Collective Investment Vehicles

The International Organization of Securities Commission (IOSCO) has, in its Report on Investment Management of the Technical Committee, defined the Collective Investment Schemes, as "an open ended collective investment scheme that issues redeemable units and invests primarily in transferable securities or money market instruments". In India, these collective investment schemes are known as collective investment vehicles (CIVs). There are three distinct categories of CIVs, namely, Mutual Funds (MFs), Collective Investment Schemes (CIS) and Venture Capital Funds (VCFs). The developments in the year 2003-04 with respect to the above three different CIVs are discussed in this chapter.

Mutual Funds

Of the three categories of CIVs, Mutual Funds (MFs) are more popular among investors and are able to mobilize huge amounts of resources. They pool the savings of different investors together by issuing 'units' and invest them into specific securities (usually stocks or bonds) with a predetermined investment objective. Hence, for an investor, investments in MF imply buying shares (or portions) of the MF and becoming the shareholders of the fund.

The Unit Trust of India (UTI) was the first MF in India set up in 1964. However, with the entry of the private sector players, the MF industry has expanded. As of end March 2004, 37 mutual funds are registered with SEBI with an asset base of Rs. 1,396,160 million. The MF industry has become very popular over the years, particularly, among the households, as investing in MFs is perceived to be less cumbersome than in equities. As a result, the number of households owning units of MFs exceeds the number of households owning equities and debentures.

In recent years, the MF schemes have diversified considerably thus expanding the basket of investment opportunities to suit the different needs of the investors. There are schemes that invest only in equities or in debt instruments or in both. The objectives of the MFs have also widened, with MFs investing in growth stocks, in stocks of a particular sector. The MFs are managed aggressively as well as passively. Thus, investors have a variety of options such as income funds, balanced funds, liquid funds, gilt funds, index funds, exchange traded funds, sectoral funds, to deploy their savings.

Policy Developments

The policy and regulatory initiatives taken during the period April 2003-June 2004 are as discussed hereunder:

I. Union Budget, 2004-05

The Union Budget of 2004-05 proposed that the equity-oriented MFs should continue to be exempt from tax on dividends. The tax rate on corporate unit holders of debt-oriented MFs have been raised from 12.5% to 20%. However the tax rate remain unchanged at 12.5% for individuals and Hindu Undivided Family (HUF).

II. Investment by MFs

(i) The Government has decided to allow MFs to invest in equities of listed overseas companies. These overseas companies should have a shareholding of at least 10% in an Indian company listed on a recognized stock exchange in India (as on January 31 of the year of investment). The overall cap for the entire MFs industry to invest in ADRs/GDRs, foreign equity and debt securities has been set at US$ 1 billion. Each MF individually is permitted to invest 10% of their net assets as on January 31 of each relevant year in foreign securities with the limit of a minimum of US$ 5 million and a maximum of US$ 50 million.

(ii) MFs are allowed to trade in interest rate derivatives listed on the stock exchanges.

(iii) In case of any scheme, if the MF is not been able to deploy funds in securities within the ambit of its investment objectives, then the MF is permitted to invest in short term deposits of any Scheduled Commercial Banks (SCBs). However, these investments have to be reported to the trustees along with the reasons, interalia, should include comparison with the interest rates offered by other SCBs.

III. Guidelines for MFs

SEBI issued the following guidelines in accordance with the provisions of Regulation 77 of the SEBI (Mutual Funds) Regulations, 1996:

(i) *Participation by MFs in Derivatives Trading:* Vide a circular dated February 6, 2004, SEBI issued the following guidelines for MFs, which they should adhere while trading in equity based derivatives. The 'hedging'/'portfolio balancing' should be clearly marked while initiating any derivatives position. At no point of time, the derivative position should result in actual or potential leverage or short sale/short position on any underlying security. In short all derivative positions should be backed by cash or stock (stocks portfolio for index derivatives) as the case may be at the time of exposure. Each MF should have a maximum derivative net position of 50% of the portfolio (i.e. net assets including cash). The maximum net derivatives exposure in terms of percentage of the portfolio value should be decided in advance by the Board of trustees. Within the overall limits of a maximum derivatives net position of 50% of the portfolio (i.e. net assets including cash), the limits on individual scrip/instrument have to be specified.

The MFs can hold different positions involving multiple derivatives positions on the same underlying. With regards to disclosure and accounting norms, each MF has to disclose the maximum net derivatives exposure in terms of the percentage of portfolio value, the limits on derivatives exposure per scrip/instrument. The data on actual exposures has to be disclosed in the half yearly portfolio statements. While calculating the industry exposure on monthly basis, the total exposure per scrip including derivatives exposure has to be considered. Gap reporting/Calendar spread analysis of all derivative positions should be reported internally on a weekly basis to a committee, which should be appointed by the Board of Trustees.

(ii) *Consolidation of Schemes:* SEBI in its circular dated June 23, 2003 clarified that any consolidation of MF schemes should be viewed as changes in fundamental attributes of the related schemes. In case of consolidation the MFs have to comply with the requirements laid down in the SEBI (Mutual Funds) Regulations, 1996. Further, the MFs are required to take the following steps: (a) the proposal and modalities of the merger/consolidation of schemes should be approved by the Boards of the AMC and Trustees in harmony with the interests of the unit holders of all concerned schemes; (b) pursuant to the approval, the MFs should file the proposals with SEBI, along with the draft offer document and requisite fees, in case a new scheme emerges after merger/consolidation. In addition, a draft letter has to be sent to all the unit holders, giving them an option to exit at prevailing NAV without exit load. To enable the investors to take well informed decisions, all relevant information such as the investment objective, asset allocation, percentage of total NPAs and percentage of total illiquid assets to net assets of individual schemes as well as consolidated schemes should be disclosed. In addition the main features of the new consolidated scheme, basis of allocation of new units by way of a numerical illustration and tax impact of the consolidation of schemes among others, should be disseminated. (c) The AMCs should maintain records of dispatch of the letters to the unit holders giving them an option to exit at prevailing NAVs and also the responses received from them.

