STUDY NOTES for NISM SERIES V MUTUAL FUND DISTRIBUTORS MODULE (Earlier - AMFI Exam)

Prepared By

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The contents have been prepared by our Company AKSHAYA INVESTMENTS, a Madurai based Financial Services & Training firm. We are into NISM / NCFM / BCFM / AMFI (Mutual Fund) Training, Stock advisory, Life & Health Insurance, Mutual Funds distribution and Tax Planning.

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We have been empanelled as Trainers in the following organizations

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Reliance Mutual Fund – (EDGE Learning Academy)
NJ India Invest – (NJ Gurukul)
ICICI Securities – (I-DIRECT)

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6. Lady Doak college
7. Sourashtra College for women
8. Gnanam School of Business
9. NPR College of Arts and Science
10. SVN College of Arts and Science
11. Hindusthan College of Arts & Science
12. RVS College of Management
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6. NJ India Invest
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7. NISM Mutual Fund Distributors
8. NISM Interest Rate Derivatives
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17. Fundamental Analysis
18. Technical Analysis
19. NCFM Commodities

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NISM SERIES V MUTUAL FUND DISTRIBUTORS EXAM

Assessment Structure

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score on the examination is 50%. There shall be negative marking of 25% of the marks assigned to a question.

INSTRUCTIONS FOR EXAM PREPARATION

1. Study the Class Notes
2. Go through "Checklist of Learning Points" provided below.
3. Go through the fact sheet.
4. Attend Model Test → www.modelexam.in

Checklist of Learning Points

WHAT IS A MUTUALFUND?

A Mutual Fund is a trust that pools the savings of a number of investors who share a common financial goal. Anybody with an investible surplus of as little as a few hundred rupees can invest in Mutual Funds. These investors buy units of a particular Mutual Fund scheme that has a defined investment objective and strategy.

The money thus collected is then invested by the fund manager in different types of securities. These could range from shares to debentures to money market instruments, depending upon the scheme's stated objectives. The income earned through these investments and the capital appreciation realized by the scheme is shared by its unit in proportion to the number of units owned by them.

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.

TYPES OF MUTUALFUND SCHEMES
(A) By Structure

Open-Ended Schemes - These do not have a fixed maturity. You deal with the Mutual Fund for your investments and Redemptions. The key feature is liquidity. You can conveniently buy and sell your units at Net Asset Value (NAV) related prices, at any point of time.

Close-Ended Schemes - Schemes that have a stipulated maturity period (ranging from 2 to 15 years) are called close ended schemes. You can invest in the scheme at the time of the initial issue and thereafter you can buy or sell the units of the scheme on the stock exchanges where they are listed.

Interval Schemes - These combine the features of open-ended and close-ended schemes. They may be traded on the stock exchange or may be open for sale or redemption during predetermined intervals at NAV related prices.

(B) By Investment Objective

Growth Schemes - Aim to provide capital appreciation over the medium to long term. These schemes normally invest a majority of their funds in equities and are willing to bear short term decline in value for possible future appreciation. These schemes are not for investors seeking regular income or needing their money back in the short term. Ideal for:

1) Investors in their prime earning years.
2) Investors seeking growth over the long term.

Income Schemes - Aim to provide regular and steady income to investors. These schemes generally invest in fixed income securities such as bonds and corporate debentures. Capital appreciation in such schemes may be limited. Ideal for: Retired people and others with a need for capital stability and regular income. Ideal for Investors who need some income to supplement their earnings.

Balanced Schemes - Aim to provide both growth and income by periodically distributing a part of the income and capital gains they earn. They invest in both shares and fixed income securities in the proportion indicated in their offer documents. In a rising stock market, the NAV of these schemes may not normally keep pace or fall equally when the market falls. Ideal for Investors looking for a combination of income and moderate growth.

Money Market / Liquid Schemes - Aim to provide easy liquidity, preservation of capital and moderate income. These schemes generally invest in safer, short term instruments such as treasury bills, certificates of deposit, commercial paper and interbank call money. Ideal for: Corporates and individual investors as a means to park their surplus funds for short periods.

Tax Saving Schemes (Equity Linked Saving Scheme - ELSS) - These schemes offer tax incentives to the investors under tax laws as prescribed from time to time and promote long term investments in equities through Mutual Funds. Ideal for: Investors seeking tax incentives. These schemes come with a lock in period of 3 years.

Other Schemes

Sectoral fund schemes are ideal for investors who have decided to invest in a particular sector.

Index fund schemes are ideal for investors who are satisfied with a return approximately equal to that of an index. These schemes attempt to replicate the performance of a particular index such as the BSE Sensex, the NSE 50 (NIFTY).

There are also schemes which invest exclusively in certain segments of the capital market, such as Large Caps, Mid Caps, Small Caps, Micro Caps, 'A' group shares, shares issued through IPO.

Fixed Maturity Plans - Fixed Maturity Plans (FMPs) are investment schemes floated by mutual funds and are close ended with a fixed tenure, the maturity period ranging from one month to three/five years. These plans are predominantly debt-oriented. The objective of such a scheme is to generate steady returns over a fixed-maturity period and protect the investor against market fluctuations.

Gold Exchange Traded Funds (GETFs) - Gold Exchange Traded Funds offer investors an innovative, cost-efficient and secure way to access the gold market. Gold ETFs are intended to offer investors a means of participating in the gold bullion market by buying and selling units on the Stock Exchanges, without taking physical delivery of gold. GOLD ETF invests in 99.99% pure GOLD. NAV of GOLD ETF depends on Real Prices of GOLD Bullion.

