NISM CERTIFICATION EXAMINATION WORK BOOK

II-B

Registrars to an Issue and Share Transfer Agents - Mutual Funds

National Institute of Securities Markets
A Capacity Building Initiative of SEBI

Workbook for

NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents –Mutual Funds Certification Examination

National Institute of Securities Market

www.nism.ac.in

This workbook has been developed to assist candidates in preparing for the National Institute of Securities Markets (NISM) Certification Examination for Registrars to an Issue and Share Transfer Agents –Mutual Fund.

Workbook Version: March 2025

Published by:

National Institute of Securities Markets

NISM Bhawan,

Plot No 82, Sector-17 Vashi,

Navi Mumbai – 400703

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NISM supports candidates by providing lucid and focused workbooks that assist them in understanding the subject and preparing for NISM Examinations. This book covers all important aspects of the functioning of the Registrars and Transfer Agents (RTA) in mutual funds. These include the basic understanding of the Indian securities markets, roles and functions of RTAs in mutual fund issuances and transaction processes and also the regulatory environment in which the RTAs operate in India.

Sashi Krishnan

Director, NISM

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While the NISM Certification examination will be largely based on material in this workbook, NISM does not guarantee that all questions in the examination will be from material covered herein.

Important

- Please note that the Test Centre workstations are equipped with either Microsoft Excel or OpenOffice Calc. Therefore, candidates are advised to be well versed with both of these software for computation of numerical.
- The sample questions and the examples discussed in the workbook are for reference purposes only. The level of difficulty may vary in the actual examination.

Acknowledgement

This workbook has been developed and reviewed by the Certification team of NISM in co-ordination with its Resource Person – Mr. Ashwani Gupta. NISM gratefully acknowledges the contribution of the Examination Committee of NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents – Mutual Funds Certification Examination consisting of industry experts.

About NISM Certifications

National Institute of Securities Markets (NISM) is a capacity building initiative of Securities and Exchange Board of India (SEBI), the securities market regulator. The Institute was established in 2006 pursuant to the Union Budget of 2005-06.

NISM is engaged in developing and administering Certification Examinations and Continuing Professional Education (CPE) Programmes for professionals employed in various segments of the Indian securities markets. These Certifications and CPE Programmes are being developed and administered by NISM as mandated under Securities and Exchange Board of India (Certification of Associated Persons in the Securities Markets) Regulations, 2007.

The skills, expertise and ethics of professionals in the securities markets are crucial in providing effective intermediation to investors and in increasing the investor confidence in market systems and processes. NISM seeks to ensure that market intermediaries meet defined minimum common benchmark of required functional knowledge through Certification Examinations and CPE Programmes on Mutual Funds, Equities, Derivatives, Securities Operations, Compliance, Portfolio Management etc.

These Certifications create quality market professionals and catalyzes greater investor participation in the markets. They also provide structured career paths to students and job aspirants in the securities markets.

About the Certification Examination for Registrars to an Issue and Share Transfer Agents – Mutual Funds

The examination seeks to create a common minimum knowledge benchmark for persons working in Registrars to an Issue and Share Transfer Agents (R&T Agent) organizations in the mutual fund R&T function, in order to enable better quality investor service, operational process efficiency and risk controls.

Examination Objectives

On successful completion of the examination the candidate should:

- Know the basics of securities and securities markets.
- Understand broadly the role and functions of the RTAs in the mutual fund issuance and transaction process.
- Know the regulatory environment in which the RTAs operate in India.

Assessment Structure

The examination consists of 100 questions of 1 mark each and should be completed in 2 hours. The passing score for the examination is 50 percent. There shall be **NO Negative Marking** in this certification examination. [1]

How to register and take the examination

To find out more and register for the examination please visit www.nism.ac.in

[1] There shall be NO Negative marking w.e.f April 1, 2025.

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NISM-Series-II-B: Registrars to an Issue and Share Transfer Agents - Mutual Fund Certification Examination

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1 Introduction to Securities

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Concept of Equity and Debt
- Features and Benefits of Equity Capital
- Features and Benefits of Debt Capital
- Features of Hybrid Instruments

1.1 Introduction to Equity and Debt

A firm that requires money to conduct its operations can fund its requirements through:

- Contribution by owners (either in form of loan or equity)
- Contribution from outsiders (either in form of loan or equity)

Businesses are typically created by promoters, who bring in the initial funds to start and nurture a business. Later as the business grows in size, the need for money can be met by additional funds brought in by the owner(s) or contributions from outsiders (public). Similarly, an investor has a choice of owning a business by contributing to equity capital or lending to a business as debt capital.

Capital used in running a business can be primarily classified based on:

- The contributors of funds
- The period for which money is contributed
- The cost of the funds to the firm
- The rights that accrue to the contributors of the funds

Contributors

Funds brought in by promoters and owners of the business are called equity capital. Equity capital can be brought in at the start of a business or at a later date as the business grows. Equity capital also can be contributed by outside investors. To enable such contribution, the business offers equity shares to outside investors, who become shareholders.

Funds brought in as loan is called debt capital. Those that contribute debt capital are called lenders to the business. Lenders can be individuals or institutions including banks. To enable

such lending, a business issues debt instruments to investors, or obtains term loans by mortgaging the assets of the company.

Time Period

The period for which capital is brought in may vary. Equity capital cannot be taken out of the firm unless the firm is liquidated. Such capital is for perpetuity.

Debt has to be repaid by the company after a certain period. The period of repayment may be short-term (less than one year) or long-term (more than one year and may go up to even 30 years or more) and is decided at the time such funds are brought in.

Cost of Capital

The business has to pay a price for using equity or debt capital. The cost may be fixed at the time the money is brought in and may constitute an obligation for the company. Debt instruments usually pay a periodic interest. The rate of interest may be pre-determined or the method by which the rate will be determined, as in the case of floating rate bonds and inflation indexed bonds, will be described upfront.

The cost of capital may vary depending on the earnings of the company, as is the case with equity capital.

Both debt and equity are reflected in the liability side of the balance sheet indicating "source of funds". A company must carefully decide the mix of debt and equity to be used in the business.

Rights of the Contributors

The contributors of capital enjoy certain rights and obligations depending upon the type of capital that they have brought in. Equity investors enjoy rights such as ownership and voting rights and rights to share the profits of the company. Debt investors have the right to receive periodic interest and return of the capital on the expiry of the fixed period. The contributors of debt capital may have their rights secured against the assets of the company.

1.2 Features of Equity Capital and Benefits to Equity Investors

Those who contribute equity capital to the company, buy equity shares, when they are issued by the company. They are called equity shareholders of the company.

Limited Liability

Equity capital is issued with limited liability. This means, if the creditors to a business are not able to recover their dues, equity shareholders will not be asked to pay up. The liability of equity shareholders in a company is limited to their contribution made to its equity capital, or on any amount unpaid which they have agreed to pay.

Ownership Rights

Equity represents ownership of the company. Equity shareholders are owners of the company in proportion of the shares held.

For example, if a company has an issued and paid-up capital of Rs.10 crore made up of 1 crore shares of Rs.10 each, and an investor owns 10 lakh equity shares, such investor owns 10% of the company.

Equity shareholders have the right to participate in the management of the company. They can do this through voting rights. Each equity share carries one vote. Major decisions of the company require resolutions to be passed, which have to be voted by a majority.

Equity capital entitles its contributors to participate in the residual profits of the company. After meeting all expenses and provisions, profit that remains in the books belongs to equity shareholders. This is generally distributed to the shareholders in the form of dividends.

Liquidity

Equity shares are first issued by a company to the public through a process called the Initial Public Offer (IPO). IPOs are made in primary market. The money raised in an IPO is used by the company for its business activities and reflected in the balance sheet of the company.

After IPO, the shares are listed on the stock exchanges, where they can be traded between investors. This is called the secondary market. Such transactions do not result in change in the capital structure of the company. Secondary market provides liquidity to the investors.

Perpetuity

Equity capital is for perpetuity. It cannot be redeemed and the company does not have an obligation to repay it. In special situations, a company may buy-back its own shares from the shareholders. Such shares shall be extinguished by the company.

Uncertain Pay-outs

Shareholders enjoy return in the form of dividends paid by the company and may also benefit by the appreciation in share price. The investors can book capital gains by selling their shares in secondary market at a price higher than the acquisition price. If share price goes down, this may result in capital loss. However, there is no guarantee of dividends or capital appreciation on equity capital. Thus, the returns from equity are uncertain.

1.3 Features of Debt Capital and Benefits to Debt Investors

Debt capital refers to the borrowings of a company. The return to an investor from debt securities is primarily in the form of interest. Those that contribute debt capital are lenders or creditors of the company. Debt capital implies regular return and security for the investor. For the company there is an obligation to make periodic interest payments and to repay the capital on maturity. A debt instrument pays interest as a percentage of its face value. The tenor of a debt instrument is fixed in advance.

Debt is raised by companies either by issuing securities such as debentures, bonds and commercial papers to the lenders or by taking a loan from a bank or financial institution. The terms at which the borrowing is being made, are mentioned in the document (or certificate) that represents the debt.

Debt is raised by the company for a fixed period after which it has to be repaid. The period of borrowing will vary depending upon the need of the company. The interest rate or coupon rate of a bond/ debenture depends on the risk of default associated with the company issuing such securities. The risk that a debt instrument may default on its interest payments is called credit risk. Credit rating of the debt security by SEBI registered Credit Rating Agency forms an important factor while investing in such securities.

Debt securities/ loans have differential rights such as secured or unsecured. A secured loan is one where lenders have a right against the assets of the company if the company fails to pay interest and/or return the principal amount borrowed. Unsecured loan is one where such rights do not exist. Debt instruments may be listed on a stock exchange.

A bond or debenture will be defined by:

- Face value
- Interest rate (also called coupon rate) and Frequency of interest payment
- Date of Maturity/ Redemption
- Other Rights of Bondholders (secured / unsecured)

A loan from a Bank or Financial Institution will be defined by:

- Amount of the Loan
- Interest Rate and Frequency of Payment
- Nature of Loan (Term Loan, overdraft limit, bill discounting etc.)
- Repayment Conditions and Time Line (As Negotiated between Borrower and Lender)
- Other Rights of Lender (secured / unsecured)

1.4 Hybrid Structures

Companies may raise capital in a form that combines the features of both debt and equity. These are called hybrid instruments.

Convertible Debentures

Convertible debentures pay interest like any other debt instrument till the date of maturity. On maturity, the debt is converted into equity shares. The terms of conversion, such as the number of equity shares that each debenture will be converted into and the price at which the conversion will take place are mentioned at the time of the issue of the debt instrument.

They are beneficial to a company as there is no cash outflow on maturity. The lender is benefitted if the conversion is below the prevailing market price of the share.

Preference Shares

Preference shares resemble debt instruments because they offer pre-determined rate of dividend. However, they do not have a fixed maturity period or a right over the assets of the company. They have a preference in the payment of dividend over ordinary equity shares and in the return of capital, if the company is wound up.

Chapter 1: Sample Questions

1. _____ capital is/are for perpetuity from the point of view of the company.
    a. Debt
    b. **Equity**
    c. Both debt and equity

2. Equity capital gives returns to the investors in the form of:
    a. Dividend
    b. Capital Appreciation
    c. **Both (a) and (b)**

3. The interest that a company will have to pay on the debt raised will depend upon its_____.
    a. **Default Risk**
    b. Market Risk
    c. Liquidity Risk

4. A debt instrument pays interest as a percentage of its _____.
    a. Current value
    b. Market value
    c. **Face value**
    d. Future value

5. Which of the following is a hybrid security?
    a. Equity shares
    b. **Preference shares**
    c. Non-convertible debentures
    d. All the options above

2 Characteristics of Equity Shares

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Investors in equity shares
- Rights of a Shareholder
- Risks in Equity Investing
- Equity related terminology
- Corporate Actions
- Preference Shares, Rights Issue and Preferential Issue

2.1 Investors in Equity Shares

A company raises equity capital to meet its need for long-term funds for expansion or continuing operations of the company. Equity capital does not impose any liability on the company in terms of returns or repayment. However, when a company issues equity capital, the investors also get proportionate control and ownership. A company can raise capital from different categories of investors. Different categories of investors have different requirements in terms of returns, risk and management control.

a. Promoters

Promoters are the group of investors who set up the company and bring in the initial capital required to start the business. This is the risk capital. At the initial stage, the entire control of the company is with the promoters. They may bring in additional capital as and when required.

As the capital needs of the business grow, promoters may invite other investors. These may include both institutions and retail public investors.

Promoters usually retain the majority shareholding in the company so that they can continue to control its affairs even after their stakes are diluted. The stage at which the promoters bring in the initial capital is the riskiest. Further, it is generally assumed that the promoter knows the business the best. Thus, the promoter / owner is the logical manager of the business. However, ownership and management may be in separate hands.

b. Institutional Investors

Institutional investors include financial institutions, venture capital firms, mutual funds, foreign financial institutions and banks among others. These are professional investors who have the ability to evaluate the business proposition, the risks associated with it and the expected returns.

The company may allot shares to such investors through a private placement or preferential issue of shares. The associated risks and returns will depend upon the stage at which the institutional investors bring in capital.

Some like venture capital firms may be willing to bring in capital for companies in the start-up stage while others like financial institutions invest in more established firms. Institutional investors such as venture capital firms may be actively involved in the management of the company while others like mutual funds may be more passive investors. To strike a balance between being a passive and active investor, SEBI has mandated that mutual funds must ensure better corporate governance in listed companies where the fund has invested. Under these guidelines, mutual funds must disclose their broad policies in exercising voting rights.[2]

Apart from the attractiveness of the business proposition, institutional investors would also be interested in factors such as exit options, since many of them may hold a significant proportion of the equity capital. Many institutional investors like venture capitalists, encourage a company to offer its shares to the public investors as an exit option for themselves.

c. Public Investors

When the equity shares are held by promoters and a few investors, it is said to be a closely held company. Such companies may also be private companies, which are not required to disclose too much of information about themselves to the public or the regulators.

When a company offers its equity shares to the public at large and lists its shares on a stock exchange, it moves from being a privately held or closely held company, to a publicly held company, which agrees to disclose periodic information about its operations and business to the public.

[2]SEBI Circular No.: CIR/CFD/CMD1/168/2019 on Stewardship Code for all Mutual Funds and all categories of AIFs, in relation to their investment in listed equities dated December 24, 2019.

Investors, other than promoters, participate in the equity of a company when a company comes out with a public issue of shares (IPO). A public issue of shares requires regulatory compliance with SEBI's guidelines and regulations governing listing of the shares on a stock exchange.

Public investors in shares may be retail investors, high net worth individuals (HNI), non-institutional investors or institutional investors. Retail investors, and to a great extent, HNIs are more interested in the returns that they can generate from their investment from capital appreciation in the value of the shares and dividend, rather than in the control and management of the company.

Large stakeholders and institutional shareholders actively participate in the affairs of the company. Some large institutional investors may be given a seat on the board of the company. Regulations require extensive and timely disclosures of all information that affects the interests of the public investors in a company.

2.2 Rights of a Shareholder

Equity share capital has distinct features which define its risk and return. These features determine the suitability of raising equity capital for the company over other sources of financing such as debt. The equity shareholders have specific rights and privileges in the company as compared to debt holders. Some of the rights of common shareholders are discussed below:

- **Ownership Rights**

Issuing ordinary equity capital implies that the company is giving ownership rights to the shareholders. Investors are given voting rights that allow them to vote on important decisions taken by the company. The voting rights are in proportion to the number of shares held by the investor and allow them to express their views by voting 'For' or 'Against' a proposal.

The General Body Meeting of shareholders is the highest decision making authority in a corporate set up. Typically, a company will call a meeting of the shareholders once a year. This meeting is known as the Annual General Meeting (AGM). Shareholders have a right to attend the AGM of the company and participate in the proceedings. Shareholders have a right to express opinions on various aspects of the Company working and vote on the various proposals put forth in the AGM.

- **Right to Dividend**

Ownership rights in a company also mean that the investors who hold equity shares are entitled to participate in the profits of the company. This participation will be in the form of dividends that are periodically declared by the company.

- **Ownership Transfer Rights**

A company is not required to return the equity capital to the investor as it is perpetual in nature. However, investors can sell their shares to other investors who may want to buy the shares.

- **Other Rights**

Shareholders have other rights such as right to inspect documents related to company workings, right to legal recourse in case of mis-management or wrong disclosure.

Also shareholders are sometimes provided with certain special rights such as Anti-dilution rights. Anti-Dilution provision gives an investor the right to maintain the same percentage ownership in a company by purchasing a proportional amount of shares in future when new securities are issued.

2.3 Risks in Equity Investing

Investment in equity shares also involves certain risks to the investors. They are explained as follows:

- **No Fixed Return**

The return in the form of dividend from equity is not pre-defined either in terms of the percentage of dividend or the date on which the payment will be made. Dividend is paid if the company makes sufficient profits and the management of the company feels it is appropriate for some of the profits to be distributed among the shareholders. In case the company makes losses or the profits made by the company is ploughed back for the expansion and other operations of the company, the shareholders may not get a dividend.

The other source of return for the holder of equity shares is the appreciation in the price of the share in the secondary market. This constitutes the major portion of the return for the equity investor. If the company's performance is bad or if the stock markets are going through a downturn, the value of the shares may actually depreciate leading to a loss for the investor. There is no guarantee that the principal amount invested in equity shares will remain intact.

- **No Fixed Tenor**

Equity shares are issued for perpetuity. This means that there is no period of maturity after which the money will be returned to the shareholders. Investors who want to exit their investments may do so by selling the shares on the stock exchange to other investors.

- **Liquidity Risk**

A shareholder has the right to sell his shares to other investors. However, there may be a difference between the price expected by the seller and the price offered by the potential buyer. This is referred to as "bid ask spread" or liquidity risk.

The risk to the shareholder arises if the shares are illiquid and not easily sold at its market value or if the shares are unlisted. The investor's investment may get stuck without an exit option or they may sell their shares at lower than fair value resulting in loss.

- **No Collateral Security**

Equity capital is not secured by the assets of the company. The cash and assets of the company are first applied to settle the claims of the lenders and creditors. The claims of the equity shareholders always rank last in order of preference. During the normal course of operations of the company, dividends are payable to the equity shareholders only after the expenses, interest and taxes are provided for. In the event of liquidation of the company, the equity shareholders are only entitled to a refund of capital after the claims of all the other creditors are satisfied from the sale of the company's assets.

2.4 Equity Terminology

i. Face Value

The total equity capital required by a company is divided into smaller denomination called the face value or par value of the equity shares. Face value of a share is the value of a company listed in its books and share certificates and is fixed. Face value of a share helps in calculating the dividend pay-out to the investors when dividends are declared by the company.

Example: If a company wishes to raise Rs 10,00,000 (ten lakh), this can be denominated as:

- one lakh shares with a face value of Rs 10 each; or
- two lakh shares with a face value of Rs 5 each; or
- ten lakh shares with a face value of Re 1 each.

ii. Share Premium

Companies issue shares at face value or at prices higher than the face value depending on the future prospects of the company. The excess amount received by the company over the face value is called the share premium.

Example: A company issues 1 lakh equity shares of face value of Rs. 10 each, to the public at Rs. 50 per share, i.e.

- Face Value of each share is Rs. 10 (par value) and
- Share Premium on each share is Rs. 40 (Rs. 50 – Rs. 10).

iii. Authorised Capital

The maximum amount of equity capital that a company will have is defined in the Memorandum of Association (MoA) of the company and is called its authorised capital.

iv. Issued Capital

The company may issue a portion of its authorised capital as and when it requires capital. The capital may be issued to the promoters, public or to specified investors. The portion of authorised capital that has been issued to investors is called issued capital.

The capital may be issued by the company either at its face value or at a premium (higher than the face value). In special cases shares may be issued at a discount (lower than the face value).

v. Paid-up Capital

When investors subscribe to the capital issued by a company, they may be required to pay the entire price at the time of issue or in tranches (instalments). The portion of the issued capital that has been fully paid-up by the shareholders is the paid-up capital of the company.

vi. Outstanding shares

Outstanding shares refer to the total number of shares issued by the company to its investors (including retail and institutions).

Example: A company decides that the maximum equity capital it needs is Rs. 20 crore. In the initial stages, the need is Rs.10 crore. It issues equity shares of Rs.10 face value, at par. Investors are required to pay Rs.5 per share with application, Rs. 5 after 6 months. What is

the authorised, issued and paid-up capital of the company, before the issue, after allotment and after 6 months? What is the number of outstanding shares of the company?

Before the issue:

Authorised capital: Rs. 20 Crore

After allotment:

Authorised capital: Rs.20 Crore

Issued capital: Rs.10 Crore

Paid up capital: Rs.5 Crore

After 6 months:

Authorised capital: Rs. 20 Crore

Issued capital: Rs.10 Crore

Paid up capital: Rs.10 Crore

Number of Outstanding Shares: 1 crore (i.e. Rs. 10 crore/ Rs. 10)

One may remember that:

- Paid up capital is always less than or equal to issued capital;
- Issued capital is always less than or equal to authorised capital.
- Authorised capital is the maximum amount that can be issued or paid up.

vii. Fully Paid-up Shares

Fully paid shares are those, of which entire face value amount is collected from shareholders upfront. Shareholder is not liable for any amount.

viii. Partly Paid-up Shares

Partly paid-up shares are those on which entire face value amount is not collected from shareholders upfront. That means, company can make call for balance unpaid portion and the shareholder will be liable to pay such call money. If the shareholder does not pay the call money as per schedule, the shares can be forfeited, including the amount already paid thereon, by the company.

2.5 Corporate Actions

A corporate action is an event initiated by a public company that will bring an actual change to the securities—equity or debt—issued by the company. Corporate actions are typically agreed upon by a company's board of directors and authorized by the shareholders.

a. Dividend

The most common corporate action is payment of dividend. Equity shareholders are entitled to share in the profits of the company. One way to do this is through the dividend that the company may periodically declare.

Dividend declared by a company is not pre-fixed in terms of the percentage of the dividend or the period when it will be declared. Dividends are declared by the company when there is sufficient profit that can be distributed among the shareholders. The board of directors of the company will take a decision on the dividend to be declared. Shareholders approve such dividend in an annual general meeting.

Dividend is computed as a percentage of the face value of the shares. A 40 percent dividend declared by a company will translate into a dividend of Rs 4 for a share with a face or par value of Rs 10 (i.e. 10*40/100), Rs 2 for a share with a face value of Rs 5 (i.e. 5*40/100). To ensure clarity for investors, SEBI has mandated that listed companies declare the dividend in terms of rupee per share.

Dividend for a company is usually declared at the end of a year which is called the final dividend. However, companies may also declare dividends during the year, called the interim dividend. Many companies have now made a regular practice of quarterly dividends.

The dividend declared by a company is a percentage of the face value of its shares. When the dividend received by an investor is compared to the market price of the share, it is called the dividend yield of the share.

Example: A company declares a dividend of 60 percent on its shares which have a face value of Rs 2. The market price of the share is Rs 80. In this case, the dividend amount is Rs 1.20 per share. The dividend yield is 1.5% (1.2/80*100).

b. Buyback of shares

Buyback of shares refers to repurchase of shares by the company from its existing shareholders. During the buyback, the company usually offers a higher price to the shareholders. However, participation in a share buyback is voluntary. The shares acquired by a company in buyback are extinguished and this results in reduction of share capital. Buyback of securities are governed by SEBI (Buy-Back of Securities) Regulations, 2018.

c. Bonus issue

A company may issue additional shares to existing shareholders without any capital contribution from the shareholders based on the number of shares an investor holds. This is known as a bonus issue. The bonus is issued against accumulated profit of the company. Bonus issue results in increase in number of outstanding shares of the company.

Example: ABC Company Ltd. declares a bonus issue in the ratio 1:2. This means that ABC Company Ltd. will issue 1 bonus share for every 2 shares held by the shareholder.

d. Stock Split and Consolidation

A company may decide to change the face value of its shares. This is done through stock split or consolidation methods. These methods change the number of outstanding shares. However, in both the cases, the value of the shares held by a shareholder remains unchanged.

When a higher face value of a share is reduced to a lower face value, it is called a stock split. It increases the number of shares in the hands of an investor, but reduces the face value of each share.

Example: Mr. L holds 100 shares of face value Rs. 10 of ABC Ltd. The company decides to divide each share into 2 shares with face value of Rs. 5 each.

Before Stock Split: Value of Mr. L's holdings is Rs. 1000 (i.e. Rs. 10 x 100)

After Stock Split: Mr. L will now hold 200 shares of face value Rs. 5. Therefore, value of Mr. L's holdings is Rs. 1000 (i.e. Rs. 5 x 200).

A consolidation refers to increasing the face value of a share from lower amount to higher amount. This reduces the number of shares held by an investor, but increases the face value of each share.

Example: Mr. S holds 100 shares of face value Rs. 2 of XYZ Ltd. The company decides to club 5 shares into 1 share with face value of Rs. 10 each.

Before Stock Consolidation: Value of Mr. S's holdings is Rs. 200 (i.e. Rs. 2 x 100)

After Stock Consolidation: Mr. S will now hold 20 shares of face value Rs. 10. Therefore, value of Mr. S's holdings is Rs. 200 (i.e. Rs. 10 x 20).

2.6 Preference Shares

When we talk of shares of a company we usually refer to the ordinary shares of a company. A company may also raise equity capital with varying rights and entitlements. These are called preference shares because they may offer certain special features or benefits to the investor. Some benefits that investors in ordinary equity capital have, such as, voting rights, may instead not be available to preference shareholders. Preference shares are usually given preference over equity shares in the payment of dividends and the repayment of capital, if the company is wound up.

Dividend is paid to the preference shareholder at a fixed rate mentioned at the time of the issue of the shares. The terms of issue may allow the preference shareholders to participate in the residual profits too in some defined ratio. These are called participating preference shares.

Preference shareholders are paid dividend only if the company has sufficient profits. The unpaid dividend may be carried forward to the following year(s) and paid if there are profits to pay the dividends, if the terms of issue of the shares so allow. Such shares are called cumulative preference shares.

The returns for the preference shares are primarily from the dividend the company pays. Non-convertible preference shares issued through a public issue or private placement may be listed on a stock exchange provided the issue meets the terms laid down by SEBI in its regulations. The scope for capital appreciation in these types of shares may be limited because they do not participate in the profits of the company. Their value is not affected by the over-performance or under-performance of the company.

Though preference shares are similar to debentures, they differ on the following points:

- A preference share holder is a shareholder of the company. A debenture holder is a creditor of the company.
- A debenture is usually secured on the assets of the company. A preference share is not secured since it is not a borrowing.

- The coupon interest on the debenture is an expense to be paid by the company before calculating the profits on which tax has to be paid. Dividends on preference shares are paid from the residual profits of the company after all external liabilities, including tax, have been paid.

2.7 Rights Issue of Shares

A company may raise equity capital from its investors at various times. Whenever a company makes a fresh issue of shares, it has an impact on the existing shareholders since their proportionate holding in the shares of the company gets diluted. A rights issue is subject to various SEBI regulations.

For example, a company may have 10 lakh outstanding shares of Rs.10 each, amounting to an issued and paid-up capital of Rs. 1 crore. If it issues another 10 lakh shares, to increase its capital, the proportion held by existing shareholders will come down by half, as the issued and paid up capital has doubled. This is called as dilution of holdings. To prevent this, Companies Act requires that a company which wants to raise more capital through an issue of shares must first offer them to the existing shareholders. An existing shareholder has a right to proportionate participation in all capital raising activity. Thus the term Rights issue.

The rights shares are offered to the existing investors in a proportion as approved by the Board of the company. For example, the company may choose to issue rights at 1 for 1, to double its capital. This means each existing shareholders will get one equity share for every one equity share that they already hold. The issued and paid up capital will double, but proportionate holdings of each shareholder will not change. The ratio and price of the rights issue is proposed by the Board of the Company. Participation in a rights issue is voluntary.

2.8 Preferential Issue

A company may issue shares to a strategic investor or collaborator at a pre-negotiated price. The pricing for such an issue is determined under various SEBI guidelines. A preferential issue dilutes (reduces) the proportionate rights of existing shareholders and thus requires approval of existing shareholders.

Chapter 2: Sample Questions

1. _____ rights give the equity investor a say in the management of the company.
   a. **Voting**
   b. Dividend
   c. Both voting and dividend

2. A 20 percent dividend declared on face value of Rs 10 and market price of Rs 120 translates into a dividend payout of _____.
   a. **Rs. 2.00**
   b. Rs. 24.00
   c. Rs. 20.00
   d. Rs. 12.00

3. A share split _____.
   a. is permitted only for preference shares
   b. **is permitted for equity shares.**
   c. is permitted for bonus shares
   d. is not permitted by law.

4. Which of the following is/are examples of corporate actions?
   a. Dividend
   b. Bonus issue
   c. Stock split
   d. **All the options above**

5. A company may issue additional shares to existing shareholders without any capital contribution from the shareholders based on the number of shares an investor holds. This is known as _____.
   a. **Bonus issue**
   b. Rights issue
   c. Preferential issue

3 Characteristics of Debt Securities

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Features of Debt Security
- Market value of debt securities
- Yield to Maturity of debt instruments
- Types of Bonds
- Features of Fixed and Floating Rate Bonds
- Credit Rating
- Money Market instruments

3.1 Features of a Debt Security

A debt security denotes a contract between the issuer (company) and the lender (investor) which allows the issuer to borrow a sum of money at pre-determined terms.

These terms are referred to as the features of a bond and include the principal, coupon (interest rate) and the maturity date of the bond. In Indian securities markets, a debt instrument denoting the borrowing of a government or public sector organizations is called a bond and the borrowings by the private corporate sector is called debenture. The terms bonds and debentures are used interchangeably.

The principal is the amount which is being borrowed by the issuer. The face value or par value of the debenture is the amount of the principal that is due on each debenture at maturity. The face value of a debenture is usually Rs. 100 or Rs. 1,000.

The coupon is the rate of interest to be paid by the borrower to the lender. This is a percentage that is applied to the face value or par value of the bond. The periodicity of interest payment (annual, semi-annual, quarterly or monthly) is also specified.

The maturity date of a bond refers to the date on which the contract requires the borrower to repay the principal amount. Different combinations of each of these features can be used to create instruments that meet the specific requirements of the borrower or the lender.

It may, therefore, be emphasised that the debt securities have distinct characteristics in contrast to equities.

- The debt holders are lenders to the company, while equity-holders are owners of the company;
- The debt securities have fixed maturity period while equities are perpetual in nature;
- The returns to debt holders are fixed at the time of issuance, whereas the equity-holders are entitled to residual profit, but not guaranteed;
- The debt holders enjoy preference over equity-holders in receiving back payments in case of winding up of the company.

3.2 Market Value of a Debt security

As stated earlier, the face value or par value of a debt instrument is its book value that represents the principal amount of the borrowing which is to be repaid to the investor at the time of maturity. If the debt instrument is traded in the market before its maturity, the value at which such trade is executed is called the market value of the debt instrument. Market value may be higher or lower than the face value of the debt instrument. Market value fluctuates due to market dynamics such as demand-supply condition, market interest rate scenario etc.

3.3 Yield from Debt Instruments

The return to an investor in bonds is known as yield. The returns to an investor in bonds, is primarily made up of the coupon payments. However, if the investor acquires or sells the bond at a price that is different from the par value it generates capital gains or loss, as the case may be. The returns to the investor in such a case can vary from the coupon. Therefore, the coupon rate of the bond is not an indicator of the returns on the bond, but merely helps in computing what cash flows would accrue periodically, to the investor.

The term 'yield', rather than 'coupon rate', is used to denote the returns to the investor.

- **Current Yield**

Current yield simply compares the coupon of a bond with its market price (Coupon of the bond divided by its market price). For example, if a bond paying an annual coupon of 12 percent is trading in the market for Rs. 109.50, then the current yield is: 12/109.5 = 10.95 percent. Current yield is a measure of return of a bond.

- **Yield to Maturity (YTM)**

Yield to maturity (YTM) is a popular and extensively used method for computing the return on a bond investment. Every bond is made up of a set of cash flows that accrue at various points in time, from the time the bond is acquired, until it is sold or redeemed.

Therefore, using the principle of finance to value the bond, the price at which the series of future cash flows should sell is the sum of the discounted value of these cash flows. The rate which equates the discounted value of the cash flows with the price of the bond is the yield to maturity of the bond.

3.4 Types of Debt Securities

i. Convertible Debt Securities

As already discussed in Unit 1, convertible debt securities are hybrid instruments with features both of debt and equity. These securities pay the pre-determined coupon payments to the holders and on maturity the same is converted into equity based on pre-defined terms. The convertible debt securities are more suitable for low credit rating companies and companies with high growth potentials.

Advantage to Issuers: As it is a low cost financing compared to other financing means, issuers are required to pay lower coupons to the lenders and also on maturity, repayment of principal amount need not be made as the security is converted into equity.

Advantage to Investors: Though the investors are paid a lower coupon rate, compared to other debt securities, the potential to earn capital appreciation on the converted security (equity) compensates the receipt of lower interest rate.

However, there involves a risk of dilution of stake of the existing shareholders in the company on conversion of the debt securities.

ii. Zero Coupon Bond

In such a bond, no coupons are paid or specified. The bond is issued at a discount to its face value. There are no intermittent payments of interest. When such a bond is issued for a very long tenor, the issue price is at a steep discount to the redemption value. Such a zero coupon bond is also called a **deep discount bond**.

The effective or implied interest earned by the buyer is the difference between the face value and the discounted price at which the bond is bought. There are also instances of zero coupon bonds being issued at par, and redeemed with interest at a premium. The essential feature of this type of bonds is the absence of periodic interest payments. They are suitable for financing projects with long gestation periods.

iii. Fixed Rate Bonds

Fixed rate bonds pay a pre-defined interest that are payable at specified intervals. Such bonds are also called as the **plain vanilla bonds**. A plain vanilla bond will have a fixed term to maturity with coupon being paid at pre-defined periods and the principal amount is repaid on maturity. The bond is usually issued at its face value and redeemed at par.

The simple variations to this structure could be a slightly varied issue price, higher or lower than par and a slightly altered redemption price, higher or lower than par. In some cases, the frequency of the interest payment could vary, from monthly, to quarterly and annual. All these variations still come under the plain vanilla definition of a bond, where the interest is paid at a fixed rate periodically, and principal returned when the bond is retired.

iv. Floating Rate Bonds

Instead of a pre-determined rate at which coupons are paid, it is possible to structure bonds, where the rate of interest is reset periodically, based on a benchmark rate such as RBI Repo Rate. Such bonds whose coupon rate is not fixed, but reset with reference to a benchmark rate, are called floating rate bonds.

For example, a company can issue a 5 year floating rate bond, with the rates being reset semi-annually with reference to the 1- year yield on central government securities and a 50 basis point mark-up. In this bond, the coupon rate is reset every six months based on the 1-year benchmark rate on government securities.

The other names, by which floating rate bonds are known, are variable rate bonds and adjustable rate bonds. These terms are generally used in the case of bonds whose coupon rates are reset at longer time intervals of a year and above. These bonds are common in the housing loan markets.

v. Inflation Indexed Bonds

Inflation Indexed Bonds (IIB) are a category of floating rate bonds where the benchmark is the inflation rate. Such instruments are generally government securities issued by the RBI that provides inflation protected returns to the investors.

vi. Amortising Bonds

The structure of some bonds may be such that the principal is not repaid at the end/maturity, but over the life of the bond. A bond in which payments that are made by the borrower includes both interest and principal, is called an amortising bond. Auto loans, consumer loans and home loans are examples of amortising bonds. The maturity of the amortising bond refers only to the last payment in the amortising schedule, because the principal is repaid over time i.e. redemption in more than one instalment.

vii. Asset-backed Securities

Asset backed securities represent a class of fixed income products, created out of pooling together assets, and creating bonds that represent participation in the cash flows from the asset pool. For example, select housing loans of a loan originator (say, a housing finance company) can be pooled, and bonds can be created, which represent a claim on the repayments made by home loan borrowers. Such bonds are called mortgage–backed securities. In some markets like India, these bonds are known as structured obligations (SO). Assets with regular streams of cash flows are ideally suited for creating asset-backed securities.

viii. Other types of bonds

Some of other structures are: (a) deferred interest bonds, where the borrower could defer the payment of coupons in the initial 1 to 3 year period; (b) Step-up bonds, where the coupon is stepped up periodically, so that the interest burden in the initial years is lower, and increases over time.

3.5 Classification of Debt Market

There are two broad ways in which bond markets can be segmented.

- Based on the type of borrower, we can segment the market between the bonds issued by governments, and those issued by non-government agencies like banks, corporations and other such entities.
- Based on the tenor of the instrument, we can segment the bond markets as short-term, medium term and long term.

These are not mutually exclusive segments. The government issues bonds to meet its requirements for various periods as does the private sector. Each issued bond has an issuer and a tenor.

Government Securities comprises the central government bonds, and quasi-government bonds issued by local governments, state governments and municipal bodies. Government securities do not have credit or default risk.

Corporate bond markets comprise pre-dominantly of short-term commercial papers and long-term bonds. Another segment comprises of short term paper issued by banks, in the form of certificates of deposit. The rate at which the non-government segment borrows depends upon the credit quality of the borrower. The credit or default risk of the borrower is defined by the credit rating of the bond. Higher the credit rating, lower is the risk of default.

3.6 Credit Rating

The biggest risk faced by investors in debt securities is the possibility of the borrower not honouring their commitment on payment of interest on the borrowing and repayment of the principal on maturity of the instruments.

The ability of the borrower to meet its obligation will depend upon factors internal and external to the business. Lenders therefore evaluate these factors associated with the borrower before entering into the transaction. The decision of a lender on whether or not to lend to a borrower and at what cost would be determined by the risk associated with the borrower. This risk of the possibility of a default on obligations by the borrower is called the credit risk of the borrower.

The credit risk of a borrower is evaluated by credit rating agencies. Credit rating agencies have to be registered with SEBI and abide by the regulations laid down in SEBI (Credit Rating Agencies) Regulations, 1999 in the conduct of such evaluations.

The credit rating agencies consider all the qualitative and quantitative factors that impact the business of the borrower and consequently their ability to meet their financial obligations. The appraisal is done by industry experts and the information collected not only from the borrower but from other sources as well. Based on their appraisal, the rating committee of the credit rating agency will assign a rating to the borrowing. Rating is therefore an exercise that converts into a symbol the ability and willingness of the company to service the instrument proposed to be issued.

The credit rating assigned to an instrument is not static but is dynamic. This means that the credit risk associated with a borrowing may change over time. Credit rating agencies are

required by SEBI to constantly monitor factors that affect the status of the instrument and to reassign a rating if the credit quality of the instrument improves or deteriorates.

SEBI has issued detailed guidelines on provisional ratings assigned by Credit Rating Agencies to debt instruments.[3] A rating will be considered as provisional, and not final, in cases where certain compliances that are crucial to the assignment of credit rating are yet to be complied with or certain documentations remain to be executed at the time of rating. All provisional ratings ('long term' or 'short term') for debt instruments need to be prefixed as 'provisional' before the rating symbol in all communications-- rating letter, press release and rating rationale.