(iii) *Advertisements by MFs:* To improve the standards of disclosures in advertisements, SEBI issued guidelines which include: (a) the MFs are mandated to carry only the statement "*Mutual Fund investments are subject to market risks, read the offer document carefully before investing*" along with advertisement, given the limited time available to the investors while passing by for reading the advertisements through hoardings/posters. Likewise, in the audio-visual media like television, a statement "*Mutual Fund investments are subject to market risks, read the offer document carefully before investing*" should be displayed on the screen for at least a period of 2 seconds, that too, in a clearly legible font-size covering at least 80% of the total screen space and accompanied by a voice over-reiteration. The remaining 20% space can be used for the name of the MF or logo or name of scheme, among others. Further, the MFs, while advertising schemes having very short investment horizons (in cash/liquid/money market), should display the simple annualized returns. The return will be based on 15 days period along with the normal annualized return based on 30 days period. In case the distribution taxes are excluded while calculating the returns, the same needs to be disclosed. While advertising pay-out dividends, it should be clearly stated that after the payment, the NAV will fall to the extent of the payout and distribution taxes (if applicable). (b) Widening the definition of sales literature to include fund fact sheets, research reports, newsletters, performance reports or summaries, telemarketing scripts, seminars texts, press releases and reprints etc. (c) the types of benchmark indices that can be used in performance advertisements should be disclosed in the offer documents. The half-yearly results should include a comparison of the returns with the benchmarks used.

(iv) *Uniform cut-off timings for applicability of NAV:* SEBI has directed the MFs to adopt uniform cut-off timings for applying NAVs both for subscriptions and redemptions. This is applicable to all schemes/plans whether existing or new, barring the international funds and transaction in units of MFs undertaken through the stock exchanges.

MF Scheme(s)/Plan(s): In case of purchases/redemptions, valid applications received up to 3 p.m. along with the local cheque or demand draft payable at par at the place where it is received, the closing NAV of the day should be applicable. But, in case of applications received after 3 p.m., the closing NAV of the next business day is applicable. If the outstation cheques/demand drafts not payable at par at the place where the application is received, then closing NAV of the day on which cheque/demand draft is credited should be applicable.

MF-Liquid Fund Scheme(s)/Plan(s): With respect to purchases, the closing NAV of the day immediately previous to the day on which funds are available for utilization should be applicable. However, in respect of applications received after 1 p.m. and if the funds are available for utilization on the same day, then the closing NAV of the same day should be applied. In case of redemptions, applications received up to 10 a.m., the NAV of the closing day is to be applied. In case of applications received after 10 a.m., the same days closing NAV should be applicable.

Applications for "switch out" and "switch in" should be treated as redemptions and purchases, respectively.

(v) *Investment/Trading in Securities by Employees of AMCs and MF Trustee Companies:* Any employee/person of the AMC willing to carry out a transaction of sale/purchase of a security has to take a prior approval from there compliance officer. The validity of the approval is to be for a week in tandem with the SEBI (Insider Trading) Regulations. The employees, hence, should refrain from transacting in any security within a period of 30 days from the date of personal transaction.

(vi) *Minimum Number of Investors in Schemes/Plans of MFs:* In consultation with Association of Mutual Funds in India (AMFI), SEBI issued guidelines stipulating the minimum number of investors in each MF schemes. Each scheme/individual plan(s) is required to have a minimum of 20 investors and no single investor should account for more than 25% of the corpus of such scheme/plan(s). This disclosure has to be made in the offer document to be filed with SEBI. In case of non-fulfillment of the aforementioned guidelines for open ended schemes, a grace period of 3 month or the end of the quarter whichever is earlier, from the close of IPO is given to balance and to ensure compliance. If the MF fails to comply, then the scheme is to be wound off. For Fixed Maturity Plans (FMPs) and Close Ended Schemes no such grace period is given. These guidelines, however, are not applicable to Exchange Traded Funds (ETFs). In case of existing open ended schemes/plans, the same conditions are required to be complied with as soon as possible and not later than December 31, 2004. However, for close ended schemes, FMPs and ETFs already in existence, the guidelines are not applicable considering the nature of the schemes/plans and in the interest of the investors.

(vii) *Role of CEO/Fund Managers:* The Chief Executive Officer (CEO) of the AMC has to ensure that the mutual fund complies with all the SEBI (MF) Regulations, guidelines and circulars issued hereto. Further, he should also make sure that the investments made by the fund managers are in the interest of the unit-holders and are designed to achieve the objectives of the scheme. Hence, he is responsible for the overall risk management function of the MF.

(viii) *Fund of Funds:* Fund of Funds (FoFs) is a financial instrument that invests in other MF schemes rather than in securities. However, a FoFs scheme is not permitted to invest in any other FoFs scheme, nor in any other assets than the schemes of MFs, except to meet the liquidity requirements for the purpose of repurchases or redemptions.

(ix) *Certification:* To foster professional standards in the operations of MFs, AMFI in association with the NSE, has developed a self-study and testing/certification programme for the employees and distributors of MFs. Further, AMFI in consultation with the SEBI, had made it mandatory to all existing personnel of MFs/AMCs, who are engaged in sales, marketing and employees to complete the certification process by September 2004. However, the existing employees above the age of 50 are exempted, but, are required to attend a refresher course organized by AMFI. They should submit a certificate to their employers by September 2004. After the September 2004, the MFs/AMCs have to necessarily engage/employ certified personnel only.