Fund of Funds (FOFs) - Fund of Funds are schemes that invest in other mutual fund schemes.

Funds Investing Abroad – Off Shore Schemes - Mutual Funds have been permitted to invest in foreign securities/ American Depository Receipts (ADRs) / Global Depository Receipts (GDRs). Some of such schemes are dedicated funds for investment abroad while others invest partly in foreign securities and partly in domestic securities. While most such schemes invest in securities across the world there are also schemes which are country specific in their investment approach. **Example: Franklin Asian Equity Fund, HSBC Brazil Fund.**

Net Asset Value (NAV) – Current market price of the unit.
Sale Price - Is the price you pay when you invest in a scheme. Also called as Offer Price.
Sale Price – NAV = Entry Load
Repurchase Price - Price at which units are repurchased / Redeemed by the Mutual Fund.
NAV – Repurchase Price = Exit Load

WHY SHOULD YOU INVEST IN MUTUAL FUNDS?

1. Professional Management - You avail of the services of experienced and skilled professionals who are backed by a dedicated investment research team which analyses the performance and prospects of companies and selects suitable investments to achieve the objectives of the scheme.

2. Diversification - Mutual Funds invest in a number of companies across a broad cross-section of industries and sectors. This diversification reduces the risk because seldom do all stocks decline at the same time and in the same proportion.

3. Convenient Administration - Investing in a Mutual Fund reduces paperwork and helps you avoid many problems such as bad deliveries, delayed payments and unnecessary follow up with brokers and companies. Mutual Funds save your time and make investing easy and convenient.

4. Return Potential - Over a medium to long term, Mutual Funds have the potential to provide a higher return as they invest in a diversified basket of selected securities.

5. Low Costs - Mutual Funds are a relatively less expensive way to invest compared to directly investing in the capital markets because the benefits of reduction in share brokerage which translate into lower costs for investors.

6. Liquidity - In open-ended schemes, you can get your money back promptly at Net Asset Value (NAV) related prices from the Mutual Fund itself. With close-ended schemes, you can sell your units on a stock exchange at the prevailing market price.

7. Transparency - You get regular information on the value of your investment in addition to disclosure on the specific investments made by your scheme, the proportion invested in each class of assets and the fund manager's investment strategy and outlook.

8. Flexibility - Through features such as Systematic Investment Plans (SIP), Systematic Withdrawal Plans (SWP) and dividend reinvestment plans, you can systematically invest or withdraw funds according to your needs and convenience.

9. Well Regulated - All Mutual Funds are registered with SEBI and they function within the provisions of strict regulations designed to protect the interests of investors. The operations of Mutual Funds are regularly monitored by SEBI.

YOUR RIGHTS AS A MUTUAL FUND UNITHOLDER

1. Receive information about the investment policies, investment objectives, financial position and general affairs of the scheme.
2. Receive dividend within 30 days of their declaration and receive the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase.
3. Vote in accordance with the Regulations to Change the Asset Management Company; Wind up the schemes.
4. Receive communication from the Trustees about change in the fundamental attributes of any scheme or any other changes which would modify the scheme and affect the interest of the unit holders & to have option to exit at prevailing Net Asset Value without any exit load.
5. Inspect the documents of the Mutual Funds specified in the scheme's offer document.
6. To publish their NAV, in accordance with the regulations: daily, in case of open-ended schemes and once a week, in case of close ended schemes.
7. To disclose your schemes' entire portfolio twice a year, un audited financial results half yearly and audited annual accounts once a year.
8. In addition many mutual funds send out newsletters periodically.
9. To see to it that investment decisions are taken in the best interest of the unit holders.
10. Investors can choose to change their distributor or go direct. In such cases, AMCs will need to comply, without insisting on any kind of No Objection Certificate from the existing distributor.
11. Unit-holders have the right to inspect key documents such as the Trust Deed, Investment Management Agreement, Custodial Services Agreement, R&T agent agreement and Memorandum & Articles of Association of the AMC.
12. Scheme-wise Annual Report or an abridged summary has to be mailed to all unit-holders within 6 months of the close of the financial year.
13. NAV has to be published daily, in at least 2 newspapers

Mutual funds are a vehicle to mobilize moneys from investors, to invest in different markets and securities

The primary role of mutual funds is to assist investors in earning an income or building their wealth, by participating in the opportunities available in the securities markets.

In order to accommodate investor preferences, mutual funds mobilize different pools of money. Each such pool of money is called a mutual fund scheme.

Mutual funds address differential expectations between investors within a scheme, by offering various options, such as dividend payout option, dividend reinvestment option and growth option.

An investor buying into a scheme gets to select the preferred option also. The investment that an investor makes in a scheme is translated into a certain number of 'Units' in the scheme. The number of units multiplied by its face value (Rs10) is the capital of the scheme – its Unit Capital.

When the profitability metric is positive, the true worth of a unit, also called Net Asset Value (NAV) goes up.

When a scheme is first made available for investment, it is called a 'New Fund Offer' (NFO). The money mobilized from investors is invested by the scheme as per the investment objective committed. Profits or losses, as the case might be, belong to the investors. The investor does not however bear a loss higher than the amount invested by him.

The relative size of mutual fund companies is assessed by their assets under management (AUM). The AUM captures the impact of the profitability metric and the flow of unit-holder money to or from the scheme.

Investor benefits from mutual funds include professional management, portfolio diversification, economies of scale, liquidity, tax deferral, tax benefits, convenient options, investment comfort, regulatory comfort and systematic approach to investing.

Limitations of mutual funds are lack of portfolio customization and an overload of schemes and scheme variants.

