual funds or Multi Asset Fund	• Rare coins • Art • Rare stamps

1.3 Four broad financial needs

Money is required to live a comfortable life. Many of the things that we need, and things we aspire for cost money. The needs could be now or sometime in the future.

When it comes to money, we all have four basic needs.

1.3.1 Transaction needs

The day-to-day life involves many transactions involving money. There could be income in the form of earning through salary, business income, investment income, rent from house property, etc.. On the other hand, there are expenses for day to day living, or entertainment, or purchase of luxury items, or even charitable contributions. All these involve transactions.

These needs can be met with the help of the banking system.

1.3.2 Protection needs

Since most individuals depend on the earning (income) of one or members of the family to fund their current expenses and financial goals, they may get into financial difficulties if the income of one of the earning members stops prematurely. This may happen on account of death of the earning member or health issues.

Life and health insurance companies provide solutions to tackle such situations.

1.3.3 Investment needs

The income and expenses that were discussed above may or may not be exactly matched. In other words, while many earn some regular monthly income, and spend some on a monthly basis; the amounts may be different. Mostly, the monthly income is higher than the monthly expenses. At the same time, every once in a while there are expenses that one has to incur, which are far more than the income for the period.

These needs can be met by investing the regular monthly surplus in some investment products.

1.3.4 Retirement needs

This is a phase of life when the income stops, but the expenses continue. These expenses can be funded through the savings and investments one has accumulated through the working life. This need is mostly taken care of through the investment products as mentioned above. However, the approach to retirement needs to be different from the other investment needs.

There are primarily two phases in retirement, (i) preretirement phase, which is also called the accumulation phase; and (ii) postretirement phase, which is also known as the distribution phase. In the former, one can use various investment products; however, it is the distribution phase, where many different products like annuities would come in to the picture.

1.4 Different types of financial goals

There are numerous examples of such financial goals. Among the most common are funding a child's education, cost of the marriage of one's son or daughter, funding the lifestyle in retirement, buying a vehicle, buying or renovating one's house, taking a big vacation. At the same time, there could be some not-so-common ones like starting one's own business, or taking a sabbatical from work and fund one's higher education.

Goal setting is a very important exercise, while planning for investments. As seen above, all the financial goals are about the need of money that cannot be fulfilled through the inflow at that time. While the expenses for the goal may be high or low, the income (from salary, professional fees, etc.) may be less than the amount required to fund the goal. This is where money needs to be withdrawn from the investments – in other words, this is why one needs to invest the money.

The first step in goal setting is to identify these events in life. After identifying the events, one needs to assign priorities – which of these are more important than the others. Retirement, or children's education fall into the responsibilities category, whereas a grand vacation maybe a good-to-have goal. Having said that, it is only the individual and the family that can decide which is which. A financial advisor or a mutual fund distributor may only guide and help one take an appropriate decision. At the same time, the role of such an intermediary could be very important.

After that, one needs to assign a timeline as well as amount of funding required at the time of such events. Take for example, if someone is planning to buy a house, one needs to decide the type of house one wants, as well as the location. These inputs would help arrive at approximate cost. After that one needs to decide by when one would like to buy this. Both the timeline and amount are critical for one to be able to plan to achieve the goal.

Such an exercise allows one to classify the goals in terms of the timeline – are the goals in the near term, or far in the future?

1.4.1 Short term needs versus Long Term Goals

The retirement goal can be broken into two parts – accumulating a sum for retirement, and then taking income out of the corpus thus accumulated.

Another look at the two approaches to classifying the goals indicates that the goals can be placed in the following matrix:

	Critically important (responsibilities or needs)	Dreams	Good-to-have
Immediate term			
Near term			
Medium term			
Long term			

The next step would be to assign amount to the financial goals. In the process of planning, this is an important question: How much would it cost? Well, this question must be answered in terms of amount needed when the goal is due. In such a case, the costs are quite likely to move up. Such a rise in the cost of the goals is called inflation with respect to the goal value.

Inflation adjustment for the goal values is critical, without which the entire planning can go haywire. The cost of education has been going up at a very fast pace over the last few decades.

Case Study: <u>Sapna's higher education</u>:

Sapna is an 8-year-old girl. Her parents want to plan for her higher education. Assume that the estimated cost of her higher education is Rs. 10 lacs (in today's price), whereas Sapna would go to college 10 years later. If the inflation in college fees is expected to be 8% p.a., her parents need to provide for Rs. 21.59 lakh in 10 years, approximately.[3] There are too many assumptions involved here–the course Sapna would pursue, the cost of the education, and the inflation. However, one needs to start with some assumptions to start. Else, the parents may plan to accumulate Rs. 10 lacs (today's cost of education), which would be grossly insufficient.

Inflation has a long term impact, and hence while planning for funding all the long term goals, one must consider inflation in the cost of the goal. On the other hand, the immediate term and near term goals may not have a big impact due to changes in price.

[3] **<u>Note</u>**: Inflation numbers are taken based on random assumptions, and only for illustration purposes.

As mentioned earlier, inflation is the rise in prices of various products, and services consumed. If the inflation is 6% p.a., the household expenses would be higher a year later in comparison to today's cost of living. If a family's monthly expenses are Rs. 30,000 currently, they would be spending Rs. 31,800 next year if the inflation is 6%. This does not look like much, but if the inflation stays at the same level, this family's monthly expenses would cross Rs. 53,000 after 10 years; and Rs. 96,000 after 20 years.

1.5 Role of mutual funds in achieving different financial goals

As discussed earlier, investors need to invest our money from time to time. These investments can be made in various financial instruments ranging from Government sponsored schemes to bank fixed deposits to company debentures to shares of companies or real estate properties of even precious metals like gold or silver.

One option is to manage the investments oneself. That would involve finding the right investments and carrying out the related research and administration work. The other option is to outsource the entire job to a professional or a company engaged in such a business.

Mutual fund is that second option – it is managed by a team of professionals, known as the asset management company. This is what really needs to be understood. By choosing to invest through mutual funds, one is not investing in alternative investment options, but only changing the way of investing money. The entire job of investing is outsourced to a professional firm.

So, the next logical question is: "which of the two choices is better – investing oneself or taking professional help to manage my investments?"

This question should be broken down into three components:

1. Can one do the job oneself?
2. Does one want to do it?
3. Can one afford to outsource?

Can one do the job oneself?

This is the question about ability. In order to do a good job, there are a few requirements, viz., ability to do the job and the availability of time required for the same. There are tasks where one may not have the skills and knowledge, e.g. a history teacher may not be able to help her daughter to study Mathematics in the higher classes. At the same time, one may not have enough time required for the job.

In either case, one is unable to do manage money oneself and should consider outsourcing it.

Does one want to do it?

Even when one has the required skills and knowledge to manage one's money, it is very likely that one may not enjoying money management – either the research and analysis or administration or accounting. At the same time, one may want to spend time on one's main profession or on certain other activities, e.g. spending time with family and friends, pursuing hobbies, etc. That also means that one needs help in managing investments.

Can one afford to outsource?

There is some cost associated with mutual funds, since the agencies involved need to be paid their professional fees. While we will cover the costs associated with managing mutual funds in a later chapter, it is important to mention here that SEBI has issued guidelines on the maximum amount that can be charged to the fund.

Most people make the mistake of comparing these fees with zero cost of managing one's own money oneself. By this comparison, the cost of mutual fund always looks higher between the two options.

What is missed out in this comparison is the hidden costs of doing the investment management job on one's own. This hidden cost comes in the form of one's time and the potential mistakes that an individual investor is likely to make.

First, let us look at the cost of one's time. Let us assume that a person generates the same investment returns as what a fund manager would have generated before the costs. Let us also assume that the cost of fund management is 2% p.a.[4] This means if one is able to generate 12% p.a. by investing oneself, the mutual fund scheme would return 10% p.a. net of the fund management charges. On a portfolio of Rs. 10 lakhs, this amounts to a saving of roughly Rs. 20,000 for the year. Is it worth spending the amount of time one is required to spend for this saving? Please consider the amount of research one has to put as well as the administration and accounting work. Someone may start thinking that this means investors with smaller portfolios should invest through mutual funds, but the bigger ones should not. This is where the concept of value of time should be looked at. The value of time may be higher in case of people with more wealth.

The second hidden cost comes in the form of the mistakes one is likely to make given the emotional attachment with one's own finances.

For most investors, mutual fund would turn out to be a better option than to build the portfolio oneself.

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[4] This is just an assumption for the purpose of illustration. The discussion on the costs associated with mutual funds is covered later in the book.

Chapter 1: Sample Questions

1. An expense of Rs. 50,000 in today's money terms is likely to be required in 3 years. Inflation is expected at 10%. How much will be the future requirement of money?

    a. 50000 X $(1 + 10\%)^3$
    b. 50000 / $(1 + 10\%)^3$
    c. 50000 + $(1 + 10\%)^3$
    d. 50000 - $(1 + 10\%)^3$

2. A greater portion of returns from conventional debt investments is generally through ________.

    a. Capital gain
    b. Interest income
    c. Dividend income
    d. Inflation

3. ________ is a safe haven asset class.

    a. Debt
    b. Gold
    c. Equity
    d. Real Estate

CHAPTER 2: CONCEPT AND ROLE OF A MUTUAL FUND

Learning Objectives:

After studying this chapter, you should know about:

- Concept and Role of mutual funds
- Classification of mutual funds
- Growth of mutual fund industry in India

2.1 Concept of a Mutual fund

A mutual fund is a professionally managed investment vehicle. Practically, one does not invest in mutual fund but invests through mutual funds. However, we hear of "investing in mutual funds" or "investing in mutual fund schemes". While that is fine for the purpose of discussions, technically it is not correct. As a mutual fund distributor, it is critical to understand the difference between the two concepts.

When someone says that one has invested in a mutual fund scheme, often, the scheme is perceived to be competing with the traditional instruments of investment, viz. equity shares, debentures, bonds, etc. The reality is that one invests in these instruments through a mutual fund scheme. In other words, through investment in a mutual fund, an investor can get access to equities, bonds, money market instruments and/or other securities, that may otherwise be unavailable to them and avail of the professional fund management services offered by an asset management company.

Thus, an investor does not get a different product, but gets a different way of investing. The difference lies in the professional way of investing, portfolio diversification, and a regulated vehicle.

Mutual fund is a vehicle (in the form of a "trust") to mobilize money from investors, to invest in different markets and securities, in line with stated investment objectives. In other words, through investment in a mutual fund, an investor can get access to equities, bonds, money market instruments and/or other securities, that may otherwise be unavailable to them and avail of the professional fund management services offered by an asset management company.

2.1.1 Role of Mutual Funds

The primary role of mutual funds is to help investors in earning an income or building their wealth, by investing in the opportunities available in securities markets. It is possible for mutual funds to structure a scheme for different kinds of investment objectives.

Mutual funds offer different kinds of schemes to cater to the need of diverse investors. In the industry, the words 'fund' and 'scheme' are used interchangeably. Various categories of schemes are called "funds". In order to ensure consistency with what is experienced in the market, this workbook goes by the industry practice. However, wherever a difference is required to be drawn, the scheme offering entity is referred to as "mutual fund" or "the fund".

The money that is raised from investors, ultimately benefits governments, companies and other entities, directly or indirectly, for funding of various projects or paying for various expenses. The projects that are facilitated through such financing, offer employment to people; the income they earn helps them buy goods and services offered by other companies, thus supporting projects of these goods and services companies. Thus, overall economic development is promoted.

As a large investor, the mutual funds can keep a check on the operations of the investee company, and their corporate governance and ethical standards.

The mutual fund industry itself offers livelihood to a large number of employees of mutual funds, distributors, registrars and various other service providers.

Higher employment, income and output in the economy boosts the revenue collection of the government through taxes and other means. When these are spent prudently, it promotes further economic development and nation-building.

Mutual funds can also act as a market stabilizer, in countering large inflows or outflows from foreign investors. Mutual funds are therefore viewed as a key participant in the capital market of any economy.

2.1.2 Investment Objectives of Mutual Funds

Mutual funds seek to mobilize money from all possible investors. Various investors have different investment preferences and needs. In order to accommodate these preferences, mutual funds mobilize different pools of money. Each such pool of money is called a mutual fund scheme.

Every scheme has a pre-announced investment objective. Investors invest in a mutual fund scheme whose investment objective reflects their own needs and preference.

The primary objective of various schemes stems from the basic needs of an investor, viz., safety, liquidity, and returns. Let us look at some examples of investment objectives (Table 2.1), as taken from the scheme information documents of certain mutual fund schemes.

Table 2.1: Examples of Investment Objectives

Investment Objectives	**Type of mutual fund scheme**
The scheme intends to provide reasonable income along with high liquidity by investing in overnight securities having a maturity of one business day.	Overnight fund
To generate capital appreciation/income from a portfolio,predominantly invested in equity and equity related instruments	Equity fund
The primary objective of the scheme is to generate long term capital appreciation by investing predominantly in equity and equity related securities of companies across the market capitalization spectrum. The fund also invests in debt and money market instruments with a view to generate regular income.	Hybrid fund
The primary objective of the scheme is to generate a steady stream ofincome through investment in fixed income securities.	Long Duration Debt fund

As can be seen from the above examples, the investment objectives are a combination of safety, liquidity, and returns (be it regular income or long-term capital appreciation).

It is in line with these objectives that the scheme would decide the investment universe i.e., the types of securities to invest in. As discussed in the previous chapter, different asset classes serve different purposes. Exactly, in the same way, the schemes that seek liquidity invest in money market securities, and those seeking capital appreciation invest in equity.

Mutual fund schemes are often classified in terms of the investment objectives, i.e., what they aim to achieve; and often interms of the investment universe, i.e., where they invest. As can be seen from the discussionabove, there is a very close relation between the two types of classifications.

The money mobilized from investors is invested by the mutual fund scheme in a portfolio of securities as per the stated investment objective. Profits or losses, as the case might be, belong to the investors or unitholders. No other entity involved in the mutual fund in any capacity participates in the scheme’s profits or losses. They are all paid a fee or commission for the contributions they make to launching and operating the schemes, and other related tasks.

2.1.3 Investment Policy of Mutual Funds

Each mutual fund scheme starts with an investment objective. Since mutual funds are investment vehicles that invest in different asset categories, the mutual fund scheme returns would depend on the returns generated from these underlying investments. Hence, once the investment objective is finalised, the mutual fund scheme's investment policy is arrived at. This is to achieve the investment objective. The investment policy includes the scheme's asset allocation and investment style.

A mutual fund scheme with the objective of providing liquidity would invest in money market instruments or in debt papers of very short-term maturity. At the same time, a mutual fund scheme that aims to generate capital appreciation over long periods would invest in equity shares. This would reflect in the scheme's asset allocation, which would be disclosed in the Scheme Information Document (SID). However, even within the same asset category, the fund manager may adopt different styles, e.g., growth style or value style; or different levels of portfolio concentration e.g., focused fund or diversified fund.

The scheme's investment policy would disclose two aspects–asset allocation and investment style.

2.1.4 Important Concepts in Mutual Funds Units

The investment that an investor makes in a scheme is translated into a certain number of 'Units' in the scheme. Thus, an investor in a scheme is issued units of the scheme.

Face Value

Typically, every unit has a face value of Rs. 10. The face value is relevant from an accounting perspective.

Unit Capital

The number of units issued by a scheme multiplied by its face value (Rs. 10) is the capital of the scheme–its Unit Capital.

Recurring Expenses

The fees or commissions paid to various mutual fund constituents come out of the expenses charged to the mutual fund scheme. These are known as recurring expenses. These expenses are charged as a percentage to the scheme's assets under management (AUM). The scheme expenses are deducted while calculating the NAV. This means that higher the expenses, lower the NAV, and hence lower the investor returns. Given this, SEBI has imposed strict limits on how many expenses could be charged to the scheme. For running the scheme of mutual funds, operating expenses are also incurred.

Net Asset Value

The true worth of a unit of the mutual fund scheme is otherwise called Net Asset Value (NAV) of the scheme. When the investment activity is profitable, the true worth of a unit increases. When there are losses, the true worth of a unit decreases. The NAV is also the net realizable value per unit in case the scheme is to be liquidated–how much money could be generated if all the holdings of the scheme are sold and converted into cash.

Assets Under Management

The sum of all investments made by investors in the mutual fund scheme is the entire mutual fund scheme's size, which is also known as the scheme's Assets Under Management (AUM). This can also be obtained by multiplying the current NAV with the total units outstanding. The relative size of mutual fund companies/asset management companies is assessed by their assets under management (AUM). When a scheme is first launched, assets under management is the amount mobilized from investors. Thereafter, if the scheme performs well then, its AUM goes up and vice versa.

Further, if the scheme is open to receiving money from investors even post-NFO, then such contributions from investors boost the AUM. Conversely, if the scheme pays any money to the investors, either as a dividend or as consideration for buying back the units of investors, the AUM falls. Dividend option of schemes is now called Income Distribution cum Capital Withdrawal (IDCW) option.

Mark to Market

The process of valuing each security in the investment portfolio of the scheme at its current market value is called Mark to Market (MTM). The mark-to-market valuation is done on a daily basis for the calculation of daily NAV of a mutual fund scheme. This results in daily fluctuations in the NAVs of all schemes.

2.1.5 Advantages of Mutual Funds for Investors

Professional Management

Mutual funds offer investors the opportunity to earn an income or build their wealth through the professional management of their investible funds. There are several aspects to such professional management viz. investing in line with the investment objective, investing based on adequate research, and ensuring that prudent investment processes are followed.

Investing in the securities markets will require the investor to open and manage multiple accounts and relationships such as broking account, demat account and others. Mutual fund investment simplifies the process of investing and holding securities.

The fund management function is not restricted to research and selection of securities to construct a portfolio of investments, but also to take care of various administrative tasks like collection of corporate benefits (for example interest payments, dividends, rights issues, buybacks, etc.), or follow up on the same.

The calculation and publishing of NAV on a daily basis means that the accounting of the entire portfolio is done on a daily basis. The investor managing one's portfolio independently would need to take too much efforts to take care of this part. All these benefits come at a very low cost and is available even for the smallest investments.Further, the expenses charged for professional management of funds are quite reasonable.

Affordable Portfolio Diversification

Investing in the units of a scheme provides investors the exposure to a range of securities held in the investment portfolio of the scheme in proportion to their holding in the scheme. Thus, an investor can get proportionate ownership in a diversified investment portfolio even for a small investment of Rs. 500 in a mutual fund scheme.

With diversification, an investor ensures that "all the eggs are not in the same basket". Consequently, the investor is less likely to lose money on all the investments at the same time. Thus, diversification helps reduce the risk in investment. In order to achieve the same level of diversification as a mutual fund scheme, investors will need to set apart several lakhs of rupees. Instead, they can achieve the diversification through an investment of less than thousand rupees in a mutual fund scheme.

Economies of Scale

Pooling of large sums of money from many investors makes it possible for the mutual fund to engage professional managers for managing investments. Individual investors with small amounts to invest cannot, by themselves, afford to engage such professional management.

Large investment corpus leads to various other economies of scale. For instance, costs related to investment research and office space gets spread across investors. Further, the higher transaction volume makes it possible to negotiate better terms with brokers, bankers and other service providers.

Mutual funds give the flexibility to an investor to organize their investments according to their convenience. Direct investments may require a much higher investment amount than what many investors may be able to invest. For example, an effectively diversified equity portfolio may require a large outlay. Mutual funds offer the same benefits at a much lower investment value since it pools small investments by multiple investors to create a large fund. Similarly, the Income distribution cum capital withdrawal (i.e. erstwhile dividend option) and growth options of mutual funds allow investors to structure the returns from the fund in the way that suits their requirements.

Thus, investing through a mutual fund offers a distinct economic advantage to an investor as compared to direct investing in terms of cost saving.

Transparency

An investor is well served if relevant information is available on time. Availability of such information is critical for making an informed investment decision. The structure of the mutual funds and the regulations by SEBI have ensured that investors get such transparency about their investments. There are three essential places from where the investor can get enough information for making informed decisions, viz., scheme related documents (SID, SAI, and KIM), portfolio disclosures, and the NAV of the scheme. Incidentally, even a prospective investor can access all this information.

Liquidity

At times, investors in financial markets are stuck with a security for which they can't find a buyer–worse, at times they can't find the company they invested in. Such investments, whose value the investor cannot easily realize in the market, are technically called illiquid investments and may result in losses for the investor.

Investors in a mutual fund scheme can recover the market value of their investments, from the mutual fund itself. Depending on the structure of the mutual fund scheme, this would be possible, either at any time, or during specific intervals, or only on the closure of the scheme. Schemes, where the money can be recovered from the mutual fund only on the closure of the scheme, are compulsorily listed on a stock exchange. In such schemes, the investor can sell the units through the stock exchange platform to recover the prevailing value of the investment.

If a 'material' development takes place related to investments in a mutual fund scheme, then such information is made available on time. This helps an investor to take an appropriate action, including taking out the money from a mutual fund scheme. This combination of transparency and liquidity enhances the safety.

Tax Deferral

Mutual funds are not liable to pay tax on the income they earn. If the same income were to be earned by the investor directly, then tax may have to be paid in the same financial year.

Mutual funds offer options, whereby the investor can let the money grow in the scheme for several years. By selecting such options, it is possible for the investor to defer the tax liability. This helps investors to legally build their wealth faster than would have been the case if they were to pay tax on the income each year.

Tax benefits

Specific schemes of mutual funds (Equity Linked Savings Schemes) give investors the benefit of deduction of the amount subscribed (up to Rs. 150,000 in a financial year under Section 80C of the old tax regime), from their income that is liable to tax. This reduces their taxable income, and thereforethe tax liability.

Convenient Options

The options offered under a scheme allow investors to structure their investments in line with their liquidity preference and tax position.

There are also transaction conveniences like the ability to withdraw only part of the money from the investment account, the ability to invest the additional amount to the account, setting up systematic transactions, etc.

Investment Comfort

Once an investment is made with a mutual fund, they make it convenient for the investor to make further purchases with very little documentation. This simplifies subsequent investment activity.

Regulatory Comfort

The regulator, Securities and Exchange Board of India (SEBI), has mandated strict checks and balances in the structure of mutual funds and their activities. Mutual fund investors benefit from such protection.

Systematic Approach to Investments

Mutual funds also offer facilities that help investors invest amounts regularly through a Systematic Investment Plan (SIP); or withdraw amounts regularly through a Systematic Withdrawal Plan (SWP); or move money between different kinds of schemes through a Systematic Transfer Plan (STP). Such systematic approaches promote investment discipline, which is useful in long-term wealth creation and protection.

2.1.6 Limitations of Mutual Fund

Lack of Portfolio Customization

Some brokerages and asset management firms offer Portfolio Management Services (PMS) to large investors. In a PMS, the investor has better control over what securities are bought and sold on his behalf. The investor can get a customized portfolio in case of PMS.

On the other hand, a unit-holder in a mutual fund is just one of several thousand investors in a scheme. Once a unit-holder has bought into the scheme, investment management is left to the fund manager (within the broad parameters of the investment objective). Thus, the unitholder cannot influence what securities or investments the scheme would invest into.

Choice Overload

There are multiple mutual fund schemes offered by several mutual fund houses and multiple options within those schemes which makes it difficult for investors to choose between them. Greater dissemination of industry information through various media and availability of professional advisors or mutual fund distributors in the market helps investors handle this overload.

In order to overcome this choice overload, SEBI has introduced the categorisation of mutualfunds to ensure uniformity in characteristics of similar type of schemes launched by different mutual funds. This would help investors to evaluate the different options available before making an informed decision to invest.

No Control Over Costs

All the investor's money is pooled together in a scheme. Costs incurred for managing the scheme are shared by all the Unit-holders in proportion to their holding of units in the scheme. Therefore, an individual investor has no control over the costs in a scheme.

SEBI has however imposed certain limits on the expenses that can be charged to any scheme. These limits, which vary with the size of assets and the nature of the scheme, are discussed later. However, at the same time, it should be noted that the market forces also push the cost down, and there are many schemes that operate at expenses much lower than the limits allowed by the regulator. This aspect turns out to be advantageous for investors.

No Guaranteed Returns

The structure of mutual funds is such that—it is a pass-through vehicle and passes on the risk and return to the fund’s investors. That itself protects the interests of the investors. A mutual fund is not a guaranteed return product. It is just another way of managing money–except that instead of an investor–it is a professional fund management team that takes care of the funds invested. The performance of these investments impacts the returns generated by the mutual fund scheme. The deciding factors are: the movement of the specific market in which the money is invested, the performance of individual securities held and the skills of the investment management team. Out of these, the fund manager can work towards improving one’s skills, but the other factors are out of his control.

2.2 Classification of Mutual Funds

Mutual funds can be classified in multiple ways. Funds can be classified based on the investment objective, as discussed earlier. We have different types of mutual fund schemes--growth funds, income funds, and liquid funds. The names of the categories suggest the investment objectives of the schemes. The other ways in which the mutual funds can be classified have been discussed below.

2.2.1 By the structure of the fund

Mutual fund schemes are structured differently. Some schemes are open for purchase and repurchase on a perpetual basis. Once the scheme is launched, the scheme remains open for transactions, and hence the name of this category of schemes is open-ended funds. On the other hand, some schemes have a fixed maturity date. This means that these schemes are structured to operate for a fixed period till the maturity date and cease to exist thereafter. Since the closure of the scheme is pre-decided, such schemes are known as close-ended schemes. Apart from these two, there are a couple of other variants, which would be discussed later.

Open-ended funds allow the investors to enter or exit at any time, after the NFO.[5] Investors can buy additional units in the scheme any time after the scheme opens for ongoing transactions. Prospective investors can also buy units. At any time, the existing investors can redeem their investments, that is, they can sell the units back to the scheme to get their money back.

Although some unit-holders may exit from the scheme, wholly or partly, the scheme continues operations with the remaining investors. The scheme does not have any kind of time frame in which it is to be closed. The ongoing entry and exit of investors imply that the unit capital in an open-ended fund would keep changing on a regular basis.

When an investor invests money in the scheme, new units would be created and thus the unit balance would increase. On the other hand, when someone exits the scheme (fully or partly), the units sold back to the scheme would be cancelled, due to which the unit balance of the scheme would go down.

Close-ended funds have a fixed maturity. Investors can buy units of a close-ended scheme, from the fund, only during its NFO. The investors cannot transact with the fund after the NFO is over. At the end of the maturity period, the scheme is wound up, units are cancelled and the money is returned to the investors. The fund makes arrangements for providing liquidity, post-NFO through listing of the units on a stock exchange. Such listing is compulsory for close-ended schemes to provide liquidity to the investors. Therefore, after the NFO, investors who want to buy units will have to find a seller for those units in the stock exchange. Similarly, investors who want to sell units will have to find a buyer for those units in the stock exchange.

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[5] NFO stands for New Fund Offer, or the launch of a mutual fund scheme. This is when the scheme is offered to public for the first time.

Since post-NFO sale and purchase of units happen to or from counter-party in the stock exchange–and not to or from the scheme–the unit capital of the scheme remains stable or fixed. Every close ended scheme, other than an equity linked savings scheme, shall be listed on a recognized stock exchange within such time period and subject to such conditions as specified by SEBI.

Post-NFO, the sale and purchase transactions happen on the stock exchange between two different investors, and the fund is not involved in the transaction. Depending on the demand-supply situation for the units of the scheme on the stock exchange, the transaction price could be higher or lower than the prevailing NAV. Therefore, the transaction price is likely to be different from the NAV. Experience suggests that most of the time, the units trade at a discount to the NAV. This can be understood logically. The buyer has money, and hence many options to choose from, whereas the seller has the units of the close-ended fund. This puts the buyer in a better bargaining position.

Interval funds combine features of both open-ended and close-ended schemes. They are largely close-ended but become open-ended at pre-specified intervals. For instance, an interval scheme might become open-ended between January 1 to 15, and July 1 to 15, each year. The benefit for investors is that, unlike in a purely close-ended scheme, they are not completely dependent on the stock exchange to be able to buy or sell units of the interval fund. However, to provide liquidity to the investors between these intervals, the units must be compulsorily listed on stock exchanges to allow investors an exit route.

The periods when an interval scheme becomes open-ended, are called 'transaction periods'; the period between the close of a transaction period, and the opening of the next transaction period is called the 'interval period'. Minimum duration of the transaction period is 2 days, and maximum duration of the interval period is 15 days. No redemption/repurchase of units is allowed except during the specified transaction period (during which both subscription and redemption may be made to and from the scheme).

While the units of close-ended and interval funds are listed on the stock exchanges, the liquidity in these units may be poor. At the same time, even when the trade happens, the actual price may be at a discount to the NAV. This happens because of the demand-supply situation for the units of the schemes, as discussed earlier.

The Exchange Traded Funds (ETF) (See box 2.1), are an innovation that addresses this liquidity issue. The market price also tracks the NAV very closely[6].

[6] https://www.sebi.gov.in/legal/circulars/jul-2021/circular-on-intra-day-net-asset-value-nav-for-transactions-in-units-of-exchange- traded-funds-directly-with-asset-management-companies_51520.html

Box 2.1: Exchange Traded Funds (ETFs)

Exchange Traded Funds (ETFs) are those mutual fund schemes that are traded on a stock exchange just like any other stock. These funds usually track an index or have a fixed portfolio strategy based on some index so they are passive in nature. In effect they are like a normal mutual fund but the only difference being that while an open-ended fund would have a single NAV at the end of the day at which all the transactions take place the situation is different for the ETF. Since the ETF is traded for the entire day, it gives multiple opportunities and prices at which the investor can either enter or exit the fund. This is similar to any other listed securities where there are multiple prices at which transactionstake place and this is witnessed for an ETF too. ETFs provide additional liquidity for investors and enable them to take benefit of changes that take place in prices during the day. The downside to this is that the prices might fluctuate quite a bit and there might be a big gap with the NAV of the fund too. So, investors need to be careful about the price at which they are undertaking their transactions. There is ease of investing in an ETF because one can buy them just like a stock and the minimum investment here is also so small that any investor can participate by having these in their portfolio. Investors who already transact on the stock exchanges and have a demat account can use these for investing in ETFs. There is a huge variety in terms of the indices on which ETFs are based and hence this provides investors with a lot of choice in terms of their investments and the kind of exposure that they can take. Increasingly mutual funds are also coming out with different variants that employ varying strategies for their ETF offerings. Like Gold ETF recently Silver ETF has also been introduced by SEBI that can be defined as a mutual fund scheme that invests primarily in silver or silver related instruments which are specified by SEBI from time to time.

2.2.2 By the management of the portfolio

Actively managed funds are funds where the fund manager has the flexibility to choose the investment portfolio, within the broad parameters of the investment objective of the scheme. Since this increases the role of the fund manager, the expenses for running the fund turn out to be higher. Investors expect actively managed funds to perform better than the market.

Passive funds invest on the basis of a specified index; whose performance it seeks to track. Thus, a passive fund tracking the S&P BSE Sensex would buy only the shares that are part of the composition of the S&P BSE Sensex. The proportion of each share in the scheme's portfolio would also be the same as the weightage assigned to the share in the S&P BSE Sensex. Thus, the performance of these funds tends to mirror the concerned index. They are not designed to perform better than the market. Such schemes are also called index schemes. Since the portfolio is determined by the index itself, the fund manager has no role in deciding on investments. Therefore, these schemes have low running costs.

SEBI has introduced Mutual Fund Lite framework for passively managed schemes of mutual funds. "MF Lite" is a mutual fund that is having only such index funds, exchange traded funds, fund of funds or other mutual fund schemes as may be specified by the SEBI from time to time. [7]

2.2.3 By the investment universe

This type of classification looks at the investment universe where the scheme may invest money. There are equity funds, fixed income funds, money market funds, gold funds, international funds, etc. Here, the category names indicate where the money could be invested.

This classification may get further specific depending on narrowing the investment universe. For example, within equity funds, we have large-cap funds, mid-cap funds, etc. Similarly, within debt funds, we have Government Securities funds and corporate debt funds.

2.2.4 Mutual fund scheme categorization and SEBI regulation

With a view to bring in standardization in the classification of mutual funds and to ensure the schemes are clearly distinct from one another, SEBI issued a circular on Categorization and Rationalization of Mutual Fund Schemes in 2017.

The objective was to bring uniformity in the characteristics of similar type of schemes launched bydifferent mutual fund houses so that the investor can objectively evaluate the schemes chosen forinvestment. Accordingly, there are five broad categories of mutual fund schemes. Within each category, there are many sub-categories.[8]

A. Equity Schemes (11 sub-categories)
B. Debt Schemes (16 sub-categories)
C. Hybrid Schemes (6 sub-categories)
D. Solution Oriented Schemes (2 sub-categories)
E. Other Schemes (2 sub-categories)

A. Equity schemes

1. **Multi Cap Fund**: An open-ended equity scheme investing across large cap, mid cap, small cap stocks. (See Box 2.2)[9]

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[7] https://www.sebi.gov.in/legal/circulars/dec-2024/introduction-of-a-mutual-funds-lite-mf-lite-framework-for-passively-managed-schemes-of-mutual-funds_90393.html

[8] SEBI Circular No. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017, and SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 4, 2017

9 https://www.sebi.gov.in/legal/circulars/sep-2020/circular-on-asset-allocation-of-multi-cap-

The minimum investment in equity and equity related instruments shall be 75 percent of total assets.

Vide SEBI Circular dated September 11, 2020, multi-cap funds shall be defined as those with minimum investment in equity & equity related instruments --75% of total assets in the following manner:

- Minimum investment in equity & equity related instruments of large cap companies:25% of total assets
- Minimum investment in equity & equity related instruments of mid cap companies: 25% of total assets
- Minimum investment in equity & equity related instruments of small cap companies: 25% of total assets

For this purpose, SEBI also defined the various market capitalization categories as under:

The same definition applies in case of other scheme categories, too, as applicable.

Box 2.2: Definition of Large-cap, Mid-cap and Small-cap

Large cap, mid cap and small cap companies are defined as follows:

1. Large Cap: 1st -100th company in terms of full market capitalization
2. Mid Cap: 101st -250th company in terms of full market capitalization
3. Small Cap: 251st company onwards in terms of full market capitalization

2. Large Cap Fund: An open-ended equity scheme predominantly investing in large cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be 80 percent of total assets.

3. Large and Mid-Cap Fund: An open-ended equity scheme investing in both large cap and mid cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be 35 percent of total assets. The minimum investment in equity and equity related instruments of mid cap stocks shall be 35 percent of total assets.

4. Mid Cap Fund: An open-ended equity scheme predominantly investing in mid cap stocks. The minimum investment in equity and equity related instruments of mid cap companies shall be 65 percent of total assets.

5. Small cap Fund: An open-ended equity scheme predominantly investing in small cap stocks.

funds_47542.html (dated September 11, 2020).

Minimum investment in equity and equity related instruments of small cap companies shall be 65 percent of total assets.

6. **Dividend Yield Fund**: An open-ended equity scheme predominantly investing in dividend yielding stocks. Scheme should predominantly invest in dividend yielding stocks. The minimum investment in equity shall be 65 percent of total assets.

7. **Value Fund or Contra Fund**: A value fund is an open-ended equity scheme following a value investment strategy. Minimum investment in equity & equity related instruments shall be 65 percent of total assets. A contra fund is an open-ended equity scheme following a contrarian investment strategy. Mutual Funds will be permitted to offer either Value fund or Contra fund.

8. **Focused Fund**: An open-ended equity scheme investing in maximum 30 stocks (the scheme needs to mention where it intends to focus, viz., multi cap, large cap, mid cap, small cap). Minimum investment in equity & equity related instruments shall be 65 percent of total assets.

9. **Sectoral/Thematic**: An open-ended equity scheme investing in a specific sector such as bank, power is a sectoral fund. While an open-ended equity scheme investing in line with an investment theme. For example, an infrastructure thematic fund might invest in shares of companies that are into infrastructure, construction, cement, steel, telecom, power etc. The minimum investment in equity and equity related instruments of a particular sector/ theme shall be 80 percent of total assets.

10. **Equity Linked Savings Scheme**: An open-ended equity linked saving scheme with a statutory lock-in of 3 years and tax benefit. The minimum investment in equity and equity related instruments shall be 80 percent of total assets (in accordance with Equity Linked Saving Scheme, 2005 notified by the Ministry of Finance).

11. **Flexi-cap Fund**: An open-ended equity scheme where the minimum investment in equity and equity related assets are 65% of the total assets. This would be a dynamic fund where there can be investment across large cap, mid cap as well as small cap stocks.

B. Debt schemes

1. **Overnight Fund**: An open-ended debt scheme investing in overnight securities. The investment is in overnight securities having a maturity of 1 day.

2. **Liquid Fund**: An open-ended liquid scheme whose investment is into debt and money market securities with a maturity of up to 91 days only.

3. **Ultra-Short Duration Fund**: An open ended ultra-short-term debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio between 3 months and 6 months.

4. **Low Duration Fund**: An open-ended low duration debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio between 6 months and 12 months.

5. **Money Market Fund**: An open-ended debt scheme investing in money market instruments having maturity up to 1 year.

6. **Short Duration Fund**: An open-ended short-term debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio between 1 year and 3 years.

7. **Medium Duration Fund**: An open-ended medium-term debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio being between 3 years to 4 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 4 years.

8. **Medium to Long Duration Fund**: An open-ended medium-term debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio between 4 years and 7 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 7 years.

9. **Long Duration Fund**: An open-ended debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio greater than 7 years.

10. **Dynamic Bond**: An open-ended dynamic debt scheme investing across duration.

11. **Corporate Bond Fund**: An open-ended debt scheme predominantly investing in AA+ and above rated corporate bonds. The minimum investment in corporate bonds shall be 80 percent of total assets (only in AA+ and above rated corporate bonds).

12. **Credit Risk Fund:** An open-ended debt scheme investing in below highest rated corporate bonds. The minimum investment in corporate bonds shall be 65 percent of total assets (only in AA (excludes AA+ rated corporate bonds) and below rated corporate bonds).[10]

13. **Banking and PSU Fund**: An open-ended debt scheme predominantly investing in debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal

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[10] Vide SEBI Circular (SEBI/HO/IMD/DF3/CIR/P/2017/114 October 6, 2017**)** words/phrases that highlight/emphasize only return aspect of the scheme shall not be used in the name of the scheme (for instance credit opportunities fund, high yield fund, credit advantage etc.)

Bonds. The minimum investment in such instruments should be 80 percent of total assets.

14. Gilt Fund: An open-ended debt scheme investing in government securities across maturity. The minimum investment in G-secs is defined to be 80 percent of total assets (across maturity).

15. Gilt Fund with 10-year constant duration: An open-ended debt scheme investing in government securities having a constant maturity of 10 years. Minimum investment in G-secs is 80 percent of total assets such that the Macaulay duration of the portfolio is equal to 10 years.

16. Floater Fund: An open-ended debt scheme predominantly investing in floating rate instruments(including fixed rate instruments converted to floating rate exposures using swaps/derivatives). Minimum investment in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives) shall be 65 percent of total assets.

C. Hybrid Schemes

1. **Conservative Hybrid Fund**: An open-ended hybrid scheme investing predominantly in debt instruments. Investment in debt instruments shall be between 75 percent and 90 percent of total assets while investment in equity and equity instruments shall be between 10 percent and 25 percent of total assets.

2. **Balanced Hybrid or Aggressive Hybrid Fund**:

Balanced Hybrid Fund: An open-ended balanced scheme investing in equity and debt instruments. The investment in equity and equity related instruments shall be between 40 percent and 60 percent of total assets while investment in debt instruments shall be between 40 percent and 60 percent. No arbitrage is permitted in this scheme.

Aggressive Hybrid Fund: An open-ended hybrid scheme investing predominantly in equityand equity related instruments. Investment in equity and equity related instruments shall be between 65 percent and 80 percent of total assets while investment in debt instruments shall be between 20 percent and 35 percent of total assets.
Mutual funds in India are permitted to offer either Aggressive Hybrid Fund or Balanced Fund.

3. **Dynamic Asset Allocation or Balanced Advantage**: It is an open-ended dynamic asset allocation fund with investment in equity/debt that is managed dynamically.

4. Multi Asset Allocation: An open-ended scheme investing in at least three asset classes with a minimum allocation of at least 10 percent each in all three asset classes. Foreign securities are not treated as a separate asset class in this kind of scheme.

5. Arbitrage Fund: An open-ended scheme investing in arbitrage opportunities. The minimum investment in equity and equity related instruments shall be 65 percent of total assets.

6. Equity Savings: An open-ended scheme investing in equity, arbitrage and debt. The minimum investment in equity and equity related instruments shall be 65 percent of total assets and the minimum investment in a debt shall be 10 percent of total assets. The minimum hedged and unhedged investment needs to be stated in the SID. Asset Allocation under defensive considerations may also be stated in the SID.

D. Solution Oriented Schemes

1. Retirement Fund: An open-ended retirement solution-oriented scheme having a lock-in of 5 years or till retirement age (whichever is earlier). This is meant for long term planning related to acquiring a corpus for retirement.

2. Children's Fund: An open-ended fund for investment for children having a lock-in for at least 5 years or till the child attains the age of majority (whichever is earlier). This is meant to invest to build a corpus for the child and their needs in the coming years.