SEBI has standardized the rating symbols used by the credit rating agencies so that investors are able to easily gauge the level of credit risk assigned to an instrument. The rating symbols and their definitions are reproduced below.[4]

I. Rating Symbols and Definitions for Long Term Debt Instruments
Long term debt instruments: The instruments with original maturity exceeding one year
Rating symbols should have CRA's first name as prefix
AAA - Instruments with this rating are considered to have the highest degree of safety regarding timely servicing of financial obligations. Such instruments carry lowest credit risk.
AA - Instruments with this rating are considered to have high degree of safety regarding timely servicing of financial obligations. Such instruments carry very low credit risk.
A - Instruments with this rating are considered to have adequate degree of safety regarding timely servicing of financial obligations. Such instruments carry low credit risk.
BBB - Instruments with this rating are considered to have moderate degree of safety regarding timely servicing of financial obligations. Such instruments carry moderate credit risk.
BB - Instruments with this rating are considered to have moderate risk of default regarding timely servicing of financial obligations.
B - Instruments with this rating are considered to have high risk of default regarding timely servicing of financial obligations.
C - Instruments with this rating are considered to have very high risk of default regarding timely servicing of financial obligations.
D - Instruments with this rating are in default or are expected to be in default soon.
***Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AA to C*. The modifiers reflect the comparative standing within the category.**

[3] SEBI Circular No.: SEBI/HO/MIRSD_CRADT/P/CIR/2021/554 dated April 27, 2021
[4] SEBI Circular No.: CIR/MIRSD/4/2011 dated June 15, 2011

II. Rating Symbols and Definitions for Short Term Debt instruments
Short term debt instruments: The instruments with original maturity of upto one year
Rating symbols should have CRA's first name as prefix
A1 – Instruments with this rating are considered to have very strong degree of safety regarding timely payment of financial obligations. Such instruments carry lowest credit risk.
A2 - Instruments with this rating are considered to have strong degree of safety regarding timely payment of financial obligations. Such instruments carry low credit risk.
A3 - Instruments with this rating are considered to have moderate degree of safety regarding timely payment of financial obligations. Such instruments carry higher credit risk as compared to instruments rated in the two higher categories.
A4- Instruments with this rating are considered to have minimal degree of safety regarding timely payment of financial obligations. Such instruments carry very high credit risk and are susceptible to default.
D - Instruments with this rating are in default or expected to be in default on maturity.
***Modifier {"+" (plus)} can be used with the rating symbols for the categories A1 to A4.* The modifier reflects the comparative standing within the category.**

III. Rating Symbols and Definitions for Long Term Debt Mutual Fund Schemes
Long term debt mutual fund schemes: The debt mutual fund schemes that have an original maturity exceeding one year
Rating symbols should have CRA's first name as prefix
AAAmfs - Schemes with this rating are considered to have the highest degree of safety regarding timely receipt of payments from the investments that they have made.
AAmfs– Schemes with this rating are considered to have the high degree of safety regarding timely receipt of payments from the investments that they have made.
Amfs - Schemes with this rating are considered to have the adequate degree of safety regarding timely receipt of payments from the investments that they have made.
BBBmfs- Schemes with this rating are considered to have the moderate degree of safety regarding timely receipt of payments from the investments that they have made.
BBmfs - Schemes with this rating are considered to have moderate risk of default regarding timely receipt of payments from the investments that they have made.
Bmfs - Schemes with this rating are considered to have high risk of default regarding timely receipt of timely receipt of payments from the investments that they have made.
Cmfs - Schemes with this rating are considered to have very high risk of default regarding timely receipt of timely receipt of payments from the investments that they have made.
***Modifiers {"+" (plus) / "-"(minus)} can be used with the rating symbols for the categories AAmfs to Cmfs*. The modifiers reflect the comparative standing within the category.**

IV. Rating Symbols and Definitions for Short Term Debt Mutual Fund Schemes
Short term debt mutual fund schemes: The debt mutual fund schemes that have an original maturity of upto one year
Rating symbols should have CRA's first name as prefix
A1mfs - Schemes with this rating are considered to have very strong degree of safety regarding timely receipt of payments from the investments that they have made.
A2mfs– Schemes with this rating are considered to have moderate degree of safety regarding timely receipt of payments from the investments that they have made.
A3mfs - Schemes with this rating are considered to have the adequate degree of safety regarding timely receipt of payments from the investments that they have made.
A4mfs- Schemes with this rating are considered to have minimal degree of safety regarding timely receipt of payments from the investments that they have made.
***Modifiers {"+" (plus)} can be used with the rating symbols for the categories A1mfs to A4mfs*. The modifier reflects the comparative standing within the category.**

Further to the above, the credit rating agencies suffix 'CE' i.e. Credit Enhancement, to the rating of instruments having explicit credit enhancement.[5] In addition to this, SEBI has introduced Expected Loss based Rating Scale for rating of projects/ instruments associated with infrastructure sector.[6]

3.6.1 Unrated Bonds

Bonds that do not have any current or valid rating by an external rating agency are unrated bonds. Since unrated instruments are more illiquid than rated instruments, the yield of such unrated instruments is higher. SEBI has provided guidelines for mutual funds on investments in unrated debt instruments.[7]

3.7 Money Market Instruments

Money market refers to the market where instruments with a maturity of less than one year are issued and traded. Money market participants are generally commercial banks and the central bank. The money market is the platform for banks and government to finance their short term capital requirements. It is a wholesale market with large volumes. It is considered the most liquid of all financial markets with borrowing and lending transactions done for shorter periods such as one day. Instruments in money markets include Commercial papers, Certificates of deposit, Treasury Bills etc. that are due to mature within 365 days, and long term government debt.

[5] SEBI Circular No. SEBI/HO/MIRSD/DOS3/CIR/P/2019/70 dated June 13, 2019.
[6] SEBI Circular No.: SEBI/HO/MIRSD/MIRSD_CRADT/P/CIR/2021/594 dated July 16, 2021.
[7] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2019/104 dated October 1, 2019.

Chapter 3: Sample Questions

1. _____ of a bond refers to the interest payable on a bond.
    a. **Coupon**
    b. Inflation rate on Principal
    c. Market Price
    d. Face Value

2. A bond with a higher credit rating will pay _____ interest rates.
    a. Higher
    b. **Lower**
    c. Unrelated

3. The prices of bonds are _____ related to interest rate movements.
    a. Directly
    b. **Inversely**
    c. Not

4. Treasury bills are essentially _____ debt securities while deep discount bonds are _____ ones.
    a. **short term; long term**
    b. long term; short term
    c. rated; unrated
    d. corporate; government

5. _____ is a reference rate for resetting the coupon rate.
    a. Bank rate
    b. **Benchmark rate**
    c. Hurdle rate
    d. Discount rate

4 Characteristics of Other Securities

Learning Objectives:

After studying this chapter, you should know about other types of securities such as:

- Warrants
- Convertible Debentures (CDs)
- Depository Receipts (DRs)
- Foreign Currency Convertible Bonds (FCCBs)
- Exchange Traded Funds (ETFs) and Index Funds
- Real Estate Investment Trusts (REITs)
- Infrastructure Investment Trusts (InvITs)

Companies raise capital using equity and debt instruments. The basic features of these instruments can be modified to suit the specific requirements of the borrowers or lenders. Such modifications bring advantages such as wider participation, better management of cash flows and better return prospects.

4.1 Warrants

Warrants give the investors the right to buy shares of the company in the future. The number of shares that the warrant entitles the holder to subscribe to at a pre-determined date and price are specified at the time of issue. Conversion/ exercise of the warrants results in increase in share capital. Warrants may be traded on the stock exchange as a security separate from the debenture with which it was issued. Warrants usually have a longer lifetime as compared to options contracts which they closely resemble.[8]

Warrants will be exercised if the share price at the time of exercise is higher than the price at which the investors have the right/ option to buy the shares. For example, assume a warrant enables an investor to buy an equity share of a company at Rs.100. The warrant will be exercised: (a) when it is due to be exercised, (b) if the price of the share in the market is more than Rs.100. If the market price is less than Rs.100, the investor can always buy from the market, rather than use the option to buy the same share at a higher price.

[8]Options refer to a type of derivatives contract that gives buyer the right to exercise the option to buy or sell the underlying security at a pre-defined date and price.

Warrants may be used by promoters to increase their stake in the company. Issue of warrants is subject to SEBI guidelines and shareholders' approval. The regulations include an upfront payment and a lock-in on conversion.

4.2 Convertible Debentures

Convertible debentures are debt instruments that can be converted into equity shares of the company at a future date. The security has features of both debt and equity. It pays periodic coupon interest till the date of redemption/ conversion into equity shares, just like any other debt instrument.

At the time of redemption of the debenture, the investors can choose to receive shares of the company instead of cash redemption.

The issuer specifies the details of the conversion at the time of making the issue. This will include:

- The date on which the conversion will be made
- The ratio of conversion i.e. the number of shares that the investor will be eligible to get for each debenture
- The price at which the shares will be allotted to the investor on conversion. Usually this is at a discount to the market price
- The proportion (full or part) of the debenture that will be converted into equity shares. Accordingly, the debenture may be referred to as Fully Convertible Debenture (FCD) or Partly Convertible Debenture (PCD) or Non-Convertible Debenture (NCD).

As already discussed in Unit 3, the advantage to the issuer of convertible debenture lies in the fact that convertible debentures usually have a lower coupon rate than pure debt instruments. This is because the yield to the investor in such debenture is not only from the coupon alone but also the possibility of capital appreciation in the investment once the debentures are converted into equity. Moreover, the issuer does not have to repay the debt on maturity since shares are issued in lieu of repayment, thus saving cash outflow. The interest rate on a convertible debenture is usually lower than the interest on a non-convertible debenture. When a convertible debenture is converted into equity both the interest and the principal are no longer payable.

The shareholding percentage of the existing shareholders gets diluted when fresh shares are issued on conversion. Thus, convertible debentures are normally issued on rights basis or with specific approval of existing shareholders. Issue of convertible debentures is governed by SEBI Regulations.

4.3 Depository Receipts

Depository receipts (DRs) are financial instruments that represent shares of a local company but are listed and traded on a stock exchange outside the country. DRs are issued in foreign currency, usually in US Dollars. DRs allow overseas investors to easily invest in a company.

To issue a DR, a specific quantity underlying equity shares of a company are lodged with a custodian bank, which authorises the issue of depository receipts against the shares. Depending on the country of issue and conditions of issue, the DRs can be converted into equity shares.

DRs are called American Depository Receipts (ADRs) if they are listed on a stock exchange in the USA such as the New York Stock Exchange or NASDAQ. If the DRs are listed on a stock exchange outside the US, they are called Global Depository Receipts (GDRs). The listing requirements of stock exchanges can be different in terms of size of the company, state of its finances, shareholding pattern and disclosure requirements.

When DRs are issued in India and listed on stock exchanges in India with foreign stocks as underlying shares, these are called Indian Depository Receipts (IDRs).

The company, whose shares are traded as DRs, gets a wider investor base from the international markets. Investors in international markets get easy access to invest in shares of an overseas company. Holding DRs, gives investors the right to dividends and capital appreciation from the underlying shares, but not voting rights.

The steps in issuing DRs are the following:

- The company has to comply with the listing requirements of the stock exchange and market regulator where they propose to get the DRs listed.
- The company appoints a depository bank which will hold the stock and issue DRs against it.
- If it is a sponsored issue, the stocks from existing shareholders are acquired and delivered to the local custodian of the depository bank. Else, the company issues fresh shares against which the DRs will be issued.
- Each DR will represent certain number of underlying shares of the company.

Once the custodian confirms that the shares have been received by them, the depository bank in the foreign country will issue the depository receipts to the brokers to trade in the chosen stock exchange where the DRs have been listed.

4.4 Foreign Currency Convertible Bonds

Foreign Currency Convertible Bonds (FCCB) are issued by Indian companies and subscribed to by investors in foreign currency. They carry a fixed interest or coupon rate and are convertible into a certain number of ordinary shares at a preferred price.

The payment of interest and repayment of principal (if required) is in foreign currency. The conversion price is usually set at a premium to the current market price of the shares. FCCBs allow companies to raise debt at lower rates abroad. It also protects the cash flows since maturity is by conversion of debt into equity. Also the time taken to raise FCCBs may be less than what takes to raise pure debt abroad.

Issuance of FCCBs is regulated by Reserve Bank of India (RBI) notifications under the Foreign Exchange Management Act (FEMA). The Issue of Foreign Currency Convertible Bonds and Ordinary Shares (Through Depository Receipt Mechanism), 1993 lays down the guidelines for such issues. The issue of FCCBs should be within the limits specified by RBI from time to time.

4.5 Exchange Traded Funds and Index Funds

Exchange Traded Funds (ETFs) are a type of mutual funds that are listed and traded on a stock exchange. ETFs are passive funds that generate returns in line with the index or benchmark. There are no investment strategies used to generate higher returns other than what the index does.

Index Funds are also passive funds but are not traded on stock exchanges. They are expected to offer a return in line with the market because they invest in a portfolio that mimics a market index. The portfolio of index funds consists of the same securities as that of market index in the exact weightages allotted to each security.

Table 4:1 draws a comparative summary among Open-ended MFs, Close-ended MFs and Index based ETFs.

Table 4:1 Comparative Summary

Parameters	**Open-ended Mutual Funds**	**Close-ended Mutual Funds**	**Index based Exchange Traded Funds (ETFs)**
Unit capital	Flexible	Fixed	Flexible
Net Asset Value (NAV)	Daily	Daily	Real time

Liquidity provider	Fund	Stock market	Fund and stock market
Transaction price	NAV linked price	Significant premium / discount to NAV	Very close to real time NAV
Portfolio disclosure	Monthly	Monthly	Daily
Intra-day trading	Not possible	Expensive (due to bid-ask spreads)	Possible at low costs

Exchange traded funds are most popular as index based ETFs. However, other variants are also possible, such as, debt oriented ETFs, Gold ETFs and Silver ETFs. Exchange Traded Funds offer a low cost investment avenue to its investors.

4.6 Investment Trusts

An Investment Trust pools the funds of its investors/ shareholders and invests them in a diversified portfolio of securities. Investment Trusts are typically close ended funds which can be traded on a stock exchange. In Indian markets, 2 types of investment trusts are operational under the appropriate SEBI Regulations.

i. Real Estate Investment Trusts (REITs)

REITs are trusts registered with SEBI that invest in commercial real estate assets. The REIT will raise funds through an initial offer and subsequently through follow-on offers, rights issue and institutional placements. The value of the assets owned or proposed to be owned by a REIT coming out with an initial offer will not be less than Rs. 500 crore and the minimum offer size will not be less than Rs.250 crore. The minimum subscription amount in an initial and follow-on offer shall be in the range of Rs. 10,000 to Rs. 15,000.[9] The units are listed on the stock exchange.

ii. Infrastructure Investment Trusts (InvITs)

InvITs are trusts registered with SEBI that invest in the infrastructure sector. The InvIT will raise funds from the public through an initial offer of units. The offer shall be for not less than Rs. 250 crores and the value of the proposed assets of the InvIT shall not be less than Rs. 500 crores. The minimum subscription amount in an initial and follow-on offer shall be in the range of Rs. 10,000 to Rs. 15,000.[10] The units are listed on a stock exchange.

[9]Vide SEBI (Real Estate Investment Trusts) (Amendment) Regulations, 2021, w.e.f. 30.07.2021.
[10]Vide SEBI (Infrastructure Investment Trusts)(Amendment) Regulations, 2021, w.e.f. 30.07.2021.

Chapter 4: Sample Questions

1. A warrant is a right to subscribe to the _____ of a company.
    a. Deposit
    b. **Equity shares**
    c. Debentures

2. Foreign Currency Convertible Bonds are used to raise capital in _____.
    a. Dollars
    b. Rupees
    c. **Foreign currencies**
    d. Euros

3. The stocks that underlie a Depository Receipt (DR) issue are held by a _____.
    a. **Depository Bank/ (Local Custodian)**
    b. Stock Exchanges
    c. Registrars and Transfer Agents
    d. Stock Brokers

4. Holders of Depository Receipts do not have _____ rights.
    a. **Voting**
    b. Dividend
    c. Dividend and Voting
    d. Capital appreciation

5. Real Estate Investment Trusts (REIT) invest in _____ real estate assets.
    a. **commercial**
    b. residential
    c. both commercial and residential

5 SEBI - Role and Regulations

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Securities and Exchange Board of India Act, 1992 and Role of SEBI
- SEBI Regulations Aimed at Investor Protection
  - SEBI (Prohibition of Insider Trading) Regulations, 2015
  - SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003
- Investor Education and Protection Fund
- SEBI (Intermediaries) Regulations, 2008
- SEBI (Depositories and Participants) Regulations, 2018

The existence of an efficient and stable financial system is essential to make the securities market vibrant, wide reaching and effective. An efficient capital market ensures that resources are priced and allocated correctly in an economy. Institutions and mechanisms that enable this must be supported by regulatory structures that will streamline and enable proper functioning of the securities markets. The purpose of securities regulations should be to have markets that are fair, transparent and efficient and ensure protection of the investors' interests.

In India the prime regulators are the Reserve Bank of India (RBI), the Securities and Exchange Board of India (SEBI), the Ministry of Corporate Affairs and the Department of Economic Affairs (DEA). Both RBI and SEBI have been set up through Acts of the Parliament which define their roles and responsibilities. SEBI is the apex regulator of the securities market and also responsible for its orderly growth and protection of the investors' interests. The RBI, as the manager of public debt, is responsible for the primary issue of government securities, all contracts involving such securities and money market instruments. Other regulators such as the Insurance Regulatory and Development Authority of India (IRDAI) and the Pension Fund Regulatory and Development Authority (PFRDA) have been set up with the specific mandate to regulate the functioning and growth of particular industries or markets.

5.1 Securities and Exchange Board of India Act, 1992 and Role of SEBI

The Securities and Exchange Board of India (SEBI) was established on April 12, 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992.

The preamble of SEBI provides for "The establishment of a Board to protect the interests of investors in securities and to promote the development of and to regulate the securities market."

The objective of SEBI is therefore to facilitate the growth and development of the capital markets in terms of mechanisms, participants and securities and to ensure the protection of the investors in the securities market.

The SEBI Act entrusts the responsibility of inspection, investigation and enforcement of the activities, systems and mechanisms of the institutions and intermediaries of the securities market. SEBI has been assigned the powers of recognizing and regulating the functions of a stock market under the Securities Contracts (Regulation) Act (SCRA).

The requirements for granting recognition to a stock exchange include representation of SEBI on the board of the stock exchange and an undertaking to make and amend their rules only with the prior approval of SEBI. The stock exchanges have to furnish periodic reports to the regulator and submit bye-laws for SEBI's approval. Stock exchanges are required to send monitoring reports daily and for every settlement. SEBI has set up surveillance mechanisms, both internal and at stock exchanges, to deal with unfair trade practices. Measures such as circuit filters, price bands and caps have led to enhanced safety in the market.

An integrated surveillance mechanism which tracks the activities of the stock exchanges, the brokers, depositories, Registrars and Transfer Agents (R&T agents), custodians and clearing agents aim at timely identification of fraudulent activities. SEBI and the central government have over-riding powers under the SCRA in all matters relating to the stock markets.

Regulating market intermediaries through registration and supervision is a primary function of the securities market regulator. Market intermediaries such as brokers, R&T agents, depositories, custodians, bankers, merchant bankers, portfolio managers and underwriters have to get themselves registered under the respective regulations of SEBI.

The regulations specify the net worth, experience, infrastructure and other requirements necessary for an intermediary to be eligible for registration. Compliance with the required eligibility provisions, the certificate of registration granted to intermediaries shall be permanent unless surrendered by the intermediary or suspended or cancelled by SEBI.

SEBI makes routine inspections of the intermediaries functioning in the securities markets to ensure compliance with prescribed standards. It can also order investigations into the operations of any of the constituents of the securities market for activities such as price manipulation, artificial volume creation, insider trading, violation of the takeover code or any

other regulation, public issue related malpractice or other unfair practices. Investigation is based on SEBI's surveillance activities or those of the stock exchange. A preliminary probe is conducted after which, if necessary, a full-fledged investigation is undertaken.

SEBI has the powers to call for information, summon persons for interrogation, examine witnesses and conduct search and seizure. If the investigations so require, SEBI is also empowered to penalize violators. The penalty could take the form of suspension, monetary penalties and cancelation of registration.

SEBI also has the mandate to ensure the streamlined functioning of the primary markets. It has laid out the eligibility, norms and rules to be followed for the public issue of securities in the SEBI (Issue of Capital and Disclosure Requirements) Regulations.

The regulations specify the minimum net worth requirements for an issuer, the minimum public holdings to be maintained and the lock-in on the holdings of the promoters. SEBI has also specified the roles and responsibilities of intermediaries in the primary markets such as the merchant bankers, underwriters, R&T agents and brokers in the guidelines for each intermediary.

These regulations impose minimum disclosure requirements on the issuer to ensure that investors have all the relevant information before making the investment. The listing agreement that companies enter into with the stock exchange has clauses for continuous and timely flow of relevant information to the investors, corporate governance and investor protection. SEBI investigates and penalizes the non-compliance to the guidelines by the issuers and intermediaries.

5.2 SEBI Regulations specifically aimed at Investor Protection

Discussed below are 2 regulations laid down by SEBI to prevent insider trading and unfair trade practices which are detrimental to the interests of the investors.

5.2.1 SEBI (Prohibition of Insider Trading) Regulations, 2015

Insider trading refers to the dealing in securities by persons connected with a company having unpublished price sensitive information that is not available to the public. Such persons include the directors and employees of the company, associates such as bankers and tax consultants or employees of the stock exchanges etc. who possess unpublished price sensitive information.

Unpublished price sensitive information is any information relating to a company or its securities, directly or indirectly, that is not generally available to the public and which upon becoming generally available, is likely to materially affect the price of the securities. Such unpublished information includes financial results, dividends, change in capital structure, changes in key managerial personnel, mergers, de-mergers, acquisitions, de-listings, disposals and expansion of business and such other transactions.

The SEBI (Prohibition of Insider Trading) Regulations, 2015 seeks to prevent insider trading which erodes the confidence of the common investors in the securities markets. SEBI's guidelines require all listed companies, registered intermediaries and fiduciaries to have comprehensive code of conduct to prevent such activity.[11] This includes appointing a compliance officer to enforce it, ensuring periodic disclosure of holding by all persons considered as insiders and ensuring data confidentiality and adherence to the requirements of the listing agreement on flow of price sensitive information.

SEBI has further notified that the listed companies, intermediaries and fiduciaries are required to promptly inform the respective Stock Exchange(s) where the concerned securities are traded, regarding any violations relating to code of conduct under SEBI (PIT) Regulations in the prescribed format. Any amount collected by the listed companies, intermediaries and fiduciaries on account of violations of code of conduct needs to be remitted to SEBI for credit to the Investor Protection and Education Fund (IPEF), administered by SEBI.[12]

If an insider trading charge is proved through SEBI's investigations, the penalties include monetary penalties, criminal prosecution, prohibiting persons from transacting in the securities markets and declaring transactions as void.

In order to strengthen the regulatory framework in relation to prohibition of insider trading in units of mutual funds, mutual fund units have been included in the SEBI (PIT) Regulations.

5.2.2 SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003

An important function of SEBI is to prohibit fraudulent and unfair trade practices relating to securities markets. The SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to the Securities Market) Regulations, 2003 enable SEBI to investigate into cases of market manipulation and fraudulent and unfair trade practices.

[11] Professional firms such as auditors, accountancy firms, law firms, analysts, insolvency professional entities, consultants, banks etc., assisting or advising listed companies shall be collectively referred to as fiduciaries for the purpose of SEBI (PIT) Regulations.

[12] SEBI Circular No.: SEBI/HO/ISD/CIR/P/2020/135 dated July 23, 2020

The regulations give a formal definition to the terms 'fraud' and 'fraudulent'. Regulation 2(1)(c) defines fraud as inclusive of any act, expression, omission or concealment committed to induce another person or his agent to deal in securities. There may or may not be wrongful gain or avoidance of any loss. However, that is inconsequential in determining if fraud has been committed.

To prevent fraud, the regulations specify prohibition of certain dealings in securities and prohibition of manipulative, fraudulent and unfair trade practices. The Regulations also specify investigation powers of SEBI and applicable penalties in case of wrong doings.

5.3 Investor Education and Protection Fund (IEPF)

The IEPF is a fund created by the Ministry of Corporate Affairs for promoting investors' awareness and protecting their interests. For administration of Investor Education and Protection Fund, Government of India has on 7th September, 2016 established Investor Education and Protection Fund Authority. The Authority is entrusted with the responsibility of administration of the Investor Education Protection Fund (IEPF), make refunds of shares, unclaimed dividends, matured deposits/debentures etc. to investors and to promote awareness among investors.

The fund is created out of contributions from the central government, state government, companies and institutions. Apart from this, unpaid dividends, matured debentures and deposits, application and call money due for refund and interest on them shall form part of the fund provided such money has remained unpaid and unclaimed for a period of 7 years from the date they were due for payment.

The fund is utilised for making refunds in respect of unclaimed dividends, matured deposits/debentures etc. to investors and to promote investors' education, awareness and protection through various investor awareness programs and other initiatives.

5.4 SEBI Regulations for Registrars and Transfer Agents

Registrar and Transfer (R&T) agents are identified as 'intermediaries' by the SEBI Act and are regulated by SEBI. They have to abide by the regulations and guidelines of the regulator. The primary regulations that govern the functioning of the R&T agents are as follows:

1. SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
2. SEBI (Intermediaries) Regulations, 2008
3. SEBI (Depositories and Participants) Regulations, 2018

5.4.1 SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993

The SEBI (Registrars to an Issue and Share Transfer Agents) Regulations came into effect in 1993 and are amended periodically. These regulations govern the constitution, capital adequacy, obligations and responsibilities, inspection and reporting norms that the R&T agent has to abide by. The same are discussed in detail in Unit 7.

5.4.2 SEBI (Intermediaries) Regulations, 2008

SEBI overseas and regulates the functioning of intermediaries such as brokers, R&T agents, Merchant bankers, Depository participants, Investment advisers and Bankers, under specific regulations and guidelines issued by the regulator. The SEBI (Intermediaries) Regulations, 2008 consolidates the common requirements which apply to all intermediaries. The salient features of the Regulations are as under:

(a) The Regulations put in place a comprehensive requirement which will apply to all intermediaries. The common requirements such as grant of registration, general obligations, common code of conduct, common procedure for action in case of default and miscellaneous provisions have been provided in the approved Intermediaries Regulations.

(b) Application for registration: An applicant may file application in the prescribed format along with additional information as required under the relevant regulations along with the requisite fees. Such application may be made through the respective stock exchange, clearing corporation or depositories if the intermediary is to be associated with these institutions. These institutions will examine the eligibility and other criterion before forwarding the applications to SEBI.

The existing intermediaries who have already been registered under the relevant regulations have to file the disclosure in the specified format. The disclosures shall be made public by uploading the information on the website specified by SEBI.

If a registered intermediary wants to operate as an intermediary in a new category, they need to file for registration by giving additional shortened forms disclosing the specific requirements of the new category as per the relevant regulations.

(c) The application will be considered based on factors such as eligibility criteria, activities in the securities market of persons associated with the applicant and whether the applicant can be considered 'Fit and Proper' based on integrity, honesty, ethical behaviour, reputation,

fairness and character of the person, not incurring any disqualifications, specified by SEBI, such as criminal complaint filed, declared insolvent, categorised as a wilful defaulter etc.[13]

(d) The registration granted to intermediaries shall be permanent unless surrendered by the intermediary or suspended or cancelled in accordance with the regulation.

(e) Intermediaries are required under the regulation to:

i. Appoint a compliance officer who will give a report to the regulator on adherence to all obligations responsibilities and eligibility criteria.
ii. Redress investor grievance within 45 days from receipt of such complaint and to maintain records of the same.
iii. Make complete disclosure of interest before making any recommendation to invest in any security to a client.
iv. Abide by the specified code of conduct in terms of protecting investors' interests, disclosing all information, maintaining high levels of service, have adequate infrastructure, exercise due diligence in all activities.

(f) SEBI can undertake inspection of the books and records of an intermediary, after giving due notice, in the interest of investors. The intermediary is required to give all cooperation in this exercise.

(g) The certificate granted to an intermediary may be revoked if it fails to comply with the requirement of the regulations or any other guidelines issued from time to time. A show cause notice is issued to the intermediary before such action is taken.

(h) While common requirements will be governed by the SEBI (Intermediaries) Regulations, the intermediary-specific requirements will continue to be as per the relevant regulations applicable to individual intermediaries.

5.4.3 SEBI (Depositories and Participants) Regulations, 2018

R&T agents are a category of intermediaries who are allowed to be participants of a depository under the SEBI (Depositories and Participants) Regulations, 2018. R&T agents have to abide by the regulations for their activities in this capacity. The application as participant must be made in accordance with the regulations and the certificate shall be granted if the depository concerned and SEBI are satisfied as to the eligibility and competence of the R&T agent. Under the regulations, the participant:

[13]Vide SEBI (Intermediaries) (Third Amendment) Regulation, 2021 w.e.f. 17 November 2021.

a) Undertakes to pay the fees, maintain records, address investor complaints within the specified time and comply with all requirements subject to which the certificate was granted.

b) Undertakes to abide by the code of conduct for participants which require them to:

i. Do all activities in such a way that investors' interests are protected.
ii. Address investor complaints within 30 days.
iii. Co-operate with the regulator in case of any enquiry or inspection.
iv. Have mechanisms in place, such as the maker-checker concept, to ensure there are checks and balances in all the transactions.
v. Maintain records and data carefully.
vi. Have good corporate governance policies in place.

c) Agrees to the followings:

i. Enter into agreements with the beneficiary owners according to the bye-laws of the depository.
ii. Open separate accounts for each beneficial owner and the accounts shall be managed separately.
iii. They must have continuous electronic connectivity with the depository.
iv. The participants must have good accounting systems and procedures in place. Records should be maintained as required and periodic reports sent to SEBI.
v. They must maintain records of all transactions between the investors and the participants- dematerialisation, rematerialisation, records of instructions and approvals.
vi. Integrity of data should be ensured and it should be protected from damage, loss or misuse. Records should be maintained depository-wise if the participant is associated with more than one depository.

Chapter 5: Sample Questions

1. The Apex regulator of the securities markets in India is _____.
   a. Reserve Bank of India (RBI)
   b. **Securities and Exchange Board of India (SEBI)**
   c. Association of Mutual Funds in India (AMFI)
   d. Ministry of Corporate Affairs (MCA)

2. Insider trading is controlled by the regulations prescribed by _____.
   a. Reserve Bank of India (RBI)
   b. **Securities and Exchange Board of India (SEBI)**
   c. Association of Mutual Funds in India (AMFI)
   d. Ministry of Corporate Affairs (MCA)

3. The Investor Education and Protection Fund (IEPF) is funded by unpaid dividends remaining unclaimed for at least_____.
   a. Five years
   b. **Seven years**
   c. Eight years
   d. Ten years

4. As per SEBI (Depositories and Participants) Regulations, all depository participants are required to abide by which of the following?
   I. Put in place good corporate governance policies
   II. Maintain records and data carefully
   III. Address investor complaints within the specified time

   a. I and II only
   b. II and III only
   c. I and III only
   d. **I, II and III**

5. The penalty that SEBI imposes on market participants for violation of any rule, regulation or Act can be in the form of _____.

   a. Police custody
   b. Judicial custody
   c. **Suspension**
   d. Confinement

6 Basics of Registrars and Transfer Agents

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Importance and Need for Registrars and Transfer Agents (RTAs)
- Types and Role of Registrars and Transfer Agents (RTAs)
- Investor Service Centre (ISC) and Official Point of Acceptance (OPA)
- Qualified Registrars and Transfer Agents (QRTAs)
- Interface between Depositories and Registrars and Transfer Agents (RTAs)
- Industry Overview RTA business

6.1 Introduction

Registrar & Transfer Agent (RTA) is an intermediary taking all the responsibilities of the back end process of the various financial and non-financial transactions for corporates and mutual funds. The RTA undertakes the responsibility of record keeping and maintenance of each and every transaction relevant to the corporate or fund house. Also, the registrar & transfer agent helps investors to get information about corporate actions. The RTA has 2 distinct roles:

a) As a custodian of data: It acts as the repository of information of investor data.
b) As a facilitator and enabler of various financial and non-financial transactions: It helps investors in processing of both financial and non-financial transactions.

All the RTAs appointed by the corporates or mutual fund houses are registered with SEBI.

Some of the tasks handled by an RTA include:

- Security dematerialization
- Payout of dividend / interest
- Investor record keeping and share transfer
- Processing purchase and redemption transactions for a MF
- Inquiry handling via phone, mail & online
- Regulatory reporting
- Issuance of duplicate share certificate
- Investor Education and Protection Fund (IEPF) claim settlement
- Change of name/ name deletion/ transposition/ transmission
- Signature and address change

As this workbook deals with the RTAs working for mutual funds, we will focus our discussion on RTAs servicing mutual funds only.

6.1.1 Need for Registrar and Transfer Agents (RTAs)

Every day a large number of transactions, like buying, selling or switching units are done by mutual fund investors. Some of the transactions are financial transactions, while others are non-financial in nature like a change in bank details, change in contact details or address etc. Each such request needs to be recorded and maintained by the fund houses. Since most mutual funds may not want to invest in these processes nor do they have the expertise to handle these huge transactions on a professional manner, they outsource this work to the registrar and transfer agents (RTA). By outsourcing these back end activities, a fund house is able to focus on its core activities.

6.1.2 Types of Registrar and Transfer Agents (RTAs)

Broadly, there are 2 types of RTAs functioning in securities markets:

a) Those serving corporates and their investors; and
b) Those serving mutual funds, their investors and distributors.

The focus of this module is on the latter segment. The following are the ways RTAs help the different stakeholders in mutual funds:

1. Mutual Fund Companies
   - Reduction in cost of maintenance of huge investor data.
   - RTA offices present in different cities serves as mutual fund offices.
   - Sending of account statements, consolidated transaction details, portfolio statements to investor on behalf of mutual fund companies.
   - Facilitating the data for consolidated account statements.
   - Providing one point customer service to the customers of mutual fund companies.
   - Facilitates various regulatory and other MIS reporting for Mutual Fund companies for submission to regulatory/statutory authorities or for internal decision making purpose.
   - Maintenance of original documents of investor applications, transaction requests and other investor correspondence.

2. Distributors
   - Helps distributors to buy and sell mutual funds on behalf of their clients.
   - Helps distributors to get a consolidated statement of sales done by them in any given month.

- Assist the AMC in Calculation of commission and facilitating the payment to distributors
- Assisting them with the queries on various processes / regulatory changes.

3. Investors
   - Provides detailed information related to new offers, NAV of funds, pay-out of income distribution cum capital withdrawal (IDCW) or maturity details etc.
   - Makes servicing related forms and information easily available to the customers.
   - Processes customer service requests, both financial and non-financial in nature.
   - Provides investors with account statements periodically, facilitates capital gains statement and self-service options
   - Replying to the queries, complaints received from the investors.
   - Assisting AMCs in sending periodic communication like portfolio statements, risk-o-meter, TER changes, annual account statements, etc.

6.1.3 Role of Registrar and Transfer Agents (RTAs)

- **Record-keeping of Investor data**

The RTA is the custodian of the investor data, both for a fund house or a corporate. RTAs are responsible to record and maintain data, both financial and non-financial, either in physical or in electronic form. RTAs ensure that the integrity of the data processing systems is maintained at all times and take necessary precautionary measures to ensure that the records are not lost, destroyed or tampered with and ensure that sufficient backup of records is available at all times at a different place.

The Depositories Act makes a distinction between a registered owner and a beneficial owner. In case of shares/mutual fund units held in demat form, the depository is the registered owner. The depository maintains its own records of the beneficial owners. When mutual fund units are transferred in electronic mode within the same depository, the beneficial owner changes but the registered owner does not change. The depository provides the details of the mutual fund holdings of the beneficial owners electronically to the Issuer or its Registrar and Transfer Agent (RTA) as of the relevant record date/ book closure for the purpose of corporate actions and distribution of corporate benefits.

In case of securities/mutual fund units held in physical form, the registered owner and the beneficial owner are the same.

- **Corporate Actions**

A corporate action is an event carried out by a company that materially impacts its stakeholders (e.g. shareholders or creditors). Common corporate actions include the payment of dividends, issue of bonus shares, stock splits, buy-back of shares, rights issue and mergers & acquisitions. Corporate actions are approved by the company's shareholders and its board of directors.

In each of these, the RTA has a critical role to play:

i. Determining the beneficiaries of the Corporate action based on book closure and record date
ii. Transfer of dividend through NEFT / RTGS. Dispatch of payment instruments in case bank details are not available
iii. Credit of new shares to demat account of the investor in case of stock split or bonus
iv. Reconciliation of funds with bankers in case of a rights issue.
v. Assistance to company for finalizing allotment and post allotment activities such as credit of shares to demat account of investor and refund of excess money if any.

- **General Operations**

In case the shares/ mutual fund units are held in electronic mode (demat), the RTA provides the interface between the corporate / fund house, investor and the Depository; whereas, in case of shares/ mutual fund units held in traditional physical format, the RTA provides the interface between the corporate / fund house and the investor. The RTA is also responsible for conversion of physical mutual fund units to demat and vice versa (if needed under any circumstances). RTAs also accept grievance redressal requests from the investors and maintain detailed records of the same.

In case of winding up of mutual fund schemes, such units can be listed and traded on a recognized stock exchange, providing investors an optional channel to exit. Initially, the trading of such units to be done in demat form. However, stock exchanges along with RTAs shall have a mechanism in place for trading and settlement of such units held in form of Statement of Accounts/ Certificate (physical form).[14]

[14] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/086 dated May 20, 2020.

6.2 Investor Service Centre (ISC) and Official Point of Acceptance (OPA)

RTAs have a wide network of branches across the country. These branches act as Investor Service Centers (ISCs) for the mutual fund houses serviced by the RTAs and thereby help in cost reduction. ISCs are the points of contact for all financial and non-financial transactions in mutual funds. ISCs are equipped with state-of-the-art infrastructure to allow easy access to information on need to know basis, products and services by the investors. Operations and customer interaction are facilitated by skilled and dedicated manpower to deliver quality service, customer satisfaction and maintain standards across branches.

Investors may invest in multiple schemes offered by various fund houses and they further perform transactions (purchases/ redemptions) on a continuous basis. As per SEBI guidelines, there is a cut-off time by when the investment has to be made to be eligible for that day's NAV. So, to make multiple investments, an investor avails the services of RTAs to conduct all his transactions. RTAs act as a single window system to investors where all the work and transaction related to various mutual funds are carried out at the ease of the investor through various Investor Service Centres.

In addition to the ISC, which are usually managed by an RTA, a fund house may specify other locations as Official Point of Acceptance (OPA). Any transactions received at these locations are deemed to have been submitted to the fund house or RTA for processing.

Some of the main tasks undertaken by an ISC / OPA are:

- Providing sale necessities like forms for investors and distributors.
- Providing KIM
- Providing statement of account on regular basis to distributors and investors
- Providing information to investors regarding new offers, pay-out of IDCW. maturity dates, etc.
- Accepting all investor transactions such as purchase, redemption, switch etc.
- Banking of cheques and facilitating electronic feeds to the banks to enable them to send the reverse feeds with updated information to the respective MF(s).
- Accepting requests for non-financial transactions such as change in bank mandate, signature update etc.

6.3 Qualified Registrar and Transfer Agents (QRTAs)

Market Infrastructure Institutions (MIIs) are those institutions (such as stock exchanges, depositories, clearing corporations etc.) that are systemically important for the country's financial development and serve as the infrastructure necessary for the securities market. Government has issued various Acts and SEBI has prescribed various Regulations from time to time for the smooth functioning of these MIIs.

SEBI constituted a Committee and held meeting in 2018 to review the regulations and relevant circulars pertaining to MIIs. The Committee also looked into the desirability of extending the MII framework to certain market intermediaries including Registrar and Transfer Agents (RTAs) servicing more than 2 crore folios. These RTAs are known as Qualified Registrars and Transfer Agents (QRTAs). SEBI has clarified that an RTA shall be categorized as QRTA if at anytime during the financial year, the folios being covered exceeds 2 crore. In case of an RTA being categorized as QRTA, they shall inform SEBI of the same within 5 working days. A QRTA shall be considered a QRTA for next 3 financial years even if there is a fall in folios below 2 crore. [15]

Given the large number of transactions handled by QRTAs, the Committee therefore recommended compliance of enhanced monitoring requirements through adoption and implementation of internal policy framework. This is discussed in detail in Unit 7.