Open-ended funds are open for investors to enter or exit at any time and do not have a fixed maturity. Investors can acquire new units from the scheme through a sale transaction at their sale price, which is linked to the NAV of the scheme.

Investors can sell their units to the scheme through a re-purchase transaction at their re-purchase price, which again is linked to the NAV.

Close-ended funds have a fixed maturity and can be bought and sold in a stock exchange.

Interval funds combine features of both open-ended and close ended schemes.

Actively managed funds are funds where the fund manager has the flexibility to choose the investment portfolio, within the broad parameters of the investment objective of the scheme.

Passive funds invest on the basis of a specified index, whose performance it seeks to track.

Gilt funds invest in only treasury bills and government securities.

Diversified debt funds on the other hand, invest in a mix of government and non-government debt securities. Junk bond schemes or high yield bond schemes invest in companies that are of poor credit quality.

Fixed maturity plans are a kind of debt fund where the investment portfolio is closely aligned to the maturity of the scheme.

Floating rate funds invest largely in floating rate debt securities

Liquid schemes or money market schemes are a variant of debt schemes that invest only in debt securities of less than 91-days maturity.

Diversified equity funds invest in a diverse mix of securities that cut across sectors.

Sector funds invest in only a specific sector.

Thematic funds invest in line with an investment theme. The investment is more broad-based than a sector fund; but narrower than a diversified equity fund.

Equity Linked Savings Schemes (ELSS) offer tax benefits to investors.

Equity Income / Dividend Yield Schemes invest in shares that fluctuate less, and therefore dividends represent a significant part of the returns on those shares.

Monthly Income Plan seeks to declare a dividend every month.

Capital Protected Schemes are close-ended schemes, which are structured to ensure that investors get their principal back, irrespective of what happens to the market.

Gold funds invest in gold and gold-related securities. They can be structured as Gold Sector Funds or ETF-Gold Schemes. Real estate funds invest in real estate. Commodity funds invest in asset classes like food crops, spices, fibres, industrial metals, energy products or precious metals as may be permitted by their investment charter.

International funds invest abroad. They are often structured as feeder funds linked to a host fund. Fund of Funds invest in other funds. Exchange Traded Funds are open-end funds that trade in the stock exchange.

SCHEME RANKINGS BASED ON RISK

- **SECTOR FUNDS ◊ Highest Risk**
- **FLEXIBLE ASSET ALLOCATION FUNDS**
- **GROWTH FUNDS**
- **JUNK BOND OR HIGH YIELD SCHEMES**
- **DIVERSIFIED EQUITY FUNDS**
- **INDEX FUNDS**
- **VALUE FUNDS**
- **EQUITY INCOME OR DIVIDEND YIELD FUNDS**
- **FIXED ASSET ALLOCATION FUNDS**
- **MIP**
- **CAPITAL PROTECTION ORIENTED FUNDS**
- **CAPITAL PROTECTED FUND**
- **DIVERSIFIED DEBT FUNDS**
- **GILT FUNDS**
- **LIQUID FUNDS OR MONEY MARKET FUNDS ◊ Lowest Risk**

AUM of the industry, as of February 2010 has touched Rs 766,869 crore from 832 schemes offered by 38 mutual funds.

Mutual funds in India are governed by SEBI (Mutual Fund) Regulations, 1996.

The regulations permit mutual funds to invest in securities including money market instruments, or gold or gold related instruments or real estate assets.

Mutual funds are constituted as Trusts. The mutual fund trust is created by one or more Sponsors, who are the main persons behind the mutual fund operation.

Every trust has beneficiaries. The beneficiaries, in the case of a mutual fund trust, are the investors who invest in various schemes of the mutual fund.In order to perform the trusteeship role, either individual may be appointed as trustees or a Trustee company may be appointed. When individuals are appointed trustees, they are jointly referred to as Board of Trustees. A trustee company functions through its Board of Directors.

Day to day management of the schemes is handled by an AMC. The AMC is appointed by the sponsor or the Trustees. Although the AMC manages the schemes, custody of the assets of the scheme (securities, gold, gold-related instruments & real estate assets) is with a Custodian, who is appointed by the Trustees.

Investors invest in various schemes of the mutual fund. The record of investors and their unit-holding may be maintained by the AMC itself, or it can appoint a Registrar & Transfer Agent (RTA).
The sponsor needs to have a minimum 40% share holding in the capital of the AMC.
The sponsor has to appoint at least 4 trustees – atleast two-thirds of them need to be independent.
Prior approval of SEBI needs to be taken, before a person is appointed as Trustee.

AMC should have networth of at least Rs10crore. At least 50% of the directors should be independent directors. Prior approval of the trustees is required, before a person is appointed as director on the board of the AMC.

SEBI regulates mutual funds, depositories, custodians and registrars & transfer agents in the country.
AMFI is an industry body, but not a self regulatory organization.
The AMFI Code of Ethics sets out the standards of good practices to be followed by the Asset Management Companies in their operations and in their dealings with investors, intermediaries and the public.

AMFI has framed AGNI, a set of guidelines and code of conduct for intermediaries, consisting of individual agents, brokers, distribution houses and banks engaged in selling of mutual fund products.

Investment objective defines the broad investment charter. Investment policy describes in greater detail, the kind of portfolio that will be maintained. Investment strategies are decided on a Day-to-day basis by the senior management of the AMC. At least 65% of the corpus should, in the normal course, be invested in the kind of securities / sectors implied by the scheme's name.

Statement of accounts is to be sent to investors within 5 days of closure of the NFO.

Investor can ask for a Unit Certificate for his Unit Holding. This is different from a Statement of Account.

