CHAPTER-I
REGULATORY FRAMEWORK AND GROWTH OF MUTUAL FUND INDUSTRY IN INDIA

Investments are a good way to earn income from the accumulated wealth. It is better to start investing at an early stage of life because the saying “the early bird catches the worm” holds true for investment earnings also. The earlier you start the better are the chances of creating large financial wealth, as you get more return for more time on your investments. A strong financial market with broad participation is essential in any economy to provide a conducive environment for investment. India is undoubtedly emerging as the next big investment destination, riding on a high savings and investment rate, as compared to other Asian economies. As per a report authored by PWC “The World in 2050”, the average real GDP growth in India will likely to be in the range of 5.8 per cent between 2007-2050, with per capita income rising to $20,000 from the current $2,932. Over 50 per cent of the population is less than 25 years of age. The proportion of working population likely to increase significantly over the next decade, and it will lead to increase in not only personal income but also the high net worth (HNI) segment, which has sizeable sum to invest. One estimate indicates that there is more than 1, 20,000 millionaires in India and the number is increasing. The household segment, therefore, professes immense scope for attracting investments. India has a strong middle class of 250-300 million, which is expected to double over the not two decades.

The mutual fund sector has come a long way and is today one of the primary movers of the nation’s financial growth. Mutual fund industry has evolved and transformed over the years, maturing with every development that is taking place. India’s first mutual fund was established in 1963, namely, Unit Trust of India (UTI), at the initiative of the Government of India and Reserve Bank of India ‘with a view to encouraging saving and investment and participation in the income, profits and gains accruing to the Corporation from the acquisition, holding, management and disposal of securities. However, the full potential of the sector has not even been scratched as the challenges of the industry offer an unprecedented opportunity for growth.
The mutual fund industry has come a long way from its humble beginnings in 1963 when the Unit Trust of India was formed. The mutual fund has emerged as a tool that allows all types of investors, irrespective of risk profile and return horizon, to participate in the financial markets and benefit from India’s growth story. Since the 1990’s when the mutual fund space opened up to the private sector, the industry has traversed a long path, adapting itself continuously, to the changes that have come along. Growth in Assets Under Management (AUM) experienced has been unprecedented, growing at a CAGR of 28 per cent over the last four years, slowing down only over the last few years, as the fallout of the global economic slowdown and financial crisis. Although investor confidence was significantly eroded and AUMs suffered a dent, the sale of mutual funds has revived over the last few years. This implies regained the confidence of investors, striving to look at alternates’ investment opportunities and any attendant higher returns, though the markets continue to be choppy.

Here in this chapter, an effort has been made to introduce the mutual fund industry in India and for the accomplishment of this objective; this chapter is divided into five sections. **Section I** describes the conceptual framework of mutual funds; **Section II** highlights Industry regulations while **Section III** elaborates the types of mutual fund schemes. **Section IV** presents the journey of mutual funds in India and **Section V** discusses the present status of mutual fund industry in India.

**SECTION-I**

**CONCEPTUAL FRAMEWORK OF MUTUAL FUNDS**

A mutual fund is a trust that pools the savings of a number of investors who share a common financial goal. It is considered the most suitable investment option for the common man as it allows investors to pool their money for a diversified selection of shares/securities, managed by professional and experienced fund managers. It helps to mitigate risks to a large extent by distributing investment across a diverse range of assets. A mutual fund’s portfolio is structured and maintained to match the investment objectives stated in its prospectus. Apart from pooling resources from small investors, they also provide informed decision-making mechanism to them. Thus, they contribute to not only financial sector participation, but also financial inclusion and
thereby enhance market efficiency. Additionally, they contribute to financial stability and help in enhancing market transparency.

Mutual fund units or shares are issued and can typically be purchased or redeemed as needed at the fund’s current Net Asset Value (NAV) per share, which is sometimes expressed as NAVPS. Mutual funds as an intermediation mechanism and product play an important role in India’s financial sector development. Now it is important to understand the meaning of mutual fund. There are number of definitions of mutual funds, few of them are discussed in this study.

**The SEBI (Mutual funds) Regulations 1993** defined a Mutual fund (MF) as a fund established in the form of a trust by a sponsor to raise monies by the Trustees through the sale of units to the public under one or more schemes for investing in securities in accordance with these regulations.

**According to Weston J. Fred and Brigham Eugene F.,** “Mutual Funds are Corporation which accepts dollars from savers and then use these dollars to buy stocks, long-term bonds, and short-term debt instruments issued by the business or government units, these corporation’s pool funds and thus reduces risk by diversification”.

**The V.N.R. Dictionary of Business and Finance** defines mutual fund as “An investment that pools the invested fund of others and invests these funds on their behalf, usually in a specific kind of investment, such as money market instruments, municipal bonds or common stock”.

**Encyclopedia Britannica** gives a comprehensive definition of the concept of mutual funds “A company that invests the funds of its subscribers in diversified securities and in return issues unit representing shares in these holdings. They make a continuous offering of new shares at net asset value (plus a sales charge) and redeem the shares on demand at net asset value, determined daily by the market value of the securities they hold”.

Thus, a mutual fund is a mediator that brings together a group of people and invests their money in stocks, bonds and other securities. Each investor owns shares, which represent a portion of the holdings of the fund. Thus, a mutual fund is one of the most viable investment options for the common man as it offers an opportunity to invest in
a diversified, professionally managed basket of securities at a relatively low cost. Each basket holds certain types of stocks, bonds or a blend of stocks and bonds to combine for one mutual fund portfolio. Since mutual funds can hold hundreds or even thousands of stocks or bonds, they are described as diversified investments.

**MUTUAL FUND MECHANICS**

The working of a mutual fund has been illustrated in the following figure 1.1.

![Figure: 1.1 Mechanics of Mutual Funds](source: Association of Mutual Funds in India (AMFI))

The mutual fund mechanics starts when the Investors with common financial objectives pool their money with the fund manager. The mutual fund issues units to investors in exchange for cash. Investors get mutual fund units on a proportionate basis for the sum contributed to the pool. It is important to know that funds do not issue a predetermined number of units as most companies do; instead, new units are issued as each new investment is made. The money collected from investors is invested in shares, debentures and other securities by the fund manager. The investment pattern depends on the mutual fund’s stated investment objective. The fund manager keeps a constant watch on the financial markets and adjusts the portfolio to achieve the highest returns. The fund manager is responsible for the investment decisions. The fund manager is assisted by the research team, dealers, brokers, and custodians, etc. The research team provides the manager complete...
information on various investment opportunities which are available in the market. The dealers execute the decisions. The fund manager performs the very important task of selecting, investing and monitoring the stocks and bonds.

The primary assets of the fund are the securities in which the fund invests and these securities generate dividends, interest and sale proceeds. At the close of every trading day, a mutual fund takes the market value of all the securities in its portfolio and deducts its expenses, advertising costs, etc. The balance is divided by the number of units owned by the unit holders to arrive at the value of one unit of the mutual fund or the net asset value, or NAV. The returns are passed on to the investors. They get a proportionate share of the fund’s income and losses.

**MUTUAL FUND STRUCTURE IN INDIA**

Akhilesh Gururani, HABSG Consulting, Mumbai described the provisions of the SEBI (MF) Regulations, 1996, pertaining to the structure of Mutual Funds in India. As per the details given by the consultant about the different entities involved in the working of mutual fund are presented as follows:

**Figure: 1.2**

Mutual Fund structure in India

![Diagram of Mutual Fund structure in India](source: Association of Mutual Funds in India (AMFI))
**Unit Holders:** The mutual fund shareholders or owners of mutual funds are called the unit holders, have the right to vote. The voting right includes the right to elect directors during the directorial elections, voting rights to approve the alterations investment advisory contract pertaining to the fund and provide approval for changing investment objectives or policies.

**The Fund Sponsor:** SEBI regulations define Sponsor as any person who either itself or in association with another body corporate establishes a mutual fund. Sponsor sets up a mutual fund to earn money by doing fund management through its subsidiary company which acts as Investment manager of the fund. Largely, a sponsor can be compared with a promoter of a company. Sponsors activities include setting up a Public Trust under Indian Trust Act, 1882 (the mutual fund), appointing trustees to manage the trust with the approval of SEBI, creating an Asset Management Company under Companies Act, 1956 (the Investment Manager) and getting the trust registered with SEBI.

- **Eligibility of Sponsor:** Mutual funds involve managing retail investor’s money and hence, it becomes important to ensure that it is run by entities with capabilities and professional merits. SEBI (Mutual fund) Regulations, 1996 specifies the eligibility criteria as: (i) Sponsor is required to have financial services business experience of at least 5 years and a positive Net worth in all the preceding five years. (ii) Sponsor’s Net worth in the immediately preceding year is required to be more than the capital contribution to AMC. (iii) Sponsor is required to be profit-making in at least three out of the last five years including the last year. (iv) The sponsor must contribute at least 40% of the Net worth of the Asset Management Company. Any entity, which contributes at least 40% to the Net worth of an AMC, is deemed sponsor and therefore is required to fulfill all the requirements given in (i) to (iv).

