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INDIAN MUTUAL FUND INDUSTRY AND OVERVIEW

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ABSTRACT

The mutual fund industry is considered as one of the most dominant players in the world economy and is an important constituent of the financial sector and India is no exception. The industry has witnessed startling growth in terms of the products and services offered, returns churned, volumes generated and the international players who have contributed to this growth. Today the industry offers different schemes ranging from equity and debt to fixed income and money market.

It is interesting to note that the major benefits of investing in a mutual funds is to capitalize on the opportunity of a professionally managed fund by a set of fund managers who apply their expertise in investment. This is beneficial to the investors who may not have the relevant knowledge and skill in investing. Besides investors have an opportunity to invest in a diversified basket of stocks at a relatively low price. Each investor owns a portion of the fund and hence shares the rise and fall in the value of the fund. A mutual fund may invest in stocks, cash, bonds or a combination of these. This paper focuses on various views of Mutual Fund and focusing on recovery of Indian Fund industry post 2008 stock market crash.

Keywords: Fixed Income, Capital Market, Money Market, Fund Manager.

I. INTRODUCTION

Mutual fund is a mechanism for pooling the resources by issuing units to the investors and investing funds in securities in accordance with objectives as disclosed in offer document. Investments in securities are spread across a wide cross-section of industries and sectors and thus the risk is reduced. Diversification reduces the risk because all stocks may not move in the same direction in the same proportion at the same time. Mutual fund issues units to the investors in accordance with quantum of money invested by them. Investors of mutual funds are known as unitholders.

The profits or losses are shared by the investors in proportion to their investments. The mutual funds normally come out with a number of schemes with different investment objectives which are launched from time to time. A mutual fund is required to be registered with Securities and Exchange Board of India (SEBI) which regulates securities markets before it can collect funds from the public.

utual funds are considered as one of the best available investment options as compare to others alternatives. They are very cost efficient and also easy to invest in. The biggest advantage of mutual funds is they provide diversification, by reducing risk & maximizing returns.

The Indian economy is growing at a steady rate of 8.5 % to 9% in the last five years or so. Most of the growth is from industry and services sector. Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganised sector is believed to be acting as a constraint to the growth impetus in these sectors. Access to affordable financial services – especially credit and insurance – enlarges livelihood opportunities and empowers the poor to take charge of their lives. Apart from these benefits, 'Financial Institutions' imparts formal identity, provides access to the payments system and to savings safety net like deposit insurance.

The role of financial institutions can be thought of in two ways. One is exclusion from the payments system –i.e. not having access to a bank account. The second type of exclusion is from formal credit markets, requiring the excluded to approach informal and exploitative markets. After nationalisation of major banks in India in 1969, there was a significant expansion of branch network to unbanked areas and stepping up of lending to agriculture, small industry and business. More recently, the focus is on establishing the basic right of every person to have access to affordable basic banking services. This paper is intended to examine the role of mutual fund organizations in financial inclusiveness with a statistical evidence of progress made by them during 2002-2010.Indian mutual funds have been organized through the Indian Trust Acts, under which they have enjoyed certain tax benefits for themselves as well as to their investors also. Indian investors have been able to invest through mutual funds since 1964 after launching of Unit Trust of India by the government of India. During the period 1987 and 1992, public sector banks and insurance companies have also

entered in to mutual fund industry. Later, private sector mutual funds have been allowed from 1993, which brought competition to the mutual fund industry. This has resulted in the introduction of new products and improvement of services which lead to massive financial inclusion programme.

II. RESEARCH METHODOLOGY

The search for this paper has been done using the online databases, Online Journal and the report of Mutual Fund research paper and the reports was done and the views and relationships expressed in this paper is through the review of paper, article and the reports.