(x) *Quoting of Bank Account Number and PAN by investors:* SEBI has made it mandatory for the investors in MF schemes to mention their bank account numbers in their applications/ requests for redemption. Additionally, wherever an application is for a total of Rs. 50,000 or more, the applicant or in the case of joint applications, each of the applicants, should mention his/her Permanent Account Number (PAN) allotted under IT Act, 1961. If the PAN has not been allotted, then the GIR number and the income-tax circle/ward/district should be mentioned. In cases where neither the PAN nor the GIR numbers have been allotted, the fact of non-allotment should be mentioned in the application form.

Market Design

The MF industry is governed by SEBI (MF) Regulations, 1996, which lays the norms for the MF and its AMC. All MFs in India are constituted as trusts and are allowed to issue open-ended and close-ended schemes under a common legal structure. This section throws light on the market design of the MFs in India.

Structure of MFs

A typical MF in India has the following constituents:

Fund Sponsor: A 'sponsor' is a person who, acting alone or in combination with another corporate body, establishes a MF. In order to register with Sebi as a MF, the sponsor should have a sound financial track record of over five years and general reputation of fairness and integrity in all his business transaction. Following its registration, in accordance with SEBI Regulations, the sponsor forms a trust, appoints a Board of Trustees and an AMC as a fund manager. Further, a custodian is appointed to carry out the custodial services for the schemes of the fund. The sponsor should contribute at least 40% of the net worth of the AMC.

Mutual Fund: A MF is established in the form of a trust under the Indian Trusts Act, 1882. The instrument of trust is executed by the sponsor in favour of trustees and is registered under the Indian Registration Act, 1908. The investor subscribes to the units issued by the MFs. The resources raised are pooled under various schemes established by the trust. These assets are held by the trustee for the benefit of unit holders. Under the Indian Trusts Act, only the trustee(s) has an independent legal capacity.

Trustees: The MF can either be managed by the Board of Trustees, which is a body of individuals, or by a Trust Company, which is a corporate body. Most of the funds in India are managed by a Board of Trustees. The trustees are appointed with the approval of SEBI. Two thirds of trustees are independent persons and are not associated with sponsors. The trustees, being the primary guardians of the unit holders' funds and assets, have to be persons of high repute and integrity. The Trustees, however, do not directly manage the portfolio of MF. It is managed by the AMC as per the defined objectives, in accordance with trust deed and SEBI (MF) Regulations.

Asset Management Company: The AMC, appointed by the sponsor or the Trustees and approved by SEBI, acts like the investment manager of the Trust. The AMC should have at least a net worth of Rs. 10 crore. It functions under the supervision of its Board of Directors, Trustees and the SEBI. In the name of the Trust, AMC floats and manages different investment 'schemes' as per the SEBI Regulations and the Investment Management agreement signed with the Trustees. The regulations require non-interfering relationship between the fund sponsors, trustees, custodians and AMC.

Apart from these, the MF has some other constituents, such as, custodians and depositories, banks, transfer agents and distributors. A custodian is appointed for safe keeping the securities and participating in the clearing system through approved depository. The bankers handle the financial dealings of the fund. Transfer agents are responsible for issue and redemption of the units. The AMC appoints distributors or brokers to sell units on behalf of the Fund, who also serve as investment advisers. Besides brokers, independent individuals are also appointed as 'agents' to market the schemes to the investors.

Types of MFs/Schemes

A wide variety of MFs/Schemes cater to different preferences of the investors based on their financial position, risk tolerance and return expectations. The MF Schemes can be broadly categorized under three headings, *viz.*, Funds by structure e.g. open ended and close ended schemes; Funds by investment objective e.g. growth schemes, income schemes, balanced schemes, money market schemes and lastly other schemes e.g. tax saving schemes, index schemes and sector specific schemes.

An open-ended fund provides the investors with an easy entry and exit option at NAV, which is declared on a daily basis. While, in close-ended funds, the investors have to wait till maturity to redeem their units, however, an entry and exit is provided through mandatory listing of units on a stock exchange. The listing is to be done within six months of the close of the subscription. Assured return schemes, is a scheme that assures a specific return to the unit holders irrespective of performance of the scheme, which are fully guaranteed either by the sponsor or AMC.

Growth/Equity Oriented Schemes provide capital appreciation over medium to long-term by investing a major part of their corpus in equities. Income/Debt Oriented Schemes provide regular and steady income to investors by investing in fixed income securities such as bonds, corporate debentures, government securities and money market instruments. Hence, they are less risky compared to equity schemes. Balanced Funds provide both growth and regular income as they invest both in equities and fixed income securities in the specified proportion as indicated in their offer documents. Money Market or Liquid Funds provide easy liquidity and preserves capital, but generates moderate income. As they invest exclusively in safer short-term instruments such as, treasury bills, certificates of deposit, commercial paper, inter-bank call money, and government securities. Index Funds replicate the portfolio of any particular index such as the S&P CNX Nifty by investing in the same securities with the same weightage as in the index. The exchange traded index funds, as the name suggests, are traded on the stock exchanges. Then, there are funds/schemes that invest in shares of specific sectors or industries such as Pharmaceuticals, Software, Fast Moving Consumer Goods (FMCG), Petroleum stocks. Some of the examples of them are UTI Software Fund, Pioneer ITI Internet Opportunities Fund, etc. As they are sectors or industries specific, the returns on these funds are dependent on the performance of the respective sectors/industries.