6.4 RTA and Depository Interface

Securities are created by the issuer (corporate / MF) through an IPO or NFO or other corporate actions. They may be held in physical form or electronic mode. Earlier, all securities were created in physical form. In recent times, electronic issuance is the norm. Further, an investor has an option to switch between physical and electronic mode.

SEBI has prescribed detail process of converting the physical securities to demat / electronic mode and vice versa. This process has to have strict protocols and process to ensure against creation of duplicate securities and any other fraud.

Companies who wish to admit their securities into the electronic mode must obtain electronic connectivity with both depositories, NSDL and CDSL. Alternately, they may use the services of an RTA for the same. The cost for setting up RTA connectivity is significantly less without compromising in any manner on security and safety of the system. The centralized architecture also allows the RTAs to provide the companies with a real time status of the holdings of their shareholders / MF unit holders.

All leading RTAs are currently connected to both NSDL and CDSL and are providing services to a number of companies across the country. A company can also obtain direct in-house connectivity with CDSL, the procedure and the cost for doing so is similar to that of a RTA.

SEBI, vide its circular on ‘Appointment of common agency for share registry work’ dated December 27, 2002, has advised issuers that "all the work related to share registry in terms of both physical and electronic should be maintained at a single point i.e either in-house by

[15] SEBI/HO/MIRSD/MIRSD-PoD-1/P/CIR/2023/36 dated March 10, 2023

the company or by a SEBI registered R & T Agent". Thus, a company may either keep the record keeping in-house, or outsource to an RTA, but not both.

The real time interface is important for:

- Converting physical securities to demat form
- Converting demat securities to physical form
- Creation of new securities due to an IPO, bonus issue or other corporate action
- Extinguishing the securities due to winding up of company, actions under Insolvency and Bankruptcy code, merger of MF schemes, winding up of a close ended scheme etc.

6.5 Financial Information Provider to Account Aggregator Network[16]

Government of India introduced a financial data-sharing system amongst financial institutions through the Account Aggregator (AA) network. An Account Aggregator (AA) is a RBI regulated Non-Banking Finance Company (NBFC) that facilitates retrieval or collection of financial information, pertaining to a customer, from Financial Information Providers (FIP) on basis of explicit consent of the customer.

RBI has notified list of eligible entities who can act as FIPs. Out of the list, AMCs through their RTAs and the Depositories are specified as FIPs in the securities markets for sharing of information. The FIPs in the securities markets shall share the 'Financial Information' pertaining to securities markets, through the AA, only on receipt of a valid consent artefact (electronic consent as defined in RBI Master Guidelines) from the customer through the AA. Post verification of the consent artefact, the FIPs in the securities markets shall digitally sign the financial information and securely transmit the same to the AA.

The financial information shared through the Account Aggregator is not stored by the AA, and it shall not be the property of the AA. This information is not to be used in any other manner except for the purpose of providing it to the customer or consented Financial Information User (FIU).

6.6 Industry Overview

The two leading Registrar and Transfer Agent (RTA) companies in India that are servicing in the mutual fund segment are Computer Age Management Services (CAMS) and KFin Technologies Private Limited (Kfintech). Both these companies are instrumental in the smooth functioning of the mutual fund companies in India. CAMS and Kfintech provide

[16] SEBI Circular No.: SEBI/HO/MRD/DCAP/P/CIR/2022/110 dated 19-Aug-2022 on Participation as Financial Information Providers in Account Aggregator framework.

services to all fund houses. RTAs also provide the facility of transacting online through their individual portals as well as a common portals such as MF Central.

Chapter 6: Sample Questions

1. The RTA as a custodian of data acts as the repository of information of _____ data.
    a. Investor
    b. Regulator
    c. Intermediaries

2. Which of the following is NOT an example of corporate actions?
    a. Bonus Issue
    b. Rights Issue
    c. Dividend Payment
    d. Purchase and sale of stocks and mutual fund units

3. Registrar and Transfer Agents (RTAs) servicing more than 2 crore folios are known as _____.
    a. Qualified RTAs
    b. Qualitative RTAs
    c. Special RTAs
    d. Superior RTAs

4. Which of the following is NOT necessary for an Investor Service Centre?
    a. Dedicated and trained staff
    b. Availability of AMC staff to assist investors
    c. Availability of sales forms and other materials
    d. State of the art infrastructure for connectivity

5. Registrar and Transfer Agent (RTA) has a critical role in Corporate Actions:
    a. Transfer of dividend through NEFT
    b. Transfer of dividend through RTGS
    c. Dispatch of dividend in case bank details are not available
    d. All the options above

7 Registrar and Transfer Agents Regulations

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Guidelines for Outsourcing of RTA functions
- SEBI (Registrars to an Issue and Share Transfer Agents) Regulations, 1993
- Enhanced Monitoring Guidelines for QRTAs
- Cyber Security and Cyber Resilience Framework for QRTAs
- System Audit Framework
- Concept of Segregated Portfolios
- Ultimate Beneficial Owners (UBO)

7.1 Guidelines under SEBI (LODR) Regulations 2015

SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015, (LODR Regulations) provides detailed regulation and guidelines for the listed entities with regards to their listing obligations and disclosure requirements.[17] The listed entities who have listed any of the following designated securities on recognised stock exchange(s) come under the purview of this regulation:

- specified securities listed on main board or SME Exchange or Innovators Growth Platform
- non-convertible securities
- Indian depository receipts
- securitised debt instruments
- security receipts
- units issued by mutual funds
- any other securities as may be specified by SEBI

LODR Regulations allows the listed entities to appoint a share transfer agent or manage the facility in-house. In case of in-house share transfer facility, as and when total number of holders of securities of the listed entities exceeds 1 lakh, the listed entity shall either register with SEBI as a Category II share transfer agent or appoint a SEBI registered Registrar to an issue and share transfer agent. The listed entity should ensure that all activities related to share transfer facility are maintained either in-house or by a SEBI registered RTA.

[17]Listed entity means an entity which has listed, on a recognised stock exchange(s), the designated securities issued by it or designated securities issued under schemes managed by it, in accordance with the listing agreement entered into between the entity and the recognised stock exchange(s).

7.2 SEBI (Registrars to an Issue and Share Transfer Agents) Regulations 1993

SEBI (RTA) Regulations seeks to regulate the registration process, activities, general obligations and responsibilities of registrar to an issue and share transfer agents.

The SEBI (RTA) Regulations defines:

(A) Registrar to an Issue as the person appointed by a body corporate or any person or group of persons to carry on the following activities on its or his or their behalf:

i. collecting applications from investors in respect of an issue
ii. keeping a proper record of applications and monies received from investors or paid to the seller of the securities
iii. assisting body corporate or person or group of persons in:
    a. determining the basis of allotment of securities in consultation with stock exchange
    b. finalising list of persons entitled to allotment
    c. processing and dispatching allotment letters, refund orders or certificates and other related documents in respect of an issue

(B) Share Transfer Agent as –

i. any person, who on behalf of any body corporate, maintains the records of holders of securities issued by such body corporate and deals with all matters connected with the transfer and redemption of its securities
ii. a department or division, by whatever name called, of a body corporate performing the activities referred in sub-clause

    (i) if at any time the total number of the holders of its securities issued exceed one lakh.

The broad heads under these regulations are:

Application for Registration:

An application has to be made in the prescribed format accompanied by non-refundable fee to SEBI for grant of registration as an R&T agent. An entity can take on assignments as a registrar and/or share transfer agent only after obtaining the certificate of registration from SEBI. The application can be for registration as a **Category I** intermediary which allows the applicant to act as a registrar to an issue and share transfer agent or as a **Category II** intermediary which allows the applicant to act either as a registrar to an issue or share transfer agent. The application shall be evaluated on the basis of:

a. Available infrastructure
b. Past experience
c. Capital adequacy
d. Integrity of partners and promoters
e. Criteria for fit and proper person

Capital Adequacy Requirements:

The net worth requirement of a Category I applicant is Rs. 50 lakhs and for a Category II is Rs. 25 lakhs. Net worth, for the purpose of this regulation, is defined as paid-up capital and free reserves in case of a body corporate and in case of partnership or proprietorship, it is value of the capital contributed and free reserves.

Obligations and Responsibilities:

The regulations require an R&T agent shall:

i. Abide by the code of conduct (see Box 7.1)
ii. Not act as R&T agent for an associate company
iii. Maintain proper books of accounts and records for a minimum period of 8 years
iv. Appoint a compliance officer who shall ensure compliance with the regulations and shall report immediately and independently to SEBI any non-compliance observed by him.

Box 7.1: Code of Conduct for RTAs

Schedule III of SEBI (RTA) Regulations, 1993 provides a detailed Code of Conduct to be followed by SEBI registered RTAs. They are as follows:

1. A Registrar to an Issue and Share Transfer Agent shall maintain high standards of integrity in the conduct of its business.

2. A Registrar to an Issue and Share Transfer Agent shall fulfill its obligations in a prompt, ethical and professional manner.

3. A Registrar to an Issue and Share Transfer Agent shall at all times exercise due diligence, ensure proper care and exercise independent professional judgment.

4. A Registrar to an Issue and Share Transfer Agent shall exercise adequate care, caution and due diligence before dematerialisation of securities by confirming and

verifying that the securities to be dematerialized have been granted listing permission by the stock exchange/s.

5. A Registrar to an Issue and Share Transfer Agent shall always endeavor to ensure that - (a) inquiries from investors are adequately dealt with; (b) grievances of investors are redressed without any delay; (c) transfer of securities held in physical form and confirmation of dematerialisation / rematerialisation requests and distribution of corporate benefits and allotment of securities is done within the time specified under any law .

6. A Registrar to an Issue and Share Transfer Agent shall make reasonable efforts to avoid misrepresentation and ensure that the information provided to the investors is not misleading.

7. A Registrar to an Issue and Share Transfer Agent shall not reject the dematerialisation / rematerialisation requests on flimsy grounds. Such request could be rejected only on valid and proper grounds and supported by relevant documents.

8. A Registrar to an Issue and Share Transfer Agent shall avoid conflict of interest and make adequate disclosure of its interest.

9. A Registrar to an Issue and Share Transfer Agent shall put in place a mechanism to resolve any conflict of interest situation that may arise in the conduct of its business or where any conflict of interest arises, shall take reasonable steps to resolve the same in an equitable manner.

10. A Registrar to an Issue and Share Transfer Agent shall make appropriate disclosure to the client of its possible source or potential areas of conflict of duties and interest which would impair its ability to render fair, objective and unbiased services.

11. A Registrar to an Issue and Share Transfer Agent shall not indulge in any unfair competition, which is likely to harm the interests of other Registrar to the issue and Share Transfer Agent or investors or is likely to place such other Registrar in a disadvantageous position in relation to the Registrar to issue and Share Transfer Agent while competing for or executing any assignment.

12. A Registrar to an Issue and Share Transfer Agent shall always endeavor to render the best possible advice to the clients having regard to their needs.

13. A Registrar to an Issue and Share Transfer Agent shall not divulge to other clients, press or any other person any confidential information about its clients which has

come to its knowledge except with the approval / authorisation of the clients or when it is required to disclose the information under any law for the time being in force.

14. A Registrar to an Issue or Share Transfer Agent shall not discriminate amongst its clients, save and except on ethical and commercial considerations.

15. A Registrar to an Issue and Share Transfer Agent shall ensure that any change in registration status / any penal action taken by SEBI or any material change in financials which may adversely affect the interests of clients / investors is promptly informed to the clients.

16. A Registrar to an Issue and Share Transfer Agent shall maintain the required level of knowledge and competency and abide by the provisions of the Act, rules, regulations, circulars and directions issued by SEBI. The Registrar to an Issue and Share Transfer Agent shall also comply with the award of the Ombudsman passed under SEBI (Ombudsman) Regulations, 2003.

17. A Registrar to an Issue and Share Transfer Agent shall co-operate with SEBI as and when required.

18. A Registrar to an Issue and Share Transfer Agent shall not neglect or fail or refuse to submit to SEBI or other agencies with which he is registered, such books, documents, correspondence, and papers or any part thereof as may be demanded / requested from time to time.

19. A Registrar to an Issue and Share Transfer Agent shall ensure that SEBI is promptly informed about any action, legal proceeding etc. initiated against it in respect of any material breach or non-compliance by it, of any law, rules, regulations, directions of SEBI or of any other regulatory body.

20. A Registrar to an Issue and Share Transfer Agent shall take adequate and necessary steps to ensure that continuity in data and record keeping is maintained and that the data or records are not lost or destroyed. Further, it shall ensure that for electronic records and data, up-to-date back up is always available with it.

21. A Registrar to an Issue and Share Transfer Agent shall endeavor to resolve all the complaints against it or in respect of the activities carried out by it as quickly as possible.

22. (a) A Registrar to an Issue and Share Transfer Agent or any of its employees shall not render, directly or indirectly any investment advice about any security in the publicly

accessible media, whether real-time or non-real-time, unless a disclosure of its long or short position in the said security has been made, while rendering such advice. (b) In case, an employee of a Registrar to an Issue and Share Transfer Agent is rendering such advice, the Registrar to an Issue and Share Transfer Agent shall ensure that it also discloses its own interest, the interests of his dependent family members and that of the employer including their long or short position in the said security, while rendering such advice.

23. A Registrar to an Issue and Share Transfer Agent shall hand-over all the records/ data and all related documents which are in its possession in its capacity as a Registrar to an Issue and / or Share Transfer Agent to the respective clients, within one month from the date of termination of agreement with the respective clients or within one month from the date of expiry/cancellation of certificate of registration as Registrar to an Issue and / or Share Transfer Agent, whichever is earlier.

24. A Registrar to an Issue and Share Transfer Agent shall not make any exaggerated statement, whether oral or written, to the clients either about its qualifications or capability to render certain services or about its achievements in regard to services rendered to other clients.

25. A Registrar to an Issue and Share Transfer Agent shall ensure that it has satisfactory internal control procedures in place as well as adequate financial and operational capabilities which can be reasonably expected to take care of any losses arising due to theft, fraud and other dishonest acts, professional misconduct or omissions.

26. A Registrar to an Issue and Share Transfer Agent shall provide adequate freedom and powers to its compliance officer for the effective discharge of its duties.

27. A Registrar to an Issue and Share Transfer Agent shall develop its own internal code of conduct for governing its internal operations and laying down its standards of appropriate conduct for its employees and officers in carrying out its duties as a Registrar to an Issue and Share Transfer Agent and as a part of the industry. Such a code may extend to the maintenance of professional excellence and standards, integrity, confidentiality, objectivity, avoidance of conflict of interests, disclosure of shareholdings and interests etc.

28. A Registrar to an Issue and Share Transfer Agent shall ensure that good corporate policies and corporate governance are in place.

29. A Registrar to an Issue and Share Transfer Agent shall ensure that any person it employs or appoints to conduct business is fit and proper and otherwise qualified to

act in the capacity so employed or appointed (including having relevant professional training or experience).

30. A Registrar to an Issue and Share Transfer Agent shall be responsible for the acts or omissions of its employees and agents in respect of the conduct of its business.

31. A Registrar to an Issue and Share Transfer Agent shall not, in respect of any dealings in securities, be party to or instrumental for - (a) creation of false market; (b) price rigging or manipulation; (c) passing of unpublished price sensitive information in respect of securities which are listed and proposed to be listed in any stock exchange to any person or intermediary.

Inspection of R&T agent's operations:

The regulator, SEBI, may inspect the operations of an RTA either on receiving a complaint from an investor or otherwise to ensure compliance with the regulations. The R&T agent is required to provide all information and co-operation to enable the inspection.

Procedure for action in case of default:

SEBI shall initiate appropriate proceedings against RTAs who fail to comply with the relevant regulations/guidelines issued by SEBI. SEBI may suspend or even cancel the registration granted to an R&T agent in case of non-compliance with the provisions of the regulations. Such a penalty will be imposed only after holding an enquiry into the facts of the case and issuing a show cause notice to the R&T agent.

Exemption from strict enforcement of regulations in special cases:[18]

With the issuance of SEBI (Regulatory Sandbox) (Amendment) Regulations, 2020, SEBI has allowed exemptions from enforcement of SEBI (RTA) Regulations for promoting innovations relating to testing new products, processes, services, business models, etc. in live environment of regulatory sandbox in the securities markets.[19] The exemption may be given to any person or class of persons from the operation of all or any of the provisions of RTA Regulations for a period not exceeding 12 months, subject to satisfying specified eligibility conditions prescribed by SEBI from time to time.[20]

[18] Vide SEBI (Regulatory Sandbox) (Amendment) Regulations, 2020 date April 17, 2020.

[19] Regulatory Sandbox means a live testing environment where new products, processes, services, business models, etc. may be deployed on a limited set of eligible customers for a specified period of time, for furthering innovation in the securities market, subject to such conditions as may be specified by SEBI.

[20] SEBI Circular No.: SEBI/HO/ITD/CIR/P/2021/575 dated June 14, 2021.

7.3 Enhanced Monitoring Guidelines for QRTAs

Qualified RTAs are market intermediaries who service more than 2 crore folios. They are also referred to as the Critical Infrastructure Institutions (CII). Given the large number of transactions handled by QRTAs, they are required to comply with enhanced monitoring requirements, through:

- adoption and implementation of internal policy framework and
- periodic reporting on-
    - key risk areas
    - data security measures
    - business continuity
    - governance structures
    - measures for enhanced investor services, service standards and grievance redressal
    - insurance against risks, etc.

In this regard, SEBI has advised QRTAs to formulate and implement a comprehensive policy framework, approved by the Board of Directors of QRTAs, based on the following aspects:[21]

a. Risk Management Policy: The QRTAs are advised to establish a clear, thorough and a well-documented risk management policy. It should include an integrated and comprehensive view of risks to the QRTAs, list of all relevant risks and systems, policies and procedures to identify, assess, monitor and manage the risks, responsibilities and accountability for risk decisions and decision making process in crises and emergencies.
b. Business Continuity Plan: QRTAs shall maintain Business Continuity Plan (BCP) and Disaster Recovery Site (DRS) with a Near site situated at location other than primary processing location (off-site), which is capable to take over operations without disruption in case of any service failure at primary processing site. QRTAs shall have written policy, protocols, processes and controls for BCP and DRS.
c. The manpower deployed at DRS/ Near Site (NS) shall have the same expertise as available at PDC in terms of knowledge/ awareness of various technological and procedural systems and processes relating to all operations such that DRS/NS can function at short notice, independently. QRTAs shall have sufficient number of trained staff at their DRS so as to have the capability of running live operations from DRS without involving staff of the PDC.

[21]SEBI Circular No.: SEBI/HO/MIRSD/DoP/CIR/P/2018/119 on Enhanced monitoring of Qualified Registrars to an Issue and Share Transfer Agents dated August 10, 2018.
SEBI Circular No SEBI/HO/IMD/IMD-TPD-1/P/CIR/2023/173 dated October 20, 2023

d. Hardware, system software, application environment, network and security devices and associated application environments of DRS and PDC shall have one to one correspondence between them.
e. Manner of keeping records: Where records are kept electronically by the QRTAs, they shall ensure that the integrity of the automatic data processing systems is maintained at all times. QRTAs shall also maintain accurate up to date records for investor servicing and take all precautions necessary to ensure that the records are not lost, destroyed or tampered with; and in the event of loss or destruction, ensure that sufficient back up of records is available at all times at a different place.
f. Wind-down Plan: Every QRTA shall devise and maintain a wind-down plan. A 'wind-down plan' means a process or plan of action employed, for transfer of the entire operations of the QRTA to an alternative RTA/ QRTA registered with SEBI, that would take over the operations of the QRTA in scenarios such as erosion of net-worth of the QRTA or its insolvency or its inability to provide critical RTA operations or services.
g. Data Access and Data Protection Policy: QRTAs shall lay down appropriate protocols, processes and controls for its activities and also for entities who wish to connect with the database of the QRTAs electronically.
h. Ensuring Integrity of Operations: QRTAs shall lay down the minimum standards, protocol and procedures for smooth running of operations, to protect the investor data and maintain information security.
i. Scalable infrastructure: The Board of Directors (BoD) of QRTAs shall approve a policy framework for up-gradation of infrastructure and technology from time to time to ensure smooth functioning and scalability for delivering services to investors at all times.
j. Board of Directors (BoD) / Committees of BoD of QRTAs: The BoD of QRTAs shall seek reports on incidents having an impact on investor protection including data security breaches that can affect investor data, etc. QRTAs shall have Committees of the Board of Directors including Audit Committee, Nomination and Remuneration Committee and IT Strategy Committee.
k. Investor Services and Service Standards:
    - QRTAs, servicing Mutual Funds investors, must have Investor Service Center in at least 100 cities based on investor population pertaining to the Mutual Funds clients they service. As regards servicing of corporate, REIT, InvIT investors, QRTAs shall maintain adequate investor service centers based on investor population. This shall be reviewed from time to time by SEBI.
    - QRTAs shall have online capabilities for investor queries, complaints and their redressal. The complaints redressal mechanism should be investor friendly and convenient. The same should have capabilities of being retrieved easily by the complainant online through complaint reference number, e-mail id, mobile no. etc.

- QRTAs, handling corporate registry functions, shall develop facility for providing services for managing Shareholders General Meetings including shareholders voting/ poll process and web streaming of all Annual General Meetings (AGMs) of all their listed client companies. QRTAs shall also look forward to providing other value added services as and when required by SEBI.
- QRTAs must publish on its website, the service standards (eg: turnaround time for services rendered).
- QRTAs should also carry out stakeholder/ investor satisfaction surveys annually, and the same should also be published on the website before March 31, every year.

l. Insurance against Risks: All QRTAs shall take adequate insurance for omissions and commissions, frauds by employee/s to protect the interests of the investors.

This enhanced reporting to be done in addition to the half-yearly periodic reporting done by RTAs as prescribed by SEBI.

7.4 Cyber Security and Cyber Resilience Framework for QRTAs[22]

Rapid technological developments in securities market have highlighted the need for maintaining a robust cyber security and cyber resilience framework to protect the integrity of data and guard against breaches of privacy. A robust cyber security and cyber resilience framework should identify the plausible sources of operational risk, both internal and external, and mitigate the impact through the use of appropriate systems, policies, procedures, and controls. Since RTAs perform important functions in providing services to holders of securities, it is desirable that RTAs have robust cyber security and cyber resilience framework in order to provide essential facilities and perform systemically critical functions relating to securities market. Accordingly, the cyber security and cyber resilience framework provided by SEBI to be applicable for QRTAs (servicing more than 2 crore folios).

Cyber-attacks and threats attempt to compromise the Confidentiality, Integrity and Availability (CIA) of the computer systems, networks and databases. *Confidentiality* refers to limiting access of systems and information to authorized users. *Integrity* is the assurance that the information is reliable and accurate. *Availability* refers to guarantee of reliable access to the systems and information by authorized users. Cyber security framework includes measures, tools and processes that are intended to prevent cyber-attacks and improve cyber resilience. Cyber Resilience is an organization's ability to prepare and respond to a cyber-attack and to continue operation during, and recover from, a cyber-attack.

[22]Vide SEBI Circular No.: SEBI/HO/MIRSD/CIR/P/2017/0000000100 dated September 8, 2017 and SEBI/HO/MIRSD/DOP/CIR/P/2019/110 dated October 15, 2019.

The cyber security and cyber resilience policy for QRTAs includes the following process to identify, assess, and manage cyber security risk associated with processes, information, networks and systems:

a. **Identify** critical IT assets and risks associated with such assets
b. **Protect** assets by deploying suitable controls, tools and measures
c. **Detect** incidents, anomalies and attacks through appropriate monitoring tools/processes
d. **Respond** by taking immediate steps after identification of the incident, anomaly or attack
e. **Recover** from incident through incident management, disaster recovery and business continuity framework

The Cyber security policy should encompass the principles prescribed by National Critical Information Infrastructure Protection Centre (NCIIPC) of National Technical Research Organisation (NTRO), Government of India, in the report titled "Guidelines for Protection of National Critical Information Infrastructure" and subsequent revisions from time to time.

Other measures to be adopted by QRTAs include:

- Appointment of Chief Information Security Officer (CISO) who would be responsible to assess, identify and reduce cyber security risks, respond to incidents, establish appropriate standards and controls, and direct the establishment and implementation of processes and procedures as per the cyber security and resilience policy approved by the Board of the QRTAs.
- Constitution of an Incident Response Team (IRT) consisting of the Managing Director and Chief Technology Officer (CTO) of the QRTA which shall be responsible for actual declaration of a disaster and invoking the BCP.
- Apart from DRS, all QRTAs shall have a Near Site (NS) to ensure zero data loss.
- In case of a disruption of critical systems for more than 30 minutes, the QRTA shall declare a "disaster" and restore operations within 45 minutes either from primary site or DRS.
- The Board of the QRTAs should constitute a Technology Committee comprising experts proficient in technology. This Technology Committee should, on a quarterly basis, review the implementation of the cyber security and cyber resilience policy.
- QRTAs should establish a reporting procedure to facilitate communication of unusual activities and events to CISO or to the senior management in a timely manner.
- QRTAs should define responsibilities of its employees, outsourced staff, and employees of vendors, who may have access or use systems / networks of QRTA's, towards ensuring the goal of cyber security.

- Cyber-attacks, threats, cyber-incidents and breaches experienced by QRTAs should be reported to SEBI within 6 hours of noticing / detecting such incidents. Such incidents should also be reported to Indian Computer Emergency Response team (CERT-In). Quarterly reports containing information on cyber-attacks and threats experienced by QRTAs and measures taken to mitigate vulnerabilities, threats and attacks including information on bugs that may be useful for other QRTAs should be submitted to SEBI through email. These reports to be submitted within 15 days after the end of each quarter.[23]
- QRTAs should conduct periodic training programs to enhance awareness level among the employees and outsourced staff, vendors, etc. on IT / Cyber security policy and standards.
- Disaster Recovery Drills should be conducted on a quarterly basis with minimal notice to the concerned staff. During drills, staff from Primary site should not be involved in supporting operations from DRS
- The QRTA shall conduct live operations from DRS at least 1 days in every three months and 2 consecutive days every 6 months on normal working days.
- QRTAs shall arrange to have its systems audited on an annual basis by an independent CISA/CISM qualified or equivalent auditor to check compliance with the above areas and shall submit the report to SEBI along with the comments of the Board of QRTAs within three months of the end of the financial year.
- QRTAs are mandated to conduct comprehensive cyber audit at least twice in a financial year.[24]

7.5 Systems Audit Framework

Considering the importance of systems audit in technology driven asset management activity and to enhance and standardize the systems audit, SEBI has prescribed systems audit framework for the Mutual Funds/ Asset Management Companies (AMCs).[25] It encompasses the audit of systems and processes related to examination of integration of front office system with the back office system, fund accounting system for calculation of net asset values, financial accounting and reporting system for the AMC, unit-holder administration and servicing systems for customer service, funds flow process, system processes for meeting regulatory requirements, prudential investment limits and access rights to systems interface. MFs/AMCs are responsible for ensuring that adequate and effective control environment exists over the IT systems in use for supporting business operations, including third parties'

[23] SEBI Circular No.: SEBI/HO/MIRSD/TPD/P/CIR/2022/96 dated July 6, 2022 on Modification in Cyber Security and Cyber resilience framework of Qualified Registrars to an Issue and Share Transfer Agents (QRTAs).
[24] SEBI Circular No.: SEBI/HO/MIRSD/MIRSD_RTAMB/P/CIR/2022/73 dated May 27, 2022 on Modification in Cyber Security and Cyber resilience framework of Qualified Registrars to an Issue and Share Transfer Agents ("QRTAs").
[25] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2019/57 on System Audit framework for Mutual Funds/ Asset Management Companies (AMCs) dated April 11, 2019.

supporting operations like Register & Transfer Agents (RTAs), Fund Accountants, Custodians etc.

In this context, RTAs are required to have Systems Audit for the following:

a. **Master Controls:**

- Whether new schemes/ funds are created in the system through an automated maker checker mechanism and based on the Scheme Information Documentation (SID) and information received from authorized sources?
- Whether new customer accounts are created and assigned schemes/ funds based on the agreement signed with the customers?
- Whether access to create/ update/ delete any master data (Customer/ Scheme/ Securities/ Broker/ Subscriptions/ Redemptions etc.) is restricted only to the authorized individuals?
- Whether changes to masters are performed through an automated maker checker mechanism?
- Whether system has the capability to capture audit trails/ logs of all changes, updation, and activities performed?
- Whether update of security prices is controlled and is updated only from authorized automated/ manual sources?

b. **Investor Servicing:**

- Whether automated maker checker controls have been implemented for processing subscription and redemption requests?
- Whether appropriate field level validations and mandatory checks are built in the system during subscription and redemption?
- Whether the system has the capability to maintain the record of all types of transactions executed on behalf of the investor for specific scheme/ investment?
- Whether the system has appropriate controls on brokerage computation and payouts?

7.6 Ultimate Beneficial Owner

The beneficial owner is defined as *"the natural person or persons who ultimately own, control or influence a client and/or persons on whose behalf a transaction is being conducted, and includes a person who exercises ultimate effective control over a legal person or arrangement."*

Identification of the beneficial owner of all investments, held except by individual investors, is necessary to prevent money laundering and ensure due diligence of KYC norms. Accordingly, the RTA (on behalf of the AMC) shall collect additional information to identify the ultimate beneficial owners (UBO) for any investment. The UBO requirements are not applicable to listed companies or subsidiaries of the same.

Controlling ownership interest means ownership of/ entitlement to:

a) more than 10 percent of shares or capital or profits in case of a company;
b) more than 10 percent of the capital or profits in case of a partnership firm, an unincorporated association or body of individuals and
c) 10 percent or more interest in case of trust.

7.7 RTA inter-operable Platform[26]

The inter-operable platform, developed jointly by all the RTAs, provides a user-friendly interface for:

(a) mutual fund transactions viz. purchase, redemption, switch etc.,
(b) initiation and tracking of service requests viz. change of email id/ contact number/ bank account details etc.,
(c) initiation and tracking of queries and complaints,
(d) accessing
    i. investment related reports such as mutual fund holdings, both in demat and standard Statement of Account, (RTAs and Depositories to share information among themselves to generate investment related reports)
    ii. transactions reports (including historic transactions),
    iii. capital gains/ loss report,
    iv. details of unclaimed dividend/ redemption etc.

The platform shall adopt the Cyber Security and Cyber Resilience Framework and comply with the guidelines for Business Continuity Plan (BCP) and Disaster Recovery (DR) issued by SEBI from time to time. All RTAs are jointly responsible for compliance of all related regulations including system audit and cyber security audit.

[26] SEBI Circular No.: SEBI/HO/IMD/IMD-II DOF3/P/CIR/2021/604 dated July 26, 2021 on RTA inter-operable Platform for enhancing investors' experience in Mutual Fund transactions / service requests.

Chapter 7: Sample Questions

1. Inter-operable Platform, developed jointly by all RTAs, facilitates which of the following services?

I. Mutual fund transactions
II. Initiating service requests
III. Accessing investment related reports

a. I and II only
b. II and III only
c. I and III only
d. I, II and III

2. Qualified RTAs are market intermediaries who service more than 2 crore folios. They are also referred to as:

a. Surgical Infrastructure Institutions (SII)
b. Formal Institution on Infrastructure (FII)
c. Critical Infrastructure Institutions (CII)
d. Critical Institute on Infrastructure (CII)

3. As per the Code of Conduct for RTAs:

a. RTA shall put in place a mechanism to resolve any conflict of interest situation
b. RTA shall co-operate with SEBI as and when required
c. RTA shall ensure corporate governance
d. all of these

4. Identification of the _____ of all investments, held except by individual investors, is necessary to prevent money laundering and ensure due diligence of KYC norms.

a. Transfer Agents
b. Beneficial Owners
c. Stock Brokers

5. Which of the following is NOT a part of the cyber security and cyber resilience framework prescribed by SEBI?

a. Catch the cyber attacker and file a police complaint.
b. Identify, assess, and manage cyber security risk.
c. Continue operations during a cyber attack.

8 Basics of Mutual Funds

LEARNING OBJECTIVES:

After studying this chapter, you should know about the following:

- Collective Investment Vehicle with proportionate ownership
- Mutual Funds
- Advantages of Mutual Funds
- Assets under Management (AUM) and Net Asset Value (NAV)
- Total Expense Ratio (TER) and its implication Direct and Regular Plans
- Concepts of T30 and B30
- Role of RTAs related to NAV and TER

8.1 Introduction to Mutual Funds

A mutual fund is an investment option, where investors contribute small amounts of money. These contributions are pooled together to make it a large sum. This sum is then invested in a portfolio of various securities.

When we say 'Mutual Fund' we are referring to the money contributed by the investors. When we say 'portfolio' we are referring to the securities in which the investments have been made.

A mutual fund thus enables investors to participate in securities markets and invest in equity shares, bonds and other such instruments by pooling their money together. A mutual fund will state its investment objective upfront. This indicates how the money will be invested and how the portfolio will be constructed. Investors choose a fund, which matches their own objectives.

For example, an equity fund may state that its objective is to invest in equity shares to generate long term growth. An investor, who likes to invest in a portfolio of equity shares, will buy the units of this fund. A liquid fund may state that its objective is to generate reasonable return with high liquidity from investing in money market instruments over the short term. Investors having a short term surplus may decide to invest in such a fund.

Collective Investment Vehicle

A mutual fund is a collective investment vehicle. Usually a mutual fund product is first described by its investment objective. Investors then invest their money in the product. The money is pooled together and is invested according to the stated objective.

Example 1:

ABC Income Fund is a debt fund that invests pre-dominantly in debt instruments, with the objective of generating regular income for its investors.

ABCC Top 100 Fund is a fund that seeks to generate capital appreciation from a portfolio of equity shares of the 100 largest listed companies.

Fund managers invest the pool of money into securities such as equity and debt, according to the stated investment objective of the fund. The risk and return of the fund depend on the investment portfolio of the fund. The benefits from the investment portfolio accrue to those that contribute to the pool. There is thus mutuality in the contribution and the benefit. Hence the name 'mutual' fund.

When a mutual fund pools money from several investors, each investor does not contribute the same sum of money. Depending on their needs and preferences, investors put in money into the fund. Therefore, each investor's share in the pool of funds is not equal.

- **Proportionate Share of Benefits**

The benefits from the fund accrue to all investors in proportion to their share in the pool.

Example 2:

Three investors invest Rs. 10,000, Rs. 20,000 and Rs. 30,000 respectively in a mutual fund. So the pooled sum is Rs. 60,000. The money is invested and gains Rs. 12000 over time. This means, the pool is now worth Rs. 72,000. The value of the investors' holding in the mutual fund also goes up proportionately (in the ratio of 1:2:3) to Rs. 12,000, Rs. 24,000 and Rs. 36,000 respectively.

Investors can contribute into a fund or redeem and take away their contributions, depending on the nature of the pool. In a closed end fund, investors tend to stay until maturity. If a fund is open-ended, investors can come in and move out at will. Therefore, there is the need to standardize the contributions of investors to be able to objectively measure their share in the fund.

- **Units of a Mutual Fund**

When investors subscribe to a mutual fund, they buy a share in the pool of funds. This share is called a unit of the mutual fund scheme. The investment in a mutual fund by an investor is represented by the number of units held.

A mutual fund investor is called a unit holder just as an investor in equity shares is called a shareholder. The ownership of the fund is jointly held by all the unit holders. Just as investors in equity hold shares of a company, mutual fund investors hold units of the fund. Each unit has a face value. This is typically Rs 10 per unit for most mutual funds.

Equity shares are offered to investors for the first time through an initial public offering (IPO). Subsequently equity shares are bought and sold on the stock exchange. Likewise, mutual funds are offered for the first time to investors through a new fund offer (NFO). Open-ended mutual fund units can be bought and sold through the fund itself. Funds enable continuous transactions at their offices and at investor service centres. Closed-ended mutual funds are compulsorily listed and can be bought and sold on the stock exchange.

Both the major stock exchanges, National Stock Exchange (NSE) and Bombay Stock Exchange (BSE) have a separate segment for mutual fund trading. Certain types of funds called Exchange Traded Funds (ETFs) can only be bought and sold through the stock exchanges.

- **Unit Capital of a Mutual Fund scheme**

Unit capital of a mutual fund scheme denotes the total value of its corpus i.e. number of units outstanding multiplied by its face value (FV). Post NFO, unit capital does not change for closed-ended mutual funds, whereas the unit capital of an open-ended mutual fund varies. Unit capital is discussed in detail in later sections.

Investments are made in rupee terms by the investor. But the fund will always record this investment in terms of number of units.

Number of units = Invested amount/Price per unit

Example 3:

If the value of a unit is Rs 10, and 2000 units have been sold at Rs 10 each, the value of the pool is 10 x 2000 = Rs 20,000.

Example 4:

If the price of 1 unit is Rs 10.225, and the amount invested is Rs 20,000, the number of units issued against this investment is 20,000/10.225 = 1955.99 units.

Units can thus be denoted as a fractional value also. Unit capital is a term used to denote the corpus of a fund. This is nothing but the total face value of all the units issued by a fund.

Example 5:

If a fund has issued 10,000 units so far, its unit capital is 10,000 x 10 (FV) = Rs 1,00,000.

According to the SEBI Regulations, each mutual fund scheme has to have a separate account. Therefore, the unit capital of each scheme is maintained to reflect its current corpus.

8.2 Advantages of Mutual Funds

The following are the advantages of mutual funds to investors:

- Portfolio diversification from securities spread over various companies, industries, issuers and maturities. The portfolio will not be affected by the bad performance of one or few of the securities.
- Low transaction cost from economies of scale. Since the fund invests large sums of money, the transaction cost comes down. Small amounts invested by investors get benefits of the large pool.
- Professional managers who are employed by mutual funds offer their expertise in managing the investors' funds, given their knowledge of markets and securities, according to the investment objective of the scheme.
- Portfolio diversification and the professional management of funds offer reduction in risk for the investor. The investment is always in a managed portfolio and not a single stock or sector. A minimum level of diversification in a mutual fund portfolio is ensured by SEBI's regulations that mandate maximum exposure to a security/issuer.
- Investors can choose their investment to suit their particular needs and preferences.
- Minimum investment required is low for most funds.
- Mutual fund transactions are flexible and easy to conduct.
- Open-ended mutual funds structure the portfolio in such a way that they are able to provide liquidity to the investor. Investors can withdraw their money from the scheme as per their requirements.

- Close-ended mutual funds are mandatorily listed on stock exchanges to provide liquidity to its investors.

8.3 Open Ended and Close Ended Mutual Funds

Units of mutual funds are first issued to investors when the scheme is launched. Subsequently, the investors' purchase and sale transactions with the fund depend upon the structure of the mutual fund.

In an open ended fund, the number of units is not constant and changes based on daily purchase and redemptions by the unitholders. The open ended structure is highly liquid as unitholders can buy additional units or sell their existing units from the fund itself. As more investments are made in a fund, the number of units increases. Similarly, when more investors choose to exit the fund and redeem their units, the number of units decreases. Purchase and redemption transactions are done at NAV-linked prices.

In a closed ended fund, the number of units is fixed after the NFO. Purchase and redemption transactions from the fund are not allowed, post NFO. To ensure liquidity, listing of closed ended funds is compulsory. Units are bought and sold in the stock exchanges at market price, based on demand and supply.

Table 8:1 provides a comparison between Open-ended and Close-ended funds.

Table 8:1 Comparison between Open-ended and Close-ended Funds		
Parameters	**Open-ended Funds**	**Close-ended Funds**
Unit Capital	Changes on regular basis.	Fixed for the life of the fund.
Number of outstanding units in the fund	Number of units change on regular basis as the fund allows purchase of additional units or redemption of existing units.	Number of units is fixed as the fund is closed for subscriptions or redemptions.

