FAQs on Mutual Funds

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I. Mutual Fund Investing

1. What are the investment avenues available to investors of securities market?

Ans. Investors have a basic choice: they can invest directly in individual securities, or they can invest through a mutual fund.

2. What is a Mutual Fund?

Ans. A mutual fund is a pool of money managed by a professional Fund Manager. A SEBI registered trust through an announcement (Called Scheme Information Document) offers to manage pool of funds in accordance with an investment objectives and collects money from public (investors). The money so collected will be invested in equities, bonds, money market instruments and/or other securities as per the investment objectives. The income/gains generated from these investments are apportioned proportionately amongst the investors after deducting applicable expenses and levies, by calculating a scheme's "Net Asset Value" or NAV.

3. What are the benefits of investing through mutual funds?

Ans. Investments through mutual funds give the following benefits:

A. A Professional investment Management
B. Risk reduction through diversification.
C. Convenience of investment and withdrawal.
D. Availability of alternative portfolio objectives.
E. Unit holders account administration and services.
F. Reduction in transaction costs.
G. Regulatory protection.

4. How is investing in banks different from investing in mutual funds?

Ans. Investor in bank deposits is called a depositor; investor in mutual funds is called a unit holder.

– Depositors can claim their deposits back on demand along with accrued interest. Interest rate is pre-fixed and only such pre-fixed interest will be payable. Bank is free to invest such deposits as per bank's business requirements and depositor cannot question the same. Mutual Fund investors (known as unit holder) has claim on the 'net asset value (NAV)' of its investment on the day on which investment is withdrawn. If 'NAV' on the day of withdrawal (redemption) is more than the 'NAV' on the day of investment, unit holder will have a gain; if NAV on the day of redemption is less than NAV on the day of investment, unit holder will incur a loss. Mutual fund has to invest the investments received from unit holders strictly in accordance with mutual fund scheme objectives.

5. Is bank an intermediary?

Ans. Bank is the largest intermediary in the financial system. Thousands of depositors pool their savings in a bank and receive a specified rate of return (interest).

6. **Is the return on deposit (interest) linked to the performance of the bank?**

Ans. Return to the deposit holders i.e. interest is not linked with the performance of the bank. Bank is bound to pay interest at the pre-announced rates.

7. **Is the return on Mutual funds linked to the performance of the fund?**

Ans. Yes return the mutual funds is linked to the performance of the portfolio managed by the fund.

8. **Do investors face risk in Mutual Funds?**

Ans. A unit holder assumes investment risk, including the possibility of reduction/loss of principal, because mutual funds invest in securities whose value may rise and fall.

9. **Are Bank Deposit Insured?**

Ans. The Deposit Insurance and Credit guarantee corporation (DICGC) insures all deposits such as savings, fixed, current, and recurring. Each depositor in a bank is insured up to a maximum of Rs.5,00,000 (Rupees Five Lakh) for both principal and interest.

10. **Are Mutual Funds Insured?**

Ans. Mutual funds are not insured under Deposit Insurance and Credit Guarantee Corporation Act, 1961. There is no other assurance to investors except that SEBI will oversees whether mutual funds are in compliance with regulations prescribed by SEBI.

11. **Who are mutual fund unit holders?**

Ans. Mutual fund unit holders are the fund shareholders.

12. **Who are bank depositors to the bank?**

Ans. Bank depositors are the banks' creditors.

13. **What do you understand by professional investment management?**

Ans. Every mutual fund scheme is managed by a professional investment manager who has capability to make investments in accordance with the mutual fund scheme objective and investment strategy. In simple terms, professional manager decides the scrips (shares or debt instruments) into which investments are to be made keeping in view potential to make gains; such decision making involves opting whether to buy, sell or hold shares to make profits. It requires understanding of markets, movement of prices in the markets, financial state of the company of the shares into which investment is to be made, etc. it is a complex process.

14. **How do fund managers manage investors' funds?**

Ans. Professional investment managers choose investments that best match the investment objective of the scheme as described in the scheme's prospectus and have a potential to gain.

Investment decision also involves decision to sell or buy or hold a share with a view to make a profit for the scheme.

15. How are investment decision taken by the fund managers?
Ans. The investment decisions are based on extensive research of the market conditions, and financial performance of the sector, individual company and specific securities.

16. How do market conditions influence the decisions making process?
Ans. Changes in market conditions will have an impact of reducing or enhancing gains or inflicting losses on an investment. As the market condition changes, professional investment managers churn their portfolios over accordingly with a view to achieve investment objectives with an endeavour to avoid loss and make gain.

17. How is the risk reduced in mutual funds?
Ans. The risk is reduced through Diversification across asset classes, sectors and securities.

18. What is the age-old axiom used for mutual fund?
Ans. The age-old axiom is that, it is not wise to put all eggs into one basket was probably in the minds of those who formed the first mutual fund. Mutual funds follow the principle of avoiding keeping all eggs in a single basket – if basket falls, all eggs break – instead if eggs are distributed in several baskets, fall of one basket, only some eggs in that basket break.

19. How does a mutual fund provide a diversification benefit?
Ans. The mutual funds provide the benefits of diversification by investing small amounts in a large number of securities.

20. What is the major advantage for retail investors offered by mutual fund?
Ans. Portfolio diversification is the major advantage stressed by mutual funds, especially for retail investors. The investment of a retail investors, if invested directly, will not be sufficient to invest into multiple shares/sectors; but when pooled together, they become large enough to distributed among several company shares and sectors.

21. Why do MF have a wide range of schemes?
Ans. The wide range of schemes arose over the years to meet the requirements of the investors with different investment objectives. Gains from the market can be achieved by investing using different combinations or patterns of investments. Each investment pattern is reflected in a separate mutual fund scheme.

22. Why is Investing in MF Cost effective?
Ans. The low costs are due to standardization, and high economies of scale (arising on account of the collective investment character). If an investor chooses to invest directly, costs like

brokerages, depository participant charges, Securities Transaction Taxes (STT), etc. have to be incurred in addition to time and effort involved in monitoring the price movements of shares in which investment is made. In case of mutual funds, all these costs are absorbed into the mutual fund expenses on which there is a regulatory ceiling and competition among mutual funds also keeps it under a check.

23. Is there any regulation regarding the expenses that can be charged to Unitholders?
Ans. SEBI has set ceiling with regard to expenses, which can be charged to the investors.

24. What Mutual Funds are not meant for?
Ans. Mutual funds are not 'get rich quick' investments.

25. Are Mutual fund Risk free?
Ans. Mutual funds are not risk-free investments (but strictly regulated and controlled). All market related risks will flow to the investors in mutual funds, but it is expected that the professional investment managers foresee these risks and take measures to mitigate or reduce these risks.

II. Mutual Fund Products

26. What are the various kinds on mutual funds?
Ans. On the basis of organizational structure, mutual funds can be classified as open-ended and Close ended funds

27. What is an Open -Ended Mutual Fund?
Ans. An open-ended mutual fund gives utmost liberty and flexibility to investors to enter and exit as and when they feel like.

28. What is a Close-Ended Mutual Fund?
Ans. Close-ended mutual funds offer a fixed timeline to investors for participating in and out of the fund. However, most of the close ended funds are listed on the exchange.

29. Where are Open Ended Mutual Funds available?
Ans. These funds are not traded in the open market. Transactions are performed directly through the fund.

30. Where are Close Ended Mutual Funds available?
Ans. They are launched through an NFO for raising money and subsequently listed on an exchange.

31. What is the maturity period for open and closed-ended mutual funds?

Ans. There is no maturity period for open ended funds while close ended mutual funds have a fixed maturity which ranges from 2-5 years.

32. What is an Interval Fund?

Ans. Interval funds combine the features of open-ended and close ended funds. The units of an interval fund can be purchased and sold/redeemed only during time intervals specified by the fund house.

33. What is the time interval for the Interval Fund?

Ans. The time intervals could be monthly, quarterly, semi-annual or annual. Thus, you can say an interval fund represents a mix of open-ended and close-ended funds in terms of subscription and redemption features.

34. Are Interval funds listed on exchanges?

Ans. Interval fund is generally not listed on stock exchanges or other secondary markets.

35. Who should invest in Interval Funds?

Ans. An interval fund is ideal for investors who have short-time financial goals and who are willing to take low to moderate levels of risk.

36. How can Interval Funds be purchased?

Ans. They can be purchased directly from the fund like open-ended mutual funds at a price calculated based on their Net Asset Value (NAV), which is assessed daily.

37. How can an investor redeem an Interval Fund?

Ans. An investor can redeem their units by selling them to the fund house during the specified redemption periods.

38. Are Interval Funds liquid?

Ans. Interval mutual funds are not liquid and therefore, not beneficial during emergencies.

39. What are the various categories of Mutual Funds in terms of their investment portfolios?

Ans. The simplest way to categories funds on the basis of their investment portfolio would be to group them as –

a. Equity Schemes
b. Debt Schemes
c. Hybrid Schemes
d. Solution Oriented Schemes
e. Other Schemes

40. What are Equity Funds?

Ans. Equity Funds concentrate their investments in equity shares.

41. What are various types of Equity Funds?

Ans. Equity funds can be categorized as Large cap fund, Mid-cap funds, Small cap funds, Multi cap funds, Index funds, Sector Funds and Equity linked saving schemes etc.,

42. What is Market Capitalization?

Ans. Market capitalization refers to the total rupee market value of a company's outstanding shares of stock.

43. How are stocks classified based on their market capitalization?

Ans. Equity shares listed on stock exchanges are classified into Large capitalised stocks (Large cap stocks), Medium capitalised stocks and Small capitalised stocks. This indicates the extent of capitalisation of the company**.** The classification based on market capitalisation is explained in the next question.

44. What are large-cap stocks?

Ans. Stocks of companies ranked from 1^{st} - 100^{th} in terms of full market capitalization are large cap stocks.

45. What are mid cap stocks?

Ans. Stocks of companies ranked 101^{st} – 250^{th} in terms of full market capitalization are mid cap stocks.

46. What are small cap stocks?

Ans. Stocks of companies ranked from 251^{st} onwards in terms of full market capitalization are small cap stocks.

47. What is a large-cap mutual fund scheme?

Ans. Large cap mutual fund schemes are those which predominately invest into Large cap stocks with a minimum investment of 80% of total assets in large cap stocks.

48. What is a mid-cap mutual fund scheme?

Ans. Mid cap mutual fund schemes are those which predominantly investing in mid cap stocks with a minimum investment of 65% of total assets in mid cap stocks.

49. What is small cap mutual funds scheme?

Ans. Small cap mutual fund schemes are those which predominantly investing in small cap stocks with a minimum investment of 65% of total assets in small cap stocks.

50. What are index funds?

Ans. An open-ended scheme replicating / tracking an index. Index funds are portfolio of securities, which have been specifically designed to represent the characteristics and attributes of a chosen target index. An index fund closely replicates the composition of index i.e. it invests in the stocks contained in the underlying index in the same proportion that such stocks are represented in the index.

51. What are the advantages of investing in index fund?

Ans. The advantages of investing in an index fund are diversification, low costs, and transparency.

52. What are various types of index funds?

Ans. Various types of index funds are fully replicated fund and sampled index fund.

53. What is a fully replicated fund?

Ans. A portfolio, which comprise of all the stocks in the same proportion as in the underlying index, is known as a fully replicated fund.

54. What is a sampled index fund?

Ans. A sampled index fund makes investments only in stocks, which are part of the index.

55. What are sector funds?

Ans. An open-ended equity scheme investing in a particular sector / theme. These funds concentrate in particular industry, such as technology, telecommunication, FMCG, petroleum, pharma etc.

56. What type of investors invest in sector funds?

Ans. Investors willing to accept higher levels of risk invests in the sector funds as these funds normally have some limited diversification.

57. What are some features of a sector fund?

Ans. Sector funds have a tendency to be more volatile than the broadly diversified portfolios. This type of fund carries the business risks that the sector carries.

58. What are primary market funds?

Ans. These are funds, which make investments in equity shares, but investments are made only during the primary market offering.

59. What is Equity Linked Savings Schemes (ELSS)?

Ans. An open-ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit.

60. What is the objective of ELSS?

Ans. The objective of ELSS is to produce long-term capital appreciation and to help investors save on income tax.

61. What is the difference between an equity fund and an ELSS?

Ans. The only difference between an equity fund and an ELSS is that the latter has a 3-year lock-in and tax benefit like other tax-saving products viz. public provident fund (PPF), national saving certificate (NSC), infrastructure bonds and insurance. Having said this, both equity fund and ELSS invest in equities as defined in the offer document.

62. Who invests in ELSS?

Ans. ELSS is suitable for equity-oriented investors seeking to generate capital appreciation from an equity portfolio as well as tax benefits.

63. What are ETFs?

Ans. Exchange traded funds are popularly known as ETFs. It is a security that tracks an index but has the flexibility of trading like a stock. An exchange traded fund (ETF) is a basket of securities that trade on an exchange, just like a stock. Such funds mainly provide exposure to a selected index.

64. How do subscription/redemption of units work in ETFs?

Ans. Large investors/ institutions can purchase units by depositing the underlying securities with the fund and can redeem by receiving the underlying shares in exchange of units. Units can also be bought and sold directly on the exchange.

65. How are ETFs similar to open-ended funds?

Ans. ETFs and open-ended funds both provide liquidity through exchanges and are flexible in fund size.

66. What are the benefits of ETFs over open-ended index funds?

Ans. ETFs can be bought and sold on the exchange at prices that are usually close to the actual intra-day NAV of the Scheme. Also, tracking error of ETFs is likely to be lower than a normal index fund.

67. How do ETFs trade close to their NAV?

Ans. ETFs are structured in a manner which allows to create new units and redeem outstanding units directly with the fund, thereby ensuring that ETFs trade close to their actual NAVs.

68. How mutual funds are classified on the basis of the management of the portfolio?

Ans. Mutual funds are classified as Active funds and passive funds on the basis of how the portfolio is managed.

69. What is Actively managed fund?

Ans. An actively managed mutual fund has an experienced manager and a management team to make investment decisions on the fund corpus. Buying/selling is done more frequently as it has a goal to outperform the market. But it has a comparatively higher fee or cost if compared to passively managed funds.

70. What is Passively managed fund?

Ans. Passively managed mutual funds often just follow a market index. Buying and selling is also less frequent in passively managed funds. It mainly tracks the market returns. It has a low cost or fee compared to actively managed fund.

71. Are ETFs actively or passively managed?

Ans. ETFs are usually passively managed funds. However, actively managed ETFs are also becoming popular.