Regulation of Funds

The MFs are regulated under the SEBI (MF) Regulations, 1996. All the MFs have to be registered with SEBI. The regulations have laid down a detailed procedure for launching of schemes, disclosures in the offer document, advertisements, listing and repurchase of close-ended schemes, offer period, transfer of units, investments, among others. Further, the regulations also specify the qualifications, eligibility criteria for the sponsor of a fund, the directors and the AMC, the contents of Trust Deed, rights and, obligations of Trustees, appointments and restrictions on business activities.

In addition, RBI also supervises the operations of bank-owned MFs. While SEBI regulates all market related and investor related activities of the bank/FI-owned funds, any issues concerning the ownership of the AMCs by banks falls under the regulatory ambit of the RBI.

Further, as the MFs, AMCs and corporate trustees are registered as companies under the Companies Act, 1956, they have to comply with the provisions of the Companies Act.

Many close-ended schemes of the MFs are listed on one or more stock exchanges. Such schemes are, therefore, subject to the regulations of the concerned stock exchange(s) through the listing agreement between the fund and the stock exchange.

MFs, being Public Trusts are governed by the Indian Trust Act, 1882, are accountable to the office of the Public Trustee, which in turn reports to the Charity Commissioner, that enforces provisions of the Indian Trusts Act.

Investment Restrictions

Investment policies of each scheme are dictated by the investment objective stated in the offer document and by the restrictions imposed by SEBI. In case of investments in money market instruments, they have to be in accordance with RBI directives. Hence, the MFs can invest only in transferable securities in the money or the capital market or in privately placed debentures or securitized debts. Investment by a MF is subject to following restrictions:

i. A MF is not permitted to invest more than 15% of its NAV in debt instruments issued by a single issuer. The instruments should be rated not below investment grade by an authorized credit rating agency. However, the 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 the AMC. This limit is not applicable for investments in government securities and money market instruments. Within the given limit, investments in at least investment grade mortgaged backed securitized debt can be made.

ii. MF schemes are not allowed to invest more than 10% of their NAV in unrated debt instruments issued by a single issuer. In addition the total investment in such instruments should not exceed 25% of the NAV of the scheme. All such investments should be made with the prior approval of the Board of Trustees and the Board of AMC.

iii. No MF under all its schemes should own more than 10% of any company's paid up capital.

iv. A scheme may invest in any other scheme under the same AMC or any other MF without charging any fees. However the aggregate inter scheme investment made by all schemes under the same AMC or in schemes under the management of any other AMC should not exceed 5% of the NAV of the MF. However, this is not applicable for any fund of funds scheme.

v. The initial issue expenses in any scheme should not exceed six per cent of the funds raised under that scheme.

vi. No MF is to make any investments in any unlisted or listed securities of an associate or group company of the sponsor in excess of 25% of the net assets or any security issued by way of private placement.

vii. MFs should not invest more than 10% of their NAV in the equity shares or equity related instruments of any company. This limit, however, is not applicable for investments in case of index funds or sector or industry specific schemes.

viii. Investments in the unlisted equity shares or equity related instruments are capped at not more than 5% of its NAV in case of open ended scheme and 10% in case of close ended scheme.

ix. Each buy and sell transactions carried out by MFs should necessarily be delivery based. It should not in any case short sell the securities or carry forward transactions or engage in badla finance. Nevertheless, MFs are permitted to enter into derivatives transactions on a recognized stock exchange for the purpose of hedging and portfolio balancing.

Disclosure of Performance

A MF has to compute net asset value (NAV) for each scheme by dividing the net assets of the scheme by the number of outstanding units as on the valuation date. The NAV reflects the performance of a scheme. The NAV is to be disseminated on daily basis in case of open ended schemes and on weekly basis in case of close ended schemes. Apart from publishing NAVs in newspapers and the web sites of respective MFs, all MFs are required to put their daily NAVs on the website of AMFI, so that the investors can access NAVs of all the MFs at one place.

Along with the NAV, sale and repurchase prices are also to be disseminated. The repurchase price should not be lower than 93% of the NAV and sale price should not be higher than 107% of NAV. The repurchase price of a close ended scheme should, however, not be less than 95% of NAV. The difference between repurchase and sale price should not exceed 7% of the sale price.

The MFs are required to publish their performance in the form of half-yearly results, which should include their returns/yields over a period of time i.e. last six months, 1 year, 3 years, 5 years and at the inception of the schemes. The MFs are required to send annual report or abridged annual report to all the unit holders at the end of the year but not later than six months from the date of closure of the relevant accounts year.

Code of Conduct

The MF regulations include codes of conduct for the MFs and AMCs, their employees and intermediaries. They are as follows:

i. Trustees and AMCs must maintain high standards of integrity and fairness in all their dealings and in the conduct of their business. They must keep the interest of all unit holders paramount in all matters.

ii. The sponsor of the MF, the trustees or the AMC or any of their employees should not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether on real-time or non real-time basis. However, while rendering such advice, a disclosure of his interest including long or short position in the said security should be made.

iii. MF schemes should not be organized, operated, managed or the portfolio of securities selected, in the interest of sponsors, directors of AMCs, members of Board of trustees or directors of Trustee Company, associated persons.

iv. Trustees and AMCs have to ensure that the dissemination of adequate, accurate, explicit and timely information about the investment policies, investment objectives, financial position and general affairs of the scheme is made to all the unit holders.

v. Excessive concentration of business with few broking firms, affiliates and also excessive holding of units in a scheme among a few investors should be avoided by the Trustees and AMCs.

vi. Trustees and AMCs should also avoid conflicts of interest in managing the affairs of the schemes and the interest of all the unit holders should govern all their activities. The investments should be made in accordance with the objectives stated in the offer documents. They should not indulge in any unethical means to sell securities or induce any investor to buy their schemes.

vii. It is expected that the Trustees and AMCs should render at all times high standards of services, exercise due diligence, ensure proper care and exercise independent professional judgment.

viii. The AMC should not make any exaggerated statement, whether oral or written, either about their qualifications or capability to render investment management services or their achievements.

