Functioning of Mutual Funds in India

- Every mutual fund in India is established under the Indian Trust Act, 1882
- In addition, it should be registered with SEBI under SEBI (Mutual Funds) Regulations, 1996
- The promoter of a mutual fund is called the sponsor
- The sponsor appoints a Board of Trustee (or Board of Directors)
- The Board of Trustees enters into relevant agreement with an Asset Management Company and a Custodian

Parties to a Mutual Fund

1. Sponsor
2. Trustee
3. Asset Management Company
4. Custodian
5. Other functionaries

Sponsor

- A sponsor is like a promoter of a JSC, who brings the mutual fund into existence
- Every mutual fund bears the name of the sponsor
- E.g., UTI sponsored the UTI mutual fund, HDFC sponsored HDFC mutual fund, Canara Bank sponsored Canbank Mutual Fund etc.,
- <u>Activities of a sponsor</u>

1. Promotion
2. Appointment
3. Track record
4. Profit making
5. Capital contribution

Trustee

- A Board of Trustee is appointed by the sponsor
- A company registered under the Companies Act can be appointed as the Trustee Company
- A Trustee Company or Board of Trustees should act according to the provisions of the Indian Trust Act, 1882
- The trustees should protect the interest of the investors
- The AMC and all other functionaries like brokers, selling agents, custodian etc., are accountable to the Trustees
- The Trustees get these powers through a Trust Deed executed by the sponsor in favour of the Trustees as per SEBI Regulation.
- The Deed is registered under Indian Trust Act
- The Trustees supervise the activities of the AMC
- They also ensure all the regulation and law are complied within the operations

Asset Management Company (AMC)

- also known as Fund Manager
- operational management of mutual fund is in the hands of AMC
- designs various schemes of the mutual fund, analyses corporate performance and securities, and buys and sells securities

Features of AMC

- registered as a private limited company
- every AMC must be registered with SEBI
- capital of the AMC is provided by the sponsor, its associates or its joint-venture partners
- every AMC must have a minimum net worth of Rs. 10 crore at all times
- an AMC can not act as AMC of more than one mutual fund
- AMC also cannot undertake any business other than asset management of a mutual fund
- AMC signs an investment management agreement should be in accordance with SEBI Regulation
- AMC charges a fee for the investment management
- all the investments, sale and purchase of securities are done by the AMC

Custodian

- They are responsible for maintaining the securities bought
- They perform the back-office function of acting on the corporate action
- They ensure that the securities are transferred to the demat account when the securities are held in the demat form
- They issue delivery instruction when the shares are sold
- Custodians also receive dividend or interest on the mutual fund's investment
- Custodians also perform certain functions on the advice of AMC regarding bonus issue, rights offer, offer for sale and buy-back

Other functionaries appointed for specialised functions are as follows -

1. Registrar and Transfer Agents
2. Brokers
3. Selling agents & Distributors
4. Depository Participants
5. Bankers
6. Legal Advisors
7. Auditors

NAV and its computation

- **Value of the unit of a mutual fund scheme is its Net Asset Value on a particular day**
- **NAV = Market Value of Investment + Current Assets + Other Assets + Accrued Income – Current Liabilities – Other Liabilities – Accrued Expenses**
- All mutual funds calculate the NAV continuously and disclose it every day by posting it on the website of AMFI (Association of Mutual Funds in India)
- For **open-ended fund**, the NAV should be calculated **everyday**
- For **close-ended fund**, the NAV should be calculated **every week**

Mutual Fund and Exchange Traded Fund

Mutual Fund

- Here, the public pays cash in the initial offer to the MF and the fund manager later invests in the stocks
- MF does buy and sell the shares in the stock market and faces excess trading expenses
- MF carries fund as it is involved in buying and selling of shares
- Only close-ended fund units are listed on a stock exchange
- The MF can change the portfolio very often
- The units are repurchased and sold again continuously
- MF units are traded at the NAV determined at the end of the day or a week

Exchange Traded Fund

- Here, the applicants should possess the specified shares & surrender them to the ETF
- ETF does not buy or sell shares in the stock market and this reduces trading expenses
- ETF does not carry any cash thereby improves the profitability of the fund
- All ETFs are listed on stock exchanges
- An ETF has a fixed portfolio
- Once the units are repurchased by the fund, the ETF cannot re-issue them
- ETF is traded continuously during the working hours of a stock exchange

Risks associated with mutual funds

1. Portfolio risks
2. Fund Management risks
3. Timing risks
4. Corporate risks
5. Industry risks
6. Market risks
7. Economic risks
8. Political risks

Problems of mutual funds in India

1. Extreme fluctuations in the stock market
2. Lack of investor education
3. Lack of transparency
4. Tracking error
5. Difficulty in distribution
6. Poor investor servicing
7. Irrational investor behaviour
8. High price-earnings multiples

Association of Mutual Funds in India

- AMFI is a registered body with SEBI acting as an apex body of AMC's in India
- aim is to establish the mutual fund industry in India as a professional and healthy market

Roles of AMFI –

1. Registration of intermediaries
2. Prescribing code of conduct
3. Interaction with SEBI
4. Representing the regulators
5. Index compilation
6. Investor awareness program
7. Conduct of research

THANK YOU