72. What are the advantages of ETFs?

Ans. ETFs protect long-term investors from inflows and outflows of short-term investors. This is because the fund does not bear extra transaction cost when buying / selling due to frequent subscriptions and redemptions. Exchange traded mechanism of ETFs helps reducing collection, disbursement and other processing charges.

73. What is a value investment strategy?

Ans. Value investing is an investment strategy that involves picking stocks that appear to be trading for less than their intrinsic or book value. Value stocks are perceived as “Cheap” in value but have a high potential of generating higher earnings.

74. What is a value fund?

Ans. An open-ended equity scheme following a value investment strategy.

75. What is a contrarian investment strategy?

Ans. Contrarian investing is an investment style in which investors purposefully go against prevailing market trends by selling when others are buying, and buying when most investors are selling. Contrarian investors typically seek out distressed stocks or short existing market trends in a bull market focused on "hot" stocks that receive media attention or prevailing market dynamics.

76. What is a contra fund?

Ans. An open-ended equity scheme following contrarian investment strategy.

77. What is a debt fund?
Ans. Debt funds concentrate their investments in debt securities. These funds are also termed as income funds.

78. What is the principal source of return of debt funds?
Ans. The principal source of their return is the interest earned on the fixed income securities held in the portfolio. There is also potential upside (downside) from the capital gains (losses). .

79. Are debt funds and income funds synonymous?
Ans. The synonymity between bond funds and income funds is a matter of portfolio objectives and portfolio composition. The convention followed in the mutual fund industry in India is to refer bond funds and income funds as one and the same.

80. What is the relationship between interest rates and bond prices?
Ans. As market interest rates decline, the market prices of bonds go up causing an upward movement in the NAV of the fund and vice versa.

81. Why are debt funds generally considered to be safer than equity funds?
Ans. This perception is partly due to the fact that issuers of bonds pay interest and principal amount when it is due. It is also partly due to the lower variability in the prices of bonds compared to prices of equity.

82. What are various categories of debt funds?
Ans. Debt funds include Overnight funds, Ultra short duration funds, Low duration funds, Money market fund, Medium duration fund, Medium to long duration fund, long duration fund, Dynamic bond fund, corporate bond fund, credit risk fun, Banking and PSU fund, Gilt fund, floater fund etc.,

83. What is a medium to long duration fund?
Ans. An open-ended debt scheme investing in debt instruments with maturity between 3 to 10 years.

84. What is a medium duration fund?
Ans. An open- ended medium term debt scheme investing in instruments with maturity between 3 years and 4 years.

85. What is a short duration Fund?
Ans. An open-ended short-term debt scheme investing in instruments with maturity between 1 year and 3 years.

86. What is a low duration fund?
Ans. An open-ended low duration debt scheme investing in instruments with Macaulay duration between 6 months and 12 months.

87. What is Ultra Short Duration Fund?
Ans. An open ended ultra- short-term debt scheme investing in instruments with maturity of less than a year.

88. What is an overnight fund?
Ans. An open-ended debt scheme investing in overnight securities

89. What is a Liquid fund?
Ans. Liquid fund invests in Debt and money market securities with maturity of up to 91days only.

90. What is a money market mutual fund?
Ans. An open-ended debt scheme investing in money market instruments.

91. Who invests in money market mutual fund?
Ans. Investors seeking stability of principal, higher liquidity and shorter investment horizon consider these funds.

92. Which risk do money market mutual funds have?
Ans. Although money market funds have low risk, there are differences in risk within and between categories of these funds.

93. Which category of funds has lowest risk?
Ans. The lowest risk category is of funds, which choose to make most of their investments in government Treasury bill and call or notice money. Category of funds which are considered to have the lowest risk are ultra-short-term funds and liquid funds.

94. What are the various money market instruments?
Ans. The various money market instruments are commercial papers, commercial bills, treasury bills, government securities having maturity up to one year, call or notice money, certificate of deposits, permitted securities under a repo / reverse repo agreement and any other instrument permitted by RBI from time to time.

95. What are some features of money market mutual funds?
Ans. The features of money market mutual funds are low risk, low return and high liquidity.

96. What is a Dynamic bond fund?

Ans. An open-ended dynamic debt scheme investing across duration.

97. What is a corporate bond fund?

Ans. Some funds may invest in government bonds/securities and corporate bonds. Corporate bond funds are open-ended debt scheme predominantly investing in highest rated corporate bonds.

98. What is the objective of corporate bond fund?

Ans. The objective of these funds is to produce higher levels of income by investing in corporate bonds.

99. What are high-grade bond funds?

Ans. The high-grade bond funds make investments only above a particular investment rating also known as investment graded funds. In India we find funds, which are advertised as AAA or AA bond funds. Such funds make most of their investments in papers, which are rated AA and above.

100. What are high yield bonds funds?

Ans. High yield bond funds are those which invest in papers that have a higher yield but also has a higher risk that is accompanied with it.

101. What is a gilt scheme?

Ans. An open-ended debt scheme investing in government securities across various maturities.

102. What is the objective of Gilt scheme?

Ans. The primary objective of gilt scheme is income generation through the receipt of coupon payments, the amortization of the discount on debt instruments or the purchase and sale of securities in the underlying portfolio. The secondary objective of the scheme is capital appreciation.

103. What type of risk is associated with gilt scheme?

Ans. The only risk associated with this type of fund is interest rate risk. These funds invest exclusively in government securities. Government securities have no default risk. But NAVs of these schemes also fluctuate due to change in interest rates and other economic factors as is the case with income or debt-oriented schemes.

104. What type of risk is not associated with gilt scheme?

Ans. A portfolio of G-Sec is free of credit risk (i.e. the risk of default by the issuer).

105. What are the investment plans offered by gilt schemes?

Ans. Under this particular category offer investors two separate investment plans (i.e. Short-Term Plan and Long-Term Plan) representing investments made and held in two separate investment portfolios.

106. What is a floating rate scheme?

Ans. An open-ended debt scheme predominantly investing in floating rate instruments.

107. What is the advantage of floating rate schemes?

Ans. These are the kinds of funds, which provide a hedge to the investors against volatile interest rates. This will enable the investors to avoid potential capital losses, which might otherwise have arisen, if the investments were in fixed rate instruments, due to volatility in the interest rates.

108. What is a bond index fund?

Ans. Like an equity index fund, in a bond index funds, investments are in the instruments comprising the underlying bond index in the same proportion.

109. What is the objective of bond index fund?

Ans. The objective is to replicate the returns of underlying bond index.

110. What is a hybrid fund?

Ans. An open-ended scheme investing in equity and debt instruments. Funds in this category are simply those with a dual stock/bond focus.

111. What are the various types of hybrid fund?

Ans. The varieties of hybrid funds are balanced fund and Asset allocation fund.

112. What is a balanced fund?

Ans. An open-ended balanced scheme investing in equity and debt instruments in almost equal proportion.

113. What is the objective of balanced funds?

Ans. Balanced funds have the objectives of payment of current income, moderate capital appreciation and preservation of capital.

114. Who invests in balanced funds?

Ans. Investors who want to hold a portfolio of combination of securities seek some current income and moderate growth with low level of risk may invest in balanced funds.

115. How does the NAV of balanced fund behave?

Ans. Generally the net asset value (NAV) of balanced funds move in a narrower range and is not as volatile as that of equity funds.

116. How do balance funds perform compared to equity funds?

Ans. Balanced funds tend to outperform the equity funds in a bearish phase and underperform them in a bullish phase.

117. What is an asset allocation fund?

Ans. An asset allocation fund is a fund that provides investors with a diversified portfolio of investments across various asset classes. Popular asset categories for asset allocation funds include stocks, bonds and cash equivalents that may be spread out geographically for additional diversification.

118. What is the objective of an asset allocation fund?

Ans. The purpose is to provide investors with truly diversified holdings and consistent returns while sparing the investor the trouble of having to accomplish asset allocation at different market conditions.

119. How do asset allocation funds determine buying stocks and bonds?

Ans. Asset allocation funds use quantitative models to determine how many stocks and bonds to buy.

120. What are various asset allocation plans?

Ans. Asset allocation plans may range from very conservative (less proportion devoted to equity) to very aggressive (more proportion devoted to equity).

121. What is the benefit of asset allocation fund to investors?

Ans. An asset allocation fund could serve as a complete investment plan for investors who can afford to own only one asset.

III. History of MF

122. Which was the first investment trust in UK?

Ans. The **Foreign and Colonial** Investment Trust (FCIT) is the first and the oldest surviving closed end fund in the world today. Established in 1868 as the **Foreign and Colonial** Government Trust in the UK.

123. When and what was the first modern day mutual fund started in the US?

Ans. The first modern-day **mutual fund**, Massachusetts Investors Trust, was created on March 21, 1924. It was the first **mutual fund** with an **open**-end structure, allowing for the continuous issue and redemption of shares by the **investment** company.

124. What was the advent of mutual fund industry in India?
Ans. Unit Trust of India (UTI) was established 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 Reserve Bank of India. It was the advent of mutual fund industry in India.

125. When did UTI was de-linked from RBI and taken over by IDBI?
Ans. In 1978 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 Rs. 6,700 crores of assets under management.

126. Who apart from the Board of trustees have the power to give directions to UTI?
Ans.In matters involving public interest the Central Government and the Reserve Bank of India had powers to give directions to UTI.

127. What was the purpose of establishing UTI?
Ans.The stated purpose of establishing the Unit Trust of India was to give a fillip to equity market.

128. When was Master Share launched and what did it do?
Ans.Master Share was launched in October 1986 ushered in the equity-oriented schemes in India.

129. Where did the UTI borrow the idea for its products from?
Ans.Unit Trust of India borrowed a number of ideas from the mutual fund industry of UK and launched a variety of innovative products addressing virtually the complete life cycle of the investors.

130. How was AMFI established?
Ans.The players in the industry came together voluntarily and established the Association of Mutual Funds in India (AMFI). This association continuously interacts with the regulator, government and other entities.

131. What is the first phase according to AMFI's classification?
Ans. The first phase during the years 1963-1987 saw UTI consolidating its position by offering a host of products and extending its reach throughout the country.

132. What is the second phase according to AMFI's classification?

Ans. The second phase (1987 – 93) marked the arrival of mutual funds sponsored by public sector banks and financial institutions.

133. What is the third phase according to AMFI's classification?

Ans. The third phase is from 1993 to 2003 with the arrival of private sector players, both Indian and foreign. 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.

134. What is the fourth phase according to AMFI's classification?

Ans. Fourth phase was from February 2003 onwards. 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 Rs. 29,835 crores as at the end of January 2003. 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.

135. In which year were the public sector banks and financial institutions permitted to establish mutual funds?

Ans. In 1987 the public sector banks and financial institutions were given permission to establish mutual funds.

136. Which public sector bank established the first mutual fund?

Ans. State Bank of India established the first mutual fund. SBI preferred to adopt the trust route and set up the mutual fund as a trust under the Indian Trusts Act, 1882. The Trust form Under the Indian Trust Act came to be the accepted legal form of mutual funds in India.

137. When did privatization happen in mutual fund industry in India?

Ans. A new era in the mutual fund industry began with the permission granted for the entry of private sector funds in 1993. Foreign asset management companies were allowed to enter the mutual fund business.

138. When did the SEBI Act got powers to regulate mutual funds in India?

Ans. In 1992, the SEBI Act was passed giving powers to SEBI to regulate the mutual funds in India. The objectives of SEBI are – to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

139. What happened with the entry of private sector players in mutual fund industry in India?

Ans. With the arrival of private sector players, open-ended funds became the dominant form of mutual fund product.

140. What is the total number of schemes and fund houses in India?

Ans. There are 1762 schemes (equity, debt, liquid, balanced, gilt, tax saving) in all as of August 2020, managed by 49 fund houses.

141.

142. When was the mutual fund testing and certification programme launched?

Ans. In July 2000, AMFI launched a mutual fund testing and certification programme for mutual fund agents, distributor advisors and employees.

143. How do mutual funds communicate with their unit holders?

Ans. Majority of the mutual funds have their own website to enhance communication with the present and the prospective unit holders.

IV. Process of investing in Mutual Fund FAQ

144. What are the different plans to invest in mutual funds?

Ans. There are two plans while opting to invest.

1. Direct Plan Mutual Funds
2. Regular Plan Mutual Funds

145. What is Direct Plan Mutual Funds?

Ans. In 2013, SEBI introduced 'Direct Plan' which has enabled investors to make independent investment choices. Hence, this step is regarded as a cornerstone reform in the mutual fund sector. In direct plans Asset Management Companies (AMC) do not charge distributor expenses and have lower expense ratio.

146. What is Regular Plan Mutual Funds?

Ans. In a regular plan, mutual funds pay a sales commission to the middleman or brokers, who bring business to them.

147. What are the modes of investment in mutual funds?

Ans. There are two modes of investments in mutual funds

1. Lump-Sum
2. Systematic Investment Plan (SIP)

148. What is a Systematic Investment Plan (SIP)?

Ans. A SIP is an option of investing a fixed sum in a mutual fund scheme on a regular basis i.e. predefined regular interval. It is similar to regular saving schemes like a recurring deposit.

149. In what frequency one can invest in SIP?

Ans. In a SIP, the investment can be done regularly on specific intervals, either weekly or monthly or quarterly.

150. What is Lump sum investing in mutual funds?

Ans. A lump sum is a single large investment done by an investor in one go in any mutual fund scheme.

151. When can you choose to invest in lumpsum?

Ans. A lump sum amount is best if you have surplus cash that you're looking to invest.

152. When can you choose to invest through SIP?

Ans. SIP is best when you want to invest small amounts every month.

153. What is the minimum investment needed to start a SIP?

Ans. Some mutual funds allow investing in SIP can be started as low as Rs. 100. In most cases, the minimum investment is Rs. 500

154. What is the minimum investment needed for lumpsum?

Ans. The minimum investment is as low as Rs.100 depending on the fund house.

155. What is a Systematic Transfer Investment Plan?

Ans. An STP or Systematic Transfer Plan moves a fixed amount of money from one mutual fund to another at regular intervals. An STP or Systematic Transfer Plan moves a fixed amount of money from one mutual fund to another at regular intervals.

156. What are to be mentioned in the form for STP?

Ans. In the STP form, you have to specify the date of the STP, the duration of the STP and the amount of the STP. For example, an STP of Rs 5,000 on the 15th of each month for a tenure of 1 year.

157. What is an OTM?

Ans. An OTM, or 'One Time Mandate' is a one-time registration process wherein the investor authorizes his banker to execute debits to his bank account up to a certain limit based on requests received from the mutual fund company.