E. Other Schemes

1. Index Funds/Exchange Traded Fund: An open-ended scheme replicating/tracking a specific index. This minimum investment in securities of a particular index (which is being replicated/ tracked) shall be 95 percent of total assets.

2. Fund of Funds (Overseas/Domestic): An open-ended fund of fund scheme investing in an underlying fund. The minimum investment in the underlying fund shall be 95 percent of total assets.

There can be only one scheme per category, except in the following cases:

1. Index funds and ETFs replicating or tracking different indices,
2. Fund of Funds having different underlying schemes, and
3. Sector funds or thematic funds investing in different sectors or themes.

Apart from the above, let us also take a look at certain other categories:

Fixed Maturity Plans are a kind of close-ended debt fund where the duration of the investment portfolio is closely aligned to the maturity of the scheme. AMCs tend to structure the scheme around pre-identified investments. Further, being close-ended schemes, they do not accept money post-NFO. Therefore, the fund manager has a little ongoing role in deciding on the investment options. Such a portfolio construction gives more clarity to investors on the likely returns if they stay invested in the scheme until its maturity (though there can be no guarantee or assurance of such returns). This helps them compare the risk and returns of the scheme with alternative investments.

Target Maturity Date Funds (TMF) are a type of debt mutual fund in India that offer a unique investment strategy. These funds are designed to mature on a specific date, typically ranging from 2 to 10 years, allowing investors to plan their financial goals accordingly. TMFs invest in bonds with matching maturities, minimizing reinvestment risk and providing predictable returns. They are ideal for investors seeking low-risk, income-generating investments with a defined horizon, such as retirement planning or children's education.

Infrastructure Debt Funds are investment vehicles that can be sponsored by commercial banks and NBFCs in India in which domestic/offshore institutional investors, especially insurance and pension funds can invest through units and bonds issued by the IDFs. Infrastructure Debt Funds (IDFs), can be set up either as a Trust or as a Company. A trust based IDF would normally be a Mutual Fund (MF), regulated by SEBI, while a company based IDF would normally be an NBFC regulated by the Reserve Bank.

Real Estate Mutual Fund scheme invests directly or indirectly in real estate assets or other permissible assets in accordance with the SEBI (Mutual Funds) Regulations, 1996. Other real estate and infrastructure investment instruments allowed by SEBI are Real Estate Investment Trusts (REITs) and Infrastructure Investment Trusts (InvITs). However, these two are not mutual fundschemes. (See Box 2.2)

Box 2.2: Real Estate Investment Trusts and Infrastructure Investment Trusts

Real Estate Investment Trusts (REIT) are trusts registered with SEBI that invest in commercial real estate assets. The REIT will raise funds through an initial offer and subsequently through follow-on offers, rights issue and institutional placements.

Infrastructure Investment Trusts (InvIT) are trusts registered with SEBI that invest in the infrastructure sector. The InvIT will raise funds from the public through an initial offer of units.

Environmental, Social and Governance ("ESG") Investing[11]

SEBI has introduced a separate sub-category for ESG investments under the thematic category of Equity schemes. Any scheme under the ESG category can be launched with one of the following strategies:

a. Exclusion
b. Integration
c. Best-in-class & Positive Screening
d. Impact investing
e. Sustainable objectives
f. Transition or transition related investments

Moneys collected under ESG schemes shall be invested in the manner as specified by the SEBI from time to time.

2.2.5 New types of funds

There is an increase in the variation seen in the kinds of funds that are being launched by mutual fund houses. Some of these variants are discussed below.

Smart Beta Fund

Smart beta funds are an extension of index or Exchange Traded Funds (ETFs) as they change the basis of the exposure in the portfolio to the index using alternative strategies. For example, a fund that tracks an index will have the same exposure as the index and this would mean weightage by market capitalisation. Smart beta strategies rely less on market cap and this could include things like equal weightage or exposure based on additional parameters. The whole idea of smart beta funds is to improve returns. Increase diversification and reduce risk.

Quant Funds

Quant funds rely on data analysis and numbers usually undertaken by machines to select the securities in the portfolio. There are pre-determined models that are created and these are derived through analysis of past data. The model then runs through the emerging data to select the holdings and make decisions about buying and selling. This takes out the human element in decision making.

[11] Candidates may read more about ESG Investing in MF at: https://www.sebi.gov.in/legal/circulars/jul-2023/new-category-of-mutual-fund-schemes-for-environmental-social-and-governance-esg-investing-and-related-disclosures-by-mutual-funds_74186.html

International REITs

A fund that invests in Real Estate Investment Trusts abroad gives an exposure to the investor both to international funds plus the commercial real estate sector. In India, too the number of REITs being listed are increasingly slowly and this kind of fund provides a different kind of holding to those who need such exposure.

Specialized Investment Fund

SEBI in its recent amendment to SEBI (Mutual Funds) Regulations, has introduced a new product line under mutual funds known as Specialized Investment Fund (SIF). The minimum required investment amount is Rs. 10 lakhs from the investors across all investment strategies.

2.3 Growth of the mutual fund industry in India

India witnessed a surge in the mutual fund assets under management (AUM) from Rs. 11.89 lakh crores in March 2015 to Rs. 66.70 lakh crore in March 2025 (source AMFI).

Another major development is the rising popularity of SIPs.[12] The SIP contribution has grown phenomenally from Rs. 8,055 crores in March 2019 to Rs. 26,400 crores in January 2025.[13]

[12]For latest updates of MF industry growth, please refer: https://www.amfiindia.com/research-information/other-data/industry-data-analysis

[13] Source: Mutual funds route to Viksit Bharat @2047, a report published by pwc and AMFI.

Chapter 2: Sample Questions

1. _____ indicates how much money can be generated per unit of mutual fund in case the scheme is liquidated.

    a. Asset Under Management
    b. Net Asset Value
    c. Market price
    d. Exit load

2. Each mutual fund scheme must have a stated investment objective. State whether True or False.

    a. True
    b. False

3. Which of the following is an advantage of mutual funds?

    a. Customized portfolio
    b. Convenience to buy stocks and bonds directly from the mutual fund
    c. Economies of scale

4. The transparency levels in mutual funds are very low. State whether True or False.

    a. True
    b. False

5. Which amongst the following categories of mutual funds have a fixed maturity date?

    a. Open-ended funds
    b. Exchange Traded Funds
    c. Close-ended funds
    d. Interval funds

6. How do ETFs differ from open-ended mutual funds in terms of trading?

    a. ETFs can only be traded once a day at NAV
    b. ETFs are traded on stock exchanges throughout the day like stocks
    c. Mutual funds provide intraday trading
    d. ETFs have fixed prices like mutual funds

CHAPTER 3: LEGAL STRUCTURE OF MUTUAL FUNDS IN INDIA

Learning Objectives:

After studying this chapter, you should know about:

- Legal Structure of mutual funds
- Key Constituents of a Mutual Fund
- Organization Structure of Asset Management Company
- Role and support functions of service providers of mutual funds

3.1 Structure of Mutual Funds in India

SEBI (Mutual Fund) Regulations, 1996 define "mutual fund" as "a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold-related instruments, silver or silver related instruments, real estate assets and such other assets and instruments as specified by SEBI from time to time." The firm must set up a separate Asset Management Company (AMC) to run a mutual fund business.

SEBI has stipulated the legal structure under which mutual funds in India need to be constituted. The structure, which has inherent checks and balances to protect the interests of the investors, can be briefly described as follows:

- Mutual funds are constituted as Trusts. Therefore, they are governed by the Indian Trusts Act, 1882

- The mutual fund trust is created by one or more Sponsors, who are the main persons behind the mutual fund business.

- Every trust has beneficiaries. The beneficiaries, in the case of a mutual fund trust, are the investors who invest in various schemes of the mutual fund, called unit-holders. The operations of the mutual fund trust are governed by a Trust Deed, which is executed between the sponsors and the trustees. SEBI has laid down various clauses that need to be part of the Trust Deed.

- The Trust acts through its trustees. Therefore, the role of protecting the interests of the beneficiaries (investors/ unit-holders) is that of the Trustees. The first trustees are named in theTrust Deed, which also prescribes the procedure for a change in Trustees.

- To perform the trusteeship role, either individuals may be appointed as trustees or a

Trustee company may be appointed. When individuals are appointed as trustees, theyare jointly referred to as 'Board of Trustees'. A trustee company functions through itsBoard of Directors.

- Day to day management of the schemes is handled by an Asset Management Company (AMC). The AMC is appointed by the sponsor or the Trustees.

- The trustees execute an investment management agreement with the AMC, setting out its responsibilities.

- Although the AMC manages the schemes, custody of the assets of the scheme (securities, gold, gold-related instruments & real estate assets & silver or silver related instruments) is with a Custodian, who is appointed by the Trustees.

- Investors invest in various schemes of the mutual fund. The record of investors and their unit-holding may be maintained by the AMC itself, or it can appoint a Registrar & Transfer Agent (RTA).

3.2 Key Constituents of a Mutual Fund

3.2.1 Sponsors

The application to SEBI for registration of a mutual fund is made by the sponsor(s). Thereafter, the sponsor invests in the capital of the AMC.

Since sponsors are the main people behind the mutual fund operation. The sponsor should have a sound track record and reputation of fairness and integrity in all business transactions. The sponsor should be carrying on business in financial services for not less than 5years. The sponsor should ensure a positive net worth (share capital plus reserves minus accumulated losses) in all the immediately preceding 5 years. The sponsor should be a fit and proper person for this kind of operation.

Association of Mutual Funds in India's (AMFI) website[14] lists the names of all the Asset Management Companies, which are members of AMFI, in terms of the category of the sponsor, viz., Banks, Institutions, Private sector, etc. Within banks, there are predominantly Indian joint ventures, and others; and similarly, within the private sector, there are Indian, foreign, and predominantly Indian joint ventures.

[14] www.amfiindia.com

3.2.2 Board of Trustees

The trustees have a critical role in ensuring that the mutual fund complies with all the regulations and protects the interests of the unit-holders.

The SEBI Regulations stipulate that:

- Every trustee must be a person of ability, integrity and standing.
- A person who is guilty of moral turpitude cannot be appointed as a trustee.
- A person convicted of any economic offence or violation of any securities law cannot be appointed as trustee.
- No AMC and no director (including independent director), officer, an employee of an AMC shall be eligible to be appointed as a trustee of a mutual fund.
- No person who is appointed as a trustee of a mutual fund shall be eligible to be appointed as trustee of any other mutual fund.

Prior approval of SEBI needs to be taken before a person is appointed as Trustee.

The sponsor will have to appoint at least 4 trustees. If a trustee company has been appointed, then that company would need to have at least 4 directors on the Board. Further, at least two-thirds of the trustees on the Board of the trustee company would need to be independent trustees i.e., not associated with the sponsor in any way.

SEBI expects Trustees to perform a key role in ensuring legal compliances and protecting the interest of investors. Accordingly, various General Due Diligence and Special Due Diligence responsibilities have been assigned to them. The rights and responsibilities include the following:

- The trustees shall enter into an Investment Management Agreement with the AMC that will define the functioning of the AMC in making and managing the mutual fund's investments.
- The trustees have the right to seek any information they require from the AMC to facilitate meeting their responsibilities as trustees.
- The trustees shall ensure before the launch of any scheme that all the key personnel and associates such as fund managers, compliance officers, R&T agents, auditors and others have been appointed and all systems are in place.

- The trustees shall periodically review the service contracts entered into for custody arrangements, transfer agency and others and ensure they are in the interest of the unitholders and that all service providers are registered with SEBI.
- The trustees shall ensure that all transactions entered into by the AMC are in compliance with the regulations and the scheme's objectives and intent.
- The trustees shall ensure that the interests of the unitholders are not compromised in any of the AMC's dealings with brokers, other associates and even unitholders of other schemes.
- If the trustees believe that the conduct of the business of the mutual fund is contrary to the provisions of the regulations, then they must take corrective action and inform SEBI of the same.
- The trustees shall not permit a change in the fundamental attributes of the scheme,[15] the trust or fees and expenses or any other change that will affect the interests of the unitholders unless written communication is sent to each unitholder, a notice is given in the newspaper with national circulation and the unitholders are given the option to exit at NAV without paying an exit load.
- On a quarterly basis the trustees shall review the transactions of the mutual fund with the AMC and its associates.
- The trustees shall periodically review the investor complaints received and their redressal by the AMC.
- The trustees shall ensure that the trust property is properly protected, held and administered.
- The trustees shall obtain and consider the reports of the auditors and compliance officers in their periodic meetings and take action as required.
- The trustees shall file half-yearly reports to SEBI.

The Trustees shall exercise independent due diligence on certain "core responsibilities", which includes:

- Ensuring fairness of the fees and expenses charged by the AMCs.
- Reviewing the performance of AMC in its schemes *vis-a-vis* performance of peers or the appropriate benchmarks.
- Ensuring that the AMCs have put in place adequate systems to prevent mis-selling to increase AUM and valuation of the AMCs.
- Ensuring that operations of AMCs are not unduly influenced by the AMCs Sponsor, its associates and other stakeholders of AMCs.
- Ensuring that undue or unfair advantage is not given by AMCs to any of their associates/group entities.
- Addressing conflicts of interest, if any, between the shareholders/stakeholders/associates of the AMCs and unitholders.
- Putting in place adequate systems to prevent misconduct including market

[15] Fundamental attribute means type of scheme, investment objective, investment patterns, terms of issue.

abuse/misuse of information by the employees, AMC and connected entities of the AMCs.

The strict provisions go a long way in promoting the independence of the role of trusteeship in a mutual fund. The trustees of mutual funds can now seek administrative assistance to monitor various activities of asset management companies.

3.2.3 Mutual Fund Trust

A mutual fund is constituted in the form of a trust and the instrument of trust is 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 of the trustees named in such an instrument.

3.2.4 Asset Management Company

Day to day operations of a mutual fund is handled by the AMC. The sponsor or, the trustees if so, authorized by the trust deed, shall appoint the AMC with the approval of SEBI.

As per SEBI regulations:

- The directors of the AMC need to be persons having adequate professional experience in the finance and financial services related field.
- The directors as well as key personnel of the AMC should not have been found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws.
- Key personnel of the AMC should not have worked for any asset management company or mutual fund or any intermediary during the period when its registration was suspended orcancelled at any time by SEBI.

Prior approval of the trustees is required before a person is appointed as a director on the board of the AMC. The AMC is responsible for conducting the activities of the mutual fund. It, therefore, arranges for the requisite offices and infrastructure, engages employees, provides for the requisite software, handles advertising and sales promotion, and interacts with regulators and various service providers.

The AMC has to take all reasonable steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of the SEBI regulations and the trust deed. Further, it has to exercise due diligence and care in all its investment decisions.

The appointment of an AMC can be terminated by a majority of the trustees, or by 75 percent of the Unit-holders. However, any change in the AMC is subject to prior approval of SEBI and the Unit-holders.

3.2.5 Custodian

The custodian has custody of the assets of the fund. As part of this role, the custodian needs to accept and give delivery of securities for the purchase and sale transactions of the various schemes of the fund. Thus, the custodian settles all the transactions on behalf of the mutual fund schemes.

All custodians need to register with SEBI under the SEBI (Custodian) Regulations 1996. The Custodian is appointed by the trustees. A custodial agreement is entered into between the trustees and the custodian.

The SEBI regulations provide that if the sponsor or its associates control 50 percent or more of the voting rights of the shares of a custodian, or if 50 percent or more of the directors of a custodian represent the interest of the sponsor or its associates, then, unless certain specific conditions are fulfilled, that custodian cannot be appointed for the mutual fund operation of the sponsor orits associate or subsidiary company.

An independent custodian ensures that the securities are indeed held in the scheme for the benefit of investors–an important control aspect. The custodian also tracks corporate actions such as dividends, bonuses and rights in companies where the fund has invested.

Unit Holder Protection Committee (UHPC)

As per the SEBI MF Regulations, 1996, the AMC is required to constitute a Unit Holder Protection Committee (UHPC). The UHPC shall be responsible for:

1. Protection of interests of unit holders of mutual fund schemes vis-à-vis all products and services provided by the AMC,

2. Ensuring adoption of sound and healthy market practices in terms of investments, sales, marketing, advertisement, management of conflict of interests, redressal of unit holders' grievances, investor awareness.

3. Compliance with laws and regulations and other related processes with specific reference to operation of the mutual fund business.

The UHPC's mandate includes (i) review the various compliance issues relating to the protection of the interests of the unit holders, and (ii) keep the unit holders well informed of and educated about mutual fund product, investor charter,[16] and complaint handling procedures.

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[16] Candidates are advised to read the investor charter for mutual https://investor.sebi.gov.in/Investor-charter.html

The UHPC is required to submit its report to the board of directors of the AMC along with recommendations for action. It will monitor the implementation of these recommendations, too.

3.3 Organization Structure of Asset Management Company

It is important to understand the various functions of an Asset Management Company (AMC) through the details of various departments within the firm (Chart 3.1).

Chart 3.1: Organisation Structure of Asset Management Company

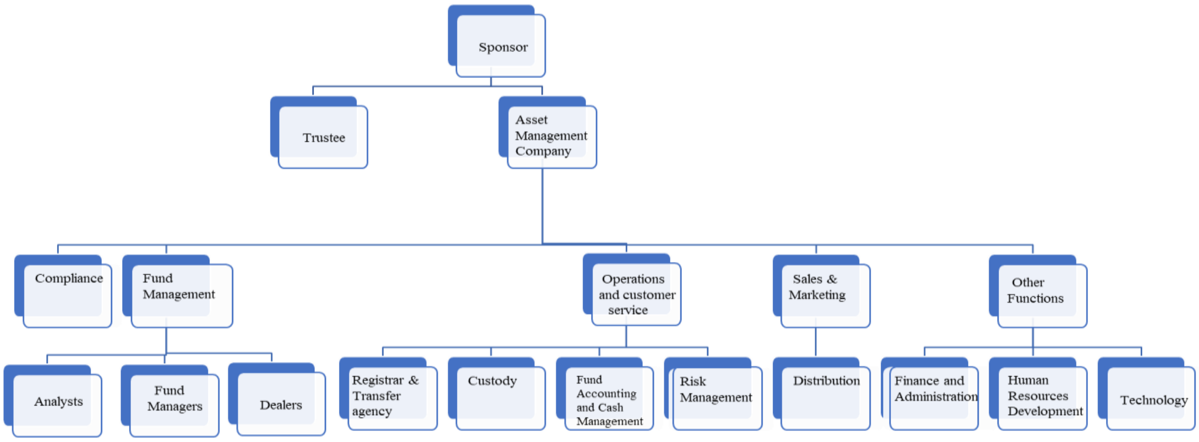

Chart 3.1 is used for the explanation of various functions within an AMC. Individual AMCs mayhave some differences in the structure.

3.3.1 Compliance Function

Compliance Officer needs to ensure all the legal compliances. In the scheme documents of new issues, the Compliance Officer signs a due-diligence certificate to the effect that all regulations have been complied with, and that all the intermediaries mentioned in the scheme related documents have the requisite statutory registrations and approvals. To ensure independence, the Compliance Officer reports directly to the head of the AMC. The Compliance Officer works closely with the Trustees on various compliance and regulatory issues. It is the responsibility of the compliance officer to report any issue of non-compliance directly and immediately to the trustees.

3.3.2 Fund management

Fund management is the most critical function in an Asset Management Company. It is at the core of the value proposition offered by the firm. The main function of this team is to invest the investors' money in line with the stated objective of the scheme and to manage the same effectively.

Normally, the team can be broken into three sub-teams, viz., the analysts, the fund managers, and the dealers.

The analysts analyse various opportunities, be it individual securities, or sectors, or the state of the markets, or the economy. Some of them may analyse the stock markets, whereas some may analyse debt markets. Within debt markets, some may evaluate credit opportunities, whereas some may analyse the interest rate movements. Their job is to identify investment opportunities.

The fund managers evaluate the opportunities presented to them by the analysts, the brokers, and other research firms. They may also identify opportunities by themselves. The performance of the scheme is the fund manager's responsibility.

The third sub-team is that of the dealers, whose responsibility is to place orders with securities brokers based on the instructions of the fund managers.

3.3.3 Operations and customer services team

When a customer visits a branch office of an AMC, s/he is attended by the customer services team. Such a team is also called the front office team. Apart from this front office team, there is also a team in the back office to help investors by resolving various queries. Both these together are part of the Customer Services Team. Many AMCs have adopted information technology solutions and have set up call centers and chatbots to answer customer queries and resolve service issues.

The Registrar and Transfer Agency (RTA), which is a big part of this unit, maintains investor records as well as allots or redeems units, processes purchase/redemption/switch requests, dividends, etc. It also generates the account statement that an investor receives.

There is a Custody Team within this group that interacts with the custodian for the purpose of settlement of various transactions that the fund management team initiates.

The Fund accounting team maintains books of accounts of each individual mutual fund scheme and calculates NAV on a daily basis.

The cash management team works as an interface between the banks and the fund management team–they ensure that money received in the bank when investors purchase units are passed on to the fund managers for further investment in securities and the investors get the redemption proceeds when they submit the redemption request.

3.3.4 Sales and Marketing Team

This team reaches out to the investors through mass media, marketing campaigns and through a distribution channel. Their major responsibilities include branding, advertising, management of various events, and distribution of mutual fund products through various distribution channels. Mostly, it is this team that would interact with the mutual fund distributors, and take care of relationship management and engagement. This team also helps in the growth of the distribution network through various interactions and training programs.

3.3.5 Other functions

These functions are largely supported functions to run the AMC operations smoothly. These include Finance/Accounts, Administration, Human Resources and Development (HRD),Information Technology. They perform various tasks that ensure smooth functioning of the AMC, as well as improve customer experiences.

- The Accounts team handles the finances of the AMC. This unit is different from the fund accounting team.
- There is an Administration Department that takes care of various facilities, offices, and other infrastructure. In many AMCs, the administration reports to the finance function.
- The HRD department is responsible for attracting, nurturing and retaining talent within the firm. They take care of the learning and development requirements of the personnel.
- The Information Technology department also referred as the Technology team, takes care of the IT infrastructure required by various functions and departments. This may also include the AMC website, as well as many facilities offered to investorsand distributors with the help of technology.

3.4 Role and Support function of Service Providers

3.4.1 Fund Accountant

The fund accountant performs the role of calculating the NAV, by collecting information about the assets and liabilities of each scheme. The AMC can either handle this activity in-house or engage a service provider. There is no need for registration with SEBI to perform this function.

3.4.2 Registrars and Transfer Agents

The Registrars and Transfer Agents (RTAs) maintain investor records. Their offices in various centers serve as Investor Service Centers (ISCs), which perform a useful role in handling the documentation of investors. The functions of the RTA include processing of purchase and redemption transactions of the investor and dealing with the financial transactions of receiving funds for purchases and making payments for redemptions, updating the unit capital of the scheme to reflect these transactions, updating the information in the individual records of the investor, called folios, keeping the investor updated about the status of their investment account and information related to the investment.

The appointment of RTA is done by the AMC. It is not compulsory to appoint an RTA. The AMC can choose to handle this activity in-house. All RTAs need to register with SEBI.

3.4.3 Auditors

Auditors are responsible for the audit of accounts.

Accounts of the mutual fund schemes need to be maintained independently of the accounts of the AMC. The auditor appointed to audit the mutual fund scheme accounts needs to be different from the auditor of the AMC.

While the scheme auditor is appointed by the Trustees, the AMC auditor is appointed by the AMC.

3.4.4 Distributors

Distributors have a key role in selling suitable types of mutual fund schemes to their clients/investors. A distributor can be empaneled with more than one AMCs. Distributors can be individuals or institutions such as distribution companies, broking companies and banks.

Distributors need to pass the NISM Certification Examination (NISM-Series- V-A: Mutual Fund Distributors (MFD) Certification Examination) and register with AMFI. Regulatory aspects of their role and, some of the distribution and channel management practices are covered later in Chapter 6 of the book.

Through a circular, SEBI has also allowed provisions for empanelment of a new cadre of mutual fund distributors, who are allowed to sell a certain limited set of schemes[17]. This new cadre of distributors can be empaneled if they clear the NISM-Series- V-B: Mutual Fund Foundation Certification Examination and register with AMFI under the particular category of distributors.

3.4.5 Collecting Bankers/Payment Aggregators

The investors' money goes into the bank account of the scheme they have invested in. These

[17] SEBI circular CIR/IMD/DF/21/2012 dated September 13, 2012.

bank accounts are maintained with collection bankers who are appointed by the AMC.

Leading collection bankers make it convenient to invest in the schemes by accepting applications of investors in most of their branches. Payment instruments against applications handed over to branches of the AMC or the RTA need to be banked with the collecting bankers so that the money is available for investment by the scheme. Thus, the banks enable the collection and payment of funds for the schemes.

Through this kind of mix of constituents and specialized service providers, most mutual funds maintain high standards of service and safety for investors.

While banks play a big role in facilitating mutual fund transactions, a new category of players have made an entry – the payment aggregators. There are some payment gateway providers, digital wallets, and payment banks. All these players facilitate the transactions by allowing investors to buy mutual fund units.

3.4.6 KYC Registration Agencies

It is mandatory for all investors in the securities market, including the mutual fund investors, to be KYC (Know Your Customer) compliant under the provisions of the Prevention of Money Laundering Act. The KYC process (covered in detail later in the book) involves establishing the identity and the address of the investor.

If the investor has to go through the KYC process with each mutual fund, then it would become a repetitive process. SEBI issued regulations for registration of central KYC Registry Agencies (KRAs) in 2011. This introduced a common KYC for investors investing in securities markets. KYC registration firms are registered with SEBI.

KRAs process various details and documents to establish the identity of the investor and assign a number through a letter. A copy of this letter can be submitted to any SEBI registered intermediary with whom the investor wants to transact. Since the KRAs deal with sensitive investor information, they are mandated to have enough checks and balances in place to ensure that confidentiality is maintained. The regulations mandate KRAs to have computerised connectivity to share data with one another.

3.4.7 Valuation agencies

SEBI has issued guidelines for the purpose of arriving at fair valuation of debt securities that are non-traded or thinly traded. According to these guidelines, there have to be at least two valuation agencies that provide valuation matrix. The AMCs have to make use of this matrix to arrive at fair valuation of these investments. AMFI has appointed CRISIL Ltd. and ICRA Ltd.

for the purpose.

3.4.8 Credit Rating Agencies

Credit rating agencies rate debt securities issued by various issuers. Fund managers consider such ratings as an initial input while taking investment decisions , prior to doing their own due diligence. In few mutual fund products, credit rating assumes greater importance. Certain categories of debt funds such as corporate bond funds, credit risk funds are defined on the basis of credit rating. Even capital protection-oriented schemes need to carry a credit rating assigned by the rating agency. Such schemes have restrictions pertaining to their investment universe, which is also a function of the creditrating assigned by these agencies.

In case of Fixed Maturity Plans (FMPs), the AMC is allowed to disclose the proposed rating profile of the scheme before the portfolio is constructed. It is then mandatory to invest in debt securities only within the proposed rating profile, or less risky papers (higher credit rating than proposed). Thus, credit rating agencies assume an important role in case of debt mutual funds.

3.4.9 Depositories and the Depository Participants

A depository is an institution, which holds the securities in dematerialised or electronic form on behalf of the investors. Initially, depositories held only equity shares on behalf of the investors, later other securities including debt securities and mutual fund units were also dematerialised. Investors have the option of holding their mutual fund units in dematerialised form through a depository participant. If not held in dematerialized form, the units are tracked in the form of Account Statements. The units of ETFs are compulsorily held in demat form as only demat securities care allowed to be traded on stock exchanges.

The depositories reach out to the investors through the depository participants. As an analogy, one can consider the depositories as the head office of a bank and the depository participants akin to the branches of the bank. Like a bank account holder does not transact directly with the head office of the bank, but only with the branch; an investor does not deal with the depository, but with the depository participant.

There are two depositories in India, viz., National Securities Depository Limited (NSDL), and Central Depository Services Limited (CDSL).

3.4.10 Stock exchanges and the transaction platforms

Investors can now transact in mutual fund units through the stock exchanges. The units of close-ended funds and ETFs are compulsorily listed on at least one stock exchange. At the same time, units of open-ended funds are also available through special segments on the stock exchanges. At the Bombay Stock Exchange (BSE), this segment is known as BSE-Star MF; while at the National Stock Exchange of India (NSE), it is called NSE Mutual Fund II Platform (NMF-II). Now, investors can also transact directly through stock exchanges.

MF Utilities India is another transaction platform for units of mutual funds. This is an initiative by the mutual fund industry under the Association of Mutual Funds in India (AMFI). This platform allows for the aggregation of transactions for a mutual fund investor. Investors can perform various transactions such as purchase, sale, switch, etc. Investors are able to complete their required transactions across multiple mutual funds using a single platform which makes it easier for them to handle.

These platforms play a very important role in enhancing the reach of mutual funds. Further, the internet and mobile based applications have helped to reduce paperwork and reduce transaction related errors. These applications make the process simple to execute and this increases the comfort level of investors to transact.

3.5 Role and Function of AMFI

- Association of Mutual Funds in India (AMFI) is the association of all the registered Asset Management Companies. The objectives of AMFI are: To define and maintain high professional and ethical standards in all areas of operation of the mutual fund industry.
- To recommend and promote best business practices and code of conduct to be followed by members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.
- To interact with SEBI and to represent to SEBI on all matters concerning the mutualfund industry.
- To represent to the Government, Reserve Bank of India and other bodies on all matters relating to the mutual fund Industry.
- To undertake a nationwide investor awareness programme to promote proper understanding of the concept and working of mutual funds.
- To disseminate information on the mutual fund industry and to undertake studies and research directly and/or in association with other bodies.
- To regulate the conduct of distributors including disciplinary actions (cancellation ofARN) for violations of Code of Conduct.
- To protect the interest of investors/unitholders.

A major role of AMFI involves the registration of mutual fund distributors, by allotting them AMFI Registration Number (ARN), which is mandatory for becoming a mutual fund distributor. Periodically, AMFI also issues various circulars recommending best practices for the asset management companies, as well as the distributors.

An important point to note here is that AMFI is neither a regulatory body nor a Self-Regulatory Organisation (SRO).

Cyber Security and Cyber Resilience

With a key objective to address evolving cyber threats, to align with the industry standards, to encourage efficient audits, and to ensure compliance by SEBI Registered Entities (REs), SEBI has issued detailed Cyber Security and Cyber Resilience Framework (CSCRF). The CSCRF also sets out standards formats for reporting by REs.

The CSCRF is standards based and broadly covers the five cyber resiliency goals adopted from Cyber Crisis Management Plan (CCMP) of Indian Computer Emergency Response Team (CERT-In) for countering Cyber Attacks and Cyber Terrorism including:

1. Anticipate
2. Withstand
3. Contain
4. Recover
5. Evolve

Chapter 3: Sample Questions

1. Mutual funds are constituted as 'Trusts' in India. Who are the beneficiaries of the trust?
    a. The employees of the Asset Management Company
    b. The mutual fund distributors
    c. Unitholders
    d. Trustees of the mutual fund

2. Who handles the day-to-day management of the mutual fund?
    a. Asset Management Company
    b. Registrar and Transfer Agency
    c. Mutual Fund Trustees
    d. Unitholders

3. Registrar and Transfer Agency function must be independent of the Asset Management Company, and it cannot be retained in-house. State whether this statement is True or False.
    a. True
    b. False

4. The custodian's major responsibility in a mutual fund is:
    a. Marketing mutual funds
    b. Managing distribution channels
    c. Holding and safeguarding securities
    d. Regulating investor complaints

CHAPTER 4: MUTUAL FUND PRODUCTS FOR THE NEW CADRE OF DISTRIBUTORS

Learning Objectives:

After studying this chapter, you should understand about:

- Liquid schemes / money market schemes
- Index Funds
- Diversified Equity Schemes
- Retirement Benefit Schemes
- Fixed Maturity Plans (FMPs)

4.1 Introduction to Mutual Fund Products for New Cadre of Distributors

Chapter 2 discussed various types of mutual funds and the scheme categorization as per the SEBI circular. This chapter deals with the specific products allowed to be distributed by the basic cadre of distributors[18].

As per the circular, the following may be considered to be empanelled as mutual fund distributors under the new cadre:

1. Postal agents,
2. Retired government and semi-government officials (class III and above or equivalent) with a service of at least 10 years,
3. Retired bank officers with a service of at least 10 years, and
4. Other similar persons (such as bank correspondents) as may be notified by AMFI/AMC from time to time

These new cadre distributors can sell only simple and performing schemes. Such products include:

1. Liquid / money market schemes
2. Index schemes
3. Diversified equity schemes
4. Retirement benefit schemes having tax benefits
5. Fixed Maturity Plans (FMPs)

These products should have returns equal to or better than their scheme benchmark returns during each of the last three years.

[18] SEBI circular CIR/IMD/DF/21/2012 dated September 13, 2012

This chapter would discuss each of these schemes in detail.

4.2 Liquid Schemes / Money Market Schemes

A Liquid Fund is an open-ended liquid scheme whose investment is into debt and money market securities with maturity of upto 91 days only.

A Money Market Fund is an open-ended debt scheme investing in money market instruments having maturity upto 1 year.

Both the above categories of funds invest in debt and money market securities, with very short maturities. As mentioned above, while money market funds can invest in money market securities that mature in less than a year; liquid funds can invest in debt and money market securities maturing within 91 days. This means the interest rate risk[19] is very low in both these funds. Money market securities also have high credit rating, and hence the credit risk[20] is very low.

These funds are considered to be among the lowest risk funds within mutual funds.

Low interest rate risk coupled with low credit risk makes these funds suitable for short term parking of surplus money. Many mutual fund distributors recommend these funds to their investors when the surplus is available for short, but uncertain periods.

Many also use these funds for another purpose. They park the customer's surplus funds in liquid or money market funds, and then periodically transfer the same in equity funds on a regular basis – a process known as Systematic Transfer Plan (STP).

4.3 Index Funds

An Index Fund is an open-ended scheme replicating/tracking a specific index. The minimum investment in securities of a particular index (which is being replicated/ tracked) shall be 95 percent of total assets. In other words, at least 95 percent of the assets of the scheme must be invested in the constituents of the index.

In order to understand an index fund, it is important to know what an index is. A stock market index is created by selecting a group of stocks that are representative of the whole market or a specified sector or segment of the market. An Index is calculated with reference to a base period and a base index value. An Index is used to give information about the price movements of products in the financial, commodities or any other markets. Financial indexes

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[19] Interest rate risk is the sensitivity of debt securities with respect to movement of interest rates within the economy. When the interest rates move up, prices of debt papers move down, and vice versa.

[20] Refer to Chapter 7 for further details on this risk.

are constructed to measure price movements of stocks, bonds, T-bills and other forms of investments. Stock market indexes are meant to capture the overall behaviour of equity markets.[21]

As mentioned in the definition above, it is a representative of the entire market, or a specified segment of the same. It is also known as the barometer of the respective market. When the value of the index moves up, the market is considered have moved up, and vice versa. Looking at it in another way, observers look at the index movement to check whether the market is up or down.

There are indices to track various markets, across asset categories. Here is a list of some of the indices available in the various markets:

- S&P BSE Sensex is an index representing stocks of 30 large companies listed on the BSE Ltd
- NIFTY 50 is an index that represents stocks of 50 large companies listed on the National Stock Exchange.
- NIFTY SmallCap 250 is an index that represents stocks of 250 small companies listed on the National Stock Exchange.
- CRISIL Liquid Fund Index is an index that seeks to track the performance of liquid funds – essentially representing liquid funds.
- I-Sec Li-Bex is an index representing Government bonds with long term maturity (of more than 7 years).
- Russell 3000 index is an index representing 3000 stocks listed in the US stock markets
- Nifty Bank Index is an index that comprises of the most liquid and large Indian banks.

An index fund is a mutual fund that replicates an index. Thus, an index fund becomes the simplest product for an investor seeking to take an exposure to a market or a segment thereof. Someone who wants to invest in large companies in India can simply buy an index fund tracking S&P BSE Sensex or Nifty. Similarly, one can take exposure to the small cap segment of the market by buying Nifty SmallCap 250 index fund (assuming that such a fund is available). As we can also see from the above examples, there are indices available on sectors, and hence there could be funds available that track such indices. There could also be mutual funds investing in foreign stocks, or even debt papers and government securities.

An index fund is also called a passive fund, since the fund manager need not be actively manage the portfolio, which only mirrors the composition of the underlying index. The role of the fund management team is only to manage the inflows into and outflows from the fund on account of purchases and redemptions; and ensure that the portfolio tracks the

[21] Source: www.nseindia.com

respective index. In other words, the fund manager does not need to decide which securities to buy or sell and when to do so.

Due to a very limited role of the fund management team, the total expense ratio (TER)[22] in case of index funds is very low. SEBI has also allowed a lower limit of the maximum expenses that could be charged.

Given such characteristics of the index funds, they make a good choice for many investors:

- As already mentioned, it is the simplest way to take exposure to any market.
- For those seeking wealth creation, but are not sure which schemes to choose, equity-oriented index funds could be an ideal choice.
- For those seeking to invest overseas, but do not possess enough skills to conduct research on foreign stocks, an index fund tracking the respective foreign market is an excellent choice.

Since the index fund tracks the underlying index, it becomes easy for an investor to understand and track the performance of the scheme. Currently in India, we have index funds available on equity indices, and majority of these are tracking the large-cap indices, viz., Nifty and Sensex.

4.4 Diversified Equity Schemes

Equity as an asset class has the potential to generate returns higher than inflation. When that happens, the purchasing power of one's money grows. In other words, one's wealth increases when the investment yields higher returns than inflation. At the same time, equity is a risky asset in that the share prices fluctuate a lot. Due to such fluctuations, there is a high possibility that one may end up buying at high prices or selling at low prices or both.

There is also a risk involved in equity investing. When an investor invests in a company's share, there is a possibility that the company does very well, and the share price moves up over the years. At the same time, if the company struggles or incurs losses or fails altogether, the shareholder loses. The loss could be as much as the entire capital invested. While investors would want to invest in such an asset category, but would also like to reduce the risk as much as possible.

The risks highlighted above can be mitigated through two things:

- By investing in a diversified portfolio made up of stocks of good quality companies in sound businesses, and

[22] See Section 2.2.3 for the discussion on Total Expense Ratio

- By staying invested for long term through ups and downs of the markets

The first can be easily achieved through investing in a diversified equity mutual fund, and once that is done, one only needs to stay invested in the mutual fund scheme, or to keep adding to the investment periodically as and when one's savings permit. For a large number of investors, SIP (Systematic Investment Plan) helps here.

A diversified equity fund is a simple type of mutual fund that invests across a wide spectrum of companies representing a number of industrial sector. Such diversification reduces the risk of owning one company's share or the risk of owning shares of companies from one industry.

Care must be taken by the distributor to see the segment of the market that such a fund is investing in – is it investing in stocks of large companies, or mid-sized companies, or small companies, or a combination of these? The large companies are generally less risky in comparison to their smaller counterparts. At the same time, these small companies also offer higher return potential. Care must be taken to understand this while selecting the schemes for the investors.

4.5 Retirement Benefit Schemes

Retirement Fund: An open-ended retirement solution-oriented scheme having a lock-in of 5 years or till retirement age (whichever is earlier). Scheme having a lock-in for at least 5 years or till retirement age whichever is earlier. The retirement benefit schemes are meant for creating a retirement corpus that can generate income to fund the lifestyle after one retires from work.

Most fund houses offer more than one options under this category to satisfy the needs of different categories of investors, depending on their risk-taking ability. For those who can afford to take high risks, there are plans that allocate more money to equity assets, whereas for the conservative investors, the fund houses offer plans with higher allocation to debt (which means lower allocation to equity).

These schemes come with a lock-in of 5 years, and offer tax benefit under Section 80C of the Income Tax Act.

Depending on the type of scheme, the investment would be predominantly between equity and debt securities. The scheme could be named an aggressive fund, or an equity fund that would invest predominantly in equity shares; however, the moderate or conservative plans (some fund houses call these equity hybrid plans and debt hybrid plans)

Resident Indians, Non-Resident Indians (NRIs), and Persons of Indian Origin (PIOs) are eligible to invest in the retirement benefit schemes only if they are of 18 years and above.

4.6 Fixed Maturity Plans (FMPs)

Fixed maturity plans are a kind of close-ended debt fund where the duration of the investment portfolio is closely aligned to the maturity of the scheme. AMCs tend to structure the scheme around pre-identified investments. Further, being close-ended schemes, they do not accept money post-NFO. Therefore, the fund manager has little ongoing role in deciding on the investment options. Such a portfolio construction gives more clarity to investors on the likely returns if they stay invested in the scheme until its maturity (though there can be no guarantee or assurance of such returns). This helps them compare the risk and returns of the scheme with alternative investments.

As already mentioned, the big benefit of such schemes is that it is relatively easy to estimate the returns expected from such schemes. At the same time, these are close-ended funds and hence no redemption is allowed before the scheme's maturity. On maturity of the scheme, the investors' money is returned. In order to provide liquidity to the investors, listing of the units of such schemes on recognized stock exchanges is compulsory. However, such listing does not guarantee liquidity, as the trading volumes in these units may be very low, or there may be no trading at all.