**Trustees:** The trust is created through a document called the trust deed which is executed by the fund sponsor in favor of the trustees. Trustees manage the trust and are responsible to the investors in the mutual funds. They are the primary guardians of the unit-holders funds and assets. Trustees can be formed in either of the two ways as a Board of Trustees, or as a Trustee Company. The provisions of Indian Trust Act,
1882, govern board of trustees or the Trustee Company. A trustee company is also subject to provisions of Companies Act, 1956.

- **Obligations of trustees:** Trustees ensure that the activities of the mutual fund are in accordance with SEBI (mutual fund) regulations, 1996. They check that the AMC has proper systems and procedures in place. Trustees also make sure that all the other fund constituents are appointed and that proper due diligence is exercised by the AMC in the appointment of constituents and business associates. All schemes floated by the AMC have to be approved by the trustees. Trustees review and ensure that the net worth of the AMC is as per the regulatory norms. They furnish to SEBI, on a half-yearly basis, a report on the activities of AMC.

- **Regulation regarding appointment of trustees:** Sponsor with prior approval of SEBI appoints trustees. There should be at least four members of the board of trustees with at least 2/3rd independent. A trustee of one mutual fund cannot be the trustee of another mutual fund unless he is an independent trustee in both cases and has the approval of both the boards. The trustees are appointed by executing and registering a trust deed under the provisions of Indian Registration Act. This trust deed is also registered with SEBI.

- **Responsibilities of trustees:** The Trustees are required to fulfill several duties and obligations in accordance with SEBI (Mutual Funds) Regulations, 1996 and the Trust Deed constituting the Mutual Fund. These include
  
  - The Trustee and the Asset Management Company entered into an Investment Management Agreement (IMA) with the approval from SEBI.
  
  - The Investment Management Agreement shall contain such clauses as are mentioned in the Fourth Schedule of the SEBI (MFs) Regulations, 1996 and other such clauses as are necessary for making investments.
  
  - The Trustees shall have a right to obtain from the Asset Management Company such information as is considered necessary by the Trustees.
• The Trustee shall ensure before the launch of any scheme that the Asset Management Company possesses/has done the following:

(a) Systems in place for its back office, dealing room and accounting;
(b) Appointed all key personnel including fund manager(s) for the Scheme(s) and submitted their bio-data which shall contain the educational qualifications, past experience in the securities market to SEBI, within 15 days of their appointment;
(c) Appointed Auditors to audit its accounts;
(d) Appointed a Compliance Officer to comply with regulatory requirement and to redress investor grievances;
(e) Appointed Registrars and laid down parameters for their supervision;
(f) Prepared a compliance manual and designed internal control mechanisms including internal audit systems; and
(g) Specified norms for empanelment of brokers and marketing agents.

**Asset Management Company:** The Asset Management Company (AMC) is the Investment Manager of the Trust. The sponsor or the trustees are so authorized by the trust deed, appoints the AMC as the “Investment Manager” of the trust (Mutual Fund) via an agreement called as ‘Investment Management Agreement’. An asset management company is a company registered under the Companies Act, 1956. Sponsor creates the asset management company and this is the entity, which manages the funds of the mutual fund (trust). The mutual fund pays a small fee to the AMC for management of its fund. The AMC acts under the supervision of Trustees and is subject to the regulations of SEBI too.

• **Role of AMC:** The AMC is an operational arm of the mutual fund. AMC is responsible for carrying out all functions related to management of the assets of the trust. The AMC structures various schemes, launches the scheme and mobilizes initial amount, manages the funds and give services to the investors. In fact, AMC is the first major constituent appointed. Later on, AMC solicits the services of other constituents like Registrar, Bankers, Brokers, Auditors, Lawyers, etc and works in close coordination with them.
• **Restrictions on business activities of the Asset Management Company:** In India, the regulator has ensured that an AMC focuses just on its core business and that the activities of AMC’s are not in a conflict of each other. These are ensured through the following restrictions on the business activities of an AMC:

  (a) An AMC shall not undertake any business activity except in the nature of portfolio management services, management, and advisory services to off-shore funds, etc, provided these activities are not in conflict with the activities of the mutual fund,

  (b) An AMC cannot invest in any of its own schemes unless full disclosure of its intention to invest has been made in the offer document, and

  (c) An AMC shall not act as a trustee of any mutual fund

**Registrar and Transfer Agent:** A mutual fund manages the money of many unit-holders across cities and towns of the country. Investor servicing not only becomes important but challenging as well. This would typically include processing investors’ application, recording the details of investors, sending them account statements and other reports on periodical basis, processing dividend payouts, making changes in investor details and keeping investor records updated by adding details of new investors and by removing details of investors who withdraw their funds from the mutual funds. It is very impractical and expensive for any mutual fund to have adequate workforce all over India for this purpose. Instead, they use entities called as Registrars and transfer agents, which generally provide services to many mutual funds. This ensures quality services across all location and keeps the costs lower for the unit-holders.

**Custodian:** Though the securities are bought and held in the name of trustees, they are not kept with them. The responsibility of safe keeping the securities lies with the custodian. Securities, which are in material form, are kept in safe custody of a custodian and securities, which are in “De-Materialized” form, are kept with a Depository participant, who acts on the advice of custodian. Custodian performs a very important back-office operation. They ensure that delivery has been taken of the
securities, which are bought, and that they are transferred in the name of the mutual fund. They also ensure that funds are paid out when securities are bought. Custodians keep the investment account of the mutual fund. They collect and account for the dividends and interest receivables on mutual fund investments. They also keep track of various corporate actions like bonus issue, rights issue, and stock split, buy back offers, open offer, etc. and act on these as per instructions of the Investment Manager.

- **Responsibility of custodian:** the responsibilities of a custodian are: (i) Provide post-trading and custodial services to the Mutual Fund; (ii) Keep securities and other instruments belonging to the Scheme in safe custody; (iii) Ensure smooth inflow/outflow of securities and such other instruments as and when necessary, in the best interests of the unit holders; (iv) Ensure that the benefits due to the holdings of the Mutual Fund are recovered; and (v) Be responsible for loss of or damage to the securities due to negligence on its part or on the part of its approved agents. The Custodian normally charge portfolio fee, transaction fee, and out-of-pocket expenses in accordance with the terms of the Custody Agreement and as per any modification made thereof from time to time.

**Regulation:** Securities and Exchange Board of India (SEBI) is the primary regulator of mutual funds in India. SEBI is also apex regulator of capital markets. Issuance and trading of capital market instruments and the regulation of capital market intermediaries are under the purview of SEBI. Apart from SEBI, mutual funds follow the regulations of other regulators in a limited manner.

- **RBI:** RBI acts as a regulator of sponsors of bank-sponsored mutual funds, especially in case of funds offering guaranteed/assured returns. No mutual fund is allowed to bring out a guaranteed returns scheme without taking approval from RBI.

- **Stock Exchange:** Closed-end funds might list their units on a stock exchange. In such a case, the listings are subject to the listing regulation of stock exchanges. Mutual funds have to sign the listing agreement and abide by its provisions, which primarily deal with periodic notifications and disclosure of information that may impact the trading of listed units.
• **Indian Trusts Act, 1882:** Recall that mutual funds are formed and registered as a public trust under the Indian Trusts Act, 1882. Hence, they have to follow the provisions of the Indian Trusts Act, 1882.

• **Ministry of Finance (MoF):** The finance ministry is the supervisor of both the RBI and SEBI. The MoF is also the appellate authority under SEBI regulations. Aggrieved parties can make appeals to the MoF on the SEBI rulings relating to mutual funds.

**Competitive Edge over Other Investment Options**

As compared to the traditional favored means of investment in India, fixed deposits are a safer option but the fact remains that the advantages that mutual funds offer, far outweigh the disadvantages of the investment. They also tend to offer better returns when compared to many other investments, while offering moderate risk to the investment itself but, the fact remains that the risk is actually mitigated as a result of the age-old saying, “don't put all your eggs in the same basket.” An investment in mutual funds can turn into a very good investment since the returns that it provides can be very good while mitigating losses. Investors also don't need to be experts on the markets since these investments are made with the help of an army of experts who take the best call possible on where to invest. But these are just a few of the advantages of mutual funds. Great as they may be, one thing must always be remembered with mutual funds, and that is that they always carry the element of risk because they are investments that are linked to the markets. The following points answer why mutual funds as an investment option having edge over others:

- **Professional management:** This is one of the main features of any mutual fund. It is not possible for every single investor to be well acquainted with the markets and know how and when to invest in it. This would ideally put an investor at a disadvantage but with mutual funds, this disadvantage is negated by the fact that the people who actually manage the funds are all experts in the industry and are backed by entire teams dedicated to market research. This means that investors can be assured that qualified people are taking all the important calls on where their money is being invested.
- **Instant diversification**: Since one of the primary rules of investment is to diversify portfolios, a mutual fund can be a simple and successful way to accomplish this goal. A mutual fund portfolio combines a variety of stocks, bonds, commodities, and cash. Mutual funds are, by nature, diversified. If one stock or asset goes down, there will be others that compensate for it. This just means that the potential for losses is spread out conservatively.