158. What are the details which have to be mentioned in the OTM form?

Ans. In an OTM form, the investor needs to mention the folio number, application number, phone number, email ID, the amount in Rupees and the period.

159. Is there any lock-in period while investing in mutual funds?

Ans. Yes, there is a 3-year lock-in period while investing in tax saving mutual funds.

160. Why can't an investor invest in mutual funds without having a PAN card number?

Ans. As per SEBI's directives and mandatory requirements, the investors are permitted to invest in units of mutual fund schemes only if they have a valid Permanent Account Number. The investor will need to apply for and get a registered PAN card before owning mutual fund investment units.

161. What do the investor has to keep in mind while filling up my mutual fund investment form?

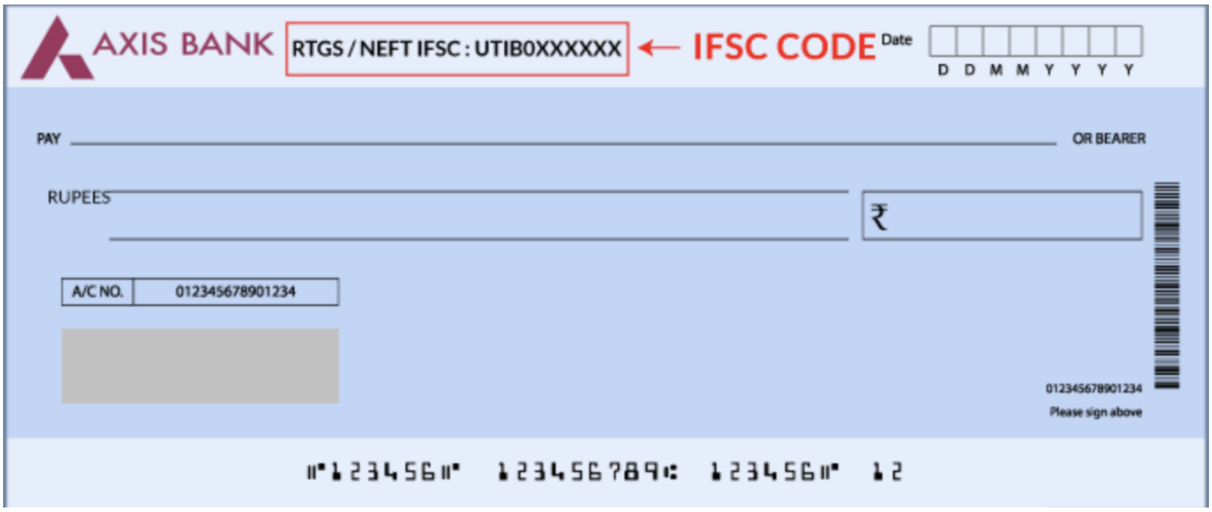
Ans. While filling the mutual fund investment form, make sure the following details are provided correctly and clearly such as the Name, address, number of units applied for, other required details and the correct bank account number to prevent fraudulent transactions as well as encashment.

162. Which are the documents needed for investing in mutual funds?

Ans. To start investing in a mutual fund scheme, a few things are needed. Such as the Pan card, bank account and the investor should be KYC compliant. The bank account should be in investor's name along with MICR and IFSC details.

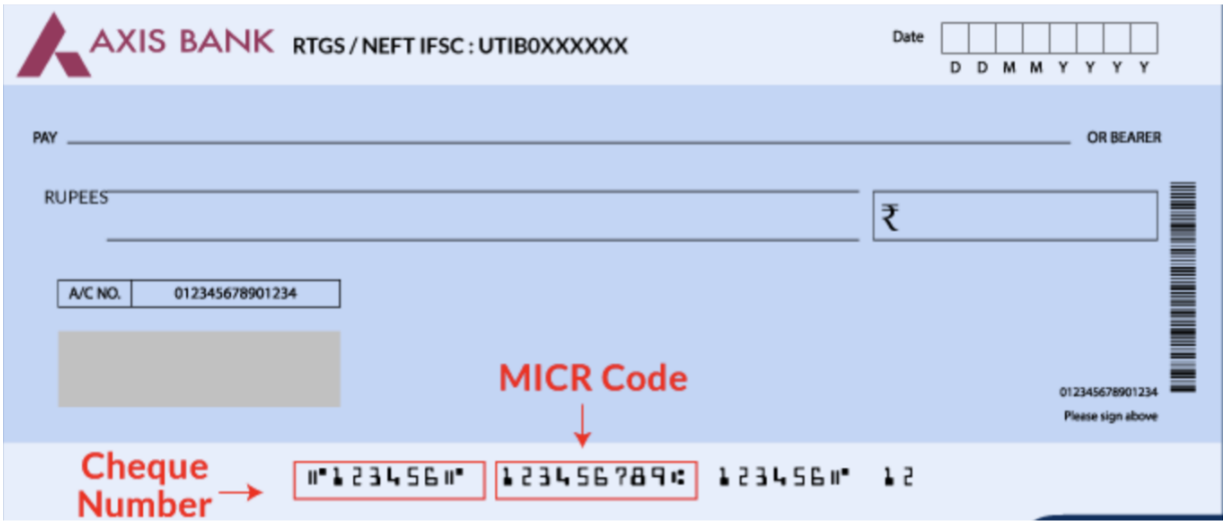
163. What is IFSC?

Ans. IFSC is an 11-digit alpha-numeric code that uniquely identifies a bank-branch participating in any RBI regulated funds transfer system. It can be seen on every cheque and also on the name details page of passbook.



164. What is MICR?

Ans. MICR Code is used in the processing of cheques by machines. This code enables faster processing of cheques.



165. Which are the two ways in which an investor can complete the IPV (in-person verification)?

Ans. An investor can complete the IPV by either visiting any of the following institutions or submitting the original documents or through videoconferencing at a pre-agreed time with the concerned intermediary.

166. How many days does it take to complete the in-person- verification?

Ans. The IPV usually gets completed within 5-7 days, post the submission of the mutual fund application form. The investment amount should also be submitted along with the application form.

167. Who should the investors contact in order to invest in mutual funds offline?

Ans. Representatives of the mutual fund company or an empaneled distributor should be contacted.

168. Who is a mutual fund distributor?

Ans. Distributors are agents of mutual fund companies who sell products of mutual fund houses to the prospective investors.

169. Who can be a mutual fund distributor?

Ans. A Mutual Fund Distributor may be an individual or a non-individual entity, such as a bank, brokering house or on-line distribution channel provider.

170. Is there any single platform to buy Mutual Funds?

Ans. Yes, Mutual fund transaction portal, MFU (Mutual Fund Utilities) is a single-window for you to transact across mutual fund schemes.

171. What is CAN (Common Account Number)?

Ans. CAN is a unique reference number issued by MFU. It maps all existing mutual fund folios across fund houses (participating in MFU), thereby providing the investor with a consolidated view of all your mutual fund investments.

172. How is CAN different from Mutual Fund folio?

Ans. CAN is similar to a Mutual Fund Folio, the only difference, while the folio is limited to one fund house, the CAN is applicable across fund houses of a single type of holding.

173. Are there any additional charges to pay if investing through Mutual Funds Utilities Portal?

Ans. There is no additional charge for mutual fund investments made through this portal. The cost of the platform is shared by the participating fund houses.

174. Can NRI invest in Indian mutual funds?

Ans. Yes, NRI can invest in Indian Mutual funds.

175. Can NRI invest in foreign currency in Indian mutual funds?

Ans. No, Mutual funds companies don't accept foreign currency. An Non Resident External (NRE) or Foreign Currency Non-Resident (FCNR) account with an Indian bank is needed.

176. What are the KYC documents needed for verification in case of NRI?

Ans. KYC documents must include recent Photograph, Pan card, passport, residence proof of outside India and bank statement.

177. Do all mutual funds houses allow NRI's of USA and Canada to invest in Indian mutual funds?

Ans. Not all mutual funds houses allow NRI's from USA and Canada because of compliance requirements under the Foreign Account Tax Compliance Act (FATCA).

178. What is mutual fund redemption?

Ans. Mutual fund redemption is how the investors sell their fund units.

179. When to exit and redeem a fund?

Ans. There is no recommend time frame to redeem a fund units but may be redeemed if money is needed, or when investor is of the opinion that it does not want to stay in the scheme any longer.

180. How can one select a mutual fund scheme?

Ans. One can select a mutual fund scheme on the basis of investment time horizon, risk appetite and financial goals and past performance of the scheme. Some schemes levy exit load; that may also be considered while investing.

181. Who are independent financial advisors?

Ans. IFA's or Independent Financial Advisers are professionals who offer their advice and views on financial matters, which also includes mutual fund investments. They help you fill the application form and other formalities for the same.

182. What is the important thing to look for in investment advisors?

Ans. One has to make sure they are registered as 'Investment Advisers' under the Securities and Exchange Board of India (SEBI).

183. What is NFO?

Ans. A New Fund Offer or NFO refers to the first subscription offering that is made to interested parties for any new funds which are offered by investment companies.

184. Is NFO the same as an IPO?

Ans. Yes, an NFO is akin to an IPO, that it is launched to raise funds. The only difference is that an IPO refers to the sale of a company's shares before its listing on a stock market exchange, whereas, an NFO is the first subscription offer for the units of a new mutual fund scheme. The NFOs are usually launched as limited period offers.

185. What criteria are to be considered while investing in NFO?

Ans. Points to be considered while investing in NFO are- Track Record of the Fund House, Track Record of the Fund Manager, Costs Associated with the Scheme and Tax implications.

V. Accounting

186. What is NAV or Net Asset Value??

Ans. NAV or Net Asset Value is equal to Unit holder's fund in the scheme (Net Assets) divided by number of outstanding units.

187. How is NAV computed?

Ans. NAV can be computed as – (Current value of investments held + Income accrued+ Current Assets – Current Liabilities- Accrued Expenses)/ Number of Outstanding Units.

188. How frequently the NAV of mutual fund is calculated?

Ans. The calculation of Net asset value (NAV) is done on daily basis.

189. How frequently NAV or Net Asset Value published and where??

Ans. The NAV of schemes shall be published on a daily basis by the Mutual Funds at least in two daily newspapers.

190. Up to how many decimal places NAV can be calculated?

Ans. NAV is to be calculated up to 4 decimal places in the case of index funds and all types of debt funds. NAV for equity and balanced funds is to be calculated up to at least 2 decimal places.

191. Can investors hold their units even in a fraction of 1 unit?

Ans. Yes, Investors can hold their units even in a fraction of 1 unit.

192. How many classes of units can be launched in the same mutual fund scheme?

Ans. Asset management companies, Trustee Company or sponsor may launch schemes either on a "load" or "no-load basis", or on a mixed basis with two classes of units in the same scheme - one with load and the other without load.

193. Are income and expense charges included for the computation of NAV?

Ans. All expenses and incomes accrued up to the valuation date shall be considered for computation of net asset value. For this purpose, while major expenses like management fees and other periodic expenses should be accrued on a day-to-day basis, other minor expenses and income need not be so accrued, provided the nonaccrual does not affect the NAV calculations by more than 1%.

194. Can initial issue expense be charged against the scheme?

Ans. Initial issue expense incurred during new fund offer cannot be charged to the scheme instead this expense is borne by the AMC or the sponsors.

195. What is expense ratio?

Ans. Expense ratio is the cost of running and managing a mutual fund which is charged to the scheme.

196. What includes expense ratio?

Ans. All expenses such as Fees to registrars/Transfer agent, Fees to trustees, custodian and auditor, Brokerage, marketing expenses, commission to distributors, Investor communication expenses, Listing and depository fees, Insurance premium, Investment fees and advisory fees, winding form part of the expense ratio. In case of Debt fund the cost of credit rating is allowed, in case of Gold ETFs cost of storage and handling of gold can be charged to the scheme expense.

197. Is there a limit to total expenses that can be charged to a scheme?

Ans. All expenses incurred by Mutual fund AMC will have to be managed within the limits specified under the Regulation of 52 of SEBI mutual fund regulations.

198. Does Total Expense Ratio (TER) have any impact on scheme's NAV?

Ans. The daily NAV of mutual fund is disclosed after deducting the expenses thus TER has a direct bearing on Scheme's NAV. The lower the expense ratio higher the NAV.

199. When are the transactions for purchase and sale of investment recognised in mutual fund schemes?

Ans. Transactions for purchase or sale of investments should be recognised as of the trade date and not as of the settlement date. This is done so that the effect of all investments traded during a financial year are recorded and reflected in the financial statements for that year.

200. When are the investment transactions recognised in mutual fund schemes that happens outside the stock market or exchange?

Ans. The investment transactions that take place outside the stock market, for example, acquisitions through private placement or purchases or sales through private equity, should be recorded in the event of a purchase, as of the date on which the scheme has an obligation to pay the price or in the event of a sale.

201. Should Asset Management Company maintain books of accounts?

Ans. Yes, every asset management company for each scheme shall keep and maintain proper books of account, records and documents. This is done so as to explain its transactions and to disclose at any point of time, the financial position of each scheme.

202. When does the financial year for mutual fund schemes end?

Ans. The financial year for all schemes shall end on March 31st of each year.

203. When does the financial year end for a scheme that commenced in the middle of a financial year?

Ans. If the scheme commenced during a financial year the disclosure and reporting requirement would apply for the period beginning from the date of its commencement and ending on March 31st.

204. How does a mutual fund declare dividends?

Ans. A mutual fund may declare dividends in accordance with the offer document and subject to such guidelines as may be specified by SEBI. The dividend warrant has to be dispatched within 30 days of the declaration of dividend.

205. Is the AMC liable in case of delay in payment of dividend?

Ans. Yes, the AMC is liable in case of delay in payment of dividend. It is liable to pay interest to the unitholders at such rate as may be specified by the regulator for the period of such delay.

206. Is the AMC liable for failure to dispatch the redemption or repurchase proceeds?

Ans. The AMC may be further liable for penalty for failure to dispatch the redemption or repurchase proceeds within the stipulated time.

207. Do Asset Management Company prepare annual report?

Ans. Every mutual fund or the asset management company shall prepare in respect of each financial year an annual report and annual statement of accounts of the schemes and the fund.

208. Are the financial statements of AMC audited?

Ans. Yes, every mutual fund shall have the annual statement of accounts audited by an auditor who is not in any way associated with the auditor of the asset management company.

209. Who appoints the auditor for the audit of the financial statements of AMC?

Ans. An auditor shall be appointed by the trustees for the audit of the financial statements of AMC.