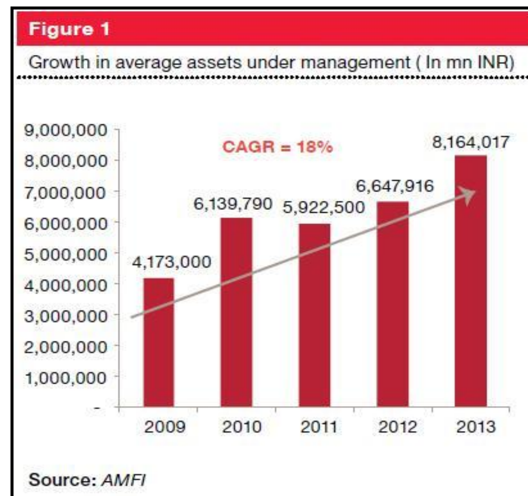
III. OBJECTIVE OF THE STUDY

1. To understand market overview of Mutual Industry.
2. The analyse performance of Indian Mutual Fund Industry in current economic situation after 2008 market crash.
3. Focusing on various measure for increasing the AUM in both equity & Debt scheme.

IV. MUTUAL FUND INDUSTRY AT GLANCE

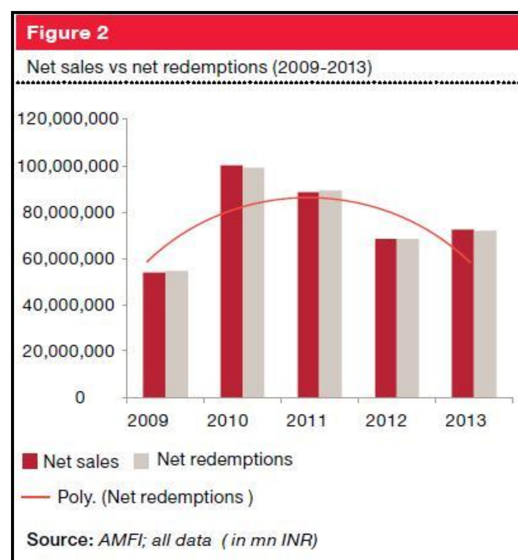
The financial services landscape is transforming, with a plethora of changes taking place on the regulatory front. Against this backdrop, asset management companies (AMCs) realise that they need to re-structure their businesses in order to meet the evolving needs of their clients and provide them with complete investment

solutions. Although emerging markets such as India provide a wide range of opportunities, it is important to tap into these avenues to fuel the growth of the mutual fund industry.

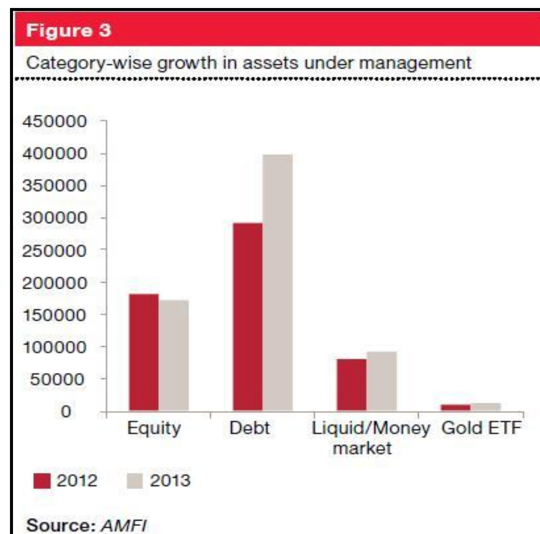


4.1 The year gone by

Amidst volatility and uncertainty in the markets, average assets under management (AUM) posted a growth of 23% for the year ended March 2013. This was considerably higher than the 12% growth reported in March 2012. The industry has grown at a compound annual growth rate (CAGR) of 18% from 2009 -2013 (see Figure 1).



However, the trend from 2010 depicts that net sales for the mutual fund industry has dipped, picking up slightly in 2013, to grow by 7% (see Figure 2).



A total of 139 new schemes were launched for the year ended March 2013, generating sales of 236,470 million INR. Furthermore, AUM under the equity segment has actually declined 5%, whereas the debt segment has grown significantly at 36% (see figure 3), which implies that investors are still wary of investing in the market looking for relatively safer investments by directing their investments into the debt bucket. Assets under management in the liquid and money market and gold exchange traded funds (ETFs) grew by 16% and 18% respectively.