- **Liquidity**: The mutual fund provides liquidity to their investors as if they ever want to get out of a mutual fund, all they have to do is instruct their broker or financial advisor. They can sell it immediately. Normally, the funds take a day to come back into the account of the investor, but that’s not so bad. Comparatively, individual stocks would take much longer to liquidate.

- **Choice of risk**: Mutual funds also offer a choice of low, medium and high risk funds. These are meant to satiate your appetite for risks. A high risk fund offers the highest returns but the losses will also be high where as a medium risk fund tends to balance risk with return a little better where as low risk funds carry the least risk of losses and, consequently, the least returns of the three too.

- **Tax benefits**: Mutual funds offer the option to invest in them and claim income tax benefits under section 80C of the IT Act. This means that the money invested in mutual funds is exempt from income tax and helps bring the taxable income down.

- **More choice**: With all the mutual fund investors can choose between high, medium and low-risk funds. They can also choose funds based on their need for return. This means that they can either choose a fund where earnings may come over a short period or one where they come over a longer period to ensure that the returns can be en-cashed just in time for a planned expense.

- **Well regulated**: The regulatory authority that oversees mutual funds is Securities and Exchange Board of India (SEBI), which has laid down strict guidelines that mutual fund providers need to follow. This ensures that there is no unfair treatment of investors and tries to ensure that the investment works in favor of both the investor and the mutual fund provider.
• **Low cost of asset management:** This is a particularly interesting feature of mutual funds. Since they acquired the money from a whole bunch of investors, the cost of the services provided, or the asset management, is relatively low.

**Limitations of Mutual Funds:** No doubt there are some benefits to make an investment in the mutual fund, but investors should also be aware of the drawbacks associated with mutual funds. Some of the disadvantages of mutual fund investments are:

• **Dilution:** Although diversification reduces the amount of risk involved in investing in mutual funds, it can also be a disadvantage due to dilution. For example, if a single security held by mutual fund doubles in value, the mutual fund itself would not double in value because that security is only one small part of the fund's holdings. By holding a large number of different investments, mutual funds tend to do neither exceptionally well nor exceptionally poorly.

• **Fees and Expenses:** Most mutual funds charge management and operating fees that pay for the fund's management expenses (usually around 1.0 per cent to 1.5 per cent per year for actively managed funds). In addition, some mutual funds charge high sales commissions, 12b-1 fees, and redemption fees. And some funds buy and trade shares so often that the transaction costs add up significantly. Some of these expenses are charged on an ongoing basis, unlike stock investments, for which a commission is paid only when you buy and sell.

• **Loss of Control:** The managers of mutual funds make all of the decisions about which securities to buy and sell and when to do so. This can make it difficult for the investors when trying to manage their portfolio. For example, the tax consequences of a decision by the manager to buy or sell an asset at a certain time might not be optimal for the mutual fund owner. The potential investor should also remember that he/she trust someone else with his/her money when they invest in a mutual fund.

• **Trading Limitations:** Although mutual funds are highly liquid in general, most mutual funds (called open-ended funds) cannot be bought or sold in the
middle of the trading day. An investor can only buy and sell them at the end of the day after they've calculated the current value of their holdings.

- **Inefficiency of Cash Reserves**: Mutual funds usually maintain large cash reserves as protection against a large number of simultaneous withdrawals. Although this provides investors with liquidity, it means that some of the fund's money is invested in cash instead of assets, which tends to lower the investor's potential return.

- **No intra-day trading on mutual funds**: An investor wants to make a trade on their mutual fund; they'll likely not know what the "NAV" price will be when they lock in the trade. That is because the NAV (Net Asset Value) is settled at the end of each trading day. If they don't lock their trade in before the end of the stock market close, they will receive the NAV as of the close of business the following day. This makes it difficult and/or impossible to capitalize on sudden movements in the market if that is something investor is trying to do.

- **Locked in Clause**: There are two different mutual fund structures - one allows you to go in and out at any time. The other one is locked in for 5-7 years. With this one, if you try to take your money out earlier, you'll get charged for it. Make sure to ask your financial advisor which type you are investing in.

**SECTION-II
REGULATORY FRAMEWORK: CHRONOLOGICAL DEVELOPMENT**

Securities and Exchange Board of India (SEBI) is the Regulatory Authority for the Indian Mutual fund industry. It aims to protect the Interest of Investors and in order to do so; SEBI has consistently introduced several regulatory measures. As the regulator of the Indian capital market, SEBI had framed its first mutual fund regulations in 1993. In these guidelines, SEBI expressed the need for creating a compliance mechanism for the functioning of the mutual fund industry. These regulations were revised and enlarged subsequently in 1996 and framed SEBI (Mutual Funds) Regulations, 1996 which is the principal regulator for the Mutual fund industry in India.
REGARDING FILING FEES: The mutual fund shall pay the minimum filing fee specified to the Board while filing the offer document and shall pay the balance filing fee calculated to the Board within such time as may be specified by the Board.

The asset management company shall not repurchase units of a capital protection oriented scheme before end of the maturity period.

A capital protection oriented scheme may be launched, subject to the following:

(a) The units of the scheme are rated by a registered credit rating agency from the viewpoint of the ability of its portfolio structure to attain protection of the capital invested therein. (b) the scheme is close ended and (c) there is compliance with such other requirements as may be specified by the Board in this behalf.

Filing fees for offer documents @ 0.03 per cent of the amount raised in the new fund offer, subject to a minimum of ₹ one lakh and a maximum of ₹ one crore.

Pending deployment of funds of a scheme in terms of investment objectives of the scheme, a mutual fund may invest them in short term deposits of schedule commercial banks, subject to such guidelines as may be specified by the Board.

A mutual fund may lend and borrow securities in accordance with the framework relating to short selling and securities lending and borrowing specified by the Board.
• **Carry forward transactions:** The funds of a scheme shall not in any manner be used in carry forward transaction.

• **Derivatives transactions:** Provided that a mutual fund may enter into derivatives transactions on a recognized stock exchange, subject to the framework specified by the Board

• **Short selling transactions:** A mutual fund may enter into short selling transactions on a recognized stock exchange, subject to the framework relating to short selling and securities lending and borrowing specified by the Board

• **Investment and advisory fees:** should not exceed three fourths of one percent (0.75%) of the weekly average net assets in case of an index fund scheme and the total expenses of the scheme including the investment and advisory fees should not exceed one and one half percent (1.5%) of the weekly average net assets.

• Every mutual fund should buy and sell securities on the basis of deliveries and in all cases of purchases, take delivery of relevant securities and in all cases of sale, deliver the securities.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (2\textsuperscript{nd} AMENDMENT) REGULATIONS, 2008 (22\textsuperscript{nd} May, 2008)

• The sale of government security already contracted for purchase shall be permitted in accordance with the guidelines issued by the Reserve Bank of India in this regard.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2009 (8\textsuperscript{th} April, 2009)

• The **asset management company** shall obtain prior in-principle approval from the recognized stock exchange(s) where units are proposed to be listed.

• The **offer document** shall contain the disclosure regarding the prior in principle approval obtained from the recognized stock exchange(s), where units are proposed to be listed in accordance with these regulations.
• **Listing of close ended schemes:** 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 the Board.

• The listing of close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be mandatory: If the said scheme provides for periodic repurchase facility to all the unit holders with restriction, if any, on the extent of such repurchase or if the said scheme provides for monthly income or caters to special classes of persons like senior citizens, women, children, widows or physically handicapped or any special class of persons providing for repurchase of units at regular intervals or If the details of such repurchase facility are clearly disclosed in the offer document or If the said scheme opens for repurchase within a period of six months from the closure of subscription or If the said scheme is a capital protection oriented scheme.

• Units of a close ended scheme, other than those of an equity linked savings scheme, launched on or after the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be repurchased before the end of maturity period of such scheme.

• **Statement of accounts or unit certificates:** The asset management company shall issue to the applicant whose application has been accepted, a statement of accounts specifying the number of units allotted to the applicant as soon as possible but not later than thirty days from the date of closure of the initial subscription list and/or from the date of receipt of the request from the unit holders in any open ended scheme.

• If an applicant so desires, the asset management company shall issue the unit certificates to the applicant within thirty days of the receipt of request for the certificate.

