

Mutual Funds

Mutual Fund (MF): a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets.

Unit: the interest of the unit holders in a scheme, which consists of each unit representing one undivided share in the assets of a scheme.

Mutual funds are trusts, which pool resources from large number of investors through issue of units under specified schemes. The funds raised are invested in capital market instruments such as shares, debentures and bonds and money-market instruments, such as commercial papers, certificates of deposits and treasury bonds. Thus a Mutual Fund is the most suitable investment for the common man as it offers an opportunity to invest in a diversified, professionally managed basket of securities at a relatively low cost. Investors can now hold their mutual fund units in dematerialised form.

The management of mutual fund comprises of a sponsor, Trustee Company and an Asset Management Company (AMC). Typically, a mutual fund is promoted by a sponsor who appoints trustee, asset Management Company and custodian. A mutual fund should be registered with SEBI.

Sponsors: They are the individuals who think of starting a mutual fund. The Sponsor approaches SEBI, the market regulator and also the regulator for mutual funds. Not everyone can start a mutual fund. SEBI will grant a permission to start a mutual fund only to a person of integrity, with significant experience in the financial sector and a certain minimum net worth. These are just some of the factors that come into play.

Trust: Once SEBI is satisfied with the credentials and eligibility of the proposed Sponsors, the Sponsors then establish a Trust under the Indian Trust Act 1882. Trusts have no legal identity in India and thus cannot enter into contracts. Hence the Trustees are the individuals authorized to act on behalf of the Trust. Contracts are entered into in the name of the Trustees. Once the Trust is created, it is registered with SEBI, after which point, this Trust is known as the mutual fund.

Asset Management Company (AMC): The Trustees appoint the AMC, which is established as a legal entity, to manage the investor's (unit holder's) money. In return for this money management on behalf of the mutual fund, the AMC is paid a fee for the services provided. This fee is to be borne by the investors and is deducted from the money collected from them. The AMC has to be approved by SEBI and it functions under the supervision of its Board of Directors, and also under the direction of the Trustees and the regulatory framework established by SEBI. It is the AMC, which in the name of the Trust, that floats new schemes and manages these schemes by buying and selling securities.

Custodian: The Custodian maintains the custody of the securities in which the scheme invests. It also keeps a tab on corporate actions such as rights, bonus and dividends declared by the companies in which the fund has invested. The Custodian is appointed by the Board of Trustees. The Custodian also participates in a clearing and settlement system through approved depository companies on behalf of mutual funds, in case of dematerialized securities.

Transfer Agents: Registrar and Transfer Agents (RTAs) maintain the investor's (unit holder's) records, reducing the burden on the AMCs.

In terms of investment objectives, mutual fund schemes can be classified as the growth funds and income funds. The growth funds invest major parts of their corpus in equity instruments and hence are exposed to comparatively higher risks. Income funds also called the debt funds. They provide steady flow of comparatively lower return for lower risks.

Depending on the type of entry and exit routes available, the mutual fund schemes can be classified as open ended and close ended. The open-ended schemes permit entry by subscription or exit by sale of units on a continuous basis. The mutual fund announces daily sale and repurchase prices of units for the purpose. The close-ended funds have fixed maturity periods e.g. 5-7 years. These schemes are kept open for subscription only during a specified period at the time of launch of the scheme.

Mutual funds sell their shares to public and redeem them at current net Assets Value (NAV)

Net Asset Value (NAV): NAV is the value of net assets under a mutual fund scheme. The NAV per unit is NAV of the scheme divided by number of units outstanding. The day of valuation of NAV is called the valuation day. The market value of portfolio is the aggregate market value of different investments. Market value of a traded security is the last closing price quoted in a stock exchange immediately before the valuation day.

A non-traded debt instrument can be valued by discounting cash flows by YTM of a comparable debt instrument as increased for lack of liquidity. The discounting rate for non-traded government securities should be the prevailing market rate. As per Regulation 51 the financial year for all the schemes shall end as of March 31st of each year. The schemewise Annual Report of a mutual fund or an abridged summary thereof shall be published through an advertisement (and an abridged schemewise annual report shall be mailed to all unitholders).

According to Eleventh Schedule, the annual report shall contain –

- (a) Report of the board of Trustees
- (b) Balance Sheet and Revenue Account
- (c) Auditor's Report
- (d) Brief statement of the Board of Trustees on specified matters
- (e) Statement giving relevant perspective historical 'per unit' statistics etc.

As per regulation 50(3) of SEBI (Mutual Funds) Regulations, 1996, the Asset Management Companies are required to follow the accounting policies and standards specified in the Ninth Schedule of the Regulations.

The Balance Sheet shall give schemewise particulars of its assets and liabilities. These particulars shall contain information enumerated in Annexures 1A and 1B hereto.

The Revenue Account shall give schemewise particulars of the income, expenditure and surplus of the mutual fund. These particulars shall contain information enumerated in Annexure 2 of this Schedule.