Table 8:1 Comparison between Open-ended and Close-ended Funds		
Parameters	**Open-ended Funds**	**Close-ended Funds**
Ongoing Transactions	Purchase and redemptions directly from/ to the fund are allowed throughout the life of the fund.	Purchase and redemptions directly from/to the fund are not allowed, post NFO. However, units can be transacted through stock exchange platform between investors.
Liquidity	Highly liquid as investors can enter and exit the fund at any time after NFO.	Compulsory listing of units provide liquidity to the investors.

8.4 Assets under Management (AUM)

A portfolio is a collection of securities. These securities can be equity shares, bonds, debentures, deposits, money market instruments, derivatives and the like. Mutual funds can invest only in marketable securities, or securities that can be traded in a market and therefore have a market price.

The value of the fund's portfolio changes with changes in market value of the securities that have been bought. The portfolio is updated every day, to represent its current market value. This process is called 'marking to market'.

The market value of the portfolio is known as the assets under management (AUM) of the fund. The value of the portfolio changes every time there is a change in market price of the securities that a mutual fund holds. This point is explained with an illustration below.

Example 6: Consider this table:

Col (1)	Col (2)	Col (3)	Col (4)	Col (5)	Col (6)
Security	**No of shares**	**Market Price Day1 (Rs)**	**Market Value Day 1 (Rs) [Col(2)*Col(3)]**	**Market Price Day 2 (Rs)**	**Market Value Day2 (Rs) [Col(2)*Col(5)]**
A	1,000	2,500	25,00,000	2,700	27,00,000
B	2,000	50	1,00,000	53	1,06,000

Col (1)	Col (2)	Col (3)	Col (4)	Col (5)	Col (6)
Security	**No of shares**	**Market Price Day1 (Rs)**	**Market Value Day 1 (Rs) [Col(2)*Col(3)]**	**Market Price Day 2 (Rs)**	**Market Value Day2 (Rs) [Col(2)*Col(5)]**
C	1,000	1,400	14,00,000	1,300	13,00,000
D	1,000	750	7,50,000	700	7,00,000
Total (Rs) (AUM)			**47,50,000**		**48,06,000**
Number of Units			4,75,000		4,75,000
Value per unit (Rs) (NAV)			**10.00**		**10.12**

As the market price of the shares changes, the value of the portfolio has changed from Rs. 47.50 lakh to Rs.48.06 lakh. Therefore, if the units had been issued at Rs. 10 each (face value), there would be 4,75,000 outstanding units (i.e. 47,50,000/10). Their market value will now be 48,06,000 / 4,75,000, which is Rs. 10.12 per unit. The value per unit is higher than Rs.10 because the value of the portfolio has also moved up.

The value of the investors' unit holdings also changes along with the market value of the portfolio. The current market value per unit is called the net asset value (NAV). NAV can move up or down, depending upon whether the value of the portfolio has moved up or down.

If the value of the portfolio falls from Rs. 47,50,000 to Rs. 45,00,000, when the price of the shares held in the portfolio fall, this will lead to the NAV per unit falling from Rs. 10 to Rs. 9.47 (i.e. 45,00,000 / 4,75,000). Thus the current value of a unit depends on the value of the portfolio of the fund, and can go up and down with changes in the market value of the portfolio.

As new investors join the scheme the number of units will increase. These units will be issued at prevailing NAV. Similarly, if existing investors exit a scheme, the number of units will decrease. Existing holders will exit the scheme at prevailing NAV. A detailed discussion on NAV is provided in section 8.6 of this Unit.

Therefore, it is important to note that AUM represents the total value of the portfolio and NAV represents the value of an individual unit. NAV and AUM data are reported on a daily basis and are publicly available. Such reporting of data has to be done within strict timelines prescribed by SEBI.

RTAs play an important role in calculating the inflows and outflows of a mutual fund scheme. RTAs are responsible to maintain records of all the transactions done by the mutual fund investors on a daily basis to ascertain the quantum of inflows and outflows of the scheme. As the inflows to the scheme increases, the AUM of the scheme also goes up and vice-versa.

8.5 Total Expense Ratio

The activities associated with portfolio management involve costs and fees. These expenses are charged to the mutual fund scheme. Regulations cover what kind of costs can be charged to the scheme and also prescribe limits on these expenses. These expenses are represented as a percentage of AUM and are called Total Expense Ratio (TER). These expenses are charged to the AUM of the scheme on a daily accrual basis.

TER, for instance if calculated at 2 percent of the AUM, is divided by 365 to get the daily accrual. The value of the portfolio is calculated daily and represented as market value (AUM). The expenses (TER) are accrued every day and charged to AUM.

- **TER Limits**

SEBI has issued guidelines on the maximum limit of TER permissible to be charged by mutual fund schemes. This depends on the investment objective of the fund and its assets under management. All mutual funds must follow these guidelines. The TER declines progressively with increase in AUM. For example, for equity schemes, the TER declines from 2.25 percent to 1.05 percent as the AUM increases. Various slabs are defined for the same.

The TER of the mutual fund scheme is subject to the following limits:

- ***In case of fund of funds (FoF) scheme:***

  (i) Investing in liquid schemes, index fund scheme and exchange traded funds, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 1.00 per cent of the daily net assets of the scheme.

  (ii) Investing a minimum of sixty-five per cent of assets under management in equity oriented schemes as per scheme information document, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 2.25 percent of the daily net assets of the scheme.

  (iii) Investing in schemes other than as specified above, the total expense ratio of the scheme including weighted average of the total expense ratio levied by the underlying scheme(s) shall not exceed 2 per cent of the daily net assets of the scheme.

Provided that the total expense ratio to be charged over and above the weighted average of the total expense ratio of the underlying scheme shall not exceed two times the weighted average of the total expense ratio levied by the underlying scheme(s), subject to the overall ceilings as stated above.

- ***In case of an index fund scheme or exchange traded fund:***
  The total expense ratio of the scheme including the investment and advisory fees shall not exceed 1.00 per cent of the daily net assets.

- ***In case of open ended schemes other than as specified for FoF and index fund schemes:***
  The total expense ratio of the scheme shall not exceed the following limits:

AUM Slab (Rs. crore)	**TER limits for Equity oriented schemes (in percent)**	**TER limits for other than equity oriented schemes (in percent)**
On the first Rs. 500 crore of the daily net assets	2.25	2.00
On the next Rs. 250 crore of the daily net assets	2.00	1.75
On the next Rs. 1,250 crore of the daily net assets	1.75	1.50
On the next Rs. 3,000 crore of the daily net assets	1.60	1.35
On the next Rs. 5,000 crore of the daily net assets	1.50	1.25
On the next Rs. 40,000 crores of the daily net assets	Total expense ratio reduction of 0.05 percent for every increase of Rs.5,000 crores of daily net assets or part thereof.	
On the balance of assets	1.05	0.80

- ***In case of close ended and interval schemes:***
  (i) The total expense ratio of equity oriented scheme(s) shall not exceed 1.25 percent of the daily net assets of the scheme.
  (ii) The total expense ratio of close ended and interval scheme(s) other than schemes specified in the above clause above shall not exceed 1.00 per cent of the daily net assets of the scheme.

The TER limits specified above for the schemes include the investment management and advisory fee, but excludes the issue or redemption expenses.

- **TER applicability for a direct and regular plan Mutual Fund**

Mutual fund offers two types of plans: Direct Plan and Regular Plan. In direct plans, mutual funds provide the option to investment in the schemes without the involvement of any distributor; whereas, in regular plans, investments are routed through a distributor. Since there is no distributors involved in a direct plan and no commission is payable, the TER of such plans are lower compared to regular plans where commissions need to be paid to the distributors involved.

SEBI has now prescribed that there should be separate disclosures for total recurring expenses for direct and regular plans apart from the disclosures of total recurring expenses of the scheme.[27]

- **Concepts of T-30 and B-30**

SEBI has classified cities as 'Top 30' (T-30) and 'Beyond top 30' (B-30) cities. T-30 refers to the top 30 geographical locations in India from where the mutual fund investments are made; whereas, B-30 refers to the locations beyond top 30 cities. The Top 30 cities mean the top 30 cities based on Association of Mutual Funds in India (AMFI) data on 'AUM by Geography – Consolidated Data for Mutual Fund Industry' as at the end of the previous financial year. The T-30 locations account for more than 80 percent of the industry AUM.

SEBI, with an objective to increase penetration of mutual funds in B-30 cities, has allowed mutual funds to charge additional expenses which can be used for distribution related expenses, including distributor commission. This means that the distributors mobilizing funds from investors located in B-30 locations (i.e. cities and towns beyond the top 30 locations) would earn higher commission. The additional TER shall be charged based on inflows from retail investors from beyond top 30 cities (B-30 cities). Accordingly, it has been decided by SEBI that inflows of amount upto Rs. 2,00,000 per transaction, by individual investors shall be considered as inflows from "retail investor".[28]

- **Role of RTAs in tagging transactions to T-30 and B-30 PIN codes**

RTAs play an important role in tagging inflows to T-30 and B-30 locations. AMFI, in consultation with SEBI, has issued a standard process to be followed by the AMCs/ RTAs for generating the report on AUM by Geography, as well as for tagging T-30/ B-30 transactions

[27] https://www.sebi.gov.in/legal/circulars/nov-2024/disclosure-of-expenses-half-yearly-returns-yield-and-risk-o-meter-of-schemes-of-mutual-funds_88230.html (this shall come into effect from Dec 5, 2024)

[28] SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2019/42 dated March 25, 2019.

to determine the additional incentive for inflows from B-30 cities.[29] The uniform procedure came into effect from April 1, 2019.

The standard procedure for tagging transactions is as follows:

1. The report on AUM by Geography as well as tagging T-30/ B-30 transactions should be based on investors' PIN code in the folio.
2. RTAs will have to use the city wise PIN code file for top 200 cities provided by AMFI to tag all purchase transactions (including switches, SIP/ STP, and IDCW reinvestments) for generating the AUM by Geography report.[30]
3. All NRI transactions (where tax status code is NRI, OCI, PIO, FIIs, QFI) should be tagged as T-30 and shown in the AUM by Geography report separately.
4. In respect of the transactions where country name is available in the application form or in KRA/ CKYC database, and the country name stated is other than 'India', the same to be tagged as T-30.
5. Where investor PIN code is available and matches with T-30 PIN code file provided by AMFI, the transaction shall be tagged as T-30.
6. If the investor PIN code is available and valid as per All India PIN Code master of Department of Posts, but does not match with the T-30 PIN code file provided by AMFI, the transaction to be tagged as:
    a. If the city name is available in the KYC city field and matches with T-30 city list or is a foreign city, the same to be tagged as T-30; else, the same to be tagged as B-30
    b. If the city name is not available in the KYC city field, the same to be tagged as B-30.
7. Where PIN code is invalid or not available, then
    a. If the city name can be positively identified as B-30, it is to be tagged as B-30
    b. If the city name cannot be positively identified as B-30, it is to be tagged as T-30
8. Wherever, fresh purchase application is accompanied with KYC form, PIN code/ investor city name as per KYC application to be considered.
9. Re-tagging needs to be done at T+15 business days if the original tagging was done based on the fresh purchase application form and KRA/ CKYC download indicates a change requirement. The date of tagging/ re-tagging of transactions will be stored in the database for audit trail purpose.
10. PIN code or investor address received through stock exchange (non-demat)/ channel partners' feed for transactions, other than fresh purchase may be ignored and RTAs should go by the address as per KYC.

[29]AMFI Circular No. 135/BP/76/2018-19 dated March 20, 2019 on Standard Procedure for tagging transactions to T-30/ B-30 PIN codes.

[30] Dividend reinvestment options have been renamed as 'Reinvestment of Income Distribution cum Capital Withdrawal' options vide SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/194 dated October 5, 2020.

11. The PIN code Master and T-30/ Foreign City Master will be reviewed by AMFI for any changes or corrections in coordination with the RTAs once every year.
12. If any AMC/ RTA discovers that any PIN code should be included in the T-30/ B-30 city list, they shall report the same to AMFI. After due review, AMFI will provide a revised T-30/ B-30 list. All revisions will be applied prospectively.

8.6 Net Assets

Net assets refer to the net value of the portfolio, after charging the expenses. When we divide the net assets of a fund by the number of outstanding units issued, we get the net asset value (NAV) per unit. Net assets of a mutual fund may change with the change in the market value of the portfolio or change in the expenses charged to the fund.

NAV is calculated as: (Total Assets – Liabilities) / No of units outstanding

Investors make investments in round figures or in multiples of one rupee. The NAV is calculated up to 2 decimal places for equity oriented mutual funds and up to 4 decimal places for index funds and all types of debt/ liquid/ money market funds. Thus the number of units allotted to an investor will include fraction units. The issue of fraction units indicates proportionate ownership and ensures that the entire amount paid by the investor is invested.

Mutual funds declare the NAV of all their schemes on every business day. The NAV of all mutual fund schemes have to be uploaded on AMFI's website (*www.amfiindia.com*) and also on the Mutual Funds' website by the time as per applicable guidelines. All mutual fund schemes (except for fund of fund schemes) shall update their latest NAVs by 11 p.m. of the same day and Fund of Fund schemes shall update the latest NAVs by 10 a.m. the following business day.

For an investor, NAV is the most important data point to evaluate the performance of their investments. RTAs ensure timely communication of latest NAVs to the unitholders.

- **Assets and Liabilities in a Mutual Fund Portfolio**

When we refer to total assets, we are referring to the market value of the mutual fund portfolio. A mutual fund rarely holds any other long-term asset in its balance sheet. There may be few receivables and accrued income, which are current assets. These are added to the portfolio value to get the total assets of the fund. Similarly, on the liability side, a mutual fund does not have long-term liabilities. The assets are fully funded by the unit capital contributed by the investors. Short term deposits not exceeding 20 percent of the net assets

of the scheme and for a period not exceeding 91 days may be made for the purpose of redemption of units or paying dividends (IDCW) to the unit holders. Therefore, when we refer to liabilities, we are referring to current liabilities, in terms of payables that may be due.

The expenses associated with managing the portfolio are accrued as current liabilities and are paid as they become due. Therefore, net assets of a fund refer to the market value of the portfolio, plus accrued incomes, less any current liabilities and accrued expenses. Net asset value (NAV) is a per unit representation of the net assets of a fund. NAV is a very frequently used term in the mutual fund industry. It refers to the current value per unit, deriving out of the current value of the mutual fund portfolio.

Example 7:

The market value of a fund's portfolio is Rs. 700 crore. If the current liabilities are Rs. 5 crore, what are the net assets?

Net assets = Portfolio value less liabilities

= 700 – 5

= Rs. 695 crore

Example 8:

Assume that the net assets of a fund are Rs. 750 crore. The unit capital (face value Rs. 10) is Rs. 250 crore. What is the NAV?

Number of units = Unit capital/Face value per unit

= 250/10

= 25 crore units

NAV = Net asset /number of units

= 750/25

= Rs. 30 per unit

Example 9:

If a fund's NAV was Rs. 15 and the number of units was 100 crore, what are its net assets?

Net Assets = NAV x Number of units

= 15 x 100

= Rs. 1500 crore

Chapter 8: Sample Questions

1. The securities that a mutual fund scheme invests in depend upon its _____.
   a. **Investment objective**
   b. Investment style
   c. Investment plan
   d. Tax scenario

2. The type of expenses that can be charged to a fund and its limit is decided by _____.
   a. Association of Mutual Funds in India
   b. **Securities and Exchange Board of India**
   c. Sponsors of Asset Management Companies
   d. Board of Trustees of Asset Management Companies

3. The unit capital of a mutual fund is Rs. 10 lakh. The face value of the fund is Rs. 10 and the NAV of the fund is Rs. 50. Calculate the number of outstanding units.
   a. 1 lakh
   b. 20000
   c. 50000
   d. 10000

4. Expenses charged to a mutual fund scheme are _____.
   a. Unlimited in nature
   b. Limited by Regulation
   c. Prohibited by SEBI

5. Distributors mobilising funds from investors located in _____ locations earn _____ commissions.
   a. B-30; Higher
   b. T-30; Higher
   c. B-30; Lower
   d. B-30; Higher

9 Mutual Fund Structure and Constituents

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Structure of a Mutual Fund
  - Sponsors
  - Trustees
  - Asset Management Company
- Other Constituents and Service Providers to Mutual Fund
  - Custodians
  - Registrar and Transfer Agents
  - Depositories
  - Distributors
- Regulatory aspects of Mutual Fund
- Digital Platforms and Payment Aggregators

Mutual funds may be structured either as a company in which investors hold shares or as a trust in which investors are the beneficiaries. In the USA, where mutual funds first began, they are set up as investment companies. In the UK, open-ended funds are created in the form of unit trusts while closed-end funds are set up as investment trusts or companies. Figure 9.1 shows the structure of a mutual fund.

Figure 9.1: Structure of a Mutual Fund

In India, mutual funds are created as trusts. The investors are the beneficial owners of the investments held by the trust. The structure to be followed by mutual funds in India is laid down in SEBI (Mutual Funds) Regulations, 1996. Mutual funds in India follow a three-tier structure of sponsor, trust and asset management company (AMC).

The sponsor promotes the mutual fund and sets up the AMC. The mutual fund itself is structured as a trust. It is managed by trustees in the beneficial interest of the unit holders. Trustees appoint an asset management company (AMC) to manage the funds.

9.1 Sponsor

The sponsor is the promoter of a mutual fund, who sets up the trust and the AMC, appoints the custodian, board of trustees and the board of directors of the AMC. The sponsor seeks regulatory approval for the mutual fund from SEBI. SEBI (Mutual Fund) Regulations define a sponsor as any person who, acting individually or in concert with another body corporate, establishes a mutual fund.

SEBI has laid down the eligibility criteria for a sponsor. A sponsor should:[31]

- Have a sound track record and general reputation of fairness and integrity in all his business transactions, i.e.
    - Should have at least five years' experience in the financial services industry.
    - Should ensure a good financial track record with positive networth in all the immediately preceding five years.
    - Should ensure that the networth is more than the proposed capital contribution of the sponsor in the asset management company. Also should ensure that in case of any change in control of the existing AMC due to acquisition of shares, the networth of the sponsor is more than the aggregate par value or market value of the shares so acquired, whichever is higher.
- Contribute at least 40 percent of the networth of the asset management company (AMC).
- Be a fit and proper person.
- Not have been guilty of fraud or has not been convicted of an offence involving moral turpitude or has not been found guilty of any economic offence.

Sponsors can be Indian companies, banks or financial institutions, foreign entities or a joint venture between the two.

9.2 Trustees

The mutual fund itself is set up as a trust. Trustees are appointed by the sponsor with SEBI approval, to act on behalf of the investors. Trustees act as the protectors of the unit holders' interests and are the primary guardians of the unit holders' funds and assets. Trustees, under

[31] Vide SEBI (Mutual Funds) (Amendment) Regulations, 2021 effective from March 5, 2021.

SEBI (Mutual Fund) Regulations, mean the Board of Trustees or the Trustee Company who hold the property of the Mutual Fund in trust for the benefit of the unit holders.[32]

The trust deed is executed by the sponsor in favour of the trustees and it deals with the establishment of the trust, the authority and responsibility of the trustees towards the unit holders and the AMC.

The trustees have the fiduciary responsibility of protecting the beneficiaries of the trust, namely the investors in the mutual fund. At least two-thirds of the members of the board of trustees have to be independent of the sponsor. Trustees are paid fees for their services.

SEBI regulations for trustees govern the appointment and functions of the trustees. There are aspects of general and specific due diligence to be exercised by trustees, to oversee the working of the AMC and the management of the mutual fund. Half Yearly Trustee Reports (HYTR) are to be submitted by trustees to SEBI specifying about the non-compliances along with the corrective measures taken on the same.[33]

9.3 Asset Management Company (AMC)

Asset Management Company (AMC) is the investment manager of the mutual fund. The AMC is set up by the sponsor, and registered with SEBI. AMCs can be structured as public or private limited companies. The capital of the AMC is contributed by the sponsor and its associates.

AMCs specialise in investment management. They manage money for a fee, usually determined as a percentage of the Assets under Management (AUM).

AMCs, that have been approved by SEBI as per the eligibility criteria laid down in SEBI (Mutual Funds) Regulations, 1996, are appointed by sponsor or trustees (if so authorised by the trust deed) to manage the funds contributed by the investors to the various schemes of the mutual fund in line with the investment objective of the respective schemes.

AMCs are the face of mutual funds. They set up offices, employ staff, create and market products, mobilise funds through distributors, manage the money and report the portfolio performance to trustees and investors.

The rights and obligations of the AMC are specified in the Investment Management Agreement signed between the trustees and the AMC.

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[32] If the trusteeship of the mutual fund is with a trustee company, wherever the context requires applicability of provisions for individual trustees, the term trustees under SEBI (MF) Regulations shall be deemed to mean the directors of board of the trustee company.

[33] SEBI Circular No.: SEBI/HO/IMD/IMD-I DOF2/P/CIR/2021/550 dated April 12, 2021

AMCs cannot engage in any business other than that of financial advisory and investment management. AMCs are required to submit to the trustees quarterly reports of each year on its activities and the compliance with the SEBI (Mutual Funds) Regulations in the specified format.[34] Compliance Test Report is submitted by AMC to SEBI on a quarterly basis.

9.4 Custodians

Custodians hold the securities or goods or gold or gold related instruments or silver or silver related instruments or other assets of the mutual fund and are responsible for their safekeeping. They hold actual custody of the assets of the mutual fund.

Custodians, registered under SEBI (Custodian) Regulations, are appointed by the trustees to carry out the custodial services for the schemes of the mutual fund. They represent the only constituent not directly appointed by the AMC. Custodians should be independent of the sponsor. That is, a sponsor cannot be a custodian of the fund as well.

Example: ICICI Bank is a sponsor of ICICI Prudential Mutual Fund. It is also a custodian bank. However, it cannot offer its custody services to ICICI Prudential Mutual fund, because it is also the sponsor of the fund.[35]

SEBI (MF) Regulations further states that the following assets may be kept in the custody of a SEBI registered custodian:

- Gold and gold related instruments, in case of a Gold ETF scheme.[36]
- Silver and silver related instruments, in case of Silver ETF scheme.[37]
- Title Deed of real estate assets held by Real Estate Mutual Fund (REMF) schemes.
- Underlying goods of the exchange traded commodity derivatives (physical settlement) wherein mutual fund schemes have invested.

Custodians settle the securities transactions of the mutual fund. This function involves:

- Delivering and accepting securities and cash, to complete transactions made in the investment portfolio of the mutual fund.

[34] SEBI Circular No.: SEBI/HO/IMD/IMD-I DOF2/P/CIR/2021/550 dated April 12, 2021.
[35] Disclaimer: Names used here/ elsewhere in the workbook are only for illustration purposes and not to recommend any scheme of AMC.
[36] Vide SEBI (Mutual Funds) (Amendment) Regulations, 2020 effective from March 6, 2020.
[37] Vide SEBI (Mutual Funds) (Third Amendment) Regulations, 2021 w.e.f. December 8, 2021.

- Tracking and completing corporate actions and payouts such as rights issue, bonus issue, offer for sale, buy back offers, dividends, interest and redemptions on the securities held by the fund.
- Coordinating with the Depository Participants (DPs) who hold the securities account of the mutual fund schemes.

Some custodians also offer fund accounting and valuation services to mutual funds.

9.5 Regulation of Mutual Funds

Mutual funds in India are regulated by SEBI (Mutual Funds) Regulations, 1996. SEBI regulations define the activities of the mutual fund on aspects relating to registration, management, products, investments, accounting, valuation, investor services and investor protection. The sponsors, the trustees, the asset management company and the custodian are required to comply with the provisions of the regulations. Mutual fund investors have recourse to the trustees, AMC and SEBI, in that order, for the redressal of their complaints.

Some key aspects of SEBI (Mutual Funds) Regulations are:

- Mutual funds have to obtain SEBI approval before they set up their business.
- AMCs have to be registered with SEBI before they get into the business of investment management.
- The constitution and management of the mutual fund, AMC and custodian have to be according to the regulations.
- All mutual fund constituents such as custodians, R&T agents, bankers and brokers have to seek SEBI registration before they work for mutual funds.
- The scheme related documents have to be prepared in the prescribed format and filed with SEBI for their comments/ observations. AMC should incorporate all such comments/ observations of SEBI and file the final copy of the offer document with SEBI prior to the launch of the scheme.
- Investment objectives, accounting and valuation of the portfolio have to be as per the SEBI regulations.
- Mutual funds have to submit periodic reports and are subject to SEBI inspection and audit.
- Mutual funds also have an industry association called the Association of Mutual Funds in India (AMFI). All AMCs are members of the AMFI. AMFI recommends and promotes best business practices and code of conduct to be followed by their members and others engaged in the activities of mutual fund and asset management including agencies connected or involved in the field of capital markets and financial services.

9.6 Constituents and Service Providers

AMCs focus on managing the portfolio of the mutual fund. The functional divisions in a typical AMC can be classified as:

- fund management
- operations
- sales and marketing
- customer service
- compliance
- finance and accounts

The core function is fund management, which cannot be outsourced. Other functions may be outsourced. All outsourcing service providers must be registered with SEBI and adhere to the specific guidelines relevant to them. SEBI has laid down principles of outsourcing which identifies nature of activities that can be outsourced and the risk management processes to be put in place.

AMCs have their direct sales teams, and also appoint distributors to sell their products. Portions of the operations functions such as investor records, fund accounting and valuation are outsourced.

Mutual fund constituents (except custodians) are appointed by the AMC with approval of the trustees. All constituents have to be registered with SEBI. Constituents are paid fees for their services. Table 9.1 lists out the various constituents and their roles:

Table 9.1: Roles of Mutual Fund Constituents

Constituent	Role
Custodian	Holds funds and securities
R&T Agent	Maintains investors' records and services investors' requests
Banks	Enable collection and payment
Auditor	Audits scheme accounts
Distributors	Distribute fund products to investors
Brokers	Execute transactions in securities

Core functions in these areas are done in-house, while other functions are outsourced to constituents. Some funds may choose to do some of these functions in-house.

9.6.1 Registrar and Transfer Agents

As already discussed in Unit 6, Registrar and Transfer agents (R&T agents) are primarily responsible for providing services to the investors. They accept and process investor transactions. R&T agents are paid a fee for their services.

They also operate investor service centres (ISCs) which act as the official points for accepting investor transactions requests with a fund.

R&T functions include:

- Issuing and redeeming units and updating the unit capital account.
- Enabling investor transactions such as purchase, redemption and switches.
- Creating, maintaining and updating investor records.
- Banking the payment instruments (cheques and drafts) given by investors and notifying the AMC.
- Processing pay-outs to investors in the form of dividends (IDCW) and redemptions.
- Sending statutory and periodic information to investors.
- Processing change in/ updation of the KYC details of the investors for physical holdings like change of address/ bank account details/ e-mail address/ telephone/ mobile/ nomination and PAN.
- Processing and updating investor holding/ title change requests viz name deletion, transmission.
- Process grievance received through e-mails and letters and those through SCORES also.

9.6.2 Depositories and Depository Participants

Unit holders may choose to hold their mutual fund units in a statement of account or in their demat accounts. They may hold the dematerialised units in their demat account with any Depository Participants of the 2 depositories, NSDL or CDSL.

Each MF scheme has been granted a unique International Securities Identification Number (ISIN) to facilitate holding of units in demat form. If the units are held in demat i.e., with the depository, such units will be transferable in accordance with the provisions of the SEBI (Depositories and Participants) Regulations, 2018.

9.6.3 Banks

Banks provide collection and payment services to mutual funds. Investor cheques are collected into the mutual fund scheme accounts by banks. The banks are responsible for collection of funds and reporting the same to RTA and other constituents on a daily basis. In case of pay-outs due to dividends (IDCW) or redemption, the same are processed through the banking system.

9.6.4 Fund Accountant

The fund accountant is responsible for calculation of AUM, NAV and determining applicable TER, commissions etc. The fund accountant relies on data provided by the RTA, bankers and custodians.

9.6.5 Auditor

Auditors audit the books of the mutual fund. There are separate auditors for the AMC's accounts. The auditor of a mutual fund, shall be a firm, including a limited liability partnership, constituted under the LLP Act, 2008 who is eligible and qualified to audit the accounts of a company under section 141 of the Companies Act, 2013.[38]

9.6.6 Brokers

Brokers execute the buy and sell transactions of the fund managers.

9.6.7 Distributors and Registered Investment Advisers

a. Distributors

AMCs appoint distributors who sell the mutual fund products to investors on behalf of the mutual fund. Distributors may work for more than one mutual fund. There is no exclusivity in mutual fund distribution.

The sponsor or an associate may act as a distributor for the fund with which they are associated. For example, ICICI Bank is the sponsor of ICICI Prudential Mutual Fund also one of its distributors.

Distributors may be individuals or institutions such as banks, Non-Banking Finance Companies (NBFCs) or broking and distribution companies. Individual distributors form the largest geographical network.

[38] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2021/024 dated March 4, 2021.

All distributors must obtain an AMFI Registration Number (ARN) and stamp the same on all application forms sourced by them to ensure payment of commission. Further, AMFI will assign a unique identification number to the employees (EUIN), relationship managers, and other such sales personnel of the distributor who interact with the investors. This number is in addition to the ARN and should be mentioned in the application forms along with the ARN.

Most large distributors provide a web portal for online transactions to their Channel Partners.

b. Registered Investment Advisers

Investment Advisers (IA) are registered under the SEBI (Investment Advisers) Regulations, 2013. IAs are expected to be neutral intermediaries who have a fiduciary responsibility to their clients. They do not earn any commission or remuneration from the AMC. They may charge a fee from their clients for providing "advice".[39] IAs cannot undertake any distribution or execution services.

c. Execution only platforms

An EOP means any digital or online platform which facilitates transactions such as subscription, redemption and switch transactions in direct plans of schemes of Mutual Funds.

9.6.8 Stock Exchange Platform and other Digital Platforms

In order to make mutual fund transactions more convenient and to have a wider reach, SEBI has allowed Stock Exchanges (SEs) to offer their existing infrastructure for buying and selling of mutual fund units, in addition to the prevailing distributor route. Accordingly, stock exchanges provided various platforms to the investors for dealing in mutual fund units such as BSE StAR and NSE Mutual Fund Platform (NMF).

Advantages to investors/other stakeholders of using stock exchange platforms:

- Independent view of customer's entire portfolio at one place
- Reduction of paperwork and ensuing errors
- Reduction of redundancy in process and data duplication at RTA and Distributor levels
- De-risking MF settlement processes by using superior Delivery v/s Payment (DVP) process provided by Stock Exchanges
- Efficiently & effectively address customer servicing issues

[39]"Investment advice" is an advice relating to investing in, purchasing, selling or otherwise dealing in securities or investment products, and advice on investment portfolio containing securities or investment products, whether written, oral or through any other means of communication for the benefit of the client and shall include financial planning.

- Extending present convenience available to Secondary market to mutual fund investors
- Enable transparency to customers
- Enable charging customers for service at the point where it is rendered

MF Utility (MFU) is an innovative "Shared Services" initiative by the Mutual Fund industry under the aegis of Association of Mutual Funds in India (AMFI), which acts as a "Transaction Aggregation Portal" through which a Mutual Fund customer is enabled to transact in multiple schemes across Mutual Funds using a single transaction and consolidated payment.

MFU facilitates the distributors / RIAs with online access to submit investor transactions thereby improving the service capability of distributors / RIAs by providing efficiency in handling transactions at their back office with substantial cost savings.

MF Central

MF Central (www.mfcentral.com) is a unified platform developed by both QRTAs that allows an investor to access portfolio / account statements, place service request and execute all types of financial transactions (purchase / redemption / switch), initiation of tracking of queries and complaints access investment related reports, transaction reports, capital gain/loss, details of unclaimed dividend/redemption on a single platform. The platform is an industry effort to minimize the need to visit various websites for transactions and service requirements and investors will able to access these services for all Mutual Funds in an integrated manner. The platform allows only investments in "single holder mode".

9.6.9 Payment Aggregator and Payment Gateway

Payment aggregators are service providers through which Mutual Funds process their payment transactions. Aggregators allow mutual funds to accept payment and bank transfers without having to set up a merchant account with a bank. Payment Gateways are entities that provide technology infrastructure to route and facilitate processing of an online payment transaction without any involvement in handling of funds.

Chapter 9: Sample Questions

1. At least _____ trustees must be independent of the sponsor.
   a. **Two-thirds**
   b. One-third
   c. Three-fourths
   d. One-fourth

2. The functioning of the Asset Management Company (AMC) is overseen by the _____.
   a. **Trustees**
   b. Registrars and Transfer Agents
   c. Custodians
   d. Sponsors

3. The remuneration of the constituents of a mutual fund is in the form of _____.
   a. Profit sharing
   b. Incentive
   c. **Fees**

4. Receiving securities and settling funds for capital market transactions done for a mutual fund is the role of the _____.
   a. Asset Management Company
   b. R&T agent
   c. Custodian
   d. Broker

5. Who appoints the mutual fund distributors?
   a. Asset Management Company
   b. Sponsor
   c. R&T agents
   d. Auditors

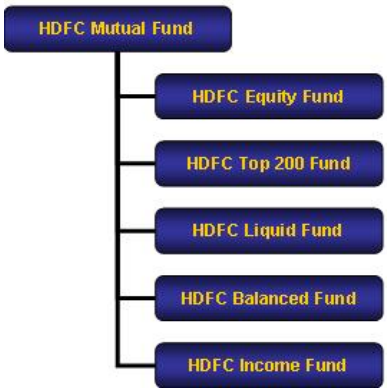
10 Mutual Fund Products

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Product Differentiation concept in case of mutual fund products
- Types of Mutual Funds: Open-ended, Close-ended and Interval funds
- Types of plans offered by Mutual Funds: Direct and Regular Plans
- Product Labeling as per investment categories, investment objectives and risk
- Product Creation Process
- Scheme related documents: Statement of Additional Information (SAI), Scheme Information Document (SID) and Key Information Memorandum (KIM)
- Mutual Fund categorization as per SEBI: Equity schemes, Debt schemes, Hybrid schemes, Solution oriented schemes and Other schemes

The term 'scheme' or 'plan' usually indicates the various products a mutual fund offers. The term 'fund' is also used to refer to a mutual fund product. When we say mutual fund, we are not referring to a particular product.



For example, HDFC mutual fund is not a single product, but represents all the schemes and products under that umbrella.[40]

HDFC Liquid Fund, on the other hand, refers to a specific product of HDFC mutual fund, which is a debt scheme, investing in debt and money market securities.

The mutual fund is an umbrella entity, and there are several funds/schemes/plans with distinct objectives underneath this entity. Investors invest in a specific fund/scheme/plan. The products offered by a mutual fund are known as schemes, or funds.

SEBI (MF) Regulations define a mutual fund as 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, money market instruments, gold or gold related

[40] Disclaimer: Names used here/ elsewhere in the workbook are only for illustration purposes and not to recommend any scheme of AMC.

instruments, silver or silver related instruments, real estate assets and instruments as may be specified by SEBI from time to time.[41]

10.1 Product Differentiation

Mutual funds offer a range of products to investors. These products are designed to meet the varying needs of investors.

Investors who are willing to take higher risks for higher level of return tend to choose equity products. Investors who seek regular income and a lower level of risk tend to choose debt products.

The investing horizon also tends to influence the choice of products. Long term investors may choose equity, while investors with short to medium term horizons choose debt and debt-oriented products.

Investors also tend to take a view on the market and investment opportunities. When they anticipate an appreciation in equity for example, they prefer equity products over debt products.

To meet the diverse needs of investors, mutual funds offer a range of equity, debt and hybrid products. They also deploy different investment strategies to achieve their investment objectives.

A mutual fund is created when investors pool their money. In practice, the product is first defined. The money is pooled later, based on this definition.

Any scheme of a Mutual Fund must have atleast 20 investors and contribution of a single investor should not exceed 25 percent of the AUM. This is commonly referred to as the 20/25 rule.[42] Further, no scheme shall have AUM of less than Rs. 20 crore. The minimum AUM has to be maintained on a continuous basis.

[41] Vide SEBI (Mutual Funds) (Amendment) Regulations, 2021 effective from March 5, 2021 and SEBI (Mutual Funds) (Third Amendment) Regulations, 2021 w.e.f. December 8, 2021.
[42] 20/25 Rule is not applicable for Exchange Traded Funds (ETFs).

10.1.1 Open-ended Funds

An open-ended fund gets its name from the fact that it does not have a maturity date. An open-ended fund offers units to investors for the first time during the new fund offer (NFO).

After the NFO, investors can buy (purchase) and sell (redeem) units of an open-ended fund, at the mutual fund offices or their investor service centres (ISCs) or through the stock exchange terminals, where applicable, on a continuous basis. The prices at which purchase and redemption transactions take place in a mutual fund are based on the net asset value (NAV) of the fund. The unit capital of an open-ended fund is not fixed, but varies according to the purchase and redemption transactions of investors.

10.1.2 Close-ended Funds

Close-ended funds run for a specific period. On the specified maturity date, all units are redeemed and the scheme comes to a close. Close-ended funds are offered in an NFO but are closed for further purchases from the mutual fund after the NFO period.

SEBI has made it mandatory for units of all closed-end schemes to be listed on stock exchanges to provide liquidity. Investors buy and sell the units among themselves, at the price prevailing in the stock market. A purchase or sale of units of close-ended schemes on the stock exchange among the investors does not result in new units being issued or existing units being redeemed by the mutual fund. Thus there is no change in the unit capital of the fund. The size of a listed close-ended fund is kept constant, as buying and selling happens in the secondary market, without recourse to the fund itself. The units may trade on the exchange at a discount or premium to the NAV depending upon investors' perception.

10.1.3 Interval Funds

An Interval fund is a hybrid product combining the features of both an open-ended and close-ended fund. They are largely close-ended but become open-ended at pre-specified intervals. Purchase and redemption transactions from/ to the mutual fund are allowed at certain predefined dates known as Specified Transaction Period. For instance, an interval fund might become open-ended between January 1 to 15, and July 1 to 15, each year. The benefit for investors is that, unlike in a purely close-ended scheme, they are not completely dependent on the stock exchange to be able to buy or sell units of the interval fund. However, to provide liquidity to the investors between these intervals, the units must be compulsorily listed on stock exchanges to allow investors an exit route.

10.2 Types of Mutual Fund Plans

Mutual funds offer investors two plans or routes to invest in a mutual fund— the Direct Plan and the Regular Plan.

10.2.1 Direct Plan

The direct plan is for investors who wish to invest directly in the mutual fund without routing their investment through a distributor. The direct plan will have a lower expense ratio since it eliminates the distribution expenses or commissions. The plan will have a separate NAV that will reflect the lower expenses under this plan.

10.2.2 Regular Plan

Under the regular plan the investor indicates a distributor through whose services the investment was made and executed. The AMFI Registration Number (ARN) is made available by the investor in the application form and the mutual fund pays the transaction charges and commissions to the distributor so identified. The expenses under the Regular plan are higher because of the distribution commissions involved.

The only difference between the two plans is the fee structure. The direct plan of a mutual fund holds exactly the same assets as the regular plan but includes no expenses for distributor commissions.

10.3 Features of Mutual Fund Products

Mutual Funds can be classified based on where they invest in, what objectives they pursue and the amount of risk they assume in the investment portfolio. Investors tend to choose mutual fund products based on their investment objectives, time horizon, market outlook and risk appetite.

Mutual funds offer a range of products, keeping in mind these diverse needs of investors. Products are defined in terms of where they will invest, what objectives they will pursue, and the kind of risk they feature.

Several products offer a combination of these factors. For example, a liquid fund focuses on short term debt markets, is for investors with short investment horizon, and features a low level of risk. It thus serves multiple objectives of an investor. Some products may be focused on a single objective. For example, a sector fund is focused on a specific sector, and is suitable to an investor who has a view on the sector and likes to implement that view by buying the sector fund.