Advertisements Code by MFs

As per the MF regulations, advertisements should be truthful, fair and clear, and not contain any statement/promise/forecast, which is untrue or misleading. The sales literature should also contain information, which is included in the current advertisement. Assuming that the investors are not trained in legal or financial matters, it should be ensured that the advertisement is set forth in a clear, concise and understandable manner. Excessive use of technical/legal jargons or complex language, inclusion or exclusion of excessive details, which is likely to detract the investors, should be avoided. Also, standardized computations such as annual dividend on face value, annual yield on the purchase price and annual compounded rate of return should be used.

Market Outcome

Resource Mobilisation

MFs are quite popular among the investors, who are wary of investing directly in the equities. The popularity of the MFs as an investment avenue is clearly visible from Table 3-1. The resources mobilized by MFs have remained steady during the period 1992-95 with annual gross mobilisation averaging Rs. 110,000 million during the period. Owing to the bearish secondary market conditions, the MFs were adversely affected in 1995-96 and 1996-97. However, in the subsequent two financial years, MFs were able to mobilise modest amounts. It was only in 1999-00 that the MF witnessed a sharp turnaround, with a record mobilisation of Rs. 199,530 million. This was due to the tax sops announced in the Union Budget 1999-00, which was also supported by the bullish trends in the equities and debt market. The year 2000-01 again witnessed a slowdown with net mobilisation falling to Rs. 71,370 million, as the secondary market turned bearish and the tax rate on income distributed by debt-oriented MFs was increased. In 2002-03, the mobilization fell to a further low of Rs. 45,800 million, with UTI having a net outflow of Rs. 94,340 million. However, the year 2003-04 witnessed a sharp rise in the net mobilization to Rs. 476,840 million, as there have been bullish sentiments in equity market and buoyancy in debt market.

During 2003-04, the number of registered MF with the SEBI stood at 37. As against 53 schemes in the year 2002-03, 46 new schemes were launched in 2003-04, of which 44 were open-ended and 2 close-ended schemes. This took the total number of schemes as at end-March 2004 to 403 against 382 as at end-March 2003. Aggregate sales of all the 403 schemes amounted to Rs. 5,901,900 million registering an increase of 88% over last year and the redemptions during the year were at Rs. 5,433,810 million an increase of 80% over

Table 3-1: Resource Mobilisation by Mutual Funds

(Rs. mn.)

Year	Public Sector MFs			Private	Grand Total
	Bank sponsored	FI sponsored	UTI	Sector MFs	
1990-91	23,520	6,040	45,530	—	75,090
1991-92	21,400	4,270	86,850	—	112,520
1992-93	12,040	7,600	110,570	—	130,210
1993-94	1,480	2,390	92,970	15,600	112,440
1994-95	7,650	5,760	86,110	13,220	112,740
1995-96	1,130	2,350	-63,140	1,330	-58,330
1996-97	60	1,370	-30,430	8,640	-20,360
1997-98	2,370	2,030	28,750	7,490	40,640
1998-99	2,310	6,910	1,700	25,190	36,110
1999-00	1,560	3,570	45,480	148,920	199,530
2000-01	— 15,200 —		3,220	92,920	111,350
2001-02	— 14,740 —		-72,840	129,470	71,370
2002-03	— 18,950 —		-94,340	121,220	45,830
2003-04	— 37,610 —		10,500*	428,730	476,840

* Data for 2003-04 relate to UTI Mutual Fund for the period February 01, 2003 to March 31, 2004.
Source: RBI.

the previous year. After adjustment of sale and purchases, there was an inflow of funds of Rs. 468,090 million during 2003-04 (Table 3-2).

Public sector MFs (including UTI) made gross mobilisation of Rs. 685,580 million accounting for about 11.62% of total resource mobilisation by MFs during 2003-04. In net terms, the public sector MFs witnessed an inflow of Rs. 55,790 million during 2003-04 as against Rs. 17,840 million during the preceding year. The private sector MFs accounted for the bulk of the mobilization, by raising about 88.4% of gross resources mobilised by MF industry during 2003-04.

The share of open-ended schemes in total funds raised by MFs registered a marginal decline to 99.54% in 2003-04 as compared to 99.85% in 2002-03. No new assured return schemes were launched in 2003-04. The share of close ended schemes, on the other hand, had a slight increase from 0.14% during 2002-03 to 0.46% during 2003-04. The open ended and close ended schemes together registered a net inflow of Rs. 460,340 million and Rs. 7,850 million in 2003-04, respectively. On the other hand, the assured return schemes registered outflows to the tune of Rs. 100 million (Table 3-3a).

Table 3-2: Accretion of Funds with Mutual Funds

(Rs. mn.)