210. Are the copies of the annual report made available to all the investors?

Ans. The scheme wise Annual Report of a mutual fund or an abridged summary shall be provided to all unitholders as soon as or may be but not later than four months from the date of closure of the relevant accounts.

211. Can mutual funds invest in the Units of REITs and INVITs?

Ans. Yes, a mutual fund can invest in Units of REITs and INVITs.

212. Can a scheme invest in another scheme under the same asset management company?

Ans. Yes, a scheme may invest in another scheme under the same asset management company or any other mutual fund without charging any fees.

213. At which price a security is valued in a scheme portfolio?

Ans. A security is valued at the last quoted closing price on the principal stock exchange where it is traded.

214. At which price a security is valued if it is not traded on a particular date?

Ans. If a security is not traded on a particular date, then it will be valued on the closing price at which it was traded on the earliest previous day.

215. What is a non-traded security?

Ans When a security (other than money market and debt securities) is not traded on any stock exchange for a period of 30 days prior to the valuation date, the script must be traded as non-traded script.

216. What is a thinly traded equity security?

Ans. A thinly traded security is one where the volume traded is less than 50,000 and value traded is less than Rs Five Lakhs in a month.

217. What is the maximum limit of illiquid securities (non-traded or thinly traded security) in a scheme?

Ans. Illiquid securities shall not exceed 15% of the total assets of the scheme.

218. How are Exchange Traded Funds (ETFs) valued?

Ans. Exchange Traded Funds or ETFs are valued at closing market prices available on the stock exchange, NSE or BSE.

219. Who decides the valuation methodologies for the underlying securities?

Ans. SEBI decides the valuation methodology of the underlying securities. This policy and procedures of the valuation are reviewed at least once by the AMC in a financial year by an internal auditor.

VI. Performance measurement of a Mutual Fund

220. How to do the performance measurement of a mutual fund?
Ans. One can begin the performance measurement of a mutual fund by comparing the fund's return with the benchmark return. Further the returns of the mutual fund can be compared with that of its peers.

221. Define rate of return?
Ans. Rate of return has many definitions. Investor needs to know the purpose for which the return is calculated. Accordingly, he/she can use an appropriate measure for the rate of return. Many of these measures are discussed in the below listed questions.

222. What is known as Holding period return or HPR?

Ans. Holding period return is the total return received from holding an asset or portfolio of assets over a specified period of time, generally expressed as a percentage.

Holding-period-return (HPR), popularly known as point to point return is:

$$HPR = (I + (E - B)) / B$$

where,

HPR = holding-period return,

I = income (e.g. Dividend),

E = ending price (or NAV at the time of exit) and

B = beginning price (or NAV at the time of entry).

223. Explain holding period return with an example.

Ans. If an investor has purchased one unit of a mutual fund scheme on 1 April 2018, for Rs. 10.00, received Rs. 2.00 as dividend, and redeemed the unit on 31 March 2019, for Rs. 12.00, then his/her holding-period-return would be,

$$HPR = \frac{(2 + (12 - 10))}{10} \times 100$$

$$HPR = 40\%$$

224. Which investment performed better: Mutual Fund X, which was held for three years and appreciated from Rs.100 to Rs.150, providing Rs.5 in dividends, or Mutual Fund B, which went from Rs.200 to Rs.320 and generated Rs.10 in distributions over four years?

Ans. Calculate Holding Period Return (HPR),

$$\textit{HPR for Fund X} = \frac{5+(150-100)}{100} = 55\%$$

$$\textit{HPR for Fund B} = \frac{10+(320-200)}{200} = 65\%$$

Fund B had the higher HPR, but it was held for four years, as opposed to the three years for which Fund X was held. Since the time periods are different, this requires annualized HPR to be calculated,

Annualized HPR for Fund X= (0.55+1)^1/3−1=**15.73%**

Annualized HPR for Fund B= (0.65+1)^1/4−1=**13.34%**

Thus, despite having the lower HPR, Fund X was the superior investment.

225. Is holding period return widely used?

Ans. Yes, holding period return measure is widely used and generally accepted indicator for performance comparison purposes. This is considered as the starting point of performance measurement exercise.

226. What is Compounded Annual Growth Rate (CAGR)?

Ans. Compound annual growth rate (CAGR) is the rate of return at which an initial investment grows from its beginning date to its ending balance (or redemption date) , assuming the profits were reinvested at the end of each year of the investment's lifespan.
The formula is,
CAGR = $(A / P)^{(1/t)} - 1$,
Where
'A' is the closing wealth,
'P' is the opening wealth and
't' is the time period in years
Suppose Mutual Fund X, which was held for three years was Rs.100 in the year 2015 which appreciated to Rs.125 in 2016, and to Rs.150 in 2017. Therefore the CAGR of fund X will be $(150/100)^{(1/2)} - 1 = 22.47\%$

227. How should the performance of mutual funds scheme be communicated?
Ans. The performance of mutual fund scheme should be advertised in terms of Compounded Annual Growth Rate (CAGR) for the past 1 year, 3 years, 5 years and since inception. In order to provide ease of understanding to retail investors, point-to-point returns on a standard investment of Rs.10,000/-shall also be provided in addition to CAGR of the scheme.

228. What is the Rupee-weighted rate of return?
Ans. The **Rupee-weighted rate of return** sets the initial value of an investment to equal the future cash flows such as dividends added, withdrawals, deposits, and the sale proceeds. It is calculated by finding the rate of return that will set the present values of all cash flows equal to the value of the initial investment. Each inflow or outflow must be discounted back to the present using a rate (r) that will make PV (inflows) = PV (outflows).

Let's say an investor buys one unit of a fund for Rs.500 that pays an annual Rs.20 dividend and sell it after two years for Rs.650. Our rupee weighted rate of return will be a rate that satisfies the following equation:

PV of Cashflows = $\frac{20}{1+r} + \frac{20}{(1+r)^2} + \frac{650}{(1+r)^3}$ = Rs.500

Solving for 'r' using a spreadsheet or financial calculator, we have a rupee weighted rate of return = 11.73%.

229. What is Time-Weighted Return (TWR)?
Ans. The time-weighted rate of return (TWR) is a measure of the compound rate of growth in a scheme.

230. Why Time-Weighted Return (TWR) is often used to compare the returns of investment managers?

Ans. - The TWR measure is often used to compare the returns of investment managers because it eliminates the distorting effects on growth rates created by inflows and outflows of money.
- The time-weighted return breaks up the return on an investment portfolio into separate intervals based on whether money was added or withdrawn from the fund.

231. How is Time-Weighted Return (TWR) calculated?
Ans. To compute Time-Weighted Return (TWR) we first add one to each year's holding-period return to determine the return's wealth relative.
- The formula to calculate TWR is:

$$TWR = \left[\prod_{i=1}^{n} \left(1 + HPR_i\right) \right]^{1/n} - 1$$

Where
TWR = time-weighted rate of return,
HPR_i = holding period return for year i and
n = number of years in measurement period
1 + HPR_i = Wealth relative

232. Explain Time-Weighted Return (TWR) with an example.
Ans. Now we know how to calculate wealth relative, i.e. (1 + HPR)

Year	HPR	Wealth Relative
2014	-0.05	0.95
2015	-0.15	0.85
2016	0.03	1.03
2017	0.31	1.31
2018	0.18	1.18
Product of wealth relative		**1.28**

TWR = (1.28) ^ (1/5) - 1
= 5.06%

233. What is a wealth ratio?
Ans. A value equal to one plus the periodic rate of return.. This value is used to link returns in computing the geometric average.

234. When is it appropriate to use Time-Weighted Return (TWR)?

Ans. TWR ignores the effect of intermediate cash flows. So, when the fund manager has no control on intermediate cash flows, TWR represents his performance better. As this is the general situation in a mutual fund that is why TWR is preferred.

235. What is arithmetic mean return?

Ans. The average annual arithmetic return is the simple average of individual total **yearly returns**.

Eg. If a holding-period rate of return of -50 percent in the first year and 100 percent in the second year. Then arithmetic mean return is as follows,

$$\text{Arithmetic mean return} = \frac{-50\% + 100\%}{2} = 25\%$$

236. What does the yearly return comprise of?

Ans. The yearly return is the sum of,

(1) The percentage gain (or loss) in the value of your portfolio due to changes in asset prices. (2) Any dividends or other cash distributions expressed as the percent of invested assets.

237. What is the average annual geometric return?

Ans. The average annual geometric return is the rate at which the sum you invested at the beginning of the period will accumulate to a given sum at the end of the period by the process of compounding, or continuously reinvesting your dividends and capital gains.

238. When are arithmetic and geometric mean different?

Ans. Arithmetic and Geometric mean are different over longer holding periods and the geometric average return is always less than the arithmetic return except when all the individual's yearly returns are exactly the same, (i.e. the series has no dispersion) in which case the geometric return equals the arithmetic return.

239. Which is the best method to estimate a future year's return based on random distribution of previous year's return?

Ans. The best estimate of a future year's return based on a random distribution of the prior years' returns is the arithmetic average return. Statistically, it is our best guess for the holding-period return in a given year.

240. When should one use arithmetic or geometric mean return?

Ans. If one wishes to estimate the expected value of an investment over a multiyear horizon conditioned on past experience, he/she should also use the arithmetic average and if, however, one wishes to estimate the probability distribution of terminal wealth then he/she should use the geometric average.

241. What is risk?

Ans. Risk in a generic sense is the possibility of loss, damage, or harm. For investment a more specific definition of risk can be given. It refers to variability in the expected return.

242. Is return the only performance measure of a fund manager's skill?

Ans. No, Risk is the key dimension of the performance measurement, and a decisive factor in determining a fund manager's skill. One cannot make a judgment about how skilful a manager is in a particular period by looking at return only.

243. What is a riskometer?

Ans. Riskometer is a graphical representation of the risk a mutual fund carries. The graph is designed as per the Association of Mutual Funds in India (AMFI) guidelines.

244. What are the different levels of risk in a riskometer?

Ans. There are 5 levels of in a riskometer which are as follows

Risk level	**Colour**	**Suitable for**
Low	Green	Those who are risk-averse and give priority to their investment.
Moderately low	Light green	Those who prefer to take nominal risks but also prioritise the safety of their investment.
Moderate	Yellow	Those who prefer to invest longer than short-term and would be ready to undertake a certain degree of risk for slightly lucrative returns.
Moderately high	Orange	Those who opt long for long-term investment and are ready to be exposed to some degree of risk.
High	Red	These are ideal for high net worth individuals or aggressive investors who want to invest for long-term and don't mind the risk of incurring losses.

245. What is standard deviation?

Ans. Standard deviation is a measure of dispersion in return. It quantifies the degree to which returns fluctuate around their average. A higher value of standard deviation means higher dispersion.

246. How to calculate standard deviation?

Ans. - The formula to calculate standard deviation is,

$$SD = \sqrt{\frac{\sum_{i=1}^{n}\left(x_i - \bar{x}\right)^2}{n}}$$

Where, xi = individual observations
x = mean of observations
n= number of observations
It is basically the square root of variance.

Example: Suppose a mutual fund achieves the following annual rates of return over the course of five years: 4%, 6%, 8.5%, 2%, and 4%.

Mean of annual rate of returns = 4% + 6.5% + 8.5% + 2% + 4% = 4.9%
5

- Therefore, standard deviation is,

$$SD = \sqrt{\frac{(4\%-4.9\%)^2+(6\%-4.9\%)^2+(8.5\%-4.9\%)^2+(2\%-4.9\%)^2+(4\%-4.9\%)^2}{5}}$$

SD= 2.46%.

- That means that each individual yearly value is an average of 2.46% away from the mean.

247. What is the general period for which standard deviation is calculated?

Ans. Standard deviation is generally calculated for monthly returns over a specific time period usually 36 months. And, because most people think about returns on an annual not monthly basis the resulting number is then modified to produce an annualized standard deviation.

248. Is a high standard deviation always a bad thing?

Ans. No, supposedly a fund that alternately gained 5% or 25% each month would have a much higher standard deviation, but it would surely be a preferable investment compared to a mutual fund that lost 1% each and every month would also have a standard deviation of zero.

249. What does a high standard deviation signify and is it a good proxy for measuring the risk of loss?

Ans. - Mathematically it is possible to have a high standard deviation of returns while exhibiting no downside risk, but in the real world, the larger the swings in a security's return the more likely it is to dip into negative territory.

- Though standard deviation measures volatility on both the upside and the downside, it's a good proxy for measuring the risk of loss with any security.

250. What is the strength or advantage of standard deviation?

Ans. One of the strengths of standard deviation is that is can be used across the board for any type of portfolio with any type of security. The calculation is the same for a portfolio of bonds as it is for a portfolio of growth stocks. Standard deviation allows portfolios with similar objectives to be compared over a particular time frame.

251. What is the excel function used to calculate standard deviation?

Ans. Standard deviation can be calculated using the 'STDEV' function in MS Excel. Since standard deviation can also be calculated using variance of a security. Use 'VAR' function to calculate variance and the use 'SQRT' function to get the square root of it.

252. How to calculate annualized Standard deviation?

Ans. If Standard deviation is calculated for monthly returns over a specific time period, to get the annualized Standard deviation we have to multiply the calculated standard deviation by square root of the number of months during a year i.e. 12. If Standard deviation is calculated for monthly returns then it should be multiplied by square root of 252 days (working days convention) or 365 days (calendar days convention)

253. How to interpret standard deviation?

Ans. If a fund has a monthly standard deviation of 3.27%. Suppose the monthly return of the scheme is 2%. This means in future:

- There is 66.7% (1 Standard deviation on normal distribution chart) probability that the fund return would be between 2% - 3.27% to 2%+3.27%
- There is 95% (2 Standard deviation on normal distribution chart) probability that the fund return would be between 2% - 6.54% to 2% + 6.54%.
- There is 99% (3 Standard deviation on normal distribution chart) probability that the fund return would be between 2% - 9.81% to 2% + 9.81%.

254. What is Systematic risk?

Ans. - Systematic risk refers to the risk inherent to the entire market or market segment. Systematic risk, also known as "un-diversifiable risk or "market risk". It affects the overall market, and not just a particular stock or industry. This type of risk is cannot be mitigated through diversification.

255. What is unsystematic risk?

Ans. Risk that is specific to individual securities and sectors and can be diversified away hence an investor should not expect compensation for bearing this type of risk as per CAPM.

256. How should a portfolio be evaluated in combination with other portfolios?

Ans. When a portfolio is evaluated in combination with other portfolios, its excess return should be adjusted by its systematic risk rather than by its total risk as per CAPM.