Investment categories: Funds can be classified depending on investment category (also called asset class) they focus on. For example, equity funds invest in equity shares; debt funds invest in debt securities; money market funds invest in money market securities; commodity funds invest in commodity-linked securities or in approved commodities such as gold or silver; real estate funds invest in property-linked securities.

Investment Objectives: Funds can be classified depending on their investment objectives. For example, growth funds seek capital appreciation and therefore invest in equity; income funds invest with the objective of generating regular income and create a portfolio of debt securities; and monthly income plans seek to derive regular income with some growth and have a bit of equity along with debt in its portfolio.

Investment Risk: Funds can be grouped according to the risk associated with the investment objective and portfolio. Equity funds have a greater degree of risk as compared to debt funds. Liquid funds are the least risky, as they invest in very short-term securities.

10.4 Product Labelling

All mutual fund schemes shall be labelled on the following parameters:

i. Nature of the scheme such as to generate wealth or provide regular income in an indicative time horizon such as short or medium or long term.

ii. A brief description of the investment objective of the scheme and the kind of product in which an investor is investing in, such as equity or debt.

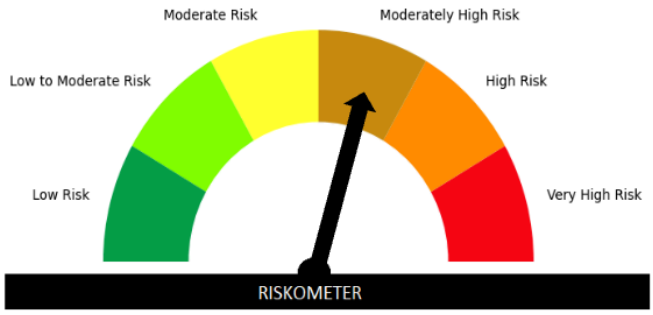
iii. Level of risk to the principal invested in the mutual fund schemes depicted through a pictorial meter known as 'Risk-o-meter'. There will also be a written statement of the risk to the principal below the 'Risk-o-meter'. (see Figure 10.1) The 'Risk-o-meter' categorizes risk in one of the following 6 levels:[43]

- Low Risk
- Low to Moderate Risk
- Moderate Risk
- Moderately High Risk
- High Risk
- Very High Risk

[43] Vide SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/197 dated October 5, 2020 – SEBI has issued detailed guidelines and methodology for evaluating risk levels of a particular mutual fund scheme. https://www.sebi.gov.in/legal/circulars/nov-2024/disclosure-of-expenses-half-yearly-returns-yield-and-risk-o-meter-of-schemes-of-mutual-funds_88230.html (November 5, 2024)

Figure 10.1: Risk-o-meter

"Riskometer: Risk level of the scheme shall be depicted by "Risk-o-meter" as given below –



The risk of the scheme/benchmark is [level of risk]

For example, the risk depicted in the above risk-o-meter is Moderately High"

The product label should be prominently published in the scheme related documents and common application form for the scheme. Any change in the risk-o-meter of a scheme should be communicated to its respective unit holders. Mutual Funds/AMCs should evaluate the risk-o-meter of their schemes on a monthly basis and disclose the same on their respective websites and AMFI website.

10.5 Strategy-based Classification

A mutual fund may invest in equity or debt markets. But the portfolio may be managed with a certain strategy to create a differentiation.

Some equity funds follow a stock selection strategy, which they think will bring about superior performance. These may include investing in turn-around stocks or special situations companies. Some equity funds may be created to capture a certain theme, such as infrastructure. This may require investing across a set of sectors that benefit from that theme. These can also be called multi-sector funds or thematic funds.

Some equity funds are created with the intention of generating dividend income for the investors by investing in stocks of dividend yield companies.

Some funds are managed passively, selecting the same stocks as in a given index, in the same proportion. They do not actively choose stocks and sectors. These are index funds. They can also be issued as Exchange traded funds (ETFs) that list on the stock exchange and can be bought or sold on the stock exchange platforms.

Debt funds invest in fixed income securities. These securities come with their defined interest income, which is paid unless there is a default. But their market value does not remain constant. Since mutual fund products have to be 'marked to market', the NAV of the debt funds also changes. For debt funds that invest in long term securities, the interest income and NAV fluctuations are higher, while for the short term funds, both are lower. Therefore debt fund strategies focus on balancing these factors.

Some debt funds have a proportion of their portfolio invested in long term securities, to get advantage of any appreciation in value. They balance the short term and long term securities depending on their view of the market. Such funds are known as flexible or dynamic debt funds.

Some debt funds pre-dominantly invest in short term securities, but hold a smaller proportion of funds in the long term debt securities. This is to enable earning the higher return of a long-term debt, while at the same time, not exposing the portfolio to risks from long-term debt.

10.6 Product Creation Process

The Asset Management Company (AMC) describes the portfolio. This description is then given a product name. An offer document is created with the product details. The draft offer document is approved by the trustees and filed with SEBI for their comments/ observations. Post the incorporation of all the comments and suggestions by SEBI (if any), AMC shall issue the final offer document. The product is open for subscription to investors as a New Fund Offer (NFO). Investors are allotted units against their investment at the face value of the units. After the money is collected, fund managers begin to construct the portfolio.

A mutual fund product is basically defined in terms of the investment portfolio. The portfolio features of a mutual fund product are defined in terms of:

- Which is the asset class the portfolio will invest in? Equities? Debt? Both?
- What are the limits on investing in the chosen asset classes?
- Will it invest in the entire range or choose some niche – like small cap equity or short term debt?
- What will the portfolio be managed for – growth, income, both?
- Will the portfolio use specific strategies?

- What is the benchmark to compare the performance of the portfolio with?

A mutual fund product can also be understood in terms of its operational features relating to investor participation. These are:

- What are the types of investors eligible to buy the units?
- How can the investor buy the units?
- What is the price of the units?
- What are the rules of entering and exiting the portfolio?
- What are the income streams the investor can expect?
- What will be the tax implication of these income streams?

Mutual fund products typically combine different portfolio and operational features.

10.6.1 Scheme related Documents[44]

SEBI requires that AMCs provide relevant and complete information to help the investor take an informed decision to invest in mutual funds. All such information is provided in the scheme related documents.

The Scheme related Documents are available free of cost at any of the Investor Service Centres (ISCs) or AMC offices. The documents have to be in the format prescribed by SEBI. Mutual Fund scheme related documents consist of:

a. **Statement of Additional Information (SAI)** which has statutory information about the mutual fund or AMC offering the scheme.
b. **Scheme Information Document (SID)** which has details of the particular scheme.[45]
c. **Key Information Memorandum (KIM)** which contains all the key information that an investor must know before investing in the scheme.

10.6.2 Statement of Additional Information (SAI)

The SAI contains information common to all schemes offered by a mutual fund. It is filed with SEBI as a one-time filing.

The information includes:

[44] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2021/024 dated March 4, 2021.
[45] Candidates are advised to read: https://www.sebi.gov.in/legal/circulars/dec-2024/upload-of-draft-scheme-information-documents_90097.html

- Details of the Sponsor, trustee, AMC and other constituents.
- Details of key personnel of the AMC and associates such as Registrars, Custodians, Bankers, Auditors and Legal Counsel.
- Condensed financial information of all the schemes launched in last 3 financial years.
- Rights of unit holders, investor grievance redressal.
- Investment valuation norms.
- Other common information.

The SAI has to be updated every financial year. Any material changes have to be incorporated immediately and uploaded on the mutual fund and AMFI websites.

10.6.3 Scheme Information Document (SID)

Information about the mutual fund scheme is provided in the Scheme Information Document (SID). This includes:

- Name and type of scheme.
- Issue dates - open, close and re-issue.
- Names of sponsor, trustee, AMC and other constituents.
- All Fundamental Attributes like Investment Objective and Policies, Asset Allocation Pattern and Liquidity Provisions.
- Fees and expenses of the scheme.
- Performance, in case of an existing scheme and benchmarks.
- All Risk Factors in the scheme as well as risk mitigation mechanisms.
- Mandatory disclosures and disclaimers.
- Closed-end debt funds have to provide the additional information on portfolio such as the policy for evaluating the credit risk in the security and sectors in which the fund will invest.
- Fund Management Team details
- General Unitholder information
- Other details like list of AMC branches, Investor Service Centres, Official Points of Acceptance.

For the open ended and interval schemes, the SID has to be updated within next six months from the end of the 1st half or 2nd half of the financial year in which schemes were launched, based on the relevant data and information as at the end of previous month. Subsequently, SID shall be updated within one month from the end of the

half-year, based on the relevant data and information as at the end of September and March respectively.[46]

If there is a change in the fundamental attributes, (a) an addendum to be displayed on the AMC website along with the existing SID; and (b) the existing SID has to be updated immediately after the lapse of the time period given to existing investors to exit the scheme. For other changes, the AMC issues an addendum which is attached to the existing SID and displayed on the AMC website.

Every Addendum has to be approved by trustees, and displayed prominently at the AMC office and Investor Service Centres (ISCs). AMCs generally circulate the copy of the addendum to all Distributors/Brokers/ISCs for the information of investors.

The information in the addendum is included in the KIM and SID, when they are revised and reprinted.

10.6.4 Key Information Memorandum (KIM)

Key information memorandum (KIM) is a synopsis of important information contained in the SID and SAI. It also contains information that is useful for filling up the application form. The application form is accompanied by the KIM. According to regulation, both application form and KIM have to be printed together and made available to the investor. The format for KIM is prescribed by SEBI.

KIM has to updated at least once in half-year, within one month from the end of the respective half-year, based on the relevant data and information as at the end of September and March and shall be filed with SEBI through electronic mode only.[47]

10.7 Types of Mutual Funds

10.7.1 Equity Funds

Equity funds invest in equity shares issued by companies. The risk of such funds is higher than that of debt funds. However, the risk levels can differ depending upon the investment strategies adopted by the fund manager. Equity funds can be classified by their investment strategy as diversified, aggressive, growth, value, sectoral and thematic funds.

[46] SEBI Circular No.: SEBI/HO/IMD/IMD-I DOF2/P/CIR/2021/0560 dated April 30, 2021.
[47] SEBI Circular No.: SEBI/HO/IMD/IMD-I DOF2/P/CIR/2021/0560 dated April 30, 2021.

The equity market is made up of large number of equity stocks. These equity stocks can be classified according to the industry they belong to, or their size. There are several types of equity funds. Each one is defined to invest in some segment of the equity market.

- **Diversified Equity Funds**

These funds invest in multiple sectors and companies. These funds feature a lower risk, compared to equity funds that invest in a specific sector or segment of equity markets.

- **Large Cap Funds**

These are funds that focus on the equity shares of large sized companies. Large companies are usually well established, and the shares are easy to buy and sell. Large cap companies also feature lower risk, due to their long performance track record and history.

- **Mid Cap Funds**

These are funds that focus on equity shares of medium sized companies. These are usually the second rung companies in the market and bought for their potential to grow in earnings and profitability and become big. Risk of failures, especially during the turn in business cycles, can also be high.

- **Small Cap Funds**

These are funds that focus on equity shares of small companies, many of them typically new and upcoming companies. They are bought for their future potential, but they can be difficult to buy and sell in large quantity. The risk of selection is high as many companies in this segment fail to grow and establish business as expected.

- **Thematic & Sector Funds**

These are funds that focus on companies in a particular theme such as infrastructure or more narrowly in a particular sector, such as banking. They appeal to investors who think that the performance of stocks in the particular theme or sector would be better than that of the broad market.

As per the SEBI circular, open-end equity mutual fund schemes have been categorized under the following sub heads:[48]

[48] Vide SEBI Circular on Categorisation and Rationalisation of Mutual Fund Schemes.

Multi Cap Fund: An open ended equity scheme investing across large cap, mid cap, small cap stocks.[49] The minimum investment in equity and equity related instruments shall be 75 percent of total assets i.e. minimum 25 percent of total assets each in large cap, mid cap and small cap companies.[50]

Large Cap Fund: An open ended equity scheme predominantly investing in large cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be 80 percent of total assets.

Large and Mid Cap Fund: An open ended equity scheme investing in both large cap and mid cap stocks. The minimum investment in equity and equity related instruments of large cap companies shall be 35 percent of total assets. The minimum investment in equity and equity related instruments of mid cap stocks shall be 35 percent of total assets.

Mid Cap Fund: An open ended equity scheme predominantly investing in mid cap stocks. The minimum investment in equity and equity related instruments of mid cap companies shall be 65 percent of total assets.

Small cap Fund: An open ended equity scheme predominantly investing in small cap stocks. Minimum investment in equity and equity related instruments of small cap companies shall be 65 percent of total assets.

Flexi Cap Fund: An open-ended, dynamic equity scheme that invests across different market capitalizations (i.e. large cap, mid-cap, and small cap). The minimum investment in equity and equity-related instruments should be 65 percent of the total assets of the scheme.[51]

Dividend Yield Fund: An open ended equity scheme predominantly investing in dividend yielding stocks. Scheme should predominantly invest in dividend yielding stocks. The minimum investment in equity shall be 65 percent of total assets.

Value Fund: A value fund is an open ended equity scheme following a value investment strategy. Minimum investment in equity & equity related instruments shall be 65 percent of total assets.

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[49]Large Cap companies are 1st-100th companies in term of full market capitalisation. Mid cap companies are 101th -250th companies in term of full market capitalisation. Small cap companies are 251st company onwards in terms of full market capitalisation. (Note: If a stock is listed on more than one recognised stock exchange, an average of full market capitalisation of the stock on all such stock exchanges will be computed. In case a stock is listed on only one stock exchange, the full market capitalisation of that stock on such an exchange will be considered. This list would be uploaded on the AMFI website and the same would be updated every six months based on the data as on the end of June and December of each year. The data shall be available on the AMFI website within 5 calendar days from the end of 6 months period. While preparing the single consolidated list of stocks, average full market capitalization of the previous six month of the stocks shall be considered.)

[50] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/172 dated September 11, 2020.

[51] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/228 dated November 6, 2020.

Contra Fund: A contra fund is an open ended equity scheme following contrarian investment strategy. Minimum investment in equity & equity related instruments shall be 65 percent of total assets.

Mutual Funds will be permitted to offer either Value fund or Contra fund.

Focused Fund: An open ended equity scheme investing in maximum 30 stocks (the scheme needs to mention where it intends to focus, viz, multi cap, large cap, mid cap, small cap). Minimum investment in equity & equity related instruments shall be 65 percent of total assets.

Sectoral/ Thematic: An open ended equity scheme investing in a specific sector such as bank, power is a sectoral fund. While an open ended equity scheme investing in line with an investment theme such as housing, infrastructure is a thematic fund. For example, an infrastructure thematic fund might invest in shares of companies that are into infrastructure, construction, cement, steel, telecom, power etc. The minimum investment in equity & equity related instruments of a particular sector/ particular theme shall be 80 percent of total assets.

Equity Linked Savings Scheme (ELSS): An open ended equity linked saving scheme with a statutory lock in of 3 years and tax benefit. The minimum investment in equity and equity related instruments shall be 80 percent of total assets (in accordance with Equity Linked Saving Scheme, 2005 notified by the Ministry of Finance).

ELSS provides tax benefits in the form of deductions under section 80C of the Income Tax Act for the amount invested. The maximum limit for claiming deduction u/s 80C is Rs. 1.5 lakh per financial year. These investments are subject to a three-year lock-in period to get the tax benefit.

10.7.2 Debt Funds

Debt funds invest predominantly in debt securities. Debt securities have a fixed term and pay a specific rate of interest. There are several types of debt funds that invest in various segments of the debt market. Debt securities are broadly classified as short term securities (money market securities) and long term securities (bonds, debentures). Very short term debt securities provide a low level of return. Longer term debt securities have the potential to provide a higher level of return, but their price can fluctuate in response to changes in interest rates. If interest rates go up, the value of a debt security goes down and vice versa. This response to changes in interest rates is called interest rate risk. Higher the maturity profile, higher the interest rate risk. This means securities with longer maturity carry a higher interest rate risk as compared to shorter maturity securities.

In debt markets, there is also categorisation based on default risk. This is usually denoted by credit rating. A debt security with a higher credit rating like AAA, has lower risk of default than say, BBB rating. Securities with lower credit rating pay a higher coupon relative to a debt instrument with the same tenor but higher credit rating.

The terms credit risk and default risk are used as synonyms. But there is a thin line of difference. Credit risk refers to the change in price of a security due to change in its rating. If the rating improves, the market will price that in for a lower yield and the price will increase. If the rating falls, market will price that for a higher yield and thus a lower price. Credit risk refers to the perception of safety. Default risk is the risk that a borrower may not honour the commitments for payment of interest and/or principal. Credit rating is an early indicator of potential default risk.

- **Liquid and Money Market Funds**

These funds invest in very short term debt instruments such as treasury bills, commercial papers and certificate of deposits. Liquid funds invest in debt and money market securities with maturity upto 91 days and Money Market funds invest in money market instruments with maturity upto 1 year.

Since liquid funds have very short-term maturity, the risk of NAV fluctuation is low. Liquid funds provide safety of principal and liquidity, depending upon the portfolio of securities.

- **Short Term Debt Funds**

Debt funds that invest in securities with slightly longer term than liquid funds are called short term debt funds. The returns from these funds are primarily from accrual income earned from coupons. The tenor of the bonds held in the portfolio will determine the contribution to the returns of the fund from capital gains, if any, as also the extent of volatility in the NAV of the fund. Longer the tenor of the bonds, greater will be the opportunity to earn capital gains and higher will be volatility in the NAV.

- **Medium and Long Term Debt Funds**

Medium and Long Term Debt funds invest pre-dominantly in a wide range of medium-term and long-term debt instruments issued by the government, companies, banks and financial institutions.

There is a higher risk of default in those funds, as compared to gilt funds, which invest in securities issued by non-government agencies that carry the risk of default. They have a

higher interest rate risk than money market funds since they invest in longer-term securities. The actual risk in a fund will depend upon the credit quality and tenor of the securities in its portfolio. These funds aim at providing regular income rather than capital appreciation.

- **Gilt Funds**

Funds that invest minimum 80 percent of its total assets in government securities are called gilt funds. Gilt funds invest in government securities across maturities. These funds do not have the risk of default since the issuer of the instruments is the government.

Gilt funds have a high degree of interest rate risk, depending on the maturity of the bonds held in the portfolio. Higher the maturity profile of the portfolio, greater is the interest rate risk in the fund.

- **Floating Rate Funds**

Floating rate debt funds are those that invest in a class of debt instruments, whose interest rates are not fixed, but change depending on a market benchmark.

- **Credit Risk Funds**

These funds seek higher interest income by investing minimum 65 percent of its total assets in below highest rated corporate debt instruments i.e. only in AA and below rated corporate bonds. Lower the credit rating, higher is the risk of default and thereby higher the interest a borrower pays.
Consider the Table 10.1 for comparison of debt funds:

Table 10.1: Comparison of Debt Funds

Debt Funds	Return	Risk	Liquidity
Liquid fund	Low	Low	High
Gilt fund	Medium	Low	High
Long Term Debt fund	Medium	Medium	High
Credit Risk fund	High	High	High

The risk in a gilt fund comes from interest rate changes; there is no credit risk.

As per the SEBI circular, open-end debt mutual fund schemes have been categorized under the following sub heads:

Overnight Fund: An open ended debt scheme investing in overnight securities. The investment is in overnight securities having maturity of 1 day.[52]

Liquid Fund: An open ended liquid scheme whose investment is into debt and money market securities with maturity of upto 91 days only.[53]

Ultra Short Duration Fund: An open ended ultra-short term debt scheme investing in debt and money market instruments with Macaulay duration between 3 months and 6 months.

Low Duration Fund: An open ended low duration debt scheme investing in debt and money market instruments with Macaulay duration between 6 months and 12 months.

Money Market Fund: An open ended debt scheme investing in money market instruments having maturity upto 1 year.

Short Duration Fund: An open ended short term debt scheme investing in debt and money market instruments with Macaulay duration between 1 year and 3 years.

Medium Duration Fund: An open ended medium term debt scheme investing in debt and money market instruments with Macaulay duration of the portfolio being between 3 years and 4 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 4 years.

Medium to Long Duration Fund: An open ended medium term debt scheme investing in debt and money market instruments with Macaulay duration between 4 years and 7 years. Portfolio Macaulay duration under anticipated adverse situation is 1 year to 7 years.

Long Duration Fund: An open ended debt scheme investing in debt and money market instruments with Macaulay duration greater than 7 years.

Dynamic Bond: An open ended dynamic debt scheme investing across duration.

Corporate Bond Fund: An open ended debt scheme predominantly investing in AA+ and above rated corporate bonds. The minimum investment in corporate bonds shall be 80 percent of total assets (only in AA+ and above rated corporate bonds).

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[52]Provisions of SEBI Circular No SEBI/IMD/DF/19/2010 dated November 26, 2010 shall be followed for Uniform cut-off timings for applicability of Net Asset Value in respect of Liquid Fund and Overnight Fund.

[53]All provisions mentioned in SEBI circular SEBI/IMD/CIR No.13/150975/09 dated January 19, 2009 in respect of liquid schemes shall be applicable. Also, provisions of SEBI Circular No SEBI/IMD/DF/19/2010 dated November 26, 2010 shall be followed for Uniform cut-off timings for applicability of Net Asset Value in respect of Liquid Fund and Overnight Fund.

Credit Risk Fund: An open ended debt scheme predominantly investing in AA and below rated corporate bonds. The minimum investment in corporate bonds shall be 65 percent of total assets (only in AA (excludes AA+ rated corporate bonds) and below rated corporate bonds).[54]

Banking and PSU Fund: An open ended debt scheme predominantly investing in debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds. The minimum investment in such instruments should be 80 percent of total assets.

Gilt Fund: An open ended debt scheme investing in government securities across maturity. The minimum investment in G-secs is defined to be 80 percent of total assets (across maturity).

Gilt Fund with 10 year constant duration: An open ended debt scheme investing in government securities having a constant maturity of 10 years. The minimum investment is defined to be 80 percent of total assets such that the Macaulay duration of the portfolio is equal to 10 years.

Floater Fund: An open ended debt scheme predominantly investing in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives). Minimum investment in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/derivatives) shall be 65 percent of total assets.

SEBI further clarified that all open ended debt schemes (except Overnight Fund, Liquid Fund, Gilt Fund and Gilt Fund with 10 year constant duration) shall hold at least 10 percent of their net assets in liquid assets, that include Cash, Government Securities, T-bills and Repo on Government Securities.[55]

10.7.3 Hybrid Funds

Funds that have a combination of asset classes such as debt and equity in their portfolio are called hybrid funds. Some mutual fund products invest in both equity and debt markets. The objective is to bring to the investor the benefit of strategically investing in both markets, in a single product.

There are three broad types of hybrid funds:

- Predominantly debt-oriented hybrids

54Vide SEBI Circular (SEBI/HO/IMD/DF3/CIR/P/2017/114 October 6, 2017) words/ phrases that highlight/ emphasize only the return aspect of the scheme shall not be used in the name of the scheme (for instance Credit Opportunities Fund, High Yield Fund, Credit Advantage etc.)

[55] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/229 dated November 6, 2020.

- Predominantly equity-oriented hybrids
- Dynamic asset allocation hybrids

- **Predominantly Debt-oriented Hybrids**

These funds invest mostly in the debt market, but invest 5 percent to 25 percent in equity. The investor gets some growth benefits of equity along with income from debt investments. Some of these funds are packaged as 'monthly income funds'.

The objective in these funds is to generate income from the debt portfolio, without taking on the risk of equity. The allocation to equity is kept lower, to enable growth and a small increase in return, without the high risk of fluctuation in NAV that comes with equity. Many of these schemes also feature a periodic payout of income distribution cum capital withdrawal.[56]

- **Predominantly Equity-oriented Hybrids**

These funds invest in the equity market, but invest up to 35 percent in debt, so that some income is generated.

Some funds invest between 40 percent and 60 percent in equity and the rest into debt instruments. Such hybrids are called balanced funds.

Balanced funds are suitable to those investors who seek the growth opportunity in equity investment, but do not have a very high risk appetite. The exposure to debt balances out the risks, and enables a combination of growth and lower risk. The proportions in equity and debt are managed tactically by the fund managers based on their view of the markets.

- **Dynamic Asset Allocation Funds**

These funds have the flexibility to invest in a 0-100 percent range in equity or debt markets. They switch out of equity markets if the risks are high, and invest in debt. They switch back into equity when markets move up again. Depending on the view of the fund managers, the switch between equity and debt is done. Therefore the portfolio of the scheme can swing between a high allocation to equity and a high allocation to debt.

[56] Dividend payout option is renamed as 'payout of income distribution cum capital withdrawal option' vide SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/194 dated October 5, 2020.

Instead of the investor doing the switches – incurring costs and taxes, the fund does it within the portfolio. Sometimes quantitative models are used as triggers for deciding the switch. The change in allocation is then done on auto-mode.

As per the SEBI circular, open-end hybrid mutual fund schemes have been categorized under the following sub heads:

Conservative Hybrid Fund: An open ended hybrid scheme investing predominantly in debt instruments. Investment in debt instruments shall be between 75 percent and 90 percent of total assets while investment in equity and equity instruments shall be between 10 percent and 25 percent of total assets.

Balanced Hybrid Fund: An open ended balanced scheme investing in equity and debt instruments. The investment in equity and equity related instruments shall be between 40 percent and 60 percent of total assets while investment in debt instruments shall be between 40 percent and 60 percent. No arbitrage is permitted in this scheme.

Aggressive Hybrid Fund: An open ended hybrid scheme investing predominantly in equity and equity related instruments. Investment in equity and equity related instruments shall be between 65 percent and 80 percent of total assets while investment in debt instruments shall be between 20 percent and 35 percent of total assets.

Mutual funds in India are permitted to offer either Aggressive Hybrid Fund or Balanced Fund.

Dynamic Asset Allocation or Balanced Advantage: It is an open ended dynamic asset allocation fund with investment in equity/debt that is managed dynamically.

Multi Asset Allocation: An open ended scheme investing in at least three asset classes with a minimum allocation of at least 10 percent each in all three asset classes. Foreign securities are not treated as a separate asset class in this kind of scheme.

Arbitrage Fund: An open ended scheme investing in arbitrage opportunities. The minimum investment in equity and equity related instruments shall be 65 percent of total assets.

Equity Savings: An open ended scheme investing in equity, arbitrage and debt. The minimum investment in equity and equity related instruments shall be 65 percent of total assets and minimum investment in debt shall be 10 percent of total assets. The minimum hedged & un-hedged investment needs to be stated in the Scheme Information Document (SID). Asset Allocation under defensive considerations may also be stated in the Offer Document.

10.7.4 Solution Oriented Schemes

The solution oriented mutual fund schemes help in attaining goals such as retirement, children's higher education.

The Union Budget of 2014 allowed the AMCs to launch pension schemes. The schemes allow an investor to choose an investment strategy (Income distribution cum capital withdrawal / growth) depending on his/ her age and risk profile. Further, a customer can change the investment strategy without attracting any capital gains. The initial investments enjoy tax benefits under section 80C. There is no separate exemption for such schemes. Such schemes will have a longer lock in period (say 5 years). On obtaining the age of 60, the investor will be able to withdraw a part of the corpus as a lump sum amount and use the balance to purchase an annuity (pension).

As per the SEBI circular, open-end solution oriented mutual fund schemes have been categorized under the following sub heads:

Retirement Fund: An open ended retirement solution oriented scheme having a lock-in of 5 years or till retirement age (whichever is earlier). Scheme having a lock-in for at least 5 years or till retirement age whichever is earlier.

Children's Fund: An open ended fund for investment for children having a lock-in for at least 5 years or till the child attains age of majority (whichever is earlier). Scheme having a lock-in for at least 5 years or till the child attains age of majority whichever is earlier.

10.7.5 Other Types of Funds

- **Fixed Maturity Plans (FMPs)**

Fixed maturity plans (FMPs) are closed-end funds that invest in debt instruments whose maturities are closely aligned to the maturity of the scheme. The debt securities are redeemed on maturity and paid to investors. An FMP structure eliminates the interest rate risk for investors if the fund is held by them until maturity. These funds may have tenors ranging from 90 days to as much as 5 years. Funds issue FMPs in a series, offering one fund after another has matured.

- **Real Estate Mutual Funds (REMFs)**

Real estate mutual funds invest in real estate directly or lend to real estate developers or buy securities of housing companies and sectors related to housing and property. They can also invest in debt instruments issued by housing projects. REMFs may invest in Real Estate Projects, Mortgage backed Securities and Equity Shares and Debentures of Real Estate Companies. Real Estate Mutual Funds are only issued as close ended funds.

Real Estate Funds are not meant for retail investors as they involve complex issues of valuations, liquidity, ownership and project risk. Currently, there are no Real Estate Mutual Funds in India.

- **Exchange Traded Funds (ETFs)**

Exchange Traded Funds are also mutual fund products that may be linked to an underlying index or commodity such as gold, but listed and traded on a stock exchange. The portfolio of an index-based ETF will reflect the specific index and the value of each unit of the ETF will be linked to the value of the underlying index. An ETF is traded on stock exchanges and the NAV and price change on real time basis in accordance with market movements.

A **Gold ETF** buys physical gold which is preserved safely by the custodian. Gold ETF allows investors to buy gold in quantities as low as 1 gm. This is done in form of demat units, where each unit approximately represents the value of 1 gm of gold. The newly introduced **Silver ETFs** invest minimum 95 percent of the net assets of the scheme in silver and silver related instruments. The investment objective of these schemes is to generate returns in line with the performance of physical silver in domestic prices.[57]

The units of an ETF are first available to investors in the NFO, after which they are listed and traded on the stock exchange at real time prices. The price of the ETF unit will be based on the NAV of the scheme. The NAV in turn is correlated to the market price of gold/silver. Most Gold ETF schemes offer an opportunity for the investor to convert units to physical gold subject to certain conditions.

- **Capital Protection Funds**

Capital Protection Funds are closed-end funds that combine debt and equity investments in the portfolio. The debt component is invested in such a manner so that it grows over the fund's tenor to the principal invested and thereby provides protection of capital. The equity component is invested to generate additional returns, typically in equity derivatives.

ESG Funds

A new category of funds called ESG Funds, short form for Environmental, Social and Governance investing is recently introduced. ESG schemes are mandated to invest at least 65% of the AUM in companies which have comprehensive Business Responsibility and Sustainability Reporting (BRSR).

- **Infrastructure Debt Funds (IDFs)**

Infrastructure Debt funds mainly undertake investment in debt securities or securitised debt instruments of infrastructure companies, infrastructure capital companies or infrastructure

[57] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2021/668 dated November 24, 2021 on Norms for Silver Exchange Traded Funds (Silver ETFs) and Gold Exchange Traded Funds (Gold ETFs).

projects, special purpose vehicles (SPVs). The aim is to provide liquidity and refinance to Infrastructure Companies and Banks that have lent to such companies.

As per the SEBI circular, open-end other mutual fund schemes have been categorized under the following sub heads:

Index Funds/ Exchange Traded Funds: An open ended scheme replicating/ tracking a specific index. This minimum investment in securities of a particular index (which is being replicated/ tracked) shall be 95 percent of total assets.

Fund of Funds (Overseas/ Domestic): An open ended fund of fund scheme investing in an underlying fund. The minimum investment in the underlying fund shall be 95 percent of total assets.

Box 10.1: Passive Funds

Passive Funds provide various advantages such as transparency, lower costs, diversification etc. to its investors over active funds. Index funds, exchange traded funds are example of passive funds. With the growing popularity of these passive funds among investors globally, Mutual Funds can launch Equity Linked Savings Scheme (ELSS) as: (a) Active ELSS under 'Equity Schemes' category or (b) Passive ELSS under 'Other Schemes' category. The passive ELSS scheme shall be based on one of the indices comprising of equity shares from top 250 companies in terms of market capitalization.

Chapter 10: Sample Questions

1. Investors buy closed-end funds from the mutual fund during _____.
   a. **New Fund Offer (NFO)**
   b. Continuous Offer
   c. Any time of the life of the fund

2. Information in the _____ is common to all schemes of a mutual fund.
   a. Scheme Information Document (SID)
   b. **Statement of Additional Information (SAI)**
   c. Fund Fact Sheet
   d. Consolidated Account Statement (CAS)

3. Liquid funds invest in debt securities with maturity _____.
   a. **Upto 91 days**
   b. Upto 365 days
   c. Upto 7 days

4. As per SEBI categorisation, the minimum investment by an Index Fund in securities of the index that is being replicated shall be _____ of total assets.
   a. 65 percent
   b. 80 percent
   c. 75 percent
   d. 95 percent

5. Sector funds are risky because _____.
   a. They diversify into new stocks
   b. They invest for longer term
   c. They invest in illiquid securities
   d. They hold a concentrated portfolio

11 Operational Concepts of Mutual Funds

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Concept of New Fund Offer—allotment, inception date and use of NFO proceeds
- Continuous / On-going Offer
- Computation of Net Asset Value (NAV)
- Operating cycle of a mutual fund
- Time stamping of transactions and Risk Controls
- Cut-off timing for applicable NAV
- Mutual fund investment through stock exchanges
- Roles of RTAs in Tax Computation
- Reporting Requirements to CBDT

11.1 New Fund Offer (NFO)

The mutual fund units are offered to the public for the first time when the scheme is launched through new fund offer (NFO). A mutual fund product begins its life on the NFO start date. Investors can start investing in the fund from this date. The NFO close date is defined in the scheme related document. During the NFO period (open date to close date) the units are purchased at the NFO price. The NFO for mutual funds (except ELSS) are open for a period not more than 15 days.

The mutual fund would need the all the applicants to be KYC complied with completed application form with the prescribed documentation and the requisite investment amount, to allot an investment folio in the name of the investor. Applications in NFO can also be made using Application Supported by Blocked Amount (ASBA) facility. The Mutual Funds/AMCs have to compulsorily provide ASBA facility to the investors for all NFOs launched on or after October 1, 2010.

Allotment of units

Once the NFO closes, there is a 'no transaction period' (usually 5 days). During this period, the investors' account folio details are created, cheques are banked, bounced cheques are returned, and the final list of unit holders who form the register of investors for the just closed NFO is created.

The mutual fund (except ELSS) should allot units and dispatch statements of accounts, showing their investment in the fund and the number of units, within the stipulated time notified by SEBI.[58]

Inception Date

The fund begins to declare its NAV from the next day of allotment. The date of allotment is the inception date of the fund, when its NAV is set at face value. Transactions in an open ended fund can begin from the next day when the first NAV of the fund will be declared. [59]

Use of NFO Proceeds

The mutual fund shall make investments out of the NFO proceeds only on or after the closure of the NFO period.

11.2 On-going/ Continuous Offer

On-going or continuous offer indicates that transactions are resumed in a fund after the allotment is over. Purchases and redemptions of units happen at NAV related prices during the on-going offer period. For liquid funds, NAV is calculated and declared every calendar day, whereas NAVs for other than liquid funds are calculated and declared every business day.[60]

In case of open-ended mutual funds, fresh units can be purchased from the fund and allotted units can be redeemed to the fund at prices linked to the NAV on an on-going basis. No new purchases from the fund can happen in case of closed-end mutual funds. Redemptions may happen after the allotment date according to the terms of the fund offer. A closed end fund has fixed term at the end of which all units are redeemed. However, investors can transact in the dematerialised mode among themselves through stock exchange platform where units of the closed end mutual funds are listed. Such listing is compulsory for close-ended schemes.

Ongoing purchases and redemptions have to be based on NAV. Consider a simple example. An investor buys 1 unit in a scheme during NFO at Rs. 10. There is a 10 percent appreciation in portfolio after that. Therefore, NAV goes up to Rs. 11. What happens if a new investor is allowed to buy another unit at Rs. 10? The total assets of the fund will be Rs. 21, and NAV drops to 21/2 = Rs. 10.50 per unit.

[58] Currently it is within 5 business days from the NFO close date. In case of ELSS, the allotment must be done within 30 days. Candidates are advised to check the SEBI website for latest updates.

[59] Schemes are required by regulation to open for transactions within 5 working days of allotment. (Candidates are advised to check SEBI website for latest websites).

[60] 'Business Day' does not include a day on which the Money Markets are closed or otherwise not accessible.

The NAV has fallen to Rs. 10.50, because another unit was purchased at Rs. 10. If the new unit was purchased at Rs 11, total net assets would be Rs. 22 and the NAV remained unchanged at Rs. 11 per unit. To be fair to both investors, the price charged to investors for buying or selling units has to be based on NAV.

The operating cycle of a mutual fund is summarized as below:

- Investor transaction is accepted by Official Point of Acceptance i.e. RTA's ISCs/AMC offices.
- Transaction is intimated to RTA back office along with the data and images
- Transactions also flow from various other sources directly to RTA from AMC websites/digital portals, Channel partners, MFU, Exchanges and other online platforms as their systems has been integrated with RTA system.
- Units are added (purchase) post realisation of funds or reduced (redemption) in the folio of investors
- Inflow and outflow resulting from transactions is reported to the AMC Treasury
- Units issued and redeemed for the day are consolidated
- Unit capital is updated for increase/decrease from the transactions
- Unit capital is communicated to AMC fund accounts
- Portfolio is valued by fund accounts/custodian
- NAV computation is done using the portfolio value and updated unit capital
- NAV is communicated to RTA for applying to investor transactions

When investor transactions are received at the ISC during a business day, the applicable NAV of that transaction is not known. The AMC (or its custodian) computes the NAV at the end of the day, after the markets have closed.

In case of electronic transactions submitted to RTA various other online/digital sources, server at AMC/RTA end is considered as Official Point of Acceptance and hence NAV reaching the AMC/RTA server is considered for the NAV applicability.

11.3 Computation of Net Asset Value (NAV)

NAV is calculated as:

(Market value of the portfolio - Expenses and liabilities) / (Number of units outstanding)

The number in the denominator can be provided by the R&T agent, only after processing the purchase and sales transactions, for which they need the applicable NAV. Therefore

transactions can be processed only the next day based on NAV of previous day. After processing the transactions, the updated unit capital is communicated to the AMC.

NAV of Day T thus includes portfolio value of Day T (Numerator) and the number of outstanding units on day T-1 (Denominator).

Mutual funds are mandated to disclose the NAVs of all schemes within a given outer time limit. Valuation process must be completed such that NAVs of schemes are computed and updated as per the stipulated time on the AMFI's website and Mutual Fund website (except for ETCDs, FoFs, schemes investing atleast 80 percent of total assets in permissible overseas investments, index funds, ETFs and other as prescribed by SEBI) [61]

All transactions are captured by R&T agent by day-end for next day's reports to fund house for cash flow projection.

NAV (Day T) = (Market value of scheme's investments + current assets – current liabilities as on Day T) / (No. of units outstanding as on Day T-1).

Other things remaining constant, any increase in outstanding units in the denominator without a corresponding increase in the numerator representing the investment of funds received, will depress the NAV.

Example: Suppose the market value of the securities of a mutual fund scheme is Rs 500 lakh. The scheme expenses are Rs. 100 lakh. The mutual fund issues 10 lakh units of Rs 10 each to its investors. So, the NAV per unit of the fund is Rs (500 – 100)/10 = Rs 40.

RTA plays a crucial role in NAV calculation. In an open ended fund, the number of units changes daily based on purchase (increase in units) and redemption (decrease in units). This change of units is monitored by the RTA.

11.4 Applicable NAV

Market fluctuations can cause the NAV to be volatile. In such situations, investors will be anxious about transacting at the correct NAV. In a product like liquid fund, there is a risk of losing interest on the investment, or paying a price that is different from market levels, if the NAV is not appropriate.

[61] SEBI/HO/IMD/IMD-IPOD2/CIR/2023/48 dated March 29, 2023

The NAV that is applicable to a transaction depends, among other things, on the day and time at which the transaction request was received at the official point of acceptance. It is therefore very critical to record the time at which a transaction was received and use this information to determine the applicable NAV for a transaction. SEBI has imposed electronic time stamping as a mandatory requirement for financial transactions related to mutual funds, for the same reason.