NAV has to be published daily, in at least 2 newspapers. NAV and Re-purchase Price is to be updated in the website of AMFI and the mutual fund

The investor/s can appoint a nominee, who will be entitled to the Units in the event of the demise of the investor/s. The investor can also pledge the units. This is normally done to offer security to a financier.

Dividend warrants have to be dispatched to investors within 30 days of declaration of the dividend

Redemption / re-purchase cheques would need to be dispatched to investors within 10 working days from the date of receipt of request.

Unit-holders have proportionate right to the beneficial ownership of the assets of the scheme.
Investors can choose to change their distributor or go direct. In such cases, AMCs will need to comply, without insisting on No Objection Certificate from the existing distributor.

Investors can choose to hold the Units in dematerialised form. The mutual fund / AMC is bound to co-ordinate with the RTA and Depository to facilitate this.

In the case of unit-holding in demat form, the demat statement given by the Depository Participant would be treated as compliance with the requirement of Statement of Account.

The mutual fund has to publish a complete statement of the scheme portfolio and the unaudited financial results, within 1 month from the close of each half year. In lieu of the advertisement, the mutual fund may choose to send the portfolio statement to all Unit-holders.

Debt-oriented, close-ended / interval, schemes /plans need to disclose their portfolio in their website every month, by the 3rd working day of the succeeding month.
Scheme-wise Annual Report or an abridged summary has to be mailed to all unit-holders within 6 months of the close of the financial year.

The Annual Report of the AMC has to be displayed on the website of the mutual fund. The Scheme-wise Annual Report will mention that Unit-holders can ask for a copy of the AMC's Annual Report.

The trustees / AMC cannot make any change in the fundamental attributes of a scheme, unless the requisite processes have been complied. This includes option to dissenting unit-holders to exit at the prevailing Net Asset Value, without any exit load. This exit window has to be open for at least 30 days.

The appointment of the AMC for a mutual fund can be terminated by a majority of the trustees or by 75% of the Unit-holders (in practice, Unit-holding) of the Scheme.

75% of the Unit-holders (in practice, Unit-holding) can pass a resolution to wind-up a scheme
If an investor feels that the trustees have not fulfilled their obligations, then he can file a suit against the trustees for breach of trust.

Under the law, a trust is a notional entity. Therefore, investors cannot sue the trust (but they can file suits against trustees, as seen above).

The principle of caveat emptor (let the buyer beware) applies to mutual fund investments.
The investor can claim his moneys from the scheme within 3 years. Payment will be based on prevailing NAV. If the investor claims the money after 3 years, then payment is based on the NAV at the end of 3 years

If a security that was written off earlier is now recovered, within 2 years of closure of the scheme, and if the amounts are substantial, then the amount is to be paid to the old investors. In other cases, the amount is to be transferred to the Investor Education Fund maintained by each mutual fund.

PAN No. and KYC documentation is compulsory for mutual fund investments. Only exception is micro-SIPs.

Investors need to give their bank account details along with the redemption request. Adequate safeguards exist to protect the investors from the possibility of a scheme going bust.
Under the SEBI guidelines, NFOs other than ELSS can remain open for a maximum of 15 days. Allotment of units or refund of moneys, as the case may be, should be done within 5 business days

of closure of the scheme. Further, open-ended schemes have to re-open for sale / re-purchase within 5 business days of the allotment.

Investors get to know the details of any NFO through the Offer Document, which is one of the most important sources of information about the scheme for investors. Investments by the investor are governed by the principle of **caveat emptor** i.e. let the buyer beware.

Mutual Fund Offer Documents have two parts: (a) Scheme Information Document (SID), which has details of the scheme (b) Statement of Additional Information (SAI), which has statutory information about the mutual fund that is offering the scheme.

In practice, SID and SAI are two separate documents, though the legal technicality is that SAI is part of the SID. Both documents need to be updated regularly.

Offer Documents in the market are "vetted" by SEBI, though SEBI does not formally "approve" them. KIM is essentially a summary of the SID and SAI. It is more easily and widely distributed in the market. As per SEBI regulations, every application form is to be accompanied by the KIM.

The changing competitive context has led to the emergence of institutional channels of distribution, to supplement the individuals who distribute mutual funds. Institutional channels build their reach through employees, agents and sub-brokers.

AMCs keep exploring newer channels of distribution to increase the size of assets managed. The internet has increased the expectations of advice that investors have from their distributors. The stock exchange brokers have become a new channel for distribution of mutual funds. These brokers too need to pass the prescribed test, get the AMFI Registration No. and get themselves empanelled with AMCs whose schemes they want to distribute.

The scheme application forms carry a suitable disclosure to the effect that the upfront commission to distributors will be paid by the investor directly to the distributor, based on his assessment of various factors including the service rendered by the distributor.

AMCs pay a trail commission for the period the investment is held in the scheme. Since trail commission is calculated as a percentage on AUM, distributors get the benefit of valuation gains in the market.

The unit-holders' funds in the scheme is commonly referred to as "net assets".

Net asset includes the amounts originally invested, the profits booked in the scheme, as well as appreciation in the investment portfolio. It goes up when the market goes up, even if the investments have not been sold.

A scheme cannot show better profits by delaying payments. While calculating profits, all the expenses that relate to a period need to be considered, irrespective of whether or not the expense has been paid. In accounting jargon, this is called accrual principle.

Similarly, any income that relates to the period will boost profits, irrespective of whether or not it has been actually received in the bank account. This again is in line with the accrual principle. In the market, when people talk of NAV, they refer to the value of each unit of the scheme. Higher the interest, dividend and capital gains earned by the scheme, higher would be the NAV. Higher the appreciation in the investment portfolio, higher would be the NAV.