257. What is Beta?

Ans. Market risk is measured by Beta. Beta relates the return of a stock or mutual fund to a market index. It reflects the sensitivity of the fund's return to fluctuations in the market index.
. Beta is given by the formula,

Beta = <u>Covariance (Market-Index return, MF/Security return)</u>

Variance (Market-Index return)

Where,

Covariance = How change in stock's return are moving to change in market's return.

Variance = How far the market's data points spread out from their average value.

Covariance (Market-Index, MF-Security) = Covariance between the index's return and the mutual fund scheme's return.

Var (Market-Index) = Variance in the index return.

Ri	Rm
3.80%	2%
1.80%	0.90%
3%	2.30%
-0.90%	-0.60%
-4.20%	4.50%
-1.90%	-1.20%
2.70%	2%
3.30%	1.80%

Example:

Where,

Ri = Return of individual security.

Rm = Return of market.

$$\text{Beta} = \frac{\text{Covariance (Rm, Ri)}}{\text{Variance (Rm)}}$$

Beta = 1.2

258. What are the parameters required to calculate beta of a mutual fund?

Ans. Beta calculation requires two series of values for a reasonably long period of time, say 3 to 5 years.

- One series of values would be the mutual fund scheme's NAV.
- The second series would be the market index on all the dates for which the NAV of the scheme has been considered.

259. How can you calculate beta in Excel?

Ans. It can be calculated using 'VAR' (Variance) and 'COVAR' (Covariance) functions in excel.

260. How to interpret beta?

Ans. A beta that is greater than one means that the fund or stock is more volatile than the benchmark index, while a beta of less than one means that the security is less volatile than the index.

Example: - For a stock with beta 1.2 means that if the market moves up 10% then the stock will move up by 12% and vice-versa.

- For a stock with beta 0.8 means that if the market moves up 10% then the stock will move up by 8% and vice-versa.

- For a stock with beta 1 means that if the market moves up 10% then the stock will move by 10% and vice-versa. It is in-line with the market.

261. What are the drawbacks of beta?

Ans.

- Beta is calculated using historical data points, so it becomes less meaningful for investors looking to predict a stock's future movements.
- Beta is also less useful for long-term investments since a stock's volatility can change significantly from year to year, depending upon the company's growth stage and other factors.

262. What does negative beta interpret?

Ans. A negative beta indicates that the security is inversely correlated to the market benchmark.

263. What are the major methods of assessing risk-adjusted performance?

Ans. The two major methods of assessing risk-adjusted performance are:

- Return per unit of risk.
- Differential return (Alpha) explain alpha before you write this answer.

264. What are the Return per unit of risk measures?

Ans. The Return per unit of risk measures are:

a) Sharpe ratio.

b) Treynor ratio.

They are majorly used for ranking fund’s performance.

265. What is the Sharpe ratio?

Ans.

- The Sharpe ratio was developed by Nobel Laureate William F. Sharpe and is used to help investors understand the return of an investment compared to its risk.
- The ratio is the average return earned in excess of the risk-free rate per unit of volatility or total risk.
- Volatility is a measure of the price fluctuations of an asset or portfolio.
- Sharpe ratio is calculated using the formula,

$$S = \frac{\left(R_p - R_F\right)}{\sigma_p}$$

Where,

Rp = Return of portfolio (Annualized)

Rf = Risk free rate (Annualized)
sp = Standard deviation of the portfolio's excess return. (Annualized)
Let's further understand how to calculate and interpret Sharpe ratio.

266. Understanding Sharpe ratio with an example.

Ans. An investor is considering investing in a blue-chip mutual fund which has returns of 15% over the last year. The current risk-free rate is 6% (10-year Government T-bill), and the standard deviation of the portfolio's returns was 12%,

$$\text{Sharpe ratio} = \frac{(15\% - 3.5\%)}{12\%}$$

Sharpe ratio = 0.75

This suggests that the fund has generated 0.75 percentage point of return above the risk-free return for each unit of standard deviation.

The greater the value of the Sharpe ratio, the more attractive the risk-adjusted return.

267. Is Sharpe ratio a measure of relative performance?

Ans. Yes, the Sharpe ratio is a measure of relative performance, in the sense that it enables the investor to compare two or more investment opportunities. A fund with a higher Sharpe ratio in relation to another is preferable as it indicates that the fund has higher risk premium for every unit of standard deviation (risk).

268. When is Sharpe ratio more relevant to use?

Ans. Sharpe ratio adjusts return to the total portfolio risk, the implicit assumption of the Sharpe measure is that the portfolio will not be combined with any other risky portfolios.

Thus, the Sharpe ratio measure is relevant for performance evaluation when we wish to evaluate several mutually exclusive portfolios.

269. How to interpret Sharpe ratio using an example

Ans. Suppose the Sharpe ratio of Fund X is 1.5 and that of Fund Y is 2.75. Then in this case, it indicates that Sharpe ratio of Fund Y in relation to Sharpe ratio of Fund X is preferable as it indicates that the fund has higher risk premium for every unit of standard deviation (risk).

270. What is the Treynor ratio?

Ans.

- The Treynor ratio, also known as the reward-to-volatility ratio, is a performance metric for determining how much excess return was generated for each unit of risk taken on by a portfolio.
- The Treynor measure adjusts excess return for systematic risk i.e. Beta.
- Treynor ratio is calculated by,

$$T = \frac{\left(R_p - R_F\right)}{\beta_p}$$

Where
T = the Treynor measure,
R_p = portfolio return,
R_f = riskless return and
β_p = portfolio beta.

271. Explain Treynor ratio with an example.

Ans. Assume that portfolio manager for a blue-chip mutual fund has returned 10.90% over the last year. The current risk-free rate is 6% (10-year Government T-bill), and the beta of the fund was 0.74,

$$T = \frac{\left(R_p - R_F\right)}{\beta_p}$$

$$T = \frac{(10.9\% - 6\%)}{0.74}$$

T = 6.62

Suppose another portfolio manager has returned 12.5% over the last year. The current risk-free rate is 6% (10-year Government T-bill), and the beta of the fund was 1.5,

$$T = \frac{(12.5\% - 6\%)}{1.5}$$

T = 4.33

So even though the second fund manager has exceeded the first one in terms of return, the beta of second fund is more than the first one. Hence on the basis of Treynor ratio the first fund has performed better.

272. When is Treynor ratio more relevant to use?

Ans. As Treynor ratio indicates return per unit of systematic risk, it is a valid performance criterion when we wish to evaluate a portfolio for excess return per unit of market risk. Like Sharpe ratio it is too a measure of relative performance.

273. What is differential return?

Ans. It is one of the Risk-adjusted return measures. It is defined as the return that should be expected for the fund scheme given its risk and to compare that with the return actually realized over the period.

274. What are considered as Differential risk-adjusted performance measures?

Ans. The differential risk-adjusted performance measures are:

a) Jensen alpha.
b) Appraisal ratio.
c) M^2 Measures.

275. What is Capital Asset pricing Model (CAPM)?

Ans. The Capital Asset pricing Model (CAPM) is a widely used method to price risky securities and it assumes that risk consists of a systematic component and a specific component (unsystematic component). The relevant risk for pricing the securities under CAPM is systematic risk.

276. How is Jensen alpha calculated?

Ans. Jensen Alpha can be formulated as:

$$\alpha = \left(R_p - R_F\right) - \beta_p\left(R_B - R_F\right)$$

Where
α = the Jensen measure (alpha),
R_p = portfolio return,
R_F = riskless return,
β_p= portfolio beta and
R_B= benchmark return

277. Understanding Jensen alpha with an example.

Ans. Example: Assume a mutual fund realized a return of 15% last year. The appropriate market index for this fund returned 12%. The beta of the fund versus that same index is 1.2, and the risk-free rate is 3%.

$$\alpha = \left(R_p - R_F\right) - \beta_p\left(R_B - R_F\right)$$

Jensen Alpha = (15% - 3%) + 1.2 x (12% - 3%)
= 12% - 10.8%
= 1.2%

*This positive Jensen alpha means that mutual fund manager earned more than required return for the risk he/she took over the course of the year.

278. How to interpret alpha returns?

Ans. A positive alpha means that return tends to be higher than required return given the beta statistic. Conversely, a negative alpha indicates that the fund is an under performer compared to the benchmark return. Alpha measures the value-added of the portfolio given its level of systematic risk.

279. What is Appraisal ratio (Information Ratio)?

Ans. Appraisal ratio is calculated by dividing alpha by the standard error (unsystematic risk).

280. How is Appraisal ratio formulated?

Ans. Appraisal ratio can be formulated as,

$$A = \frac{\alpha}{\sigma_c}$$

Where
A = the appraisal ratio,
α = alpha and
σ_c = the standard error (unsystematic risk).

Let's assume Mutual Fund XYZ has an alpha of 0.06 and an unsystematic risk of 0.60. Using this information and the formula above,
Mutual Fund XYZ's appraisal ratio is 0.06 / 0.60 = 0.01.

281. How to interpret Appraisal ratio?

Ans.

- The numerator represents the fund manager's ability to use his skill and information to generate a portfolio return that differs from the benchmark against which his performance is being measured.
- The denominator measures the amount of residual (unsystematic) risk that is incurred in pursuit of those excess returns.
- Thus, this ratio can be viewed as a benefit to cost ratio that assesses the quality of fund manager's skill.
- The higher the ratio, the better the performance of the manager.

282. Who derived the M^2 Measure and What is M^2 Measure?

Ans. M^2 Franco Modigliani and his granddaughter Lea Modigliani in the year 1997 derived a risk-adjusted performance measure. It is also known as Modigliani–Modigliani measure.
This measure adjusts the risk of a particular portfolio so that it matches the risk of the market portfolio and then calculating the appropriate return for that portfolio. The return that this adjusted portfolio earns is called M^2.

283. How is M^2 Measure calculated?

Ans. M^2 Measure is calculated by,

$M^2 = (\sigma_m / \sigma_{mf}) \text{ X } (R_{mf} – R_f) + R_f,$
Where,
σ_m is the standard deviation of the market
σ_{mf} is the standard deviation of the scheme
R_f is the risk-free return and
R_{mf} is the return on the scheme.

284. How to interpret M^2 Measure?

Ans. Since the standard deviations have been equalized, M^2 can be directly compared with the return in the market. A high (low) M^2 indicates that the portfolio has outperformed (under-performed) the market portfolio.

285. Are measures involving beta appropriate to evaluate the performance of debt securities?

Ans. No, Beta is considered theoretically unsound for debt schemes as beta is based on the capital assets pricing model, which is empirically tested for equities.

286. How interest rates impact the bond portfolio?

Ans. Bonds prices are sensitive to changes in market interest rates. Bond portfolio prices change in the opposite direction of changes in market rates of interest. As market rates of interest increase (decrease) the market values of the bond portfolios decrease (increase).

287. What is bond's duration?

Ans. The price sensitivity of a bond to changes in interest rates is approximated by the bond's duration. Duration measures the average time required for the investor to receive the investment and the interest on it.

288. Is the bond's duration similar to the maturity of the bond?

Ans. It is similar to the maturity of the bond except that the maturity only considers the timings and the amount of the final payment of a bond. Duration, on the other hand also considers the impact of the timing and magnitude of coupon payments.

289. What is a zero-coupon bond and its duration?

Ans. A zero-coupon bond is a debt security that does not pay interest but instead trades at a deep discount, rendering a profit at maturity, when the bond is redeemed for its full-face value. Duration of a zero-coupon bond is the same as its maturity.

290. What is the relationship between duration and maturity of the bond?

Ans. Bonds with long maturities and low coupons have the longest durations. These bonds are more sensitive to a change in market interest rates and thus are more volatile in a changing rate environment. Conversely, bonds with shorter maturity dates or higher coupons will have shorter durations. Bonds with shorter durations are less sensitive to changing rates and thus are less volatile in a changing rate environment.

291. What is the significance of duration?

Ans. The significance of the duration is that greater the duration, more volatile is the portfolio's return in respect to changes in the level of interest rates.

292. What is yield-to-maturity or YTM?

Ans. Yield to maturity (YTM) is the total return anticipated on a bond if the bond is held until it matures. Yield to maturity is considered a long-term bond yield but is expressed as an annual rate. Basically, it is the internal rate of return (IRR) of an investment in a bond.

Eg: Assume that there is a bond on the market priced at Rs. 850 and that the bond comes with a face value of Rs. 1,000 (a fairly common face value for bonds). On this bond, yearly coupons are Rs. 150. The coupon rate for the bond is 15% and the bond will reach maturity in 7 years.

$$YTM = \frac{C + \frac{FV - PV}{t}}{\frac{FV + PV}{2}}$$

$$YTM = \frac{150 + \frac{1{,}000 - 850}{7}}{\frac{1{,}000 + 850}{2}} = 18.53\%$$

Therefore, the YTM is 18.53%.

293. How is the bond's duration calculated?

Ans. Bond's duration is formulated as,

$$Duration = \frac{\sum_{i=1}^{t} \frac{TxC}{(1+r)^t} + \frac{nxM}{(1+r)^n}}{\sum_{1=1}^{n} \frac{C}{(1+r)^t} + \frac{M}{(1+r)^n}}$$

where

C = semiannual coupon interest payment

r = one-half the relevant market rate of interest

n = number of years to maturity

t = number of semiannual coupon payments

M = principal value of the bond

T = period in which cash flow is received

* The duration measure calculated here is known as **the Macaulay duration**, named for Frederick Macaulay, who was among the first to use this measure in studying the returns on fixed-income securities.

- The denominator in the duration formula is the market value of the bond.
- The numerator, which at first glance appears similar to the denominator, weights the present value of each cash flow, $C/(1 + r)^t$ by the time period in which it is to be received.

Bond Duration is proportional to the risk associated with the debt mutual funds. Debt funds with low duration are perceived to be less risky compared to Long duration funds because the risk of interest rates is low in low duration bond. So investors should be cautious while selecting a fund as per his/her risk appetite.

294. What is known as modified duration?

Ans. A slight variant to the Macaulay duration is known as modified duration.
The modified duration of a bond helps investors understand how much a bond's price will rise or fall if the YTM rises or falls by 1%.

295. How is modified duration calculated?

Ans. Modified duration is formulated as,

$$\text{Modified duration} = \frac{\text{Macaulay duration}}{1 + r}$$

Where,
r = Yield to maturity (YTM) (Annualized)

296. Understanding Modified duration with an example.

Ans. Example: If Macaulay duration of a bond is 2.684 and its Yield to maturity is 6% annualized. What is the modified duration?

$$\text{Modified Duration} = \frac{\text{Macaulay duration}}{1 + \text{YTM}}$$

$$= 2.684 / (1 + 6\%)$$

Modified Duration = 2.53

* In this case, if the YTM increases from 6% to 7% because interest rates are rising, the bond's value should fall by 2.53%. Similarly, the bond's price should rise by 2.53% if the YTM falls from 6% to 5%.