• An applicant in a close ended scheme whose application has been accepted shall have the option either to receive the statement of accounts or to hold
units in dematerialized form and the asset management company shall issue to such applicant, a statement of accounts specifying the number of units allotted to the applicant or issue units in dematerialized form as soon as possible but not later than thirty days from the date of closure of the initial subscription list.

- The asset management company shall issue units in dematerialized form to a unit holder in a close ended scheme listed on a recognized stock exchange within two working days of the receipt of request from the unit holder.

- A unit holder, in a close ended scheme listed on a recognized stock exchange, who desires to trade in units, shall hold units in dematerialized form.

**Delisting of units:** The units of a mutual fund scheme shall be delisted from a recognized stock exchange in accordance with the guidelines as may be specified by the Board.

- Provided that the Net Asset Value of a close ended scheme, other than that of equity linked savings scheme, shall be calculated on daily basis and published in at least two daily newspapers having circulation all over India.

- Provided that the repurchase price of the units of close ended scheme launched prior to the commencement of the Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2009 shall not be lower than ninety five per cent of the Net Asset Value.

**SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (2nd AMENDMENT) REGULATIONS, 2009 (5th June, 2009)**

- No mutual fund scheme shall invest more than thirty percent of its net assets in money market instruments of an issuer provided that such limit shall not be applicable for investments in Government securities, treasury bills and collateralized borrowing and lending obligations.

**SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2010 (29th July, 2010)**

The total expenses of the scheme excluding issue or redemption expenses, whether initially borne by the mutual fund or by the asset management company, but including the investment management and advisory fee shall be subject to the following limits:
In case of a fund of funds scheme, the total expenses of the scheme including the management fees shall be either: not exceeding 0.75% of the daily or weekly average net assets, depending upon whether the NAV of the scheme is calculated on daily or weekly basis. Or it may consist of – a) management fees for the scheme not exceeding 0.75% of the daily or weekly average net assets depending upon whether the NAV of the scheme is calculated on daily or weekly basis b) Other expenses relating to administration of the scheme; and c) charges levied by the underlying schemes provided that the sum total of (a), (b) and the weighted average of the total expense ratio of the underlying schemes shall not exceed 2.50% of the daily or weekly average net assets (depending upon whether the NAV of the scheme is calculated on daily or weekly basis) of the scheme.

In case of an index fund scheme or exchange traded fund, the total expenses of the scheme including the investment and advisory fees shall not exceed one and one half percent (1.5%) of the weekly average net assets.

In case of any other scheme: a) on the 100 crores of the daily or average weekly net assets 2.5%; b) on the next Rs.300 crores of the daily or average weekly net assets 2.25%; c) on the next Rs.300 crores of the daily or average weekly net assets 2.0%; d) on the balance of the assets 1.75%.

In respect of a scheme investing in bonds such recurring expenses shall be lesser by at least 0.25% of the daily or weekly average net assets outstanding in each financial year.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2011 (30th August, 2011)

Restrictions on business activities of the asset management company: The asset management company shall not act as a trustee of any mutual fund, not undertake any business activities other than in the nature of management and advisory services provided to pooled assets including offshore funds, insurance funds, pension funds, provident funds, if any of such activities are not in conflict with the activities of the mutual fund.
• It ensures that there is no material conflict of interest across different activities

• the absence of conflict of interest shall be disclosed to the trustees and unit holders in scheme information document and statement of additional information;

• there are unavoidable conflict of interest situations, it shall satisfy itself that disclosures are made of source of conflict, potential ‘material risk or damage’ to investor interests and detailed parameters for the same;

• it appoints separate fund manager for each separate fund managed by it unless the investment objectives and asset allocation are same and the portfolio is replicated across all the funds managed by the fund manager, within a period of six months from the date of notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011;

• it ensures fair treatment of investors across different products that shall include, but not limited to, simultaneous buy and sell in the same equity security only through market mechanism and a written trade order management system; and

• it ensures independence to key personnel handling the relevant conflict of interest is provided through removal of direct link between remuneration to relevant asset management company personnel and revenues generated by that activity:

• the asset management company may, itself or through its subsidiaries, undertake portfolio management services and advisory services for other than broad based fund till further directions, as may be specified by the Board, subject to compliance with the following additional conditions:-

  • it satisfies the Board that key personnel of the asset management company, the system, back office, bank and securities accounts are segregated activity wise and there exist system to prohibit access to inside information of various activities;
- It meets with the capital adequacy requirements, if any, separately for each of such activities and obtains separate approval, if necessary under the relevant regulations.

- The asset management company shall not invest in any of its scheme, unless full disclosure of its intention to invest has been made in the offer documents, in case of schemes launched after the notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011.

- An asset management company shall not be entitled to charge any fee on its investment in that scheme.

- The asset management company shall not carry out its operations including trading desk, unit holder servicing and investment operations outside the territory of India:

  - The asset management company having any of its operations outside India shall wind up and bring them within the territory of India within a period of one year from the date of notification of Securities and Exchange Board of India (Mutual Funds) (Amendment) Regulations, 2011.

  - The Board may grant a further period of one year if it is satisfied that there was sufficient cause for not winding up of the operation outside India within that period.

- The asset management company shall ensure that consolidated account statement for each calendar month is issued, on or before tenth day of succeeding month, detailing all the transactions and holding at the end of the month including transaction charges 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.

- The asset management company shall ensure that a consolidated account statement every half yearly (September/ March) is issued, on or before tenth day of succeeding month, 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.

- The asset management company shall identify common investor across fund houses by their permanent account number for the purposes of sending consolidated account statement.

**Chapter VI -B Infrastructure Debt Fund Schemes** were introduced with complete Definitions, Applicability, Eligibility criteria for launching infrastructure debt fund scheme, Conditions for infrastructure debt fund schemes, Permissible investments, Valuation of assets and declaration of net asset value, Duties of asset management company, Disclosures in offer document and other disclosures and Transactions by employees, etc.

**SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2012 (21st February, 2012)**

- **Advertisement** shall include all forms of communication issued by or on behalf of the asset management company/mutual fund that may influence investment decisions of any investor/prospective investors.

- The asset management company shall compute and carry out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and shall publish the same.

- The asset management company and the sponsor of the mutual fund shall be liable to compensate the affected investors and/or the scheme for any unfair treatment to any investor as a result of inappropriate valuation.

- The asset management company shall report and disclose all the transactions in debt and money market securities, including inter scheme transfers, as may be specified by the Board.

- **Valuation of investments:** Every mutual fund shall ensure that the asset management company computes and carries out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and publishes the same.
• **Action against mutual fund or asset Management Company:** without prejudice to regulation 68, a mutual fund or asset management company shall be liable for action under the applicable provisions of the Act and the Regulations framed thereunder: (a) in case the advertisement issued is in contravention with the Advertisement Code specified in Sixth Schedule; (b) in case the valuation of securities is in contravention of the Principles of Fair Valuation specified in Eighth Schedule.

• **SIXTH SCHEDULE** for the Sixth Schedule, the following schedule shall be substituted, namely:
  
  - Advertisements shall be accurate, true, fair, clear, complete, unambiguous and concise.
  - Advertisements shall not contain statements which 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 which 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 the 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 complex language and the inclusion of excessive details which may detract the investors should be avoided.
  - Advertisements shall contain information which is timely and consistent with the disclosures made in the Scheme Information
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.

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.

- Principles of Fair Valuation: Mutual fund shall value its investments to ensure fair treatment to all investors including existing investors as well as investors seeking to purchase or redeem units of mutual funds in all schemes at all points of time.

SECURITIES AND EXCHANGE BOARD OF INDIA MUTUAL FUNDS (AMENDMENT) REGULATIONS, 2013 (16th April, 2013)

- The infrastructure debt fund schemes may raise monies through private placement of units, subject to the conditions specified in these regulations.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (3rd AMENDMENT) REGULATIONS, 2013

- The asset management company may become a proprietary trading member for carrying out trades in the debt segment of a recognized stock exchange, on behalf of a mutual fund.

- The sponsor or its associates hold 50 per cent or more of the voting rights of the share capital of the custodian, such custodian may act as custodian for a mutual fund constituted by the same sponsor or any of its associates or subsidiary company if: (i) The sponsor has a net worth of at least ₹ twenty thousand crore at all points of time; (ii) 50 per cent or more of the directors of
the custodian are those who do not represent the interest of the sponsor or its associates; (iii) The custodian and the asset management company of a mutual fund are not subsidiaries of each other; (iv) No person is a director of both the custodian and the asset management company of a mutual fund; and (v) The custodian and the asset management company of a mutual fund sign an undertaking that they will act independently of each other in their dealings with the scheme.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2014

- An asset management company of a mutual fund eligible to launch only infrastructure debt fund schemes, shall have a net worth of not less than ₹ ten crore.