The Asset Management Companies (AMCs) are required to publish a list of such simple and performing schemes on their websites to enable to new cadre of distributors to distribute these schemes to their clients.

Drivers of returns

In the liquid and money market funds, the major driver of the scheme returns would be the yield earned from the debt instruments. Similarly, in case of FMPs too, the returns would come from the yield on the debt securities.

The diversified equity funds and the index funds would derive the returns from the returns generated by the portfolio of stocks the scheme has invested in.

The returns from the retirement funds would depend on how the money is allocated between equity and debt.

<u>Chapter 4: Sample Questions</u>

1. Which of the following scheme categories is permitted to be distributed by the new cadre of distributors?

    a. All Government Securities Schemes
    b. Index schemes
    c. Credit Risk Schemes
    d. Arbitrage Schemes

2. Which of the following would be close-ended mutual fund scheme?

    a. Fixed Maturity Plans (FMPs)
    b. Index Schemes
    c. Diversified Equity Schemes
    d. Retirement Benefit Schemes

3. Which among the following schemes is most likely to have a lock-in period of at least 5 years?

    a. Fixed Maturity Plans (FMPs)
    b. Index Schemes
    c. Diversified Equity Schemes
    d. Retirement Benefit Schemes

CHAPTER 5: SCHEME RELATED INFORMATION

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Mandatory Documents
    - Scheme Information Document
    - Statement of Additional Information
    - Key Information Memorandum
- Non-Mandatory Documents

5.1 Mandatory Documents

"Mutual fund investments are subject to market risk. Please read all scheme related documents before investing." These lines are mentioned in all mutual fund related communications. So, what are the scheme related documents?

The legal documents that provide the information that the investor requires are available in the scheme related documents (Scheme Information Document, Statement of Additional Information) and the Key Information Memorandum.

Scheme related documents can be used for making an informed investment decision. The suitability of a mutual fund scheme to an investor depends upon the features of the scheme and matching it to the needs of the investor from the investment.

Investors need to note that their investments are governed by the principle of caveat emptor i.e., let the buyer beware. An investor is presumed to have read and understood the scheme related documents before investing in a mutual fund scheme. In fact, since this is a contractual arrangement, the person signing the application form has legally accepted the terms of the offer. Therefore, an investor cannot claim at a future date of being unaware of afact that was disclosed in the scheme related documents.

There are primarily two important documents for understanding about the mutual fund scheme:

a) Scheme Information Document (SID), which has details of the particular scheme[23]

b) Statement of Additional Information (SAI), which has statutory information about the mutual fund or AMC, that is offering the scheme.

[23] https://www.sebi.gov.in/legal/circulars/nov-2023/simplification-and-streamlining-of-offer-documents-of-mutual-fund-schemes_78665.html

It stands to reason that a single SAI is relevant for all the schemes offered by a mutual fund. In practice, SID and SAI are two separate documents, though the legal technicality is that SAI is part of the SID.

Both documents are prepared in the format prescribed by SEBI and submitted to SEBI. The contents need to flow in the same sequence as in the prescribed format. The mutual fund is permitted to add any other disclosure, which it feels, is 'material' for the investor.

Since investors are not sophisticated experts of finance or law, the documents are prepared in simple language, and in a clear, concise and easy to understand style.

While SEBI does not approve or disapprove the Scheme Related Documents, it gives its observations. The mutual fund needs to incorporate these observations in these documents. Thus, the Documents in the market are "vetted" by SEBI, and not approved by SEBI.[24]

Draft SID and SAI are public documents, available for viewing on SEBI's website (www.sebi.gov.in). The final documents (after incorporating SEBI's observations) have to be hosted on AMFI's website (www.amfiindia.com) two days before the issue opens. Every mutual fund, on its website, provides for download of these documents for all its current schemes.

Objective of the scheme related documents

SID and SAI together are the primary source of information for any investor—existing as well as prospective. These are the operating documents that describe the product.

Since the investor is required to make an informed investment decision, these documents serve the purpose of providing the required information in an easy-to-understand language.

The units of the scheme are offered to the investor through the scheme related documents. By signing the application form and making a payment, the investor is accepting the offer, and by issuing units against such an acceptance, the mutual fund then completes the contract.Thus, the scheme related documents contain information that forms the basis of the contractual relationship between the investor and the fund.

5.1.1 Scheme Information Document

The Scheme Information Document (SID) sets forth the information about the scheme that a prospective investor ought to know before investing. An SID remains effectiveuntil a 'material change' (other than a change in fundamental attributes and within the purview of the SID) occurs and thereafter changes are filed with SEBI and communicated to the investors or publicly notified by advertisements in the newspapers, subject to the applicable Regulations.

[24] Candidates are advised to read the circular: https://www.sebi.gov.in/legal/circulars/dec-2024/upload-of-draft-scheme-information-documents_90097.html

It is essential to read and understand the SID.

5.1.2 Statement of Additional Information

Statement of Additional Information (SAI), has statutory information about the mutual fund or AMC that is offering the scheme. Therefore, a single SAI is relevant for all the schemes offered by a mutual fund.

Content of Statement of Additional Information

Every mutual fund, on its website, provides for download of its SAI. However, investors have a right to ask for a printed copy of the SAI. Through the AMFI website (www.amfiindia.com), investors can access the SAI of all the mutual funds. the features of a mutual fund scheme.

Content of SAI	Description of Content
Constituents of the mutual fund	**SAI** gives complete details of the constituents of the mutual fund--Sponsors, AMC and Trustee Company, of service providers {Custodian, Registrar & Transfer Agent, Statutory Auditor, Fund Accountant (if outsourced) and Collecting Bankers}. This includes their experience, condensed financial information (for schemes launched in last 3 financial years), key personnel, rights and obligations and other information the investor may require to evaluate the investment.
How to Apply	**SAI** provides guidance on how to apply.
Rights of Unit-holders	SAI details the rights to beneficial ownership of the assetsof the scheme, timelines for servicing investor applications and acknowledgements, right to receive information and disclosures and to exercise the optionto exit in the event of changes in the scheme, and other rights of investors.

Investment Valuation Norms	**SAI** provides the details of the regulatory specifications on how different securities in the portfolio will be valued. The rules for valuation are standardized by the regulator, SEBI.
Tax, Legal & General Information	SAI provides information on legal aspects of the investment that deal with nominations, transfer and transmission of units, investment by minors, pledge/lien on units and others. Also, this section provides details regarding taxation and other general information.
Investor Grievance	provides details of how the investor can register a grievance.

5.1.3 Key Information Memorandum

While an investor is expected to read all the scheme related documents, circulation of the same along with the application forms is too difficult and costly, especially if the printed forms are to be distributed. In order to ensure the investor gets access to sufficient information in spite of such a constraint, a Key Information Memorandum (KIM) is mandatorily circulated along with the application form.

KIM is essentially a summary of the SID and SAI. It contains the key points of these documents that are essential for the investor to know to make a decision on the suitability of the investment for their needs. It is more easily and widely distributed in the market. As per SEBI regulations, every application form is to be accompanied by the KIM.

Some of the key items contained in the KIM are as follows:

- Name of the AMC, mutual fund, Trustee, Fund Manager and scheme
- Dates of Issue Opening, Issue Closing and Re-opening for Sale and Re-purchase
- Investment Objective
- Asset allocation pattern of the scheme
- The risk profile of the scheme i.e., a snapshot of the risk to the principal invested, the suitable investment horizon for investment and the type of securities that the schemewill invest in.
- Plans and Options

- Benchmark Index
- Dividend Policy
- Performance of scheme and benchmark over last 1 year, 3 years, 5 years and since inception.
- Expenses of the scheme
- Information regarding registration of investor grievances

5.1.4 Addendum

While the SID, SAI and KIM need to be updated periodically, the interim changes are updated through the issuance of such addendum. The addendum is considered to be a part of the scheme related documents and must accompany the KIM.

5.1.5 Updation of Scheme Documents—Regulatory provisions

Updation of SID

For the open ended and interval schemes, the SID shall be updated within next six months from the end of the 1st half or 2nd half of the financial year in which schemes were launched, based on the relevant data and information as at the end of previous month. Subsequently, SID shall be updated within one month from the end of the half-year, based on the relevant data and information as at the end of September and March respectively.

The procedure to be followed in case of changes to the open ended and interval scheme shall be as under:

a. In case of change in fundamental attributes in terms of Regulation 18 (15A)

   i. An addendum to the existing SID shall be issued and displayed on AMC website immediately.
   ii. SID shall be revised and updated immediately after completion of duration of the exit option (not less than 30 days from the notice date).
   iii. A public notice shall be given in respect of such changes in one English daily newspaper having nationwide circulation as well as in a newspaper published in the language of region where the Head Office of the Mutual Fund is situated.

b. In case of other changes:

   i. The AMC shall be required to issue an addendum and display the same on its website immediately.
   ii. The addendum shall be circulated to all the distributors/brokers/Investor Service Centre (ISC) so that the same can be attached to all KIM and SID already in stock till it is updated.

iii. Latest applicable addendum shall be a part of KIM and SID. (e.g. in case of changes in load structure the addendum carrying the latest applicable load structure shall be attached to all KIM and SID already in stock till it is updated).

iv. Further, the account statements shall continue to include applicable load structure.

Updation of SAI

- Regular update has to be done by the end of 3 months of every financial year. Material changes have to be updated on an ongoing basis and uploaded on the websites of the mutual fund and AMFI.

Updation of KIM

- KIM shall be updated at least once in half-year, within one month from the end of the respective half-year, based on the relevant data and information as at the end of September and March and shall be filed with SEBI forthwith through electronic modeonly.

5.1.6 Other Mandatory information/disclosure

While the scheme information documents provide mandatory information that help a prospective investor to make informed investment decision, the existing investors in a mutual fund scheme also need to track the progress of their investments.

There are two key disclosures that an investor should receive for that purpose, viz., the current value of one's investments, and information about where the scheme has invested.

The current value of investments is a function of the number of units in an investor's account and the NAV per unit. In order to get the current value of the investments, one has to multiply the number of units with the NAV.

Current value of investments = Unit balance in the investor's account X current NAV

This means that an investor should be able to regularly know the NAV. The unit balance can be seen from the latest account statement that one would have got. Chapter 9 has a detailed discussion on when and how an investor gets the account statement.

Disclosure of Daily NAV

Each scheme's NAV is required to be disclosed at the end of each business day. The same is published on the website of the AMC. The Mutual Fund declares the Net Asset Value of the scheme on every business day on AMFI's website www.amfiindia.com (as per the time limit for uploading NAV defined in the applicable guidelines) and also on their website.[25]

In case of open-ended schemes, the NAV is calculated for all business days and released to the Press. In Liquid and Overnight Funds, NAVs are declared on Sundays / holidays as well, which reflects the accrual for that day. In case of closed-ended schemes, the NAV is calculated at least once a week.

With the availability of historical NAV, an investor should also be able to calculate how a scheme has performed over whatever period one wants to check for.

Disclosure of Total Expense Ratio

One of the important factors that impact the scheme's NAV is the Total Expense Ratio (TER), charged to the scheme. Though the same is very tightly regulated through SEBI regulations, the investor should know about the scheme expense ratio. SEBI has mandated that the Asset Management Companies (AMCs) should prominently disclose on a daily basis, the Total expense ratio (scheme-wise, date-wise) of all schemes under a separate head – "Total Expense Ratio of Mutual Fund Schemes" on their website. The same must also be published on the AMFI website. The AMCs are also required to send the update to the investors through email whenever there is a change in the expense ratio.

Scheme-wise dashboard on mutual fund website

Each AMC is also required to publish a scheme performance dashboard on the website, and update it on a regular basis. The dashboard highlights how various schemes of the mutual fund have performed over various holding periods. The scheme performance data is also available on the AMFI website.[26]

Most AMCs allow this dashboard to be downloaded in a tabular form. This contains the following information about the schemes of the mutual fund:

- Scheme name
- Scheme classification and category: For example, Equity multi-cap scheme; or Solution-oriented scheme–retirement fund
- Type of scheme: Open-ended or close-ended
- The investment objective of the scheme

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[25] In order to enable consideration of all trades during a day for valuation, it has been decided to extend the present timeline up to 11.00 p.m. for uploading the NAVs of all schemes (except of fund of fund) on the website of AMFI and respective AMCs. (Vide SEBI Circular dated September 24, 2019).

[26] https://www.amfiindia.com/research-information/other-data/mf-scheme-performance-details

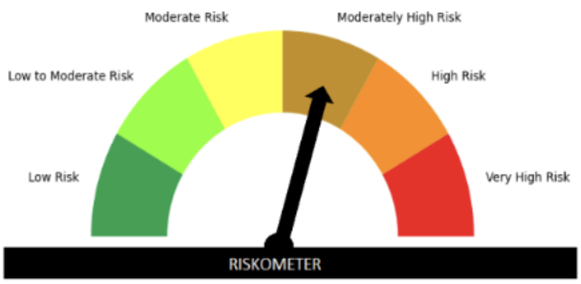
- Name of the fund manager
- Benchmark index (including additional benchmark, if any)
- Exit load and lock-in period (if any)
- Plans and options: For example, direct and regular plans; Income Distribution cum capital withdrawal and growth options, etc.
- Minimum investment amount
- Month-end AUM
- TER
- Scheme inception date
- Month-end portfolio
- Scheme performance

Such a dashboard allows an investor to make an easy comparison of schemes across the mutual fund.

Risk-o-meter

Mutual Fund/AMCs shall also disclose risk-o-meter of the scheme and benchmark while disclosing the performance of scheme vis-à-vis benchmark.[27]

"Riskometer: Risk level of the scheme shall be depicted by "Risk-o-meter" as given below –



The risk of the scheme/benchmark is [level of risk]

For example, the risk depicted in the above risk-o-meter is Moderately High"

Portfolio disclosure

This is a list of securities where the corpus of the scheme is currently invested. The market value of these investments is also stated in portfolio disclosures. Mutual Funds/ AMCs shall disclose portfolio (along with ISIN) as on the last day of the month / half-year for all their schemes on their respective website and on the website of AMFI within 10 days from the close

[27] https://www.sebi.gov.in/legal/circulars/nov-2024/disclosure-of-expenses-half-yearly-returns-yield-and-risk-o-meter-of-schemes-of-mutual-funds_88230.html (November 5, 2024)

of each month/ half-year respectively in a user-friendly and downloadable spreadsheet format. For debt schemes, such disclosure shall be done on fortnightly basis within 5 days of every fortnight. In addition to the current portfolio disclosure, yield of the instrument shall also be disclosed.

Financial results

The mutual fund shall before the expiry of one month from the close of each half year, (Mar 31 and Sep 30 shall display the unaudited financial results on the AMC website, the advertisement in this reference will be published by the fund in at least one English daily newspaper having nationwide circulation and, in a newspaper, having wide circulation published in the language of the region where the head office of the fund is situated.

Annual reports and related disclosures

Annual report or abridged summary is required to be hosted on AMCs website and on the website of AMFI. This is sent by email to the investors who have registered their email id with the fund, no later than four months from the date of closure of the relevant financial year i.e., March 31 each year. Investors' who have not registered their email-id have an option of receiving a physical copy of the Annual report or an Abridged summary thereof.

5.2 Non-Mandatory Disclosures

Fund Factsheet

One of the most popular documents from the mutual fund is the monthly Fund Factsheet. This document is extensively used by investors, fund distributors, fund rating agencies, research analysts, media and others to access information about the various schemes of the mutual fund. While it is not a regulatory requirement to publish the monthly fact sheet, it is a market practice followed by all the fund houses, on a voluntary basis. Since fund factsheet is a marketing and information document, various SEBI regulations pertaining to information disclosure are applicable to it.

The fund factsheet contains the basic information of each scheme such as the inception date, corpus size (AUM), current NAV, benchmark and a pictorial depiction of the fund's style of managing the fund. The fund's performance relative to the benchmark is provided for the different periods along with the benchmark returns, as required by SEBI's regulations. The factsheet also provides the SIP returns in the scheme, portfolio allocation to different sectors and securities. However, some fund houses do not disclose the entire portfolio but only the top 10 holdings.

In the factsheet, security wise as well as sector wise allocation is provided for equity schemes. Some factsheets also disclose the derivatives exposure taken by the mutual fund schemes. In the debt funds, the factsheet discloses the rating profile of the various securities, and a snapshot of exposure of the scheme to various rating baskets.

Portfolio features such as the price-earnings ratio (PE), Beta and other risk measures such as standard deviation and Sharpe ratio (in case of equity funds), credit rating profile, average maturity and duration (in case of debt funds) are also available in the factsheet. The factsheet also provides investment details such as the minimum investment amount, the plans and options available in the scheme, the loads and expenses and systematic transaction facilities available in the fund.

<u>Chapter 5: Sample Questions</u>

1. "Please read the scheme related documents carefully" – which documents does this line refer to?
    a. Scheme Information Document and audited balance sheet of the Asset Management Company
    b. Trust deed and Key Information Memorandum
    c. Statement of Additional Information and fund fact sheet
    d. Scheme Information Document and Statement of Additional Information

2. Which of the following statements is 'TRUE' with respect to the Scheme Information Document (SID) and Statement of Additional Information (SAI)?
    a. These two documents are prepared in the format prescribed by Association of Mutual Funds in India as part of AMFI's Code of Conduct
    b. These two documents are prepared in the format prescribed by Association of Mutual Funds in India as part of AMFI's Best Practices Circular
    c. These two documents are prepared in the format prescribed by Securities and Exchange Board of India
    d. Each Asset Management Company is free to prepare these documents in the format they desire

3. What is the purpose of the mutual fund Risk-o-meter?
    a. To display fund expenses
    b. To show past returns of the fund
    c. To depict the risk level associated with the mutual fund scheme
    d. To show portfolio holdings

4. How often must mutual funds disclose their portfolio holdings on their website?
    a. Annually
    b. Quarterly
    c. Monthly or half-yearly (fortnightly for debt schemes)
    d. Weekly

5. Which body prescribes the format of SID and SAI?
    a. Reserve Bank of India (RBI)
    b. Securities and Exchange Board of India (SEBI)
    c. Ministry of Finance
    d. Association of Mutual Funds in India (AMFI)

6. The Scheme Information Document (SID) contains:
    a. Statutory details of the mutual fund and AMC
    b. Key details of a particular mutual fund scheme
    c. Only taxation and legal aspects of investments
    d. Information about investor grievances only

CHAPTER 6: FUND DISTRIBUTION AND CHANNEL MANAGEMENT PRACTICES

Learning Objectives:

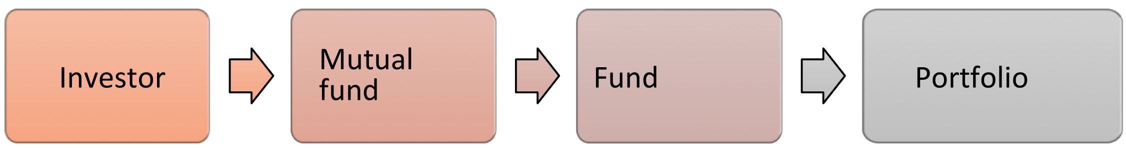
After studying this chapter, you should know about:

- Role and importance of mutual fund distributors
- Different kinds of mutual fund distributors
- Modes of distribution
- Pre-requisites to become a mutual fund distributor
- Revenue of a mutual fund distributor
- Commission disclosure mandated by SEBI
- Due Diligence Process by AMCs for Distributors of Mutual Funds
- Nomination facilities for mutual fund distributors
- Change of distributors

6.1 The role and importance of mutual fund distributors

An investor needs to invest the money in a portfolio of various investment options to achieve financial goals. This process of building a portfolio could be achieved with the help of the selection of a basket of mutual fund schemes. However, one may still need help in constructing a portfolio with the help of an expert. This expert could be a mutual fund distributor.

Chart 6.1: Mutual Fund Investors, professionals and portfolio



In Chart 6.1, two professionals have been shown between the investor and her investment portfolio, viz., a mutual fund distributor, and a fund manager. This fund manager could be a mutual fund manager managing a mutual fund portfolio in line with the scheme's investment objectives, as discussed earlier.

The fund manager analyses various inputs and data points including the company specific or industry specific information, and economy wide factors. The analysis may include about liquidity aspects in the market, and the mood of the market participants. After such a detailed analysis, the fund manager constructs a portfolio of securities in line with the stated objective ơ the mutual fund scheme.

On the other hand, the mutual fund distributor's job is to assess the needs, limitations, resources and financial goals of the investor. This analysis would help the mutual fund distributor arrive at a suitable asset allocation plan for the investor. Armed with this, the distributor then goes on to identify mutual fund schemes, which are appropriate for the investor in the given situation.

Look at this in another way, the mutual fund distributor analyses the situation of the investor; whereas the fund manager analyses the market factors. Both the professionals play important roles in helping the investor achieve one's financial goals.

With that background look at various categories of mutual fund distributors.

6.2 Different kinds of mutual fund distributors

Mutual funds are distributed in India to the investors through multiple channels, viz., individual mutual fund distributors, bank branches, national distributors through their branches or their sub-agents, post offices, and directly by the AMCs. While the category of distributors is also varied, the platforms used are also many. Funds may be distributed through the traditional method of using paper-based application forms, or through electronic platforms such as websites, mobile phones and stock exchanges.

Let us first look at the different categories and their characteristics.

6.2.1 Individual players

India has a long history of distribution of financial products through individuals. Both Life Insurance Corporation of India Ltd (LIC), and Unit Trust of India (UTI) depended on a huge force of individual agents. While the two institutions made various products and solutions available, the agency force (i.e., individual agents) ensured these products reached the households. These same agents also distributed the small savings products, and to that extent, they played a huge role in bringing household savings into financial products.

Almost all of them operated as individuals, and single-handedly, without any staff or skeleton staff, mainly to handle the paperwork. Even today, this is a very large part of the distribution link between the asset management companies and the investors. Quite a few new mutual fund distributors start their business this way – single-handedly, as individuals.

Later, some of them expand and grow into larger entities. While the former is known as the "individual" channel, the rest can be called the "non-individual" channel.

The traditional non-institutional channels operate through different business models. These could be as under:

- Through their own branch offices and employees
- Through a network of sub-agents

6.2.2 Non-individual entities

Non-individual entities include partnerships, regional distributors, national distributors, NBFCs, banks, stockbrokers, etc. Out of these, the distribution companies and banks are sometimes referred as institutional distributors.

In both cases, the investor is serviced by an individual—be it an employee of the firm or a sub-agent. However, the difference lies in the operations of the firm and its cost structure—the former incurs fixed expenses of running the large operations, whereas the latter have higher variable costs. The employees earn through salary, whereas the sub-agents earn a commission, which is linked to the business generated.

Within the non-individual distributors, there are different business models.

Banks

Banks have emerged as a prominent channel for the distribution of mutual fund products to their account holders. Within the banking structure, the multinational banks were the first to enter the business of mutual fund distribution. The private sector banks and the public-sector banks entered the business much later. Nowadays, even some cooperative banks are also distributing mutual funds. Banks employ different business units catering to different client segments, viz., retail banking and wealth management or priority banking or private banking. The categorization is based on the wealth of the clients or the surplus available for investment in financial assets.

Mutual funds have built relationships with PSU banks that have a wide reach in non-urban centres to distribute mutual fund products through them. Also, private and foreign banks actively participate in the distribution process of mutual fund products.

Many others like stock brokers and NBFC also use a similar classification between retail clients and wealthy clients. While some **NBFCs and stock brokers** reach out to service their clients through their own employees, some have empaneled sub-agents. One may also call it an agency channel. These sub-agents are not employees of the firm but purely work as an extended distribution arm.

While the banks and NBFCs may operate at a national level, there could be some other firms that only distribute financial products. Some of these firms may have a national presence, while some others may operate within a region. These are often referred as **national distributor or regional distributors** in the mutual fund industry.

Some new players have entered the fray of late. These are the e-commerce platforms and few other online distributors that also distribute mutual fund schemes. These players operate through the internet without having a physical office for the clients to visit. SEBI Circular dated 13 June 2023 provides the guidelines for Execution Only Platforms, relevant for digital / online platforms.

6.3 Modes of distribution

Traditionally, not just mutual funds, but all financial products were distributed through the use of application forms printed on paper. This process involved carrying physical forms to the client's place and then depositing those forms at the respective official points of acceptance (OPOAs). With the advent of the internet and mobile phones, the distribution channel shifted to digital mode. Of late, the balance is shifting towards digital transactions, though the physical paper-based transactions continue in a significant way.

Many distributors and their investors still prefer the paper mode, whereas the new age Internet-based businesses, viz. e-commerce platforms, and online distributors operate entirely through the digital mode.

On the other hand, there are a few that employ a hybrid mode, where some transactions take place digitally, some others happen physically.

The different models of online distribution are discussed below.

6.3.1 Online Channel Partners

The advent of the internet has changed the way business is conducted in many industries, and mutual fund distribution is no different. The distributors are able to expand their business beyond geographical boundaries. Investors, also prefer to transact through the internet, rather than the cumbersome paperwork and dependence on the distributor. A few distributors offer transaction support through their own websites.

6.3.2 Stock Exchange Platforms

SEBI has facilitated buying and selling of the units of open-ended mutual funds through the stock exchanges. Exchanges have developed mutual fund transaction engines for this purpose.

The low cost and deeper reach of the stock exchange network enable an increased level of participation of retail investors in mutual funds. AMCs are required to list the units of close-ended and interval schemes on a stock exchange and the units of ETFs are also bought and sold in the stock exchange.

Both National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) have extended their trading platforms to help the stock exchange brokers become a channel for investors to transact in Mutual Fund units. NSE's platform is called NMF II Platform. BSE's platform is the BSE StAR Mutual Funds Platform.

6.3.3 Aggregating platforms

MF Utilities (MFU) is a transaction aggregating platform that connects investors, RTAs, distributors, banks, AMCs and others. MFU facilitates the distributors with online access to submit investor transactions. This platform provides them with a single point for time-stamping of transactions, document submission, paperless transaction facility, and login facility for their clients.

Investors who register on the MFU are allotted a Common Account Number (CAN) under which all their mutual fund holdings are consolidated. Investors have to be KYC compliant to register for a CAN. If an investor is not already KYC compliant, then the MFU will facilitate KYC registration along with the allotment of 'CAN'.

The MFU offers a Common Transaction Form to transact in multiple schemes across participating mutual funds using a single form. The form can be submitted through a mutual fund distributor or to neutral Points of Service (PoS) and others irrespective of the RTA servicing the mutual fund. MFU offers multiple modes of payments for investment through physical and electronic means. MFU allows a single payment for multiple subscriptions made under a single form. The existing mutual fund holding is mapped to the CAN based on PAN, holding pattern and other parameters. Investors may have multiple CANs based on the combination of holdings and mode of holding. Investors can also request online access through which they can submit transactions, view holdings and lodge and track complaints. The bank and nomination details provided to the MFU at the time of registering for the CAN will override the information provided in the folios.

Now another similar platform called MF Central has been launched, promoted by KFintech and CAMS.

6.3.4 Computer-based and Mobile-based Apps offered by distributors

Apart from the above platforms and the websites of distributors, the transaction facilities are now available on mobile devices –smartphones, feature phones, and tablet computers. This makes it even more convenient than going to a website. These are through apps that are created by distributors in order to facilitate investments for their clients. These multiple channels make it easier for clients to transact in a simple manner.

6.3.5 Electronic platforms created by the AMCs

Apart from the above, various AMCs have also created their own facilities like web-based and mobile-based applications that facilitate various transactions. Many AMCs also offer transaction facilities through SMS and WhatsApp. When an investor uses these platforms then they are dealing directly with the mutual fund.

6.3.6 New age investment platforms

The Indian investors have also seen the emergence of new-age investment platforms. These are technology-based platforms that allow investors to invest in mutual funds apart from other areas like stocks, bonds etc. One of the key features of these platforms is the simplicity of investment without the hassle of too much paperwork plus its low cost. On many of these platforms, investors can buy direct plans of mutual funds too. These are available both through websites as well as apps so it also becomes simple to interact with. Examples of these include Groww, Kuvera, Paytm money, Coin etc.

6.4 Pre-requisites to become Distributor of a Mutual Fund

An Asset Management Company may appoint an individual, bank, non-banking finance company or distribution company as a distributor. SEBI has mandated mutual fund distributors, agents or any persons employed or to be employed in the sale and/or distribution of mutual fund products, to have a valid certification from the National Instituteof Securities Markets (NISM) by passing NISM Series-V-A: Mutual Fund Distributors Certification Examination.

In order to be eligible to sell or market mutual funds, the following are compulsory:

- **Obtaining NISM Certification**

−The individual needs to pass the NISM certification examination mandated by SEBI.

− For persons who have attained the age of 50 years or who have at least 10 years of experience in the securities markets in the sale and/ or distribution of mutual fund products as of May 31, 2010, can obtain the certification either by passing the NISM certification examination or qualifying for Continuing Professional Education (CPE) by obtaining such classroom credits as may be specified by NISM from time to time.[28]

[28] SEBI Gazette Notification Ref. No. LAD-NRO/GN/2010-11/09/6422 http://www.nism.ac.in/nism18042016/index.php/circulars/173-sebi-notification-on-nism-series-v-a-mutual- fund-distributors-dated-may-31-2010

- **Know Your Distributor Requirements**

As part of SEBI's drive to streamline the distribution process of mutual fund products, AMFI has introduced the KYD process to verify the correctness of the information provided in the registration documents and to have verification of the ARN holders.[29]

The process consists of document verification and a bio-metric process.

- Self-attested copy of the PAN card and specific documents as proof of address to be submitted along with application form at the CAMS-PoS (Computer Age Management Services-Points of Service). The original documents have to be presented for verification.
- The bio-metric process consists of taking the impression of the index finger of the right hand of the ARN holder. This is done at the PoS at the time of submission of documents (both for new registrations and renewal of ARN). In case of non-individual distributors, the bio-metric process will be conducted on specified authorized persons.
- An acknowledgement confirming the completion of KYD process is received from the CAMS-PoS.
- The existing ARN holders have to send the photocopy of the acknowledgement to all the AMCs with whom they are empaneled.

- **Obtaining AMFI Registration Number**

After obtaining the certification and completing KYD requirements, the next stage is to register with AMFI. On registration, AMFI allots an AMFI Registration Number (ARN). Individuals from the exempted category (i.e., who have attained the age of 50 years or have at least 10 years of experience as of May 31, 2010) can obtain the ARN without passing the certifying examination, provided they have attended the prescribed CPE program. Minimum age for obtaining ARN is 18 years.

- **Empanelment with AMCs**

Armed with the ARN No., the distributor/stock exchange broker can get empaneled with any number of AMCs. Alternatively, they can become agents of a distributor who is already empaneled with AMCs. Empanelment with the AMC or enrolment as an agent of an empaneled distributor is compulsory to be able to sell mutual fund schemes and earn the commissions.

Institutions that are into the distribution of mutual funds need to register with AMFI. The employees of these institutions need to clear the NISM Series V-A: Mutual Fund Distributors Certification Examination and obtain an Employee Unique Identification Number (EUIN) from

[29] The new cadre of distributors are not required to comply with KYD/ bio-metrics requirements. However, they are

AMFI. The Intermediaries have to ensure that the employees quotethe EUIN in the Application Form for their client's investments. There is no separate ARNrequired for these employees since they operate under the ARN of the institution that they are working for required to submit self-attested copies of identity proof (photo PAN card of individual applicants/ in case of Proprietary concern, PAN card of the Proprietary Concern (if available) or Photo PAN Card of the Proprietor) and address proof, as mentioned in KYD application form.

6.3.1 Procedure for getting empanelled as a mutual fund distributor with AMC

Empanellment with an AMC is a simple process. There is a Request for Empanellment Form to be filled in. This provides for basic details, such as:

- Personal information of applicant–Name of person, Age, Trade Name, Contact Information, ARN, PAN, Income tax category (such as Resident Individual, Company, Non-Resident Indian, Foreign Company).
- Names and contact information of key people handling sales and operations.
- Business details, such as office area, number of branches, number of employees, geographical area covered, years of experience, number of investors, number of agents, fund houses already empanelled in, size of AUM etc.
- Bank details and preferences regarding Direct Credit of brokerage in the bank account.
- Preferences regarding receiving information from the AMC.
- Nominee
- The applicant also needs to sign a declaration, which provides for the following:
    - Correctness and completeness of information provided
    - Commitment to keep all the transactional information confidential
    - Commitment to abide by instructions given, as also statutory codes, guidelines and circulars
    - Not to issue advertisement or publicity material other than that provided by theAMC or pre-approved by the AMC
    - Ensure that the risk factors are mentioned along with performance and otherrelated information
    - Provide all the information and documents that the AMC may ask for fromtime to time

- Ensure that all employees who are engaged in selling or marketing of mutualfunds have an EUIN.

- Undertake not to rebate commission back to investors, or attract investorsthrough the temptation of rebate/gifts, pass back of commission etc.
- Power to the AMC to terminate the empanelment at any time
- Some AMCs directly empanel only distributors who are likely to generate adequate business – and request others to work under one or the otherempanelled distributors.
- At times, AMCs link the levels of commission to the volumes generated. In suchcases, an agent might find it beneficial to work under an established distributor.

While many of the above clauses would be included in the application forms, there is no standard format, and each asset management company use their own format for collecting such details, as well as for empanelment of distributors.

6.5 Revenue for a mutual fund distributor

The mutual fund distributor earns revenue in the form of commission income for the distribution of the mutual fund products/schemes in the manner specified by SEBI from time to time. SEBI has recently withdrawn the benefits of upfront commission and transaction charges for the MFDs [30].

Further, AMFI has described the commission structure for MFDs which is as follows:

Mutual fund distributors receive commission on the investments mobilised by them under Regular Plan of MF schemes from the AMCs with whom they are empaneled. The trail commission is typically paid on monthly basis as per the commission structure decided by the respective AMCs as per their business policy.

As per SEBI MF Regulations, AMCs shall adopt full trail model of commission in all schemes, without payment of any upfront commission or upfronting of any trail commission, directly or indirectly, in cash or kind, through sponsorships, or any other route.

In other words, incentives in any other form to the distributor which is not in the form of trail commission is not permitted as per above regulatory guideline. In short, MFDs are paid only trail commission and, such trail commission can be paid only in monetary terms.

In order to discourage mis-selling by mutual fund distributors, under Regulation 52(4A), SEBI has introduced a provision ‘‘the asset management company shall pay charges or commission or fees related to distribution of mutual fund schemes, and in the manner as may be specified by SEBI from time to time”.

[30] https://www.amfiindia.com/distributor-corner/importantinformation_distributors

SEBI has introduced a revised framework for paying additional commission to mutual fund distributors for mobilising investments from new investors. It aims to promote investor inclusion, especially among smaller towns and women investors. [31]

Further, in case of switch transaction to NFO of a regular plan of mutual fund scheme from an existing scheme managed by the same AMC, the AMC shall ensure that the distribution commission paid is lower of the commissions offered under the two schemes of switch transaction.[32]

6.5.1 Concept of Trail Commission

Trail commission is calculated as a percentage of the net assets attributable to the Units sold by the distributor. The commission payable is calculated on the daily balances and paid out periodically to the distributor as per the agreement entered into with AMC.

The trail commission is normally paid by the AMC on a quarterly basis or monthly basis. Since it is calculated on net assets, distributors benefit from increase in net assets arising out of valuation gains in the market.

For example, suppose an investor has bought 1000 units at Rs. 10 each. The distributor who procured the investment may have been paid an initial commission calculated as a percentage on 1000 units X Rs. 10 i.e., Rs 10,000.

Later, suppose the NAV of the scheme goes up to Rs.15. Trail commission is payable on 1000 units * Rs 15 i.e., Rs 15,000 – not the Rs 10,000 mobilised. In short, trail commission depends on the NAV.

Further, unlike products like insurance, where agent commission is paid for a limited number of years, a mutual fund distributor is paid trail commission for as long as the investor's money is held in the fund.

Such indexing of agent commissions to the current value of the investment, and the absence of a time limitation to earning it, are unique benefits that make it attractive for distributors to sell mutual funds.

Let us take an example here. A distributor mobilised a sum of Rs. 10 lakhs on a particular day when the scheme's NAV was Rs. 10.0000. The total units allotted were 1,00,000.

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[31] Candidates are advised to read regulation 52(4A) and SEBI Circular dated November 27, 2025 regarding the additional incentives to distributors for onboarding new individual investors from B-30 cities and women investors: https://www.sebi.gov.in/legal/circulars/nov-2025/additional-incentives-to-distributors-for-onboarding-new-individual-investors-from-b-30-cities-and-women-investors_98007.html

[32] SEBI circular no. SEBI/HO/IMD/IMD-PoD-1/P/CIR/2025/23

In this case (Rs. 10,00,000 / Rs. 10.0000). We have assumed a trail commission rate of 1% p.a. in this case. Given below is the table showing calculation of trail commission for the month of July 2019. (All NAVs are randomly generated, and not of any actual scheme).[33]

Date	NAV(A)	Value(B)	Trail commission (B*1%/365)
01-Aug-19	10.0000	10,00,000.00	27.40
02-Aug-19	10.0270	10,02,698.66	27.47
03-Aug-19	10.0270	10,02,698.66	27.47
04-Aug-19	10.0270	10,02,698.66	27.47
05-Aug-19	9.9140	9,91,396.69	27.16
06-Aug-19	9.9888	9,98,879.74	27.37
07-Aug-19	9.9114	9,91,144.38	27.15
08-Aug-19	10.0835	10,08,348.30	27.63
09-Aug-19	10.1522	10,15,224.62	27.81
10-Aug-19	10.1522	10,15,224.62	27.81
11-Aug-19	10.1522	10,15,224.62	27.81
12-Aug-19	10.1522	10,15,224.62	27.81
13-Aug-19	9.9837	9,98,374.86	27.35
14-Aug-19	10.0792	10,07,920.67	27.61
15-Aug-19	10.0792	10,07,920.67	27.61
16-Aug-19	10.0897	10,08,968.80	27.64
17-Aug-19	10.0897	10,08,968.80	27.64
18-Aug-19	10.0897	10,08,968.80	27.64
19-Aug-19	10.1038	10,10,377.83	27.68
20-Aug-19	10.0837	10,08,365.86	27.63
21-Aug-19	10.0114	10,01,135.92	27.43
22-Aug-19	9.8527	9,85,267.02	26.99
23-Aug-19	9.9143	9,91,432.35	27.16
24-Aug-19	9.9143	9,91,432.35	27.16
25-Aug-19	9.9143	9,91,432.35	27.16
26-Aug-19	10.1285	10,12,853.10	27.75

[33] This is taken only for the purpose of the calculation and in no way is any indication of the trail commission payable.

27-Aug-19	10.1683	10,16,828.15	27.86
28-Aug-19	10.1171	10,11,710.96	27.72
29-Aug-19	10.0137	10,01,367.16	27.43
30-Aug-19	10.0849	10,08,494.98	27.63
31-Aug-19	10.0849	10,08,494.98	27.63
Total trail commission for the period:			853.13

No. of units allotted = 1,00,000 at NAV of Rs. 10.0000

Trail Commission is 1 percent of Value i.e., Rs.10,00,000 and subsequently as the NAV changes, the value changes.

Table 6.1 Calculation of trail commission for distributors

In the above example, the trail commission is calculated for each day using the below formula:

Trail commission for the day = AUM X trail commission rate p.a./365

Since the trail commission rate is mentioned as percent per annum, the same needs to be divided by 365 to arrive at the daily trail commission amount.

Smart distributors have accumulated a portfolio of loyal investors to whom they offer superior service. The trail commission on these investments ensures a steadily rising income for the distributor. Additional investments from the same investors, and other investors referred by the current investors, help them grow the portfolio.

A point to note is that the commission is payable to the distributors to mobilize money from their clients. Hence, no commission is payable to the distributor for their own investments (self-business).

Regulations require distributors to disclose to their investors all commissions in the form of trail commissions or any other form payable to them from similar competing schemes of a different mutual fund from amongst which the particular scheme was recommended to the investor.

6.5.2 Additional commission for promoting mutual funds [34]

With a view to promoting mutual funds SEBI has allowed mutual funds to charge additional expenses, which can be used for distribution related expenses,including distributor commission[35]. For example, distributors mobilising funds from investors located in B-30 locations (cities and towns beyond the top 30 locations) would earn higher commission for promoting mutual funds. We will cover the details of additional expenses later in Chapter 7.

6.5.3 Transaction Charges[36]

SEBI earlier permitted mutual fund distributors to receive transaction charges for subscriptions of ₹10,000 and above, deducted from the investor’s investment amount. However, as per SEBI's circular issued in 2025, this transaction charges framework has been withdrawn. There by removing the following:

- The investor-borne transaction charges,
- The requirement for investors to pay upfront commissions to distributors.

Distributors will be compensated directly by Asset Management Companies (AMCs), in line with SEBI’s view that distributors act as agents of AMCs. No charges will be deducted from investor contributions.

6.5.4 Applicability of GST on distributors commission

The Goods and Services Tax (GST) was implemented in July 2017 and is applicable to individuals supplying goods or services with an annual turnover exceeding Rs. 20 lakhs. Typically, the supplier pays GST, but for certain goods/services, the recipient must pay under the reverse charge mechanism.