In a scenario of declining interest rates, for March 2013 the distribution of assets under management have understandably been heavily skewed towards debt at 72% of total assets under management. A fall in interest rates is indicative of higher returns for long-term debt and gilt funds. Furthermore, it has been observed that in the case of investments held for over a period of 24 months, assets under management held by retail investors in the non-equity segment was 36%, whereas for the short term, it was only 11%, suggesting the fact that in the current environment, investors are preferring debt funds for an even longer time span exceeding 24 months.

4.2 Capital -Market Overview

In a scenario of declining interest rates, for March 2013 the distribution of assets under management have understandably been heavily skewed towards debt at 72% of total assets under management. A fall in interest rates is indicative of higher returns for long-term debt and gilt funds. Furthermore, it has been observed that in the case of investments held for over a period of 24 months, assets under management held by retail investors in the non-equity segment was 36%, whereas for the short term, it was only 11%, suggesting the fact that in the current environment, investors are preferring debt funds for an even longer time span exceeding 24 months.

Retail Investors	One to three months	Six to twelve months	Over twenty four months
Equity (% to category)	4.02	7.52	63.04
Non-equity (% to category)	11.18	15.96	36.25

Source: *AMFI, March 2013*

Even though the industry has witnessed growth during the last year, the rise in assets under management has been coupled with erosion of the investor base, evident from the loss of 3.6 million folios as at March 2013. The equity segment saw a decline of 4.4 million folios, although the debt segment showed an addition of 0.8 million folios. This again indicates that investors are inclined towards relatively safer investments, not wanting to undertake risk in these volatile and uncertain markets. A rise has also been reported in the AMFI registration number (ARN) registrations, as a consequence of reduction in ARN fees. Since the SEBI permitted retired bank officials, school teachers, postal agents, etc to sell mutual fund schemes, AMCs have been geared up to derive maximum benefit from this opportunity to create a far-reaching distribution network, especially in B-15 cities and towns. An additional reason for AMCs to draw on this opportunity is being able to charge a higher total expense ratio if they achieve their investment targets in these cities.

Above Table shows current Mutual Fund AUM across all AMC.

ASSETS UNDER MANAGEMENT AS ON SEPTEMBER 30, 2013
TYPE AND CATEGORY WISE **(Rs. in Crore)**

	Open End	Close End	Interval Fund	TOTAL	% to Total
INCOME	285,812	123,339	15,445	424,596	57
	231,697	116,897	3,728	352,322	49
EQUITY	140,143	494	–	140,637	19
	162,709	2	–	162,711	23
BALANCED	15,205	13	–	15,218	2
	17,004	12	–	17,016	2
LIQUID/MONEY MARKET	122,142	–	–	122,142	17
	144,675	–	–	144,675	20
GILT	7,386	–	–	7,386	1
	3,356	–	–	3,356	@
ELSS-EQUITY	19,739	2,074	–	21,813	3
	22,131	2,504	–	24,635	4
GOLD ETF	10,415	–	–	10,415	1
	11,198	–	–	11,198	2
OTHER ETFs	1,392	–	–	1,392	@
	1,806	–	–	1,806	@
FUND OF FUNDS INVESTING OVERSEAS	2,370	–	–	2,370	@
	2,394	–	–	2,394	@
TOTAL	604,604	125,920	15,445	745,969	100
	596,970	119,415	3,728	720,113	100

Notes :
1. @ Less than 1 %.
2. Figures in RED denote figures for the corresponding period of the previous year.

V. ROLE OF REGULATOR: UPDATES

During the year, the Securities and Exchange Board of India ('SEBI') announced a series of measures to invigorate the mutual fund industry, especially distribution of mutual funds. A gist of the regulatory amendments announced during the year is appended below.

The SEBI *vide* a circular1 announced the following measures:

<u>A] For mutual fund investors:</u>

Separate plan for direct investors

To promote direct investment by the investors in existing and new schemes, the SEBI directed mutual funds / asset management companies ('AMC') to provide a separate plan for direct investments with a lower expense ratio. Furthermore, no commission or brokerage can be paid from such plans.

Single plan structure for mutual fund schemes

To remove disparity in expense structure of different plans, the SEBI directed mutual funds / AMCs to launch schemes under a single plan, and ensure that all new investors are subject to a single expense structure.