297. How to calculate a Bond portfolio's duration?

Ans. Bond durations have the desirable property of being additive. As a result, the duration of an entire bond portfolio can be computed as the weighted average duration of each bond, where the weights are the proportion of the fund in each bond:

Bond portfolio duration =

$$\sum_{i=1}^{n} W_i \text{ x } D_i$$

Where
n = number of bonds
W_i = percent of the fund's value represented by each bond
D_i = duration of each bond

298. How is percentage price change in a bond portfolio calculated?

Ans. % change in the price of a bond portfolio =

(-Modified duration) x (Change in interest rate in basis points)

The same change in interest rates affects a longer maturity debt security more than a shorter maturity debt security.

299. Which maturity bond is riskier, and which is most preferred by an investor?
Ans. Generally, yields on bonds increase as bonds' maturities increase. So, longer the maturity of the bond, higher is the yield but it also carries a higher amount of price and duration sensitivity. Bond Duration is proportional to the risk associated with the debt mutual funds. Debt funds with low duration are perceived to be less risky compared to Long duration funds because the risk of interest rates is low in low duration bond. Longer the duration more is the bond susceptible to interest rates and price fluctuations. So investors should be cautious while selecting a fund as per his/her risk appetite. The most preferred by an investors are low or short duration bonds.

300. How is the performance measured of an index fund?
Ans. Performance of an index fund be it debt index fund or equity index fund is measured by computing tracking error (TE).

301. What is tracking error (TE)?
Ans. Tracking error is a statistic that indicates the divergence of the return of the fund from the index. Tracking error is given by,

Tracking error (TE) = $\sqrt{Variance(Rp - Rm)}$

Where,
Variance = variance of the difference
Rp = Return of the mutual fund portfolio
Rm = Return on the appropriate index benchmark

Example: Assume that there is a large-cap index fund benchmarked to the Nifty 50 index. Next, assume that the mutual fund and the index realized the following returns over a given five-year period:

- Mutual Fund: 11%, 3%, 12%, 14% and 8%.
- S&P 500 index: 12%, 5%, 13%, 9% and 7%.

Therefore,

Tracking error =
$$\sqrt{(11\% - 12\%)^2 + (3\% - 5\%)^2 + (12\% - 13\%)^2 + (14\% - 9\%)^2 + (8\% - 7\%)^2}$$
5 - 1

Tracking error = 2.82%

* Annualised TE is the standard measure of performance of an index fund.

302. How to interpret tracking error?
Ans.

- The tracking error show much the fund has deviated from the benchmark portfolio.
- Evaluating a past tracking error of a portfolio manager may provide insight into the level of benchmark risk control the manager may demonstrate in the future.

303. What does low tracking error signify?

Ans. Low tracking error indicate that the performance of the portfolio is close to the performance of the benchmark. Low error are common with index funds and ETFs that replicate the composition of major stock market indices.

304. What does high tracking error signify?

Ans. High errors reveal that the portfolio's performance is deviating from the performance of the benchmark. The high errors can indicate that the portfolio substantially beat the benchmark, or signal that the portfolio significantly underperformed the benchmark.

305. Tracking error of which period is more important for a fund manager?

Ans. A long-term trend TE should be calculated for a long period of time. In practical terms this would normally be 36 or 60 months. However, a fund manager is more likely to track his performance daily and make corrections to the fund periodically.

306. What are the reasons for a higher Tracking error TE?

Ans. The reason for the existence of TE is the expense ratio because funds have fees whereas indices do not. Hence higher the expense ratio, more will be the tracking error. Time lag in replicating the index also contributes to tracking error.

307. Do we need to make adjustments while calculating return if load is present?

Ans. Yes, adjustments are required to be made in the sale and redemption price for calculating actual rate of return if load is present.

308. What is sale/subscription price?

Ans.

- The price or NAV a unit holder is charged while investing in an open-ended scheme is called sales price.
- The sale/ subscription price of the units on an on-going basis will be based on the applicable NAV plus applicable entry load if any.
- The sale/ subscription price will be calculated using the following formula:

$$\text{Sale/Subscription price} = \frac{\text{Applicable NAV}}{1 - \text{Entry load (if any)}}$$

309. What is Redemption/ Repurchase Price?

Ans.

- Repurchase or redemption price is the price or NAV at which an open-ended scheme purchases or redeems its units from the unit holders.
- It is to be calculated on the basis of the applicable NAV and exit Load (if any). The repurchase price per unit of the respective will be calculated using the following formula:

Redemption/ Repurchase Price = Applicable NAV X [1 - Exit load (if any)]

310. What price do funds tracking agencies use to measure the performance of the funds?

Ans. Funds tracking agencies calculate the performance of the funds on NAV basis.

311. What is the portfolio turnover rate?

Ans. Portfolio turnover is a measure of how frequently securities within a fund are bought and sold by the managers. Portfolio turnover is calculated by taking either the total amount of new securities purchased or the number of securities sold (whichever is less) over a particular period, divided by the average net assets of the fund. The measurement is usually reported for a 12-month time period.

312. What does a high turnover ratio imply?

Ans. A high turnover ratio means high transaction costs due to higher brokerages and settlement fees.

313. Where is the low expense ratio observed?

Ans. The lowest expense ratios are observed among liquid funds> in equity funds, index funds and ETFs have lower expenses ratio because they are passively managed.

314. Where is the high expense ratio observed?

Ans. Actively managed Equity funds have higher expense ratios than fixed income funds. Funds that invest internationally tend to have significantly higher expense ratios than do domestic portfolios, due to greater research and other costs associated with foreign investing.

315. Where to find the expense ratio of a mutual fund scheme?

Ans. An investor can check information on a scheme's expenses ratio in its offer document and Fact sheets.

316. What is performance evaluation?

Ans. Performance evaluation involves benchmarking and peer group analysis. After measuring the performance, the next important step is to evaluate it against the fund's suggested benchmark to address more important issues like how the measured return measures up to the similar investment opportunities.

317. What is benchmarking?

Ans. Benchmarking is the practice of comparing business processes and performance metrics (here mutual funds) to industry bests and best practices (indexes).

318. How benchmarking mutual fund portfolios is done?

Ans. Indices are used for benchmarking mutual fund portfolios.

319. What is the important thing while selecting an index as a benchmark for an equity portfolio?

Ans. While selecting an index as a benchmark for equity portfolio it is important to ensure that the capitalization of the portfolio matches with that of the index.
The second important aspect is the mix of stocks i.e., whether the index comprises all growth stocks or value stocks.

320. What are the benchmarks used for debt-oriented schemes and balanced funds?

Ans. For various types of debt-oriented schemes and balanced fund schemes SEBI in consultation with AMFI has arrived at specific indices.

321. What is peer group analysis?

Ans. Peer group analysis is simply ranking the fund manager performance. The term "peer group" is generally applied to a group of fund managers defined by a specific asset class or investment style. Peer group analysis is an extensively used tool of performance evaluation by the mutual fund industry.

322. What does a peer group consist of?

Ans. Generally, a peer group is the collection of the fund managers that are investing in the similar segment of the market, i.e., equity, fixed income or a mix of both.
Peer groups can be more narrowly defined on the basis of style. Examples of style peer groups include funds making investments in large capitalization stocks, small capitalization, and sector specific investing like technology stocks etc.

323. What should one do to track a fund's performance?

Ans. - In order to make informed investment decisions, an investor should monitor the performance of the schemes.
- Tracking funds' performance involves recording the NAV on a regular basis, if not daily at least monthly or quarterly.
- AMFI and many other sites, newspapers, especially business papers publish NAV information. Investors can use some appropriate measure of return and look at the performance of these funds.

324. When and where are the mutual funds required to publish their financial statements?

Ans. The Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 require the mutual funds to publish their half-yearly results in newspapers and disclosure of full portfolio on half-yearly basis within one month from the end of the half-year in one English daily newspaper circulating in the whole of India and in a newspaper published in the language of the region where the head office of the mutual fund is situated.

325. Where and how mutual fund investors can check the performance of the funds?
Ans. Investors can check the performance of the fund by looking at its fact sheet. Factsheets are periodically (monthly) published by the mutual funds. The factsheets of the mutual funds are available through AMFI's site.

326. What information does a factsheet provide for equity-based funds?
Ans. Factsheet provides the following information:

1. Investment objective of the scheme
2. AUM of the scheme
3. Date of allotment of the units (inception date)
4. Benchmark of the scheme
5. Portfolio turnover
6. Statistical measures
    a. Standard deviation
    b. Beta
    c. Sharpe ratio Treynor ratio
7. Sector allocation
8. Performance of the scheme
9. CAGR
10. Growth of Rs. 10000 invested in the scheme for a period of
    a. 1 year
    b. 3 years
    c. 5 years
    d. Since inception
11. Information on dividend
12. Information on load
13. Portfolio allocation – sector wise & securities wise
14. Information on the fund manager

327. What information does a factsheet provide for fixed income-based funds?
Ans.

1. Investment objective of the scheme
2. AUM of the scheme
3. Date of allotment of the units (inception date)
4. Benchmark of the scheme
5. Portfolio turnover

6. Average Maturity
7. Modified Duration
8. Macaulay Duration
9. YTM
10. Instrument type/ issuer name
11. Dividend history
12. Information on load
13. Information on the fund manager

VII. Taxation of Mutual Funds/MF Investors

328. What is Securities Transaction Tax (STT)?

Ans. Securities Transaction Tax (STT) is a direct tax levied on every purchase and sale of securities that are listed on the recognized stock exchanges in India. Taxable securities include equity, derivatives, unit of equity oriented mutual fund
.

329. What is Capital Gains Tax?

Ans. Capital Gain can be defined as the difference between sale price and acquisition cost of the investment. The tax paid on these capital gains by the investors is called capital gains tax.

330. Are capital gains classified into different categories?

Ans. Yes, capital gains are classified into two heads: (a) Short Term Capital Gains and (b) Long Term Capital Gains.

331. What is the tenor for short-term capital gains/investments in mutual fund schemes?

Ans. The tenor for short-term investment in mutual fund schemes is based on two parts: (a) investment held for 12 months or less (Equity Oriented Schemes) and (b) investment held for 36 months or less (Other than Equity Oriented Schemes).

332. What is indexation?

Ans. Indexation refers to adjusting the cost of acquisition, based on the cost of inflation index published by Central Board of Direct Taxes (CBDT).
The formula for indexation is – Cost of Acquisition * (CII in the year of sale/CII in the year of purchase), where CII is Cost Inflation Index.

333. Which capital gain is applicable for indexation?

Ans. Only long-term capital gain from Other than Equity Oriented Mutual Fund (debt funds, gold funds, etc.) can be indexed for inflation.

334. How can investors apply for indexation benefits?

Ans. In Other than equity oriented Mutual fund indexation benefit is given for long term capital gain (LTCG) i.e. 36 months or more and the tax rate is 20% with indexation.

VIII. Organizational Structure of Mutual Funds

335. Who mandates the structure of mutual funds in India?

Ans. The legal structure of mutual fund is mandated by SEBI Mutual Fund Regulations 1996.

336. How is a mutual fund organized in India?

Ans. Mutual Fund in India is organised as a Trust under Public Trust Act in India. SEBI regulations suggest model trust deed. The trustees of the trust can be natural person (s) or a trustee company. Most of the mutual funds in India opted for Trustee Company structure for appointing trustees. However, after launching a scheme, trust entrusts the management of the affairs of the mutual fund schemes to an Asset Management Company (AMC).

337. What is the primary role of trustees?

Ans. The roles of trustees are:

- The main role of a trustee is to ensure that the interest of the unit holders is protected while making sure that the mutual fund complies with all the regulations of SEBI.
- The trustee must ensure that the AMC has put in place adequate systems for dealing, execution of purchase and sale orders, back office systems through appointment of RTA, proper checks and balances for new flows and redemptions etc.
- The trust also ensures that all the key personnel of a mutual fund are appointed with adequate qualifications and skills. This includes the appointment of critical employees like the CEO, CIO, fund managers etc.
- The trustee is the custodian of the trust of millions of mutual fund investors.

338. What is the structure of a mutual fund in India?

Ans. The mutual fund in India is constituted with the following constituents:

1. Sponsor
2. Trustees
3. Custodian
4. Asset Management Company
    - Distributors/Agents
    - Banker
    - Registrar and Transfer Agents
5. Internal and statutory auditors.
6. Compliance officer.

339. Who is a sponsor?

Ans. A sponsor

- Initiates the process of setting up a mutual fund trust.
- Establishes the fund – registers and forms the trust and also appoints the trustees.
- Gets the trust/mutual fund entity registered with SEBI

340. How are the instruments in a trust organized?

Ans. The instrument of trust has to be in the form of a deed, duly registered under the provisions of the Indian Registration Act, 1908 executed by the sponsor in favour of the trustees named in such an instrument.

IX. Regulation of Mutual Fund

341. Who regulates the Mutual funds industry in India?

Ans. The Securities and Exchange Board of India (SEBI), the watchdog of Indian capital Market regulates the Mutual fund industry in India.

342. How do mutual funds raise money?

Ans. Mutual funds raise money through sale of units to the public.

343. Are Mutual Funds allowed to invest in all asset classes?

Ans. Mutual funds are permitted to invest only in securities and asset classes prescribed in the SEBI (Mutual Fund) Regulations.

344. What kind of ownership do the Mutual fund investors hold?

Ans. The Investors are the beneficial owner of their investment represented by units held.

345. Do Mutual Funds need to be registered?

346. Ans. Yes, all mutual funds are required to register with the Securities and Exchange Board of India. Registration is intended to provide adequate and accurate disclosure of material facts concerning the mutual fund.

347.

348. What are the eligibility criteria for registration of a mutual fund?

Ans.