Lower the expenses, higher would be the NAV. The difference between the NAV and Re-purchase Price is called the "exit load".

Schemes can also calibrate the load when investors offer their units for re-purchase. Investors would be incentivized to hold their units longer, by reducing the load as the unit holding period increased. Such structures of load are called "Contingent Deferred Sales Charge (CDSC)

SEBI has banned entry loads. So, the Sale Price needs to be the same as NAV. Exit loads / CDSC in excess of 1% of the redemption proceeds have to be credited back to the scheme immediately i.e. they are not available for the AMC to bear selling expenses. Exit load structure needs to be the same for all unitholders representing a portfolio.

Initial issue expenses need to be met by the AMC. There are limits to the recurring expenses that can be charged to the scheme. These are linked to the nature of the scheme and its net assets.

Dividends can be paid out of distributable reserves. SEBI has prescribed a conservative approach to its calculation.

NAV is to be calculated upto 4 decimal places in the case of index funds, liquid funds and other debt funds. NAV for equity and balanced funds is to be calculated upto at least 2 decimal places. Investors can hold their units even in a fraction of 1 unit.

However, current stock exchange trading systems may restrict transacting on the exchange to whole units.

Detailed norms on valuation of debt and equity securities determine the valuation of the portfolio, and therefore the NAV of every scheme.

Mutual funds are exempt from tax. However, Securities Transaction Tax (STT) is applicable on investments in equity and equity mutual fund schemes. Additional tax on income distributed (Dividend distribution tax) is applicable on dividends paid by debt mutual fund schemes.

Taxability of capital gains, and treatment of capital losses is different between equity and debt schemes, and also between short term and long term. Upto 1 year investment holding is short term.

There is no Tax Deducted at Source (TDS) on dividend payments or re-purchase payments to resident investors. Withholding tax is applicable for some non-resident investors.

Setting of capital losses against capital gains and other income is subject to limitations to prevent tax avoidance. Investment in mutual fund units is exempt from Wealth Tax.

Product	Transaction	STT rate
Equity-Delivery & for Exchange Traded Equity Funds	Purchase	0.125%
	Sell	0.125%
Sale of Futures and Options	**Sell**	**0.017%**
Equity MF – Repurchase	Sell	0.25%

Dividend Distribution Tax	**Individuals / HUF**	**Corporate**
Equity Schemes	NIL	NIL
Debt Schemes	12.5%	30%
Liquid Schemes	25%	30%

Capital Gains Tax	**Equity Schemes**	**Non-Equity Schemes**
LTCG Tax	NIL	Lesser of 10% without indexation or 20% with indexation
STCG Tax	15%	Added to total income and taxed as per the slab

Loss	Set Off Against
Short Term	Long Term / Short Term Gain
Long Term (Debt)	Long Term Gain (Debt)
Long Term Equity	Cannot be Set Off

Benchmark for Equity Schemes - SENSEX,S&P CNX Nifty, BSE 100
Benchmark for Debt Schemes - NSE's MIBOR, CRISIL LiquiFEX for Liquid Schemes
Gilt Schemes Si-Bex (1 to 3 years), Mi-Bex (3 to 7 years) & Li-Bex (more than 7 years)

Individual and non-individual investors are permitted to invest in mutual funds in India. Foreign nationals, foreign entities and OCBs are not permitted to invest. Since FIIs are permitted to invest, foreign entities can take this route. The 'Who can invest' section of the Offer Document is the best source to check on eligibility to invest.

Once an investor obtains a Mutual Fund Identification Number (MIN) from CDSL Ventures Ltd, they can apply with any mutual fund.

Micro SIPs i.e. SIPs with annual investment below Rs 50,000 is exempted from the PAN Card requirement.

Besides KYC, non-individual investors need to provide additional documentation to support their investment.

Demat makes it possible to trade in Units in the stock exchange. Full application form is to be filled for a first time investment in a mutual fund. Thereafter, additional investments in the same mutual fund are simpler. Only transaction slip would need to be filled.

Investors can pay for their Unit purchases through cheque / DD, Net-based remittances, ECS / Standing Instructions or ASBA. MBanking is likely to increase in importance in the days to come. Non-resident investment on repatriation basis has to be paid through cheque on NRE account, or a banker's certificate that investment is made out of moneys remitted from abroad. Transaction Slip can be used for re-purchase.

Investors can indicate the amount to re-purchase or the number of units to repurchase. Cut-off timings have been specified for different types of schemes and different contexts to determine the applicable NAV for sale and re-purchase transactions. These are not applicable for NFOs and International Schemes. Time Stamping is a mechanism to ensure that the cut-off timing is strictly followed.

NSE's platform is called NEAT MFSS. BSE's platform is BSE StAR Mutual Funds Platform.

Dividend payout, Dividend investment and Growth are 3 possible options within a scheme. Each option has different implications on the investor's bank account, investor's taxation and scheme NAV.

A constant amount is regularly invested in SIP, withdrawn in SWP and transferred between schemes in STP. These minimize the risk of timing the decisions wrongly.

Triggers are another way of bring discipline into investing. Nomination and Pledge options are available for mutual fund investors.

The portfolio is the main driver of returns in a mutual fund scheme. The underlying factors are different for each asset class. Fundamental Analysis and Technical Analysis are two disciplines of securities analysis. Fundamental Analysis entails review of the company's fundamentals viz. financial statements, quality of management, competitive position in its product / service market etc. Technical analysts study price-volume charts of the company's share prices. It is generally agreed that longer term investment decisions are best taken through a fundamental analysis approach, while technical analysis comes in handy for shorter term speculative decisions, including intra-day trading. Even where a fundamental analysis-based decision has been taken on a stock, technical analysis might help decide when to implement the decision i.e. the timing.