- The sponsor or asset management company shall invest not less than one percent of the amount which would be raised in the new fund offer or ₹ fifty lakh, whichever is less, in the growth option of the scheme and such investment shall not be redeemed unless the scheme is wound up and this sub-regulation shall not apply to close ended schemes.

- The amount calculated as per this sub-regulation shall be invested within one year from the date of notification of these regulations.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (2nd AMENDMENT) REGULATIONS, 2014

- Provided that in cases where the Board is satisfied that an asset management company is taking steps to meet the net worth requirement within the specified time, the asset management company may be allowed to launch up to two new schemes per year.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2015

- Foreign Account Tax Compliance Act (FATCA) which came into effect from November 01 2015, an anti-tax evasion law, has led to a few mutual funds to refuse fresh investment from US residents.
• **SEBI on way towards gating guidelines**

SEBI may come out with gating guidelines to restrict redemption in short term debt schemes. SEBI is reviewing exigency clauses of various debt funds and is likely to issue guidelines on these practices in the near future.

• **Building an internal credit risk evaluation capability**

Amidst increasing worries about excessive credit risks, SEBI has intensified its vigilance with increasing incidence of high exposure to some low-quality papers. Fund houses are expected to develop credit rating expertise on their own considering that mutual fund industry had an exposure of ₹ 4000 crore to downgraded paper as on July 2015 which went up to ₹ 13,000 crore in August 2015.

**SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2016**

• A mutual fund scheme shall not invest more than 10% of its NAV in debt instruments comprising money market instruments and non-money market instruments issued by a single issuer which are rated not below investment grade by a credit rating agency authorized to carry out such activity under the Act. Such investment limit may be extended to 12% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of directors of the asset management company provided: a) This limit shall not be applicable for investments in Government Securities, treasury bills and collateralized borrowing and lending obligations. b) The investment within such limit can be made in mortgaged backed securitized debts which are rated not below investment grade by a credit rating agency registered with the Board. c) The schemes already in existence shall within an appropriate time and in the manner, as may be specified by the Board, conform to such limits.

• **Executive compensation linked to fund size:** SEBI recently examined compensation structure of key AMC personnel including fund managers operating from abroad for the last three years to ascertain if the fund houses are over compensating the executives at the expense of fund profitability and
hence investor interests. Although, fund officials believe that compensation levels do not affect investors since the total expense ratio (TER) is regulated by SEBI. If the compensation is regulated as per the fund size or profitability it might affect the growth of smaller AMCs. Any regulation / curb on the ceiling limit of remuneration would adversely affect getting right talent especially for small players and newly floated mutual funds.

SECURITIES AND EXCHANGE BOARD OF INDIA (MUTUAL FUNDS) (AMENDMENT) REGULATIONS, 2017

A mutual fund may invest in the units of REITs and InvITs subject to the following:

(a) No mutual fund under all its schemes shall own more than 10% of units issued by a single issuer of REIT and InvIT and

(b) A mutual fund scheme shall not invest more than 10% of its NAV in the units of REIT and InvIT and more than 5% of its NAV in the units of REIT and InvIT issued by a single issuer.

The limits mentioned above shall not be applicable for investments in case of index fund or sector or industry specific scheme pertaining to REIT and InvIT.”

SECTION-III

TYPES OF MUTUAL FUND SCHEMES

The objectives of mutual funds are to provide continuous liquidity and higher yields with high degree of safety to investors. Based on these objectives, different type of mutual fund schemes have evolved. There are a wide variety of mutual fund schemes that cater to the needs of investors whatever be their age, financial position, risk tolerance and return expectations.

(A) Schemes by Structure (Maturity Period): A mutual fund scheme can be of three types depending on its maturity period.

1) Open Ended Scheme: An open ended scheme/fund is one that is available for subscription and repurchase on a continuous basis. These schemes do not have a fixed maturity period. Investors can conveniently buy and sell units at Net Asset Value (NAV) related price which are declared on a daily basis. The key feature of open ended schemes is liquidity.
2) **Close-ended Scheme**: A close ended scheme/fund has a stipulated maturity period i.e. 5-7 year. The fund is open for subscription only during a specified period at the time of launch of the scheme. Investors can invest in the scheme at the time of the initial public issue and thereafter they can buy or sell the units of the scheme on the stock exchange where the units are listed. In order to provide an exit route to the investors, some close-ended funds given an option of selling back the units to the mutual fund through periodic repurchase at NAV related prices. SEBI regulations stipulates that at least one of the two exist routes is provided to the investors i.e. either repurchase facility or through listing on stock exchanges. These mutual funds schemes disclose NAV generally on weekly basis.

3) **Interval Scheme**: Interval schemes combine the features of open ended and close-ended schemes. They are open for sale or redemption during predetermined intervals at NAV related prices.

**(B) Schemes by Investment Objectives**

A scheme can also be classified considering its investment objective. Such scheme may be open ended or close ended schemes as described earlier. Such schemes may be classified mainly as under:-

1) **Growth/Equity oriented schemes**: The main objective of growth funds is capital appreciation over the medium to long term period. The most of the funds are invested in equity shares with significant growth potential and offer higher return to investors in the long term. These funds assume the risks associated with equity investments. However, there is no guarantee or assurance of returns. These schemes are usually close-ended and listed on stock exchanges. These schemes are ideal for:

   - Investors in their prime earning years
   - Investors seeking growth over the long term

Various mutual fund schemes are presented in the Figure 1.3.
Figure 1.3
Types of Mutual Fund Schemes

MUTUAL FUND SCHEMES

BY STRUCTURE
- Open Ended Schemes
- Close Ended Schemes
- Interval Schemes

BY INVESTMENT OBJECTIVES
- Growth/Equity Oriented Schemes
- Income/Debt Oriented Schemes
- Balanced Schemes
- Money Market/Liquid Schemes

BY GEOGRAPHICAL CLASSIFICATION
- Domestic Funds
- Off Shore Funds

OTHER SCHEMES
- Gilt Funds
- Sector Specific Funds
- Tax Saving Schemes
- Equity Linked Saving Schemes
- Load or No Load Funds
- Special Schemes
- Index Funds
- Exchange Traded Funds
- Funds of Fund
- Fixed Maturity Plans
- Capital Protection Oriented schemes
- Gold Exchange Trade Fund
- Quantitative Funds
2) **Income/Debt Oriented Schemes:** The aim of income funds is to provide regular and steady income to investors. Such schemes generally invest in fixed income securities such as bonds, corporate debenture, etc. Such funds are less risky compared to equity schemes. These funds are not affected because of the fluctuations in equity markets. However, opportunities of capital appreciation are also limited in such funds. The NAV of such funds are affected because of change in interest rate. If the interest rates fall, NAVs of such funds are likely to increase in the short run and vice versa. However, long term investors may not bother about these fluctuations. These schemes are suitable for:

- Retired people and others with a need for capital stability and regular income.
- Investors who need some income to supplement their earnings.

3) **Balanced Schemes:** The aim of balanced fund is to provide both growth and regular income as such schemes invest both in equities and fixed income securities in the proportion indicated in their offer documents. These are appropriate for investors looking for moderate growth. They generally invest 40-60 per cent in equity and debt instruments. These funds are also affected because of the fluctuations in share prices in the stock markets. However, NAVs of such funds are likely to be less volatile compared to pure equity funds. These schemes are ideal for:

- Investors looking for a combination of income and moderate growth.

4) **Money Market/Liquid Schemes:** The main objective of money market/liquid schemes is to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer, short term instruments such as treasury bills, certificates of deposit, commercial paper and interbank call money. Return on these schemes may fluctuate, depending upon the interest rates prevailing in the market. These schemes are performed by:

- Corporate and individual investors as a means to park their surplus funds for short periods or awaiting more favorable investment alternatives.
C) Schemes by Geographical Classification:

A scheme may be classified on the basis of geographical location. Such schemes may be:

1) **Domestic Funds:** Funds which mobilize resources from a particular geographical locality i.e. country of origin are domestic funds. The market is limited and confined to the boundaries of a nation in which the fund operates. They can invest only in the securities which are issued and traded in the domestic financial markets.

2) **Off-Share funds:** Off share funds attract foreign capital for investment in the Country of the issuing Company. They facilitates cross border funds flow which leads to an increase in foreign currency and foreign exchange reserves. Such mutual funds are invested in securities of foreign companies. They open domestic capital market to international investors. Many mutual funds in India have launched a number of off-share funds, either independently or jointly with foreign investment management companies. The first off share fund, the India fund, was launched by UNIT Trust of India in July 1986 in collaboration with the US fund manager, Merril Lynch.