- **(a)** the sponsor should have a sound track-record and general reputation of fairness and integrity in all his business transactions
- **(b)** the sponsor has contributed or contributes at least 40% to the net worth of the asset management company
- **(c)** the sponsor or any of its directors or the principal officer to be employed by the mutual fund should not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence
- **(d)** appointment of trustees to act as trustees for the mutual fund in accordance with the provisions of the regulations
- **(e)** appointment of asset management company to manage the mutual fund and operate the scheme of such funds in accordance with the provisions of these regulations
- **(f)** appointment of custodian in order to keep custody of the securities

349. What are the terms and conditions of registration of a mutual fund ?

Ans. The registration granted to a mutual fund under regulation 9, shall be subject to the following terms and conditions

a. the trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations
b. the mutual fund shall forthwith inform the Board, if any information or particulars previously submitted to the Board was misleading or false in any material respect
c. the mutual fund shall forthwith inform the Board, of any material change in the information or particulars previously furnished, which have a bearing on the registration granted by it
d. payment of fees as specified in the regulations and the Second Schedule.

350. What is the meaning of Sound-track record in the registration eligibility criteria?

Ans. For the purposes of this clause "sound track record" shall mean the sponsor should

a) be carrying on business in financial services for a period of not less than five years
b) the net worth is positive in all the immediately preceding five years
c) the net worth in the immediately preceding year is more than the capital contribution of the sponsor in the asset management company
d) the sponsor has profits after providing for depreciation, interest and tax in three out of the immediately preceding five years, including the fifth year.

351. Who is deemed to be a sponsor?

Ans. Any person who holds 40% or more of the net worth of an AMC shall be deemed to be a sponsor and will be required to fulfill the eligibility criteria specified in SEBI (Mutual fund) regulation.

352. What are the norms for Shareholding and governance for a sponsor in mutual funds?

Ans. No sponsor of a mutual fund, its associate or group company including the asset management company of the fund, through the schemes of the mutual fund or otherwise, individually or collectively, directly or indirectly, have

a. 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund
b. representation on the board of the asset management company or the trustee company of any other mutual fund

353. What are the norms for Shareholding and governance for a Shareholder?

Ans. Any shareholder holding 10% or more of the share-holding or voting rights in the asset management company or the trustee company of a mutual fund, shall not have, directly or indirectly,

a. 10% or more of the share-holding or voting rights in the asset management company or the trustee company of any other mutual fund
b. Representation on the board of the asset management company or the trustee company of any other mutual fund.

354. Can the Unit holders Challenge the Trustee's action?

Ans. In a trust structure, the beneficial owner has no power to challenge the *bone fide* actions of the trustee. Given this, the effectiveness of the trust structure depends on how trustworthy the trustees are. Certain decisions of mutual funds can be questioned through Unit holders meeting specifically called for the purpose. (check regulations please)

Sudden jump to custodians – please complete questions relating to amc before going to custodians.

355. What is the prescribed structure of Board of AMC ?

Ans. The board of directors of an asset management company has at least fifty per cent directors, who are not associate of, or associated in any manner with, the sponsor or any of its subsidiaries or the trustees.

356. Is there any Minimum Net worth threshold for Asset Management Companies (AMCs)?

Ans. Yes, Regulation 21(f) states that the asset management company has a net worth of not less than rupees 50 Crore (fifty crore).

357. Can the controlling interest in an AMC be changed?

Ans. No change in the controlling interest of the AMC shall be made unless

a. prior approval of the trustees and the Board is obtained
b. a written communication about the proposed change is sent to each unit holder and an advertisement is given in one 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 situated
c. the unit holders are given an option to exit on the prevailing Net Asset Value without any exit load.

358. What is meant by back office?

Ans. The back office is the portion of a company made up of administration and support personnel who are not client-facing. Back-office functions include settlements, clearances, record maintenance, regulatory compliance, audit and accounting, and IT services. For example, a financial services firm is segmented into three parts: the front office (e.g., sales, marketing, and customer support), the middle office (risk management), and the back office (administrative and support services).

359. What are the requirements of back office to launch a scheme?

Ans. Dealing room, accounting, compliance and investor grievance redressal, appoint all key personnel including fund manager(s) for scheme(s), appoint a compliance officer to take care of regulatory requirement and investor complaints, prepare a compliance manual and design internal control mechanisms including internal audit systems, institute a mechanism for handling investor complaints, appoint registrars and custodian and lay down parameters for their supervision, lay down norms for empanelment of brokers and marketing agents and appoint auditors.

360. Who are Key Managerial personnel's in an AMC?

Ans. Key Managerial Personnel refers to a group of people who are in charge of maintaining the operations of the company. Key Managerial Personnel (KMP) are people who have authority and responsibility for planning, directing and controlling the activities of the reporting enterprise. (e.g. Whole time director, CIO, CFO, etc.)

361. Is there any requirement of discloser related to Key personnel of AMCs?

Ans. The bio-data of all the key personnel should be filed with SEBI and an undertaking given by the trustees/board of directors of the AMC, the AMC would file half yearly statements of dealings in securities by the persons identified as key personnel in the AMC or the Trustee Company.

362. Why do Mutual funds need stringent rules and regulations?

Ans. Mutual fund schemes are repositories of trust and of investors' hard-earned money. With SEBI (Mutual Fund) regulations, all mutual funds have been brought under a common regulatory framework to ensure greater degree of transparency in their operations. Mutual funds deal with investments of public who invest with faith in professional management of investments; mutual funds are formed as pass through vehicles – pass the market risks to investors; Therefore, regulations prescribe a framework designed to protect the interests of the investors, and ensure that each mutual fund scheme is managed strictly in accordance with the stated objective and investment strategy.

363. How do SEBI Mutual fund regulation address various governance issues and prevent conflict of interest?

Ans. The existing SEBI Mutual Fund Regulations have tried to address the issue, through separation of various entities which constitute a mutual fund - sponsor, trustees, asset management companies and custodian.

364. What are fundamental attributes of a scheme?

Ans. The fundamental attributes of the scheme are the objectives, structure, investment pattern, etc.

365. What needs to be done in case of any change in Fundamental attribute of the scheme?

Ans. The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders is carried out without the consent of unit holders and the unit holders are given an option to exit at the prevailing Net Asset Value (NAV) without any exit load.

366. What is a Scheme information document (SID)?

Ans. A **Scheme information document (SID)** provides essential information about the scheme in a way that will assist investors in making informed decisions about whether to purchase the units being offered.

367. What are the disclosures made by an offer document?

Ans.

- The constitution of the mutual fund including the details regarding the sponsor, the trustees, the AMC, the custodian and the responsibilities and functions of each constituent of the mutual fund.
- The detailed investment objective of the scheme and the investment pattern likely to be followed by the AMC.
- The risk profile of the investments; and risk factors.
- Information related to redemption of units, the tax benefits available to unit holders, the principles of valuation of investments, the method of calculation of NAV
- The frequency and mode of distribution of income, the duration of the scheme, the detailed break-up of the expenses that will be incurred for the management of the scheme and the extent to which expenses are loaded on the scheme,
- The rights of the unit holders and all such information that is necessary to enable the prospective investor to take an informed decision to invest in the scheme.

368. What are the rules regarding nomination in mutual funds?

Ans.

a. The AMC shall provide an option to the unit holder to nominate a person in whom the units held by him shall vest in the event of his death
b. Where the units are held by more than one person jointly, the joint unit holders may together nominate a person in whom all the rights in the units shall vest in the event of death of all the joint unit holders.

369. Can Mutual Funds Advertise their schemes?

Ans. Yes, following the advertisement code under Regulation 30 of the SEBI (Mutual Funds) Regulations, 1996 regarding the sale, distribution and advertising of mutual funds.

Advertisements or sales literature must be carefully worded and explained. The advertisement for each scheme shall disclose the investment objective for each scheme

370. What are the measures taken for advertising a MF scheme?

Ans. The offer document and advertisement materials shall not be misleading or contain any statement or opinion, which is incorrect or false. These steps ensure that potential investors are aware of the benefits as well as the potential risks involved in mutual fund investing, SEBI has prescribed an advertisement code. Advertisements in respect of every scheme shall be in conformity with the Advertisement Code.

371. Is the listing of all close ended schemes mandatory?

Ans. Listing of close ended scheme is mandatory except

a. if the said scheme provides for periodic repurchase facility to all the unit holders with restriction, if any, on the extent of such repurchase
b. 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
c. if the details of such repurchase facility are clearly disclosed in the offer document
d. if the said scheme opens for repurchase within a period of six months from the closure of subscription
e. if the said scheme is a capital protection-oriented scheme

372. What are the rules regarding refund of application money?

Ans. The mutual fund and AMC shall be liable to refund the application money to the applicants

if the mutual fund fails to receive the minimum subscription amount

a. if the moneys received from the applicants for units are in excess of subscription

Any amount refundable shall be refunded within a period of five working days from the date of closure of subscription list,

In the event of failure to refund the amounts within the period specified in sub-regulation (3), the asset management company shall be liable to pay interest to the applicants at a rate of fifteen per cent per annum from the expiry of five working days from the date of closure of the subscription list

373. How to exit a Mutual fund scheme and are the units transferable?

Ans.

a. A unit unless otherwise restricted or prohibited under the scheme, shall be freely transferable by act of parties or by operation of law
b. 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
c. The asset management company shall, on production of instrument of transfer together with relevant unit certificates, register the transfer and return the unit certificate to the transferee within thirty days from the date of such production

374. Can a mutual fund scheme offer guaranteed return?

Ans. No guaranteed return shall be provided in a scheme

a. unless such returns are fully guaranteed by the sponsor or the AMC
b. unless a statement indicating the name of the person who will guarantee the return, is made in the offer document
c. The manner in which the guarantee is to be met has been stated in the offer document.

375. Are Mutual funds allowed to launch a capital protection fund?

Ans. 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
c. there is compliance with such other requirements as may be specified by the SEBI in this behalf check out if you have reproduced the regulation well enough.

376. What are the rules regarding winding up of a close ended scheme upon expiry?

Ans.

A. A close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period

B. A scheme of a mutual fund may be wound up, after repaying the amount due to the unit holders

- **a.** on the happening of any event which, in the opinion of the trustees, requires the scheme to be wound up
- **b.** if seventy-five per cent of the unit holders of a scheme pass a resolution that the scheme be wound up
- **c.** If the Board so directs in the interest of the unit holders.

377. What are the rules regarding winding up of a scheme for statutory reasons?

Ans. Where a scheme is to be wound up under sub-regulation (2), the trustees shall give notice disclosing the circumstances leading to the winding up of the scheme

- **a.** to the Board
- **b.** in two daily newspapers having circulation all over India, a vernacular newspaper circulating at the place where the mutual fund is formed.

378. What are the effects of winding up?

Ans. On and from the date of the publication of notice under clause (*b*) of sub-regulation (3) of regulation 39 of (SEBI (Mutual fund) regulation), the trustee or the AMC as the case may be, shall

a. cease to carry on any business activities in respect of the scheme so wound up

b. cease to create or cancel units in the scheme
c. cease to issue or redeem units in the scheme

379. What are the instruments that mutual funds can invest in?

Ans. Subject to other provisions of these regulations, a mutual fund may invest moneys collected under any of its schemes only in

a. Securities
b. money market instruments
c. privately placed debentures
d. securitized debt instruments, which are either asset backed, or mortgage backed securities;
e. gold or gold related instruments
f. real estate assets as defined in clause (a) of regulation 49A of SEBI (Mutual fund) regulation
g. infrastructure debt instrument and assets as specified in clause (1) of regulation 49L of SEBI (Mutual fund) regulation

380. Is there any restriction on mutual funds to invest in a single company?

Ans. Investments by mutual funds are subject to investment restrictions. These restrictions are essentially prudential investment norms, most of which are universally followed by mutual funds to ensure portfolio risk diversification. The schemes are permitted to invest only up to 10% of their net assets in schemes of a single issuer.

381. What are the eligibility criteria for issue of real estate mutual fund scheme?

Ans. A Certificate of registration may be granted under regulation 9 to an applicant proposing to launch only real estate mutual fund schemes if he

A. has been carrying on business in real estate for a period of not less than five years
B. fulfills eligibility criteria provided in regulation 7, except that specified in item (i) of the Explanation to clause (a) thereof

1. A real estate mutual fund scheme of a mutual fund registered under sub regulation (1) shall not invest in the securities mentioned in sub-clauses (ii) to (iii) of clause (a) or in clause (b) of sub-regulation (2) of regulation 49E unless it has key personnel having adequate professional experience in finance and financial services related field
2. An existing mutual fund may launch a real estate mutual fund scheme if it has an adequate number of key personnel and directors having adequate experience in real estate.

382. What are the conditions related to the issue of real estate mutual fund schemes?

Ans.

a. Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange, **provided** that the redemption of a real estate mutual fund scheme may be done in a staggered manner

b. The units issued by a real estate mutual fund scheme shall not confer any right on the unit holders to use the real estate assets held by the scheme and any provision to the contrary in the trust deed or in the terms of issue shall be void

c. The title deeds pertaining to real estate assets held by a real estate mutual fund scheme shall be kept in safe custody with the custodian of the mutual fund

d. A real estate mutual fund scheme shall not undertake lending or housing finance activities

e. All financial transactions of a real estate mutual fund scheme shall be routed through banking channels and they shall not be cash or unaccounted transactions.

383. What are the usages of real estate assets of a real estate mutual fund scheme?

Ans.

1. The asset management company may let out or lease out the real estate assets held by the real estate mutual fund scheme if the term of such lease or letting does not extend beyond the period of maturity of the scheme
2. Where real estate assets are let out or leased out, the asset management company shall diligently collect the rents or other income in a timely manner
3. Real estate assets held by a real estate mutual fund scheme may be let out to the sponsor, asset management company or any of their associates, at market price or otherwise on commercial terms

   Provided that not more than 25% of the total rental income of the scheme shall be derived from assets so let out.

384. What are the eligibility criteria for launching an infrastructure debt fund scheme?

Ans.

a. An existing mutual fund may launch an infrastructure debt fund scheme if it has an adequate number of key personnel having adequate experience in the infrastructure sector.

b. certificate of registration may be granted under regulation 9 to an applicant proposing to launch only infrastructure debt fund schemes if the sponsor or the parent company of the sponsor

1. has been carrying on activities or business in infrastructure financing sector for a period of not less than five years
2. fulfills eligibility criteria provided in Regulation 7 of **SEBI (Mutual fund) regulation**

For the purpose of this clause, 'parent company of the sponsor' shall mean a company which holds at least 75% of paid up equity share capital of the sponsor

385. What is the offering period for an Infrastructure debt fund?

Ans. No scheme of an infrastructure debt fund, in the case of a public offer, shall be open for subscription for more than forty-five days.

386. What are the rules regarding private placement of infrastructure debt fund schemes?

Ans.