Growth investment style entails investing in high growth stocks. Value investment style is an approach of picking up stocks which are valued lower, based on fundamental analysis. In a top-down approach, sector allocation is the key decision. Stock selection is important in bottom-up approach.

The returns in a debt portfolio are largely driven by interest rates and yield spreads. If the portfolio manager expects interest rates to rise, then the portfolio is switched towards a higher proportion of floating rate instruments; or fixed rate instruments of shorter tenor. On the other hand, if the expectation is that interest rates would fall, then the manager increases the exposure to longer term fixed rate debt securities.

This additional return offered by a non-government issuer, above the yield that the government offers, is called yield spread. Better the credit quality, lower the yield spread.

Gold is a truly international asset, whose quality can be objectively measured. The value of gold in India depends on the international price of gold (which is quoted in foreign currency), the exchange rate for converting the currency into Indian rupees, and any duties on the import of gold. Unlike gold, which is a global asset, real estate is a local asset. It cannot be transported – and its value is driven by local factors.

Returns can be measured in various ways – Simple Returns, Annualised Returns, Compounded Returns, Compounded Annual Growth Rate. CAGR assumes that all dividend payouts are reinvested in the scheme at the ex-dividend NAV.

SEBI guidelines govern disclosures of return by mutual fund schemes. Loads and taxes pull the investor's returns below that earned by the Scheme. Investor returns are also influenced by various actions of the investor himself.

Risks in mutual fund schemes would depend on the nature of portfolio, its liquidity, outside liabilities and composition of unitholders. Fluctuation in returns is a measure of risk. Variance and Standard Deviation are risk measures for all kinds of schemes; beta is relevant for equity; modified duration and weighted average maturity are applicable for debt schemes.

Benchmarking is a form of relative returns comparison. It helps in assessing under-performance or out-performance. Choice of benchmark depends on scheme type, choice of investment universe, choice of portfolio concentration and the underlying exposure.

Sharpe Ratio, Treynor Ratio and Alpha are bases to evaluate a fund manager's performance based on risk-adjusted returns. Quantitative measures are based on historical performance, which may or may not be replicated in future. Scheme evaluation is an art, not a science.

Asset allocation is the approach of spreading one's investments between multiple asset classes to diversify the underlying risk. The sequence of decision making in selecting a scheme is: Step 1 – Deciding on the scheme category (based on asset allocation); Step 2 – Selecting a scheme within the category; Step 3 – Selecting the right option within the scheme.

While investing in equity funds, a principle to internalize is that markets are more predictable in the long term, than in the short term. So, it is better to consider equity funds, when the investment horizon is adequately long.

In an actively managed diversified fund, the fund manager performs the role of ensuring higher exposure to the better performing sectors or stocks. An investor, investing or taking money out of a sector fund has effectively taken up the role of making the sector choices.

It can be risky to invest in mid-cap / small cap funds during periods of economic turmoil. As the economy recovers, and investors start investing in the market, the valuations in front-line stocks turn expensive. At this stage, the mid-cap / small cap funds offer attractive investment opportunities. Over longer periods, some of the mid/small cap companies have the potential to become largecap companies thus rewarding investors.

Arbitrage funds are not meant for equity risk exposure, but to lock into a better risk-return relationship than liquid funds – and ride on the tax benefits that equity schemes offer.

The comparable for a liquid scheme in the case of retail investors is a savings bank account. Switching some of the savings bank deposits into liquid schemes can improve the returns for him.
Businesses, which in any case do not earn a return on their current account, can transfer some of the surpluses to liquid schemes.

Balanced schemes offer the benefit of diversity of asset classes within the scheme. A single investment gives exposure to both debt and equity.

Investors need to understand the structure of the gold schemes more closely, before investing.

Equity investors would like to convince themselves that the sectors and companies where the scheme has taken higher exposure are sectors / companies that are indeed promising.

Debt investors would ensure that the weighted average maturity of the portfolio is in line with their view on interest rates.

Investors in non-gilt debt schemes will keep an eye on credit quality of the portfolio – and watch out for sector concentration in the portfolio, even if the securities have a high credit rating.

Any cost is a drag on investor's returns. Investors need to be particularly careful about the cost structure of debt schemes. SEBI legislations prescribe a maximum exit load of 7%.

Leveraging is taking large positions with a small outlay of funds.

Securities issued by the Government are called Government Securities or G-Sec or Gilt.
Treasury Bills are short term debt instruments issued by the RBI.
Certificates of Deposit are issued by Banks (for 91 days to 1 year) or Financial Institutions (for 1 to 3 years)
Commercial Papers are short term securities (upto 1 year) issued by companies.

Bonds / Debentures are generally issued for tenors beyond a year. Governments and public sector companies tend to issue bonds, while private sector companies issue debentures.

The difference between the yield on Gilt and the yield on a non-Government Debt security is called its yield spread.

Significant Unit holder means any entity holding 5% or more of the total corpus of any scheme.
Maximum investment per investor is limited to 25% of the Net Assets of the scheme.
A scheme should have a minimum of 20 investors at any point of time.

Amongst index schemes, tracking error is a basis to select the better scheme. Lower the tracking error, the better it is. Similarly, Gold ETFs need to be selected based on how well they track gold prices.