D) Other Schemes:

A good number of other schemes are also available for investors who want to opt mutual fund investments. A variety of schemes catering to various needs of the investors are available and coming in the market to fulfill their needs. Some of the schemes are discussed below:

1) **Gilt Funds:** These funds invest exclusively in government securities as Government securities have no default risk. NAVs of these schemes also fluctuate due to change in interest rates and other economic factor as in the case with income or debt oriented schemes. With a view to creating a wider investor base for government securities, the Reserve Bank of India encouraged setting up of gilt funds. These funds are provided liquidity support by the Reserve Bank.
2) **Sector Specific funds:** These are the funds/schemes which invest in the securities of only those sector or industries as specified in the offer documents e.g. Pharmaceuticals, software, fast moving consumer goods (FMCG), petroleum stocks, etc. The return in these funds is dependent on the performance of the respective sectors/industries. While these funds may give higher returns, they are more risky compared to diversified funds. Investors need to keep a watch on the performance of those sectors/industries and must exit at an appropriate time.

3) **Tax Saving Schemes:** These schemes are designed on the basis of tax policy with special tax incentives to the investors. Mutual funds have introduced a number of tax saving schemes. These are close-ended schemes and investments are made for ten years, although investor can avail of encashment facility after three years. These schemes contain various options like income, growth or capital appreciation. The latest scheme offered is the systematic withdrawal plan (SWP) which enables the investors to reduce their tax incidence on dividends.

4) **Equity Linked Saving Schemes:** In order to encourage investors to invest in equity market the government has given tax-concessions through special schemes. Investment in these schemes entitles the investor to claim an income tax rebate, but these schemes carry a lock-in period before the end of which funds cannot be withdrawn.

5) **Load or No Load Funds:** Mutual funds incur certain expenses such as brokerage, marketing expenses and communication expenses. These expenses are known as ‘load’ and are recovered by the fund when it sells the units to investors or repurchase the units from withholders. In other words, load is a sales charge or commission, assessed by certain mutual funds to cover their selling costs. Loads can be of two types:

   - Front end load or sales load, is a charge collected at the time when an investor enters into the scheme.
   - Back-end load or repurchase load is a charge collected when the investor gets out of the scheme.
Schemes that don’t charge a load are called ‘No-Load’ schemes. In other words, if the asset management company bears the load during the initial launch of the scheme, then these schemes are known as no load schemes. However, these no-load schemes can have an exit load when the unit holder gets out of the scheme before a stipulated period mentioned in the initial offer. This is done to prevent short term investments and redemptions.

6) **Special Schemes:** Mutual funds have launched special scheme to cater to the special needs of investors. UTI has launched special schemes such as children’s Gift Growth Fund 1986, Housing Unit Scheme 1992 and Venture Capital funds. Besides, there are also other schemes which invest exclusively in certain segments of the capital market, such as Large Caps, Mid Caps, Small Caps, Micro Caps, ‘A’ group shares, shares issued through Initial Public Offering (IPOs), etc.

7) **Index Funds:** Index funds replicate the portfolio of a particular index such as the BSE, S&P, and NSE 5 etc. These schemes invest in the securities in the same weight age comprising of an index. NAVs of such schemes would rise or fall in accordance with the rise or fall in the index, though not exactly by the same percentage due to some factors known as “Tracking error” in technical terms. These funds are ideal for investor who is satisfied with a return approximately equal to that of an index.

8) **Exchange Traded Funds (ETFs):** ETFs are essentially index funds that are listed and traded on exchanges like stocks. Globally, ETFs have opened a whole new panorama of investment opportunities to retail as well as institutional investors. ETFs enable investor to gain broad exposure to entire stock markets as well as specific sectors with relative ease, on a real-time basis and at a lower cost than many other forms of investing. An ETF is a basket of stocks that reflects the composition of an index, like S&P, CNX Nifty, BSE SENSEX, CNX Bank Index, CNX PSU Bank Index, etc. The ETF’s trading value is based on the net asset value of the underlying stocks that it represents. It can be compared to a stock that can be bought and sold on real time basis during the market hours. The first ETF in India, Benchmark Nifty BEEs, was
opened for subscription on December 12, 2001 and listed on the NSE on January 8, 2002.

9) **Funds of Funds (FOFs)**: FOFs are schemes that invest in other mutual fund schemes. The portfolio of these schemes comprise only of units of other mutual funds schemes and cash/money market securities/short term deposits pending deployment. The first FOF was launched by Franklin Templeton Mutual Fund on October 17, 2003. Fund of Funds can be sector specific e.g. Real Estate FOFs, Theme Specific e.g. Equity FOFs, objective specific e.g. Life Stages FOFs or Style Specific e.g. Aggressive/Cautions FOFs, etc.

10) **Fixed Maturity Plans (FMPs)**: FMPs are investment schemes floated by mutual funds and are close ended with a fixed tenure, the maturity period ranging from one month to three/five years. These plans are predominantly debt oriented, while some of them may have a small equity component. The objective of such a scheme is to generate steady returns over a fixed maturity period and protect the investor against market fluctuations. FMPs are typically passively managed fixed income schemes with the fund manager locking into investments with maturities corresponding with the maturity of the plan. FMPs are not guaranteed products.

11) **Capital Protection Oriented Schemes**: The schemes that endeavor to protect the capital as the primary objective by investing in high quality fixed income securities and generates capital appreciation by investing in equity/equity related instrument as a secondary objective. The first capital protection oriented fund in India i.e. Franklin Templeton Capital Protection Oriented Fund was opened for subscription on October 31, 2006.

12) **Gold Exchange Traded Funds (GETFs)**: GETFs offer investors an innovative, cost efficient and secure way to access the gold market. Gold ETFs are intended to offer investors a means of participating in gold bullion market by buying and selling units on the stock exchanges, without taking physical delivery of gold. The first gold ETF in India, known as Benchmark GETF was opened for subscription on Feb. 15, 2007 and got listed on the NSE on April 17, 2007.
13) **Quantitative Funds:** A quantitative fund is an investment fund that selects securities based on quantitative analysis. The managers of such funds build compacter-based models to determine whether or not an investment is attractive. In a pure “Quant Shop” the final decision to buy or sell is made by the model. However, there is a middle ground where the fund manager will use human judgment in addition to a quantitative model. The first quant based mutual fund schemes in India was Lotus Agile fund that opened for subscription on October 25, 2007.

**SECTION-IV**

**GROWTH OF MUTUAL FUND INDUSTRY IN INDIA**

In the last few years the MF Industry has grown significantly. The history of Mutual Funds in India can be broadly divided into five distinct phases as explained by the Association of Mutual Funds in India (AMFI) is as under:

**First Phase (1964 to 1987)**

The first phase of mutual fund started with the establishment of Unit Trust of India (UTI) in 1963 by an Act of Parliament. It was set up by the Reserve Bank of India and functioned under the Regulatory and administrative control of the Apex Bank of India till 1978 later on UTI was de-linked from the RBI and the Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The first scheme launched by UTI was Unit Scheme 1964. At the end of 1988 UTI had ₹ 6,700 crores of assets under management.

**Second Phase –Entry of Public Sector Funds (1987 to 1993)**

1987 marked the entry of public sector mutual funds which were set up by public sector banks; Life Insurance Corporation of India (LIC) and General Insurance Corporation of India (GIC). SBI Mutual Fund was the first non-UTI Mutual Fund established in June 1987 followed by Can bank Mutual Fund (Dec 87), Punjab National Bank Mutual Fund (Aug 89), Indian Bank Mutual Fund (Nov 89), Bank of India (Jun 90), Bank of Baroda Mutual Fund (Oct 92). LIC established its mutual fund in June 1989 while GIC had set up its mutual fund in December 1990. At the end of 1993, the mutual fund industry had assets under management of ₹ 47,004 crores.
Third Phase – Entry of Private Sector Funds (1993 to 2003)

A new era started in the Indian mutual fund industry with the entry of private sector funds in 1993, providing the Indian investors a wider choice of fund families. Also, 1993 was the year in which the first Mutual Fund Regulations came into being, under which all mutual funds, except UTI were to be registered and governed. The erstwhile Kothari Pioneer (now merged with Franklin Templeton) was the first private sector mutual fund registered in July 1993.

The 1993 SEBI (Mutual Fund) Regulations were substituted by a more comprehensive and revised Mutual Fund Regulations in 1996. The industry now functions under the SEBI (Mutual Fund) Regulations 1996. As at the end of January 2003, there were 33 mutual funds with total assets of ₹ 1, 21,805 crores. The Unit Trust of India with ₹ 44,541 crores of assets under management was way ahead of other mutual funds.

Fourth Phase (February 2003 to April 2014)

In February 2003, following the repeal of the Unit Trust of India Act 1963 UTI was bifurcated into two separate entities. One is the Specified Undertaking of the Unit Trust of India with assets under management of ₹ 29,835 crores as at the end of January 2003, representing broadly, the assets of US 64 scheme, assured return and certain other schemes. The Specified Undertaking of Unit Trust of India, functioning under an administrator and under the rules framed by Government of India and does not come under the purview of the Mutual Fund Regulations.