Cash investments in mutual funds

In order to enhance the reach of mutual fund products amongst small investors who may not be tax payers and who may not have Permanent Account Numbers / bank accounts, the SEBI permitted cash transactions in mutual fund schemes to the extent of Rs. 20,000 per investor

per mutual fund per financial year, subject to compliance with anti-money laundering rules and regulations.

Investor education and awareness

The SEBI directed mutual funds / AMCs to, annually, set apart at least two basis points on daily net assets within the maximum limit of total expense ratio ('TER') for investor education and awareness initiatives.

Harmonising applicability of Net Asset Value ('NAV') across schemes

The SEBI directed that in respect of purchase of units of mutual fund schemes (other than liquid

schemes), the closing NAV of the day on which the funds are actually for available for utilisation shall be applicable irrespective of the time of receipt of application. This would apply in cases where the mutual fund investments are made for an amount of INR 2 lakhs or more.

Disclosure requirements

The SEBI directed additional disclosure requirements pertaining to portfolio disclosures, financial result disclosures, etc. on mutual funds/AMCs.

B] For Distributors:

Additional TER on inflows from smaller cities/towns

To improve the geographical reach of mutual funds, AMCs are now allowed to charge additional TER (upto 30 bps) with respect to inflows beyond top 15 cities, subject to the satisfaction of certain conditions.

Widening of distributors base

To increase the base of mutual fund distributors, the SEBI has permitted a new cadre of distributors which includes postal agents, retired government and semi-government officials, retired teachers, retired bank officers and other persons (such as bank correspondents) to sell units of simple and performing mutual fund schemes.

C] For AMCs:

Service tax chargeable to scheme

The SEBI allowed AMCs to charge service tax payable on investment and advisory fees to the mutual fund scheme, in addition to the maximum amount of TER.

Prudential limits on portfolio concentration risk

The SEBI directed mutual funds/AMCs to ensure that the total exposure of debt schemes of mutual funds in a particular sector (excluding investments in Bank CDs, CBLO, G-Secs, T-Bills and AAA rated securities issued by Public Financial Institutions and Public Sector Banks) shall not exceed 30% of the net assets of the scheme. In light of the important role played by the Housing Finance Companies ('HFC') in the housing sector, the SEBI

vide a subsequent circular2 has permitted an additional exposure not exceeding 10% of net assets of the debt oriented scheme for investments in HFCs.

• Product Labeling in mutual funds

To address the issue of mis-selling, the SEBI vide its circular3 , has, with effect from July 1, 2013, directed all existing schemes and all schemes to be launched on or thereafter, to be labelled considering the level of risk associated with them. Product labels must be disclosed in the Key Information Memorandum, Scheme Information Documents and common application forms.

• Participation in Credit Default Swaps ('CDS') and in repo

The SEBI, vide its circular4 , has permitted mutual funds to buy credit protection to hedge the credit risk on their investments in corporate bonds, subject to compliance with the Reserve Bank of India ('RBI') guidelines on CDS for corporate bonds. However, mutual funds cannot sell protection, and hence they cannot enter into short positions in the CDS contracts.

• Deployment of client's fund in liquid mutual funds by portfolio managers

The SEBI, vide its circular5 has clarified that pending investment of funds by portfolio managers, they can deploy funds, on short term basis, in liquid mutual fund schemes.

• Investments by Qualified Foreign Investors ('QFI')

The limits applicable for investments made by QFIs in mutual funds have been revised upwards to:

• The aggregate investments by QFIs in equity schemes of mutual funds shall be capped at a maximum of USD 10 billion

• Investment in corporate debt securities and mutual fund debt schemes is subject to a total overall ceiling of USD 1 billion

• Additionally, up to USD 3 billion can be invested in those debt mutual fund schemes that hold at least 25% of their assets in the infrastructure sector (either in debt, equity, or both)

• Key policy announcements in Union Budget 2013

As a part of the budget speech, the Finance Minister announced the following:

• Introduction of a dedicated debt segment on the stock exchange on which debt mutual fund schemes can be traded.

• Mutual fund distributors to be allowed as members in the mutual fund segment of the stock exchange.

• Pension funds and provident funds to be permitted to invest in exchange traded funds, debt mutual funds and asset backed securities.