Category	2002-03			2003-04			Management at the end of	
	Sale	Purchase	Net	Sale	Purchase	Net	March-03	March-04
A Public Sector (i+ii+iii)	**356,870**	**339,030**	**17,840**	**685,580**	**629,790**	**55,790**	**239,420**	**346,240**
i. Unit Trust of India	70,620	72,460	-1,840	—	—	—	135,160 [a]	—
ii. Bank Sponsored	110,900	105,360	5,540	466,610	431,830	34,780	44,910	280,850
iii. Institution Sponsored	175,350	161,210	14,140	218,970	197,960	21,010	59,350	65,390
B Private Sector (i+ii+iii+iv)	**2,789,860**	**2,673,220**	**116,640**	**5,216,320**	**4,804,020**	**412,300**	**555,220**	**1,049,920**
i. Indian	833,510	793,410	40,100	1,430,500	1,331,310	99,190	101,800	198,850
ii. Joint Ventures - Predominately Indian	715,130	683,330	31,800	1,405,450	1,272,800	132,650	154,590	331,430
iii. Joint Ventures - Predominately Foreign	1,241,220	1,196,480	44,740	2,169,480	2,007,430	162,050	298,830	483,310
iv. Foreign	—	—	—	210,890	192,480	18,410	—	36,330
Grand Total (A+B)	**3,146,730**	**3,012,250**	**134,480**	**5,901,900**	**5,433,810**	**468,090**	**794,640[a]**	**1,396,160**

Source: AMFI Updates.

Note: A Erstwhile UTI has been bifurcated into UTI Mutual Fund and the Specified Undertaking of the Unit Trust of India effective February 2003 and hence the data pertaining to the Specified Undertaking of the Unit Trust of India under the Assets under management for the period April 2002 to March 2003 are not included in the table presented above.

Table 3-3a: Scheme-wise Resource Mobilisation by Mutual Funds

(Rs. mn.)

Scheme	2002-03		2003-04	
	Sale	Purchase	Sale	Purchase
Open-ended	3,142,060	3,006,460	5,874,800	5,414,460
Close-ended	4,670	5,190	27,100	19,250
Assured Return	—	600	—	100
Total	**3,146,730**	**3,012,250**	**5,901,900**	**5,433,810**

Source: AMFI Updates

With the decline in interest rates during past few years, the liquid/money market schemes have become very popular among investors due to the attractive returns delivered by them. They have accounted for almost two-thirds of the total resources mobilized. The sale as well as repurchase has been very high in case of these schemes, resulting in a net inflow of Rs. 245,770 million during the year. However, the balanced schemes and the ELSS schemes have witnessed outflows to the extent of Rs. 131 million and Rs. 4,661 million, respectively during 2003-04. The income schemes raised about 29.3% of resources mobilising Rs. 1,729,390 million during 2003-04 (Table 3-3b).

Table 3-3b: Scheme-wise Resource Mobilisation by Mutual Funds

(Rs. mn.)

Scheme	2002-03		2003-04	
	Sale	Purchase	Sale	Purchase
Income	1,094,230	1,004,080	1,729,390	1,601,440
Growth	46,180	39,170	266,420	189,580
Balanced	3,610	7,560	25,230	25,360
Liquid/Money Market	1,950,470	1,900,420	3,756,460	3,510,690
Gilt	52,020	58,920	123,870	101,550
ELSS	220	2,100	530	5,190
Total	**3,146,730**	**3,012,250**	**5,901,900**	**5,433,810**

Source: AMFI Updates.

Assets under Management

As on March 31, 2004, the MFs have managed assets of Rs. 1,396,160 million. As shown in Table 3-2, the share of private sector MFs in total assets managed increased from 69.8% as at end-March 2003 to 75% as at end-March 2004 (Chart 3-1). During the year the assets under management of the private sector MFs increased by Rs. 494,700 million amounting to an aggregate of Rs. 1,049,920 million.

The open ended schemes and the close ended schemes as at end-March 2004 accounted for 96.35% and 3.65% of total assets under management of MFs, respectively (Table 3-4).

The income schemes accounted for 44.8% of total assets under management of MFs as at end-March 2004, followed by liquid/money market schemes with 29.9%. The growth

Table 3-4: Assets under Management as at end March, 2004

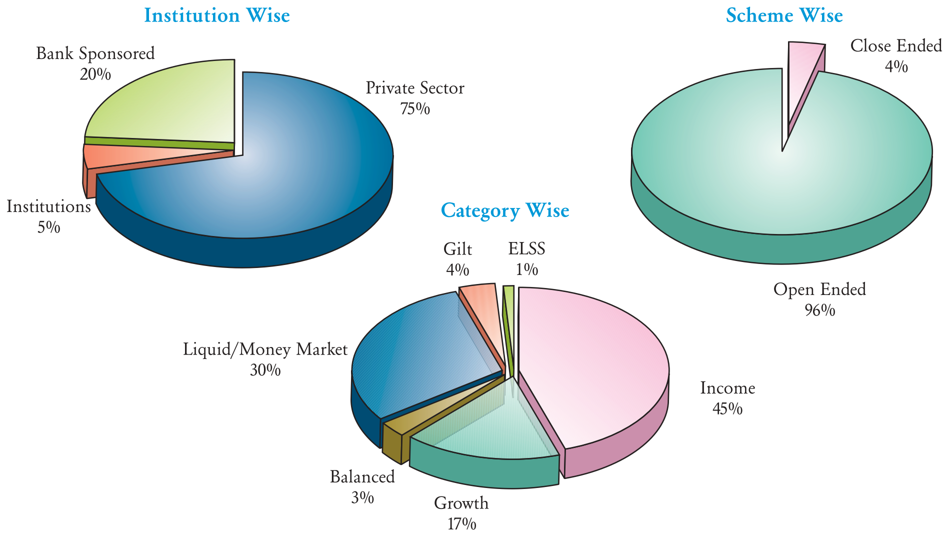
(Rs. mn.)