The second is the UTI Mutual Fund, sponsored by SBI, PNB, BOB and LIC. It is registered with SEBI and functions under the Mutual Fund Regulations. With the bifurcation of the erstwhile UTI which had in March 2000 more than ₹ 76,000 crores of assets under management and with the setting up of a UTI Mutual Fund, conforming to the SEBI Mutual Fund Regulations, and with recent mergers taking place among different private sector funds, the mutual fund industry has entered its current phase of consolidation and growth. The following figure indicates the growth of assets over the years.
The overall journey of mutual fund in India is depicted in table 1.1:
# Table 1.1
## The Journey of Mutual Funds in India

<table>
<thead>
<tr>
<th>Year</th>
<th>Growth of Mutual Fund Industry in India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1963</td>
<td>• Formation of the unit trust of India</td>
</tr>
<tr>
<td>1964</td>
<td>• Launch of the maiden scheme of UTI- Unit Scheme 1964</td>
</tr>
<tr>
<td>1987</td>
<td>• Entry of public sector funds- SBI Mutual Fund was the first one followed by Canbank Mutual Fund</td>
</tr>
<tr>
<td>1993</td>
<td>• Emergence of private sector funds- Franklin Templeton(erstwhile Kothari Pioneer) was the first of its kind</td>
</tr>
<tr>
<td>1993-2003</td>
<td>• Robust growth and revised mutual fund regulation from SEBI in 1996, entry of foreign funds, several mergers and acquisitions</td>
</tr>
<tr>
<td>2009</td>
<td>• Removal of the entry load</td>
</tr>
</tbody>
</table>
| 2012 | • Single plan structure for mutual funds schemes  
• Cash investment allowed in mutual funds  
• Fungibility of total expense ratio(TER) allowed  
• Portion of TER to be used for investors education  
• Entire exit load to be credited to the scheme  
• Launch of Rajiv Gandhi Equity Savings Scheme(RGESS) |
| 2013 | • Reduction in Securities Transaction Tax (STT) for equity funds  
• Uniform dividend distribution Tax ( DTT) of 25 per cent on all debt mutual funds  
• Product labeling  
• Introduction of direct plans |
| 2014 | • Changed the definition of “long term” for debt mutual funds to 36 months from 12 months for indexation benefit  
• Tax exemption limit for investment in financial instruments under section 80C raised to + 1.50 lakh from ₹ 1 lakh. |
| 2015 | • Launch of MF Utility (MFU) – an online platform by AMFI  
• SEBI asked fund houses to shift from color coding to Riskometer which classified schemes based on the risk profile  
• EPFO started investing in the equity market via Exchange Traded Fund( ETF)  
• SEBI allowed gold ETFs to invest up to 20 per cent of their assets in the government gold monetization scheme. |
| 2016 | • SEBI tightened norms for mutual fund investment in corporate bonds  
• Allowed investment advisors to use the infrastructure of the stock exchanges for sale and purchase of mutual fund units.  
• Provide easy entry to the foreign fund managers keen to enter India |
| 2017 | • SEBI allowed celebrities to endorse mutual funds products  
• Allowed investment up to ₹ 50,000 per mutual fund per financial year through digital wallets  
• Instant access facility to the liquid funds investors (via online mode) of up to ₹50,000 or 90 per cent of the folio value whichever is lower  
• Government discontinued the tax benefits of RGESS  
• Allowed mutual funds to invest in Real Estate investment Trusts (REITs) Infrastructure Investment Trusts(InvITs) |

Source: Securities and Exchange Board of India (SEBI), Association of Mutual Funds in India (AMFI)
In fact, even though financial year 2015-16 was not a very good year for the Indian securities market, the MF Industry witnessed steady positive net inflows month after month, even when the FIIs were pulling out in a big way. This was largely because of the ‘hand-holding’ of the investors by the MF distributors and convincing them to stay invested and/or invests at lower NAVs when the market had fallen.

**Graph 1.2**

Growth of Asset under Management

![Graph 1.2](image)

Source: Association of Mutual Funds in India (AMFI)

**SECTION-V**

**PRESENT STATUS OF MUTUAL FUND INDUSTRY IN INDIA**

As per the report authored by PwC it is identified that the mutual fund industry today presents a picture of opportunity and challenges. As the industry sensitizes itself to the changing regulatory, landscape, business strategies are endeavoring to respond to these developments. Amidst this changing business and regulatory environment, asset management companies and all service providers, including distributors, have to re-examine their business models and embrace the changing business landscape. Now withstanding the recent growth challenges, mutual fund continue to be an efficient
vehicle offering varied investment products at a reasonable cost to household to participate in the long term growth prospects of our economy.

The latest statistics of the Indian mutual fund industry as per Association of Mutual Funds in India (AMFI) says that the Indian mutual fund industry though has registered a six-fold increase in Asset Under Management over the last 10 years yet it has to emerge as the preferred investment choice for retail investors in India.

Table 1.2 exhibits the latest statistics of the Indian mutual fund industry and table 1.3 explains the change in AUM in a span of 10 years.

**Table 1.2**

**Latest Statistics of the Indian Mutual Fund Industry**

<table>
<thead>
<tr>
<th></th>
<th>August 2017</th>
<th>₹ 20.97 lakh crore.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Average Assets Under Management (AAUM)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total number of accounts (or folios as per mutual fund parlance)</td>
<td>as on August 31, 2017</td>
<td>6.08 crore (60.8 million)</td>
</tr>
<tr>
<td>Number of folios under Equity, ELSS and Balanced schemes,</td>
<td>as on August 31, 2017</td>
<td>4.94 crore (49.4 million).</td>
</tr>
</tbody>
</table>

Source: Association of Mutual Funds in India (AMFI)

**Table 1.3**

**Change in AUM in a Span of 10 Years**

<table>
<thead>
<tr>
<th>AUM As on as on 31st March, 2007</th>
<th>AUM As on as on 31st August, 2017</th>
<th>change</th>
</tr>
</thead>
<tbody>
<tr>
<td>₹ 3.26 trillion</td>
<td>₹ 20.59 trillion</td>
<td>more than six-fold increase</td>
</tr>
</tbody>
</table>

Source: Association of Mutual Funds in India (AMFI)

The table 1.4 represent the present status of assets under management with mutual funds.
## Table 1.4
### Present Status of Assets under Management with Mutual Funds
(as per Mutual Fund Asset Monitor)