For mutual fund distributors registered with GST, they must raise an invoice for their commission and pay GST. However, under Section 9(4) of the CGST Act and Section 5(4) of the IGST Act, recipients are liable to pay GST on purchases from unregistered suppliers

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[34] Candidates are advised to read regulation 52(4A) and SEBI Circular dated November 27, 2025 regarding the additional incentives to distributors for onboarding new individual investors from B-30 cities and women investors: https://www.sebi.gov.in/legal/circulars/nov-2025/additional-incentives-to-distributors-for-onboarding-new-individual-investors-from-b-30-cities-and-women-investors_98007.html

[35] As per the prevailing regulatory guidelines, distributors are eligible only for Trail commission, the upfront commission or transaction charges have been discontinued: https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

[36] https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

through the reverse charge. Hence, Asset Management Companies (AMCs) or mutual funds must pay GST under reverse charge on commissions to unregistered distributors.

6.6 Commission Disclosure mandated by SEBI

SEBI has mandated Mutual Funds/AMCs to disclose on their respective websites the total commission and expenses paid to distributors who satisfy one or more of the following conditions with respect to non-institutional (retail and HNI) investors:

i. Multiple points of presence (More than 20 locations)

ii. AUM raised over Rs. 100 crores across the industry in the non-institutionalcategory but including high net worth individuals (HNIs).

iii. The commission received of over Rs. 1 crore p.a. across industry

iv. The commission received of over Rs. 50 lakhs from a single Mutual Fund/AMC.

Mutual Funds/AMCs shall also submit the above data to AMFI. AMFI shall disclose the consolidated data in this regard on its website.

In addition to the total commission and expenses paid to distributors, mutual funds / AMCs need to make additional disclosures regarding distributor-wise gross inflows (indicating whether the distributor is an associate or group company of the sponsor(s) of the mutual fund), net inflows, average assets under management and ratio of AUM to gross inflows on their respective website on a yearly basis.

In case the data indicates that a distributor has an excessive portfolio turnover ratio, i.e., more than two times the industry average, AMCs conduct an additional due diligence of such distributors. Mutual Funds/ AMCs are required to submit the above data to AMFI and consolidated data with respect to the same will be disclosed on the AMFI website.

6.7 Due Diligence Process by AMCs for Distributors of Mutual Funds[37]

SEBI has mandated AMCs to put in place a due diligence process to regulate distributors who qualify any one of the following criteria:

a. Multiple point presence (More than 20 locations)

b. AUM raised over Rs. 100 crores across the industry in the non-institutionalcategory but including high net worth individuals (HNIs)

c. The commission received of over Rs. 1 Crore p.a. across industry

d. The commission received of over Rs. 50 Lakhs from a single mutual fund

6.8 Difference between distributors and Investment Advisors

An investment advisor means any person, who for consideration, is engaged in the business of providing investment advice to clients or other persons or group of persons and includes

[37] Candidates are advised to Refer SEBI Circular No. CIR/IMD/DF/13/2011 dated August 22, 2011 for more details.

any person who holds out himself as an investment adviser, by whatever name called; It excludes any distributor of mutual funds who is registered with an association of asset management companies of mutual funds, providing any investment advice to its clients incidental to its primary activity.

This definition makes it clear that any person who holds out as an investment advisor would be covered. So, a distributor cannot call themselves an investment advisor. Further, an investment advisor cannot earn both from advisory as well as distribution commission so this needs to be known as both the activities need to be separated.

6.8.1 Advisory

This refers to a service where a distributor represents to offer advice while distributing the product, it will be subject to the principle of 'appropriateness' of products to that customer category. Appropriateness is defined as selling only that product that is identified as best suited for investors within a defined upper ceiling of risk appetite. No exception shall be made. (See Box 6.8.3: Do mutual funds advise[15] their clients?)

6.8.2 Execution only

a. In case of transactions that are not booked as 'advisory', it shall still require:

i. If the distributor has information to believe that the transaction is not appropriate for the customer, a written communication be made to the investorregarding the unsuitability of the product. The communication shall have to be duly acknowledged and accepted by investor.

ii. A customer confirmation to the effect that the transaction is 'execution only' notwithstanding the advice of inappropriateness from that distributor be obtained prior to the execution of the transaction.

iii. That on all such 'execution only' transactions, the customer is not required to pay the distributor anything other than the standard flat transaction charges.[38]

b. There shall be no third categorization of customer relationship / transaction.

c. While selling mutual fund products of the distributors' group/associates, the distributor shall make disclosure to the customer regarding the conflict of interest arising from the distributor selling such products.

Compliance and risk management functions of the distributor shall include a review of defined management processes for:

i. The criteria to be used in review of products and the periodicity of such review.

ii. The factors to be included in determining the risk appetite of the customer and the

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[38]As per the prevailing regulatory guidelines, distributors are eligible only for Trail commission, the upfront commission or transaction charges have been discontinued: https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

investment categorization and periodicity of such review.

Other kinds of due diligence performed are:

i. Review of transactions, exceptions identification, escalation and resolutionprocess by internal audit.
ii. Recruitment, training, certification and performance review of all personnelengaged in this business.
iii. Customer on-boarding and relationship management process, servicing standards, enquiry / grievance handling mechanism.
iv. Internal/external audit processes, their comments/observations as it relates toMF distribution business.
v. Findings of ongoing review from a sample survey of investors.

Mutual funds/AMCs may implement additional measures as deemed appropriate to help achieve greater investor protection. At this stage, it is important to note here that the advice offered by mutual fund distributors is incidental to the business of fund distribution, and hence the distributors cannot project themselves as investment advisors or financial planners. Please refer to the AMFI guidance on MFD nomenclature dated October 20, 2020.

Box. 6.8.3 Do mutual fund distributors advise their clients

SEBI Investor Adviser Regulations, 2013 exempt distributors of mutual funds from registration as investment advisers, so long as the distributor is providing any investment advice to one's clients incidental to the primary activity of distribution offunds.

At the same time, the due diligence process mentioned above also defines the customer relationships or transactions only in two ways, viz. advisory, or execution only. In both cases, however, the common thing for the mutual fund distributor is tosee whether the product is suitable for the client or not. No third categorization of customer relationships or transactions is allowed. The distributor must perform an analysis of suitability.

Ensuring suitability is also a part of the SEBI (Prohibition of Fraudulent and Unfair TradePractices relating to securities market) 2003. This amendment to the regulation included mis selling in units of a mutual fund scheme within the ambit of the mis-selling regulation. The regulation defines mis-selling in units of mutual fund schemes as any of the below:

1. Making a false or misleading statement, or
2. Concealing or omitting material facts of the scheme, or
3. Concealing the associated risk factors of the scheme, or
4. Not taking reasonable care to ensure the suitability of the scheme to the buyer.

   A look at the above provisions would help one understand the role of a mutual fund distributor. If a mutual fund distributor does not take care of the above, one would be considered to be involved in mis-selling activities.

6.9 Nomination facilities to Agents/Distributors and Payment of Commission to Nominee[39]

The livelihood of a large number of mutual fund distributors (self-employed individuals) depends on the commission income primarily the trail commission. The mutual fund distributor builds his long-term source of income by bringing-in business. In case of the death of a mutual fund distributor (MFD), there would be a loss of income for his/her family. Therefore, to provide protection against loss of income to the mutual fund distributor's family, AMFI has advised its members (AMCs) to offer nomination facility to the AMFI registered mutual fund distributors, as a uniform practice across the industry to enable the nominee to receive a commission. Therefore, the AMCs provide nomination facility to the mutual fund distributors at the time of empanelment.
Accordingly, commissions are paid to the nominees or legal heirs (where no nominee is registered) of the deceased MFDs. The AMCs may require the legal heirs to produce necessary documents evidencing legal heirship/succession where nomination is not registered. Such commission shall be payable till such time the ARN code of the deceased agent/distributor is not changed by the investor. However, no new business is permitted under the ARN code of the deceased MFD. Also, no new systematic transactions or changes to existing systematic transactions can be registered under the ARN code of the deceased MF.

However, the distributors are encouraged to provide nominations to reduce the unnecessary hurdles which the legal heirs of a deceased distributor may face in obtaining legal heir certificate/succession certificate etc. Wherever the nominees are registered, the payment of commission can be made to the registered nominees, without the requirement of legal heir certificate, succession certificate etc. on submission of necessary documents such as death certificate.

- A nominee/legal heir need not be an ARN holder to claim and receive the commission.

- Commission can be paid to the nominee/legal heir only for those assets which were procured by the deceased MFD during the validity of his ARN prior to his/her demise. ARN of the deceased agent/distributor should be valid on the date of demise of ARN holder and commission payment/ ARN should not have been suspended by AMFI, for whatsoever reason, at the time of the demise of ARN holder. The future expiry of the ARN of the deceased agent/distributor post his demise is not taken into account for continued payment of upfront [40]and trail commission to the nominee/legal heir. Commission can be

[39] https://www.amfiindia.com/Themes/Theme1/downloads/circulars/CIRARN151213.pdf
https://www.amfiindia.com/Themes/Theme1/downloads/circulars/AMFICircular135BP872020-21.pdf
[40] As per the prevailing regulatory guidelines, distributors are eligible only for Trail commission, the upfront commission or transaction charges have been discontinued: https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

paid to the nominee till AUM under the ARN of the deceased ARN holder becomes nil

- The nominee shall receive the commissions only as trustee for the legal heirs of the deceased MFD.
- Nominees or legal heirs are not allowed to transfer the assets to his/her account unless a specific request is received from the investors in this regard. In case a specificrequest is received from the investor, the assets can be transferred provided the nominee or legal heir is a valid ARN Holder.

Nominee/legal heir of the ARN holder are required to intimate AMFI about demise of ARN holder along with a true copy of death certificate duly attested by Gazette Officer. On receipt of such intimation, AMFI will intimate all AMCs about the demise of the ARN holder. However, this isnot applicable for Overseas Distributors.

For being eligible for transfer of AUM of the deceased mutual fund distributor:
(a) ARN of the deceased agent / distributor should have been valid on the date of demise of the distributor and his/her commission payment/ ARN should not have been suspended for any reason whatsoever, at the time of his/her demise.

(b) the Nominee/ legal heir should have a valid ARN as on the date of request for transfer of AUM and should be KYD compliant and should have submitted his/her annual declaration(s)of self-certification (where applicable) due as on the date of request for transfer of AUM. Also, his/her ARN should not have been suspended by AMFI for any reason whatsoever.

2. Only those assets which were procured by the deceased Agent / Distributor prior to his/her demise and during the validity of his/her ARN can be transferred to the ARN of the nominee/ legal heir.[41]

6.10 Change of distributor

While the trail commission is payable to the distributor for mobilisation of money from the investors, the other purpose of the same is also to ensure that the investor continues to receive regular updates and various services from the distributor. The distributor also keeps getting compensation for such efforts. However, the mutual fund industry allows the investor to change the distributor, without specifying any reason.

In order to remove any possibility of any wrongdoing, e.g., inducing or forcing the investor to request a change of distributor code in the folio, the industry has taken a decision. In case of a change of distributor code in a folio, no commission would be payable to any distributor, neither the old one nor the new one.

[41] Candidates are advised to read Annexure B of AMFI Circular dated July 16, 2020: https://www.amfiindia.com/Themes/Theme1/downloads/circulars/AMFICircular135BP872020-21.pdf

Investors can choose to change their distributor or go direct. This needs to be done through a written request by the investor. In such cases, AMCs will need to comply, without insisting on any kind of 'No Objection Certificate' from the existing distributor. In such a case, the commission would not be payable to either of the distributors– the old or the new. Such provisions ensure two things simultaneously. While the investor reserves the right to change the distributor, a distributor is discouraged to lure a client to change the code. At the same time, if a distributor has opted for voluntary cessation of business, the investor should not be left in the lurch. Hence, if the change of distributor code is initiated by the investor on account of voluntary cessation of business by the distributor, the new distributor would get the trail commission as per the guidelines specified by SEBI or AMFI from time to time.

A distributor can initiate a change in the distributor code in the folios of one's clients on account of any of the following:

Change in the name/legal status of the distributor (such as an individual MF distributor converting his MF distribution business to a partnership firm, a partnership firm converting itself into Limited Liability Partnership (LLP), a private limited company converting itself into a public limited company or vice versa;

i. Merger/acquisition/consolidation/transfer of business/new code acquired within the same group in case of non-individual distributors;

ii. Transfer of AUM consolidation initiative within the same family/close relatives in case of individual distributors; and

iii. Transfer of business by individual distributors

In no other circumstances, such a change would be allowed. At the same time, the transfer of AUM can happen only if the entire AUM is getting transferred from the existing distributor, and only in the name of a valid ARN holder, who is KYD compliant. The old ARN has to be surrendered and no further business can be done under that ARN, once the AUM transfer is complete. AMFI has prescribed a detailed procedure for effecting such a change.

Chapter 6: Sample questions:

1. Only individuals are allowed to distribute mutual funds in India. State whether True or False.
    a. True
    b. False

2. In what form do mutual fund distributors earn revenue?
    a. Commission from mutual funds for distribution of the schemes
    b. Fees collected from the investors
    c. Commission received from Association of Mutual Funds in India
    d. Investment advisory fee from mutual funds

3. What is the Common Account Number (CAN) in MF Utilities?
    a. A number issued for each transaction
    b. A single reference for all mutual fund investments of an investor
    c. A bank account for electronic payments
    d. A code for distributors only

4. Which platforms connect investors, RTAs, distributors, banks, and AMCs for mutual fund transactions?
    a. Groww and Paytm Money
    b. RBI and SEBI portals
    c. Stock Exchanges
    d. MF Utilities and MF Central

5. Which of the following costs will investors no longer bear after SEBI's 2025 circular?
    a. Stamp duty
    b. Transaction charges and upfront distributor commissions
    c. Exit load
    d. Securities transaction tax

CHAPTER 7: PERFORMANCE OF MUTUAL FUNDS

Learning Objectives:

After studying this chapter, you should understand about:

- Calculation of returns of mutual fund schemes
- Concept of loads and application of exit load in calculating transaction price
- Concept of risk in a mutual fund investment
- Concept of risk-adjusted return
- Scheme Benchmarks for mutual fund schemes

7.1 Calculation of returns of mutual fund schemes

The returns from an investment is calculated by comparing the cost paid to acquire the asset (outflow) or the starting value of the investment to what is earned from it (inflows) and computing the rate of return. The inflows can be from periodic payouts such as interest from fixed income securities and dividends from equity investments and gains or losses from a change in the value of the investment. The calculation of return for a period will take both the income earned and gains/loss into consideration, even if the gains/loss have not been realized.

7.1.1 Simple Return

Suppose one invested in a scheme at a NAV of Rs. 12. Later, the NAV went up to Rs. 15. How much is the investment return?

The Simple Return can be calculated with the following formula:

$$\frac{(\mathbf{LaterValue}\ \mathit{minus}\ \mathbf{InitialValue}) \times 100}{\mathbf{InitialValue}}$$

$$\frac{(\mathbf{Rs15}\ \mathit{minus}\ \mathbf{Rs12}) \times 100}{\mathbf{Rs12}}$$

i.e. 25 percent

Thus, simple return is simply the change in the value of an investment over a period of time.

7.1.2 Annualized Return

Two investment options have indicated their returns since inception as 5 percent and 3 percent respectively. If the first investment was in existence for 6 months, and the second for 4 months, then the two returns are obviously not comparable. Annualisation helps us compare the returns of two different time periods.

The Annualized Return can be calculated as:

$$\frac{\textbf{Simple Return} \times 12}{\textbf{Period of Simple Return} \text{ (in months)}}$$

Investment 1 $\frac{5 \text{ percent} \times 12}{6}$ i.e. 10 percent	Investment 2 $\frac{3\, percent \times 12}{4}$ i.e. 9 percent

7.1.3 Compounded Return

Total return is a comprehensive measure of returns because it takes into account all the benefits earned from an investment. However, the time taken to generate returns should also be given due importance. In the earlier example, the total return of 40 percent looks attractive but if the initial investment was made 5 years ago, will this investment still be considered as a good investment option? Hence, total return may not be an appropriate measure of return especially for investment period greater than a year.

To calculate long term returns, we can use CAGR i.e. Compounded Annualized Growth Rate. Now the compound interest formula can be applied.

(Later Value/Initial Value) ^(1/n) - 1

Where 'n' is the period in years.

We can easily understand CAGR returns by comparing it with simple interest calculation. Below we have calculated simple interest return and CAGR return on an investment of Rs. 1 lakh generating 8 percent returns p.a. for a period of 5 years.

Returns based on Simple Interest				
Years	Initial Investment	Rate of Interest (in percent)	Interest reinvested	Value at end of the year
Year 1	1,00,000	8	8,000	1,08,000
Year 2	-	8	8,000	1,16,000
Year 3	-	8	8,000	1,24,000
Year 4	-	8	8,000	1,32,000
Year 5	-	8	8,000	1,40,000

Returns based on Compound Interest or CAGR				
Years	Initial Investment (Rs.)	Rate of Interest (percent)	Interest reinvested (Rs.)	Value at end of the year (Rs.)
Year 1	1,00,000	8	8,000	1,08,000
Year 2	-	8	8,640	1,16,640
Year 3	-	8	9,331	1,25,971
Year 4	-	8	10,078	1,36,049
Year 5	-	8	10,884	1,46,933

The reason for the difference in end value of investment after 5 years is the way returns are calculated. When an investment generates simple interest, the return is earned only on the initial investment every single year. However, in case of CAGR method the interest / return earned during a period is added back to the principal amount. As a result, interest is reinvested in the asset so that interest is earned on interest. This is called the compounding effect.

The impact on returns due to compounding may be marginal in the initial years but for longer periods the positive difference in returns could be jaw dropping.

7.1.4 Total return

Mutual funds can offer returns in two forms; capital gains or losses and dividend. Total return can be positive or negative.

For example, Ashish invested in an equity mutual fund Rs. 1 lakh, at NAV of Rs. 10. He was allotted 10,000 units. The scheme declared dividend of Rs. 2. The current NAV of the scheme is Rs. 12. Calculate the total return on investment?

$$\textbf{Total Return} = \frac{\textbf{(End Value – Begin Value) + Dividend}}{\textbf{Begin Value}} \textbf{ * 100}$$

Begin value = Rs.1,00,000

End Value = Rs.12 * 10,000 units = Rs.1,20,000

Dividend = Rs. 2 * 10000 units = Rs. 20,000

$$\text{Total Return} = \frac{(1,20,000 – 1,00,000) + 20,000}{1,00,000} * 100$$

$$= \frac{40,000 * 100}{1,00,000}$$

Total Return = 40%

Whenever a dividend is paid – and compounding is to be considered - the CAGR technique prescribed by SEBI is used to calculate the total return.

7.2 Concept of loads and application of exit load in calculating transaction price

As per the current regulations, entry load is not allowed, however, exit load is permitted, and many schemes do carry some exit loads. This section would discuss the application of exit loads and the impact on transaction price.

In the earlier example, the CAGR was calculated with the closing NAV as Rs. 15. However, if an exit load of 1 percent was applicable, then the investor will receive only 99 percent of Rs. 15 i.e. Rs. 14.85 on re-purchase. Thus, the investment return would be lower than the scheme returns.

Loads thus drag down the investor's return below the scheme return. Even taxes can pull down the investor's post-tax returns.

While calculating investor returns for a period, instead of the later value of NAV (which is used for calculating scheme returns), the amount actually received / receivable by the investor (i.e. NAV minus Exit Load, if any) would need to be used.

SEBI Norms regarding Representation of Returns by Mutual Funds in India

Mutual funds are not permitted to promise any returns, unless it is an assured returns scheme. Assured returns schemes call for a guarantor who is named in the - SID. The guarantor will need to write out a cheque, if the scheme is otherwise not able to pay the assured return.

Advertisement Code and guidelines for disclosing performance related information of mutual fund schemes are prescribed by SEBI. The same has been discussed in earlier.

7.3 Concept of risk in a mutual fund investment

Investing in mutual fund units carries risks such as trading volumes, settlement issues, liquidity risk, and default risk, including the potential loss of principal. The value of investments in the scheme may rise or fall due to fluctuations in the price, value, or interest rates of the underlying securities. The scheme's NAV can be affected by broader market movements, influenced by factors like interest rates, currency changes, government policies, taxation, and political or economic developments.

Past performance of the Sponsor, AMC, or Mutual Fund does not guarantee future results. The scheme's name does not reflect its quality or future returns.

Liquidity Risk

A scheme's liquidity can be affected by factors like trading volumes, settlement periods, and transfer procedures. While generally invested in liquid securities, liquidity may be impacted by market, sector, or company-specific events. Portfolio rebalancing and redemptions can lead to price fluctuations.

Settlement delays in Indian financial markets may leave assets temporarily un-invested, causing missed investment opportunities. Illiquid markets, especially in the secondary debt and money markets, can prevent timely selling of securities, potentially leading to losses if market conditions deteriorate.

Although government securities are more liquid, extreme market volatility or RBI regulatory changes may still challenge liquidity.

Interest Rate Risk

Fixed income securities such as government bonds, corporate bonds, money market instruments and derivatives run price-risk or interest-rate risk. Generally, when interest rates rise, prices of existing fixed income securities fall and when interest rates drop, such prices increase. The extent of fall or rise in the prices depends upon the coupon and maturity of the security. It also depends upon the yield level at which the security is being traded.

Derivatives carry the risk of adverse changes in the price due to change in interest rates.

Re-investment Risk

The investments made by the Scheme are subject to reinvestment risk. This risk refers to the interest rate levels at which cash flows received from the securities in the Scheme are reinvested. The additional income from reinvestment is the ‘interest on interest’ component. The risk is that the rate at which interim cash flows can be reinvested may be lower than that originally assumed.

Political Risk

Investments in mutual fund Units in India may be materially adversely impacted by Indian politics and changes in the political scenario in India either at the central, state or local level. Actions of the central government or respective state governments in the future could have a significant effect on the Indian economy, which could affect companies, general business and market conditions, prices and yields of securities in which the Scheme invest.

The occurrence of selective unrest or external tensions could adversely affect the political and economic stability of India and consequently have an impact on the securities in which the Scheme invests. Delays or changes in the development of conducive policy frameworks could also have an impact on the securities in which the Scheme invests.

Economic Risk

A slowdown in economic growth or macro-economic imbalances such as the increase in central and state level fiscal deficits may adversely affect investments in the country. The underlying growth in the economy is expected to have a direct impact on the volume of new investments in the country.

Foreign Currency Risk

The Scheme may be denominated in Indian Rupees (INR) which is different from the home currency for Foreign Portfolio Investors in the mutual fund units. The INR value of investments when translated into home currency by Foreign Portfolio Investors could be lower because of the currency movements. The AMC does not manage currency risk for Foreign Portfolio Investors and it is the sole responsibility of the Foreign Portfolio Investors to manage or reduce currency risk on their own. The Sponsor/Fund/Trustees/ AMC are not liable for any loss to Foreign Investors arising from such changes in exchange rates.

Settlement Risk (Counterparty Risk) - Specific floating rate assets may also be created by swapping a fixed return into a floating rate return. In such a swap, there is the risk that the counterparty (who will pay floating rate return and receive fixed rate return) may default.

Risks associated with transaction in Units through stock exchange(s)

In respect of transaction in Units of the Scheme through stock exchanges, allotment and redemption of Units on any Business Day will depend upon the order processing /settlement by BSE/NSE and their respective clearing corporations on which the Fund has no control.

Risk related to equity and equity related securities

Equity and equity-related securities are volatile and subject to daily price fluctuations. Liquidity in the scheme can be restricted by trading volumes and extended settlement periods, sometimes caused by unforeseen circumstances. If the scheme faces settlement issues, it may miss investment opportunities. Similarly, an inability to sell securities in the portfolio could lead to potential losses if the value of those securities declines. Additionally, the scheme's investments may be affected by factors like interest rates, currency exchange rates, changes in laws or government policies, taxation laws, and broader political or economic developments impacting specific sectors or the entire market.

Risk associated with short selling and Stock Lending

Securities lending involves lending securities through an approved intermediary to a borrower for a specified period, with the condition that equivalent securities will be returned, along with any corporate benefits. Risks include the possibility of counterparty failure, leading to loss of collateral, inability to return the securities, and loss of corporate benefits.

Short selling involves selling securities that the seller does not own, borrowing them, and later repurchasing them to return to the lender. Risks include counterparty risk and liquidity risk, as the borrowed security may become illiquid, forcing the seller to repurchase at a higher price, potentially causing losses.

Risks associated with mid-cap and small-cap companies

Investment in mid-cap and small-cap companies are based on the premise that these companies have the ability to increase their earnings at a faster pace as compared to large-cap companies and grow into larger, more valuable companies. However, as with all equity investments, there is a risk that such companies may not achieve their expected earnings results, or there could be an unexpected change in the market, both of which may adversely affect investment results.

Historically, it has been observed that as you go down the capitalization spectrum i.e. from large- cap stocks to mid-cap stocks and beyond, there are higher risks in terms of volatility and market liquidity. Scheme also invests in mid-cap and small-cap companies and hence is exposed to associated risks.

Risk associated with Dividend

Dividend is due only when declared and there is no assurance that a company (even though it may have a track record of payment of dividend in the past) may continue paying dividend in future. As such, the schemes are vulnerable to instances where investments in securities may not earn dividend or where lesser dividend is declared by a company in subsequent years in which investments are made by schemes. As the profitability of companies are likely to vary and have a material bearing on their ability to declare and pay dividend, the performance of the schemes may be adversely affected due to such factors.

Sources of risks in debt funds

Reinvestment Risk

Investments in fixed income securities carry re-investment risk as interest rates prevailing on the coupon payment or maturity dates may differ from the original coupon of the bond.

Rating Migration Risk

Fixed income securities are exposed to rating migration risk, which could impact the price on account of change in the credit rating. For example: One notch downgrade of a AAA rated issuer to AA+ will have an adverse impact on the price of the security and vice-versa for an upgrade of a AA+ issuer.

Term Structure of Interest Rates Risk

The Term Structure of Interest Rates Risk affects the Net Asset Value (NAV) of a scheme invested in fixed income securities. When interest rates fall, the value of fixed income securities rises, and when rates rise, the value declines. This risk is minimal in liquid and money market funds. However, for Fixed Maturity Funds, the risk does not impact returns for investors who remain invested until maturity.

Credit Risk

Fixed income securities (debt and money market securities) are subject to the risk of an issuer's inability to meet interest and principal payments on its debt obligations. The Investment Manager will endeavour to manage credit risk through in-house credit analysis.

Different types of securities in which the Scheme would invest as given in the SID carry different levels of credit risk. Accordingly, the Scheme' risk may increase or decrease depending upon their investment patterns. E.g. corporate bonds carry a higher amount of risk than Government securities. Further, even among corporate bonds, bonds which are rated AAA are comparatively less risky than bonds which are AA rated.

The credit risk is the risk that the counter party will default in its obligations and is generally small as in a Derivative transaction there is generally no exchange of the principal amount.

Risks associated with Creation of Segregated portfolio

Investor holding units of segregated portfolio may not able to liquidate their holding till the time recovery of money from the issuer. Security comprises of segregated portfolio may not realise any value. Listing of units of segregated portfolio on recognised stock exchange does not necessarily guarantee their liquidity. There may not be active trading of units in the stock market. Further trading price of units on the stock market may be significantly lower than the prevailing NAV.

Risk Factors Associated with Investments in REITs and InvITs:

REITs and InvITs are exposed to risks such as price risk, interest rate risk, credit risk, liquidity risk, reinvestment risk, and the risk of lower-than-expected distributions. Distributions depend on the net cash flows available, which are mainly driven by dividends, interest, and principal payments from portfolio assets.

However, various risk management strategies are employed to address these risks. These strategies include diversification, regular monitoring of asset performance, credit checks on counterparties, interest rate hedging, and maintaining liquidity buffers to ensure smoother cash flows and mitigate the impact of market fluctuations.

Managing Market Liquidity Risk

The liquidity risk is managed by creating a portfolio which has adequate access to liquidity. The Investment Manager selects fixed income securities, which have or are expected to have high secondary market liquidity. There is good secondary market liquidity in government securities. As far as other long dated fixed income securities are concerned, the endeavour is to invest in high quality securities, for example bonds issued by public sector entities. Market Liquidity Risk will be managed actively within the portfolio liquidity limits. The first access to liquidity is through cash and fixed income securities.

Managing Credit Risk

Credit risk in fixed income securities is managed by investing in securities from issuers with strong credit profiles. The credit research process involves detailed in-house analysis and due diligence. Limits are set for each issuer (excluding the Government of India) regarding the amount and maximum allowable tenor. The credit process includes an initial and periodic review of the issuer's financial and operational strength, ensuring ongoing risk assessment.

Re-investment Risk

Re-investment Risk is prevalent for fixed income securities, but as the fixed income investments of the Scheme are generally short duration in nature, the impact can be expected to be small.

Market Risk related to equity and equity related securities

The Investment Manager aims to invest in companies after conducting thorough due diligence and research. Since many of these companies may not be extensively covered by third-party research firms, the Investment Manager relies on its own analysis. This includes one-on-one meetings with company management, attending conferences, analyst meetings, and teleconferences.

The analysis focuses on several factors, including the company's financial condition (both historical and current), potential value creation, earnings growth, capital structure, business prospects, policy environment, management strength, market share, brand equity, competitive edge, research capabilities, technological expertise, and corporate governance transparency.

Managing Risk associated with favourable taxation of equity-oriented Scheme

This risk is mitigated as there is a regular monitoring of equity exposure of each of the equity oriented Scheme of the Fund.

Difference between market / systematic risk and company specific risk

Investments face two main types of risks: company-specific (unsystematic) risks and systematic risks. Company-specific risks, like a labour strike, impact individual firms and can be reduced through diversification. Systematic risks, such as inflation, affect the entire economy and cannot be mitigated by diversification, making them non-diversifiable or market risks.

Fund managers can reduce unsystematic risk by diversifying across different companies but cannot avoid systematic risks except by staying out of the market. While some managers shift between equities and cash depending on market outlook, SEBI regulations limit the extent of cash allocation. Other managers stay fully invested, accepting systematic risk, as they believe investors understand the risks associated with the scheme.

Finance theory suggests investors are rewarded only for taking non-diversifiable (systematic) risks. To outperform the benchmark, fund managers must take on some unsystematic risks by selecting specific securities.

The fund managers adopt active management strategy in order to outperform the scheme's benchmark index. For that purpose, the manager would have no choice but to take certain unsystematic risks by taking a view on the individual securities.

Mutual fund investments are subject to market risks

"Mutual fund investments are subject to market risks. Please read the scheme-related documents carefully before investing." This regulatory disclaimer highlights the fact that mutual funds pass on investment risks to investors, unlike fixed deposits where returns are promised. In mutual funds, the investor owns the fund and is exposed to risks such as credit risk if investments default.

While diversification helps mitigate certain risks like credit risk, it cannot protect against market-wide price fluctuations. Mutual fund NAVs can fluctuate based on market conditions, especially in volatile markets like equities. However, stable markets lead to less fluctuation, as seen in funds like overnight funds.

In essence, mutual funds don't carry risk themselves—it's the underlying investments that do. Diversification helps manage individual security risk but cannot eliminate broader market risk.

7.4 Concept of risk-adjusted return

Investors primarily select mutual funds based on the returns generated. However, to make a more informed choice, it's essential to assess the consistency of these returns and how they compare to the fund's benchmark and peer group. An actively managed fund should ideally perform well in rising markets and decline less than its benchmark in falling markets.

Simply looking at return figures is not enough for investment decisions; the scheme's suitability to an investor's needs must also factor in associated risks, including the volatility of returns over time. Higher volatility indicates a riskier scheme.

A common method for evaluating fund managers is through the risk-reward relationship, where returns should align with the risks taken. A fund manager who takes on more risk should achieve higher returns to justify that risk, while a manager earning lower returns may be able to justify this by taking less risk. These evaluations are often conducted through measures of risk-adjusted returns.

The different kind of risk-adjusted returns are:

(a) Sharpe Ratio

Sharpe ratio is a very commonly used measure of risk-adjusted returns.

An investor can invest with the government and earn a risk-free rate of return (R_f). T-Bill index is a good measure of this risk-free return.

Through investment in a scheme, a risk is taken, and a return is earned (R_s).

The difference between the two returns i.e. $R_s – R_f$ is called risk premium. It is like a premium that the investor has earned for the risk taken, as compared to government's risk-free return.

This risk premium is to be compared with the risk taken. Sharpe Ratio uses Standard Deviation as a measure of risk. It is calculated as:

Sharpe Ratio = (R_s minus R_f) ÷ Standard Deviation

Thus, if risk free return is 5 percent, and a scheme with standard deviation of 0.5 percent earned a return of 7 percent, its Sharpe Ratio would be (7 percent - 5 percent) ÷ 0.5 percent i.e. 4.

Sharpe Ratio is effectively the risk premium generated by assuming per unit of risk. Higher the Sharpe Ratio, better the scheme is considered to be.

Sharpe Ratio comparisons can be undertaken only for comparable schemes. For example, Sharpe Ratio of an equity scheme cannot be compared with the Sharpe Ratio of a debt scheme.

(b) Treynor Ratio

Like Sharpe Ratio, Treynor Ratio too is a risk premium per unit of risk.

Computation of risk premium is the same as was done for the Sharpe Ratio. However, for risk, Treynor Ratio uses Beta.

Treynor Ratio is thus calculated as:

Treynor Ratio = (R_s minus R_f) ÷ Beta

Thus, if risk free return is 5 percent, and a scheme with Beta of 1.2 earned a return of 8 percent, its Treynor Ratio would be (8 percent - 5 percent) ÷ 1.2 i.e. 2.5.

Higher the Treynor Ratio, better the scheme is considered to be. Since the concept of Beta is more relevant for diversified equity schemes, Treynor Ratio comparisons should ideally be restricted to such schemes.

11.7.1 Information ratio

Information ratio is an established financial ratio to measure the risk-adjusted return of any scheme portfolio. It is often used as a measure of a portfolio manager's level of skill and ability to generate excess returns adjusted for risk, relative to a benchmark. It also attempts to identify the consistency of the performance by incorporating standard deviation (risk) into the calculation.

It is mandatory for the AMCs to disclose the Information Ratio as a financial metric to measure the risk-adjusted return of a portfolio. This is the only measure of risk-adjusted returns that is mandatory to disclose.

The information ratio must be disclosed by the AMCs on their website on a daily basis. It would also be available on AMFI website in a comparable format.

Information Ratio is calculated as under:

Information Ratio (IR)
= (Portfolio Return-Benchmark return)/Standard deviation of Excess Return

For the purpose of the above calculation, the benchmark must be the tier-I benchmark used for the scheme (as disclosed in the SID). The standard deviation of excess returns shall be calculated on the basis of daily return values.

By specifying the above method of calculation and disclosure norms, SEBI[42] has standardized both.

Tracking Error

The Beta of the market, by definition is 1. An index fund mirrors the index. Therefore, the index fund too would have a Beta of 1, and it ought to earn the same return as the market. The difference between an index fund's return and the market return is the tracking error.

Tracking error is a measure of the consistency of the out-performance of the fund manager relative to the benchmark. Earlier it was used as a measure of how closely an index fund tracked the returns from the benchmark to which it was indexed. The tracking error was expected to be zero. Now, the tracking error is used to measure how consistently a fund is able to out-perform its benchmark. It is not enough if the fund is able to generate a high excess return, it must do so consistently.

Tracking error is calculated as the standard deviation of the excess returns generated by the fund. The tracking error has to be low for a consistently out-performing fund.

In case of an index fund, this measure assumes great importance. The measure of a good index fund is a very low tracking error.

7.5 Scheme Benchmarks for mutual fund schemes

Mutual fund schemes invest in the market for the benefit of Unit-holders. How well did a scheme perform? An approach to assess the performance is to pre-define a comparable – a benchmark – against which the scheme can be compared.

- A credible benchmark should meet the following requirements: It should be in sync with (a) the investment objective of the scheme (i.e. the securities or variables that go into the calculation of the benchmark should be representative of the kind of portfolio implicit in the scheme's investment objective); (b) asset allocation pattern; and (c) investment strategy of the scheme.
- The benchmark should be calculated by an independent agency in a transparent manner, and published regularly. Most benchmarks are constructed by stock exchanges, credit rating agencies, securities research houses or financial publications.

[42] SEBI circular no. SEBI/HO/IMD/IMD-PoD-2/P/CIR/2025/6 dated January 17, 2025

Choice of benchmark is simplest for an index fund. The investment objective is clear on the index that the scheme would track. That index would then be the benchmark for the scheme.

For mutual fund schemes, selecting a benchmark is subjective and decided by the Asset Management Company (AMC) in consultation with the trustees. The Scheme Information Document (SID) must mention the chosen benchmark, and the scheme's past performance must be compared with the benchmark's performance over the same period. The fund may change its benchmark later due to reasons like a change in the scheme’s investment objective, index construction, or the availability of a more suitable index. Such changes require consultation with trustees, justification, and documentation. Mutual fund schemes must disclose the benchmark index used for performance comparison. Some important points relating to benchmarking have been highlighted in Box 7.1.

Price Return Index or Total Return Index

Box 7.1: Some Important Facts Relating to Benchmarking

With an objective to enable the investors to compare the performance of a scheme vis-à-vis an appropriate benchmark, SEBI has mandated:

- Selection of a benchmark for the scheme of a mutual fund to be in alignment with the investment objective, asset allocation pattern and investment strategy of the scheme.
- The performance of the schemes of a mutual fund to be benchmarked to the Total Return variant of the Index chosen as a benchmark.
- Mutual funds should use a composite CAGR figure of the performance of the PRI benchmark (till the date from which TRI is available) and the TRI (subsequently) to compare the performance of their scheme in case TRI is not available for that particular period(s).

Earlier, the Mutual Fund schemes were benchmarked to the Price Return variant of an Index (PRI). PRI only captures capital gains of the index constituents. With effect from February 1, 2018, the mutual fund schemes are benchmarked to the Total Return variant of an Index (TRI). The Total Return variant of an index takes into account all dividends/ interest payments that are generated from the basket of constituents that make up the index in addition to the capital gains.

Such a change was required to ensure that the performance comparison is fair. The scheme performance would be calculated after adding the dividends that the scheme has earned from the investments. Even in case of dividend option, the scheme performance is calculated using the Reinvestment of Income distribution cum capital withdrawal method. In such a case, if the scheme performance is compared with that of PRI, it would give a slight advantage to the scheme. The shift to TRI has been another one in the direction of increasing transparency of mutual funds.

In other words, this would make it appear that fewer schemes are able to beat their benchmark indices. While the reality has not changed, the presentation of the same has changed. The gap between the returns between PRI and TRI is the amount of dividend.

Basis of Choosing an appropriate performance benchmark

Thus, the scheme's benchmark must be chosen on the basis of the following:

- Scheme's investment objective,
- Investment strategy of the scheme, and
- The scheme's asset allocation pattern

To standardize and bring-in uniformity in the benchmarks of mutual fund schemes, vide SEBI circular dated October 27, 2021, it has been notified that there will be a two-tiered structure for benchmarking of certain category of schemes. The first tier benchmark will be reflective of the category of the scheme, and the second tier benchmark will be demonstrative of the investment style/strategy of the Fund Manager within the category. All the benchmarks followed will necessarily be Total Return Indices.

All the benchmarks followed will necessarily be Total Return Indices.

Type of Scheme	**Type of Benchmark**	
	Tier-1	**Tier-2**
Income /Debt Oriented Schemes	One Broad Market Index per Index provider for each category such as NIFTY Ultra Short Duration Debt Index or CRISIL Ultra Short Term Debt Index for Ultra Short Duration Fund Category	Bespoke according to Investment Style/Strategy of the Index like AAA Bond Index
Growth / Equity Oriented Schemes	One Broad Market Index per Index Provider for each category e.g.: S&P BSE100 Index or NSE 100 Index for Large Cap Fund Category	Bespoke according to Investment Style/Strategy of the Index e.g.: Nifty 50 Index
Hybrid and Solution	There would be a single benchmark, i.e., Broad Market Benchmark wherever available or bespoke to be created for schemes, which would then be applicable across industry	

Type of Scheme	Type of Benchmark	
	Tier-1	Tier-2
Oriented Schemes		
Thematic/ Sectoral schemes	There would be a single benchmark as characteristics of the schemes are already tapered according to the theme/sector	
Index Funds and Exchange Traded Funds(ETFs)	There would be a single benchmark as these schemes replicate an underlying index	
Fund of Funds Schemes (FoFs)	If a FoF scheme is investing in a single fund, then benchmark of the underlying scheme will be used for corresponding FoF. However, in case a FoF scheme invests in multiple schemes, then Broad Market Index will be applied.	