Scheme	Open Ended	Close Ended	Assured Returns	Total
Income	608,540	16,700	—	625,240
Growth	221,540	14,590	—	236,130
Balanced	32,960	7,840	—	40,800
Liquid/Money Market	417,040	—	—	417,040
Gilt	60,260	—	—	60,260
ELSS	4,890	11,800	—	16,690
Total	**1,345,230**	**50,930**	**—**	**1,396,160**

Source: AMFI Updates.

schemes accounted for 16.9% of assets under management of MFs as at end-March 2004 (Chart 3-1).

Chart 3-1: Assets under Management at the end of March 2004



Index Funds

Index funds attempt to copy the performance of a stock market index such as Nifty or Sensex as closely as possible. This is done by investing in all the stocks that comprise the index in proportions equal to the weightage given to those stocks in the index. Unlike a typical MF, index funds do not actively trade stocks throughout the year. They may at times hold their stocks for the full year even if there are changes in the composition of index; this reduces transaction costs. Index funds are considered, particularly, appropriate for conservative long-term investors looking at moderate risk, moderate return arising out of a well-diversified portfolio. Since Index funds are passively managed, the bias of the fund managers in stock selection is reduced, yet providing returns at par with the index.

Some of the index funds based on S&P CNX Nifty are UTI Nifty Fund, Franklin India Index Fund and IDBI Principal Index Fund. Templeton launched the 'Franklin India Index Tax Fund' in February 2001, which has been the first tax saving index fund based on S&P CNX Nifty. There are a total of twelve funds based on S&P Nifty: Franklin India Index Fund, Franklin India Tax Index Fund, IDBI Principal Index Fund, UTI Nifty Fund, Magnum Index Fund, IL&FS Index Fund Nifty Plan, Prudential ICICI Index Fund Nifty Plan, HDFC Index Fund Nifty Plan, Birla Index Fund, LIC Index Fund, ING Vysya Nifty Plus Fund and Tata Index Fund (Table 3-5). The table shows that the index funds closely track their benchmark indices.

Table 3-5: Performance of Index Funds

Index Funds	Launch Date	Returns*			Base Index
		3 months	6 months	12 months	
Principal Index Fund	July 26, 1999	-29.71	-7.75	34.88	S&P CNX Nifty
Franklin India Index Tax Fund	February 26, 2001	-6.40	23.21	79.89	S&P CNX Nifty
Franklin India Index Fund	August 4, 2001	-6.04	23.58	80.04	S&P CNX Nifty
UTI Nifty Fund	March 27, 2000	-6.74	24.04	83.60	S&P CNX Nifty
UTI Master Index	June 29, 1998	-4.68	24.78	84.70	BSE Sensex
SBI Magnum Index Fund	December 1, 2001	-24.15	0.39	47.77	S&P CNX Nifty
IL&FS Index Fund	February 1, 2002	-6.66	-15.14	24.71	S&P CNX Nifty
Prudential ICICI Index Fund	February 1, 2002	-6.32	23.97	82.29	S&P CNX Nifty
HDFC Index Fund	July 1, 2002	-6.50	24.35	81.86	S&P CNX Nifty
Birla Index Fund	September 17, 2002	-19.25	-30.21	2.69	S&P CNX Nifty
LIC Index Fund	November 1, 2002	-18.20	8.37	-36.62	S&P CNX Nifty
Tata Index Fund	February 1, 2003	-18.64	-25.47	9.20	S&P CNX Nifty
ING Vysya Nifty Plus Fund	February 6, 2004	—	—	—	S&P CNX Nifty
S&P CNX Nifty	November 3, 1995	-5.74	25.04	81.14	—
BSE Sensex	January 2, 1986	-4.25	25.54	83.38	—

* Returns are calculated as on March 31, 2004

Exchange Traded Funds

An Exchange Traded Fund (ETF) is a type of Investment Company whose investment objective is to achieve similar returns as in case of a particular market index. An ETF is similar to an index fund, but the ETFs can invest in either all of the securities or a representative sample of securities included in the index. Importantly, the ETFs offer a one-stop exposure to a diversified basket of securities that can be traded in real time like an individual stock. ETFs first came into existence in USA in 1993. Some of the popular ETFs are: SPDRs (Spiders) based on the S&P 500 Index, QQQs (Cubes) based on the Nasdaq-100 Index, iSHARES based on MSCI Indices, TRAHK (Tracks) based on the Hang Seng Index and DIAMONDs based on Dow Jones Industrial Average (DJIA).

Like index funds, ETFs are also passively managed funds wherein subscription/redemption of units implies exchange with underlying securities. These being exchange traded, units can be bought and sold directly on the exchange, hence, cost of distribution is much lower and the reach is wider. These savings are passed on to the investors in the form of lower costs. The structure of ETFs is such that it protects long-term investors from inflows and outflows of short-term investor. ETFs are highly flexible and can be used as a tool for gaining instant exposure to the equity markets.

The first ETF in India, based on S&P CNX Nifty, was the Nifty Benchmark Exchange Traded Scheme (Nifty BeES). This was launched by Benchmark Mutual Fund in December 2001. It is bought and sold like any other stock on NSE. Over the past three years, few more ETFs have been introduced, they are: Junior Nifty BeES based on CNX Nifty Junior, S&P CNX Nifty UTI Depository Receipts Schemes (SUNDER) based on S&P CNX Nifty, Bank BeES (Banking Index Benchmark Exchange Traded Scheme) tracking the CNX Bank Index. Further the Benchmark Mutual Fund has launched a money market ETF in India which is incidentally the only money market ETF in the world. It is known as the Liquid BeES (Liquid Benchmark Exchange Traded Scheme). Prudential ICICI Mutual Fund also launched an ETF based on the BSE Sensex, SPICE (Sensex Prudential ICICI Exchange Traded Fund), trading for which has started on January 13, 2003.