11.5 Time Stamping and Risk Control

The time stamping guidelines defined by SEBI have to be complied with at all official points of acceptance of investor transactions. Mutual fund offices and designated investor service centres (ISCs) are official points of acceptance.

The time stamping machine captures the time of receipt of a transaction at the ISC. The machine records a required number of impressions. A document that has to be time-stamped is passed through a slot in the machine. The location code, machine identifier, date, time (hh:mm) and running serial number are generated in every time stamp.

All financial transactions are processed in the R&T system as per the applicable NAV according to the recorded time stamp on the document.

As per the SEBI Regulations, a document evidencing purchase and its corresponding payment instrument should have the same time stamp serial number. That is, an application form and the accompanying cheque should have identical time stamping impressions.

- **Time stamping of transactions**

In case of purchase transactions, the impressions are affixed on the face of the application form or transaction slip and on the back of the payment instrument.

In case of a purchase accompanied by an electronic fund transfer fax copy of the form and of the transfer instruction, are time-stamped. Transactions that are electronically enabled such as online transactions, are time stamped based on server timings.

Some transactions such as redemptions, switches and transfers are not accompanied by a payment instrument. For such transactions, impressions of the time stamp are affixed on the face of the application (transaction request) and on the investors' acknowledgement copy. If no acknowledgement is issued, then the application is stamped twice.

Non-financial transactions are not accompanied by a payment instrument. For such transactions all impressions of the time stamp are affixed on the transaction request itself.

- **Risk Controls in Time Stamping**

The time stamp impression has to be affixed on a blank space in a document. Care has to be taken to ensure that the time stamping impression does not overwrite anything in the documents. Since the time stamp impression is used for determining applicable NAV, it has to be clear, legible and readable.

Since the AMC offices are official points of acceptance, they also receive transactions and timestamp them. The applicable NAV is based on the time stamp made at the AMC office. Therefore, for document control purposes the ISCs only time stamp the cover sheet received from the AMC.

Offices of distributors are not official points of acceptance. Therefore, they cannot time stamp the transactions received at their offices. Each transaction request received at the ISC in a bunch from distributors should be individually time stamped. The NAV on these transactions is applied as per the time stamp on each individual transaction request. This is irrespective of the time of receipt of the bunch.

Applications for fresh purchases or additional purchases should always be accompanied by a payment instrument. Since the time stamp on the application and the payment instrument should be identical, it should be ensured that both are received together.

If at the time of carrying out basic checks, a document is found to be incomplete the transaction request should not be time stamped. It should be returned over the counter for corrections. If an error is found in a transaction request that has been accepted and time-stamped, it should not be returned (even if the transaction is found unacceptable). AMCs may provide specific instructions for such situations.

The following are time stamping machine maintenance procedures that are to be followed at the ISC:

- In order to ensure that all the machines at the ISC are in workable condition, they have to be tested every day as per a laid down process.
- The machine should remain locked at all times except when replacement of ribbon or ink cartridge is required. The key should be kept in the custody of the ISC head.

- A machine log should be maintained at a branch level. The log should be used to record instances of the machine having been opened. This includes replacement of cartridge and break down.
- Every morning, the first time stamp serial number should be verified with that of the last time stamp serial number of the previous day, to ensure that it is continuous.
- Daily control reports are generated by all official points of acceptance, indicating the first, last and the time stamp serial number at cut-off time, for transactions received during the day.

11.6 Cut Off Time

The applicable NAV for a financial transaction is according to the time stamp. This eliminates uncertainty associated with financial transactions and brings in uniformity in their treatment.

The applicable NAV for a mutual fund transaction will depend upon:

- The day of the transaction
- The time of the transaction
- The type of scheme
- The availability of clear funds for utilization by the mutual funds.

The day of the transaction matters because markets and mutual funds do not work every day. Both may not be open on a given transaction day. If it is not a business day for the fund, there would be no NAV on that date. However, Liquid funds publish NAV every calendar day, as the change in NAV is only made up of interest accrual. As per SEBI circular, a business day does not include a day on which the money markets are closed or otherwise not accessible.

The time of the transaction is stamped on the transaction documents. The applicable NAV will depend on the time of receiving the transaction. Cut-off time has been prescribed by SEBI for various categories of funds and transactions.

Applicable NAV for liquid funds varies from other funds. Liquid fund remittances may be made electronically and deployed on the same day. Therefore, they have an earlier cut-off time.

The applicable NAV for transactions received on a business day, depend on the cut-off time, as summarized in Table 11.1 below:

Table 11.1: Applicable NAV based on Cut-off Timings

Type of Scheme	Transaction	Cut-off time	Applicable NAV
Equity oriented funds and debt funds (except liquid funds)	Purchases and Switch ins	3.00 pm	Irrespective of the time of receipt of application, the closing NAV of the day on which the funds are available for utilisation is applicable.[62]
Liquid fund*	Purchases and Switch ins	1.30 pm[63]	If application is received upto the cut off time on a day and funds are available for utilisation before the cut-off time, without availing any credit facility, whether intra-day or otherwise, the closing NAV of the day immediately preceding the day of receipt of application is applicable.
			If application is received after cut off time on a day and funds are available for utilisation on the same day without availing any credit facility, whether intra-day or otherwise, the closing NAV of the day immediately preceding the next business day is applicable.
			Irrespective of the time of receipt of applications, where the funds are not available for utilisation before the cut-off time, without availing any credit facility, whether intraday or otherwise, the closing NAV of the day immediately preceding the day on which the funds are available for utilisation is applicable.
Equity Oriented Funds, Debt funds (Other than Liquid funds)	Redemptions and Switch outs	3.00pm	If application is received upto the cut off time, the closing NAV of the day on which the application is received is applicable.

[62] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2020/175 dated September 17, 2020.

[63] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2019/101 on Risk management framework for liquid and overnight funds and norms governing investment in short term deposits dated September 20, 2019.

Type of Scheme	Transaction	Cut-off time	Applicable NAV
			If application is received after the cut off time, the closing NAV of the next business day is applicable.
Liquid funds*	Redemptions and Switch outs	3.00pm	If application is received upto the cut off time, the closing NAV of the day immediately preceding the next business day is applicable. If redemption request is received through Instant Access Facility (IAF)# upto the cut off time, then the lower of the following is applicable: (a) NAV of previous calendar day; and (b) NAV of calendar day on which application is received.
			If application is received after the cut off time, the closing NAV of the next business day is applicable. If redemption request is received through Instant Access Facility (IAF)# after the cut off time, then the lower of the following is applicable: (a) NAV of calendar day on which such application is received; and (b) NAV of the next calendar day.

*****_Mutual Funds shall calculate NAV for each calendar day for their liquid fund schemes and plans._

#_Mutual Funds/ AMCs can offer Instant Access Facility (IAF) only in Overnight and Liquid schemes._[64]

The above cut-off timings are not applicable to:

- New Fund Offers (NFOs)

[64] SEBI Circular No. SEBI/HO/IMD/IMD-II DOF3/P/CIR/2021/608 dated July 30, 2021 on Deployment of unclaimed redemption and dividend amounts and Instant Access Facility in Overnight Funds.

- International Schemes
- Transactions in Mutual Fund units undertaken on a recognized Stock Exchange

Consider the following case as an example:

Assume that in a particular week, Monday, Wednesday, Thursday and Friday are business days, whereas all the other days are non-business days. The week would look as under:

- Sunday – non-business day
- Monday – business day
- Tuesday – non-business day
- Wednesday – business day
- Thursday – business day
- Friday – business day
- Saturday – non-business day

Given the above details, following are some examples of transactions to understand what NAV would be applicable:

1. An investor submits an application on Monday to buy units of an equity mutual fund scheme for Rs. 3,00,000.

   If application is made on Monday and fund gets realized on Wednesday by 2 pm, it will be Wednesday's NAV.

2. An investor makes an application to purchase units of a liquid fund

   If application is made on Monday and fund gets realized by 1 p.m. on Monday, it will be Sunday's NAV. If it gets realized by 3 pm on Monday, it will be Tuesday's NAV. If it gets realized by 10 am on Wednesday, it will be Tuesday's NAV.

3. An investor makes an application for redemption of units of equity fund on Monday

   If the application is submitted before the cut-off time, the redemption would be processed at Monday’s NAV. However, if the application is submitted after the cut-off time, the applicable NAV would be of Wednesday. (Remember: Tuesday is a non-business day).

4. Redemption from liquid fund, application submitted on Monday

If the application is submitted before the cut-off time, the redemption would be processed at Tuesday's NAV. However, if the application is submitted after the cut-off time, the applicable NAV would be of Wednesday. (Remember: Tuesday is a non-business day).

11.7 Segregated Portfolios

Segregated Portfolio (popularly referred to as side pocket) is allowed by SEBI in case of debt/ money market instruments facing default or downgrade of part of its portfolio.[65] The concept of segregated portfolio means to separate / segregate the debt/ money market instruments facing a "credit event" from the main portfolio. This ensures liquidity and fair treatment for all investors. Creation of segregated portfolio is based on issuer-level credit events and are implemented at the ISIN-level. Credit event is defined as downgrade of a debt instrument below investment grade by SEBI registered Credit Rating Agency (CRA). The Scheme Information Document (SID) must have a specific provision allowing for creation of a segregated portfolio and such actions must be approved by the Trustees.

In partial modification to the above circular, SEBI permitted to create segregated portfolio of unrated debt or money market instruments by mutual fund schemes of an issuer that does not have any outstanding rated debt or money market instruments subject to the following:[66]

- Segregated portfolio of such unrated debt or money market instruments may be created only in case of actual default of either the interest or the principal amount.

Earlier, credit event was considered for creation of segregated portfolio; however vide the modification, 'actual default' by the issuer of such instruments was considered for creation of segregated portfolio.

In case of a segregated portfolio, the following additional points may be noted:

- Segregated portfolio will be effective from the day of credit event.
- An email or SMS to be sent to all unitholders of the concerned scheme.
- NAV of both the segregated portfolio and main portfolio to be declared daily.
- No redemption and subscription are allowed in the segregated portfolio. However, in order to facilitate exit to unitholders in segregated portfolio, AMC shall enable listing of units of segregated portfolio on the recognized stock exchange within 10 working

[65] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2018/160 on Creation of Segregated Portfolio in mutual fund schemes dated December 18, 2018.
[66] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2019/127 on Creation of Segregated Portfolio in mutual fund schemes dated November 7, 2019.

days of creation of segregated portfolio and also enable transfer of such units on receipt of transfer requests. AMCs cannot charge investment and advisory fees on the segregated portfolio. However, TER (excluding the investment and advisory fees) can be charged, on a pro-rata basis only upon recovery of the investments in segregated portfolio.

- Upon recovery of money, (partial or full), it shall be immediately distributed to the investors in proportion to their holding in the segregated portfolio.
- Periodic Review of Action Taken to recover the investments of segregated portfolio.
- Adequate disclosure of the segregated portfolio shall appear in all scheme-related documents.
- Capital gains / loss to be calculated from date of original investment and not from date of segregation.

SEBI also emphasized that existence of the provisions for segregated portfolio should not encourage the AMCs to take undue credit risk in the scheme portfolio. Any mis-use of the provisions of segregated portfolio, would be considered serious and stringent action may be taken.

The segregated portfolio is in effect a close-ended fund carved out of the main fund. The RTA has responsibilities to:

- Calculate NAV
- Inform investors of NAV
- Issue account statements for the segregated fund
- Distribute any money recovered
- Ensure compliances for TER and reporting
- Ensure smooth operation of the main portfolio with no restrictions on purchase and redemption

11.8 Investing in Mutual Funds through Stock Exchanges[67]

The terminals of stock exchanges can be used for transacting in mutual fund units. The brokers, who intend to offer the facility, must comply with the empanelment requirement and abide by the code of conduct and applicable SEBI guidelines for mutual fund distributors.

Folio details for transactions done are sent by brokers to the R&T agent who allot units for purchases and release funds for redemption requests. Such Mutual Fund Distributors do not

[67] SEBI Circular No. SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/635 dated October 4, 2021, Refer SEBI letter No. SEBI/HO/IMD/IMD-I DOF5/P/OW/2022/10847/1 dated March 15, 2022

handle pay-out and pay-in of funds as well as units on behalf of investors. The pay-in is directly received by the Clearing Corporation and pay-out is directly made to investor's account. In the same manner, units are credited and debited directly from the demat account of the investors by the Clearing Corporation. SEBI has notified that pooling of funds/ units by stock brokers/ clearing members are discontinued for mutual fund transactions.[68]

The online platforms offered by stock exchanges such as NSE Mutual Fund Platform (NMF II) and BSE StAr Mutual Fund are available to SEBI Registered Investment Advisors (RIAs) to purchase and redeem mutual fund units directly from Mutual Fund/Asset Management Companies on behalf of their clients, including direct plans.

In order to further increase the reach of these platforms, SEBI has allowed investors to directly access infrastructure of the recognised stock exchanges to purchase and redeem mutual fund units directly from Mutual Fund/ Asset Management Companies.[69]

Some advantages of investing in mutual funds through stock exchanges include:

- Independent view of customer's entire portfolio at one place;
- Reduction of paperwork and ensuing errors;
- Reduction of redundancy in process and data duplication at RTA and Distributor levels;
- De-risking mutual fund settlement processes by using superior Delivery v/s Payment (DVP) process provided by Stock Exchanges;
- Extending present convenience available to Secondary market investors to mutual fund investors; and

11.9 Holding Units in Dematerialized Form

Mutual fund investors can choose to hold units in dematerialized form. The choice to hold units in demat mode is provided in the subscription form and the ISIN for each option of each scheme is quoted in the statement of account sent to the investors. This applies to new units purchased by investors as well as existing units represented by the statement of account. Once the units are held in demat mode, for redemption and all profile changes such as nomination, bank account, contact details etc. the investor is required to contact his DP. The RTA/AMC will use the details available in the DP account of the investor.

All schemes of Alternative Investment Funds (AIF) are mandated to hold their investments in dematerialized form w.e.f. October 1, 2024.

[68] SEBI Circular No.: SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/635 dated October 4, 2021 on Discontinuation of usage of pool accounts for transactions in units of Mutual Funds on the Stock Exchange Platforms.

[69] SEBI Circular No. SEBI/HO/MRD1/DSAP/CIR/P/2020/29 on Facilitating transaction in Mutual Fund schemes through the Stock Exchange Infrastructure dated February 26, 2020.

11.10 Role of RTA in Tax Computation

- **Tax Deducted at Source (TDS) on Capital Gains for Non-Resident Indians (NRI)**

TDS is applicable for redemptions by NRIs. An RTA will check the residential status of each redemption application and flag the NRI applications for TDS. After the NRI application is flagged, capital gains are determined. The tax liability is determined based on holding period (long term or short term capital gains) and type of scheme (debt or equity).

- **Tax Deducted at Source (TDS) on Dividend (IDCW)**

The Finance Act 2020 has mandated that Dividends (IDCW) from Mutual Funds to be taxed in the hands of the investors. Earlier, dividends were tax free in the hands of the investor and Dividend Distribution Tax (DDT) was applicable.

For resident Indians, TDS is applicable at 10 percent for all dividends, both in equity and debt schemes. Dividend income (in respect of units of a mutual fund) below Rs. 5,000 in a financial year is exempt from TDS. In case, PAN is not available or is not submitted, the TDS rate shall be 20 percent.

For non-resident Indians (NRIs), TDS shall be at 20 percent of the dividend (IDCW) amount.

As the RTAs maintain detailed records of all transactions of the customers, they help in determining the applicability of TDS.

If PAN is not linked with Aadhaar, higher TDS will get attracted.

- **Securities Transaction Tax (STT)**

Securities Transaction Tax (STT) refers to the tax that has to be paid at the time of redemption or switch to other schemes or sale of units of equity oriented mutual funds, whether sold on stock exchange or otherwise. Concessional (lower) rate of tax is paid on Equity Mutual Funds since they are subject to Securities Transaction Tax (STT). STT is not applicable on purchase of units of an equity scheme. It is also not applicable to transactions in debt and liquid funds. The STT amount must be shown separately in the Statement of Account issued to the investor. STT applicability for investors in equity oriented mutual funds is provided in Table 11.2.

Table 11.2: STT applicability for Investors in Equity oriented Mutual funds

Transaction	Rates (in percent)	Payable by
Purchase of units of equity oriented mutual funds	NIL	Purchaser
Sale of units of equity oriented mutual fund (delivery based)	0.001	Seller

Transaction	Rates (in percent)	Payable by
Sale of equity shares, units of business trust, units of equity oriented mutual fund (non delivery based)	0.025	Seller
Sale of units of an equity oriented mutual fund to the mutual fund	0.001	Seller

The RTA shall ensure correct deduction of STT applicable for the defined set of schemes and for the applicable transactions. RTA, then share the STT registers to the respective MF/ AMCs for onward remittance to the relevant government authorities.

Stamp duty is payable at the rate of 0.005% (Rs 5 per lakh) is applicable to all mutual fund transactions since July 2020. This includes any new investments made in mutual fund schemes, whether they are equity, debt funds, or exchange-traded funds, and regardless of the mode of investment, be it SIPs or STPs. It's important to note that this duty is only imposed on the purchase of new mutual fund units and does not apply when selling or redeeming existing units. The RTA will ensure that the stamp duty amount is shown separately in the account statement and also ensure collection of the same from investors and deposit to Government.

11.11 Reporting Requirements to Central Board of Direct Taxes (CBDT)

- **Foreign Account Tax Compliance Act (FATCA)**

The Foreign Account Tax Compliance Act (FATCA) is a US law that aims to combat tax evasion by US persons opening accounts offshore. It enhances due diligence and information reporting requirements for both individual and entity accounts. On July 9, 2015, India signed Inter-Governmental Agreement (IGA) with the USA for implementation of FATCA i.e. the Indian financial institutions will provide the necessary information to Indian tax authorities, which will then be transmitted to USA automatically. Investors are required to provide FATCA declaration and inform Fund House whenever the status changes.

- **Common Reporting Standards (CRS)**

The G20 and Organisation of Economic Development (OECD) countries have together developed a Common Reporting Standard (CRS) on Automatic Exchange of Information (AEOI). The CRS on AEOI requires the financial institutions of the “source” jurisdiction to collect and report information to their tax authorities about account holders “resident” in other countries, such information having to be transmitted “automatically’ annually. CRS aims at easy and quick information sharing to help combat tax evasion.

In India, the Central Board of Direct Taxes (CBDT) is the nodal agency for all tax related compliances and exchange of information between governments. The RTA shall provide all relevant information in the necessary format to CBDT and flag any non- compliant investor folios for necessary action.

RTA facilitates the data after identification of reportable accounts, reports the same to AMC in unloadable format in CBDT Reporting portal. In any DQR (Data Quality Report) raised by CBDT, AMC will download and share with RTA for necessary. RTA will review and support AMC in submission of revised statements as may be required.

- **Statement of Financial Transactions (SFT)**

As per section 285BA of the Income Tax Act, specified entities are required to furnish a statement of financial transaction or reportable account in respect of specified financial transactions or any reportable account registered/recorded/maintained by them during the financial year to the income-tax authority or such other prescribed authority. Thus, on basis of the information provided by certain prescribed entities in statement of financial transaction or reportable account, the Income-tax Department keeps a track of specified financial transactions carried on by a person during the year.

A trustee of a Mutual Fund or such other person managing the affairs of the Mutual Fund are required to report details of receipt from any person of an amount aggregating to Rs. 10 lakh or more in a financial year for acquiring units of one or more schemes of a Mutual Fund (other than the amount received on account of transfer from one scheme to another scheme of that Mutual Fund) to the Income Tax authority. RTA, on behalf of the AMC, facilitates the data in the reportable format for upload into CBDT reporting portal.

Independently, MFRTAs are mandated to submit Statement of Financial Transactions (SFT-081) which encompasses transactions attracting capital gains to CBDT through the defined mechanism.

- **Centralization of Certifications under FATCA and CRS**

SEBI has mandated that intermediaries who are Reporting Financial Institutions (RFI), shall upload the FATCA CRA certifications obtained from clients onto the system of KRAs w.e.f. July 1, 2024. Further, existing certifications obtained prior to July 1, 2024 shall be uploaded within 90 days from July 1, 2024.

Chapter 11: Sample Questions

1. During the New Fund Offer (NFO) the investors buy mutual fund units at:

a. **NFO Price**
b. NAV
c. Market Price

2. Details of the unit capital required for calculating Net Asset Value (NAV) is provided by _____.

a. Trustees of Asset Management Company
b. SEBI
c. **Registrar and Transfer Agent**
d. AMFI

3. On-going purchases and redemptions of open ended funds have to be based on which of the following?

a. Cost Price
b. Unit Price
c. **Net Asset Value**

4. With respect to Securities Transaction Tax (STT), which of the following statements are TRUE?

I. STT is not applicable on purchase of units of an equity mutual fund scheme
II. STT is not applicable on transactions of debt and liquid schemes
III. STT is applicable on sale transactions of an equity scheme

a. I only
b. II only
c. I and III only
d. **I, II and III**

5. A segregated portfolio can be created only if the _____ has specific provisions allowing for the same.

a. Statement of Additional Information (SAI)
b. **Scheme Information Document (SID)**
c. Fact sheet
d. Trust Deed

12 Investors in Mutual Funds

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Types of Investors in Mutual Funds
- PAN and KYC norms for investing in mutual funds
- eKYC, KRA and cKYCR
- Documents Required by Different Types of Investors for new folio creation
- Nomination and Power of Attorney
- FATCA and CRS compliance

There are two broad categories of investors in a mutual fund: individual investors and institutional investors. The investment process and the documentation details are different for both these categories.

12.1 Individual Investors

These investors invest for their personal benefit or benefit of their family. Following are the types of individual investors:

1. Resident Indian adult individuals - Investors above 18 years of age, invest either singly or jointly (maximum 3 holders).
2. Minors - An individual investor, who is under 18 years of age, can invest through their parents/Legal guardians.
3. Hindu Undivided Family (HUF) - HUF is an Indian structure where the pool of money belonging to a family, is managed by a designated member of the family, identified as 'karta'. Transactions on behalf of HUF are done by the karta, in his name. He indicates that he is acting on behalf of HUF, by writing the "HUF" alongside his name.
4. Non Resident Indian (NRI)/ Person of Indian Origin (PIO) resident abroad - Indian citizens, who are working abroad, and their family residing abroad, are typical NRIs. A PIO is an individual whose spouse, parent or grandparent is an Indian citizen or an NRI.
5. Foreign Investors - Foreign nationals who meet KYC requirements may invest in equity schemes floated by domestic mutual funds.

Unless specifically mentioned as non-resident, all individual investors are assumed to be resident. The Finance Act, 2020 substituted the provisions for determination of residential status with effect from Assessment Year 2021-22. The residential status of an Individual is

determined on basis of his citizenship, period of stay in India and total income from Indian sources.[70]

12.2 Institutional Investors

The following are the various types of institutional investors who invest in mutual funds in India:

1. Private and Public Companies - These are companies set up under the Indian Companies Act, and have the Memorandum of Association (MoA) and Articles of Association (AoA) which lay out their objectives and functions. They are governed by their Board of Directors.
2. Partnership Firms - These are firms set up by individuals who are partners coming together under a partnership deed.
3. Association of Persons (AoP) - These are associations set up by individuals to undertake a set of activities as defined by their charter.
4. Societies and Trusts - These are organisations that pool-in individual contributions and manage them according to set objectives. Trusts and societies can be set up for social, religious, and educational purposes.
5. Banks and Financial Institutions (FIs) - Banks are set up under the Banking Regulations Act. Financial institutions are either set up by an Act or as corporations.
6. Foreign Portfolio Investors (FPIs) – FPIs are foreign institutions that are permitted to invest in the Indian securities markets after having obtained registration as Foreign Portfolio Investor (FPI) from SEBI.
7. Overseas Corporate Bodies (OCBs) - OCBs are organisations formed by NRIs, or entities in which majority stake is held by NRIs. OCBs are currently prohibited from investing in Indian mutual funds.

12.3 Investor Information and Documentations

12.3.1 Individual Investors

Individual investors investing in mutual funds are required to provide the following information when they invest in mutual funds:

<u>Name</u>

Name of the investor is used to identify the person in whose name the investment has been made. In a mutual fund, the beneficiary is the person who is holding the folio. Name should

[70] https://www.incometaxindia.gov.in/Tutorials/9.%20Non-resident.pdf (as amended by Finance Act)

be quoted as per PAN card as it is being validated with Income Tax database. If the response from the Income Tax database returned as Not matched, transactions may get rejected.

Signature

Signature is the identity of the investor in the records of the mutual fund. It is verified for every transaction. All valid transactions should carry the signature of the investor.

Joint holders

An application can have up to three joint holders. They may decide to operate their investments jointly or on either or survivor basis. All joint holders' signatures are captured in the R&T system irrespective of the mode of operation.

Address for correspondence

The address of the investor is to enable physical identification of the investor's location. Therefore, post box numbers are not accepted. In case of an NRI investor, overseas address is required. Address of the first holder is the address for correspondence in the investor records.

- **Minors**

An individual investor whose age is less than 18 years on the date of investment is a **minor** investor. If the application is made in the name of the minor, date of birth has to be compulsorily provided along with supporting documents.

Minors are not legally authorised to enter into contracts on their own behalf, or issue cheques to third parties. Therefore the financial transactions of minors are conducted by their guardian on their behalf.

Guardians have to provide all details, as if they are investing in the mutual fund themselves. Guardian's PAN is provided and the guardian must undergo the KYC process. Guardians are also required to sign the application form and payment instruments on behalf of the minors.

SEBI, in its circular, prescribed a uniform process to be followed by all AMCs in respect of the investments made in the name of minor through a guardian.[71] The regulator has allowed payment for investment, by means of cheque, demand draft or any other mode, to be

[71] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2019/166 on Investment in units of Mutual Funds in the name of minor through guardian and ease of process for transmission of units dated December 24, 2019.

accepted from the bank account of the minor or from a joint account of the minor with the guardian only. For existing folios, the AMCs should insist upon a change of pay-out bank mandate before redemption is processed. Irrespective of the source of payment for subscription, all redemption proceeds shall be credited to a bank account in name of the minor.[72]

- **Non Resident Indian (NRI) Investors**

An NRI can invest in mutual funds only from an NRE or NRO bank account. The Non-Resident External Rupee (NRE) account is a rupee account from which money can be sent back to the country of your residence and the Non-Resident Ordinary Rupee (NRO) account is a non-repatriable rupee account.

An NRI investor, in addition to their normal KYC documents, needs to provide a copy of their passport and overseas address proof to complete their KYC process. Indian PAN is necessary for investments by an NRI.

- **Hindu Undivided Family (HUF)**

A Hindu Undivided Family (HUF) consists of persons descended from a common ancestor. The HUF is represented by the head of the family known as Karta.

For investment by an HUF, the following documents are required:

- PAN Card of HUF and Karta,
- HUF deed mentioning details of all members of the HUF such as date of birth, gender, PAN etc;
- Cheque from bank account in name of the HUF only.

12.3.2 Corporate

In case of investment by a Corporate, the following additional documents are needed:

- Copy of Memorandum and Articles of Association, clearly highlighting that such investment is permissible;
- Board resolution for the investment
- List of Signatories and Operating Instructions
- KYC documents for all Authorized Signatories

[72] SEBI/HO/IMD/POD-II/CIR/2023/0069 dated May 12, 2023

12.4 Know Your Customer (KYC) Norms

In order to ensure that illegal funds are not routed into Indian markets, the government has promulgated the Prevention of Money Laundering Act (PMLA). According to this Act, the identity of those entering into financial transactions must be known and verified. The procedure to do this is now known as KYC (Know Your Customer) norms.

KYC norms apply to opening bank accounts, trading accounts, mutual fund accounts, demat accounts and all such financial relationships. Proof of identity of the customer, and proof of residence are verified to comply with KYC norms.

Proof of identity

Permanent Account Number (PAN) is an identification number issued by the Income Tax authority. PAN has been notified as the single identification number for all financial market transactions. PAN card with photograph is mandatory for all applicants except those who are specifically exempt from obtaining PAN. Investments (including SIPs and lump sum investments) in Mutual Fund schemes upto Rs.50,000 per investor per year per mutual fund are exempt from PAN requirement. Investors have to give an undertaking to this effect and provide an alternate photo identity such as the Aadhaar card, Passport, Voter's Id, Driving License or other photo-identity card which serve as the proof of identity.

The registered intermediaries verifies the PAN of their clients online at the Income Tax website without insisting on the original or copy of PAN card.

Registered intermediaries at the time of commencement of an account-based relationship shall identify their clients, verify their identity and obtain information on the purpose and intended nature of the business relationship.

The name as mentioned in the KYC form shall match the name as mentioned in the Proof of Identity (PoI) submitted.

Providing PAN details is compulsory for all mutual fund investments. However, there are some PAN exempt mutual fund investments. See Box 12.1 for details:

Box 12.1: PAN exempt Investments in Mutual Funds

The following mutual fund investments are exempt from providing PAN:

- Micro-SIPs i.e. SIPs where annual investment (12 month rolling or April-March financial year) does not exceed Rs 50,000.
- Small investors making lumpsum investment upto Rs. 50,000 per mutual fund per financial year.

Rs. 50,000 is a composite limit for the small investor's Micro-SIP and lump sum investments together.

Investment by individuals, minors and sole-proprietary firms within the limits specified above are exempted from the requirement of PAN card. However, the KYC norms have to be complied with a SEBI registered KRA. Investors must quote the PAN Exempt KYC Reference Number (PEKRN) issued by the KRA and submit a copy of the letter along with the application form.

Instead of the PAN, the investors (including joint holders) can submit other photo identification documents such as Aadhaar Card, Voter's Id etc. for KYC verification. However, there is no threshold amount limit for the following exempted categories:

- Investors residing in the state of Sikkim,
- UN entities / multilateral agencies exempt from paying taxes / filing tax returns in India, etc.
- Investments on behalf of Government undertakings

Proof of address

The following documents shall be accepted as PoI: Officially valid document (OVD) defined as per Rule 2 (d) of Prevention of Money-Laundering (Maintenance of Records) Rules, 2005 (PML Rules):

- the passport
- the driving licence
- proof of possession of Aadhaar number
- the Voter's Identity Card issued by Election Commission of India
- job card issued by NREGA duly signed by an officer of the State Government
- the letter issued by the National Population Register containing details of name address; or any other document as notified by the Central Government in consultation with the Regulator.

Further, in terms of proviso to the above Rule, where simplified measures are applied for verifying the identity of the clients, the following documents shall also be deemed to be officially valid document:

- Identity card/ document with applicant's photo, issued by the Central/State Government Departments, Statutory/Regulatory Authorities, Public Sector Undertakings, Scheduled Commercial Banks and Public Financial Institutions.
- Letter issued by a gazetted officer, with a duly attested photograph of the person.

Further, in terms of Rule 9(18) of PML rules, 2005, in case the officially valid document furnished by the client does not contain updated address, the following documents (or their equivalent e-documents thereof) shall be as deemed to be officially valid document for the limited purpose of proof of address, provided that the client shall submit updated officially valid document (or their equivalent e-documents thereof) with current address within a period of three months of submitting the following documents:

utility bill which is not more than two months old of any service provider (electricity, telephone, post-paid mobile phone, piped gas, water bill);

- property or municipal tax receipt
- pension or family pension payment orders (PPOs) issued to retired employees by Government Departments or Public Sector Undertakings, if they contain the address;
- letter of allotment of accommodation from employer issued by state or central government departments, statutory or regulatory bodies, public sector undertakings, scheduled commercial banks, financial institutions and listed companies and leave and licence agreements with such employers allotting official accommodation.

If communication and permanent addresses are different, then documentary proofs have to be provided for both. The proof of address in the name of the spouse may be accepted.

The copies of the documents (proof of identity and proof of address) produced, have to be self-attested and the originals have to be provided for verification purpose. In case, the originals are not produced for verification then the copies of the documents must be attested by persons authorized to do so.

SEBI has mandated a uniform KYC procedure for mutual funds, brokers, depository participants, portfolio managers and venture capital funds. The investors can undergo the KYC process with any of the above intermediaries and it will be applicable for their transactions with the other intermediaries too. Investors have to complete the KYC form in two parts. Part I requires personal information to be provided and proof of address and identity given along with self-attested supporting documents. Additional information required by an intermediary

is provided in Part II. The information for KYC is uploaded by the intermediary onto the system provided by a centralized agency called the KYC Registration Agency (KRA). The KRA will maintain the information and make it available to the intermediaries.

12.4.1 eKYC

eKYC is a paper-less Aadhaar based process for fulfilling KYC requirement to start investing in Mutual Funds (MFs). SEBI has allowed Aadhaar based KYC to be used for MF investments, for the convenience of investors. Some of the AMCs, KFintech and CAMS on their websites have facilitated eKYC for investors in MFs.

The regular KYC process requires submission of KYC form with investor signature and additional documents for identity and address proof. In person verification (IPV) and sighting the original documents needs to be completed by a competent person. eKYC completely eliminates paperwork and IPV to complete the KYC process. Government of India has notified various reporting entities (approved by UIDAI and SEBI) as a KYC User Agency (KUA) to accept investor's Aadhaar number and complete KYC Verification with one-time password (OTP). These registered KUAs can further allow SEBI registered intermediaries and mutual fund distributors as sub-KUA to undertake Aadhaar authentication of their clients for the purpose of KYC.[73] The list of entities eligible to work as sub-KUAs are notified by Government of India. Such entities need to enter into an agreement with the KUAs and register themselves with UIDAI as sub-KUAs.[74]

Investor can visit the websites of the registered KUAs to get the process initiated. He needs Aadhaar number, PAN number and personal details such as mobile number and email-id, registered with UIDAI. Mobile number is mandatory. He can authenticate himself by receiving OTP on the registered mobile number. PAN of such client is to be verified from the income tax website.

SEBI has provided guidance to restrict investments to Rs. 50,000 per annum per MF and payment for the same is made through electronic transfer from the client's bank account registered with that Mutual Fund for OTP based KYC. However, in case of investments greater that Rs. 50,000 per annum per MF, the investor needs to do IPV or biometric-based authentication. That can be done through a distributor or at any office of CAMS/ KFintech.

SEBI has also mandated an In Person Verification (IPV) of the client to be conducted by the intermediary with whom the KYC is being done. However, SEBI has exempted conduct of an IPV in the following cases:[75]

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[73] Vide SEBI Circular No.: SEBI/HO/MIRSD/DOP/CIR/P/2020/80 dated May 12, 2020 and SEBI Circular No.: SEBI/HO/MIRSD/DOP/CIR/P/2020/167 dated September 8, 2020.

[74] SEBI Circular No.: SEBI/HO/MIRSD/SEC-5/P/CIR/2022/99 dated July 20, 2022 on Entities allowed to use e-KYC Aadhaar Authentication services of UIDAI in Securities Market as sub-KUA.

[75] SEBI Circular No.: SEBI/HO/MIRSD/DOP/CIR/P/2020/73 dated April 24, 2020.

- IPV/ Video IPV would not be required when the KYC of the investor is completed using the Aadhaar authentication / verification of UIDAI.
- IPV/ Video IPV shall not be required by the registered intermediaries when the KYC form has been submitted online, documents have been provided through Digi locker or any other source which could be verified online.

Use of Technology to facilitate online KYC[76]

Constant technology evolution in the financial markets and introduction of innovative platforms has allowed investors to complete KYC process online. In order to make the online KYC facility robust, SEBI has issued various circulars and guidelines from time to time. The following facilities have been allowed by SEBI to induce ease of doing business in securities markets:

i. eSign service can facilitate an Aadhaar holder to forward the KYC documents after digitally signing the same. The eSign mechanism of Aadhaar shall be accepted in lieu of wet signature on the documents provided by the investor. Even the cropped signature affixed on the online KYC form under eSign shall also be accepted as valid signature.
ii. Investor's KYC can be completed through online / App based KYC, in-person verification through video, online submission of Officially Valid Document (OVD) / other documents under eSign.

12.4.2 KYC Registration Agencies (KRA)

KYC once completed, is valid across mutual funds and all the other SEBI-registered intermediaries (i.e. across capital market). KYC information is maintained by KYC Registration Agencies (KRA). SEBI has mandated that KRAs to share data and information with other KRAs through inter-operability process (IOP) and in t urn to all SEBI registered intermediaries (SRIs) so that retail investors are not inconvenienced in the KYC documentation. Further KRAs may share information with other market regulators such as RBI, IRDAI, PFRDA if the respective regulators notifies so.

SEBI has also allowed KRAs to independently validate records of clients whose KYC have been completed using Aadhaar. KRAs shall validate the clients' details through (a) UIDAI for Aadhaar, (b) OTP for mobile number and email id (wherever quoted by the investor) or based on successful delivery status of Email/SMS and (c) Income Tax database for PAN. On successful completion of KYC validation, and update the KYC status. PAN is used as KYC identifier and the same may be used by the clients for account opening with any other intermediary,

[76] SEBI Circular No.: SEBI/HO/MIRSD/DOP/CIR/P/2020/73 dated April 24, 2020.

without repeating the KYC process.[77] Provided KYC is completed using Aadhaar as OVD. If all KYC attributes gets validated, KYC status will be updated as KYC Validated.

In case of Non-Aadhaar is used as OVD, since Name and address could not be validated against source data, KYC status for such records will be KYC Registered and can transact only with the existing Funds.

As per SEBI 14-May-24 circular, PAN-Aadhaar linkage is disconnected from ascertaining the KYC status. Clients in whose case, PAN Aadhaar linkage are not found to be verified, shall be allowed to transact with the existing intermediary subject to valid PAN, however the client's KYC shall not be allowed portability in securities market.

As a part of the Risk Management framework, KRAs shall verify PAN, Name and Address within the prescribed time of receipt of the relevant records from the investor. Additionally, the KRA shall verify the mobile number and email ID. Clients whose details cannot be verified will not be allowed to transact further until the details are duly verified. For clients whose details are verified, they do not have to undergo KYC process again when dealing with different intermediaries.[78]

12.4.3 Central KYC Registry (CKYCR)[79]

Vide Notification dated November 26, 2015, the Government of India authorised the Central Registry of Securitisation and Asset Reconstruction and Security Interest of India (CERSAI) to act as and to perform the functions of the Central KYC Registry (CKYCR) under the PML Rules 2005, including receiving, storing, safeguarding and retrieving the KYC records in digital form of all the clients in the financial sector.[80]

To get CKYC done, one may approach a financial intermediary regulated by RBI, SEBI, IRDAI or PFRDA like a bank, a NBFC, a stock broker, AMC, a distributor or an Insurance company.

The KYC template finalised by CERSAI has to be used by the registered intermediaries for opening account for individuals. The registered intermediaries shall upload the KYC data with Central KYC Records Registry (CKYCR) in respect of all individual accounts opened on or after August 1, 2016 where KYC is required to be carried out as per the circulars issued by SEBI from time to time. Also, the registered intermediaries should upload KYC records pertaining to the accounts of the individuals opened prior to August 1, 2016 as and when updated KYC information is received from the clients.

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[77] SEBI Circular No.: SEBI/HO/MIRSD/DoP/P/CIR/2022/46 dated April 6, 2022 on Guidelines in pursuance of amendment to SEBI KYC Registration Agency (KRA) Regulations, 2011.

[78] SEBI/HO/MIRSD/FATF/P/CIR/2023/0144

[79] SEBI Circular No.: SEBI/HO/MIRSD/DOP/CIR/P/2021/31 dated March 10, 2021.

[80] Client as defined in clause (ha) sub section (1) of Section 2 of the Prevention of Money Laundering Act, 2002 dated November 2015.

As the CKYCR facility is fully operational for individual clients, SEBI further has rolled out the implementation of CKYCR for Legal Entity (LE) accounts opened on or after April 2021. The registered intermediaries shall ensure that in case of LE accounts opened prior to April 1, 2021, the KYC records are uploaded on to CKYCR when the updated KYC information is obtained/received from the client.