Chapter 7: Sample Questions

1. Which amongst the following is a measure of risk-adjusted returns of mutual fund scheme?
    a. Standard deviation
    b. Beta
    c. Variance
    d. Sharpe ratio

2. Which of the following cannot be considered for the purpose of selecting a scheme's benchmark?
    a. Mutual fund scheme's investment objective
    b. Investment strategy of the MF scheme
    c. Scheme's asset allocation pattern
    d. Scheme's past returns

3. _________ takes into account all dividends generated from the basket of constituents that make up the index in addition to the capital gains.
    a. Total return index
    b. Price return index
    c. Dividend return index

4. Which risk involves the difficulty of redeeming mutual fund units due to lack of buyers or market disruptions?
    a. Credit risk
    b. Liquidity risk
    c. Interest rate risk
    d. Manager risk

5. When interest rates rise, the price of existing fixed income securities in a mutual fund generally:
    a. Rises
    b. Falls
    c. Remains unchanged
    d. Doubles

6. The risk that mutual fund units cannot be traded or liquidated easily is known as:
    a. Settlement risk
    b. Political risk
    c. Reinvestment risk
    d. Liquidity risk

CHAPTER 8: TAXATION

Learning Objectives:

After studying this chapter, you should know about:

- Applicability of taxes in respect of mutual funds
- Capital Gains
- Dividend Income
- Difference between dividend distribution tax and capital gains tax
- Setting off Gains and Losses under Income Tax Act
- Securities Transaction Tax
- Tax benefits under Section 80 C of Income Tax Act, 1961
- Tax Deducted at Source

When anyone considers making an investment, one of the objectives is to get some investment returns. However, such returns on investments or income from investments may be subject to tax. The investor would get the income after the payment of taxes. In such a case, it is important to understand the taxation associated with one's investments. This chapter covers taxation in respect of mutual funds. As discussed earlier, the mutual fund is an investment vehicle that invests in various investment options. Hence, a distributor of mutual funds must understand the tax applicable on the income of the mutual fund scheme, as well as the tax applicable on investments made by an investor in mutual fund schemes.

8.1 Applicability of taxes in respect of mutual funds

8.1.1 Income from investment in mutual fund units

Investors must consider the effect of taxes on their investment returns. It is not how much you earn, but how much you keep after taxes that counts. As a mutual fund is a pass-through vehicle, we must consider the income at two levels– income earned by the fund, and income earned by the investor.

8.1.2 Income earned by mutual fund schemes

The schemes of the mutual funds invest in marketable securities like shares and debentures. These securities generate income in the form of dividend or interest. Apart from this, when the fund buys and sells the shares and debentures in the securities market, there could be capital gains or losses. Interest, dividend and capital gains form the income of the mutual fund.

As per the prevailing tax laws in India, a mutual fund's income is exempt from income tax, since mutual funds are constituted as trusts in India for the benefits of the unitholders. Section

10(23)(D) of the Income Tax Act exempts all the income earned by the mutual fund schemes from any tax.

8.1.3 Income earned by the investor from investment in mutual fund units

We have already seen that the investor can choose from two options within the scheme, viz. (earlier called Dividend) Income Distribution cum Capital Withdrawal (IDCW) option and growth. The one who has opted for Income distribution cum capital withdrawal (dividend) may get incomein form of dividends, whereas the investor in the growth plan would not get any dividend whatsoever, irrespective of the profits earned by the fund.

The investor in the growth plan would earn capital gains (or losses) whenever one sells the units of the scheme. On the other hand, the investor in the Income Distribution cum capital withdrawal (dividend) plan may get dividend, as and when declared by the fund, as well as capital gains (or losses) when one sells the units.

Both these may have different tax treatment in comparison to the income that one earns through salary or professional fees and other means. The tax structure is different for different types of investors, as well as for different categories of funds, too.

Let us take a look at the applicable tax rates in case of capital gains and dividends. The tax rates would vary as under:

- **Type of income**: The capital gains are taxed differently in comparison to the dividend income (IDCW).
- **Holding period**: Capital gains may be categorized as short term and long term based on the holding period. At the same time, within capital gains, short term capital gains may attract different tax rates in comparison to long term capital gains.

- **Type of mutual fund schemes**: Income from equity-oriented mutual fund schemes is taxed at different rates in comparison to non-equity-oriented schemes. The Income Tax Act defines two categories of mutual funds, viz., equity-oriented funds and non- equity-oriented funds. The schemes holding more than 65 percent of the assets undermanagement in equity shares listed on recognised stock exchanges in India are classified as equity-oriented mutual fund schemes. All the other schemes are classifiedas non-equity-oriented schemes. For example, fund-of-funds investing in other equitymutual fund schemes, would be classified as non-equity-oriented schemes. Though the said scheme is eventually investing in equity assets (equity mutual funds), it is classified as a non-equity-oriented scheme for the purpose of income tax.

- **Type of investor**: The tax treatment may differ for Resident Indian Investors, NRIs, andnonindividual investors. It must be noted that in case of joint holding, the income, beit capital gains or dividend, would be considered to have been earned by the first holder.

- Date of purchase: The union budget 2023 brought some changes in the taxation of capital gains. These changes were applicable from April 1, 2023 onwards. Investments made prior to that date, i.e., April 1, 2023 would enjoy the old tax structure.

- Date of redemption: Union budget for the year 2024-25 was presented in the parliament in July 2024 after the new government was formed basis the results of union elections 2024. To achieve the objective of simplification of taxes, this budget brought about many changes, primarily the tax on capital gains. The new tax rules became effective immediately. However, If the units are redeemed before July 23, 2024, the old tax rates would apply. The new tax rates would be applicable for units redeemed on or after July 23, 2024.

8.2 Capital Gains

When a unitholder sells units of the scheme, the selling price could be different from the price at which the units were bought. The difference between the purchase price of the units and the selling price of the units would be treated as capital gain (or loss). If the selling price is higher than the purchase price, there is an incidence of capital gain, whereas if the selling price is lower than the purchase price, there is a capital loss. The capital gains are subject to tax. Capital gains tax is classified depending on the period of holding and the type of funds invested in.

Capital gains are classified into two categories: short term capital gains and long-term capital gains. For classifying assets into long-term and short-term, there will only be two holding periods: 12 months and 24 months. The holding period for all listed securities as well as for units of equity-oriented funds is 12 months. The holding period for all other assets is 24 months.

Equity mutual funds were exempt from long term capital gains tax earlier. In the Union Budget of the year 2018, this was changed. Starting April 2018, long term capital gains became taxable. Relating to this, there are two important provisions that are discussed here:

1. **Grandfathering of capital gains:** Since the capital gains from equity assets were non-taxable till the announcement of the budget in 2018, an introduction of the tax wouldhave meant that even the gains earned till then would also become taxable. This is equivalent to introducing tax with retrospective effect. In order to avoid such a situation, the finance minister introduced a clause, which came to be known as the "grandfathering of the capital gains". This meant that the capital gains earned till January 31, 2018 would not be taxable, which means that for all the equity mutual funds that one has invested in, the valuation as on January 31, 2018 becomes the base point. Gains would be calculated for the purpose of tax by

taking the higher of thepurchase price or the NAV as on January 31, 2018. The grandfathering benefit was offered in order to ensure that the effect of the tax is only on a prospective basis and not retrospective.

a. The long-term capital appreciation in the various investments in equity-oriented mutual funds was exempt from tax, as per the prevailing law still the above change. If the appreciation prior to such an announcement was also subject to tax, it would tant amount to retrospective taxation.

b. What this means is that if someone had invested Rs. 1,00,000 in an equity- oriented mutual fund scheme in 2017 (or any such period prior to the grandfathering date of January 31, 2018) and the value of the investments as on January 31, 2018 was Rs. 2,00,000.

Scenario: 1

If the investor sells the investments completely and realises a value of Rs. 1,80,000 on February 9, 2018 then the long-term capital gains for the purpose of taxes would be considered to be zero, since the realisedvalue is less than the value of investments on January 31, 2018 (i.e., thedifference between the realised value of Rs. 1,80,000 and the value on January 31, 2018 – Rs. 2,00,000).

Scenario 2:

If the investor sells the investments completely and realises a value of Rs. 2,20,000; the long-term capital gains for the purpose of taxation would be considered to be Rs. 20,000 (The difference between the realised value of Rs. 2,20,000 and the value on January 31, 2018 – Rs. 2,00,000).

2. **Exemption up to Rs. 1.25 lakhs:** In case of long-term capital gains arising out of equity shares and equity-oriented mutual funds, the tax is applicable only on the capital gainsabove Rs. 1.25 lakhs. The first Rs. 1.25 lakhs worth of long-term capital gain from this category istax-exempt.

For example, if an investor has earned a total long term capital gain worth Rs.90,000 in a year, the entire capital gain would be exempt from tax. On the other hand, if the total capital gain is Rs. 1,35,000; the first Rs. 1,25,000 wouldbe exempt from capital gains tax, but the next Rs. 10,000 would be subject to tax.

8.3 Dividend income (IDCW option)

Dividend income from mutual funds used to be tax-free in the hands of the investor. There was no tax payable at all, irrespective of how much dividend one earned. However, the dividend would be paid to the investor after the deduction of dividend distribution tax from the scheme itself. To that extent, although the dividend was tax-free, the NAV reduced to the extent of the dividend as well as the dividend distribution tax. Thus, this tax had an impact on the investor’s after-tax returns.

In the Union Budget presented by the finance minister in February 2020, the situation changed. The dividend distribution tax has been done away with, whereas the dividend would henceforth be added to the taxable income of the assessee for the year. This means the dividends would be taxable in the hands of the recipient at the applicable tax rate.

What is the change for those who opted for Income distribution cum capital withdrawal (dividend) option in mutual funds?
In the new regime, tax on dividend would be a function of the applicable rate of tax based on the total income for the year, and hence the tax rate goes up for those with higher income. This means those who were in higher tax earlier might have paid a lower tax on the dividend income in comparison to their nominal rate of tax. This difference goes away. On the other hand, the investors, who were tax-exempt also had to still bear the impact of the dividend distribution tax in the earlier regime. Now with the changes proposed, the dividend income would be tax exempt for investors in various tax-exempt categories, for example charitable trusts, mutual fund schemes and individuals in the tax-exempt slab.

Let us understand one important difference between dividend distribution tax (old regime) and the tax on dividends in the hands of investors (new regime). The dividend distribution tax was not considered a tax in the hands of the investor, and hence it was not available as a setoff against any other tax liability. On the other hand, in the new regime, tax on dividends can be reduced through various exemptions and adjustments, as applicable.

It must also be noted here that the NAV of the scheme goes down more than the amount received in the hands of the investor.

Post-tax dividend received by the investor = Dividend paid out by the scheme – Tax payable thereon, as per the applicable tax slab

On the other hand, the growth option works out to be more tax-efficient. Since the mutual fund schemes are tax-exempt, and the capital gains are realized only when booked, one can allow the gains to run without worrying about tax on the same. This concept is known as deferment of taxes and allows one the benefit of compounding before tax.

8.4 Stamp Duty on Mutual Fund Units

With effect from July 1, 2020, mutual fund units issued against Purchase transactions (whether through lump-sum investments or SIP or STP or switch-ins or Reinvestment of Income distribution cum capital withdrawal) would be subject to levy of stamp duty* @ 0.005% of the amount invested.[43] Transfer of mutual fund units (such as transfers between demat accounts) is subject to payment of stamp duty* @ 0.015%. Box 8.2 provides some more details regarding stamp dutyon mutual fund units.

Box 8.2: Stamp Duty on MF units

In adherence to the amendments carried out in the Indian Stamp Act in February 2019, stamp-duty is required to be paid for issue and transfer of Mutual Fund units with effect from1 July 2020.
• Stamp duty @0.005% of the investment amount shall be applicable at the time of **<u>issue of units</u>** for both physical and demat units.
• Units will be allotted for the amount available post deduction of stamp duty.
• Stamp duty will be applicable to all transactions pertaining to scheme inflows:
    • Purchase
    • Additional Purchase
    • Reinvestment of Income distribution cum capital withdrawal
    • Systematic Investment Plan (SIP)
    • Systematic Transfer Plan (STP)
    • Income distribution cum capital withdrawal (Dividend) Transfer Plan (DTP).This will also include triggers from past SIP/STP registrations.

8.5 Setting off of Capital Gains and Losses under Income Tax Act

The Income Tax Act provides for taxation under various heads of income viz. salaries, income from house property, profits & gains of business or profession, capital gains, and income from other sources. In the normal course, one would expect that a loss in one head of income can be adjusted (set off) against gains in another head of income, since a person is liable to pay tax on the total income for the year. However, there are limitations to such set-off. A few key provisions here are:

- Capital loss, short term or long term, cannot be set off against any other head ofincome (e.g., salaries).

- Short term capital loss is to be set off against short term capital gain or long-term

[43] Pursuant to Notification No. S.O. 4419(E) dated December 10, 2019 issued by Department of Revenue, Ministry of Finance, Government of India, read with Part I of Chapter IV of Notification dated February 21, 2019 issued by Legislative Department, Ministry of Law and Justice, Government of India on the Finance Act, 2019, and subsequent Notification dated March 30, 2020 issued by Department of Revenue, Ministry of Finance, Government of India.

capital gain.

- Long term capital loss can only be set off against long term capital gain.

Several other factors go into taxation or tax exemption.

8.6 Securities Transaction Tax

When an investor sells units of an equity fund in the stock exchange, or offers them for re-purchase to the fund, he will have to incur Securities Transaction Tax (STT) i.e., STT is applicable only on redemption/switch to other schemes/sale of units of equity oriented mutual funds whether sold on stock exchange or otherwise.

STT is not applicable on purchase of units of an equity scheme. It is also not applicable to transactions in debt securities or debt mutual fund schemes.

STT applicability for Investors in Equity oriented Mutual funds

Transaction	Rates (in percent)	Payable by
Purchase of units of equity oriented mutual fund	Nil	Purchaser
Sale of units of equity oriented mutual fund (deliverybased)	0.001	Seller
Sale of equity shares, units of business trust, units ofequity oriented mutual fund (non- delivery based)	0.025	Seller
Sale of units of an equity oriented mutual fund to themutual fund	0.001	Seller

8.7 Tax benefit under Section 80C of the Income Tax Act

Certain mutual fund schemes, known as Equity Linked Savings Schemes (ELSS) are eligible for deduction under Section 80C of the Income Tax Act under the old tax regime. As the name suggests, this is an equity- linked scheme, and hence the scheme invests in equity shares. The benefit is available up to Rs. 1.50 lacs per year per taxpayer in case of individuals and HUFs. The scheme has a lock-in period of three years from the date of investment.

Let us now understand some nuances of this.

First of all, this is one of the eligible investments under Section 80C, where the limit is to be shared across the eligible avenues. This means if someone has exhausted the limit under the said section through some other avenue, any investment in ELSS would not get any additional tax exemption, but the investment would still be locked-in for a minimum period of three years.

Second, if one is investing in this scheme through SIP, each investment would be locked-in from the date of the respective investment. The lock-in for the entire amount would not get over on completion of 3 years from the date of the first SIP instalment.

Third, if one opts for (dividend) Income distribution cum capital withdrawal reinvestment plan, each time a dividend is reinvested, the same would also attract a 3-year lock-in. Most AMCs have done away with this option in case of ELSS. They only allow growth option or dividend pay-out.

Fourth, the tax benefit would be available to the first holder, in case of a joint holding.

The finance minister, in the Union Budget 2020, proposed two parallel tax structures for the individual taxpayers. There is an old structure, which was applicable before the budget was presented that allowed different kinds of exemptions and deductions under various sections of the Income Tax Act. A parallel tax structure has been announced in Union Budget 2020, which has more slabs, and lower rates of taxes for similar slabs. However, under the new regime, most exemptions have been removed. Those who opt for this new structure would not be able to take the benefit of tax-saving under Section 80C. Hence, for these investors, ELSS is just another equity-oriented mutual fund scheme that carries a lock-in provision.

There are also a few retirements oriented funds including some that are more than a couple of decades-old which have the benefit of Section 80C. These funds have a lock-in of 5 years and they are meant for accumulation of corpus for a person for their later years. Investing in these funds would also allow the investor to get a Section 80C deduction. However, one should check whether a specific retirement fund has this benefit because not all of them in operation have this Section 80C benefit.

8.8 Tax Deducted at Source

There is no TDS on re-purchase proceeds to resident investors. However, for certain cases of non-resident investments, the same is applicable. The income tax regulations prescribe different rates, depending on the nature of the investor (Indian/ Foreign and Individual/Institutional), nature of investment (equity/debt) and nature of the income (dividend/capital gain). In case of dividends (IDCW) from mutual fund schemes, even for resident Indians, TDS is applicable. The tax is required to be deducted at 10 percent on the dividend amount if it exceeds Rs. 5,000.

Further, Government of India has entered into Double Taxation Avoidance Agreements

(DTAA) with several countries. These agreements too, specify rates for Withholding Tax.

The TDS applicable for non-resident investors is the lower of the rate specified in the income tax regulations or the tax specified in the DTAA of the country where the investor is resident. The investor, however, will need to provide sufficient information and documents to satisfy the mutual fund that he is entitled to such concessional rate as is specified in the DTAA.

8.9 Applicability of GST

AMC(s) can charge GST, as per applicable Taxation Laws, to the schemes within the limits prescribed under SEBI (Mutual Fund) Regulations.

- GST on fees paid on investment management and advisory fees shall be charged to the scheme in addition to the overall limits specified as per the Total Expense Ratio (TER) provisions.

- GST on all the fees other than investment and advisory fees shall be charged to the scheme within the maximum limit of TER.

- GST on exit load, if any, shall be deducted from the exit load and the net amount shall be credited to the scheme.
- GST on brokerage and transaction cost paid for execution of trade, if any, shall bewithin the limit of TER.

- The commission payable to the distributors of mutual funds may be subject to GST, as applicable in case of the ARN holder. Such tax cannot be charged to the scheme.

Chapter 8: Sample Questions:

1. What is the tax applicable on the income earned by the mutual fund schemes?
    a. It is a function of the type of income since dividends, short term capital gains and long-term capital gains attract different tax rates
    b. Income earned by a mutual fund is exempt from taxes
    c. 10 percent plus surcharge and cess
    d. It is a function of the marginal rate of tax applicable to the respective investor in the mutual fund scheme

2. Redemption from which of the following mutual fund schemes would attract Securities Transaction Tax (STT) for an investor?
    a. Multi-cap mutual fund
    b. Government Securities Fund
    c. Liquid Fund
    d. Overnight Fund

3. What is the mandatory lock-in period for ELSS mutual funds to qualify for Section 80C benefits?
    a. 1 year
    b. 2 years
    c. 3 years
    d. 5 years

CHAPTER 9: INVESTOR SERVICES

Learning Objectives:

After studying this chapter, you should know about:

- New Fund Offer Process
- NFO price and on-going price for subscription of mutual fund schemes
- Investment Plans and Options
- Allotment of mutual fund units to investors
- Content and periodicity of Statement of Account
- Mutual Fund Investor
- Application form of mutual funds
- Financial Transactions in mutual funds through online and physical mechanism
- Cut-off timing and Time stamping
- KYC requirements for mutual fund investors
- Different types of systematic transactions
- Operational aspects of Systematic Transactions
- Process of Non-Financial Transactions in Mutual Funds
- Change in Status of Special Investor Categories
- Investor transactions – turnaround times

Mutual fund is an investment vehicle for a large number of investors. In order to provide uniform experience, it is critical that various processes and investor services are standardized. Such standardization lends comfort to the investors since they know what to expect and when. They also know what not to expect in terms of services.

We would look at various investor services involved at various stages in the life of a mutual fund investment.

9.1 The NFO process

New Fund Offer

Units in a mutual fund scheme are offered to investors for the first time through a New Fund Offer (NFO). The following are a few key steps leading to the NFO:

- The Asset Management Company (AMC) decides on a scheme to take to the market. This is decided on the basis of inputs from the Chief Investment Officer (CIO) on investment objectives that would benefit investors, and inputs from the Chief Marketing Officer (CMO) on the interest in the market for the investment objectives.

An AMC can have one fund/scheme in a category. There are defined funds within broad Equity, Debt and Hybrid categories. Hence the NFO has to be in a category where the AMC does not already have a fund/scheme. Or, it has to be in a category where an AMC can have multiple funds/schemes e.g. Sector/Theme, Index or Fund of Funds.

- AMC prepares the Scheme Information Document for the NFO. This needs to be approved by the Trustees and the Board of Directors (BoD) of the AMC.
- The documents are then filed with SEBI. The observations that SEBI makes on the SID need to be incorporated. After approval by the trustees, the same can be issued in the market.
- The AMC decides on a suitable timetable for the issue, keeping in mind the market situation.
- The AMC launches its advertising and public relations campaigns to make investors aware of the NFO. These need to comply with SEBI's advertising code.
- The AMC holds events for intermediaries and the press to make them familiar with the scheme, its unique features, benefits for investors, etc.
- The Scheme Documents and Application Forms are distributed to market intermediaries, and circulated in the market so that investors can apply in the NFO.

Three dates are relevant for the NFO of an open-ended scheme:

NFO Open Date – This is the date from which investors can invest in the NFO

NFO Close Date – This is the date up to which investors can invest in the NFO

Scheme Re-Opening Date – This is the date from which the investors can offer their units for re-purchase to the scheme (at the re-purchase price); or buy new units of the scheme (at the sale price). The AMC announces Sale and Re-purchase prices from the Scheme Re-Opening Date.

Close-ended Schemes have an NFO Open Date and NFO Close Date. But they have no Scheme Re-opening Date, because the scheme does not sell or re-purchase units. Investors will need to buy or sell units from the stock exchange where the scheme is listed.

Under the SEBI guidelines, NFOs other than ELSS can remain open for a maximum of 15 days.

9.2 New Fund Offer Price/On-going Offer Price for subscription

New Fund Offer (NFO) Price is the price per unit that the investors have to pay to invest during the NFO.

Ongoing price for purchase, redemption (sale) /switch outs (to other schemes/plans of the Mutual Fund) by investors is the price at which the investor purchases or receives redemptions/switch-outs

9.3 Investment Plans and Services

9.3.1 Direct and Regular Plans

Chapter 6 discussed various fund distribution practices. Investors have a choice of going through the distributors or invest directly through the AMC. Since the distribution services involve charges with respect to the various services provided by the distributor, any investor going direct is assumed to have decided not to avail those services. In such a case, the investor may not bear the cost of such services. Each mutual fund has to offer two plans to the investors, viz., regular plan and direct plan. Both these would have different total expense ratio (TER).

The direct plan shall have a lower expense ratio excluding distribution expenses, commission, etc., and no commission shall be paid from such plans. Since the TER is different in both cases, the plans will have separate NAVs.

It must be clearly understood that the direct plan is only for those investors, who purchase units directly from the fund and the same is not available for investors who route their investments through a distributor. If investment (purchase/repurchase) is routed through a distributor, then it is considered that one has chosen to invest in the Regular Plan.

Apart from these two plans at different NAVs, the AMC cannot offer separate plans based on expense ratio.

9.3.2 Income Distribution cum capital withdrawal (Dividend) Pay-out, Income Distribution cum capital withdrawal (Dividend) Re-Investment and Growth Options

Most mutual fund schemes offer two options – Income Distribution cum capital withdrawal (Dividend) and Growth. A third option, which is possible, is the Re-investment of Income Distribution cum capital withdrawal (Dividend) re-investment Option. From April 1, 2021 the dividend option has been renamed to Income Distribution cum capital withdrawal to reflect the actual situation about the income earned by the investor. These are different options within a scheme having the same portfolio. Therefore, the portfolio returns are the same for all three options. However,they differ in the structure of cash flows and income accruals for the unit-holder, and therefore there is a difference in the unitholder’s taxability, number of units held and value of those units. The post-tax return from each of these options will therefore be different.

In a Pay-out of Income Distribution cum capital withdrawal plan, the fund declares a dividend from time to time. Some schemes (liquid and debt funds with very short-term maturity) even declare a dividend daily, subject to the availability of profits. When a dividend is paid, the NAV of the units falls to that extent.

The reduced NAV, after a Pay-out of Income distribution cum capital withdrawal, is called ex-Dividend NAV. After a dividend is announced, and until it is paid out, it is referred to as cum-Dividend NAV.

In a Pay-out of Income Distribution cum capital withdrawal (Income distribution cum capital withdrawal) option, the investor receives the dividend in his bank account. However, the Pay-out of Income distribution cum capital withdrawal plan does not change thenumber of units held by the investor.

The dividend received in the hands of the investor will be taxed in the hands of the investor, as per the current tax laws. In addition, the nature of the income which the mutual fund has to provide a break up for will determine the head under which this is taxed.

In an Income Distribution cum capital withdrawal (dividend) re-investment option, as in the case of pay-out option, NAV declines to the extent of dividend. The resulting NAV is called ex-dividend NAV, like in case of Pay-out of Income Distribution cum capital withdrawal plan.

However, the investor does not receive the dividend in his bank account; the amount is re-invested in the same scheme and additional units are allotted to the investor. The reinvestment happens at the ex-dividend NAV. Thus, if dividend is Rs 2 per unit on a Unit-holder’s 100 units, the dividend would amount to Rs 200. Assuming the ex-dividend NAV of the scheme is Rs 20, then Rs 200 ÷ Rs 20 i.e., 10 units will be added to the unit-holder’s portfolio.

In a **growth option,** dividend is not declared. Therefore, nothing is received in the bank account (unlike Income Distribution cum capital withdrawal pay-out option) and there is nothing to re-invest (unlike Income Distribution cum capital withdrawal re- investment option). The NAV would therefore capture the full value of the portfolio gains. As in the case of Income Distribution cum capital withdrawal pay-out option, there will be no accretion to the number of units held. The NAV of those units will however be higher, to reflect the gain in the portfolio.

Across the three options, the investor can also receive money by offering his/her units for re-purchase or selling them in the stock market. Taxability would depend on the scheme type and period of holding, as discussed earlier. Table 9.1 summarises, the implication of the 3 options and Illustration 9.1 explains the implications for investors who opt for these three different options.

Table 9.1: Implications of different options in mutual funds

Parameter	Income Distribution cum capital withdrawal (Pay outOption)	Income Distribution cum capital withdrawal(Re-investment Option)	Growth Option
Dividend received in bank account	Yes	No	No
Tax on Dividend	Yes	Yes	N.A.
Increase in number of units on account of re-investment of dividend	No	Yes	No
NAV change	NAV declines to the extent of dividend.	NAV declines to the extent of dividend.	NAV captures the portfolio changes entirely.

Illustration 9.1: Investment options for different investors

Investor A, Investor B and Investor C invests in 100 units of a mutual fund scheme at a NAV of Rs.10 in the growth, Income Distribution cum capital withdrawal payout and Income Distribution cum capital withdrawal reinvestment option respectively. The NAV appreciates to Rs.12 and the mutual fund declares a dividend of 10 percent.

a. What is the dividend amount that the investors are entitled to receive?

The dividend amount is 10 percent of the face value of Rs.10, Re.1 per unit.

b. Which of the investors in the scheme are entitled to receive the dividend?

Investors in the Income Distribution cum capital withdrawal (payout) and Income Distributioncum capital withdrawal (reinvestment) option, i.e., investor B and Investor C are entitled to receive the dividend.

c. How will the dividend be received by B and C?

B will be paid out the dividend of Rs.100 (i.e., Re 1 X 100 units) while the dividend amountofRs.100 due to C will be reinvested in the scheme at the ex-dividend NAV of Rs.11 (Rs.12(NAV)- Re1 (Dividend))

d. How many additional units will be received by C?

Investor C will receive Rs.100/Rs.11 = 9.09 additional units on account of the dividend reinvested.

e. What is the value of the investment and return earned by each investor calculated on theex-dividend date?

Investor A: The value of the investments is Rs.1200 (i.e., 100 units x Rs.12). Rs.200 is earned ascapital gains from the appreciation in the NAV from Rs.10 to Rs.12

Investor B: The value of the investment is Rs.1100 (i.e., 100 units x Rs.11). Rs.100 is earned as dividend and Rs.100 as capital gains from the appreciation in the NAV from Rs.10 to Rs.11 (ex- dividend). The total return earned is Rs.200

Investor C: The value of the units is Rs.1200 (i.e., 109.09 units x Rs.11). The units held goes up after the re-investment of dividend to 109.09 units. The NAV comes down to Rs.11 after the payment of dividend. The returns earned are Rs.100 as capital gains on the original 100 units held and Rs.100 earned as dividends that is re-invested.

The post-tax returns to each of the investors will be different since the tax applicable on dividend and capital gains earned are different.

9.4 Allotment of Units to the Investor

NFO: Since entry load is banned, units in an NFO are sold at the face value i.e., Rs. 10. So the investment amount divided by Rs. 10 would give the number of units the investor has bought.

Subject to the receipt of the specified minimum subscription amount for the scheme, full allotment is made to all valid applications received during the New Fund Offer. The Trustee reserves the right, at their discretion without assigning any reason thereof, to reject any application. Allotment is completed within 5 business days after the closure of the New Fund Offer. In case of applicant who have quoted their demat account, the units are credited within2 working days to the demat account as per the depository account details as stated by the applicant in the application form.

Allotment of units and transfer of allotment advice to FPIs (Foreign Portfolio Investors) is subject to RBI approval if required. Investors who have applied in non-depository mode are entitled to receive the account statement of units within 5 Business Days of the closure of the NFO Period. For applicants applying through the ASBA mode, on intimation of allotment by CAMS to the banker the investors account is debited to the extent of the amount due thereon.

On-going offer: The price at which units are sold to an investor as part of ongoing sales in an open-end scheme is the sale price, which in turn is the applicable NAV (currently entry load is not permitted by regulation, hence the sales price is equal to the NAV). The investment amount divided by the sale price would give the number of units the investor has bought. Thus, an investor who has invested Rs. 12,000, in a scheme where the applicable sale price is Rs 12, will be allotted Rs 12,000 ÷ Rs 12 i.e., 1,000 units.

In a rights issue, the price at which the units are offered is clear at the time of investment. The investment amount divided by the rights price gives the number of units that the investor has bought. It may however be noted that rights issues, which are common for shares, are less meaningful for units of mutual fund schemes.

In a bonus issue, the investor does not pay anything. The fund allots new units for free. Thus, in a 1:3 bonus issue, the investor is allotted 1 new unit (free) for every 3 units already held by the investor. Since the net assets of the scheme remain the same – only the number of units' increases - the NAV will get reduced proportionately and the value of the investor's holding does not change as a result of the bonus issue.

On allotment, units are credited to the investor's demat account (if the investor has opted for receiving dematerialised units) as specified in the ASBA application form. The units of the

Scheme held in the dematerialised form are fully and freely transferable.[44]

If application is rejected, full amount will be refunded within 5 business days from the date of closure of NFO. If refunded later than 5 business days, interest @ 15 percent p.a. for delay period will be paid and charged to the AMC.

9.5 Account statements for investments

Monthly Statement of Account

Mutual funds issue the Statement of Account every month if there is a transaction during the month. It shows for each transaction (sale/re-purchase), the value of the transaction, the relevant NAV and the number of units transacted. Besides, it also provides the closing balance of units held in that folio and the value of those units based on the latest NAV.

Annual Account Statement

The Mutual Funds provide the Account Statement to the Unit-holders who have not transacted during the last six months prior to the date of generation of account statements. The Account Statement reflects the latest closing balance and value of the units prior to the date of generation of the account statement.

The account statements in such cases may be generated and issued annually. Alternately, soft copy of the account statements is sent to the investors registered e-mail address, instead of physical statement, if so mandated.

Consolidated Account Statement

The asset management company shall ensure that consolidated account statement for each calendar month is issued (post/email), as per the timeline specified by SEBI from time to time, detailing all the transactions and holding at the end of the month paid to the distributor, across all schemes of all mutual funds, to all the investors in whose folios transaction has taken place during that month.

Provided that the asset management company shall ensure that a consolidated account statement every half yearly is issued, as per the timeline specified by SEBI from time to time, detailing holding at the end of the six month, across all schemes of all mutual funds, to all such investors in whose folios no transaction has taken place during that period;

Further, the asset management company shall identify common investor across fund houses by their permanent account number for the purposes of sending consolidated account statement.

[44] However, this is subject to lock-in period, if any and subject to lien, if any marked on the units in accordance with the provisions of SEBI (Depositories and Participants) Regulations, 1996 as may be amended from time to time and as stated in.

Explanation:- As per Mutual Fund Regulations, the word ‘transaction’ includes purchase, redemption, switch, dividend payout, dividend reinvestment, systematic investment plan, systematic withdrawal plan, systematic transfer plan and bonus transactions.

9.6 Mutual Fund Investors

Eligibility to Invest

The following categories of people/entities are eligible to purchase units of most schemes of mutual funds:

Individual Investors

They invest for their personal benefit or the benefit of their family. Following are the types of individual investors:

- Resident Indian adult individuals, above the age of 18: They can invest, either singly or jointly (not exceeding three names).
- Minors i.e., persons below the age of 18: Since they are not legally eligible to enter intoa contract, they need to invest through their guardians. SEBI has modified Investment in units of Mutual Funds in the name of minor through guardian stating that the payment for investment by any mode shall be accepted from the bank account of the minor, parent or legal guardian of the minor, or from a joint account of the minor with parent or legal guardian. For existing folios, the AMCs shall insist upon a Change of Pay-out Bank mandate before redemption is processed.[45]
- Hindu Undivided Families (HUFs): Here, family members pool the family money (inherited) for investments. The head of the family (called “Karta”) invests on behalf of the family. Against his name in the application, he would add the letters “HUF” to show that the investment belongs to the family.
- Non-Resident Indians (NRIs)/Persons of Indian Origin (PIO) resident abroad: Indian citizens, who are working abroad, and their family residing abroad, are typical NRIs who invest in India. Some Indians go on to become citizens of foreign countries such as the US, Canada, New Zealand etc. Since India did not permit dual citizenship earlier, they needed to give up their Indian citizenship. However, their status as erstwhile Indians, entitles them to invest in mutual fund schemes on full repatriation or non-repatriation basis. As part of the documentation, they need to provide their PIO (Person of Indian Origin) Card/OCI (Overseas Citizenship of India) Card. NRI/PIO residents abroad have the facility of investing on a repatriable basis i.e., when they sell

[45] Candidates are requested to read the circular: https://www.sebi.gov.in/legal/circulars/may-2023/investment-in-units-of-mutual-funds-in-the-name-of-minor-through-guardian_71148.html

their investments, the sale proceeds can be transferred abroad. Alternatively, theycan invest on a non-repatriable basis, in which case the proceeds from the sale of those investments cannot be remitted abroad.

- Foreign investors: They can invest in equity schemes of MFs registered with SEBI after completing the KYC process

Non-individual Investors

Here, the investments are made by organizations/institutions. Their authorized individuals sign the documents on behalf of the organizations/institutions they represent. Following are the types of non-individual investors:

- Companies / corporate bodies, registered in India
- Registered Societies and Co-operative Societies
- Trustees of Religious and Charitable Trusts
- Trustees of private trusts
- Partner(s) of Partnership Firms
- Association of Persons or Body of Individuals, whether incorporated or not
- Banks (including Co-operative Banks and Regional Rural Banks) and Financial Institutions and Investment Institutions
- Other Mutual Funds registered with SEBI
- Foreign Portfolio Investors registered with SEBI
- International Multilateral Agencies approved by the Government of India
- Army/Navy/Air Force, Para-Military Units and other eligible institutions
- Scientific and Industrial Research Organizations
- Universities and Educational Institutions
- Foreign portfolio investors who meet KYC requirements to invest in equity and debtschemes of Mutual Funds can invest through two routes:
- Direct route - Holding MF units in demat account through a SEBI registered depository participant (DP).
- Indirect route- Holding MF units via Unit Confirmation Receipt (UCR)

Sources of Information on Eligibility to invest

The individual investors eligible to invest as detailed above can invest in any mutual fund scheme unless the mutual fund comes out with a specific scheme, or a plan within a scheme, that is not intended for any category of investors.

The non-individual investors eligible to invest as detailed above can invest in any mutual fund scheme. However, in some schemes, only specific classes of non-individual investors are permitted. For instance, some Gilt schemes have specific plans, which are open only for Provident Funds, Superannuation and Gratuity Funds, Pension Funds, Religious and Charitable Trusts and Private Trusts.

Therefore, it is a good practice to check the 'Who can Invest?' section of the Scheme Information Document (SID), especially for a first-time investor.

9.7 Filling the Application Form for Mutual Funds

The information required to be provided in the application form is discussed below.

Direct Plan and Regular Plan

Investors have the option to invest (purchase or subscribe to mutual fund units) directly without routing the investment through a distributor (Direct Plan). In this case, the investor must mention "Direct" in the space provided in the application form for entering the AMFI Registration Number (ARN).

If the investment (purchase/subscription) is routed through a distributor/Advisor (Regular Plan) then the ARN/RIA number and other details have to be provided in the space provided for the same.

Unit Holder Information

A mutual fund investment can have up to three holders. All the holders must be investors eligible to invest in a mutual fund. The folio is created in the name of the first holder who is the primary investor. All benefits of the investments such as dividends, redemption payments and tax benefits will go to the first holder.

The information to be provided includes the name(s), nationality, identity proof and KYC compliance, signatures of all the holder(s), address and communication details of the first holder. In case of FPI/NRI/PIO investors, an overseas address must also be provided.

Minor as a unit holder

An investment made for a minor (less than 18 years) is done through a guardian who complies with the KYC and PAN requirements and all other formalities as if the investment was for themselves. The guardian is typically a natural parent or court appointed legal guardian. The documents to establish the natural relationship/legal guardianship (notarized photocopy of the court order) has to be provided at the time of investment. The date of birth of the minor has to be provided in the application form and the proof of age of the minor investor has to be given along with the application. An investment for a minor cannot have joint holders. On attaining maturity, the information of the erstwhile minor investor has to replace that of the guardian. KYC, PAN, Signature attested by banker and bank account details are updated in the folio. The guardian can no longer operate the folio and the account will be frozen for operations till the change of status of the erstwhile minor is updated.

POA as a unit holder

Similarly, a folio operated under a Power of Attorney (PoA), requires the PoA holder and issuer to comply with the KYC and PAN requirements and a certified copy of the PoA to be submitted to the mutual fund before the holder can operate the folio. The grantor or investor can continue to operate the account despite granting a PoA. The PoA holder can conduct all transactions except make or change nominations.

Status of the Holder and Mode of Holding

Other information that has to be provided includes the status of the first holder as an individual or non-individual and mode of holding and operating the account as single/joint/either or survivor. The selection has to be made at the time of application and may be altered at any point in time. If no selection is made, then the default option is applied. The default option is mentioned in the application form. Once a mutual fund folio is created as a jointly held account there can be no change in the joint holders. A joint holder cannot be deleted or a new one added, except in the event of death can a name be deleted.

Once the first holder's PAN is validated for KYC, the address provided in the KYC form will override the information provided in the application form.

KYC Details

The KYC acknowledgement letter as proof of compliance with the KYC norms by each holder has to accompany the application form. Also, additional KYC details are mandatorily collected in the application form relating to occupation, gross annual income or net worth and politically exposed persons status for both individual and non-individual applicants.

FATCA and CRS Details

For applicants, including guardians, whose country of birth/citizenship/nationality/tax residency is other than India, the application requires additional information under Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS). The information that is required is:

- Place/City of Birth, Country of Birth, Country of Citizenship/Nationality
- Is the investor's Tax Residency/Country of Birth/Citizenship/Nationality other than India (Yes or No)?

- If yes, indicate all countries in which the investor is resident for tax purpose andthe associated Tax ID number (Details of Country of Tax Residency and Tax PayerReference ID).

Bank Account Details

It is mandatory for investors to provide the bank details of the sole/first holder of the folio in the application form. This includes the name of the bank where the account is held, the branch and the city, the account number, type of account (current, savings, NRO, NRE, FCNRand others), MICR code and IFSC details.

For unit holders opting to hold the units in dematerialized form, the bank account details provided in the application form should match the details of the bank account that is linked to the demat account.

If the pay-out bank account is different from the bank account through which the payment for the purchase of the units was processed then additional documents to validate the pay- out account have to be provided along with the application form. This additional document may be an original cancelled cheque of the pay-out account where the account number and name of the first holder of the folio are printed on the face of the cheque, a self-attested copyof the bank pass book or bank statement showing the first holder's name and account, with entries not older than 3 months, or a letter on the bank letterhead providing the details of the account.

Dividends and redemption proceeds will be credited directly to the bank account via electronic modes such as direct credit, NEFT, NACH facility. Applicants can also choose to receive the payments through cheque/demand draft.

For Minors: Payment for investment should be made by means of a cheque, demand draft or any other mode shall be accepted from the bank account of the minor or from a joint account of the minor with the guardian only. For existing folios, the AMCs are required to insist upon a change of pay-out bank mandate before redemption is processed.[46]

Investment Details

Investors have to make their choice of scheme, plan, option and pay-out option at the time of making the application. Each scheme will offer a regular plan where the investment is routed through a distributor and a direct plan where the applicant invests directly without the assistance of a distributor.

The expense ratio for the regular plan is higher since there are distribution costs to be

[46] SEBI Circular dated December 24, 2019

accounted for. Each scheme will also typically offer a growth option and an Income Distribution cum capital withdrawal (dividend) option. The Income Distribution cum capital withdrawal (dividend) option may offer a pay-out and a re-investment option. Under the pay-out option there may also be different frequencies of dividend payment offered.

While the scheme selection is mandatory to be done by the applicant, however, if the other selections are not made then the default option will apply. The default options will be clearly mentioned in the instructions listed in the application form.