A comparative view of ETFs vis-à-vis other funds are presented in the table below:

Parameter	Open-Ended Fund	Close-Ended Fund	Exchange Traded Fund
Fund Size	Flexible	Fixed	Flexible
NAV	Daily	Daily	Real time
Liquidity provider	Fund itself	Stock Market	Stock Market/Fund itself
Sale Price	At NAV plus load if any	Significant Premium/ Discount to NAV	Very close to actual NAV of scheme
Availability	Fund itself	Through Exchange where listed	Through Exchange where listed/fund itself
Portfolio Disclosures	Monthly	Monthly	Daily/Real time
Uses	Equitising Cash	—	Equitising cash, hedging, Arbitrage
Intra-day trading	Not Possible	Expensive	Possible at low cost

Collective Investment Schemes

A Collective Investment Scheme (CIS) is any scheme or arrangement made or offered by any company, which pools the contributions, or payments made by the investors, and deploy the same. Despite the similarity between the CIS and MF regarding the pooling of savings and issuing of securities, they differ in their investment objective. While MF invests exclusively in securities, CIS confine their investment to plantations and real estate. Any entity proposing to operate as a Collective Investment Management Company (CIMC) has to apply for registration with SEBI.

Guidelines under CIS Regulations

The SEBI (CIS) Regulations specifically state that, without obtaining a certificate of registration from SEBI, no entity can sponsor a CIS. The other regulations are as follows:

i. CIS should be floated as a public company registered under the provisions of the Companies Act, 1956 and the memorandum of association should specify management of CIS as one of its objectives.

ii. The company at the time of registration as CIMC should have a minimum net worth of Rs. 5 crore (provided that at the time of making the application, the applicant should have a minimum net worth of Rs. 3 crore which should be increased to Rs. 5 crore within three years from the date of grant of registration).

iii. The offer document should disclose adequate information to enable investors to take informed decisions. The offer document should also indicate the maximum and minimum amount expected to be raised. No scheme should be kept open for subscription for a period more than 90 days.

iv. Each scheme has to obtain a rating from a recognized credit rating agency and the projects to be undertaken should be appraised by an empanelled appraising committee.

v. CIMC should launch only close ended schemes with a minimum duration of three calendar years. These schemes are prohibited from guaranteeing or assuring returns.

vi. CIMC should obtain adequate insurance policy for protection of the scheme's property.

vii. Advertisements for each and every scheme have to conform to the SEBI's advertisement code.

viii. The units of every scheme should be listed immediately after the allotment is over, which is not later than six weeks from the date of closure of the scheme on the stock exchanges.

ix. The CIMC on behalf of the scheme should before the expiry of one month from the close of each quarter publish its unaudited financial results in one daily newspaper having nation wide circulation and in the regional newspaper of the region where the head office of the CIMC is situated.

As on March 31, 2004, there was no CIS entity registered with SEBI. SEBI had initiated action against 568 CIS entities for their failure to wind up their schemes and make repayments to investors.

Venture Capital Funds

Venture Capital Fund (VCF) is a fund established in the form of a trust or a company including a body corporate having a dedicated pool of capital, raised in the specified manner and invested in Venture Capital Undertakings (VCUs). VCU is a domestic company whose shares is not listed on a stock exchange and is engaged in a business for providing services, production, or manufacture of article. A company or body corporate to carry on activities as a VCF has to obtain a certificate from SEBI and comply with the regulations prescribed in the SEBI (Venture Capital Regulations) 1996. Unlike MFs and CIS, there is no retail participations in VCFs.

Regulations for VCFs

The salient features of the SEBI (Venture Capital Regulations), 1996 are as follows:

i. The minimum investment in a VCF by an investor should not be less than Rs. 5 lakh; the minimum corpus of the fund before it starts activities should be at least Rs. 5 crore.

ii. A VCF seeking to avail benefit under the relevant provisions of the Income Tax Act will be required to disinvest its holdings within a period of one year from the listing of the VCU.

iii. The VCF is eligible to participate in the IPO through book building route as Qualified Institutional Buyer.

iv. Automatic exemption is granted from open offer requirements in case of transfer of shares from VCFs in Foreign Venture Capital Investors (FVCIs) to promoters of a venture capital undertaking.

Investment Restrictions

i. The VCF have to disclose the investment strategy at the time of application for registration and should not have invested more than 25% corpus of the fund in any one VCU. A VCF, also, cannot invest in associated companies. At least 75% of the investible funds should be invested in unlisted equity shares or equity linked instruments.

ii. Not more than 25% of the investible funds may be invested by way of subscription to IPO of a VCU whose shares are proposed to be listed subject to lock-in period of one year and debt or debt instrument of a VCU in which the VCF has already made an investment by way of equity.

As on March 31, 2004 the total count of VCFs and FVCIs stood at 45 and 9 respectively. All VCFs are now required to provide information pertaining to their venture capital activity for every quarter starting from the quarter ending December 2000.

According to a survey conducted under the aegis of Indian Venture Capital Association (IVCA) by Thomson Venture Economics (Thomson Financial) and Prime Database, India ranked second as the most active VC market in Asia Pacific (excluding Japan). Indian VC funds received US $ 241.8 million in new commitments in 2002 and have invested $ 590.21 million in Indian Companies in the same year. 76 Indian companies received investments; the average value of each deal is around $ 7.11 million. 53% of companies that raised venture capital were in the Information Technology sector.