CKYCR shall process the KYC records received from a reporting entity for de-duplication and issue a unique KYC Identifier for each client to the reporting entity. Where an investor submits a KYC Identifier to a registered intermediary, providing consent to download records from CKYCR, then such intermediary shall retrieve the KYC records online from CKYCR using the KYC Identifier and the investor shall not be required to submit the same KYC records or information or any other additional identification documents or details, unless there is a change in the information of the investor as existing in the records of CKYCR.

12.5 Power of Attorney

Individual investors can empower someone they trust, to do transactions on their behalf. This is done by executing a Power of Attorney (PoA). This facility is mostly used by NRIs who are unable to manage their investments staying in a foreign country.

Since minors cannot enter into valid contracts, there is no question of a PoA for a minor. The guardian plays a role similar to a PoA holder acting on behalf of the minor.

A Power of Attorney (PoA) has two parties – the grantor who is the primary investor who grants the rights; and the Attorney (or holder of PoA) who is authorised to execute an agreed set of actions on behalf of the grantor.

PoA holders usually exercise all the rights of an investor in a mutual fund. They have to be compliant with the requirements of PAN and KYC. They can do normal transactions such as purchase and redemption of units on behalf of the investor. They also operate the bank account of the investor. The rights of the PoA holder are defined in the PoA.

The grantor's signature is recorded in the folio for purposes of verification. The grantor can continue to operate the account even after giving a PoA.

12.6 Nomination[81]

Mutual fund investors can nominate someone to receive the investment proceeds in the event of their death or Opt out of Nomination. Nominees can be minors, in which case, the details of guardian will also have to be provided. First holder in a mutual fund folio cannot be the guardian of a minor nominee for that folio. In case of death of an investor, the MF will transmit the units in favour of the nominee. Nomination can be made in favour of a maximum of ten nominees.

Only individual investors can make a nomination. Investments by minors cannot have a nomination.

A Power of Attorney holder cannot make a nomination. PoA holders are also not authorised to change the nomination details in an investor's folio. They also cannot be a nominee of the original investor.

AMCs and RTAs are expected to encourage investors to complete the "*choice of nomination*" by sending a communication on fortnightly basis and pop-up message can be displayed where nomination is not made or opt-out declaration not submitted.

12.7 FATCA and CRS Compliance

Mutual Fund investors, including guardians, whose country of birth/ citizenship/ nationality/ tax residency is other than India, are required to furnish additional information under Foreign Account Tax Compliance Act (FATCA) and Common Reporting Standards (CRS). The information that is required is:

- Place/ City of Birth, Country of Birth, Country of Citizenship/ Nationality
- Is the investor's Tax Residency/ Country of Birth/ Citizenship/ Nationality other than India (Yes or No)
    - If yes, indicate all countries in which the investor is resident for tax purpose and the associated Tax ID number (Details of Country of Tax Residency and Tax Payer Reference ID).

[81] Candidates are advised to read https://www.sebi.gov.in/legal/circulars/jan-2025/circular-on-revise-and-revamp-nomination-facilities-in-the-indian-securities-market_90698.html

12.8 Investor Charter[82]

SEBI has issued separate investor charters for each of its registered intermediaries, including mutual funds and RTAs. The investor charters detail out the services provided to investors, rights of investors, various activities of MFs/RTAs with timelines, and Grievance Redressal Mechanism.

The rights and responsibilities of investors in mutual fund domain, as stated in the investor charters, are as follows:

Rights of Investors

1. Right to receive information and details about the scheme including about its investment philosophy, risk profile, portfolio holdings, fees, charges and expenses and such other information as may be required under SEBI regulations to enable investors to make an informed decision about investing in a scheme, prior to making any such investment.
2. Right to timely receipt of statements/ reports such as account statements, Consolidated Account Statement (CAS) Annual report / abridged annual report etc.
3. Right to timely disclosure of daily Net Asset Values (NAV), Portfolio and Performance of each scheme including scheme's AUM, investment objective, expense ratios on mutual fund website.
4. Right to timely receipt of redemption proceeds/ dividend (IDCW) payments/ refunds, as applicable.
5. Right to be notified about any change in the fundamental attributes (features) of a mutual fund scheme in which the investor has investments and to be provided a right to exit the scheme without cost, if so desired, as a result of the fundamental attribute change.
6. Right to timely redressal of grievances and complaints and right to escalate unresolved complaints to the SCORES portal.

Responsibilities of Investors

1. To read all scheme related documents and understand the scheme features and the risks involved and suitability of the scheme to the investor's risk profile.
2. To provide and keep updated KYC details including address, tax status, residency, and other key information such as PAN & bank account details.
3. To provide own email address and mobile number and to promptly notify changes to this information, if any.

[82] SEBI Circular Nos.: SEBI/HO/MIRSD/MIRSD_RTAMB/P/CIR/2021/670 dated November 26, 2021 and SEBI/HO/IMD-II/IMD-II_DOF10/P/CIR/2021/00677 dated December 10, 2021 on Investor Charter and disclosure of Investor Complaints.

4. To check Account Statement & Consolidated Account Statements for discrepancy, if any and promptly bring any such discrepancies to the notice of the Asset Management Company.
5. To read communications/ notices/ addendums/ press releases, etc. sent or published by the mutual fund via newspapers, email, etc.
6. To consider availing facility to nominate in respect of investments made in Mutual Funds.
7. To invest through registered and regulated entities and not to invest based on speculation, rumour or informal advice.
8. To keep confidential critical information such as user ID, password, etc.
9. To invest by issuing payments in the name of the Mutual fund/ scheme only and not in the name of any other entity.
10. To protect oneself by not issuing blank cheques or blank signed transaction instructions.
11. To avoid using third-party bank accounts for fund flows for subscription or redemption of units.
12. To ensure that correct and complete Bank details are recorded with RTA to facilitate prompt electronic credit of dividend/ interest/ redemption amounts.
13. To ensure that the documents provided for availing any investor service request are complete in all respects and keep copies of documents sent to the RTA.
14. To not deal with unauthorized persons for any investor service requests such as change in/ updation of address, e-mail id, mobile number and bank details.

12.9 Centralised Mechanism for Reporting the Demise of an Investor

SEBI has mandated a centralised mechanism for reporting the demise of an investor thru KRAs.[83]Once a KRA or other intermediary receives notification of the death of an investor, they are required to obtain the death certificate and PAN of the deceased and verify the same. The verification may be through the website of the issuing authority or in OSV (original seen and verified) mode. After verification of the details, the intermediary shall submit a KYC modification request and block for debit all folios of the deceased investor. Joint accounts or E or S accounts shall be allowed to operate as per the original mandate.

[83] SEBI/HO/OIAE/OIAE_IAD-1/P/CIR/2023/163

Chapter 12: Sample Questions

1. Which of the followings are not allowed to invest in mutual funds in India?
    a. Resident Indian adult investors
    b. Non-Resident Indian investors
    c. Hindu Undivided Family
    d. **Overseas Corporate Body**

2. Institutional investors include:
    a. Public and private companies
    b. Partnership firms and associations of persons
    c. Societies and trusts
    d. **All the options given**

3. In a mutual fund transaction by a minor the PAN details of the _____ has to be given.
    a. Minor
    b. **Guardian**
    c. Distributor
    d. Both Guardian and Distributor

4. _____ cannot be a nominee of a mutual fund investor.
    a. **Power of Attorney holder**
    b. Legal heir
    c. Minor

5. Which of the following are responsibilities of investors in mutual fund domain, as specified under the Investor Charter?
    a. To check Account Statement for discrepancy, if any and promptly bring any such discrepancies to the notice of the Asset Management Company.
    b. To consider availing facility to nominate in respect of investments made in Mutual Funds
    c. To invest by issuing payments in the name of the Mutual fund/ scheme only and not in the name of any other entity.
    d. **All the options given**

13 Banking Operations in Mutual Funds

LEARNING OBJECTIVES:

After studying this chapter, you should know about:

- Different modes of Payments and types of payment instruments
- Different types of bank accounts maintained by mutual funds
- Efficient Clearing Mechanisms
- Role of RTAs in banking operations

13.1 Payment Mechanism

Payments for mutual fund transactions need to be made through the banking channel modes that have been approved by the regulators. The acceptable modes of payments are through online transactions or different payment mechanisms such as cheque, demand draft and cash.

Payments for any mutual fund transactions are, therefore, made in either of the following forms

- Electronic / Online mode
- Physical cheque mode
- Cash Payments with limitations
- E-Wallets with limitations

13.1.1 Electronic/ Online Payments

Electronic payment instruments are modern facilities, where the clearing process need not be initiated by the mutual fund. The investor completes the transfer of funds, and provides the proof of such transfer to the mutual fund. In order to complete the electronic transfer of funds, investors must know the scheme's account details. AMCs provide this information to investors. The electronic payment mode offers variety of options to the investors.

- **National Electronic Funds Transfer (NEFT)**

NEFT is a nation-wide payment system facilitating to move funds electronically from one account to another. On opting transfer of funds through NEFT, they get credited to the transferee account in batch processing. There is no limit imposed by the RBI for funds transfer through NEFT system. However, banks may place amount limits based on their own risk perception. To facilitate and encourage electronic payments, NEFT is available on 24/7 basis on all days of the year. Further, RBI has instructed all banks to waive off all charges for NEFT done from savings bank account w.e.f. January 1, 2020.

- **Real Time Gross Settlement (RTGS)**

RTGS is a facility to move funds electronically on an instant basis. Funds are immediately transferred from one bank to another. RTGS is used for transactions above Rs 2 lakhs, with no upper ceiling. As in case of NEFT, RBI has instructed all banks to waive off charges for RTGS facility too.

- **Auto Debit and Standing Instructions (SI)**

For periodic payments such as Systematic Investment Plans (SIP), investors may issue an auto debit instruction to its bank towards payment to the specified MF scheme. This allows the investors bank to make the payment for specified amount on specified date without repetitive permission or authorisation.

On the specified date, each month, the bank will automatically transfer money from the investor's account to the account of the mutual fund. The bank accepts 'Standing Instructions' (also called 'Direct Debit') if both investor and mutual fund have an account with the same bank.

- **Application Supported by Blocked Amount (ASBA)**

ASBA is a payment facility available to investors for all mutual fund NFOs, launched on or after October 1, 2010. The investor blocks the required sum of money in the bank account to subscribe to the NFO. The investor account gets debited only on allotment of the units. Banks specified by SEBI provide the facility. Mutual Funds/ AMCs shall make all relevant disclosures in this regard in the Statement of Additional Information (SAI).

- **E-wallet**

E-Wallets are a virtual or digital version of the physical wallet. Money is loaded to the E-Wallet and used as required to make payments and transfer funds to other E-Wallets. However, they cannot be used to transfer money to a bank account. Wallets of banks, payment banks and e-commerce platforms are commonly called E-Wallets.

The use of E-Wallets is subject to certain conditions like following regulations pertaining to cut-off timings, time stamping etc. MFs/ AMCs ensure that total subscription through e-wallets for an investor is restricted to Rs.50,000 per investor per financial year. This limit of Rs.50,000 is an umbrella limit for investments by an investor through both E-Wallet and/or cash, per mutual fund per financial year. MFs/ AMCs shall ensure that only amounts loaded into e-wallet through cash or debit card or net banking, can be used for subscription to MF schemes. Any amount loaded into e-wallet through credit card, cash back, promotional

scheme etc. are not allowed for subscription to MF schemes. Also, no third-party transactions are allowed through e-wallets. It should be ensured that all e-wallets are fully compliant with KYC norms as prescribed by RBI.[84]

Digital payments such as Net Banking, Debit cards, Unified Payment Interface (UPI) are amongst the accepted modes of payments for mutual fund schemes currently.

13.1.2 Physical Payments

Investors may use payment instruments like cheques and demand drafts for purchasing mutual fund units.

- **Cheque**

Payments through cheques differ in terms of how the funds are collected from the payer's account into the beneficiary's account. This transfer usually involves more than one bank, or more than one branch of the same bank, and sometimes a centralized clearing agency.

i. Transfer Cheque: If the investor holds accounts in the same bank as that of the mutual fund, then the cheque only involves a transfer of funds within the same bank.
ii. Local Cheque: If the investor's account is with another bank but in the same city, the collecting bank will have to go through the local clearing house, to get the cheque collected.
iii. Outstation Cheque: If the paying bank account is located in another city, the cheque will have to go through two clearing houses at two different locations. These are not accepted now as it impacts the NAV applicability as realization takes time.

Most banks offer multi-city cheques or at par cheques facility to their preferred or current account customers. At par implies that the instrument is as good as drawn on any other branch of the same bank. An at-par cheque is a local cheque when presented at any of the bank's branches and goes into local clearing. In modern banking, there is no practical difference between a local cheque and outstation cheque.

With the introduction of the Cheque Truncation System (CTS), physical cheques do not move between locations for clearing, instead cheque images of requisite quality move in the CTS processing cycle.

[84] SEBI/HO/IMD/IMD-PoD-2/P/CIR/2023/40 DATED march 23, 2023

Third-Party Cheques

A cheque issued by any person other than the investor of the mutual fund investment is a third-party cheque.

Any cheque which is issued from the bank account where 1st holder/applicant is not one of the account holders, is considered as third party cheque Demand Drafts

In cases where mutual funds are unable to reach investors in certain locations and are unable to provide for a branch or Investor Service Centres (ISC), they accept Demand Drafts (DDs) and also bear the charges upto the amount as may be specified in SAI. Demand drafts have to be payable on any bank in the nearest ISC or mutual fund branch's clearing area. It is sent by the collection bank for local clearing.

13.1.3 Cash Payments

Investors have the option of investing in mutual funds through cash, to the extent of Rs. 50,000 per investor per mutual fund per financial year. Only resident individuals, sole proprietorships and minors (through their guardians), who are KYC compliant, can make cash investments. It may be further noted that, mutual funds do not accept cash (beyond the specified limits), money orders or out-station cheques.

Although investment can be made in cash, repayments in the form of redemptions, dividend payments, etc. can be paid only through banking channel. The pay-out bank details have to be provided by the investor in the application form.

13.2 Third Party Verification (TPV) and Payment to Valid Account[85]

For mitigating the risks of third-party payments, the RTAs are required to validate the transactions while accepting/ processing of the investment as per the following:

1. This validation for physical applications would be done with any one of them:
    a. 'Penny drop' facility or PAN based account validation facility provided by NPCI.
    b. Original cancelled cheque with name and matching the name with the investor name
    c. Self-certified copy of cheque/passbook, verified with the original by AMC / RTA, which matches the investor name

[85] SEBI Circular Nos.: SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/634 dated October 4, 2021, SEBI/HO/IMD/IMD-I DOF5/P/CIR/2021/635 dated October 4, 2021 and SEBI/HO/IMD/IMD-I DOF5/P/CIR/2022/29 dated March 15, 2022.

2. RTA/AMC shall make sure that the investment amount is accepted through only such modes where independent traceability of end investor can be ensured, and source account details are readily available.
3. For each of the amounts collected through one-time mandate (OTM) and transferred to an Approved Account, the Payment Aggregator (PA) shall provide the bank account number, remitter name, etc. to the respective AMC.
4. For other modes of payment instruments, including net-banking, AMC and PA shall permit payments only from banks which provide real time account validation or banks which provide source bank account information as a reverse feed, not later than the day following the date of payment by investor.
5. In case funds are received from a bank account that is not verified and registered in the investor folio; and such bank account cannot be verified as belonging to the investor, then the subscription transaction shall be rejected and the amount so collected shall be refunded to the same bank account from where the PA had collected the funds.
6. Detailed information at each stage of the relevant transaction, including rejection, shall be made available at the same time to all the stakeholders involved in the transactions, as applicable, including investors, RTAs, MFDs, IAs, etc.
7. Payment Aggregators (PA) shall provide access to the relevant documentations to a third-party auditor appointed by AMC/ AMFI to verify compliance with the provisions of the AMFI guidelines on process for mitigating risks of co-mingling of funds at the level of payment aggregator and payment gateway, including crediting of the Approved Accounts. AMFI may require such audits to be carried out at least on an annual basis or at such other frequencies as may be specified by the AMFI.
8. Redemption proceeds shall be credited only to a verified bank mandate. AMC/ RTAs shall ensure that payment is credited directly to the registered and verified bank account of the investor mapped with the concerned folio, after due verification. The process carried out by AMC/ RTAs to verify bank account details i.e. investor name, bank account number, bank name, etc. shall be available as audit trail.
9. In case of subscription or redemption of units, Two-Factor Authentication (2FA) (for online transactions) and signature method (for offline transactions) shall be used for authentication. One of the Factors for such Two-Factor Authentication for non-demat redemption shall be a One-Time Password sent to the unitholder at his/ her email/ phone number registered with the AMC. In case of demat redemption, process of authentication as laid down by the Depositories shall be followed.[86] Two factor authentication was earlier required only for redemption. w.e.f April 1, 2023 two factor authentication is also required for subscription transactions. For SIP and other recurring transactions, two factor authentication shall be applicable only at the time of registration of such recurring mandate.

[86] SEBI/HO/IMD/IMD-1 DOF1/P/CIR/2022/132

13.3 Bank Accounts maintained by Mutual Funds

A mutual fund scheme has several bank accounts through which it receives and pays out money for various purposes. The types of accounts maintained are as under:

- Collection Accounts are maintained to receive investments into schemes from investors.
- Investment Accounts are maintained by the custodian bank, to settle securities transactions.
- Redemption Accounts are specifically funded to pay-out investors.
- Expense Accounts are used to meet regular fund running expenses.

A mutual fund does not keep money in the bank accounts idle. Idle funds do not earn any return. At the same time, it is also important to make all payments that become due, on time. Mutual funds therefore need to manage their cash balances efficiently. Banks enable mutual funds to efficiently use their cash balances by providing a facility called Cash Management Service (CMS).

A mutual fund scheme may appoint one or more collecting bankers. The names of such banks and their branches are listed in the new fund offer (NFO) application form. Since the NFO price applies uniformly to all purchases during the NFO period, there is no time stamping requirement. Therefore, the branches of the collecting bank are also available for collecting NFO applications and payment instruments.

Investors use various payment options offered by the banking system for buying mutual fund units. These payment instruments collected at ISCs and AMC offices are also deposited into the collecting bank. Deposit into the collecting bank account is done by using manual pay-in slips or pay-in slips generated from the system using scheme CMS codes.

The collecting banks provide a CMS code for each scheme. Its bank branches upload the soft copy of the pay-in details into its CMS. The collecting banker notifies the AMC and the R&T agent about the status of the deposited instrument.

The functions of collecting bankers are as follows:

- They collect payment instruments through the clearing process to realise the funds paid by the investors.

- They provide reverse feeds showing the cleared or bounced status of the instruments.
- The NFO collecting bankers accept NFO applications. After the NFO, they provide a 'collections confirmation certificate'. The bank's collection figures are reconciled with the R&T agent's records before allotting units to investors.

13.4 Electronic Clearing Mechanisms

13.4.1 NPCI and NACH

National Payments Corporation of India (NPCI) is an umbrella organization for all retail payments and settlement system in India. It was set up with the guidance and support of the Reserve Bank of India (RBI) and Indian Banks' Association (IBA).

The core objective is to consolidate and integrate the multiple systems with varying service levels into nation-wide uniform and standard business process for all retail payment systems. The other objective was to facilitate an affordable payment mechanism to benefit the common man across the country and help financial inclusion.

NPCI was incorporated as a Section 25 Company in December 2008. The aim is to create infrastructure of large dimension and operate on high volumes resulting in payment services at a fraction of the present cost structure.

National Automated Clearing House (NACH) is a centralised clearing system launched by the National Payments Corporation of India (NPCI). NACH aims to replace and consolidate multiple existing Electronic Clearing Service (ECS) systems across India and create a faster and more efficient clearing platform. It is a web-based solution for Banks, Financial Institutions, Corporate and Governments, to facilitate interbank high-volume electronic transactions which are repetitive and periodic in nature. This has been introduced in place of ECS for repetitive payments. NACH have same day presentation and settlement, including returns processing.

The various facilities offered by NACH include standardisation and digitisation of mandates, overall simplification, reduction of operational cost, and minimisation of activation time. Existing ECS mandates are now been moved to the NACH platform, in partnership with the participating banks. However, no intervention from investors will be necessary in this regard.

The service is now active in all Indian banks with core banking facility. It comes in two variants – NACH Credit and NACH Debit. The significant benefits to bank customers include automatic debits from their account for bill payments (telephone, electricity, etc), loan instalments,

insurance premiums, SIPs and more. Not only this, NACH is useful for corporate and financial institutions that make payments in bulk like dividend distributions, salaries, interests, pensions, etc.

13.4.2 Cheque Truncation System (CTS)

CTS is a project of the Reserve Bank of India (RBI), commenced in 2010, for faster clearing of cheques. Cheque truncation means stopping the flow of the physical cheques issued by a drawer to the drawee branch. Instead of the physical instrument, an electronic image of the cheque is sent to the drawee bank for payment. This eliminates the need to move the physical instruments across branches resulting in an effective reduction in the time required for payment of cheques, the associated cost of transit and delays in processing, etc., thus speeding up the process of collection or realization of cheques.

13.5 Role of Registrars and Transfer Agents (RTAs) in Banking Operations

RTAs play an important role in banking operations for mutual fund transactions. It helps in efficient handling of cheque receipt or return, reconciliations and verification of cut-off time for NAV applicability.

In case of electronic payments made by investors for purchasing mutual fund units, RTA is required to reconcile the receipt of funds with the applications and highlight discrepancies, if any, in the same. If any mismatch is found, the transaction is flagged as 'Not in Good Order' (NIGO) and units are not issued to the investors. When payments are made through physical payment modes such as cheque, the RTA sends the payment instruments for clearing in stipulated time and to reconcile the same for cheque return. The RTA ensures that units are not issued to any investors in case of cheque return.

For Liquid funds, RTA has to ensure that clear funds are available at the time of allotment of units. For redemptions and dividend (IDCW) pay-outs, RTA ensures that the payee details are captured properly in the system for electronic payment; where electronic payments are not possible, RTA issues payment instruments and sends the same to the investor through registered mail.

Chapter 13: Sample Questions

1. Redemption proceeds from mutual fund schemes are received through which of the following?
    a. Cash
    b. Bank transfers
    c. Cheques
    d. **Bank transfers or cheques**

2. Which of the following payment modes is accepted for investing in a mutual fund?
    a. Cash
    b. Demand Draft
    c. Bank Transfer
    d. **All of these options**

3. _____ is an electronic fund transfer method that moves funds instantaneously.
    a. Standing Instruction
    b. Bank mandate
    c. **RTGS**
    d. Bearer cheque

4. National Automated Clearing House (NACH) is used by retail investors for _____.
    a. **Systematic Investment Plans (SIP)**
    b. One-time lump-sum investments

5. Mutual Fund transactions with discrepancy between purchase applications and payment receipts are tagged as "NIGO'. What does NIGO stand for?

    a. Not in General Order
    b. **Not in Good Order**
    c. New Investor Generated Option
    d. Negative Inflow Gross Order

14 Financial Transactions

LEARNING OBJECTIVES:

After studying this chapter, you should know about the mechanism and processes related to financial transactions in case of mutual funds:

- Application form and Transaction slip
- Purchase and Redemption Cycle
- Statement of Accounts and Consolidated Account Statement
- Concepts of Entry and Exit Load
- Switches and Systemic Transactions
- Timelines for Various Financial Transactions
- Role of RTA in Calculation of Commission

Mutual funds involve large number of financial transactions on daily basis. These are:

- Purchases by investors (fresh/ additional)
- Redemptions (repurchases) and Switchovers
- Dividend pay-outs (Pay-out of Income Distribution cum Capital Withdrawal)
- Payment of commission to the mutual fund distributors
- Systematic Registrations

14.1 Application Form Vs Transaction Slip

Application Form

The application form provides required information about an investor of a mutual fund. The information captured in the application form is entered in the RTA records. The investor is then assigned a folio number by the AMC. A folio is like a bank account number, created for a fund house and its investors. Investors can hold units under multiple schemes of a fund house, in a folio.

An investor fills out the details in the application form and signs it. In order to verify subsequent transactions from the investor, the investor's signature is scanned and maintained in the RTA system. For subsequent purchase transactions, if the folio number is quoted, several fields in an application form need not be filled up again.

The fields in the application form are largely standardized across mutual funds, because of the mandatory information requirement. There are however, minor differences in the presentation, detail and font sizes. Some of the fields in the application form are mandatory,

for the application to be correct and complete. The application form should then be checked and validated for these fields before accepting it.

The following are mandatory fields:

- Investor status in terms of resident/non-resident
- Details of bank account (pay-in and pay-out)
- Complete address of first holder
- Date of birth and guardian details for minors with documentary proof for DOB and relationship
- PAN/PEKRN details
- Signature of applicants
- scheme, plan and option

Nomination or declaration of Opted Out

Other declarations such as FATCA/CRS, UBO, NPO

Declaration on Email/Mobile relating to.

Any other documents mandated by SEBI/AMFI/SID from time to time

Transaction Slip

The application form is designed to capture all investor information for the first time. Investors can use a transaction slip for subsequent transactions. A transaction slip has the pre-printed folio number to identify the investor in the system.

The transaction slip is designed to capture multiple transaction type requests. Investors use it for carrying out redemptions, additional purchases, switches and even non-financial transactions such as change of address or change of bank details. It has to be signed according to the mode of holding of the folio, to be valid.

Most AMCs provide transaction slip as a counterfoil to the account statement sent to the investor. The transaction slip has the folio number and account number of the investor, pre-printed. An investor can either use a pre-printed transaction slip form or he can use a blank transaction slip, which is available with AMC branches, distributors and ISCs and write the folio number in the space provided.

14.2 Purchase Transactions

Mutual fund units can be purchased during NFO or after the scheme opens for on-going offer (if open-ended) after allotment of NFO units. When a new investor applies for units either during NFO or during continuous offer, it is called fresh purchase. Fresh purchases are made

by investors by submitting an application form, complete in all respects along with the payment instruments. When a payment instrument is received it has to be ensured that: (a) scheme name is mentioned on the instrument, and is same as on the application form; (b) short name or abbreviation used for scheme name is one of valid alternatives as per offer document/AMC instructions; (c) the cheque date is current or valid (not stale or more than 3 months old); (d) the cheque is not post-dated; (e) amount in words and figures matches with the investment amount; (f) cheque is signed by the investor/ guardian in case of a minor investor; (g) cheque is not mutilated.

After the fresh purchase, every subsequent purchase by the unit holder is called additional purchase. Additional units can be purchased by using a transaction slip. An existing investor may decide to make additional purchases under a new folio. This will be considered as fresh purchase.

The various steps involved in a purchase transaction are:

- Investor transaction is accepted by ISCs/AMC
- Transaction is intimated to RTA back office
- Units are added (purchase) on realisation of funds or reduced (redemption) in the folio of investors
- Inflow and outflow resulting from transactions is reported to the AMC Treasury
- Units issued and redeemed for the day are consolidated
- Unit capital is updated for increase/decrease due the transactions
- Unit capital is communicated to AMC fund accounts
- Portfolio is valued by fund accounts/custodian
- NAV computation is done using the portfolio value and updated unit capital
- NAV is communicated to RTA for applying to investor transactions

14.2.1 Entry Load

Entry load is a percentage of the NAV of the unit. In an NFO, load is charged as percentage of the face value. Entry load increases the price at which an investor buys units. Hence, for the same amount invested, units allotted to investors paying a load are lesser, as compared to units allotted without load.

It may be noted that SEBI has abolished entry load vide its circular SEBI/IMD/CIR No. 4/ 168230/09 applicable from August 1, 2009. However, the candidate should be familiar with the concept.

14.3 Redemptions and IDCW (dividend) payouts

After the NFO, when a scheme re-opens, the continuous offer is for both purchase and redemption of units. Redemption refers to investors' request to return their investments in a fund.

In case of open-ended funds, on redemption, the units are extinguished or cancelled and are not re-issued. Redemption alters the unit capital of an open ended scheme. Therefore, outstanding unit capital is communicated by the RTAs, after processing all purchase and redemption transactions for every business day.

In case of closed-end funds, redemption of units happens only on the maturity date of the scheme. Redemption may be allowed during specified periods under the Interval Funds before maturity date or at a cost as specified in the offer document.

Investors can specify the redemption of units held in a folio either in terms of number of units or as amount in rupees. Where redemption is specified in amount, the investor must ensure that the value of their holding is sufficient to meet the amount.

Investors can redeem all or part of the units in a folio; or they can redeem all or part of the amount in the folio. The redemption request has to be equal to or more than the minimum amount or units specified in the offer document. Mutual funds may specify the minimum balance to be maintained in a folio after redemption.

Mutual fund investors are required to indicate in the application form, their preference for receiving redemption proceeds. The proceeds can be paid by cheque or through direct credit as indicated. As per SEBI mandate, the account holder's bank account and bank details have to be printed on the redemption cheques, to prevent fraudulent encashment. PAN card is compulsory for all redemption transactions.

Redemption cheques drawn are payable to the first holder in a folio. Mutual funds cannot issue third party payments. If the AMC's paying bank is not present in the location where the investor is, redemption proceeds are paid by demand draft. If the investor redeems units purchased on multiple dates, redemption will be made on a ‘first-in-first-out’ basis.

AMCs may also use instruments or payment channels such as RTGS, NEFT, IMPS, direct credit, etc. or any other mode allowed by RBI from time to time, for payments including refunds to unitholders in addition to the cheque, demand draft or dividend warrants.[87]
Redemption proceeds have to paid to unit holder within the time stipulated by SEBI. Dividends have to paid to investors within the time stipulated by SEBI.[88] Delays attract a 15 percent p.a. penal interest to be paid by the AMC.

However, Instant Access Facility (IAF) helps credit of redemption proceeds in the bank account of the investor on the same day of redemption request, subject to prescribed limits. IAF is offered for Overnight and Liquid schemes of the mutual funds for resident individual investors only through the website or mobile app of the AMC

Redemption proceeds have to be paid to NRI investors as per the RBI regulations in force. The general rule to remember is that redemption payments have to be paid according to the source of funds of the purchase transaction.

Those investments that have been made from NRE or FCNR accounts or by remittance of foreign exchange from abroad can be paid on a repatriation basis. If the investor mandates, such payment can be made into a non-repatriable account. If the investment has been made from a rupee account, or an NRO account, redemption cannot be paid into a repatriable account. Capital gains arising on redemption have to be deducted at source for NRI investors.

14.3.1 Exit Load

Exit load has the effect of reducing the redemption price for the investor. If the investor has specified the redemption in unit terms, the redemption value comes down because of the load.

For example, at a NAV of Rs. 20 per unit, redeeming 1000 units will get the investor Rs. 20,000. However, if the exit load is 1 percent, the redemption price is Rs. (20 - 0.20) = Rs. 19.80. Therefore, the redemption proceeds are Rs. 19,800 for 1000 units.

If the amount to be redeemed is specified, the number of units that has to be redeemed goes up after applying the exit load.

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[87] SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2021/024 dated March 4, 2021.

[88] SEBI/HO/IMD/IMD-DOF2/P/CIR/2022/161 dated November 25, 2022 (Redemption proceeds have to paid to unit holder within 3 working days (earlier 10 working days). Dividends have to paid to investors within seven working days from the record date.) Candidates are advised to read the latest circular for the latest stipulated time period.

In the above example, the investor has to redeem 1010.10 units to get a redemption amount of Rs. 20,000. Loads are charged to investors at the discretion of the AMC and are mentioned in the offer document. However, they are subject to an overall limit imposed by SEBI. SEBI does not permit exit loads to be charged on the basis of the type of investor. AMCs cannot have differential exit load structure for different types of investors or based on transaction amount. All investors must be treated equally in regard to exit loads.

14.4 Account Statements for Investments

14.4.1 Statement of Accounts (SoA)

Statement of Accounts (SoA) is a proof of investment for the investor. A SoA is sent when an investor makes a fresh purchase transaction. The amount, price, and units are shown. For subsequent transactions, apart from these details, the balance units in the folio and their current market value are also shown in the SoA. RTA on behalf of mutual funds, despatch SoAs to investors, whenever there is a transaction in a folio.

As per SEBI regulations, the dispatch date should not be later than 5 working days from the date of the transaction. In case of NFOs, the SoA has to be sent within 5 working days of closure of NFO/ or from the date of receipt of the request from the unit holders. Statement of Accounts (SoA) is issued every month if there is a transaction in a folio during the month. If there are no transactions in a folio in a six month period, a SoA will be sent annually, giving the latest closing balance. Alternately, soft-copy of the account statements is sent to the investors' registered e-mail address, instead of physical statement, if so mandated.

In case of systematic transactions, mutual funds dispatch the SoAs to the unit holders once every quarter ending March, June, September and December within 10 working days of the end of the respective quarter. The first SoA is, however, issued within 10 working days of the initial transaction.

Mutual funds also provide SoAs to unit holders within 5 working days, without any charges, if specific requests are received from the investors. Further, if so mandated, a soft copy of the SoA is sent through e-mail to the unit holders on a monthly basis.

14.4.2 Consolidated Account Statement (CAS)

Pursuant to the Interim Budget announcement in 2014 to create one record for all financial assets of every individual, AMCs/ RTAs share the requisite information with the Depositories on monthly basis to enable generation of CAS. The depositories and the AMCs/ RTAs have put

in place systems to facilitate generation and dispatch of single CAS for investors having mutual fund investments and holding demat accounts.

Consolidation of account statements are done on the basis of PAN. In case of multiple holding, PAN of the first holder and pattern of holding are considered. Based on the PANs provided by the AMCs/RTAs, the Depositories match their PAN database to determine the common PANs and allocate the PANs among themselves for the purpose of sending CAS. For PANs which are common between depositories and AMCs, the Depositories send the CAS. In other cases (i.e. PANs with no demat account and only MF units holding), the AMCs/ RTAs continue to send the CAS to their unit holders.

If there is any transaction in any of the demat accounts of the investor or in any of his mutual fund folios, then CAS shall be sent to that investor through email on monthly basis. In case there is no transaction in any of the mutual fund and demat accounts then CAS with holding details shall be sent to the investors by email on half yearly basis. In respect of half-yearly CAS, the AMCs/MF-RTAs shall provide the data with respect to the common PANs to the depositories on or before eighth(8th) day of April and October every year. The depositories shall then consolidate and dispatch the CAS to investors that have opted for delivery via electronic mode, on or before the eighteenth (18th) day of April and October and to investors that have opted for delivery via physical mode, on or before the twenty-first (21st) day of April and October. However, where an investor does not wish to receive CAS through email, option shall be given to the investor to receive the CAS in physical form at the address registered with the Depositories and the AMCs/MF-RTAs. [89]

A proper grievance redressal mechanism is put in place by the depositories and the AMCs/RTAs and details of the same are communicated to the investors through CAS. AMCs/RTAs are accountable for the authenticity of the information provided through CAS in respect of MF investments and timely sharing of such information with Depositories. The Depositories are responsible for the timely dispatch of CAS to the investors serviced by them and the demat account information.

If an investor does not wish to receive CAS from Depositories, an option is given to the investor to indicate negative consent. Where such an option is exercised, the concerned depository informs the AMC/RTA accordingly and the data with respect to the said investor is not shared by the AMC/RTA with the depository.

[89] SEBI Circular Ref No. SEBI/HO/MRD/PoD1/CIR/P/2025/16 dated February 14, 2025 https://www.sebi.gov.in/legal/circulars/feb-2025/revised-timelines-for-issuance-of-consolidated-account-statement-cas-by-depositories_91927.html

RTAs also issue a consolidated account statement covering all mutual fund investments of an investor, across all AMCs, across all RTAs. Investors can also get a consolidated statement of account for all family members having common email ID.

14.5 Switch

A switch is a redemption and purchase transaction rolled into one. A redeeming scheme is called source scheme from which money is switched out; the purchasing scheme is called target scheme, into which the money is switched in. This is known as inter scheme switch. Switch can also be done from one option to another. An investor who has chosen a growth option can switch to a pay-out of income distribution cum capital withdrawal option, for example.[90] A switch saves both time and effort for an investor.

The following are steps an investor would have to normally take to move funds from one scheme to the other:

- Fill a redemption request and submit it (Day T)
- Receive redemption cheque and deposit it in bank (Day T+3/T+4)
- Receive cleared funds in bank account (Day T+5)
- Fill a purchase request for the desired scheme and submit with a cheque (Day T+5)

The above steps spread across five days can be crunched into a single transaction in switch request. The transaction will be put through by the RTA in the books and the funds will be credited to the scheme's account.

AMCs may or may not charge loads to switch transactions. Generally, no exit load is charged for switching within options of the same scheme. For inter-scheme switching, the AMC may specify an independent load structure, which may differ based on the nature of the source scheme and the target scheme, whether it is liquid, equity, or debt fund.

Switch transactions always have two legs – the switch-out leg and the switch-in leg. Switch-out leg is treated as redemption and switch-in leg is treated as purchase. Both options are processed at the respective applicable NAV of the scheme.

The procedure to determine the applicable NAV for switch transactions is similar to the process for individual purchase and redemption transactions.

[90] Dividend payout options have been renamed as 'Payout of income distribution cum capital withdrawal option' effective April 1, 2021.

Switch is a facility that is allowed to investors for ease of transactions. However, each switch transaction is subject to long term / short term capital gains in the hands of the investor based on holding period and type of scheme.

14.6 Systematic Transactions

Mutual funds offer its investors systematic transaction facilities. Systematic Transactions are of three types:

- Systematic Investment Plan (SIP)
- Systematic Transfer Plan (STP)
- Systematic Withdrawal Plan (SWP)

The systematic transactions are executed at the applicable NAV (*discussed in Unit 11*) on the date of transaction. In case of transfers, each leg of the transfer (redemption and purchase) are executed at the applicable NAV for each scheme.

14.6.1 Systematic Investment Plan (SIP)

Most mutual funds offer the investors Systematic Investment Plan (SIP), a facility to make periodic or recurring purchases in mutual fund schemes. SIP is like a recurring deposit with a mutual fund. SIP can be viewed as a series of purchase transactions. SIP serves the purpose of accumulation and growth of capital.

The difference between SIP and a regular purchase transaction are as follows (Table 14.1):

Table 14.1: Comparison between Lump-sum Mutual Fund Investment and Systematic Investment Plan

Feature	Regular/ Lump-sum Mutual Fund Investment	Systematic Investment Plan
Minimum Investment	Usually Rs 5000	Usually Rs 500
Entry Load	Abolished by SEBI effective from August 1, 2009.	
Payment Mode	Valid cheque on investment date, electronic payment modes.	Post-dated cheques or electronic transfer options on a set of future dates.
Account Statement	Within 5 working days of investment.	It would be part of CAS. Mutual funds may choose to send email

Feature	Regular/ Lump-sum Mutual Fund Investment	Systematic Investment Plan
		statement after every instalment as an additional feature but not mandatory.

Investors commit a periodic investment over a chosen length of time. AMCs offer specific intervals in which SIP investments can be made and the period or tenure of the SIP. These can be monthly, quarterly, half yearly or annual. SIPs are to be made on specific dates, for example - 5th, 15th or 25th of a month. SIPs can be committed for six months, one year, or even more as defined by the AMC.

An investor can invest over a year by selecting a date, for example 15th of the month, and invest Rs. 1000 each, on the 15th of every month for the entire year. SIPs can be made along with an NFO. The first instalment is at the NFO purchase price and is allotted like an NFO. The second instalment begins after the scheme reopens for purchase transactions.

14.6.2 Systematic Withdrawal Plan (SWP) and Systematic Transfer Plan (STP)

Mutual funds also offer investors systematic withdrawal plans and systematic transfer plans.

Systematic Withdrawal Plan (SWP) is a facility for periodic or recurring redemptions. This facility allows unit holders to withdraw sums from an existing scheme at periodic intervals.