Payment Details

The details of the payment instrument the bank account through which the payment for the investments is being made has to be mentioned in the application form. The payment has to be made out to the account specified by the mutual fund in the application form. The application number or folio number should be mentioned on the reverse of the payment instrument. The bank through which the payment is made need not be the same as the bank account details provided in the application form to receive dividend and redemption proceeds.

Unit Holding Option

Investors have the option to hold the units in physical mode or demat mode. If the units are to be held in a demat account then the details of the beneficiary account, name and ID of the depository participant (DP) has to be provided. The name(s), mode of holding, PAN details and bank account of the applicant will be verified against the depository data. A copy of the DP statement has to accompany the application to be able to verify the details of the account.The dividend and redemption proceeds will be paid out to the bank account linked to the demat account.

If an investor opts to hold the units in dematerialized form in an existing demat account, then the applicant(s) details provided in the application form has to be the same as that appearing in the demat account with the depository participant. The KYC performed by the depository participant will be considered as KYC verification done by the mutual fund. A copy of the Client Master Form/demat statement showing active demat account details should be provided for verification of details.

Nomination[47]

[47]Candidates are advised to read this circular which shall come into effect from March 1, 2025. https://www.sebi.gov.in/legal/circulars/jan-2025/circular-on-revise-and-revamp-nomination-facilities-in-the-indian-securities-market_90698.html

The applicant can make a nomination in favour of number of nominees and in the manner as specified by SEBI. The nomination can be made at the time of application or subsequently at any time. A folio held by a single holder should have a nomination made in the application. Some mutual funds may require the applicant to provide a separate declaration of the intention not to nominate. Others may have a provision that not providing the nomination details may be considered as consent to proceed with the application without a nomination.

Minimum Investment

The Scheme Information Document (SID) and Key Information Memorandum (KIM) provides information on the minimum application amount. Typically, the limit may be higher for the initial investment required to initiate the folio and lower for subsequent purchases. While investing, the investor needs to confirm that the investment meets the minimum investment limit set by the mutual fund for the scheme. The application has to be signed by all the holders irrespective of the mode of holding.

9.8 Financial Transactions with Mutual Funds

Financial transaction in mutual funds include purchase of mutual fund units (initial purchase in an NFO and additional purchases in an ongoing offer), redemptions i.e., sale transactions and switches. These are explained below.

Initial Purchase of Mutual Fund Units

Fresh purchase or initial purchase of mutual fund units in a scheme can be made during the new fund offer (NFO) period or even subsequently in an open-ended scheme, during the open offer period. The mutual fund would need the completed application form with the prescribed documentation and the requisite investment amount, to allot an investment folioin the name of the investor.

Application forms are available with offices of AMCs, distributors and Investor Service Centres (ISCs). They are also downloadable from the websites of the AMCs concerned. The common application form, with Key Information Memorandum (KIM), is designed for fresh purchases i.e., instances where the investor does not have an investment account (technically called “folio”) with the specific mutual fund.

An existing investor can also use the application form to make fresh purchases in other schemes of the same mutual fund or even make additional purchases in a scheme. In this case, the assigned folio number has to be provided and all the personal information already captured under the folio will apply to the new investment being made also. The information on unit holders does not have to be provided again. The information provided in the application form is used to create the investor record or folio with the mutual fund.

Additional Purchases

Once an investor has a folio with a mutual fund, subsequent investments with the same mutual fund do not call for the full application form and documentation. Only a transaction slip needs to be filled giving the folio number, and submitted with the requisite payment. A transaction slip can be used to make additional purchases in an open-ended scheme in which the investor has already invested. It can also be used to make fresh purchases in another scheme of the same mutual fund under the same folio.

Most mutual funds send a transaction slip (with the investor's folio number pre-printed) along with the Statement of Account. Alternatively, blank transaction slip (without pre-printed folio number), which is available with branches of the AMC, distributors and ISCs, or downloadable from internet, can be used. An application form may also be used to make additional purchases and the investor can mention the existing folio number in the appropriate place provided for the same. The personal data and bank account details as they feature in the existing folio would apply to the additional investment being made and override any conflicting information provided in the application form. If the name of the holder in the folio does not match that provided in the application for additional investment, then the application form may be rejected at the discretion of the AMC.

The investor needs to confirm that the investment is above the minimum investment limit set by the mutual fund for additional purchases in the scheme.

Repurchase of Units

The investor in an open-ended scheme can offer the units for repurchase to the mutual fund. The transaction slip needs to be filled out to affect the re-purchase. The folio number, names of the unit holders and the scheme, plan and option from which the redemption is requested should be clearly mentioned. The request should be signed according to the mode of holding of the folio. Investor has the option to decide on the repurchase amount (which is generally the case) or number of units offered for re-purchase. The re-purchase price is the applicable NAV (which is discussed later in this unit under 'Cut-off Time') less Exit Load.

If the investor has specified the re-purchase amount, then that amount divided by the re-purchase price would be the number of units that will be reduced from his folio.

If the investor has specified the number of re-purchase units, then those many units will be reduced from his folio; payment would be made equivalent to the number of units re-purchased, multiplied by the re-purchase price. Units will be redeemed on a First-in-First-Out (FIFO) basis.

If, while effecting the re-purchase, the investment holding in the folio goes below the minimum limit for maintaining the folio set by the mutual fund for the scheme, then all the units may be re-purchased and the investment folio of the investor may be closed.

The redemption request can be made physically by submitting the duly filled transaction slip at any of the Investor Service Centres, branch offices of the mutual fund.

Units held in dematerialized form have to be redeemed through the depository participant (DP). The investor has to submit the duly completed redemption form (available with the DP) to the DP. After verification, the DP will electronically execute the redemption request which will then be forwarded to the AMC/RTA. After verifying the redemption request, the AMC/RTA will make the payment to the investor's bank account registered with the demat account.

The pooling of funds and/or units by stock brokers/clearing members in any form or manner has been discontinued for mutual fund transactions. For both demat and non-demat mode transactions, the units will be credited and debited directly to/from the investors' demat account/folio account without routing it through the pool account of the stock brokers/clearing members. However, for redemption of units held in dematerialised mode, the practice of issuance of Delivery Instruction Slip ('DIS') (physical or electronic) to the Depository Participant to debit the units for delivery to clearing corporation can be continued[48].

Switch

A switch is redemption from one scheme and a purchase into another combined into one transaction.

9.8.1 Payment Mechanism for mutual fund purchases

Payments for mutual fund purchases need to be made through the banking channel modes that have been approved by the regulators. The acceptable modes of payments are through online transactions or different payment mechanisms such as cheque, demand draft and cash etc..

Online Transactions

Investors can conduct their mutual fund transactions online. The investor is required to fill in the requisite details in an application form. Based on this, the investor is allotted a user name and password (Personal Identification Number – PIN). This can be used by the investor to make additional purchases of units in the mutual fund or to request re-purchase of the unitsheld in the mutual fund. Payment transactions are made through the internet banking facilityprovided by banks.

Digital payment mediums or electronic payment mediums use digital modes for making and

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[48] https://www.sebi.gov.in/legal/circulars/mar-2022/discontinuation-of-usage-of-pool-accounts-for-transactions-in-the-units-of-mutual-funds-two-factor-authentication-2fa-for-redemption-and-other-related-requirements-extension-of-timeline_57471.html

receiving payments. There is no use of cash in physical form and the payment cycle is completed online. Digital payments provide advantages of ease and speed of payment process, the safety of funds and provide a record of funds usage. However, there is the risk of data theft and some of the modes of payment may be difficult for a person not comfortablewith technology. In order to safeguard interest of investors, SEBI has mandated the Two-Factor Authentication for subscription and redemption transactions in the units of Mutual Funds.[49]

The Digital Payment Mediums available include the following:

Internet Banking

Internet banking is the most commonly used digital payment service. It provides access to banking services anywhere and at any time through the official website of the banking institution. Net banking allows fund transfers to own and third-party accounts, online bill payments, online shopping and other such facilities that involves making and receiving payments. The National Electronic Fund Transfer (NEFT) facility allows the digital transfer of funds between bank accounts. The Immediate Payment Service (IMPS) is an instant interbank electronic fund transfer available to registered users of banks through mobile phones, net banking and ATMs.

Remittance can also be made directly to the bank account of the scheme through Real Time Gross Settlement (RTGS)/National Electronic Funds Transfer (NEFT) facilities (for transfers within India) or SWIFT transfer (for transfers from abroad). While RTGS transfers are instantaneous, NEFT transfers are batched together in the banking system and effected at various times during the day. SWIFT transfers tend to pass through multiple banks in different geographies, and multiple levels within the same bank, resulting in delays. All banks and their branches are not enabled to provide electronic transfer facilities.

Before money is remitted directly to the mutual fund, it is advisable to get the proper bank account details from the AMC/distributor. The details of the mutual fund, such as account number, account name, IFSC details etc. are required to do an electronic transfer. Some mutual funds may provide this information in the application form. The bank will generate a unique transaction reference number. The acknowledgement from the bank for the transfer request has to be appended along with the application as proof of transfer. The account number mentioned in the transfer instruction copy provided as proof should have the first holder as one of the account holders.

National Automated Clearing House (NACH) is a centralised clearing system launched by the National Payments Corporation of India (NPCI). NACH aims to replace and consolidate multiple

[49]https://www.sebi.gov.in/legal/circulars/sep-2022/two-factor-authentication-for_transactions-in-units-of-mutual-funds_63557.html

existing Electronic Clearing Service (ECS) systems across India and create a faster andmore efficient clearing platform. It is a web-based solution for Banks, Financial Institutions, Corporate and Governments, to facilitate interbank high volume, electronic transactions which are repetitive and periodic in nature. This has been introduced in place of ECS for repetitive payments. NACH have same day presentation and settlement, including returns processing.

The various facilities offered by NACH include standardisation and digitisation of mandates, overall simplification, reduction of operational cost, and minimisation of activation time. Existing ECS mandates are now been moved to the NACH platform, in partnership with the participating banks. However, no intervention from investors will be necessary in this regard.

The service is now active in all Indian banks with core banking facility. It comes in two variants– NACH Credit and NACH Debit. The significant benefits to bank customers include automatic debits from their account for bill payments (telephone, electricity, etc.), loan instalments, insurance premiums, SIPs and more. Not only this, NACH is useful for corporate and financial institutions that make payments in bulk like dividend distributions, salaries, interests, pensions, etc.

M-Banking i.e., mobile banking is another convenient way for investment and transaction purpose.
Stock exchange platform and MFU platform are also used for purchase transactions.

Unified Payment Interface

The Unified Payment Interface (UPI) allows fund transfer between accounts through the mobile app. The users have to register for a mobile banking facility to be able to use the app. There are many UPI apps available such as BHIM, banking applications, Aadhaar app etc. which one can download on their phone. After the application (app) is downloaded, a VirtualPayment Address (VPA) has to be created by going through an authentication process. This islike an email address and links the UPI app to the user's bank account through the mobile phone registered with the bank. The VPA can be changed if so desired. Multiple bank accountscan be linked to a VPA, but one account has to be designated as the default account. To make payments using the UPI, one needs the VPA of the payee. The user can also receive funds using the UPI. A new version of the UPI allows the transfer of funds using the Aadhaar number instead of a VPA.

Application Supported by Blocked Amount

Application Supported by Blocked Amount (ASBA) is a facility where the investment application in a New Fund Offer (NFO) is accompanied by an authorization to the bank to block the amount of the application money in the investor's bank account.

The benefit of ASBA is that the money goes out of the investor's bank account only on an allotment. Until then, it keeps earning interest for the investor. Further, since the money transferred from the investor's bank account is the exact application money that is due on account of the allotment, the investor does not have to wait for any refund.

Aadhaar Enabled Payment Service

Aadhaar Enabled Payment Service (AEPS) allows bank to bank transaction using the Aadhaar number of the customer. The Aadhaar number has to be linked to the bank account to be able to use AEPS. The account holder can withdraw and deposit cash and transfer money to another account linked to the Aadhaar number. The AEPS uses the fingerprint of the individual as the password to authorize transactions and is thus a secure mode of transfer of funds.

National Unified USSD Platform

National Unified USSD Platform (NUUP) based mobile banking allows transactions even without a smartphone and internet. The code *99# dialed from the phone registered with a bank for a bank account allows transactions such as making payments, checking balances, fund transfers and getting a mini statement. Most leading banks support this service. NUUP is currently available in 11 regional languages.

Cards

Cards are the most commonly used mode of digital payments. Debit cards are issued by banks to their account holders and allow card holders to carry out fund transactions linked to their bank account. Credit cards are issued by banks and other approved entities and allow credit card holders to use the card up to approved credit limits. Prepaid cards can also be used to make card payments. The cards are used by swiping it at the merchants' PoS device. A PIN may be required to confirm the transaction in case of a debit card. Online payments can also be made using cards. The drawback is that the merchant may have to pay a charge on each transaction done through credit cards. Mutual funds purchases using credit cards are not allowed.

E-Wallets

E-Wallets are a virtual or digital version of the physical wallet. Money is loaded to the E-Wallet and used as required to make payments and transfer funds to other E-Wallets. However, they cannot be used to transfer money to a bank account. Using the E-Wallet does not require a PIN or Password which makes them susceptible to unauthorized use by anyone who can get access to the mobile phone on which the Wallet is stored. Wallets of banks, payment banks and e-commerce platforms are commonly called E-Wallets. The use of E-Wallets is subject to certain conditions like following regulations pertaining to cut-off timings, time stamping etc. MFs/AMCs shall ensure that total subscription through e-wallets for an investor is restricted to Rs.50,000/- per investor per financial year. This limit of Rs.50,000/- would be an umbrella limit for investments by an investor through both E-Wallet and/or cash, per mutual fund per financial year. MFs/ AMCs shall ensure that only amounts loaded into e-wallet through cash or debit card or net banking, can be used for subscription to MF schemes. Any amount loaded into e-wallet through credit card, cash back, promotional scheme etc. are not allowed for subscription to MF schemes. Also, no third-party transactions are allowed through e-wallets. It shall be ensured that all e-wallets are fully compliant with KYC norms as prescribed by Reserve Bank of India.[50]

Digital payments such as Net Banking, Debit cards, UPI are amongst the accepted modes of payment for mutual fund schemes currently.

One-Time Mandate (OTM) is a payment facility that investors can use to authorize their bank to process debits to their specified bank account raised by a specified mutual fund for purchase of units. The debits happen through the National Automated Clearing House (NACH). It eliminates the need for the investor to initiate payment every time a purchase transaction is conducted. It is a one-time process to register a bank account under this facility. An existing investor can fill up the OTM form to register a bank account and hand it over to the Investor Service Centre for processing. A new investor can submit the OTM form along with the application form for subscription. The OTM mandate requires the bank name, bank account number, account type, IFSC and MICR code to be provided to identify the account to be registered. A cancelled cheque or copy with the name and account number pre-printed on it has to accompany the application form for verification of the account details. The folio number for existing investors and the application form number for new investors have to be provided along with the email id and phone number. Investors can select the frequency at which debit can be made, monthly, quarterly, half-yearly, or 'As and when presented' and specify the fixed amount that can be debited. The mandate also allows account holders to specify the maximum amount that can be debited on a daily basis and select the category— 'As and when presented' under the frequency parameter to enable multiple SIP or other purchase debits under the folio. For example, investors can mandate an amount of Rs.5000/-that can be debited as and when presented. There is no limit on number of transactions as long as the total amount is within the daily maximum limit specified in the mandate. The period for which the mandate will be valid should also be specified in the form. The name(s) and signatures of the bank account holders have to be affixed on the form. Registering the OTM can take 3 to 4 weeks.

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[50] https://www.sebi.gov.in/legal/circulars/mar-2023/e-wallet-investments-in-mutual-funds_69254.html

The OTM mandate is at a folio level. This means that the folio holder can use the OTM mandate for all purchase transactions under the folio. Mutual funds may specify the schemesand the type of purchase transactions that can be conducted through the OTM— Fresh lumpsum purchase, additional purchase, SIP investments.

The OTM can be used to make the eligible purchases through physical, online, SMS and other modes of transaction offered by the mutual fund. The mandate can be cancelled by submitting the OTM form indicating cancellation.

Other payment mechanism for mutual fund purchases

Cheque/Demand Draft

Application forms for fresh investment/transaction slip for additional purchase is normally accompanied by a cheque/demand draft (DD) drawn in favour of the scheme in which the application is to be made. In order to prevent misuse of physical payment instruments, mutual funds prescribe precautions such as mentioning of the name/PAN number of the investor and details of the scheme on the payment instrument. A separate payment instrument should accompany each scheme/each plan.

Cheques are signed by the account holder, while DDs are signed by the banker. Generally, DDs are accepted only if the investor is from a location where there is no official collection centre for the application. The bank charges for the outstation DD will be borne by the AMC within specified limits.

NRI/PIO applications need to be accompanied by a cheque drawn on an NRO/NRE/FCNR account (for non-repatriable investment) or NRE/FCNR account (for repatriable investment). If Indian Rupee Drafts are purchased abroad or cheques issued from NRE/FCNR account an account debit certificate from the bank issuing the draft confirming the debit and/or Foreign Inward Remittance Certificate (FIRC) by the investor's banker shall also be enclosed to certify the source of funds as remitted from abroad.

The payment instrument would need to be local i.e., cheque should be drawn on a local bank account. If it is drawn on an out-station bank account, then the bank should offer the facility of 'at par' payment in the location where the application form and cheque are submitted. If such an 'at par' facility is available, 'payable at par at …… (list of locations / all over India)' would be clearly mentioned on the face or back of the cheque. Cheques accompanying the investment application are to be signed by the investor and drawn on an account in which the first holder is an account holder.

Similarly, DD should clearly mention the place of payment as the location where the application form/transaction slip and payment instrument are being submitted. The payment instrument should not be post-dated (except for future instalments under SIP),and not stale (i.e., cheque date should not be more than 3 months older than the date on which the cheque is to be banked). Third-party cheques are not accepted except in special cases. To know about Third Party Payments, refer to Box.9.1

Box:9.1 Third Party Payments

A third-party payment is defined as one made through a bank account other than that of the first holder of the folio. If the payment is made through a joint bank account, then the person mentioned as the first holder of the folio should be one of the joint holders for the payment to be considered non-third-party payment.

There are some exceptions where third party payments will be accepted.

- Payment by Parents/Grand-Parents/Related Persons on behalf of a minor in consideration of natural love and affection or as gift for a value not exceeding Rs 50,000/-for each regular purchase or per SIP instalment. 'Related Person' means any person investing on behalf of a minor in consideration of natural love and affection or as a gift. In such cases, persons who make payment should be KYC Compliant and sign Third PartyDeclaration form.
- Employer making payments on behalf of the employee through payroll deductions, and custodian on behalf of FPIs are permitted third-party payments.
- Payments by the AMC to its empanelled distributors on account of commissions etc. in the form of units of the mutual fund scheme managed by the AMC either through an SIPor lump sum investments or a similar arrangement of payment of commission by a Company to its agents will also be considered accepted third-party payments. AMCs arerequired to put checks and balances in place to verify such transactions.

A Third-Party Declaration form duly completed has to accompany the application where the payment is from this source. The beneficial investor has to be clearly identified in the form by giving the full name of the first/sole investor and using the folio number if it is an existing number or the application form number for a new investment. Compliance with the KYC norms and providing the PAN details are mandatory by the third party making the payment irrespective of the amount involved. The source of funds with which the payments are being made should be clearly established. Where the payment is being made by cheque then the name of the third party making the payment should be pre-printed on the cheque. If this is not available, then a bank statement or pass book having the party's name or letter on the bank's letterhead giving details of the bank account held should be attached. Similarly, if the payment is made by a pre-funded instrument such as a demand draft, then proof of the funding having come from the third-party's account has to be enclosed. If electronic modes such as RTGS/NEFT, NACH or account transfer are used then the acknowledgement copy of the instructions to the bank has to be provided. The purpose of the documentary proof is to provide AMC the evidence that the payment was made out of the bank account of the third party and should therefore have the details of the account holder clearly mentioned. Pre-funded instruments such as demand drafts issued against cash for Rs.50,000 or more will not be accepted as payment.

Cash Payments

Mutual funds usually do not accept cash. Small investors, who may not be taxpayers and may not have PAN/bank accounts, such as farmers, small traders/businessmen/workers are allowed cash transactions for the purchase of units in mutual funds to the extent of Rs. 50,000/-per investor, per mutual fund, per financial year. This is subject to compliance with the Prevention of Money Laundering Act, 2002 and SEBI Circulars on Anti Money Laundering (AML) and other applicable AML rules, regulations and guidelines. This facility is available only for resident individuals, sole proprietorships and minors investing through their guardians. They must be compliant with the KYC norms, whether or not they have a PAN. The application must be submitted in physical mode to avail of this payment option. A prescribed deposit slip for making cash investments available at the Investor Service Centre (ISC) has to be used to give details of the scheme in which the investment is being made and the amount of investment. The deposit slip along with the cash has to be deposited at the bank branches designated to accept the cash investments. The acknowledgement copy of the bank slip received from the bank along with the application form/transaction slip has to be submitted to the ISC for timestamping.

Although investment can be made in cash, repayment in form of redemptions, dividend payments etc. can be only through the banking channel. The pay-out bank details have to be provided in the application form.

Apart from the above-mentioned exception for small investors, application money needs to come through normal banking channels. Instruments or payment modes that are not accepted for payment include Stock-invests, Postal orders, Money orders, Cash (except as discussed above), Outstation cheques and Post-dated cheques (except for systematic investments).

AMCs may also use instruments or payment channels such as RTGS, NEFT, IMPS, direct credit, etc. or anyother mode allowed by Reserve Bank of India from time to time, for payments including refunds to unitholders in addition to the cheque, demand draft or dividend warrants

9.8.2 Payment Mechanism for Repurchase of Units

The investor has various options for receiving the money, due to him from the scheme on re-purchase of units:

Cheque

This is a traditional approach, where the receipt of money in the investor’s bank account is delayed on account of the processes involved viz. time taken by the AMC to prepare and send the cheque, time taken by postal authorities/courier to deliver the cheque, time taken by the investor to deposit the cheque in the bank, and time taken by the banking system to transfer the proceeds to the investor's bank account.

Electronic Modes

Electronic modes allow for the repurchase proceeds to be transferred electronically to the investor's bank account. This is much faster because the various processes mentioned earlier for payment by cheque, are obviated. A Direct Credit from the mutual fund's account to that of the investor can be done provided the investor holds an account with a bank with which the mutual fund has the arrangement to make direct credits. Other electronic modes include RTGS/NEFT/NACH etc. Details such as the account number, branch address, IFSC/MICR code have to be provided to the mutual fund to enable credit to the bank accounts of investors of redemption amounts and dividends. This information is collected at the time of making the application. Electronic modes may not be available to all investors, depending upon their geographic location and/or the bank and branch with which they hold their account. In such cases, cheques and demand drafts will be used to make payments to the investors.

The redemption proceeds will be paid in favour of the sole/first holder of the folio. If the proceeds are paid by cheque, then the same will be sent to the unitholders address.

For units held in dematerialized form, the redemption proceeds will be paid into the bank account registered with the DP.

It may be noted that for non-resident investors, payment is made by the AMC in rupees. In case the investment has been made on a repatriable basis, and the investor wishes to transfer the money abroad, the costs associated with converting the rupees into any foreign currency would be to the account of the investor. Proceeds of investments made on a repatriable basis can be credited to an NRE or FCNR account, as required by the investor. In case of redemptions by NRIs there will also be tax deducted at source as applicable.

Mutual funds provide investors the facility to register multiple bank accounts to facilitate receiving the redemption, dividends and any other payouts from the fund. An individual investor can register up to five bank accounts and a non-individual investor, ten. The first holder of the folio must be an account holder in each of the accounts that are registered. One of the accounts is designated as the default account, and unless otherwise specified all credits are made to this account by the mutual fund. Investors can change the default bank account at any time by instructing the AMC to do so.

In case of NRI investments, if the payment for the investment was made through an NRO account, then the registered account should also be of the same type. If payment was routed through an NRE account, then the registered accounts can be an NRO or NRE account.

A redemption request may be accompanied by a request to credit the amount to an account other than the default bank account registered with the mutual fund. If this account is among the bank accounts that have already been registered with the mutual fund under the facility to register multiple bank accounts, then the credit will be made to the desired account. If the account has not been registered, then the amount will be credited to the default bank account and the request for change in the bank account will not be processed.

Instant Access Facility

IAF facilitates credit of redemption proceeds in the bank account of the investor on the same day of the redemption request. The MFs/AMCs can offer IAF only in Liquid schemes of the mutual fund. The monetary limit under the IAF is Rs. 50,000 or 90 percent of the latest value of an investment in the scheme, whichever is lower. This limit is applicable per day per scheme per investor. Also, there can be repurchase transactions through the stock exchange platform or MFU platform.

9.9 Cut-off Time and Time Stamping

As seen earlier, the sale and re-purchase prices are a function of the applicable NAV. In order to ensure fairness to investors, SEBI has prescribed cut-off timing to determine the applicable NAV. The provisions, which are uniformly applicable for all mutual funds, are as follows:

Type of Scheme	Transaction	Cut off time	Applicable NAV
Equity oriented funds and debt funds (except liquid and overnight funds) in respect of transaction of any amount[51]	Purchases and Switch ins	3.00 pm	Irrespective of the time of receipt of application, NAV of the business day on which the funds are available for utilisation without availing of any credit facility before the cut-off time of that day is

[51] Vide SEBI circular dated September 17, 2020, it was decided that with respect to purchase of units of MF schemes (except liquid and overnight schemes), closing NAV of the day shall be applicable, on which the funds are available for utilisation irrespective of the size and time of receipt of such application. Until now, investors who gave a cheque for below Rs 2,00,000 got the same day's NAV, while those putting more got the NAV of the day when the cheque was realised.

Candidates are advised to read: https://www.sebi.gov.in/legal/circulars/sep-2020/circular-on-mutual-funds_47574.html and https://www.sebi.gov.in/legal/circulars/dec-2020/circular-on-mutual-funds_48630.htmlfor more details.

Type of Scheme	Transaction	Cut off time	Applicable NAV
			applicable.
Liquid fund and Overnight Funds	Purchases and Switch ins	1.30 pm	If application received up to the cut off on a day and funds are available for utilisation before the cut-off time, without availing any credit facility, whether intra-day or otherwise then closing NAV of the day immediately preceding the day of the receipt of application is applicable.
			If application received after cut offtime on a day and funds are available for utilisation on the same day whether intra- day or otherwise, the closing NAV of the day immediately preceding the next business day is applicable. [Mutual funds shall calculate NAV for each calendar day for their liquid fund schemes and plans.]

Type of Scheme	Transaction	Cut off time	Applicable NAV
			Irrespective of the time of receipt of applications, where the funds are not available for utilisation before the cut-off time, without availing any credit facility, whether intra- day or otherwise, the closing NAV of the day immediately preceding the day on which the funds are available for utilisation.
Equity Oriented Funds, Debt funds (Other than Liquid funds)	Redemptions and Switch outs	3.00 pm	Same day NAV if received before cut off time.
			Next business day NAV for applications received after cut offtime.
Type of Scheme	Transaction	Cut off time	Applicable NAV
Liquid funds	Redemptions and Switch outs	3.00 pm	NAV of day immediately preceding the next business day, if received before cut off time. If redemption request is received through Instant Access Facility (IAF)up to the cut off time, then the lower of: (a) NAV of previous calendar day and (b) NAV of calendar day on which application is received

Type of Scheme	Transaction	Cut off time	Applicable NAV
			Next business day NAV for applications received after cut off time. If redemption request is received through Instant Access Facility (IAF)after the cut off time, then the lower of: (a) NAV of calendarday on which such application is received and (b) NAV of next calendar day
Overnight funds (The revised cut-off timings will come into force from June 01, 2025.)	Redemptionsand Switch outs	Applications received up to 3:00 PM	Closing NAV of the day immediately preceding the next business day will apply.
		Applications received after 3:00 PM	Closing NAV of the next business day will apply.
		Online applications	Cut-off timing extended to **7:00 PM** for overnight fund schemes.

The scheme shall deploy the funds received in new fund offer within the time period as may be specified by the Board from time to time.

The above cut-off timing is not applicable for NFOs and International Schemes.These are explained with some examples below:
Consider the following case as an example:
Assume that in a particular week, Monday, Wednesday, Thursday and Friday are businessdays, whereas all the other days are non-business days. The week would look as under:

- Sunday – non-business day
- Monday – business day
- Tuesday – non-business day
- Wednesday – business day
- Thursday – business day
- Friday – business day
- Saturday – non-business day

Given the above details, the following are some examples of transactions to understand what NAV would be applicable:

1. An investor submits an application on Monday to buy units of an equity mutual fundscheme for Rs. 3,00,000.

   If an application is made on Monday and the fund gets realized on Wednesday by 2 pm, it will be Wednesday's NAV. If funds are realized or available for utilisation on Wednesday by 5 pm, then it will be Thursday's NAV.

2. An investor makes an application to purchase units of a liquid fund

   If an application is made on Monday and the fund gets realized by 1 p.m. on Monday,it will be Sunday's NAV. If it gets realized by 3 pm on Monday, it will be Tuesday's NAV.If it gets realized by 10 am on Wednesday, it will be Tuesday's NAV.

3. An investor makes an application for redemption of units of equity fund on Monday

   If the application is submitted before the cut-off time, the redemption would be processed at Monday’s NAV. However, if the application is submitted after the cut-offtime, the applicable NAV would be of Wednesday. (Remember: Tuesday is a non- business day).

4. Redemption from the liquid fund, application submitted on Monday

If the application is submitted before the cut-off time, the redemption would be processed at Sunday's NAV. However, if the application is submitted after the cut-offtime, the applicable NAV would be of Wednesday. (Remember: Tuesday is a non- business day).

Time Stamping

The precision in setting cut-off timing makes sense only if there is a foolproof mechanism of capturing the time at which the sale and re-purchase applications are received. This is ensured through the following:

Mutual funds disclose Official Points of Acceptance (OPoAs) and their addresses in theSID and their website. All transaction requests need to be submitted at the OPoAs. The time stamping on the transaction requests is done at the official points of acceptance.

As a convenience, the distributor may accept the transaction request from the investor, but this would need to be sent to an OPoA at the earliest. When the cut-off timing is applied, the time when it is submitted to the OPoA is relevant–not the time when the investor submits the transaction request to the distributor.

These points of acceptance have time-stamping machines with a tamper-proof seal. Opening the machine for repairs or maintenance is permitted only by vendors or nominated persons of the mutual fund. Such opening of the machine has to be properly documented and reported to the Trustees.

Applications are sequentially numbered from the first number of the machine to the last number of the machine before a new numbering cycle is started for the machine. The daily time stamping of the application does not start with serial 1.

Application for purchase of units is stamped with automatically generated location code, machine identifier, serial number, date and time; the reverse of the payment instrument has to be similarly stamped with the same number; the acknowledgement issued to the investor gets a similar stamp.

Application for re-purchase and investor's acknowledgement are stamped with the same information.

Similarly, applications for non-financial transactions like the change of address, and investor's acknowledgement are stamped. However, here stamping of time is not relevant; the date stamping is pertinent.

For online transactions, the time as per the web server to which the instruction goes is used in determining the NAV for sale/re-purchase transactions.

9.10 KYC Requirements for Mutual Fund Investors

All investors, both individual and non-individual, including joint holders, NRIs, PoA holders and its issuers, and guardians in the case of minors have to be KYC compliant, irrespective of the investment value. This applies for transactions such as new/additional purchases, switch transactions, new systematic investment plan (SIP)/micro-SIP registrations received from the effective date, new systematic transfer plan (STP) registrations from the effective date, new Transfer of Income distribution cum capital withdrawal plan ((dividend transfer plan)) (DTP) registrations from effective date.

The KYC process involves establishing the identity and address of the investor as required under the Anti-Money Laundering Laws. The application for investment must be accompanied by the acknowledgement for having completed the KYC process issued by the KYC Registration Agency (KRA).

Broadly, mutual fund investors need to submit the following documents to the distributor or other capital market intermediary registered with SEBI, such as stock broker and depository participant. The information is updated in the central system of the KRA.

9.10.1 KYC Documents

For the KYC process (for establishing proof of identity and address), the following documents are required:

- Permanent Account Number (PAN) Card with photograph is mandatory for all applicants except those who are specifically exempt from obtaining PAN. This serves as the proof of identity. With a view to bring about operational flexibility and in order to ease the PAN verification process, SEBI has provided that market intermediaries may verify the PAN of their clients online at the Income Tax website without insisting on the original PAN card, provided that the client has presented a document for Proofof Identity other than the PAN card.

- There are some PAN exempts mutual fund investment. See Box 9.2 for details.

- The following categories of investors are exempt from producing PAN:

    - In case of transactions undertaken on behalf of the Central/State governmentand by officials appointed by the court.
    - Investors residing in the state of Sikkim.
    - UN entities/Multilateral agencies exempt from paying taxes/filing tax returnsin India.
    - Investments (including SIPs and lump sum investments) in Mutual Fundschemes up to Rs. 50,000/- per investor per year per mutual fund.

These categories of investors however have to provide an alternate document such as the Aadhaar card, Passport, Voter's Id, Driving License or other photo-identity card which serve as the proof of identity.

- Proof of Address such as Passport, Voter's Id, Ration card, Driving License, bank account statement, utility bill and other specified documents. If the address for communication and permanent address are different then documentary proofs have to be provided for both. The proof of address in the name of the spouse may be accepted.

The copies of the documents produced have to be self-attested and the originals have to be provided for verification purpose. In case, the originals are not produced for verification then the copies of the documents must be attested by persons authorized to do so. The sample KYC forms can be accessed here:[52]

[52] https://www.camsonline.com/assets/PDF/EMAIL_MOBILE_UPDATE/CAMSKRA_latest_Form_KYC.pdf and https://www.camsonline.com/Investors/Service-requests/Service-Request-Forms/CAMSKRA-KYC-Non-Individuals

Box 9.2: PAN Exempt Investments in Mutual Funds

Providing Permanent Account Number (PAN) is compulsory for all mutual fund investments. An exception has been made for Micro-SIPs i.e., SIPs where annual investment (12 month rolling or April-March financial year) does not exceed Rs 50,000. Similarly, as discussed earlier in this chapter, small investors investing up to Rs. 50,000 per mutual fund per financial year do not need to provide PAN Card. Rs. 50,000 is a composite limit for the small investor's Micro-SIP and lump sum investments together.

Investment by individuals, minors and sole-proprietary firms within the limits specified above are exempted from the requirement of PAN card. However, the KYC norms have to be complied with a SEBI registered KRA. Investors must quote the PANExempt KYC Reference Number (PEKRN) issued by the KRA and submit a copy of the letter with the application form.

Instead of the PAN, the investors (including joint holders) can submit any one of the following PHOTO IDENTIFICATION documents for KYC verification:

- Voter Identity Card
- Driving License
- Government / Defense identification card
- Passport
- Photo Ration Card
- Photo Debit Card (Credit card not included because it may not be backed up by a bank account)
- Employee ID cards issued by companies registered with the Registrarof Companies
- Photo Identification issued by Bank Managers of Scheduled Commercial Banks / Gazetted Officer/Elected Representatives to theLegislative Assembly / Parliament
- ID card issued to employees of Scheduled Commercial / State /DistrictCo-operative Banks
- Senior Citizen / Freedom Fighter ID card issued by Government
- Cards issued by Universities/deemed Universities or institutes understatutes like Institute of Chartered Accountants of India, Institute of Cost Accountants of India and Institute of Company Secretaries of India
- Permanent Retirement Account Number (PRAN) card issued to National Pension System (NPS) subscribers by CRA (NSDL)
- Any other photo ID card issued by Central Government / State Governments /Municipal authorities / Government organizations like ESIC / EPFO.

The Document must be current and valid and the copy shall be self-attested by the investor/attested by the ARN holder mentioning the AMFI Registration Number (ARN).

9.10.2 KYC Registration Agencies

Centralised KYC Registration Agencies

SEBI has instituted a centralised KYC process for the capital market, including mutual funds. This is a significant benefit for the investor. Based on the completion of the KYC process with one capital market intermediary, the investor can invest across the capital market. KYC Registration Agencies (KRAs) facilitate this centralised KYC process.

Once a capital market intermediary has performed an In-Person Verification (IPV) of the investor and other documentation requirements are in place, and the intermediary uploads the investor's data to the database of a KRA, the KYC is valid across the capital market. The investor can benefit from that KYC to invest in any part of the capital market (not limited to mutual funds).

SEBI circulars dated August 22, 2011, October 5, 2011, and December 26, 2013, on uniform KYC norms prescribed a standard account opening form (AOF). Part I of the form contains the basic KYC details of the investor used by all SEBI registered intermediaries and Part II of the form contains additional information specific to dealing in the stock exchanges.

Vide Notification dated November 26, 2015, the Government of India authorised the Central Registry of Securitisation and Asset Reconstruction and Security Interest of India (CERSAI) to act as and to perform the functions of the Central KYC Record Registry under the PML Rules 2005, including receiving, storing, safeguarding and retrieving the KYC records in digital form of all the clients in the financial sector.[53]

The KYC template finalised by CERSAI has to be used by the registered intermediaries as Part I of the AOF for individuals. The registered intermediaries shall upload the KYC data with Central KYC Records Registry (cKYCR) in respect of all individual accounts opened on or after August 1, 2016, where KYC is required to be carried out as per the circulars issued by SEBI from time to time. Some of the key functions of the Central KYC Registry have been mentioned below:

- It shall be responsible for electronically storing, safeguarding and retrieving the Know Your Customer (KYC) records and making such records available online to reporting entities or Director.
- Information updated about a customer shall be disseminated on request by Central KYC Registry to any reporting entity that avail the services of the Central KYC Registryin respect of the customer.
- The services of the Central KYC Registry will be available on payment of theprescribed fee, in advance.
- It shall process the KYC records received from a reporting entity for de-duplicationand issue a unique KYC Identifier for each client to the reporting entity.

Where a customer submits a KYC identifier to a reporting entity, then such reporting entity

[53] Client as defined in clause (ha) sub section (1) of Section 2 of the Prevention of Money Laundering Act, 2002 datedNovember 2015.

shall download the KYC records from the Central KYC Registry by using the KYC Identifier and shall not require a customer to submit the documents again unless:

- There is a change in the information of the customer as existing in the records of the Central KYC Registry.
- The current address of the client is required to be verified.
- The reporting entity considers it necessary in order to verify the identity oraddress of the client, or to perform enhanced due diligence or to build an appropriate risk profile of the client.

KYC through e-KYC service of UIDAI

In consultation with the Unique Identification Authority of India (UIDAI) and the market participants, the e-KYC service launched by UIDAI has also been accepted as a valid process for KYC verification. The information containing relevant client details and photograph made available from UIDAI as a result of the e-KYC process shall be treated as sufficient proof of Identity and Address of the client. However, the client shall have to authorize the intermediary to access his data through the UIDAI system.[54]

Entities in the securities market, as may be notified by the Central Government, shall be allowed to undertake Aadhaar Authentication under section 11A of the PMLA. These entities would be registered with UIDAI as KYC user agency (KUA) and shall allow all the SEBI registered intermediaries/mutual fund distributors to undertake the Aadhaar Authentication of their clients for the purpose of KYC through them.

The SEBI registered intermediaries/mutual fund distributors, who want to undertake Aadhaar authentication services through KUAs, shall enter into an agreement with any one KUA and get themselves registered with UIDAI as sub-KUAs. The agreement in this regard shall be prescribed by UIDAI. Upon notification by the Central Government/registration with UIDAI, the KUAs and sub- KUAs shall adopt the following process for the Aadhaar e-KYC of investors (resident) in the securities market.

KYC through Intermediaries

Where the investors choose to hold the units in demat form or for applicants who choose to invest through the stock exchange infrastructure, the KYC performed by the Depository Participant will be considered in compliance with the KYC norms.

Additional details of the investor, namely occupation, Gross Annual Income/ Net worth and Politically Exposed Persons (PEP) status are also captured in the application form by mutual

[54] SEBI circular no. SEBI/HO/MIRSD/DOP/CIR/P/2019/123 dated November 05, 2019

funds. This is mandatory information and has to be provided both by individuals and non-individuals.

Centralised KRAs have made the KYC process simpler for investors. Mutual funds, depositories, registrars and transfer agents, KYD compliant mutual fund distributors and brokers are authorised to facilitate the KYC documentation of investors.

9.10.3 KYC Process

KYC Process entails the following:

- The requisite form has to be filled-in along with supporting documents. The supporting documents (identity and address proof) are verified with the original documents. Alternatively, the investor can provide a True Copy attested by a Notary Public, Gazetted Officer or Manager of a Scheduled Commercial Bank.
- The original documents of the identity and address proof are returned to the investor after verification while the forms and supporting documents are uploaded in the server of any centralised KRA.
- The intermediaries mentioned in 9.10.2 are also authorised to perform an In-Person Verification (IPV) of the investor, which is mandatory. The name, designation and organisation of the person conducting the IPV has to be recorded on the KYC form. An IPV performed by Scheduled Commercial Bank is also acceptable for mutual fund investments.