Mutual fund research agencies assign a rank to the performance of each scheme within a scheme category (ranking). Some of these analyses cluster the schemes within a category into groups, based on well-defined performance traits (rating).

Seeking to be invested in the best fund in every category in every quarter is neither an ideal objective, nor a feasible target proposition. Indeed, the costs associated with switching between schemes are likely to severely impact the investors' returns. The underlying returns in a scheme, arising out of its portfolio and cost economics, is what is available for investors in its various options viz. Dividend payout, dividend re-investment and growth options.

Dividend payout option has the benefit of money flow to the investor; growth option has the benefit of letting the money grow in the fund on gross basis (i.e. without annual taxation). Dividend reinvestment option neither gives the cash flows nor allows the money to grow in the fund on gross basis. Taxation and liquidity needs are a factor in deciding between the options. The advisor needs to understand the investor's situation before advising.

Many AMCs, distribution houses and mutual fund research houses offer free tools in their website to help understand performance of schemes.

Physical assets like land, building and gold have value and can be touched, felt and used. Financial assets have value, but cannot be touched, felt or used as part of their core value. Shares, debentures, fixed deposits, bank accounts and mutual fund schemes are all examples of financial assets that investors normally invest in.

The difference in comfort is perhaps a reason why nearly half the wealth of Indians is locked in physical assets. There are four financial asset alternatives to holding gold in physical form – ETF Gold, Gold Sector Fund, Gold Futures & Gold Deposits.

Wealth Tax is applicable on gold holding (beyond the jewellery meant for personal use). Mutual fund schemes (gold linked or otherwise) and gold deposit schemes are exempted from Wealth Tax.

Real estate in physical form has several disadvantages. Therefore, investors worldwide prefer financial assets as a form of real estate investment.

Bank deposits and mutual fund debt schemes have their respective merits and demerits. Interest earned in a bank deposit is taxable each year. However, if a unit holder allows the investment to grow in a mutual fund scheme, then no income tax is payable on year to year accretions. In the absence of the drag of annual taxation, the money can grow much faster in a mutual fund scheme.

Financial planning is a planned and systematic approach to provide for the financial goals that will help people realise their aspirations, and feel happy. The costs related to financial goals, in today's terms, need to be translated into the rupee requirement in future. This is done using
the formula A = P X (1 + i)n

The objective of financial planning is to ensure that the right amount of money is available at the right time to meet the various financial goals of the investor. An objective of financial planning is also to let the investor know in advance, if some financial goal is not likely to be fulfilled. The process of financial planning helps in understanding the investor better, and cementing the relationship with the investor's family. This becomes the basis for a long term relationship between the investor and the financial planner.

A "goal-oriented financial plan" is a financial plan for a specific goal. An alternate approach is a "comprehensive financial plan" where all the financial goals of a person are taken together, and the investment strategies worked out on that basis.

The Certified Financial Planner – Board of Standards (USA) proposes the following sequence of steps for a comprehensive financial plan:
• Establish and Define the Client-Planner Relationship
• Gather Client Data, Define Client Goals
• Analyse and Evaluate Client's Financial Status
• Develop and Present Financial Planning
• Implement the Financial Planning Recommendations
• Monitor the Financial Planning Recommendations

Life Cycle and Wealth cycle approaches help understand the investor better.

There are differences between investors with respect to the levels of risk they are comfortable with (risk appetite). Risk profiling is an approach to understand the risk appetite of investors - an essential pre-requisite to advice investors on their investments. Risk profilers have their limitations. Risk profile is influenced by personal information, family information and financial information.

Spreading one's exposure across different asset classes (equity, debt, gold, real estate etc.) balances the risk. Some international researches suggest that asset allocation and investment policy can better explain portfolio performance, as compared to being exposed to the right asset classes (asset allocation) is a more critical driver of portfolio profitability than selection of securities within an asset class (stock selection) and investment timing.

Strategic Asset Allocation is the ideal that comes out of the risk profile of the individual. Tactical Asset Allocation is the decision that comes out of calls on the likely behaviour of the market. Financial planners often work with model portfolios – the asset allocation mix that is most appropriate for different risk appetite levels. The financial planner would have a model portfolio for every distinct client profile.

Model Portfolio

Young call centre / BPO employee with no dependents

1. 50% in Diversified Equity Funds through SIP
2. 20% in Sector Fund, 10% each in Gold ETF, Diversified Debt, Liquid.

Young married single income family with two school going kids

1. 35% diversified equity schemes; 15% in gold ETF,
2. 30% diversified debt fund, 10% each in Sector and liquid schemes

Single income family with grown up children who are yet to settle

1. 35% diversified equity schemes; 20% liquid schemes
2. 15% each in gold ETF, gilt fund & diversified debt fund

Couple in their seventies, with no immediate family support

1. 15% diversified equity index scheme; 10% gold ETF
2. 30% gilt fund, 30% diversified debt fund, 15% liquid schemes

Couple in their seventies, with no immediate family support but very sound physically and mentally, & a large investible corpus

1. 20% diversified equity scheme; 10% diversified equity index scheme;
2. 10% each in Gold ETF & Liquid, 25% each in gilt & diversified debt fund

KYC Requirements for Mutual Fund Investors

The following investors have to be KYC compliant, irrespective of the investment value:

• Non-individual investors i.e. companies, partnership firms, trusts, HUF etc.

• Non-Resident Indians

• Investors coming through channel distributors

The benefit of exemption from KYC documentation for investment value upto Rs 50,000 via SIP is therefore not available for the above-mentioned categories of investors.