<table>
<thead>
<tr>
<th>Mutual Funds</th>
<th>March 2017 Assets under Management (₹ Cr.)</th>
<th>June 2017 Assets under Management (₹ Cr.)</th>
<th>Change Assets under Management (₹ Cr.)</th>
<th>%Change</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICICI Prudential Mutual Fund</td>
<td>242,961</td>
<td>260,225</td>
<td>17,264</td>
<td>7.11</td>
</tr>
<tr>
<td>HDFC Mutual Fund</td>
<td>237,178</td>
<td>253,044</td>
<td>15,867</td>
<td>6.69</td>
</tr>
<tr>
<td>Reliance Mutual Fund</td>
<td>210,891</td>
<td>222,964</td>
<td>12,073</td>
<td>5.72</td>
</tr>
<tr>
<td>Aditya Birla Sun Life Mutual Fund</td>
<td>195,049</td>
<td>205,715</td>
<td>10,666</td>
<td>5.47</td>
</tr>
<tr>
<td>SBI Mutual Fund</td>
<td>157,025</td>
<td>168,816</td>
<td>11,791</td>
<td>7.51</td>
</tr>
<tr>
<td>UTI Mutual Fund</td>
<td>136,810</td>
<td>145,340</td>
<td>8,530</td>
<td>6.23</td>
</tr>
<tr>
<td>Kotak Mahindra Mutual Fund</td>
<td>92,216</td>
<td>101,197</td>
<td>8,981</td>
<td>9.74</td>
</tr>
<tr>
<td>Franklin Templeton Mutual Fund</td>
<td>81,615</td>
<td>90,619</td>
<td>9,004</td>
<td>11.03</td>
</tr>
<tr>
<td>DSP BlackRock Mutual Fund</td>
<td>64,177</td>
<td>70,991</td>
<td>6,814</td>
<td>10.62</td>
</tr>
<tr>
<td>Axis Mutual Fund</td>
<td>57,700</td>
<td>63,599</td>
<td>5,899</td>
<td>10.22</td>
</tr>
<tr>
<td>IDFC Mutual Fund</td>
<td>60,636</td>
<td>61,361</td>
<td>725</td>
<td>1.20</td>
</tr>
<tr>
<td>L&amp;T Mutual Fund</td>
<td>39,300</td>
<td>44,484</td>
<td>5,184</td>
<td>13.19</td>
</tr>
<tr>
<td>Tata Mutual Fund</td>
<td>42,619</td>
<td>42,148</td>
<td>-471</td>
<td>-1.11</td>
</tr>
<tr>
<td>Sundaram Mutual Fund</td>
<td>29,370</td>
<td>32,178</td>
<td>2,809</td>
<td>9.56</td>
</tr>
<tr>
<td>DHFL Pramerica Mutual Fund</td>
<td>26,117</td>
<td>25,720</td>
<td>-397</td>
<td>-1.52</td>
</tr>
<tr>
<td>Invesco Mutual Fund</td>
<td>23,528</td>
<td>24,258</td>
<td>730</td>
<td>3.10</td>
</tr>
<tr>
<td>LIC Mutual Fund</td>
<td>21,475</td>
<td>22,514</td>
<td>1,039</td>
<td>4.84</td>
</tr>
<tr>
<td>JM Financial Mutual Fund</td>
<td>13,668</td>
<td>12,313</td>
<td>-1,355</td>
<td>-9.91</td>
</tr>
<tr>
<td>Baroda Pioneer Mutual Fund</td>
<td>10,324</td>
<td>10,764</td>
<td>440</td>
<td>4.26</td>
</tr>
<tr>
<td>Canara Robeco Mutual Fund</td>
<td>9,940</td>
<td>10,752</td>
<td>813</td>
<td>8.18</td>
</tr>
<tr>
<td>Motilal Oswal Mutual Fund</td>
<td>8,115</td>
<td>10,373</td>
<td>2,257</td>
<td>27.82</td>
</tr>
<tr>
<td>Indiabulls Mutual Fund</td>
<td>10,820</td>
<td>10,071</td>
<td>-748</td>
<td>-6.92</td>
</tr>
<tr>
<td>HSBC Mutual Fund</td>
<td>8,812</td>
<td>9,316</td>
<td>504</td>
<td>5.72</td>
</tr>
<tr>
<td>Mirae Asset Mutual Fund</td>
<td>7,457</td>
<td>9,201</td>
<td>1,744</td>
<td>23.39</td>
</tr>
<tr>
<td>IDBI Mutual Fund</td>
<td>7,719</td>
<td>7,296</td>
<td>-423</td>
<td>-5.48</td>
</tr>
<tr>
<td>Edelweiss Mutual Fund</td>
<td>6,918</td>
<td>7,272</td>
<td>354</td>
<td>5.12</td>
</tr>
<tr>
<td>BNP Paribas Mutual Fund</td>
<td>5,891</td>
<td>6,477</td>
<td>587</td>
<td>9.96</td>
</tr>
<tr>
<td>PRINCIPAL Mutual Fund</td>
<td>5,347</td>
<td>5,422</td>
<td>75</td>
<td>1.41</td>
</tr>
<tr>
<td>BOI AXA Mutual Fund</td>
<td>3,552</td>
<td>4,014</td>
<td>461</td>
<td>12.99</td>
</tr>
<tr>
<td>Union Mutual Fund</td>
<td>3,416</td>
<td>3,767</td>
<td>351</td>
<td>10.27</td>
</tr>
<tr>
<td>Mahindra Mutual Fund</td>
<td>1,995</td>
<td>2,105</td>
<td>110</td>
<td>5.50</td>
</tr>
<tr>
<td>Quantum Mutual Fund</td>
<td>962</td>
<td>1,066</td>
<td>104</td>
<td>10.85</td>
</tr>
<tr>
<td>Peerless Mutual Fund</td>
<td>1,062</td>
<td>955</td>
<td>-106</td>
<td>-10.02</td>
</tr>
<tr>
<td>IIFL Mutual Fund</td>
<td>565</td>
<td>820</td>
<td>256</td>
<td>45.27</td>
</tr>
<tr>
<td>PPFAS Mutual Fund</td>
<td>696</td>
<td>760</td>
<td>64</td>
<td>9.22</td>
</tr>
<tr>
<td>Taurus Mutual Fund</td>
<td>1,876</td>
<td>583</td>
<td>-1,293</td>
<td>-68.94</td>
</tr>
<tr>
<td>Escorts Mutual Fund</td>
<td>243</td>
<td>258</td>
<td>16</td>
<td>6.52</td>
</tr>
<tr>
<td>Sahara Mutual Fund</td>
<td>67</td>
<td>67</td>
<td>0</td>
<td>0.13</td>
</tr>
<tr>
<td>Shriram Mutual Fund</td>
<td>41</td>
<td>42</td>
<td>1</td>
<td>3.11</td>
</tr>
<tr>
<td>Total</td>
<td>1,828,151</td>
<td>1,948,870</td>
<td>120,718</td>
<td>6.19</td>
</tr>
</tbody>
</table>

Source: http://www.moneycontrol.com/mutual-funds/amc-assets-monitor
OPPORTUNITIES AND CHALLENGES AHEAD FOR MUTUAL FUND INDUSTRY

Opportunities

The Indian Chamber of Commerce (ICC), with the help of PwC, in the report namely Mutual funds 2.0 Expanding into new horizons has identified and highlighted new areas of growth and key influencers for the success and expansion of the MF industry in India. In their report they presented an analysis of the MF landscape, how it has changed in 2016 and the key trends which have impacted its growth in the last financial year and how regulations as well as market conditions have helped the industry flourish in the last decade. The report highlighted that with lower bank interest rates and demonetization, the AUM of the Indian MF industry are expected to touch ₹ 20 lakh crore (The Economics Times, Jan 2017). AUM of Indian mutual fund industry may touch ₹ 20 lakh crore sooner than expected. Investors are increasingly concerned about keeping their surplus funds in savings bank accounts and the use of digitization has made the industry more appealing. The industry will see robust growth in the next 2–3 years, driven by opportunities created by Govt. recent initiatives in the following areas ways:

- Improved distribution efficiencies have enhanced reach across the country as distributors can now provide ready analysis to customers on the field.
- Range of mobile and online apps for tracking and transacting end-to-end platforms have enabled seamless customer experience.
- Mutual fund utility (MFU) has allowed investors to place orders with multiple AMCs and transfer funds seamlessly, all through a single window.
- e-KYC using Aadhar has proved to be a game changer for online investing. In the future, technology platforms and Aadhar will be leveraged for various government schemes.
- Increasing use of robo-advisory has made it simpler for investors to make decisions.
• Redemption of MFs (ultra-short funds) using a debit card—offered by two popular robo-advisory platforms, as well as top fund houses have made the transaction process more convenient.

• Demonetization has created a surge of inflows into structured investments such as MFs.

• Advisory regulations have allowed investors to get into advisory-only arrangements with financial advisors.

• Capping of MF commissions will help to prevent mis-selling; it also promotes innovation in customer acquisition and enables cost efficiencies.

• SEBI has proposed allowing the sale of MFs through leading e-commerce websites.

• Introduction of payments banks and small finance banks has improved financial inclusion.

• For Budget 2017, SEBI had recommended that the period of holding in respect of long-term debt fund units be reduced to one year from the existing 3 years, and an increase in the investment limit for tax-saving MF schemes. However, this has been shelved till a later date.

• Debt funds dominate the Indian markets; however, with increasing investor education, equity funds have witnessed an increase in the past 2 years.

• SEBI has taken the initiative to consolidate fund houses and schemes to facilitate better understanding and increased investment.

• To promote investment in the semi-urban and rural parts of the country, fund houses are focusing on specific schemes for customers in these parts of the country.

• Within alternative investment funds (AIFs), exchange-traded funds (ETFs) are likely to be one of the main products to drive significant growth, propelled by the deflationary impact to rates from the blow of demonetization.

• Recently, SEBI has relaxed the norms for real estate investment trusts (REITs)—allowing them to invest a larger portion of their funds (up to 20% from the current level of 10%) in assets under construction, along with proposed changes to facilitate easier entry for offshore fund managers.
Challenges

While a large population, which is moving towards economic wellbeing, promises for a strong customer base for financial services, it also poses a challenge to service providers in tapping resources. Mutual funds face a double challenge—Firstly, increasing their share in the urban markets that have seen crowding of products and vendors, and secondly, capturing the attention of investors in sub-urban and rural markets that have been largely averse to complex financial instruments, and is often unreachable through traditional distribution channels. Mutual funds will have to leverage technology to drive innovation in products, and adopt alternate distribution channels to be successful in the Indian market. As the industry grows in size, it is expected to see increased attention from regulatory bodies, working towards protecting the interest of the customers. In addition to it, a larger push from the state towards financial inclusion and retail participation in the markets is expected to bring about changes in taxation pertaining to Mutual Fund products. These two factors together are expected to drive AUM growth across asset classes in the next few years. Mutual Funds will have to use a combination of product innovation, distribution channel optimization and cutting edge technology to stay ahead in the highly competitive industry so as to have a larger share of the pie. Despite increased participation from the individual segment, Mutual Funds are still far from being an investment vehicle of choice for the larger Indian investment population – signaling a huge market potential.