Once these processes are completed and the details are uploaded on the KRA's servers, the KYC process is complete. The investor does not need any further KYC for dealing in any part of the securities market (depository, stock exchange transactions, mutual fund transactions etc.).

Similarly, in the event of change of address or any other information, the mutual fund investor needs to fill the standard form and follow the prescribed process only once, with any of the intermediaries mentioned above. Based on that, the information will be updated with all the mutual funds and other capital market related parties where the investor has invested.

SEBI has eased the Know Your Client (KYC) Process by enabling Online KYC, use of Technology/ App by the registered intermediary. The use of technological innovations which can facilitate online KYC has been allowed. This facilitates the investors to complete the KYC without the requirement of physically visiting the office of the intermediary. SEBI has enabled the usage of eSign, Digi locker and electronic signature as permitted by the Government of India under the Information Technology Act, 2000 and the Rules made thereunder.

The process involves the investor visiting the app or the online website of the Registered Intermediary (RI) and then filling up the KYC form online along with the submission of documents too online. Details like the name, photograph, address, mobile number, email id, bank details of the investor are captured online along with the PAN, signed cancelled cheque which is provided through eSign. This is then verified through various means. The mobile number and email are verified through a One Time Password (OTP) or other verifiable mechanism. The Aadhar number is verified through the UIDAI authentication system, PAN is verified through the online Tax database, bank account system is verified through penny drop mechanism or some other mechanism using API of the bank. Any other officially verified documents have to be submitted through Digi locker or eSign mechanism. Once this is done the online process can be completed by the investor taking a printout of the KYC form and submitting this along with their wet-signature through a scanned copy under eSign or affixing the online cropped signature and submitting the same to the RI by eSign.

The enablement has been done to facilitate investor to submit their Officially Valid Documents (OVDs) for the purpose of KYC to the SEBI intermediary's online/digital platform, App, through e-mail or electronic means.

The Hon'ble Supreme Court in its judgement dated April 30, 2025, emphasized the need for equal and accessible inclusion of persons with disabilities for availing financial services and directed to ensure that the process of digital KYC is accessible to persons with disabilities. In order to make the digital KYC process inclusive and accessible, FAQ on Account opening by Persons with Disabilities has been revised and is available on 'SEBI Website → FAQs → Know Your Client Requirements, Demat / Trading Account Opening → FAQ on Account Opening by Persons with Disabilities.[55]

KYC for Minors

Where an investment is made by a minor, KYC requirements have to be complied with by the Guardian. The proof of age of the minor has to be provided.

KYC for Power of Attorney holder on behalf of an investor

In the case of investments by a Power of Attorney (PoA) holder on behalf of an investor, KYC requirements have to be complied with, by both, investor and PoA holder. A PoA holder cannot apply for KYC compliance on behalf of the issuer of the PoA.

KYC for NRIs

For NRI investors PAN is the sole identification number for KYC compliance. A copy of the passport/PIO card/OCI card and overseas address proof is mandatory.

9.10.4 Additional Requirements applicable for Institutional Investors

Since institutional investors are not natural persons, authorised individuals invest on behalf of the institution. Therefore, the following additional documents are essential:

[55] https://www.sebi.gov.in/sebi_data/faqfiles/may-2025/1747995205392.pdf

- Eligibility for the investing institution to invest. For instance, a company/trust is eligible to invest under the laws of the country, but the company's own incorporation documents (Memorandum of Association and Articles of Association or Trust Deed) may not have provided for such investments. The company/trust cannot invest if its incorporation documents do not provide for investments of this type. Similarly, in some states, permission of the Charity Commissioner is necessary, before Religious and Charitable Trusts can invest.

- Authorisation for the investing institution to invest. This is typically in the form of a Board Resolution.

- Authorisation for the official to sign the documents on behalf of the investing institution. This again is provided for in the Board Resolution. In case of other non- individual investors, too the list of authorised signatories would be required. The mutual fund can allow transactions only if the transaction form/slip carries the signature of any (one or more, as required) of the authorised signatories.

- SEBI has mandated that investor other than individuals have to provide details of the 'Ultimate Beneficial Owner' (UBO) of the investments and submit documents to establish their identity of such UBOs through any of the identity proofs acceptable under the KYC norms. An UBO of a company is one who owns or is entitled to more than 25 percent of its shares or profits, more than 15 percent in case of partnerships and body of persons. In case of a trust, this includes the settler, the trustees, the beneficiaries who are entitled to 15 percent or more of the benefits. The UBO requirements are not applicable to listed companies or subsidiaries of the same.

These documentation requirements for institutional investors are in addition to the normal KYC documentation, discussed earlier.

Legal Information and Mandatory Declarations

As part of the Client Due Diligence (CDD) process under the Prevention of Money Laundering Act, all categories of investors of SEBI registered intermediaries, which includes mutual funds, except individual investors and a company that is listed on a stock exchange or is a majority owned subsidiary of such a company is required to provide the information to establish and verify the identity of the persons who beneficially own or control the securities account. The proof of identity of the Ultimate Beneficial Owner (UBO) such as Name/s, Address, PAN/Passport together with self-attested copy and the UBO declaration form has to be submitted to the AMC/RTA. In case there is a change in the UBO then the same should be intimated to the AMC/RTA.

Foreign Account Tax Compliance Act and Common Reporting Standards

To comply with the requirements of the Foreign Account Tax Compliance Act (FATCA) and

Common Reporting Standards (CRS) provisions, financial institutions, including mutual funds, are required to undertake a due diligence process to identify foreign reportable accounts and collect such information as required under the said provisions and report the same to the US Internal Revenue Service/any other foreign government or to the Indian Tax Authorities for onward transmission to the concerned foreign authorities. The application form requires information to be provided if the citizenship/nationality/place of birth/tax residency are places other than India for all categories of investors. The countries of tax residency and respective taxpayer reference ID has to be provided. Once an investor is identified as covered under the said regulation, the entire investment value of all the folios held will be reported. The identity of the investors and their direct and indirect beneficiaries and controlling persons will be reported. If there is a change in the status of the investor after the information is first provided, then the same has to be reported to the mutual fund within the time stipulated by the regulators.

9.11 Systematic Transactions

Mutual funds provide transactional facilities that allow investors to tailor investments and structure pay-outs to suit their specific needs and goals. Systematic transactions, such as systematic investments, withdrawals and transfers, enable periodic investments and withdrawals that investors can align to the available investible surplus, need for regular funds or rebalancing the investments to manage risks. Signing up for systematic transactions also enables these transactions to be executed without the intervention of the investor every time, thus protecting the portfolio from investor inertia.

9.11.1 Systematic Investment Plan (SIP)

It is considered a good practice to invest regularly, particularly in volatile markets such as equity markets. SIP is an approach where the investor invests constant amounts at regular intervals. A benefit of such an approach, particularly in equity schemes, is that it averages the unitholder's cost of acquisition since more units are bought for the same amount of investment when the price/markets are down and fewer units when the price/markets are up.

Suppose an investor were to invest Rs 1,000 per month for 6 months. If, in the first month, the NAV is Rs 10, the investor will be allotted Rs 1,000 ÷ Rs 10 i.e., 100 units. In the second month, if the NAV has gone up to Rs 12, the allotment of units will go down to Rs 1,000 ÷ Rs 12 i.e., 83.333 units. If the NAV goes down to Rs 9 in the following month, the unit-holder will be allotted a higher number of Rs 1,000 ÷ Rs 9 i.e., 111.111 units.

Thus, the investor acquires his units at lower than the average of the NAV on the 6 transaction dates during the 6 months – a reason why this approach is also called Rupee Cost Averaging.

Systematic investing allows investors to buy into a volatile market overtime at an average price without having to predict market movements.

It is easier for investors to generate the smaller amounts required to invest through a periodic investment plan than the large sums required to make lump sum investments. Saving for goals becomes easier when investible surpluses are periodically invested.

Mutual funds make it convenient for investors to lock into SIPs by investing through Post-Dated Cheques (PDCs), NACH or Standing Instructions (SI).

An SIP can be used to initiate a fresh purchase in a scheme and open a folio or make additional purchases in an existing folio. The initial investment to initiate an SIP purchase is typically lower than that for a lump-sum purchase. An SIP can also be initiated during a New Fund Offer (NFO).

9.11.2 Systematic Withdrawal Plan (SWP)

Just as investors do not want to buy all their units at a market peak, they do not want to risk redeeming all their units in a market trough. Investors can therefore opt for the safer route of offering for re-purchase a constant value of units over a period of time.

Suppose an investor registers to withdraw Rs. 1,000 per month for 6 months. If in the first month, the NAV is Rs 10, the investor’s unit-holding will be reduced by Rs. 1,000 ÷ Rs. 10 i.e., 100 units. In the second month, if the NAV has gone up to Rs. 12, the unit-holding will go down by fewer units viz. Rs. 1,000 ÷ Rs. 12 i.e., 83.333 units. If the NAV goes down to Rs 9 in the following month, the unit-holder will be offering for re-purchase a higher number of units viz. Rs 1,000 ÷ Rs 9 i.e., 111.111 units.

Thus, the investor re-purchases his units at an average NAV during the 6-month period. The investor does not end up in the unfortunate position of exiting all the units in a market trough. Since units are being redeemed, exit loads and taxes will apply. The effect of exit loads will increase the number of units that needs to be redeemed to withdraw a fixed amount of money since it reduces the effective price for the investor.

In the earlier example, if there was an exit load of 1 percent then the first tranche of withdrawal when the NAV is at Rs.10 will be for 101.0101 units since the exit load of 1 percent reduces the applicable NAV for the investor to Rs.9.90 from the Rs.10. In order to get Rs.1000 the investor, therefore, has to redeem 101.0101 units.

Mutual funds make it convenient for investors to manage their SWPs by registering the amount, periodicity (generally, monthly) and period for their SWP. Some schemes even offer the facility of transferring only the appreciation or the dividend.

In this option, the withdrawal is not fixed but will vary depending upon the availability of appreciation in the specific investment chosen by the investor. The advantage of a variable SWP relative to a fixed amount of withdrawal is that the capital invested will not be withdrawn. Depending upon the type of SWP chosen the mutual fund will re-purchase or redeem the appropriate number of units of the unit-holder, without the formality of having to give a re-purchase instruction for each transaction. An investor may opt for SWP for several reasons:

- To minimise the risk of redeeming all the units during a market trough.
- Meet liquidity needs for regular expenses.
- Assuming the scheme is profitable, the re-purchase ensures that some of the profits are being regularly encashed by the investor.

9.11.3 Systematic Transfer Plan (STP)

This is a variation of SWP. While in a SWP the constant amount is paid to the investor at the pre-specified frequency, in a STP, the amount that is withdrawn from a scheme (called the source scheme) is re-invested in some other scheme (called the target scheme) of the same mutual fund. Thus, it operates as a SWP from the source scheme, and a SIP into the target scheme. Since the investor is effectively switching between schemes, it is also called "switch" if it is just one transaction or tranche. If there are multiple tranches over a fixed period on pre-defined date of an amount that is defined ahead, then it is an STP. The transfer of funds from the source scheme is equivalent to redemption. Exit loads and taxes will apply like any other redemption transactions. The minimum investment and redemption limits specified by the mutual fund for the schemes will not apply to an STP. The mutual fund will also specify the source schemes from which the switch/transfer can be made and the target schemes into which the switch/transfer can be made. If the unit-holder were to do this SWP and SIP as separate transactions.

- The Unit-holder ends up waiting for funds during the time period that it takes to receive the re-purchase proceeds, and has idle funds, during the time it takes to re-invest in the second scheme. During this period, the market movements can be adverse for the unit- holder.
- The Unit-holder has to do two sets of paper work (Redeem and Purchase) for every period.

The STP offered by mutual funds is a cost-effective and convenient facility. It can be used by investors to make periodic investments into a volatile market such as equity, or to rebalance a portfolio, or to book profits. Investors can choose to transfer a fixed amount each period or to transfer the appreciation in a scheme.

Example

An investor who holds lump sum amount of Rs.10 lakhs in a short-term debt fund and registers for an STP to transfer Rs.100000 each month over 10 instalments to a diversified equity scheme of the same mutual fund. There is an exit load of 0.25 percent on redemption from the short-term debt fund up to three months from the date of allotment and no exit load thereafter.

The first 3 instalments of Rs.1,00,000 transferred will be after the exit load of 0.25 percent. The load chargeable on each instalment will be Rs.250 and the amount transferred to the equity scheme will be Rs. 99750. After the third instalment, there will be no exit load and the full amount of Rs.1,00,000 will be transferred. Any return earned on the short-term debt fund will be taxed as applicable.

9.11.4 Switch

A switch is a redemption from one scheme and a purchase into another combined into one transaction. For example, investors who believe that equity markets have peaked and want to book profits can switch out from an equity scheme and switch into a short-term debt fund.

9.11.5 Transfer of Income distribution cum capital withdrawal plan (dividend transfer plan)

Transfer of Income distribution cum capital withdrawal plan ((dividend transfer plan) (DTP) is a facility that allows investors to invest the dividend earned in a mutual fund investment into another scheme of the same mutual fund. Investors with a lowrisk profile can get some benefits of diversification by transferring dividends earned from debt funds into equity funds. Similarly, dividends earned in equity funds can be transferred into debt funds to rebalance the portfolio and manage risks. Mutual funds decide the schemes, plans and options from which the dividends can be transferred and the target schemes to which they can be transferred.

The investor must hold units in the Income distribution cum capital withdrawal (dividend) option of a scheme to sign up for this facility. Once the investor registers a DTP, any existing instruction for Income distribution cum capital withdrawal or dividend re-investment will be overridden. All the units held under the scheme, plan and option selected for DTP will be covered under the transfer.The investor has to clearly identify the source scheme, plan and option from which the transfer has to be made and the target scheme, plan and option to which the dividend shouldbe transferred. The units in the target scheme will be held in the same folio as the source scheme. The minimum application amount specified for the target scheme will not apply to investments made under a DTP. The mutual fund may specify a minimum amount of dividendthat can be transferred. The dividend is invested in the target scheme on the next business day after the record date for the Income distribution cum capital withdrawal in the source scheme.

Mutual funds may require the DTP enrolment form to be registered a specific number of days before the record date for the dividend. The DTP mandate will stand automatically terminated when the unit holding in the source scheme becomes nil. It can also be terminated by sending awritten request to the mutual fund.

9.12 Operational aspects of Systematic Transactions

Mutual funds specify the schemes in which systematic transactions are offered. The fund also specifies the minimum investment for each tranche, the dates on which the transactions can be conducted and the minimum period for which the investor can sign up. From the available options, the investor can choose the amount of the periodic transaction, the frequency (monthly, quarterly, semi-annual, annual), the period over which the transaction will be done and the dates. In case of a minor investor, however, the SIP will be registered only till the date of the minor attaining majority even though the instructions may be for a period beyond the date of majority. A default SIP date, frequency, end date may be specified by the scheme which will be applied in case the investor does not make a selection. Mutual funds may also offer the facility to increase the instalment amount periodically.

A new investor has to submit both the application form as well as the SIP enrollment form to register for an SIP. The information provided in both forms have to tally. In case of an existing investor only the SIP enrollment form has to be submitted. The enrollment form requires the names, PAN and KYC compliance of all the holders of the folio and their signatures. For existing investors only, the folio number needs to be provided. The enrollment form has to be signed asper the mode of holding of the existing folio. The investment details to be provided in the form includes the scheme, plan and option selected. The SIP details to be provided are the SIP amount, frequency, SIP date and the start and end date for the SIP period. The details of the bank account that is registered for NACH/Direct Debit/Standing Instructions for the SIP should be provided in the form. The information available under the folio, such as unitholder details and mode of holding, will apply to the SIP investments also. The signature of the investor in the application form/folio records and enrollment form has to be the same. In case the existing folio is operated jointly then the SIP form has to be signed by all the holders.

The enrollment form has to be submitted to the mutual fund a specified number of days before the first instalment, typically 15 to 30 days. For example, assume a mutual fund requires a registration time of 30 days for an SIP enrollment. An investor submits an enrollment form on 5th September and selects 15th as the SIP date. The first instalment will be 15th of October since 30 days are required for registration. The enrollment time may come down if investors already have a One-Time Mandate (OTM) registered in the folio for making payments.

The payment modes accepted for SIPs include post-dated cheques and electronic payment modes such as NACH, direct debit and standing instructions (SI). The cheque numbers, date and amount for each cheque has to be provided. An authorization to the bank to execute the electronic payment has to be signed which will be registered with the bank by the mutual fund. To avail of the NACH facility of the RBI, the applicant should have an account with a bank in a city where the facility is approved by RBI and the bank should participate in the local MICR clearing. Direct debit and Standing Instructions are facilities that the investor can use if they hold an account with a bank and in a branch that has a tie-up with the mutual fund. The first instalment should accompany the enrollment form. This can either be through a cheque drawn on the bank which is registered for NACH/Direct Debit/SI for the SIP, or any other bank provided a photocopy of a cheque drawn on the bank registered for the electronic payment is also enclosed with the enrollment form. Alternatively, the first instalment need not be paid by cheque, if the enrollment form is attested by the bank which is registered for debiting the instalments.

SIP Top-up Facility

Mutual funds provide an additional facility through an SIP to enhance the disciplined savings of investors. It is called the SIP Top-Up facility. Investors have the option to increase the SIP amount at intervals chosen by them. The increase can be of a fixed amount or a percentage of the existing SIP amount. For example, assume an investor has registered for a monthly SIP of Rs.2500 for a 3-year period and has also signed up to top-up the SIP at an annual frequency by Rs.500. In the first year the SIP instalment will be Rs. 2500. The second-year each monthly instalment will be increased by Rs. 500 to Rs. 3000 and in the third year it will go up to Rs.3500. If the investor had instead signed up for a 10 percent annual increase, then the SIP instalment goes up to Rs.2750 (2500 +10 percent of 2500) in the second year and Rs.3025 (2750+ 10 percent of 2750) in year 3. The top-up facility helps investors increase their savings with time as income and investible surpluses go up. Investors have the option to either set an upper limit for the SIP with the Top-up facility or the date from which the SIP Top-Up amount will cease. Once it reaches the pre-defined upper limit or the pre-defined date, the Top-up facility is discontinued. However, the SIP amount along with the Top-up amount will remain constant till the end of the SIP tenure.

Investors register for the Top-up facility at the time of enrolling for the SIP. An existing SIP investor can also register for a Top-up facility. The details of the existing SIP, such as scheme/plan, frequency, duration and amount have to be correctly provided while registering for the top-up facility. Mutual funds may not offer the Top-up facility for Micro-SIPs or it may be subject to the condition that the SIP amount and the Top-Up together does not exceed Rs. 50,000 in a rolling 12-month period or financial year.

Renewal and Cancellation of SIP

To renew an SIP, a renewal form has to be submitted giving details of the scheme, plan and option, SIP amount, SIP date and period.

An SIP can be cancelled by giving due notice of the same to the AMC by providing details of the SIP such as folio number, scheme name, option, bank details and mode of payment. The period of notice required will be specified by the AMC. The bank mandate, in case of electronic payment mode, also has to be cancelled. An SIP may also stand cancelled if there are insufficient funds in the bank account when payment is due.

Registration and Cancellation of SWP

In case of systematic withdrawals, the investor has to register the SWP with the mutual fund and specify details such as the scheme, plan, option, amount of withdrawal, frequency and the period of the SWP. The selections have to be made from the options provided by the mutual fund. The mutual fund may specify a minimum period before the first withdrawal before which the enrollment form has to be submitted. The credits will be made to the default bank account, or any other account as required by the investor and registered with the mutual fund. The mutual fund may specify the minimum amounts for each tranche of a systematic withdrawal transaction. Typically, this is lower than what is specified for a redemption from the scheme.

An SWP will stand cancelled when all the units are redeemed. Investors can choose to cance SWP by giving notice in writing to the mutual fund giving full details of the mandate such as scheme name, plan, option, folio details, SWP amount, frequency and period.

Registering and Cancellation of STP and Switches

In case of systematic transfers and switches, the source and target schemes have to be selected at the time of registering the STP or Switch. The schemes from and to which transfers and switches can be made are defined by the mutual fund. The minimum amount of transfer is also fixed by the mutual fund. The frequency, number of instalments and the dates of the transfer are selected by the investor in the form for registering the STP. Mutual funds will require a notice period for registering and cancelling the STP.

A Switch instruction will be given by the investor using the Transaction slip. The investor has to provide the folio number, scheme, plan and option from which the switch will be made. The switch can be defined in rupees or the number of units. The scheme, plan and option into which the switch has to be made should be provided. The units of the target scheme acquired under a switch or transfer will be under the same folio as the source scheme.

Execution of Systematic Transactions

Each tranche of a systematic transaction will be executed at the applicable NAV on the date of the transaction. In case of transfers, each leg of the transfer (redemption and purchase) will be executed at the applicable NAV for each scheme. The investor will have to bear the loads and taxes as applicable. A systematic transaction can be cancelled at any time by giving the mutual fund notice in writing.

Triggers

It is not uncommon for investors to rue missed opportunities of buying or selling because they could not give the requisite instructions in time. This is addressed through the trigger option that is offered by some mutual funds.

For instance, an investor can book profits by specifying that the units would be re-purchased if the market reaches a particular level. In that case, once the market reaches that level, the units would be re-purchased, without the need for going through a separate re-purchase documentation. It stands to reason that if the market continues to go up after the trigger is activated, the investor loses on the further gain. A date trigger instructs the mutual fund to redeem the units specified on a particular date. Or, the investor could set a stop-loss trigger by identifying the level of the NAV or the percentage depreciation in the value of the investment at which the investment should be redeemed so that the investment is protected from a further fall in value.

Similarly, an investor can set a trigger to transfer money into an equity scheme when the market goes down, say 20 percent, or the transfer can be triggered by a fall in the NAV of the equity scheme by a defined percentage. This would help the investor conveniently increase his position in equities, when the markets decline. Typically, triggers are set on the value of indices or the investment. Investors can choose to redeem just the appreciation or the entire holding value on the activation of the trigger or a percentage of the current value of the investment. Investors will choose this depending upon the type of trigger. For example, a stop loss trigger may go with redeeming the entire investment value while an appreciation trigger may be paired with redeeming the amount of appreciation. Investors may also choose to switch to another scheme on the activation of the trigger. Mutual funds decide the type of triggers that will be offered and the schemes on which they will be offered. For each investment under a folio, a separate trigger facility request has to be made. A notice period may be specified by the mutual fund for registering and cancelling a trigger facility. A trigger is a one-time facility that extinguishes when the trigger is activated and the corresponding action is completed.

9.13 Non-Financial Transactions in Mutual Funds

9.13.1 Nomination

Most investors like clarity about what would happen to their unit-holding, in the unfortunate event of their demise. This clarity can be achieved by executing a Nomination Form, where the nominee's name is specified. The nomination made in a folio applies to all the investments held under the folio. Nomination can be made in favour of number of nominees and in the manner as prescribed by SEBI. Where there are multiple nominees, the unitholder(s) must define the percentage holding for each nominee making a total of 100 percent.

If the percentages are not clearly indicated, then the nomination will be made equally among the nominees. In case of a folio held in the name of a single individual, the nomination is required unless the holder specifically confirms their intent not to nominate at the time of making the application. In the case of joint holding, every unit-holder will have to sign the nomination form, irrespective of the mode of holding. Only individual investors can make a nomination. Investments by minors cannot have a nomination. A Power of Attorney holder cannot make a nomination.

Nominees

The nominee can be an individual, including minors and NRIs, central and state governments and local authorities. If the nominee is a minor, then a guardian too can be specified. A nomination cannot be made in favour of a trust (except a religious or charitable trust), society, body corporate, partnership, Karta of a HUF or a Power of Attorney holder.

Change in Nomination

A nomination can be changed or cancelled at any time. The change or cancellation has to be made by all the unitholders who made the original nomination, irrespective of the mode of holding. When a new nomination is registered with the AMC, the earlier nomination made, ifany, stands automatically superseded. The death of a nominee will cancel the nomination made, if it is a single nominee. If there are multiple nominees, in the event of the death of one or more nominees the transmission of units will be made in favour of the remaining nominee(s).

Nomination in case of demat holdings of mutual fund

For units held in dematerialized mode, the nominee made for the demat account will apply. Such nominations will be governed by the bye-laws of the depository.

Nominee to act on behalf of incapacitated investors[56]

[56] SEBI circular no. SEBI/HO/OIAE/OIAE_IAD-3/P/ON/2025/01650

Mutual fund investors have the option to empower any one of the nominees (excluding minor nominees) to operate the investor's account / folio, if the investor is physically incapacitated, but still has the capacity to contract. Further, the investor can specify either percentage or absolute value of assets in the account / folio that can be encashed by such nominee. The investor can change such mandate any number of times without any restriction.

The applicant can make a nomination[57] in favour of number of nominees and in the manner as specified by SEBI. The nomination can be made at the time of application or subsequently at any time. A folio held by a single holder should have a nomination made in the application.

Mutual Funds may require the applicant to provide a separate declaration of the intention not to nominate or consider not providing the nomination details as consent to proceed with the application without a nomination.

As per new SEBI rules, investors subscribing to mutual fund units on or after September 30, 2023 will have the choice of either provide nomination or opt out of nomination by providing a signed declaration.[58]

In a further simplification of processes, the provisions related to compulsory appoint a nominee or to give a declaration would be optional for the mutual fund folios having joint holding pattern.

9.13.2 Pledge/Lien of Units

Banks, NBFCs and other financiers often lend money against the pledge of Units by the Unitholder. This is affected through a Pledge Form executed by the unit-holder (pledger). The form has a provision for specifying the party in whose favour the units are pledged (pledgee). The units that are offered as security for a loan should have completed the lock-in period if any. All the unit-holders, irrespective of the mode of holding, of the folio, must sign the form requesting the marking of the lien in favour of the lender. The form should clearly state the name of the unit-holder(s) as it appears in the folio, identify the scheme, plan and option and the number of units on which the lien should be marked. A non-individual entity must enclose

[57] Candidates are advised to read this circular which shall come into effect from March 1, 2025. https://www.sebi.gov.in/legal/circulars/jan-2025/circular-on-revise-and-revamp-nomination-facilities-in-the-indian-securities-market_90698.html

[58] The circular, issued on 15 June 2022, stated that "All the AMCs are advised to set deadline as March 31, 2023 for nomination / opting out of nomination for all the existing individual unit holder(s) holding mutual fund units either solely or jointly as mentioned at para 1 above, failing which the folios shall be frozen for debits".

Via another Circular dated 28 March 2023, SEBI has postponed the applicable date to 30 September 2023, for freezing of folio.

a board resolution and other authorization for the person pledging the units. Once units are pledged, the Unit-holder/s cannot sell or switch out the pledged units, until the pledgee gives a written no-objection to release the pledge. As long as the lien is marked, the lender will have the authority to enforce the pledge and redeem units after providing the documents necessary for the same. The minimum redemption requirement for a scheme will not apply in these cases. The Pay-out of Income distribution cum capital withdrawal plan declared on units under lien may be paid to the unit- holder or the lender depending upon the agreement.

9.13.3 Demat Account

Dematerialisation is a process whereby an investor's holding of investments in physical form (paper), is converted into a digital record. The benefit of holding investments in demat form is that investors' purchase and sale of investments get automatically added or subtracted from their investment demat account, without having to execute cumbersome paperwork. Settlement of most transactions in the stock exchange needs to be compulsorily done in demat form.

In order to avail this facility, the investor needs to open a demat account with a depository participant. The access of demat facility for mutual fund investors has increased, with National Stock Exchange and Bombay Stock Exchange making available screen-based platforms for purchase and sale of mutual fund schemes.

Mutual funds are required to provide investors the option to hold the units in demat form. The mutual fund has to obtain an ISIN for each option of a scheme and make the information available in all the account statements sent to the investor. The application form for mostly all schemes has an option to provide the demat account details in case the investor chooses to hold the units in demat form. The demat facility is typically initiated by the mutual fund, which would tie up with a Depository (like National Securities Depository Ltd or Central Depository Services (India) Ltd). On the basis of this tie-up, investors can open a demat account with a Depository Participant and dematerialize their investment holdings i.e., convert their physical units into demat units. Usual KYC documentation is required for opening the account. However, once the KYC including IPV is performed for opening a demat account, no separateKYC is required to be done by the AMC or distributor or any other capital market intermediary.If KYC has already been done by any other capital market intermediary, then the DP will not insist on another KYC.

The option to apply for the units in dematerialized form is provided in the application form. The name of the Depository Participant with whom the investor holds the account, DP ID number and Beneficiary Account Number has to be provided. A copy of the DP statement enclosed with the application form may help the mutual fund verify the information provided in the application form. The name(s), mode of holding of the demat account and PAN of the holders are matched with the application for units and the units will be directly credited to the demat account after the realization of funds. If the data provided in the application form does not match the depository data, then the application will be considered as invalid for processing under demat mode and instead, the investor may be issued units in physical mode, provided the application is otherwise valid. All details such as an address, bank account details, nomination for the units held in demat form is according to the information available in the depository's records. Any changes to the said information have to be made by contacting the depository. Redemption requests for units held in demat mode have to be submitted to the depository or through the stock exchange platform.

Investors can also choose to get their existing units (as represented by the statement of account) dematerialized. On dematerialisation, the investor's unit-holding will be added to his/her demat account. As and when the investor sells the unit-holding, the relevant number of units will be reduced from the investor's demat account. The proceeds of redemptions as well as the Payout of Income distribution cum capital withdrawal will be credited to the bank account linked to the demat account.The investor benefits from a demat account are as follows:

- Less paperwork in buying or selling the mutual fund units, and correspondingly, accepting or giving delivery of the units.
- Direct credit of bonus and rights units that the investor is entitled to, into the investor's demat account.
- Change of address or other details needs to be given only to the Depository Participant, instead of separately providing it to every company/mutual fund where the investor has invested and holds demat units.
- Consolidate all investments in mutual funds, direct equity, debentures and othersunder one account.

The investor also has the option to convert the demat units into physical form. This process is called re-materialisation.

9.13.4 Change in Folio Details

The personal information of the investor captured under the folio is liable to changes that have to be updated in the records. Some of the information, such as name, address, status and contact details, are provided during the KYC compliance process. Any changes have to be updated with the KRA using the change form. The KRA will communicate the updated information to all the mutual funds. Others, such as a change in bank accounts, change in the mode of holding in operating a folio, or the nominations made in an investment, have to be updated with each mutual fund.

Change in Personal Information

The KYC Registration Agency (KRA) prescribes a change form to be used to register change, ifany, in the information provided at the time of the Know Your Customer (KYC) process. Theseinclude:

- Change in Name
- Change in Status/ Nationality
- Change in PAN
- Change in permanent address or address for correspondence
- Change in Contact Details
- Change in name of spouse/father

In the Change Form the individual has to provide the name, date of birth, PAN or PERN (PAN Exempt Reference Number), and Aadhaar number, as per the original KYC records to identify themselves in the records of the KRA. A self-attested copy of the PAN, where available, has to accompany a change request. The new or changed information has to be provided in the space provided for the same in the form. Any change has to be supported by documents and the details provided in the form should match the documentary proofs provided. The documents have to be self-attested and the originals have to be produced for verification. If the originals are not available for verification, then the copies have to be attested by entities authorized to do so.

If the units are held in dematerialized form, the procedure for a change in address would be as determined by the depository participant.

A change in the guardian in a minor's folio will require the new guardian to comply with KYC and PAN requirements, provide bank account details and a no-objection certificate from the existing guardian.

The change in the status of an investor from minor to major will require the PAN and KYC compliance of the investor to replace that of the guardian. The signature of the investor and the new bank account details have to be updated in the records. The guardian will then cease operating the account.

Change in Bank Account Details

A change in bank account details has to be directly registered with each mutual fund. Investors can register up to five bank accounts with a mutual fund for individual investors and 10 for non-individuals. One of the registered accounts will be designated as the default account into which all the dividend and redemption proceeds will be credited. Investors can instruct the mutual fund to credit the proceeds to any of the other accounts too at the time of executing a redemption transaction. The investor can add or delete accounts within the limits specified. If the default bank account is being deleted from the list of registered accounts, then before that another account has to be designated as the default bank account in the Multiple Bank Registration Form. Details to be provided for adding a bank account are the name of the bank, account number and type, branch address, IFSC and MICRcode. The form should be accompanied by a cancelled cheque of the said account with the name of the first holder of the mutual fund folio pre-printed on it. If the name is not pre- printed on it then a bank statement, passbook or bank certificate that gives the name, account number and address should be enclosed. If photocopies are submitted, then the original should be produced for verifications. The form for registering the change has to be signed according to the mode of holding of the folio.

If the investor has not used the facility to register multiple bank accounts, then the Change of Bank details form can be used to change the existing bank account linked to the folio and provide details of the new bank account.

9.13.5 Transmission of Units

Transmission is the process of transferring units to the person entitled to receive them in the event of the death of the unitholder. The person entitled to receive it depends upon the folio conditions of joint holding and nomination. If the first holder passes away, the second holder is substituted as the first holder. In a singly held folio with nominations, the units are transferred to the nominee. If a folio is jointly held and has nominations, the right of the joint holder will take precedence. If there are no nominations in the folio, the units are transmitted to the legal successors. See Box 9.3 for understanding nomination in the context of mutual fund investments.

Before the transfer is affected, the mutual fund will insist on the KYC documentation from the nominee, the death certificate of the deceased unit-holder, and an indemnity against future problems for the mutual fund arising out of the transfer.

SEBI had directed the AMCs to adopt a standard Transmission Request Form and a common set of documents for transmission of units as prescribed by AMFI and to make the same available on the websites of AMCs, RTAs and AMFI.[59]

[59]Vide SEBI circular no. SEBI/HO/IMD/DF3/CIR/P/2019/166 dated December 24, 2019

Box 9.3: Nomination in mutual fund investments

It is important to note here that nomination is only an authorization for the mutual fund to transfer the units to the nominee in the event of demise of the unit-holder.

The nominee holds the units in trust for the legal heirs of the investor. It does not create any title or beneficial interest in the units in favour of the nominee after the death of the unit-holder. The inheritance laws applicable to the unit-holder too need to be considered by the investor if they are looking at nomination as a way of passingon their wealth to their heirs.

As per new SEBI rules, investors subscribing to mutual fund units on or after August 1, 2022 will have the choice of either provide nomination or opt out of nomination by providing a signed declaration.

Pursuant to the above, AMFI, in consultation with AMFIs Standing Committee on Operations/Compliance and Risk, has reviewed and updated the existing AMFI guidelines for Transmission of Units including the supporting documents and has introduced the Transmission Request Forms to be used under different situations.

A request for transmission has to be made in the Transmission Request form and an NOC form has to be submitted. The documents that are required for a valid transmission claim will depend upon the situation.

9.14 Change in Status of Special Investor Categories

Minors, NRIs, HUFs investing through a constituted attorney constitute a special category of individual investors. Some of these investors do not make investments directly instead investments are made by designated entities on their behalf. These categories of individual investors require additional documentation and process, due to their differential status with respect to taxation and mode of operation of investments or restrictions on certain components of investment activity.

9.14.1 Minor turned Major

Once the minor becomes major, financial transactions are disallowed in their account. No debits or redemptions can be made in bank accounts; mutual funds folios or demat account of minors-turned-major. Minors are not eligible to sign documents, enter into contracts, or issue third party cheques. However, after a minor becomes major, they can conduct such transactions, only after their signature is attested by their banker.

KYC: Minors attaining the majority will have to complete all the KYC process by submitting proof of identity and address. Banks and depositories may also insist on personal verification of the minor-turned-major. On becoming a major, the erstwhile minor investor has to complete the KYC details, provide updated bank account details including the cancelled original cheque leaf of the new account. No further transactions shall be allowed till the status of the minor is changed to major.

PAN Card: The PAN issued to a minor will have to be resubmitted to the Income Tax authorities, for issuance of a new card, with the same number, but the new signature of the minor-turned-major.

Demat Account: Since demat accounts of minors can be held only on a single-name basis, the account opening process has to be redone for a minor-turned-major. This involves the opening of a new demat account. Securities held in the old demat account with minor status are transferred to the new demat account.

Mutual Fund Investments: When the units are held on behalf of the minor, the ownership of the units, vest with the minor. The guardian may operate the minor's account only until the minor attains the age of majority. As per SEBI circular no. SEBI/HO/IMD/DF3/CIR/P/2019/166 dated December 24, 2019[60], upon the minor attaining the status of a major, the minor in whose name the investment was made is required to provide all the KYC details, updated bank account details including cancelled original cheque leaf of the new account. No further transactions shall be allowed till the status of the minor is changed to major.

The guardian is then not allowed to undertake any financial or non-financial transactions from the date of the minor attaining majority. All existing standing instructions like SIP, SWP & STP, if registered for a period beyond the date on which the minor attains majority will cease to be executed from the date of the minor attaining majority.

In short, the minor's account is frozen for operation by the guardian on the day the minor attains the age of majority and no further customer-initiated transactions shall be permitted till the status is changed from minor to major. (Note: Pay-out of Income distribution cum capital withdrawal Option or Reinvestment of Income distribution cum capital withdrawal Option, where applicable, shall continue to be processed. In such cases, dividend amount, net of TDS (wherever applicable), shall be credited to the unitholder's registered bank account or reinvested in the folio, as the case may be.)

Before submitting the MAM application form for change in status from Minor to Major, the unitholder is required to Apply for PAN and obtain a PAN card; Complete the KYC process; and Change his/her status in his/her existing bank account from Minor to Major OR open a

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[60] The circular has been partially modified, for more details read at https://www.sebi.gov.in/legal/circulars/may-2023/investment-in-units-of-mutual-funds-in-the-name-of-minor-through-guardian_71148.html

newbank account immediately upon becoming a major and procure a new cheque book with his/her name pre-printed thereon.

Documents required for change in status from Minor to Major:

1) The prescribed MAM form duly filled in all respects.
2) Copy of PAN Card of the applicant
3) KYC Acknowledgment or a duly completed KYC form.
4) A cancelled cheque leaf with the applicant's name pre-printed or the applicant's latest BankStatement/Passbook.
5) Signature attestation by the bankers)
6) Nomination Form.
7) A fresh SIP, STP, SWP mandate in the prescribed form (in order to continue the SIP, STP,SWP, if applicable.)

Systematic Transactions (SIP, SWP, STP and others): Standing instructions like Systematic Investment Plans (SIP), Systematic Withdrawal Plans (SWP), Systematic Transfer Plans (STP) are registered in a minor folio only till the date of the minor attaining majority, even though the instructions may be for an extended period. When the minor is approaching the age of majority, AMCs usually send letters advising the guardian and the minor to submit the form along with prescribed documents to change the status of the account/folio to "major". All SIP, STP, SWP and any other standing instruction registered in the minor's account are suspended if the documents are not received by the date when the minor attains majority.

9.14.2 NRI to Resident Indian

If a person returns to India and forgoes the NRI status, he needs to carry out certain procedures with respect to his investments and bank accounts.

Bank Account: Once an NRI becomes a RI, he cannot operate his NRO/NRE/FCNR (B) accounts. He needs to inform to the bank about the change of status to resident Indian and needs to open a Resident Rupee Account. Account opening documents such as address proof, identity proof, photographs need to be submitted. A Resident Foreign Currency (RFC) account may be opened by a returning Indian to transfer balances from NRE /FCNR (B) accounts. This account can hold foreign currency and continue to receive funds in foreign currency from investments abroad.

Demat Account: Just like a bank account, the returning NRI needs to inform change of status to the designated authorised dealer branch through which the investor had made investments in the Portfolio Investment Scheme, as well as the DP with whom he has opened a demat account. A new demat account with 'Resident' status needs to be opened. All the balances held in the NRI demat account shall be transferred to the new 'Resident' demat account. After transfer, the NRI demat account will get closed.

Mutual Fund Investments: The NRI needs to inform the relevant AMCs about the change of status, change of address and bank details with respect to mutual fund investments. KYC change form needs to be sent to the KYC registration agency for change of status, address and bank details. An acknowledgement shall be issued by the KYC registration agency on submission of request and will carry out the necessary changes in its records. Once the investor is flagged as an NRI, TDS will be deducted at source on gains made on sale/redemption of mutual fund investments by NRIs as applicable.

9.14.3 Change in Karta of HUF

For change in 'Karta' of a HUF, a letter is required from the new Karta stating the reason for change of Karta in mutual fund records. The respective AMC may have a specific form. Name of the deceased Karta, folio number, scheme, unit details may be mentioned in the letter signed by the new Karta. KYC documents of the new Karta and the HUF need to be provided. If the HUF is already KYC compliant, the HUF KYC need not be furnished. Along with the letter and KYC documents, the following must be enclosed:

- Attested copy of death certificate
- Bank certificate stating signature and details of new Karta
- Indemnity bond signed by all co-parceners and new Karta

9.15 Investor transactions – turnaround times

SEBI's guidelines prescribe the turnaround times for investors' transactions with the mutual fund for various services such as NAV calculation and disclosure, subscription period of mutual fund schemes, allotment and refund of money, scheme wise annual report, portfolio statement to be sent to unitholders, half-yearly disclosures, Consolidated account statements etc.