Systematic Transfer Plan (STP) is a facility for periodic redemption from one scheme and investment into another scheme of the same fund. STP allows unit holders to transfer fixed sums from an existing scheme to another scheme of the same mutual fund at specified intervals.

STP is used either as a variation of SIP or to periodically book profits. SWP is usually used by retired persons to get a regular income.

Unit holders can redeem or purchase units at the Applicable NAV on the respective SWP/ STP dates. However, if any of the dates on which the redemption / transfer is sought is a non-business day, the units are redeemed at the Applicable NAV of the next business day.

Some funds give investors the choice of withdrawing or transferring a fixed sum over a defined period. This is known as the **fixed option**. Under this option, a unit holder withdraws or switches a fixed amount of not less than the minimum from his unit account.

Investors can also opt for withdrawing or transferring only the appreciation on the investment. This is known as the **appreciation option**. Under this option, a unit holder withdraws or switches an amount equal to the periodic appreciation on the original investment. A unit holder can redeem or switch only proportionate number of units, which when multiplied by the applicable NAV equals the appreciation in the investment over the last period.

Some funds also provide the facility of determining the amount to be switched from one scheme to another based on the pre-defined target value of the scheme to which funds are being transferred. In a **transfer of income distribution cum capital withdrawal plan**, investors are given the option of automatically transferring the dividend (IDCW) declared in a source scheme to an identified target scheme.[91]

14.7 Turn-around-times for various Financial Transactions with Mutual Funds

SEBI has mandated timelines for various transactions. These are summarized in Table 14.2 below:

Table 14.2: Turn-around-times for various investor transactions with Mutual Funds

Service provided by Mutual Funds	Turn-Around-Time (TAT)
NAV Calculation and disclosure for post NFO	On a daily basis[92]
Mutual Fund Schemes NFLO (other than ELSS) to remain open for subscription	Maximum of 15 days
Mutual Fund Schemes to allot units or refund Money in case of NFO	Within 5 business days of closure of NFOs[93]
Re-opening for ongoing sale/re-purchase of open ended scheme (other than ELSS)- NFO	Within 5 business days of allotment
Dispatch of Dividend (IDCW) payments to investors	Within 15 days from the record date[94]
Dispatch of Redemption/re-purchase cheques to Investors	Within 3 working days from the date of receipt of transaction request. In case of overseas funds, it should be dispatched within 5 business days.

[91] Dividend transfer plans have been renamed as 'Transfer of income distribution cum capital withdrawal plan' effective from April 1, 2021.

[92] This should be disclosed on the website of AMFI and the mutual fund. Mutual Funds/AMC's shall extend facility of sending latest available NAVs to unitholders through SMS, upon receiving a specific request in this regard.

[93] In the event of delays in refunds (in case of NFOs), investors need to be paid interest at the rate of 15 percent p.a. for the period of the delay. This interest cannot be charged to the scheme.

[94] Vide SEBI (Mutual Funds) (Amendment) Regulations, 2021 effective from March 5, 2021.

Service provided by Mutual Funds	Turn-Around-Time (TAT)
	AMFI has specified additional timelines in specific circumstances.
Unit certificate	To be issued within 5 working days of the receipt of request for the certificate. For close ended schemes, units in demat form to be issued to unitholders within 2 working days of the receipt of request from unitholders.
Despatch of Statement of Accounts (SoA):	
NFO/ ongoing transactions (other than systematic transactions)	Within 5 working days from the date of transaction
Initial systematic transactions: SIP / STP / SWP	Within 10 working days
Ongoing systematic transactions: SIP/STP/SWP	It will be part of CAS
On specific request by investors in systematic transactions	It will be dispatched to investor within 5 working days without any cost.

14.8 Role of RTA in Commission Payment

RTA has a significant role in Commission payment to distributors. Some of the activities where an RTA is involved are to:

- Determine average assets for payment of trail commission
- Transaction charges deduction and payments, wherever applicable
- Determine if a transaction sourced from T-30 or B-30 locations based on pin codes
- Determine claw backs and reversals, if any
- Determine inflows from SIP transactions made by new investors to the mutual fund industry, identified by PAN, for calculating the amount of upfront trail commission payable to distributors

As per SEBI guidelines, mutual funds are required to adopt full trail model of commission in all schemes, without payment of any upfront commission or upfronting of any trail commission. However, upfronting of trail commission is allowed only in case of inflows through SIPs. Upfronting of trail commission means payment of expected future trail commission upfront at the time of the transaction.[95]

[95] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2018/137 on Total Expense Ratio (TER) and Performance Disclosure for Mutual Funds dated October 22, 2018.

The upfronting of trail commissions, based on SIP inflows, shall be up to 1 percent payable yearly in advance, for a maximum period of three years. Implementation of this, therefore, requires system integration at RTA's end.

The following carve out to be implemented by the AMCs:[96]

- The upfronting of trail commission is applicable for SIP of up to Rs. 3000 per month, per scheme, for an investor who is investing for the first time in Mutual Fund schemes.
- For a new investor, as identified above, only the first SIP(s) purchased by the investor shall be eligible for upfronting. In this regard, if multiple SIP(s) are purchased on different dates, the SIP(s) in respect of which the instalment starts on the earliest date shall be considered for upfronting.
- The upfront trail commission to be paid from AMC's books.
- The said commission to be amortized on daily basis to the scheme over the period for which the payment has been made. A complete audit trail of upfronting of trail commissions from the AMC's books and amortization of the same to scheme(s) thereafter to be made available for inspection.
- The said commission will be charged to the scheme as 'commissions' and should also account for computing the TER differential between regular and direct plans in each scheme.
- The commission paid to be recovered on pro-rata basis from the distributors, if the SIP is not continued for the period for which the commission is paid.

[96] Vide SEBI Circular No.: SEBI/HO/IMD/DF2/CIR/P/2019/42 on Review on Commission, Expenses, Disclosure norms etc. - Mutual Fund dated March 25, 2019.

Chapter 14: Sample Questions

1. The application form for a fresh purchase of mutual fund units has to be signed by _____.
    a. First holder
    b. First and second holder
    c. **All joint holders**

2. A transaction slip is usually used when the investor knows _____.
    a. **His own folio number**
    b. Scheme name
    c. Scheme bank account
    d. Scheme collecting bank

3. Information provided by a mutual fund investor in an application form is recorded by _____ under the allotted folio number.
    a. Collecting bank
    b. **R&T agents**
    c. Distributor
    d. AMC staff

4. Exit load has the effect of _____ the redemption amount for the investors.
    a. **Reducing**
    b. Increasing
    c. Equalising
    d. Distributing

5. Investors can redeem their mutual fund units at a price based on the _____.
    a. Unit cost price
    b. **Net Asset Value**
    c. Unit face value
    d. Unit paid up value

15 Non-Financial Transactions

LEARNING OBJECTIVES:

After studying this chapter, you should know how different non-financial transactions relating to mutual funds are carried out. These relate to:

- Changes in Investor Details
- Registration of Nominee/ Power of Attorney
- Transmission of Units
- Change in Investment Option of a scheme
- Investor Grievance Redressal Mechanisms
- Value Added Services provided by RTAs

Investors may need to update or change the personal information given to the mutual fund. Address for communication, bank details, and change in status among others, may require change from time to time. These transactions are non-financial transactions. They do not have a financial or NAV implication.

An investor becomes a unit holder of a mutual fund after buying units of the fund. Investors provide general information about themselves in the application form at the time of purchase. The registrar and transfer agent (RTA) capture the contact address, bank account details, status, plan or option chosen and all other relevant information. The R&T agent links the information given in the application to the folio allotted to the investor. In other words, folio number is a unique identification number that helps R&T agent recognise an investor.

15.1 Change in Name (Individual Investors)

Investors may request a change of name under which they have invested in a mutual fund scheme. Common cases for change of name are change of first/ middle name, women changing their maiden name due to marriage, change in name due to divorce etc. In such cases, investors must submit a letter requesting the change along with the following documents, as the case may be:

- Self-attested copy of PAN card in the new name
- KYC confirmation or acknowledgement copy in the new name
- Name change certificate by a regulatory authority
- Gazette Notification towards name change duly Notarized

- Copy of Marriage Certificate duly verified and attested by Notary
- Copy of court order regarding divorce duly Notarized
- Details of the Folio
- Signature of the account holder (the unit holder whose name is being changed must sign with the old signature and the new signature)
- Bank account details with the new name incorporated (name change to be documented in bank before change request in MF folio)

15.2 Change of Address

Investors provide their address and contact details in the application form during the first purchase. R&T agent captures this information and maintains it. The statement of account (SoA) and other statutory communication goes to the address for communication mentioned by the investor.

Change of address request for folios that are KRA compliant will not be registered by the fund, and investor should get the address updated with KRA first. Investors may request a change of address or contact details only by applying to the KRA by using a KYC update form, where they will provide their new address. They should mention their PAN details and the new address. They also have to submit documentary proof for the change of address.

After updating the new address in the records, the KRA communicates the change in address to the R&T agents, who will update all the folios of the investor, across mutual funds, using the PAN as the identification for the investor.

For non KYC folios, self-attested proof of address and PAN Card (or any other proof of identity for PAN exempt cases only) are to be submitted for change request at AMC offices or Investor Service Centres of RTAs.

15.3 Change of Bank Details

It is mandatory to provide details of investor's bank account at the time of investing in a mutual fund. As per SEBI regulations, dividend (IDCW) and redemptions are payable only to the investor's bank accounts registered with RTA. RTAs must make effort to directly credit the same to Investors' bank account; if direct credit is not possible, investor bank account details should be printed on the payment instrument.

Investors may register multiple bank accounts and indicate the default account into which the redemption proceeds should be paid. An individual investor can register upto 5 bank accounts with a mutual fund and a non-individual investor can register upto 10 bank accounts. They can add and delete from the list of registered bank accounts. Investors may request a change in the bank details either at the time of a redemption or otherwise through the prescribed format for change in bank details.

Investors should provide the complete details of the bank account for the Change of Bank request to be valid. This includes bank name, branch name, MICR (where applicable), IFSC code (where applicable), account number and type of account. The investor should also submit a bank mandate form along with either a cancelled blank cheque leaf or self-attested copy of bank statement/ passbook (not older than 3 months) or bank's letter certifying bank account details, duly signed by bank manager/ authorised person of bank to enable verification of the bank details. The normal practice is for the AMC to do a test transaction of Re. 1/- to validate the bank details.

In addition to the above documents, investors may also require to submit cancelled cheque leaf/ bank statement etc. of the old bank account. This helps to ascertain the authenticity of the service request. Whenever any change of bank mandate request is received simultaneously with, or just prior to submission of a redemption request, mutual funds / RTAs allow a cooling period of 10 days as a precautionary measure against unauthorized/ fraudulent transactions.

15.4 Change in/ Updation of Other Details

- **Contact details (e-mail id/ Mobile number)**

An email id or a mobile number can be registered in folios of only one investor (PAN). In case a customer wishes to change his/her contact details i.e. email ID or mobile number, the investor is required to give a simple application for the same. Such application should be signed by all joint holders. RTA and AMC website also provide a form that the investor may use for the same. Further, if an email id or mobile number belongs to a family member needs to be registered, then "Family Declaration" needs to be submitted by the investor. The facility to change the contact details may be provided on AMC/RTA website. However, if the investor desires to change both Email ID and Mobile number together, a cooling period of 10 days is required to be followed between change of both values.

- **Permanent Account Number (PAN)**

Investors need to compulsorily provide their PAN information in their mutual fund folios to be able to redeem their investments. Investors can update PAN details in their folio either on

the website of mutual fund or physically submit PAN details along with the updated PAN copy to the mutual fund's office or Investor Service Centres (ISCs). RTAs provide online facilities to provide PAN details in folios where PAN information is not available or to update the information. Investors are required to upload a self-attested copy of PAN of all the unit holders. RTA validates the signature against their records before updating the PAN information. This process needs to be followed individually for each mutual fund in which the investor holds investments. It must be ensured that Name in the folio should match with the Name as per Income Tax database and it should be Valid as per Income Tax database.

15.5 Minor becoming Major

In case of a minor unit holder becoming a major, customers (who have attained majority) should first obtain new PAN card, complete KYC process with KRA through the intermediary and update information with the Bank. The AMC may be informed of the change after above steps are completed.

The minor, upon attaining the status of major, is required to provide all the KYC details, updated bank account details, including cancelled original cheque leaf of the new account. No further transactions are allowed till the status of the minor is updated to major in the records of the AMC.

15.6 Registration of Power of Attorney (PoA)

An investor can register the power of attorney (PoA) either at the time of opening a fresh mutual fund folio or in his existing mutual fund folio.

- **PoA in fresh mutual fund folio**: The investor is required to provide the name of the PoA holder in the application form along with PAN and KYC details of the PoA holder and notarized copy of PoA.
- **PoA in existing mutual fund folio**: Investors can register PoA by giving separate letter with details of PoA holder and request to register the POA in the folio. The investor is required to submit a copy of PAN card, KYC details of the PoA holder along with the notarized PoA.

The PoA document must carry the signature of the designated PoA holder. PoA without signature of PoA holder is not accepted.

Once this PoA registration is accepted in the folio, the PoA holder can start transacting on behalf of the investor. Cancelling PoA can be done by giving a letter to the respective mutual fund company. Both the PoA registration and cancellation will be reflected on the account statement as a non-financial transaction.

15.7 Registration of Nominee[97]

An investor may appoint a nominee for his investments in case of his death. A few salient points need to be kept in mind:

- Nomination facility is available for individual investors only. Nomination facility is not available for non-individuals such as corporate, Trust, HUF, Minors etc.
- Investors can nominate up to 10 Nominees in the account/folio.
- Investor shall mandatorily provide any one of the following—PAN or Driving Licence number or last 4 digits of Aadhar (only document number is required, not the document). Also, full contact details of the nominee(s) residential address, e-mail, relationship of nominee with the investor and date of birth of the nominee (if minor) is required.
- POA holder(s) cannot nominate.
- Minor may be a nominee. In that case, a guardian must also be mentioned to manage the investments on behalf of the nominee.
- An investor may change nominee as and when required.
- Appointment and change of nominee will reflect as a non-financial transaction in the account statement.
- If a single investor does not wish to appoint a nominee, they must give a specific declaration for the same.
- In case of death of the investor, nominee/claimant is required to complete his/her KYC and submit a request for transmission of units. Once the units are transmitted to the nominee/claimant, he/she may redeem the same or continue the investment.
- The rights in the units will rest in the Nominee(s) only upon death of all unit holders.
- In case of investors opting to hold the Units in demat form, the nomination details provided by the investor to the depository participant will be applicable.
- The nominees(s) shall receive the assets of deceased sole account/sole holder(s) as trustee on behalf of legal heir(s) of deceased holder(s) thereby effecting due discharge of concerned regulated entity.
- Legal heir(s) of nominee shall not be eligible to inherit the assets of the investor if the nominee predeceases the investor.
- Upon demise of one of the nominees prior to the demise of the investor and if no change is made in the nomination, then the assets shall be distributed to the surviving nominees on pro rata basis upon demise of the investor.
- In case of any subsisting credit facilities secured by a duly created pledge, the regulated entity shall obtain due discharge from the creditors prior to transmission of assets to the nominee(s) or legal heir/s / legal representative/s, as the case may be.
- Nomination shall be mandatory for single holding only. The requirement of nomination shall be optional for jointly held accounts / folios.

[97] Candidates are advised to read the detailed circular : https://www.sebi.gov.in/legal/circulars/jan-2025/circular-on-revise-and-revamp-nomination-facilities-in-the-indian-securities-market_90698.html

- Regulated entities shall provide acknowledgement to the investor for each and every instance, irrespective of the mode of nomination. They shall maintain physical or electronic records, as the case may be, of the nomination, its acknowledgement etc. for a period of eight years after transmission of the folio/ account.
- Regulated entities shall provide in their periodic statement of holding, either the a) name(s) of the nominee(s) or b) whether or not nomination has been made by the investor – Y/N. The aforesaid shall be as per the choice of the investor.
- In case the investor specifies multiple nominees, then he / she shall also specify the percentage share for each nominee. In absence of such specification, the regulated entity shall apportionment the assets equally among all the nominees. In case of demise of the investor and any one of the nominees, the regulated entities shall distribute the assets pro rata to the remaining nominees.
- Nominee to act on behalf of incapacitated investors
    - empower, any one of the nominees (excluding minor nominee) to operate the investor's account / folio, if the investor is physical incapacitated, but still has the capacity to contract,
    - specify either the percentage or absolute value of assets in the account/ folio that can be encashed by such nominee,
    - change such mandate any number of times without any restriction.

SEBI has mandated that all individual MF investors are required to either (a) declare nominee(s) for their folios or (b) opt-out of nomination through a signed declaration.[98] The nomination form or the declaration form for opting out of nomination, as the case may be, can be submitted either in physical or online mode. The physical forms should carry the wet signatures of all the unitholders. In case of online option, instead of wet signature(s) of all the unitholder(s), AMCs shall validate the forms:

- digital signature certificate or
- Aadhar based e-Sign or by using e-Sign facility recognized under Information Technology Act, 2000; or
- through two factor authentication (2FA) in which one of the factor shall be a One-Time Password sent to the unitholder at his/her email/ phone number registered with the AMC.

In absence of nomination, the regulated entity shall transmit the assets in the account / folio to either the legal heir(s) or legal representative(s) of the holders as per the rules of intestate succession or as per the Will of the latter, as the case may be, after following the prescribed procedure.

[98] SEBI Circular Nos.: SEBI/HO/OIAE/OIAE_IAD-3/P/ON/2025/01650 dated January 10, 2025 Revise and Revamp Nomination Facilities in the Indian Securities Market.

15.8 Pledge and Lien Marking

Mutual Fund units may be offered as collateral for various types of loans. In such cases, the borrower/ unit holder write a letter to the AMCs/ RTAs requesting to pledge the units in favour of the lender. The unit holder provides the details such as the folio number, the scheme and the number of units for which lien has to be marked. The RTA records the event and marks a lien in favour of the lender. However, the amount of loan and other terms of the loan are a commercial agreement between the borrower and the lender and RTA/ AMC have no role to play in the same. Once lien is marked, the units cannot be redeemed by the investor/ borrower without a no objection certificate (NOC) issued by the lender. The lien may be removed at the request of the lender only. In case the borrower is unable to pay the loan, the lender may "invoke" the pledge and have the units transmitted in their favour. In case of death of an investor, rights of the lender / lien holder supersede the rights of the joint holder/ nominee.

15.9 Transmission of Units[99]

Transmission is the process to transfer mutual fund units in case of the demise of the unit holder. The transfer of units can be done to the claimant who can be the surviving unit holder or the nominee registered in the folio or the legal heir. If the first holder of the mutual fund units passes away, the units are transmitted to the second holder. In case there is only one holder, the units are transmitted to the nominee/ legal heir.

A request form along with the supporting mandatory documents is required to be submitted by the unitholder/ nominee/ claimant to the RTA/ Mutual Fund, informing about the demise of the unit holder and to process the transmission of units. The documents required for transmission of units under various situations are listed below:

I. Transmission to surviving unit holders in case of death of the 1st holder:[100]

a. Transmission Request Form (Form T2) for transmission of units to the surviving unitholder(s)

b. Death Certificate in original or photocopy duly notarized or attested by Gazetted Officer or a Notary Public in original.

c. Copy of PAN card of the surviving joint holder(s) (if PAN is not provided already).

[99]For details refer to: https://www.amfiindia.com/investor-corner/investor-center/procedure-to-claim.html

[100] Deletion of names of deceased 2nd or 3rd holder to be done by submitting Request Form (Form T1) by the surviving unit holders through
SEBI Circular Nos.: SEBI/HO/OIAE/OIAE_IAD-3/P/ON/2025/01650 dated January 10, 2025 Revise and Revamp Nomination Facilities in the Indian Securities Market.

d. Cancelled cheque of the new first unit holder with the claimant's name pre-printed or recent bank account statement/ pass book (not more than 3 months old) of the new first holder.

e. KYC Acknowledgement or KYC Form of the surviving unit holders (if not already provided).

f. FATCA & CRS details.

g. Transmission will be completed only once the status of the KYC is "KYC complied".

h. Additional documentation required: ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other OVD as per PMLA guidelines] of the deceased person attested by the claimant(s), duly notarized or originals can be shown at the AMC branches and OSV seal attested by them.

Rule of Survivorship[101]

- In case of joint accounts / holdings, upon demise of one or more joint holder(s), the regulated entity shall transmit the assets held to the surviving holder(s) vide name deletion
- The surviving member(s) shall receive the assets as owner(s) and not as a trustee.
- Surviving joint holders shall be entitled to continue with or change or cancel the nominations made previously.
- The mode of operation (of the joint account), namely that of the first named holder OR anyone or survivor OR either-or survivor basis OR joint, etc. shall be unaffected by the rule of survivorship.
- The norms applicable for operation of the account / folio shall be mutatis mutandis applicable for nomination.

II. Transmission to registered nominee(s) in case of death of sole or all unit holders:

For transmission of assets to the registered nominee(s), the regulated entity shall require only the following:

a. Transmission Request Form (Form T3) for transmission of units in favour of nominee(s)

b. Self-attested copy of Death Certificate of the deceased investor,

c. due completion, updating or reaffirming of the KYC of nominee/s,

[101] https://www.sebi.gov.in/legal/circulars/jan-2025/circular-on-revise-and-revamp-nomination-facilities-in-the-indian-securities-market_90698.html

d. due discharge from the creditors if there are subsisting credit facilities secured by a duly created pledge
e. Regulated entities shall not seek any other documentation including affidavits, indemnities, undertakings, attestations or notarizations from the nominee(s),
f. No claims in respect of such transmission shall subsist against regulated entities and any claim or contestation shall be only amongst the nominee(s) and the claimants without reference to regulated entities.
g. Self attested Copy of birth certificate, in case the nominee is a minor
h. Self attested Copy of PAN card of the nominee/ guardian (in case of nominee is a minor)
i. Cancelled cheque with the nominee's name pre-printed or copy of nominee's recent bank account statement/ pass book (not more than 3 months old) if the registered bank mandate does not belong to registered Nominee(s).

   Additional documentation required:

   ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other valid OVD as per PMLA guidelines] of the deceased person attested by the claimant(s), duly notarized or originals can be shown at the AMC branches and OSV seal attested by them.
j. FATCA & CRS details
k. In case of joint accounts when all joint holders simultaneously pass away, the regulated entity shall transmit the assets in the account / folio to the registered nominee(s) for effecting its due discharge. In absence of nomination, the regulated entity shall transmit the assets in the account / folio to either;
   - the legal heir(s) or legal representative(s) of the youngest of the joint holders as per the rules of intestate succession or
   - as per the Will of the latter, as the case may be, after following the prescribed procedure.

III. Transmission to claimant/s, where nominee is not registered, in case of death of sole or all unit holders:

a. Transmission Request Form (Form T3) for transmission of units to the claimant.
b. Death Certificate in original or photocopy duly notarized or attested by Gazetted Officer or a Notary Public in original.
c. Self-attested Copy of birth certificate, in case the claimant is a minor.
d. Self-attested Copy of PAN card of the claimant/ guardian (in case of claimant is a minor).

e. KYC Acknowledgement or KYC Form of the claimant/ guardian (in case of claimant is a minor). Transmission process will be completed only after the KYC status is updated as "KYC complied'.

f. Cancelled cheque with the claimant's name pre-printed or copy of claimant's recent bank account statement/ pass book (not more than 3 months old).

g. Additional documentation required:

ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other valid OVD as per PMLA guidelines] of the deceased person attested by the claimant(s), duly notarized or originals can be shown at the AMC branches and OSV seal attested by them.

h. If transmission amount is upto Rs. 5 lakhs: (as per AMFI Guidelines dated January 31, 2024)

    i. Bank attestation of signature of the claimant by the Bank Manager (in prescribed format). In case the claimant is a minor, the signature of the guardian (as per the bank account of the minor or the joint account of the minor with the guardian) shall be attested.

    ii. Any appropriate document evidencing relationship of the claimant/s with the deceased unitholder/s.

    iii. Bond of Indemnity to be furnished by Legal Heirs for Transmission of Units without production of Legal Representation.

    Provided that in case the legal heir(s)/claimant(s) is submitting the Succession Certificate or Probate of Will or Letter of Administration or appropriate Court order wherein the claimant is named as a beneficiary, an affidavit as per defined Annexure from such legal heir/claimant(s) alone would be sufficient, i.e., Bond of Indemnity is not required.

    iv. Individual Affidavits to be given by each legal heir in the prescribed format.

    v. NOC from other Legal Heirs as per the defined format.

i. If transmission amount is more than Rs. 5 lakhs:

    i. Signature of the claimant duly attested by a Notary Public or a Judicial Magistrate First Class (JMFC) in the space provided for signature attestation in the TRF itself below the signature of the claimant. In case the claimant is a minor, the signature of the guardian (as per the bank account of the minor or the joint account of the minor with the guardian) shall be attested.

ii. Individual affidavits from legal heir(s) in the prescribed format.

iii. Where transmission value at the PAN-level is more than ₹5 lakh, but less than ₹10 lakhs, any one of the documents mentioned below:

Notarized copy of Registered Will along with a Notarized indemnity bond from the claimant (appropriate beneficiary of the will) to whom the securities are to be transmitted, as per the format specified. **OR**

Legal Heirship Certificate or its equivalent, along with:

(i) a Notarized indemnity bond from the legal heir(s) / claimant(s) to whom the securities are to be transmitted, as per the format specified provided and

(ii) No Objection Certificate from all the non-claimants (i.e., remaining legal-heirs), duly attested by a Notary Public, JFMC or by a Gazetted Officer as per the format specified.

iv. Where transmission value at the PAN-level is more than ₹10 lakhs, any one of the documents mentioned below:

(i) Notarised copy of Probated Will; **OR**

(ii) Succession Certificate issued by a competent court, **OR**

(iii) Letter of Administration or court decree, in case of Intestate Succession.

(iv) Identity proof (e.g., copy of PAN card, redacted Aadhaar card, passport) of all legal heirs signing the NOC/affidavit other than claimant/s (i.e., legal heirs other than the claimant mentioned in Probate or Letters of Administration or Succession Certificate).

j. FATCA & CRS details

IV. Transmission in case of Hindu Undivided Family (HUF), due to death of Karta:[102]

HUF, being a Hindu Undivided Family, the property of the family is managed by the Karta and HUF does not come to an end in the event of death of the Karta. In such a case, the members of the HUF will appoint the new Karta who needs to submit following documents for transmission:

[102] Transmission Request Form (Form T5) to be submitted by claimant for transmission of units upon death of Karta of HUF, where there is no surviving co-parceners or the HUF has been dissolved/ partitioned after demise of the Karta.

a. Request Form (Form T4) for change of Karta upon demise of the registered Karta

b. Death Certificate in original or photocopy duly notarized or attested by Gazetted Officer or a Notary Public

c. Duly certified Bank certificate stating that the signature and details of new Karta have been appended in the bank account of the HUF and attesting the Signature of the new Karta

d. KYC Acknowledgement or KYC Form of the new Karta and KYC of HUF, if not already available. Transmission will be completed only after the KYC status is updated as "KYC compiled".

e. Indemnity bond signed by all the surviving co-parceners and new Karta in the defined format.

Any appropriate document evidencing relationship of the new Karta and the other coparceners with the deceased Karta.

Additional documentation required:
a) ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other valid OVD as per PMLA guidelines] of the deceased Karta attested by the new Karta, duly notarized or originals to be shown at the AMC branches.

If the transmission amount is for more than ₹ 5 lakh, the signature of the new Karta) shall be attested by a Notary Public or a JMFC in the space provided for signature attestation in the TRF itself below the signature of the claimant.

f. FATCA & CRS details

V. Transmission of Units to the claimant/s upon death of the Karta of HUF, where there is no surviving co-parcener or the HUF has been dissolved/partitioned after demise of the Karta

a. Transmission Request Form (Form T5) for Transmission of Units to the Claimant.

b. Death certificate of the deceased Karta in original OR photocopy thereof attested by a notary public/gazette officer in original copy of birth certificate.

c. Self -attested copy of PAN Card of the claimant(s) / guardian (in case the claimant is a minor).

d. KYC acknowledgment or KYC form of the claimant(s) /guardian (in case the claimant is a minor). Transmission will be completed only after the status of the KYC is updated as "KYC complied".

e. Cancelled cheque with the claimant's name pre-printed thereon OR copy of the claimant's recent bank statement/passbook which is not more than 3 months old.

f. If the transmission amount is upto Rs. 5 lakh, attestation of the signature of the claimant by bank manager as per Annexure-I(a). In case the claimant is a minor, the signature of the guardian (as per the minor's bank account / minors joint account with the guardian) shall be attested.

   If the transmission amount is for more than Rs. 5 lakh, the signature of the claimant shall be attested by a Notary Public or a JMFC in the space provided for signature attestation in the TRF itself below the signature of the claimant.

g. Bond of Indemnity to be furnished by the Claimant as per Annexure-VI.

h. If the HUF has been dissolved/partitioned by the surviving members after demise of the Karta, the transmission of units shall be processed on the basis of any of the following documents:

   i. Notarized copy of Settlement Deed, OR

   ii. Notarized copy of Deed of Partition, OR

   iii. Notarized copy of Decree of the relevant competent Court.

   Additional documentation required:

   ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other valid OVD as per PMLA guidelines] of the deceased person attested by the claimant(s), duly notarized or originals can be shown at the AMC branches and Original Seen & Verified stamp attested by them.

It is to be noted that PAN card copy or any other proof of identity of claimant/s is not required separately, if the claimant has already complied with the KYC procedure. Where the units are to be transmitted to a claimant who is a minor, various documents like KYC, PAN, Bank details, indemnity should be of the guardian of the nominee.

SEBI, in its recent circular, has prescribed ease of process for transmission of units which are to be mandatorily followed by all the Mutual Funds/ AMCs.[103] They are:

[103] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2019/166 on Investment in units of Mutual Funds in the name of minor through guardian and ease of process for transmission of units dated December 24, 2019.

i. To improve the processing turnaround time (TAT) for transmission requests, AMCs are required to implement image based processing wherever the claimant is a nominee or a joint holder in the investor folio.

ii. AMCs should have a dedicated Central Help Desk and a webpage carrying the relevant information and instructions in order to provide assistance on the transmission process.

iii. AMCs should adopt a common Transmission Request Form (common fields) and No Objection Certificate (NOC) form. All such forms and formats to be made available on the website of the AMCs, RTAs and AMFI.

iv. AMCs should implement a common set of document requirements for transmission of units to claimant who are nominees or joint holders in the investor account.

v. AMCs should also implement a uniform process for treatment of unclaimed funds to be transferred to the claimant including the unclaimed dividends.

vi. AMCs should not accept requests for redemption from a claimant pending completion of the transmission of units in his /her favour.

vii. AMFI guidelines has given additional inputs/risk mitigation measures

VI. Deletion of names of the deceased unit holders in case of death of 2nd and/or 3rd Holder

i. Request Form (Form T1) from surviving unitholder(s) requesting for Deletion of Name of Deceased 2nd and/or 3rd Holder.

ii. Death Certificate in original or photocopy of the death certificate self-attested and attested by a notary public/gazette officer in original. Fresh Bank Mandate Form along with cancelled cheque of the new bank account (only if there is a change in existing bank mandate)

iii. Fresh Nomination Form (or Nomination Opt-out form) in case there is no nomination or a change in existing nomination is desired by the surviving unit holders.

iv. KYC Acknowledgment or KYC Form of the surviving unit holder(s), *if not KYC compliant*. Transmission will be completed only once the status of the KYC is “KYC complied”.

v. Additional documentation required:

ID proof [PAN/Redacted Aadhaar/Voter ID / Passport or any other valid Officially Valid Document (OVD) as per PMLA guidelines] of the deceased person attested

by the claimant(s), duly notarized or originals can be shown at the AMC branches and Original Seen and verified (OSV) seal attested by them.

15.10 Change in Option

Investors choose a pay-out/ re-investment option or growth option when they apply for a scheme. Further, investors who have chosen the pay-out/ reinvestment option in a mutual fund investment select between: (a) Pay-out of Income Distribution cum Capital Withdrawal (IDCW) option and (b) Re-investment of Income Distribution cum Capital Withdrawal (IDCW) option.

Mutual Fund units when sold at higher price (NAV) than the face value, a portion of sale value represents realised capital gains and can be used to pay dividend. In order to clearly communicate to the investors that, under pay-out/ reinvestment option of a Mutual Fund Scheme, certain portion of his capital can be distributed (paid-out/ re-invested) as dividend, Thus, SEBI has decided to rename the 'dividend options' of all the existing and proposed mutual fund schemes as follows:[104]

Option / Plan (Existing)	**New Name**
Dividend Pay-out Option	Pay-out of Income distribution cum capital withdrawal option
Dividend Re-investment Option	Re-investment of Income distribution cum capital withdrawal option
Dividend Transfer Plan	Transfer of Income distribution cum capital withdrawal plan

Investors may want to change from pay-out of income distribution cum capital withdrawal option to re-investment of income distribution cum capital withdrawal option. To request this change, investors can use either the transaction slip (switch option provided in the slip) or write a letter to the mutual fund. Investors have to provide the folio details.

If the investor decides to change the IDCW option, there is no financial implication. This is because the NAV for pay-out and re-investment of IDCW options are the same. Therefore, change of IDCW option is a non-financial transaction and not a financial transaction.

[104] SEBI Circular No.: SEBI/HO/IMD/DF3/CIR/P/2020/194 dated October 5, 2020.

15.11 Change in Corporate Name or Status

Change in corporate status refers to the change from a private limited company to a public limited company or from a partnership firm into a private limited company. Change in the name of a company can happen when there is a merger or acquisition, or the board decides to change the name. The investments in the old name will have to now be held in the new name, for valid transactions to happen.

The following documents should accompany the change of status request:

- The name change certificate from the Registrar of Companies.
- An authorisation to invest, approval from the board, and list of authorised signatories.

15.11.1 Change in Authorised Signatories

Institutional investors authorise officials to sign on their behalf. Companies change or replace authorised signatories from time to time. Officials holding senior positions in institutions change. Companies recruit new officials when old ones leave or get transferred. As a result, authorised signatories change.

R&T agent is given this information so that the necessary validation of the investment transaction happens with the updated authorised signatories list.

The corporate or institution should submit the following documents to register a change in authorized signatories:

- Certified true copy of the Board of Directors resolution authorising the change.
- Instruction letter from the corporate or institution signed by the existing authorised signatory with names and specimen signatures of the new signatories.

15.11.2. Investor Grievance Redressal

An investor has the right for redressal of all his complaints related to services provided by AMCs and RTAs.

15.11.2 Route provided by RTA

In the event of any grievances arising regarding the services of the AMC/ mutual fund scheme, the investors can approach the Investor Service Centre of RTA clearly explaining the service issue that needs to be resolved. If the issue is not redressed, the investor may choose to write an email to the dedicated department or call centre of AMC/RTA. In case, the issue still

remains pending, the investor may send an email to the Compliance Officer who will take care of the redressal of the same.

15.11.3 Route provided by AMC

In case of any grievance/ complaint, an investor can also approach the concerned Mutual Fund/ Investor Service Centre of the Mutual Fund. If the complaint remains unresolved, the investor may write to the designated Investor Relations Officer of the mutual fund, details of whom are provided in the SID/ website of the concerned mutual fund.

In addition to the above, investor can write to SEBI with the complaints details (in case it remains unresolved).

15.11.4 SEBI Complaint Redress System (SCORES)

The investor has the option to use SEBI's online investor grievance redress system, SCORES (SEBI Complaint Redress System), to register complaints, follow-up and track the status of the same. (www.scores.gov.in)

AMCs/ RTAs must disclose information on all investor complaints received by them and redressal thereof in a specified format, on their respective websites and AMFI website, on a monthly basis, latest by 7th of succeeding month.[105]

In case you have tried resolving your dispute with an Intermediary, but are dissatisfied with the resolution, you can file the dispute on SCORES, SEBI's investor grievance redressal portal. If you are further dissatisfied with the resolution on SCORES, you can file the dispute on SMART ODR and your dispute will be redressed within 90 days. Use SMART ODR to track your case as it progresses through the dispute resolution cycle.

15.12 Value Added services by RTAs

RTA provides various value added services to investors to help them better monitor their investments and enabling investors in efficient tax planning/ filing. RTAs issue the following statement and reports to its investors:

- Consolidated account statement for individual/ all family members with common email ID. This includes information such as investment amount, number of units held, asset allocation (debt / equity) etc.
- Statement of realized capital gains
- Report of pay-out of IDCW

[105] SEBI Circular Nos.: SEBI/HO/MIRSD/MIRSD_RTAMB/P/CIR/2021/670 dated November 26, 2021 and SEBI/HO/IMD-II/IMD-II_DOF10/P/CIR/2021/00677 dated December 10, 2021 on Investor Charter.

- Statement of ELSS
- Statement of unrealized capital gains. This is helpful for an investor to make decisions about tax implications of redemptions
- Statement of Grandfathered Equity Schemes. This incorporates NAV as on January 31, 2018 and is useful for tax planning for redemptions.
- Holding and Portfolio Valuation Statement for helping an investor understand his net-worth and make asset allocation decisions and plan future investments.

15.13 Timelines pertaining to various services provided by RTAs

SEBI has mandated timelines for various non-financial transactions.[106] These are summarized in Table 15.1 below:

Table 15.1: Turn-around-times for various investor services provided by RTAs

Service provided by RTAs	Turn-Around-Time (TAT)
Processing of transmission request	21 days
Processing of request for change-in/ updation of:	
Name/ Signature/ Nomination	21 days
Contact details (address/ e-mail id/ mobile number)/ Bank account details/ PAN	15 days
Providing response to the inquiries of the investors and Redressal of Grievance	21 days

[106] SEBI Circular No.: SEBI/HO/MIRSD/MIRSD_RTAMB/P/CIR/2021/670 dated November 26, 2021 on Publishing Investor Charter and Disclosure of Complaints by Registrar and Share Transfer Agents (RTAs) on their Websites.

15.14 MITRA - Mutual Fund Investment Tracing and Retrieval Assistant

MITRA platform is developed and hosted by the QRTAs (CAMS and KFintech) and available through a link on MFCentral / AMCs / AMFI / MFRTA) and it facilitate the investors with a searchable database of inactive and unclaimed Mutual Fund folios at an industry-level which will empower the investors in following manner:

- Enable investors to identify the overlooked investments or any investments made by any other person for which he/she may be rightful legal claimant.
- Encourage investors to do KYC as per the current norms thus reducing the number of non-KYC compliant folios.
- Contribute towards building a transparent financial ecosystem and will be reliable medium for investors to find their inactive and unclaimed Mutual Fund investments.
- Build and incorporate mitigants against fraud risk

An inactive folio shall be defined as "Mutual Fund Folio(s) where no investor-initiated transaction/s (financial and non-financial) have taken place in the last 10 years, but unit balance is available". [107]

[107] For detailed process flow, please visit www.mfcentral.com

Chapter 15: Sample Questions

1. Which of the following change requests can be made by mutual fund investors to update details in their folio?
    a. Change of address
    b. Change of bank details
    c. Change of nominee
    d. **All the options above**

2. A change request in the authorized signatories of an institutional investor has to be accompanied by which of the following?
    a. **Copy of the Board of Directors resolution authorising the change**
    b. Copy of Memorandum of Association
    c. Copy of Articles of Association
    d. All the options above

3. Changes in the personal information of the investor are made by the _____ in the mutual fund folio.
    a. **Registrar and Transfer Agent**
    b. Mutual Fund Distributor
    c. Custodians
    d. Regulator

4. The person who executes the Power of Attorney (PoA) is called the _____.
    a. **Grantor**
    b. Attorney
    c. Sponsor
    d. Agent

5. A non-financial transaction request has to be signed _____.
    a. By the first holder
    b. **By unit holders as per the mode of holding**
    c. By all the joint holders
    d. By any of the unit holders

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