SEBI is keen that investors have unrestricted access to AMCs, and thus ensure that AMCs can execute all financial and non-financial transactions of investors. Therefore, it has been stipulated that:

a) All new folios/ accounts shall be opened only after ensuring that all investor-related documents including account opening documents, PAN, KYC, PoA (if applicable), specimen signature are available with AMCs/RTAs and not just with the distributor.

b) For existing folios, AMCs are responsible for updation of the investor related documents including account opening documents, PAN, KYC, PoA (if applicable), specimen signature by November 15, 2010.

Payment Mechanism for Purchase / Additional Purchase

Cheques accompanying the investment application are to be signed by the investor. Third-party cheques are not accepted.

Derivative Investments - Mutual Funds are barred from writing options (they can buy options) or purchasing instruments with embedded written options.

In India, mutual fund AUM is hardly 10% of bank deposits.

Factors that Influence the Investor's Risk Profile

1. Risk appetite increases as the number of earning members increases
2. Risk appetite decreases as the number of dependent member's increases
3. Risk appetite is higher when life expectancy is longer. Lower the age, higher the risk that can be taken. People earning regular income can take more risk than those with unpredictable income streams.
4. Well qualified and multi skilled professionals can afford to take more risk
5. Those with steady jobs are better positioned to take risk
6. Daring and adventurous people are better positioned mentally to take risk.
7. Higher the capital base, better the ability to financially take the downsides of risk.

Recurring Expense Limits

Net Assets	Equity	Debt
First 100 Crores	2.50%	2.25%
Next 300 Crores	2.25%	2.00%
Next 300 Crores	2.00%	1.75%
Above 700 crores	1.75%	1.50%

- For FOF the total expenses should not exceed 0.75%
- For Index Funds – 1.5%
- Recurring Expenses includes Fund Management Fee also

INVESTMENT MANAGEMENT FEE

- First 100 Crores – 1.25%
- Remaining Net Assets – 1%

NPS

Pension Funds Regulatory and Development Authority (PFRDA) is the regulator
Tier I (Pension account), is non-withdrawable

Tier II (Savings account) is withdrawable
An active Tier I account is a pre-requisite for opening a Tier II account
Investors can invest through Points of Presence (POP)

Asset Class E: Equity market instruments
Asset Class C: Corporate Bonds
Asset Class G: Government Securities

NPS managed by 6 Pension Fund Managers (PFMs)

Personal Retirement Account Number (PRAN), is applicable across all the PFMs where the investor's money is invested

PPF

Maturity Period – 15 Years
A/c Opened in PO or Nationalised Banks
Interest – Tax Free
Min Amount Rs.500 Max Rs.70,000 per year
Single, Joint, Minor with Guardian
NRI can open
80 C Section Benefit

Abbreviations

A/A Articles of Association
ACE AMFI Code of Ethics
AGNI AMFI Guidelines & Norms for Intermediaries
AMC Asset Management Company
AMFI Association of Mutual Funds in India
AML Anti-Money Laundering
ARN AMFI Registration Number
ASBA Application Supported by Blocked Amount
CAGR Compounded Annual Growth Rate
CDSC Contingent Deferred Sales Charge
CFT Combating Financing of Terrorism
CVL CDSL Ventures Ltd
DD Demand Draft
DDT Dividend Distribution Tax (Additional Tax on Income Distribution)
DP Depository Participant
ECS Electronic Clearing Service
F&O Futures & Options
FCNR Foreign Currency Non-Resident account
FEMA Foreign Exchange Management Act, 1999
FII Foreign Institutional Investor

FIRC Foreign Inward Remittance Certificate
FMP Fixed Maturity Plan
HUF Hindu Undivided Family
ISC Investor Service Centre
KIM Key Information Memorandum
KYC Know Your Customer
M/A Memorandum of Association
M-Banking Mobile Banking
MF Mutual Fund
Micro-SIP SIP with annual aggregate investment less than Rs 50,000
MIN Mutual Fund Identification Number
NAV Net Asset Value
NBFC Non-Banking Finance Company
NEFT National Electronic Funds Transfer
NFO New Fund Offer
NOC No Objection Certificate
NPA Non-Performing Asset
NRE Non-Resident External account
NRI Non-Resident Indian
NRO Non-Resident Ordinary account
PAN Permanent Account Number
PDC Post-Dated Cheques
PFM Pension Fund Manager
PFRDA Pension Fund Regulatory & Development Authority
PIO Person of Indian Origin
PMLA Prevention of Money Laundering Act
PoA Power of Attorney / Points of Acceptance, depending on context
POP Points of Presence
RBI Reserve Bank of India
RTA Registrars & Transfer Agents
RTGS Real Time Gross Settlement
SAI Statement of Additional Information
SEBI Securities & Exchange Board of India
SID Scheme Information Document
SIP Systematic Investment Plan
SRO Self Regulatory Organisation
STP Systematic Transfer Plan
STT Securities Transaction Tax
SWP Systematic Withdrawal Plan
SWIFT Society for Worldwide Interbank Financial Telecommunication

USEFUL WEBSITES

Credence Analytics (www.credenceanalytics.com)
CRISIL (www.crisil.com)
Lipper (www.lipperweb.com)

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Morning Star (www.morningstar.com)
Value Research (www.valueresearchonline.com)
www.modelexam.in (Model Test for NISM/NCFM/BCFM Exams)

IMPORTANT NOTE :

1. Attend **ALL** Questions
2. For the questions you don't know the right answer – Try to eliminate the wrong answers and take a guess on the remaining answers.
3. DO NOT MUG UP the question & answers. It's not the right to way to prepare for any NISM exam. Good understanding of Concepts is essential.

All the Best ☺