9.16 Unclaimed Assets

Over a number of years, mutual fund investors sometimes lose track of their investments considering investments might have been made in physical form with bare minimum KYC details. The investments in open-ended growth option mutual fund schemes may remain invested perpetually until and unless investor / investor's nominee / legal heir approaches the concerned AMC for redemption / transfer / transmission. Due to non-availability of PAN, email ID or valid address, it is also possible that these MF folios may not appear in the unitholder's Consolidated Account Statement (CAS). Thus, inactivity in mutual fund folios could be on account of the investor losing track of one's investments, demise, etc. Such inactive folios may become susceptible to fraudulent redemptions.

In line with its core mandate of investor protection and safeguarding investor interests, SEBI has directed its efforts towards minimizing the creation of unclaimed assets in the securities market. To address this issue in the Indian securities market, SEBI has implemented several measures, including:

a) Stipulation of norms for inactive / dormant accounts and folios,

b) Mandating furnishing of contact and bank details by investors,

c) Mandating investors to either provide nomination or expressly opt-out from making a nomination,

d) Simplification of norms for transmission,

e) Centralized mechanism for reporting demise of investor.

In line with the above, the RTAs have developed a platform to trace inactive and unclaimed mutual fund folios. The platform is named Mutual Fund Investment Tracing and Retrieval Assistant (MITRA). This platform would allow search at the industry level and empower the investors in the following manner:

a) Enable investors to identify the overlooked investments or any investments made by any other person for which he / she may be rightful legal claimant,

b) Encourage investors to do KYC as per the current norms, thus reducing the number of non-KYC compliant folios,

c) The MITRA platform will lead to the reduction in the unclaimed mutual fund folios,

d) Contribute towards building a transparent financial ecosystem and will be reliable medium for investors to find their inactive and unclaimed mutual fund investments,

e) Build and incorporate mitigants against fraud risk

The MITRA platform will be hosted by the two Qualified RTAs (QRTAs), viz., CAMS and K-Fintech, as agents of AMCs. The platform can be accessed through a link on the websites of the AMCs, the two QRTAs, AMFI and SEBI.

Another measure to reduce unidentified unclaimed assets is to harness the power of the digital infrastructure: both publicly available DigiLocker and infrastructure of the SEBI registered KRAs.

DigiLocker is a digital document wallet of the Government of India facilitating the citizens in obtaining and storing documents like Aadhar, PAN, driving licence, death certificate, etc. Government of India has stipulated that institutions delivering citizen services shall integrate their system with DigiLocker. Bank account statements, insurance policies and statements of NPS are already available in the DigiLocker. The inclusion of mutual fund and demat holding statements within DigiLocker can make available the entire financial holdings of individuals in a single account.

DigiLocker also provides nomination facility to its users. The nominee or the nominees specified by the user are authorized to access the digital information of the user upon the demise of the user. For this purpose, while specifying the nominee, the user is required to provide the mobile number and email address of the nominee.

Chapter 9: Sample Questions

1. What term is used to describe the Net Asset Value (NAV) of the scheme after the dividend is paid out (Remember the NAV would have dropped to the extent of the dividend paid?
   a. Ex-Dividend NAV
   b. Cum-Dividend NAV
   c. Lower NAV
   d. Dividend NAV

2. At what price are the bonus units issued to the unitholder?
   a. The price is decided by the AMC in consultation with the trustees
   b. The bonus units are allotted free of cost
   c. At the prevailing NAV
   d. At the prevailing NAV divided by the bonus ratio

3. Which of the following statements is True?
   a. Hindu Undivided Families (HUFs) are not allowed to invest in mutual fund schemes
   b. Minors cannot invest in mutual fund schemes
   c. Foreign investors can invest in Indian mutual fund schemes, provided they have completed the Know-Your-Client (KYC) formalities

4. Whose KYC needs to be completed in case of an application by a minor?
   a. The minor
   b. The guardian
   c. Any family member of the minor
   d. No KYC is required in case of applications by minor

5. Which platform has been developed by RTAs to help investors trace inactive and unclaimed mutual fund folios?
   a. Digi Locker
   b. CAS Portal
   c. **Mutual Fund Investment Tracing and Retrieval Assistant (MITRA)**
   d. AMFI Finder

6. Which of the following statements about mutual fund nominations under SEBI's new rules is correct?
   a. Power of Attorney holders can nominate beneficiaries
   b. Investors can nominate up to 10 individuals per folio
   c. Only NRIs can be nominated
   d. Investments by minors require a mandatory nomination

7. What is the effect of a bonus issue on the value of an investor's mutual fund holding?

    a. Value increases
    b. Value decreases
    c. Value remains the same but NAV per unit reduces
    d. Investor pays for new units

8. Which of the following payment modes is NOT accepted for SIP instalments?

    a. Post-dated cheques
    b. NACH
    c. Standing Instructions
    d. Cash payments

9. When does the blocked amount in the ASBA facility leave the investor's bank account?

    a. At the time of application submission
    b. Immediately after the NFO opens
    c. Only when the investor is allotted units
    d. After a fixed lock-in period

10. What is the main difference between a Direct Plan and a Regular Plan in mutual funds?

    a. Different fund managers
    b. Different investment portfolios
    c. Difference in total expense ratio (TER) due to distribution expenses
    d. Direct Plan offers higher risk

CHAPTER 10: LEGAL AND REGULATORY ENVIRONMENT

Learning Objectives:
After studying this chapter, you should understand about:

- Role of Securities and Exchange Board of India
- Regulatory reforms by SEBI
- Investor Grievance Redressal
- AMFI Code of Conduct for Intermediaries

10.1 Role of Securities and Exchange Board of India

As mentioned earlier, securities markets in India are regulated by the Securities and Exchange Board of India (SEBI). It regulates, among other entities, mutual funds, depositories, custodians, registrars and transfer agents (RTAs) and credit rating agencies in the country.

The Preamble of the Securities and Exchange Board of India describes the basic functions of the Securities and Exchange Board of India as "...to protect the interests of investors in securities and to promote the development of, and to regulate the securities market and for matters connected therewith or incidental thereto".

The regulations cover three important aspects to achieve the above objectives:

- Disclosures by issuers of securities, e.g. companies that issue shares or debentures, and mutual funds that issue mutual fund units
- Efficiency of transactions in the securities markets
- Low transaction costs

Apart from the above, various other areas also warrant regulations, such as:

- Deliberate speculation in stock markets
- Insider trading
- Excessive risks taken by mutual funds
- Inadequate collateral by issuers of debt securities

If such activities are unchecked, the trust of the investors would be lost in the functioning of the markets, which eventually may lead to drying up of precious financial resources. This would further dry up the investment activity, or channelling of household savings in capital markets that the economy needs for growth.

10.1.1 Regulatory reforms by SEBI

SEBI issued the mutual fund regulations in 1996 in the form of SEBI (Mutual Funds) Regulations, 1996. Since then, there have been many amendments through various regulations and circulars. In all the cases, the objective has always remained to protect the interests of the mutual fund investors, and to empower investors to take informed investment decisions. For this purpose, the regulations have covered many aspects like investor services, accounting of NAV and valuation norms, disclosures, investment norms, to name a few.

Some of the important provisions of the regulations are discussed below:

SEBI circular on mutual fund scheme categorization and rationalization aimed towards conversion and consolidation of existing schemes and new products. The objective was to reduce the number of schemes to one per category in the open-ended arena, so that investors do not get confused. However, that required consolidation through merger of certain schemes with other schemes. The SEBI regulations and circulars detail the procedure of such scheme mergers, as well as the disclosures of performance of such schemes. The circular on scheme categorization and rationalization, mandated that there can be only one scheme per category within the fund house. Various other provisions such as definition of various categories based on market capitalization were included to bring-in uniformity.

During the 2018 credit crisis, SEBI laid down the provision for creating segregated portfolios for protecting the interests of the unitholders and giving fair treatment to all investors in case of a credit event and to deal with liquidity risk.

Presently, in terms Regulation 32 of SEBI (Mutual Funds) Regulations, 1996 ("MF Regulations") and SEBI Circular no. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, every close-ended scheme and units of segregated portfolio shall be listed on recognized stock exchanges. As per MF Regulations, there are several steps envisaged with respect to winding up of Mutual Fund schemes before the scheme ceases to exist. During this process, such units can be listed and traded on a recognized stock exchange, which may provide an exit to investors.

The units of mutual fund schemes which are in the process of winding-up (due to any event which, in the opinion of the trustees, requires the scheme to be wound up) then those schemes have to be listed on recognized stock exchange. However, pursuant to listing, trading on stock exchange mechanism will not be mandatory for investors, rather, if they so desire, may avail an optional channel to exit provided to them. Initially, trading in units of such a listed scheme that is under the process of winding up, shall be in dematerialised form.

In the year 2008, when there was global liquidity crisis, SEBI brought many reforms such as allowing premature redemption in case of FMPs, disallowing the phrase "liquid plus" while naming mutual fund schemes.

SEBI also mandated that the scheme performance should be compared with the total return index, as against the price return index. A Price Return Index considers only the price movement of its constituents and thus captures only the capital gains of the constituents. On the other hand, a Total Returns index takes into account all dividends/ interest payments that are generated from the basket of components that make up the index in addition to the capital gains. The cash flows are presumed to be notionally reinvested on their ex-date into the basket of underlying components that make up the index. A Mutual Fund scheme takes into consideration, capital gains as well as the dividend earnings / interest income of the instruments in which it has invested while calculating the return generated by the scheme. TRI is more appropriate as a benchmark to compare the performance of mutual fund schemes. Therefore, SEBI stipulated that all Mutual Fund Schemes be benchmarked against Total Return Indices from February 01, 2018 onwards

SEBI regulations and circulars also mandate exposure limits for investments by mutual fund schemes to ensure that investors get a diversified portfolio and the schemes remain true-to-label.

The advertisements, valuation of securities, calculation of NAV – each of these aspects are very tightly regulated. Such approach ensures that the Indian mutual fund industry remains one of the most regulated and transparent investment options for investors.

10.1.2 Mutual Funds Regulations

The applicable guidelines for mutual funds are set out in SEBI (Mutual Funds) Regulations, 1996, as amended from time to time. Some aspects of these regulations are discussed in various sections of this workbook. An updated and comprehensive list of circulars issued by SEBI can be found in the Mutual Funds section of SEBI's website: www.sebi.gov.in. Master Circulars, which capture the essence of various circulars issued from time to time, may be downloaded from www.sebi.gov.in.[61]

Wherever applicable, mutual funds need to comply with regulations issued by other regulators also. For instance, RBI regulates the money market and foreign exchange market in the country. Therefore, mutual funds need to comply with RBI's regulations regarding investment in the money market, investments outside the country, investments from people other than Indians resident in India, remittances (inward and outward) of foreign currency etc.

Stock Exchanges are regulated by SEBI. Every stock exchange has its own listing, trading and margining rules. Mutual Funds need to comply with the rules of the exchanges with which

[61] Candidates are advised to read the SEBI master circular on mutual funds issued from time to time along with other circulars issued by SEBI.

they choose to have a business relationship i.e. for listing the units of the mutual fund schemes launched by them.

10.1.3 Investment restrictions and portfolio diversification norms for mutual fund schemes

Mutual fund is a managed investment vehicle. It is a pass-through vehicle—in that the risks and the returns are passed on to the unitholders. The investors have no control, over the investment management of the mutual fund. It is in this context that SEBI has laid down regulations pertaining to investment universe, restrictions and portfolio diversification for investment by mutual fund schemes. Such regulations intend to control the risks taken by the mutual fund managers.

The SEBI Regulations provide for various limits to the kind of investments that are possible in mutual fund schemes. In few cases, there are also aggregate limits for all schemes of a mutual fund. The regulator’s objective behind setting these limits is to ensure mitigation of risks in the scheme and protecting the investor’s interests. The restrictions specified apply at the time of making the investment. Some of the important restrictions specified are:

- The Mutual Fund will buy and sell securities on delivery basis. Securities purchased will be transferred in the name of the Mutual Fund on account of the respective scheme.
- The Mutual Fund shall not advance any loans.
- The scheme will not invest in the unlisted or privately placed securities of any associate or group company of the sponsor.

10.1.4 SEBI Advertisement Code for Mutual Funds

The important provisions pertaining to SEBI’s Advertising Code for mutual funds (MFs) are listed below:

- Advertisements shall be accurate, true, fair, clear, complete, unambiguous and concise.

- Advertisements shall not contain statements that are false, misleading, biased or deceptive, based on assumption/projections and shall not contain any testimonials or any ranking based on any criteria.

- Advertisements shall not be so designed as likely to be misunderstood or likely to disguise the significance of any statement. Advertisements shall not contain statements that directly or by implication or by omission may mislead the investor.

- Advertisements shall not carry any slogan that is exaggerated or unwarranted or slogan that is inconsistent with or unrelated to nature and risk and return profile of the product.

- No celebrities shall form part of the advertisement.

- Advertisements shall not be so framed as to exploit the lack of experience or knowledge of the investors. Extensive use of technical or legal terminology or complexlanguage and the inclusion of excessive details which may detract the investors shouldbe avoided.

- Advertisements shall contain information that is timely and consistent with the disclosures made in the Scheme Information Document, Statement of Additional Information and the Key Information Memorandum.

- No advertisement shall directly or indirectly discredit other advertisements or make unfair comparisons.

- Advertisements shall be accompanied by a standard warning in legible fonts which states 'Mutual Fund investments are subject to market risks, read all scheme related documents carefully.' No addition or deletion of words shall be made to the standard warning.

- Advertisements in vernacular language(s) shall contain the standard warning as specified in previous clause in the vernacular language.

- In audio-visual media-based advertisements, the standard warning in visual and accompanying voice-over reiteration shall be audible in a clear and understandable manner. For example, in standard warning, both the visual and the voice-over reiteration containing 14 words running for at least 5 seconds may be considered as clear and understandable. Advertisement issued by mutual funds shall be in terms of Sixth Scheduleof SEBI (Mutual Fund) Regulations, 1996. In addition to the provisions of the SixthSchedule, mutual funds shall comply with the following:[19]

- While advertising pay out of dividends, all advertisements shall disclose the dividends declared or paid in rupees per unit along with the face value of each unit of that scheme and the prevailing NAV at the time of declaration of the dividend. Further, for pay out of dividends at maturity of closed-ended scheme(s)/ at completion of the interval period of interval scheme(s), AMC shall advertise that "the entire distributablesurplus at the time of maturity or at the completion of the interval period shall be distributed."

- In case of Overnight funds, Liquid funds and Money Market funds, wherein investors have very short investment horizon, the performance can be advertised by simple annualisation of yields if a performance figure is available for at least 7 days, 15 days and 30 days provided it does not reflect an unrealistic or misleading picture of the performance or future performance of the scheme.

Advertisement Guidelines for Mutual Funds[62]

Disclosing performance-related information of mutual fund schemes:

- When the mutual fund scheme has been in existence for more than three years:
    - Performance advertisement of mutual fund schemes shall be provided in terms of CAGR for the past 1 year, 3 years, 5 years and since inception.[63]
    - Point-to-point returns on a standard investment of Rs. 10,000 shall also be shown in addition to CAGR for the scheme to provide ease of understanding to retail investors.
    - It should be clearly mentioned whether the disclosed performance is of regular or direct plan of the Mutual Fund. A footnote should clearly mention that different plans have different expense structures.
    - If the same fund manager has not managed the scheme for the full period for which the information is being published in the advertisement, the same should be disclosed in the footnote.
- Where the scheme has been in existence for less than six months past performance shall not be provided. Further, if the scheme has been in existence for more than six months but less than one year, then simple annualized growth rate of the scheme forthe past 6 months from the last day of month-end preceding the date of advertisement shall be provided.
- In the case of money market schemes or cash and liquid schemes, wherein investors have very short investment horizon, the performance can be

[62] Vide SEBI Circular: CIR/IMD/DF/23/2017 dated March 15, 2017 (https://www.sebi.gov.in/legal/circulars/mar-2017/review-of-advertisement-guidelines-for-mutual-funds_34367.html)

[63] To disclose the performance of mutual fund schemes since inception, SEBI has clarified that such disclosure of performance shall be made since the date of allotment of units in the scheme.

advertised by simple annualization of yields if a performance figure is available for at least 7 days, 15 days and 30 days. Further, it should not give an unrealistic or misleading picture about the performance or future performance of the scheme.

- For the sake of standardization, a similar return in INR and by way of CAGR must be shown for the following apart from the scheme benchmarks:

Scheme Type	Benchmark
Equity scheme	Sensex/Nifty
All Debt Schemes having duration /maturity upto 1year and Arbitrage Funds	1 year T-Bill
All Debt Schemes which are not coveredin Point 2	10 years dated GoI security
Conservative Hybrid Fund	10 years dated GoI security
Balanced Hybrid Fund / Aggressive Hybrid Fund / Dynamic Asset Allocation or Balanced Advantage / Multi Asset Allocation	Sensex or Nifty
Equity Savings	10 years dated GoI security
Retirement Fund / Children's Fund	Sensex or Nifty
Index Funds / ETFs & FoFs (Overseas/ Domestic)	Appropriate benchmark based on the underlying asset allocation as per above

These disclosures shall form part of the Statement of Additional Information and all advertisements of Mutual Funds.

- When the performance of a particular mutual fund scheme is advertised, the advertisement shall also include the performance data of all the other schemes managed by the fund managers of that particular scheme. Such performance data of the other schemes managed by the fund manager shall be provided as follows:

- Performance of other schemes managed by the fund manager, along with their respective scheme's benchmark, shall be provided in terms of CAGR for a period of 1 year, 3 years and 5 years.

- In case the number of schemes managed by a fund manager is more than six, thenthe AMC may disclose the total number of schemes managed by that fund manager along with the performance data of top 3 and bottom 3 schemes (in addition to the performance data of the scheme for which the advertisement is being made) managed by that fund manager in all performance-related advertisements. However, in such cases, AMCs shall ensure that a true and fair view of the performance of the fund manager is communicated by providing additional disclosures if required.

- If a mutual fund scheme has not been managed by the same fund manager for thefull period of information being published in the advertisement, the same shouldbe disclosed in a footnote.

- Further, for the advertisement published in internet-enabled media, mutual fundsshall be permitted to provide an exact website link to such summarized information of the performance of other schemes managed by the concerned fund manager.

Celebrity endorsements of Mutual Funds at industry level:

- SEBI has permitted celebrity endorsements at the industry level for the purpose of increasing awareness of Mutual Funds as a financial product category. However, such celebrity endorsements of Mutual Funds at industry level are subject to the following conditions:

  - The celebrity endorsements shall not promote a scheme of a particular Mutual Fund or be used as a branding exercise of a Mutual Fund house/AMC.

  - Expenses towards such celebrity endorsements shall be limited to the amounts that are aggregated by Mutual Funds at industry level for the purpose of conducting investor education and awareness initiatives.

  - Prior approval of SEBI shall be required for issuance of any endorsement of Mutual Funds as a financial product, which features a celebrity for the purpose of increasing awareness of Mutual Funds.

SEBI Guidelines for Circulation of Unauthenticated News

SEBI has issued guidelines to all market intermediaries relating to the circulation of unauthenticated news through various modes of communication. Following are the guidelines stipulated by SEBI:

- Proper internal code of conduct and controls should be put in place by market intermediaries registered with SEBI. Employees/temporary staff/voluntary workers etc. employed/working in the offices of market intermediaries should not encourage or circulate rumors or unverified information obtained from client, industry, any tradeor any other sources without verification.

- Access to Blogs/Chat forums/Messenger sites etc. should either be restricted or undersupervision or access should not be allowed.

- Logs for any usage of such Blogs/Chat forums/Messenger sites (called by any nomenclature) have to be treated as records and the same should be maintained as specified by the respective Regulations which govern the concerned intermediary.

- Employees should be directed that any market related news received by them either in their official mail/personal mail/blog or in any other manner, should be forwarded only after the same has been seen and approved by the concerned Intermediary's Compliance Officer. If an employee fails to do so, he/she shall be deemed to have violated the various provisions contained in SEBI Act/Rules/Regulations etc. and shallbe liable for action. The Compliance Officer shall also be held liable for breach of dutyin this regard.

10.1.5 Investors' Rights & Obligations

Mutual fund investors are entitled to some important rights which are meant to protect the investments and bring more transparency to the mutual fund investors. These rights are bifurcated into two parts—AMC related rights and Fund related rights. Some of these rights have been discussed below.

Right to beneficial ownership

Unit-holders have proportionate right to the beneficial ownership of the assets of the scheme. Investor can ask for a Unit Certificate for his Unit-holding. Investors also have the option to receive allotment of mutual fund units of open ended and closed end schemes in their demat account. The mutual fund/AMC is bound to co-ordinate with the RTA and

Depository to facilitate this.[64] Units of all mutual fund schemes held in dematerialised form are freely transferable.[65]

Right to change the distributor

Investors can choose to change their distributor or opt for direct investing. This needs to be done through a written request by the investor. In such cases, AMCs will need to comply, without insisting on any kind of 'No Objection Certificate' from the existing distributor.

Right to Inspect documents

Unit-holders have the right to inspect key documents such as the Trust Deed, Investment Management Agreement, Custodial Services Agreement, RTA agreement and Memorandum & Articles of Association of the AMC.

Right to appoint nominees

The investors can appoint upto 10 nominees, who will be entitled to the 'Units' in the event of the demise of the investors. The investor can also specify the percentage distribution between the nominees. If no distribution is indicated, then an equal distribution between the nominees will be presumed.

Right to pledge mutual fund units

Investors can pledge their mutual fund units. This is normally done to offer security to a financier.

Right to grievance redressal

There is a formal grievance redressal policy for investors. SEBI has mandated that the status of complaints redressed should be published by each AMC in their annual report. The same should be available on the website of the mutual fund and on AMFI's website. It should provide the status of the number of complaints received by the AMC, the time taken to resolve the complaints and the status of pending complaints.

The scheme related documents also have details of the number of complaints received and their disposal. Pending investor complaints can be a ground for SEBI to refuse permission to the AMC to launch new schemes.

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[64] In the case of unit-holding in demat form, the demat statement given by the Depository Participant would be treated as compliance with the requirement of Statement of Account.

[65] However, in case of Equity Linked Savings Scheme (ELSS), free transferability of units (whether in demat or physical form) is curtailed for the statutory minimum holding period.

Rights of investors in context of change in Fundamental Attributes

If there is a change in the fundamental attributes of a mutual fund scheme, then the unitholders are provided the option to exit at the prevailing NAV without any exit load. This exit window has to be open for the time stipulated by SEBI. The Trustees/AMC have to send a written communication about the change in fundamental attributes of a scheme to all the unit holders and have to advertise about the change in fundamental attribute in an English daily newspaper having nationwide circulation and in a newspaper published in the language of the region where the head office of the mutual fund is located.

Rights to terminate appointment of an AMCs

75 percent of unit holders can terminate the appointment of an AMC. Also, 75 percent of the unitholders (unitholding) can pass a resolution to wind up a scheme. The Trustees are bound to obtain consent of the unit-holders:

- Whenever required to do so by SEBI, in the interest of the unit-holders.
- Whenever required to do so by 75 percent of the unit-holders (in practice, Unit-holding) of the scheme.
- When the majority of the trustees decide to wind-up a scheme or prematurely redeem the units of a close ended scheme.

If an investor feels that the trustees have not fulfilled their obligations, then he can file a suit against the trustees for breach of trust. Under the law, a trust is a notional entity, therefore investors cannot sue the trust but they can file suits against trustees.

Right to unclaimed amounts[66]

AMC is expected to make a continuous effort to remind the investors through letters to claim their dues. The Annual Report has to mention the unclaimed amount and the number of such investors for each scheme. Recovery of unclaimed amounts by the investors is as follows:

- If the investor claims the money within 3 years, then payment is based on prevailing NAV i.e. after adding the income earned on the unclaimed money.
- If the investor claims the money after 3 years, then payment is based on the NAV at the end of 3 years.

Investors also have rights to various services such as receiving account statements,

[66] The mutual fund has to deploy unclaimed dividend and redemption amounts in the money market and in a separate plan of Liquid scheme floated by mutual funds especially for investing the unclaimed amounts. AMC can recover investment management and advisory fees on management of these unclaimed amounts, at a maximum rate of 0.50 percent per annum and there shall be no exit loads charged on this plan.

statements of portfolios, half-yearly disclosures etc. To enhance transparency, SEBI has mandated mutual funds to disclose details of debt and money market securities transacted in their schemes portfolio, including inter-scheme transfers, on a daily basis with a time lag of 15 days in a prescribed format.

Proceeds of Illiquid Securities

It is possible that security was treated as wholly or partly non-recoverable at the time of maturity or winding up of a scheme. The security may subsequently yield a higher amount to the scheme. Treatment of such excess is as follows:

- If the amounts are substantial and recovered within 2 years, then the amount is to be paid to the old investors
- In other cases, the amount is to be transferred to the Investor Education Fundmaintained by each mutual fund

10.2 Investor Grievance Redressal

In the event of any issue with the AMC or mutual fund scheme, the investor can first approach the investor service centre. If the issue is not redressed, even after taking it up at senior levels in the AMC, then the investor can write to SEBI with the details.[67]

SEBI Complaint Redress System (SCORES)

SCORES— SEBI Complaint Redress System is a web based centralized grievance redress system of SEBI. SCORES enables investors to lodge and follow up their complaints and track the status of redressal of such complaints online from the website (https://scores.sebi.gov.in/) from any location. This enables the market intermediaries and listed companies to receive the complaints online from investors, redress such complaints and report redressal online. All the activities starting from lodging of a complaint till its closure by SEBI is online and works in an automated environment. An investor, who is not familiar with SCORES or does not have access to SCORES, can lodge complaints in physical form at any of the offices of SEBI. Such complaints are scanned and then uploaded in SCORES for processing

Entities against which complaints are handled by SEBI include:

- Listed companies / registrar & transfer agents
- Brokers / stock exchanges

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[67] The principle of *caveat emptor* (let the buyer beware) applies to mutual fund investments. So, the unit-holder cannot seek legal protection on the grounds of not being aware, especially when it comes to the provisions of law, and matters fairly and transparently stated in the -Scheme Documents. Unit-holders have a right to proceed against the AMC or trustees in certain cases. However, a proposed investor i.e. someone who has not invested in the scheme does not have the same rights.

- Depository participants / depository
- Mutual funds
- Portfolio Managers
- Other entities (KYC Collective investment scheme, Merchant banker, Credit rating, Foreign institutional investor etc.)

Securities and Exchange Board of India ('SEBI') has introduced an Online Dispute Resolution Portal (ODR Portal), a platform for resolution of disputes arising in the Indian Securities Market with Market participant including Mutual Funds.

ODR Portal named SMART ODR Portal – 'Securities Market Approach for Resolution Through ODR' is being made available for investors on https://smartodr.in/login.

The ODR portal offers a platform to investors to file any complaints in case the investor is not satisfied with the resolution of the complaints raised directly with the Asset Management Company or through the SCORES platform of SEBI. Investors can raise the dispute resolution process through the ODR portal only when within the applicable law of limitation and when it is not under consideration under SCORES guidelines or not pending before any court.

10.3 AMFI Code of Conduct for Intermediaries

10.3.1 AMFI Code of Ethics (ACE)

One of the objectives of the Association of Mutual Funds in India (AMFI) is to promote the investors' interest by defining and maintaining high ethical and professional standards in the mutual fund industry. The AMFI Code of Ethics (ACE) sets out the standards of good practices to be followed by the Asset Management Companies in their operations and in their dealings with investors, intermediaries and the public.

SEBI (Mutual Funds) Regulation, 1996 requires all Asset Management Companies and Trustees to abide by the Code of Conduct as specified in the Fifth Schedule to the Regulation. The AMFI Code has been drawn up to supplement that schedule, to encourage standards higher than those prescribed by the Regulations for the benefit of investors in the mutual fund industry.

While the SEBI Code of Conduct lays down broad principles, the AMFI Code of Ethics (ACE) sets more explicit standards for AMCs and Trustees.

AMFI Code of Ethics

1.0 INTEGRITY

1.1 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.

1.2 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
- brokers and other market intermediaries
- associates of the Members
- a special class selected from out of unitholders

2.0 DUE DILIGENCE

2.1 Members in the conduct of their Asset Management business shall at all times

- render high standards of service.
- exercise due diligence.
- exercise independent professional judgment.

2.2 Members shall have and employ effectively adequate resources and procedures which are needed for the conduct of Asset Management activities.

3.0 DISCLOSURES

3.1 Members shall ensure timely dissemination to all unitholders of adequate, accurate, and explicit information presented in a simple language about the investment objectives, investment policies, financial position and general affairs of the scheme.

3.2 Members shall disclose to unitholders investment pattern, portfolio details, ratios of expenses to net assets and total income and portfolio turnover wherever applicable in respect of schemes on annual basis.

3.3 Members shall in respect of transactions of purchase and sale of securities entered into with any of their associates or any significant unitholder.

- submit to the Board of Trustees details of such transactions, justifying its fairness to the scheme.
- disclose to the unitholders details of the transaction in brief through annual and half yearly reports.

3.4 All transactions of purchase and sale of securities by key personnel who are directly involved in investment operations shall be disclosed to the compliance officer of the member at least on half yearly basis and subsequently reported to the Board of Trustees if found having conflict of interest with the transactions of the fund.

4.0 PROFESSIONAL SELLING PRACTICES

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

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

4.3 Members shall endeavour to ensure that at all times

- investors are provided with true and adequate information without any misleading or exaggerated claims to investors about their capability to render certain services or their achievements in regard to services rendered to other clients,
- investors are made aware of attendant risks in members' schemes before any investment decision is made by the investors,
- copies of prospectus, memoranda and related literature is made available to investors on request,
- adequate steps are taken for fair allotment of mutual fund units and refund of application moneys without delay and within the prescribed time limits and,
- complaints from investors are fairly and expeditiously dealt with.

4.4 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 SID, 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 risks of any scheme being offered by the Members.
- not induce investors by offering benefits which are extraneous to the scheme.
- 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.

5.0 INVESTMENT PRACTICES

5.1 Members shall manage all the schemes in accordance with the fundamental investment objectives and investment policies stated in the SID and take investment decisions solely in the interest of the unit-holders.

5.2 Members shall not knowingly buy or sell securities for any of their schemes from or to

- any director, officer, or employee of the member
- any trustee or any director, officer, or employee of the Trustee Company

6.0 OPERATIONS

6.1 Members shall avoid conflicts of interest in managing the affairs of the schemes and shall keep the interest of all unit-holder's paramount in all matters relating to the scheme.

6.2 Members or any of their directors, officers or employees shall not indulge in front running (buying or selling of any securities ahead of transaction of the fund, with access to information regarding the transaction which is not public and which is material to making an investment decision, so as to derive unfair advantage).

6.3 Members or any of their directors, officers or employees shall not indulge in self-dealing (using their position to engage in transactions with the fund by which they benefit unfairly at the expense of the fund and the unit-holders).

6.4 Members shall not engage in any act, practice or course of business in connection with the purchase or sale, directly or indirectly, of any security held or to be acquired by any scheme managed by the Members, and in purchase, sale and redemption of units of schemes managed by the Members, which is fraudulent, deceptive or manipulative.

6.5 Members shall not, in respect of any securities, be party to-

- creating a false market,
- price rigging or manipulation
- passing of price sensitive information to brokers, Members of stock exchanges and other players in the capital markets or take action which is unethical or unfair to investors.

6.6 Employees, officers and directors of the Members shall not work as agents/ brokers for selling of the schemes of the Members, except in their capacity as employees of the Member or the Trustee Company.

6.7 Members shall not make any change in the fundamental attributes of a scheme, without the prior approval of unitholders except when such change is consequent on changes in the regulations.

6.8 Members shall avoid excessive concentration of business with any broking firm, and excessive holding of units in a scheme by few persons or entities.

7.0 REPORTING PRACTICES

7.1 Members shall follow comparable and standardized valuation policies in accordance with the SEBI Mutual Fund Regulations.

7.2 Members shall follow uniform performance reporting on the basis of total return.

7.3 Members shall ensure scheme-wise segregation of cash and securities accounts.

8.0 UNFAIR COMPETITION

Members shall not make any statement or become privy to any act, practice or competition, which is likely to be harmful to the interests of other Members or is likely to place other Members in a disadvantageous position in relation to a market player or investors, while competing for investible funds.

9.0 OBSERVANCE OF STATUTES, RULES AND REGULATIONS

Members shall abide by the letter and spirit of the provisions of the Statutes, Rules and Regulations which may be applicable and relevant to the activities carried on by the Members.

10.0 ENFORCEMENT

Members shall:

- widely disseminate the AMFI Code to all persons and entities covered by it
- make observance of the Code a condition of employment
- make violation of the provisions of the code, a ground for revocation of contractual arrangement without redress and a cause for disciplinary action
- require that each officer and employee of the Member sign a statement that he/she has received and read a copy of the Code
- establish internal controls and compliance mechanisms, including assigning supervisory responsibility
- designate one person with primary responsibility for exercising compliance with power to fully investigate all possible violations and report to competent authority
- file regular reports to the Trustees on a half yearly and annual basis regarding observance of the Code and special reports as circumstances require

- maintain records of all activities and transactions for at least three years, which records shall be subject to review by the Trustees

- dedicate adequate resources to carrying out the provisions of the Code

11.0 DEFINITIONS

When used in this code, unless the context otherwise requires

(a) AMFI

"AMFI" means the Association of Mutual Funds in India

(b) Associate

"Associate" means and includes an 'associate' as defined in regulation 2(c) of SEBI (Mutual Fund) Regulations 1996.

(c) Fundamental investment policies

The "fundamental investment policies" of a scheme managed by a member means the investment objectives, policies, and terms of the scheme, that are considered fundamental attributes of the scheme and on the basis of which unitholders have invested in the scheme.

(d) Member

A "member" means the member of the Association of Mutual Funds in India.

(e) SEBI

"SEBI" means Securities and Exchange Board of India.

(f) Significant Unit holder

A "Significant Unit holder" means any entity holding 5 percent or more of the total corpus of any scheme managed by the member and includes all entities directly or indirectly controlled by such a unit holder.

(g) Trustee

A "trustee" means a member of the Board of Trustees or a director of the Trustee Company.

(h) Trustee Company

A "Trustee Company" is a company incorporated as a Trustee Company and set up for the purpose of managing a mutual fund.

10.3.2 AMFI's Code of Conduct for Intermediaries of Mutual Funds

AMFI has also framed a set of guidelines and code of conduct for intermediaries (known as AMFI Guidelines & Norms for Intermediaries (AGNI), consisting of individual agents, brokers, distribution houses and banks engaged in selling of mutual fund products.

In the event of breach of the Code of Conduct by an intermediary, the following sequence of steps is initiated by AMFI:

- Write to the intermediary (enclosing copies of the complaint and other documentary evidence) and ask for an explanation within 3 weeks.
- In case explanation is not received within 3 weeks, or if the explanation is not satisfactory, AMFI will issue a warning letter indicating that any subsequent violation will result in cancellation of AMFI registration.
- If there is a proven second violation by the intermediary, the registration will be cancelled, and intimation sent to all AMCs.

The intermediary has a right of appeal to AMFI.

AMFI's Code of Conduct for Intermediaries of Mutual Funds

Consider investor's interest as paramount and take necessary steps to ensure that the investor's interest is protected in all circumstances.

Adhere to SEBI Mutual Fund Regulations and guidelines issued from time to time related to distributors, selling, distribution and advertising practices. Be fully conversant with the key provisions of the Scheme Information Document (SID), Statement of Additional Information (SAI) and Key Information Memorandum (KIM) as well as the operational requirements of various schemes.

Comply with SEBI guidelines/requirements issued from time to time in preparation of sales, promotional or any other literature about any schemes. Performance disclosures should also comply with the requirements specified by SEBI. Provide full and latest information of schemes to investors in the form of SAI, SID, addenda, performance reports, fact sheets, portfolio disclosures and brochures; and recommend schemes appropriate for the investor's risk profile and needs.

Highlight risk factors of each scheme, desist from misrepresentation and exaggeration and urge investors to go through SAI/SID/KIM before deciding to make investments.

Disclose to the investors all material information including all the commissions (in the form of trail or any other mode) received for the different competing schemes of various Mutual Funds from amongst which the scheme is being recommended to the investors.

Abstain from indicating or assuring returns in any type of scheme, unless the SID is explicit in this regard.

Maintain necessary infrastructure to support the AMCs in maintaining high service standards to investors, and ensure that critical operations such as forwarding forms and cheques to AMCs/registrars and despatch of statement of account and redemption cheques to investors are done within the time frame prescribed in the SID/SAI and SEBI Mutual Fund Regulations.

Do not collude with investors in faulty business practices such as bouncing of cheques, wrong claiming of dividend/redemption cheques, splitting of applications in the schemes to circumvent regulations for any benefit, etc.

Do not undertake commission driven malpractices such as:

a. recommending inappropriate products solely because the intermediary is getting higher commissions there from.

b. encouraging over transacting and churning of Mutual Fund investments to earn higher commissions.

c. splitting of applications to earn higher transaction charges / commissions.[68]

Abstain from making negative statements about any AMC or scheme and ensure that comparisons, if any, are made with similar and comparable products along with complete facts.

Intermediaries shall keep themselves abreast with the developments relating to the Mutual Fund Industry as also changes in the scheme information and information on mutual fund / AMC like changes in fundamental attributes, changes in controlling interest, loads, liquidity provisions, and other material aspects and deal with the investors appropriately having regard to the up to date information.

Maintain confidentiality of all investor details, deals and transactions.

Intermediaries shall keep investor's interest and suitability to their financial needs as paramount and that extra commission or incentive should never form the basis for recommending a scheme to the investor.

Intermediaries shall not rebate commission back to investors and abstain from attracting investors through temptation of rebate/gifts etc.

To protect the investors from potential fraudulent activities, intermediary should take reasonable steps to ensure that the investor's address and contact details filled in the mutual fund application form are investor's own details, and not of any third party. Where the

[68] As per the prevailing regulatory guidelines, distributors are eligible only for Trail commission, the upfront commission or transaction charges have been discontinued: https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

required information is not available in the application form, intermediary should make reasonable efforts to obtain accurate and updated information from the investor. Intermediaries should abstain from filling wrong / incorrect information or information of their own or of their employees, officials or agents as the investor's address and contact details in the application form, even if requested by the investor to do so. Intermediary should abstain from tampering in any way with the application form submitted by the investor, including inserting, deleting or modifying any information in the application form provided by the investor.

Intermediaries including the sales personnel of intermediaries engaged in sales / marketing shall obtain NISM certification and register themselves with AMFI and obtain an Employee Unique Identification Number (EUIN) from AMFI apart from AMFI Registration Number (ARN). The Intermediaries shall ensure that the employees quote the EUIN in the Application Form for investments. The NISM certification and AMFI registration shall be renewed on timely basis. Employees in other functional areas should also be encouraged to obtain the same certification.

Intermediaries shall comply with the Know Your Distributor (KYD) norms issued by AMFI.

Co-operate with and provide support to AMCs, AMFI, competent regulatory authorities, Due Diligence Agencies (as applicable) in relation to the activities of the intermediary or any regulatory requirement and matters connected thereto.

Provide all documents of its investors in terms of the Anti-Money Laundering / Combating Financing of Terrorism requirements, including KYC documents / Power of Attorney / investor's agreement(s), etc. with Intermediaries as may be required by AMCs from time to time.

Be diligent in attesting / certifying investor documents and performing In Person Verification (IPV) of investors for the KYC process in accordance with the guidelines prescribed by AMFI / KYC Registration Agency (KRA) from time to time.

Adhere to AMFI guidelines and Code of Conduct issued from time to time related to distributors, selling, distribution and advertising practices.

Intimate the AMC and AMFI any changes in the intermediary's status, constitution, address, contact details or any other information provided at the time of obtaining AMFI Registration.

Observe high standards of ethics, integrity and fairness in all its dealings with all parties – investors, Mutual Funds/ AMCs, Registrars & Transfer Agents and other intermediaries. Render at all times high standards of service, exercise due diligence, and ensure proper care.

Intermediaries satisfying the criteria specified by SEBI for due diligence exercise, shall maintain the requisite documentation in respect of the "Advisory" or "Execution Only" services provided by them to the investors.

Intermediaries shall refund to AMCs, either by set off against future commissions or payment, all incentives of any nature, including commissions received, that are subject to claw-back as per SEBI regulations or the terms and conditions issued by respective AMC.

In respect of purchases (including switch-in's) into any fund w.e.f January 1, 2013, in the event of any switches from Regular Plan (Broker Plan) to Direct Plan, all upfront commissions paid to distributors shall be liable to complete and / or proportionate claw-back.[69]

Do not indulge in fraudulent or unfair trade practices of any kind while selling units of Schemes of any mutual fund. Selling of units of schemes of any mutual fund by any intermediary directly or indirectly by making false or misleading statement, concealing or omitting material facts of the scheme, concealing the associated risk factors of the schemes or not taking reasonable care to ensure suitability of the scheme to the investor will be construed as fraudulent / unfair trade practice.

[69] As per the prevailing regulatory guidelines, distributors are eligible only for Trail commission, the upfront commission or transaction charges have been discontinued: https://www.sebi.gov.in/legal/circulars/aug-2025/transaction-charges-paid-to-mutual-fund-distributors_95950.html

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