1. The units of an infrastructure debt fund scheme may be offered through private placement to less than fifty persons, subject to approval by the trustees and the board of the asset management company.
2. The offer made under sub-regulation (1), shall be subject to the following
   - **A.** A placement memorandum, in the manner as specified by the Board, shall be filed by the mutual fund with the Board at least seven days prior to the launch of the scheme; and
   - **B.** the mutual fund shall pay to the Board, filing fee as specified in the Second Schedule

387. Do the Mutual funds report NAV of each scheme?

Ans. Yes, Mutual funds are required to update the NAV of the scheme and the sale/repurchase prices of their schemes on the AMFI website on a daily basis in case of open-ended schemes.

388. Can mutual funds borrow funds?

Ans. Mutual funds can borrow only to meet the temporary liquidity needs for the purpose of repurchase, redemption of units or payment of interest or dividend to the unit holders. Provided that the mutual fund shall not borrow more than 20% of the net asset of the scheme and the duration of such a borrowing shall not exceed a period of six months.

The trustees are required to ensure that borrowing is used as a measure of last resort and determine whether the mutual fund could borrow should be disclosed in the scheme offer

389. How are the investors' grievances being redressed?

Ans. Mutual funds need to specify in the offer document the name of the contact person whom unit holders may approach in case of any query, complaints or grievances. The names of the directors of AMC and trustees are also given in the offer documents; and they can also be approached. Historical information about the investors' complaints and redressal form a part of the offer document.

390. Can investors approach SEBI with their Grievances?

Ans. Yes, Investors can approach SEBI for redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned mutual fund and follows up with them till the matter is resolved. SCORES is an online platform designed to help investors to lodge their complaints, pertaining to securities market, online with SEBI against listed companies and SEBI registered intermediaries. All complaints received by SEBI against listed companies and SEBI registered intermediaries are dealt through SCORES.

391. Can the Sponsor, Trustee, AMCs or any of their employees advise about any security?

Ans. No, they shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real – time or non-real-time, unless a disclosure of his interest including long or short position in the said security has been made, while rendering such advice. If someone does that then he needs to disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

392. To what extent of total NAV, a Mutual fund can invest in the debt instrument of a single issuer? Too jumpy – bring all investment restriction related questions in a single place.

Ans. A mutual fund scheme shall not invest more than 15% of its NAV in debt 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 20% of the NAV of the scheme with the prior approval of the Board of Trustees and the Board of AMC.

393. What are mortgage backed securities?

Ans. A mortgage-backed security (MBS) is an investment similar to a bond that is made up of a bundle of home loans bought from the banks that issued them. MBS is a type of asset-backed security. Investors in MBS receive periodic payments similar to bond coupon payments.

394. Can mutual funds invest in mortgage back securities?

Ans. Mutual funds can invest in mortgaged backed securitized debt which are rated not below investment grade by a credit rating agency registered with the Board, provided that this is included in the above mentioned 15% limit.

395. Can Mutual Funds invest in derivative instruments?

Ans. Yes, MFs can invest in derivative products as prescribed by regulation.

396. Can Mutual funds invest in unlisted Non-convertible Debentures (NCDs)?

Ans. Mutual fund schemes may invest in unlisted Non-Convertible Debentures (NCDs) not exceeding 10% of the debt portfolio of the scheme subject to the condition that such unlisted NCDs have a simple structure.

397. What percentage of paid up capital of a company can a Mutual funds hold?

Ans. No mutual fund under all its schemes should own more than ten per cent of any company's paid up capital carrying voting rights.

398. Can an investment be switched from one scheme to another scheme of the same mutual fund?

399.

Ans. Transfers of investments from one scheme to another scheme in the same mutual fund shall be allowed only if,

a. Such transfers are done at the prevailing market price for quoted instruments on spot basis,
b. The securities so transferred shall be in conformity with the investment objective of the scheme to which such transfer has been made.
   From January 01 2021 interscheme transfers are not permitted.

400. Can a scheme invest in another scheme?

Ans. A scheme may invest in another scheme under the same AMC or any other mutual fund without charging any fees, provided that aggregate inter-scheme investment made by all schemes under the same management or in schemes under the management of any other AMC shall not exceed 5% of the net asset value of the mutual fund. A fund of funds (FOF)—also known as a multi-manager investment—is a pooled investment fund that invests in other types of funds. FOFs usually invests in other mutual funds. Funds of funds tend to have higher expense ratios than regular mutual funds. The fund of funds (FOF) strategy aims to achieve broad diversification and minimal risk.

401. Are there any restrictions on Mutual funds to invest in their group company?

Ans. Mutual fund scheme shall not make any investment in

a. any unlisted security of an associate or group company of the sponsor
b. any security issued by way of private placement by an associate or group company of the sponsor
c. Listed securities of group companies of the sponsor which is in excess of 25% of the net assets.

402. What is the restriction for mutual funds on investment in unlisted equity share?

Ans. Mutual fund scheme shall not invest more than 5% of its NAV in the unlisted equity shares or equity related instruments in case of open-ended scheme and 10% of its NAV in case of close ended scheme.

403. What are the Investment restrictions related to fund of Funds?

Ans. A fund of funds scheme shall be subject to the following investment restrictions:

a. A fund of funds scheme shall not invest in any other fund of funds scheme;
b. A fund of funds scheme shall not invest its assets other than in schemes of mutual funds, except to the extent of funds required for meeting the liquidity requirements for the purpose of repurchases or redemptions, as disclosed in the offer document of fund of funds scheme.

404. What are the restrictions on mutual funds to invest in REITs and INVITs?

Ans. Mutual funds under all its schemes shall not own more than 10% of units issued by a single issuer of REIT and INVITs.

- A mutual fund scheme shall not invest
    i. more than 10% of its NAV in the units of REIT and INVITs
    ii. more than 5% of its NAV in the units of REIT and INVITs issued by a single issuer
- Provided that the limits mentioned in sub-clauses (i) and (ii) above shall not be applicable for investments in case of index fund or sector or industry specific scheme pertaining to REIT and INVITs.

405. What are the basic disclosures made by AMFI members?

Ans. The basic disclosures made by AMFI members are:

- Members shall ensure timely dissemination to all unit holders 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.
- Members shall disclose to unit holders investment patterns, portfolio details, ratios of expenses to net assets and total income and portfolio turnover wherever applicable in respect of schemes on an annual basis.

406. What are the disclosures needed for transactions by Key personnel?

Ans. 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.

407. What are the Operational ethics that needed to be followed by Members?

Ans. The Operational ethics that needed to be followed by Members are,

- Members shall avoid conflicts of interest in managing the affairs of the schemes and shall keep the interest of all unit holders paramount in all matters relating to the scheme
- 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.
- Members shall not, in respect of any securities, be party to-
    a. creating a false market
    b. price rigging or manipulation
    c. 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

- 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.
- Members shall avoid excessive concentration of business with any broking firm, and excessive holding of units in a scheme by few persons or entities.

408. What is front running?

Ans. Front-running is trading stock or any other financial asset by a broker who has inside knowledge of a future transaction that is about to affect its price substantially. This exploitation of information that is not yet public is illegal and unethical.

409. What is self-dealing?

Ans. Self-dealing is an illegal act that happens when a fiduciary acts in their own best interest in a transaction, rather than in the best interest of their clients. Self-dealing can consist of actions such as using company funds as a personal loan, assuming a deal or opportunity for oneself, or using insider information in a stock market transaction.

410. What is the regulation regarding Front-running and self-dealing?

Ans. No Members or any of their directors, officers or employees shall not indulge in front running or self-dealing, 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.

411. What are the prescribed Reporting practices for Members?

Ans.

- Members must follow comparable and standardized valuation policies in accordance with the SEBI Mutual Fund Regulations
- Members must follow uniform performance reporting on the basis of total return.
- Members must ensure scheme wise segregation of cash and securities accounts.

412. Who cannot be a trustee?

Ans. An asset management company or any of its officers or employees are not be eligible to act as a trustee of any mutual fund.

Further, no person who is appointed as a trustee of a mutual fund can be appointed as a trustee of any other mutual fund unless - such a person is an independent trustee and he /she has taken prior approval of the mutual fund of which he is a trustee.

413. What is the regulation for Independent trustees?

Ans. Two thirds of the trustees shall be independent persons. They shall not be associated with the sponsors in any manner.

414. Who is accountable for the funds?

Ans. The trustees are accountable for the funds and property of the schemes.

415. What are the rights and obligations of trustees with respect to Asset Management Company (AMC)?

Ans.

- The trustees enter into an investment management agreement with the AMC
- The trustees shall have a right to obtain from the AMC such information as is considered necessary by the trustees.
- The trustees shall ensure before the launch of any scheme that the AMC has its systems, processes and personnel in place.
- The trustees shall ensure that all the activities of the AMC are in accordance with the provisions of these regulations.
- The trustees shall ensure that the AMC has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors.

416. What processes should the trustee ensure before the launch of any scheme?

Ans. The trustees shall ensure before the launch of any scheme that the asset management company has:

- Systems in place for its back office, dealing room and accounting; appointed all key personnel including fund manager(s) for the scheme(s)
- Appointed auditors to audit its accounts;
- Appointed a compliance officer
- Appointed registrars and laid down parameters for their supervision;
- Prepared a compliance manual and designed internal control mechanisms including internal audit systems;
- Specified norms for empanelment of brokers and marketing agents.

417. What is the responsibility of a Compliance officer?

Ans. A compliance officer is responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines instructions etc. issued by SEBI or the Central Government and for redressal of investors' grievances.

418. What measures should the trustee take with the AMC with respect to brokers?

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

419. What measures should the trustee take with the AMC with respect to associates?

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

420. What measures should the trustee take with the AMC with respect to regulations?

Ans. The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme. The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations.

421. What measures should the trustee take with the AMC with respect to management of the fund?

Ans. The trustees shall ensure that the asset management company has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company.

422. What powers does a trustee have over the AMC with respect to conduct of business?

Ans. Where the trustees have reason to believe that the conduct of business of the mutual fund is not in accordance with these regulations and the scheme, they shall forthwith take such remedial steps as are necessary by them and shall immediately inform SEBI of the violation and the action taken by them.

423. Who is responsible for filing calculations for income of a fund?

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

Each trustee shall file the details of his transactions of dealing in securities with the mutual fund on a quarterly basis. But in practice AMC is responsible for this.

424. What are the rights and obligations of trustees with respect to the Fund?

Ans.

- The trustees shall ensure that no change in the fundamental attributes of any scheme or the trust or fees and expenses payable or any other change which would modify the scheme and affects the interest of unit holders shall be carried out
- The trustees shall ensure regular monitoring and reporting of the AMC and report to SEBI as and when required.

- The trustees shall quarterly review all transactions carried out between the mutual funds, Asset Management Company and its associates.

425. What are the rights and obligations of trustees with respect to the Unit holders?

Ans.

- The trustees shall periodically review all service contracts such as custody arrangements, transfer agency of the securities and satisfy itself that such contracts are executed in the interest of the unit holders.
- The trustees shall ensure that there is no conflict of interest between the manner of deployment of its net worth by the AMC and the interest of the unit holders.
- The trustees shall periodically review the investor complaints received and the redressal of the same by the AMC.

426. What are the rights and obligations of trustees with respect to the SEBI?

Ans.

- The trustees shall abide by the Code of Conduct as specified in the regulations.
- The trustees shall furnish to SEBI on a half yearly basis:
    - a report on the activities of the mutual fund
    - a certificate stating that the trustees have satisfied themselves that there have been no instances of self-dealing or front running by any of the trustees, directors and key personnel of the asset management company;
    - A certificate to the effect that the asset management company has been managing the schemes independently of any other activities.

427. What is an Asset Management Company?

Ans. The asset management company carries out the business of the mutual fund. The asset management company shall not undertake any other business activities.

428. What are the exceptions to the business activities taken up by the AMC?

Ans. The AMC shall not undertake any other business activities except activities in the nature of [portfolio management services] management and advisory services to offshore funds, pension funds, provident funds, venture capital funds, management of insurance funds, financial consultancy and exchange of research on commercial basis, if any of such activities are not in conflict with the activities of the mutual fund.

429. Who appoints the Asset Management Company?

Ans. The asset management company is appointed by the sponsor or if so, authorized by the trust deed, the trustee.

430. Who can terminate the AMC?

Ans. The appointment of an asset management company can be terminated by majority of the trustees or by seventy-five per cent of the unit-holders of the scheme.

431. What are the eligibility criteria to be appointed as an AMC?

Ans.

a. The asset management company should have directors having adequate professional experience in finance and financial services related fields and not be found guilty of moral turpitude or convicted of any economic offence or violation of any securities laws.
b. Its key personnel should have not been found guilty of moral turpitude or convicted of economic offence or violation of securities laws.
c. The board of directors of such AMC should have at least fifty percent independent directors.
d. The chairman of the AMC should not be a trustee of any mutual fund.
e. The AMC should have a net worth of not less than rupees ten crores.

432. What do AMC get for managing the money of the unit holders?

Ans. AMC earns a fee for managing the funds of the investors. The fee is defined as a percentage of the funds managed by the asset management company. The fee is charged to the scheme within the ceiling prescribed by SEBI.

433. Who can be a custodian of a Mutual Fund?

Ans. A bank or a Company meeting the eligibility criteria can be a custodian. An entity registered as custodian with SEBI can be custodian.

434. What are the functions of a custodian?

Ans. The mutual fund shall appoint a custodian to hold the fund's securities in safekeeping, settles securities transactions for the fund, collects interest and dividends paid on securities, and records information on stock splits and other corporate actions.

435. What are some banks or companies who provide custodial services?

Ans.

- HDFC Bank
- Citibank
- Deutsche Bank
- SBI India
- HSBC
- Stock holding corp of India
- SBI- SG global securities services limited
- Axis Bank
- BNP Paribas
- DBS Bank India Limited

- Edelweiss custodial services
- ICICI
- Kotak Mahindra

436. What is the role of Registrar and Transfer Agent?

Ans. R&TA maintains records of the unit holders' account.

437. Can a fund hire an independent party to be Registrar and Transfer Agent?

Ans. A fund may choose to hire an independent third party who is registered with the SEBI to provide such services or carryout these activities in house.

438. What is the purpose of the Registrar and Transfer Agent in the fund?

Ans. The registrar and transfer agent forms the most vital interface between the unit holders and mutual fund. Most of the communication between these two parties takes place through registrar and transfer agent.

439. What is the role of Distributors or Agents?

Ans. To reach their products across the length and breadth of the country, mutual funds take the services of distributors/agents.

440. Who can be distributors or agents?

Ans. Distributors comprises of banks, non-banking financial companies and other distribution companies. Individuals constitute the agency force.

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