VI. TAXATION POLICY: UPDATES

• Extension of tax benefits under RGESS

Vide the Finance Act 2013; the following amendments have been incorporated:

• Investments in listed units of an equity oriented fund are eligible for deduction;

• The period to claim the deduction has been extended from one year to three consecutive years.

• The income threshold of an individual tax payer for being eligible to claim the deduction has been increased from INR 1 million to INR 1.2 million.

• Special taxation regime for securitisation trusts

The Securitisation Trust would be required to pay additional income-tax on the income distributed by it, as follows:

1. Where recipients of income are not chargeable to tax (for example, as illustrated in the Memorandum explaining the provisions of the Finance Bill, 2013, mutual funds)– Nil;

2. Individuals and HUFs – 25%;

3. Any other person – 30%.

• Income subjected to the income distribution tax as above, shall be exempt in the hands of the recipients. Reduction in rates of Securities Transaction Tax ('STT') for equity oriented funds

• Reduction in rates of Securities Transaction Tax ('STT') for equity oriented funds

The Finance Act, 2013 has reduced the rates of STT on purchase and sale of equity oriented mutual funds as under:

Nature of transactions	Before 1.6.2013	On and after 1.6.2013
Delivery-based purchase on recognised stock exchange	0.1%	Nil
Delivery-based sale on recognised stock exchange	0.1%	0.001%
Sale to the mutual fund	0.25%	0.001%

- **Increase in tax rates for income distributed by debt schemes**

The tax rate on income distributed by a debt mutual fund scheme is increased from 12.5% to 5%, where the income is distributed to an individual or a Hindu undivided family.

• Infrastructure Debt Fund ('IDF MF') scheme

Background

In order to attract funds for infrastructure financing, the infrastructure debt fund scheme was launched where a NBFC or a mutual fund can set up an Infrastructure Debt Fund. The salient
features of the IDF MF scheme are as follows:

• IDF MFs can be set up by any existing mutual fund. Additionally, companies which have been engaged in infrastructure financing can set-up mutual funds exclusively for the purpose of launching IDF MF Schemes.

• IDF MFs are required to invest at least 90% of their assets in debt securities of infrastructure companies, infrastructure special purpose vehicles ('SPV') (not more than 10% to be invested in
listed or unlisted equity).

• Minimum investment in IDF MF from a single investor should be at least INR 1o million with a unit size of at least INR 1 million. IDF MFs are required to have a firm commitment to the extent of INR 250 million from strategic investors.

• IDF MFs should have a minimum of five investors. To provide fiscal incentive, the withholding rate on interest to be received by non-residents from IDF, set up as a NBFC was reduced to 5%. However, distribution of income by an IDF-MF continued to a distribution tax at the rate of 12.5%/30%. On account of this disparity on the rates, IDF-MF structures were of a competitive disadvantage as compared to IDF-NBFC structure. In order to address the issue of the disparity in rates, the Finance Act, 2013, has now reduced the dividend

distribution tax rates for income distributed by an IDF MF to a non-resident from 12.5% / 30% to 5%. The amendment is expected to provide impetus to IDF MFs, and could pave the way for investments in infrastructure debt schemes launched by mutual funds.

VII. REMARK FROM INDUSTRY- STAKEHOLDERS

1. Long-term performance

To attract retail investors, a stable long-term performance by funds is most desirable. Asset management companies with a good track record over a period of time will be successful in drawing more funds from investors.

2. Uncertain market environment

Going forward sluggish economic growth, high rate of inflation and slowdown of consumer demand is predicted in 2013. This has in turn adversely affected the investors' ability to invest in financial markets. Investors are hesitant to approach capital markets and wary of risk in these challenging times.

3. Attractiveness of income funds

In a scenario where inflation is high and the RBI is lowering interest rates, investors are showing an interest in the fixed income market. Riding on the expectation that rates could be cut further in 2013, the market looks promising for gilt funds, bond funds and income funds.

4. Positioning mutual funds as a long term product

Mutual funds need to be positioned appropriately as a long term product in the investor's mind. Distributors hence need to be incentivised adequately in order to sell the product correctly to investors.

5. Commission structure

The clawback of commissions has incentivized some investors to shift to a trail model. National distributors on the other hand are hesitant, as they are always under pressure to meet short termtargets, in which case, earning an upfront commission works better for them.

6. Additional total expense ratio (TER)

The directive on total expense ratio has given a lift to sales in B-15 cities. This has been a well-thought out move from the regulator's side, and has helped to align the interests of various stakeholders in the industry to some extent.

7. Overseas mutual fund players evaluate acquisition opportunities in Indian AMCs

With multiple positive regulatory changes taking place in the Indian market, overseas players are likely to gauge the opportunity of increasing penetration.

8. Infrastructure debt funds

There is huge opportunity in the category of infrastructure debt funds, given the heavy investments in infrastructure planned for India. This can prove to be a lucrative area for fund houses and launching new funds in this space could reap huge returns.

9. Online technology

Many fund houses face operational issues trying to incorporate technology into their processes. Also, continuous updating and migration pose a problem.

10. Consolidation in the industry

Increasing competition and cost burden on the market players are leading to a phase of consolidation in the industry. For smaller fund houses, sustainability and profitability is a key concern, stemming from high distribution and operational costs.

VII. RECOMMENDATION BY MARKET EXPERTS

1. Increase the distribution strength

Compared to the insurance sales force, the strength of the mutual fund network appears to be dismal. Quoting an industry CEO, "there are over 0.3 million insurance agents in India, while only 16,000 distributors for mutual funds." This data implies that investors are likely to meet insurance agents much more frequently than mutual fund distributors and hence likely to park their surplus funds in insurance policies rather than mutual fund products.

2. Alternative distribution model

The mutual fund industry needs to explore an alternative mode of distribution, for expansion and growth. The option of a tied distribution model could be explored, where the agent is tied to a particular institution. Although this model has worked in some countries it leans towards a closed architecture model, restricting the choice of the investor. The viability of its success in India needs to be measured. Fund houses can also look at the possibility of investing in an active sales force. The online channel of distribution also exists, although its full potential has not been exploited as yet.

3. Need to upgrade distribution networks

In the current scenario, the industry needs willingness from asset management companies to invest more in the distributor community. The smaller asset management companies due to lack of funds, find it more challenging to invest in the distribution channel. Training and educating the distributors are integral to increasing penetration of mutual fund products.

4. New cadre of distributors to take the industry forward

The new cadre of distributors such as postal agents, retired officials and school teachers, etc will likely rake in inflows from smaller towns and cities. This cadre of distributors will be crucial in mobilising the savings of the smaller towns and directing these savings towards mutual fund investments.

5. Product design

Mutual fund products need to be simplified if they have be sold to the masses through a public sector bank channel. The product needs to mimic a fixed deposit, and provide a predictable income. Also, these products need to be solution oriented. In the past, some fund houses launched similar schemes with minor differences. The SEBI has directed a move towards a consolidation of schemes to make the process simpler for investors. If the right product or solution is not available to be sold to customers, it will be difficult to create a 'pull' factor.

6. Technology mix

To overcome operational challenges, measures need to be taken to improve the existing infrastructure and to bring in more efficiency while increasing the scale of operations. This is not possible without the back-up of a good technology mix. It is also a key facilitator to break down underpenetrated markets

IX. CONCLUSION

The current economic scenario with sticky inflation and rising fuel prices is likely to adversely impact perceptions, resulting in depressed equity inflows into the market. Steps need to be taken to instil confidence in the minds of the investor and to encourage him to invest in mutual funds, even in times of uncertainty.

We believe that the mutual fund industry manifests huge opportunity for growth and further penetration, and this can be achieved over time, with support from technology. The key lies in strengthening distribution networks and enhancing levels of investor education to increase presence in rural areas. In terms of opportunity, the infrastructure debt market has become very attractive, luring investors to invest in this space. Also, it is critical for the industry at this point to assess and capitalise the value that pension products bring to the growth of the mutual fund industry. Lastly, it may perhaps be useful if the mutual fund industry emulated some best practices from other industries and sectors to transition to the next level of growth.

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Circulars:

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- *Circular No. CIR/IMD/DF/24/2012 dated November 19, 2012*
- *Circular No. CIR/IMD/DF/5/2013 dated March 18, 2013*
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