Training on Mutual Funds for AMFI Certification

ICICI Prudential Mutual Fund AMC

Agenda

- Session 1 : The concept & Role of MF
- Session 2 : Fund Structure & Constituents
- Session 3 : Legal & Regulatory Framework
- Session 4 : The Offer Document
- Session 5 : Fund Distribution & Sales Practices
- Session 6 : Accounting, Valuation & Taxation
- Session 7 : Investor Services
- Session 8 : Investment Management
- Session 9 : Measuring & Evaluating Mutual Fund Performance
- Session 10: Financial Planning
- Session 11: Asset allocation, fund selection & model portfolio
- Session 12: Business Ethics in Mutual Funds

ICICI PRUDENTIAL ASSET MANAGEMENT

Session 1

Concept & Role of Mutual Funds

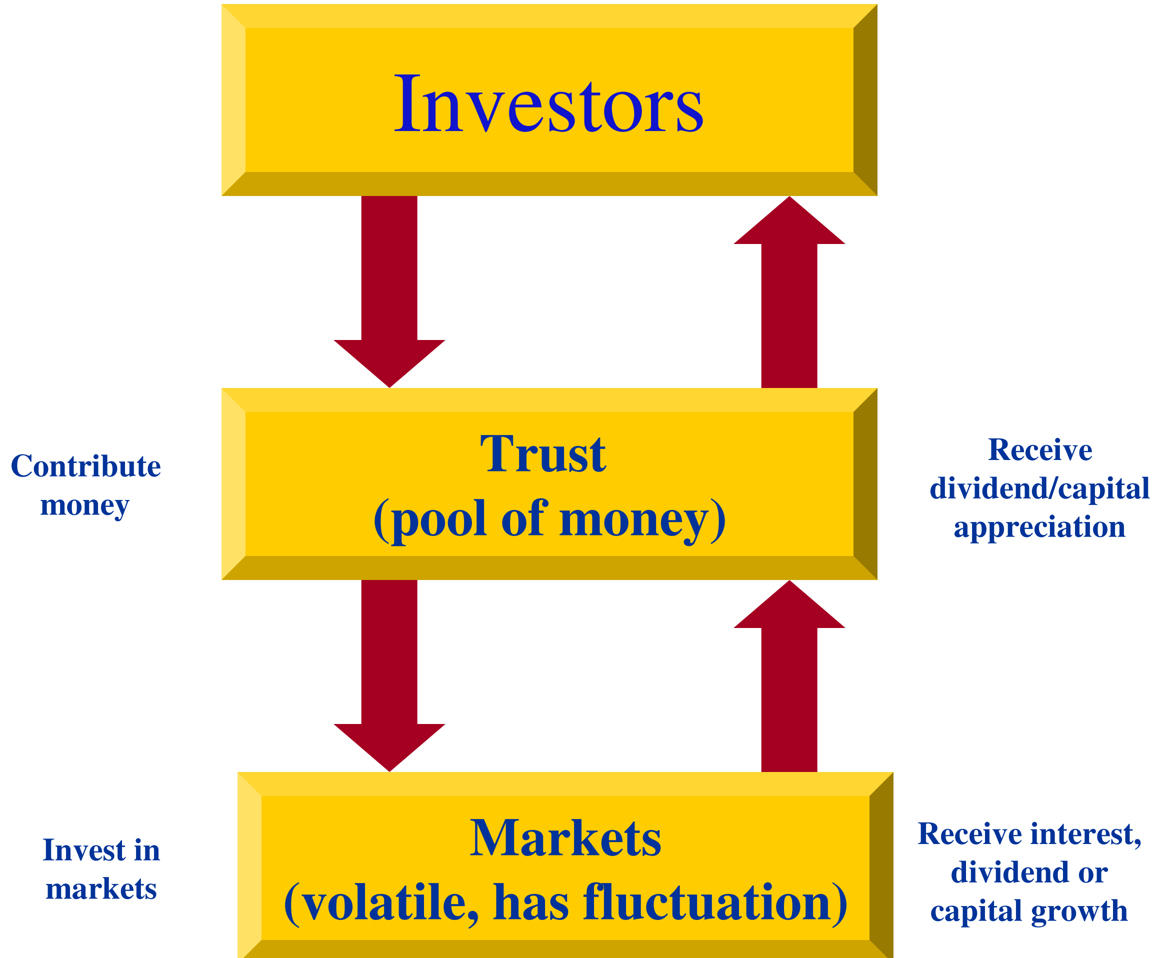
Evolution of Mutual Funds

- **Phase 1 (1964-87) :** **Growth of UTI**
- **Phase 2 (1987-93) :** **Entry of Public Sector Funds-S.B.I.,Canara etc.**
- **Phase 3 (1993-96) :** **Emergence of Private Sector Mutual Funds**
  Joint Ventures between Foreign Funds & Indian Promoters - bringing latest product innovation, investment management techniques, and investor-servicing technology
- **Phase 4 (1996-99) :** **Growth and SEBI Regulation**
- **Phase 5 (1999-04) :**
  - **UTI Act 1963 repealed in Feb 2003**
  - **UTI Mutual Fund becomes SEBI compliant**
  - **Assured Return Schemes of UTI taken over by a special undertaking administered by GOI**
  - **Emergence of large & uniform industry**
- **Phase 6 (2004…) :** **Consolidation & Growth**
  32 Mutual Funds as at 31-03-07

ICICI PRUDENTIAL ASSET MANAGEMENT

What is a Mutual Fund?

A mutual fund is a pool of money collected from investors and is invested according to stated investment objectives.



ICICI PRUDENTIAL ASSET MANAGEMENT

Characteristics of a Mutual Fund

- Investors own the mutual fund.
- Professional managers manage the affairs for a fee.
- The funds are invested in a portfolio of marketable securities, reflecting the investment objective.
- Value of the portfolio and investors' holdings, alters with change in market value of investments.

Pros and Cons of Mutual Funds

- Advantages of Mutual Funds
  - Portfolio diversification
  - Professional management
  - Reduction in risk
  - Reduction in transaction cost
  - Liquidity
  - Convenience and flexibility
- Disadvantages of Mutual Funds
  - No control over costs
  - No tailor-made portfolios
  - Issues relating to management of a portfolio of mutual funds

ICICI PRUDENTIAL ASSET MANAGEMENT

Types of Mutual Fund

Mutual Funds can be classified as:

- **Close ended / Open-ended Funds**
- **Load Fund / No-Load Funds**
- **Tax-exempt / Non-Tax exempt Funds**
  - **ICICI Prudential Tax Plan**

- **Commodity Funds**
- **Real Estate Funds**
- **Fund of Funds(FOF)**

ICICI PRUDENTIAL ASSET MANAGEMENT

LOAD FUNDS

- Load is one time fee payable by the investor when they enter / exit an open-ended scheme.
- Loads are charged to recover initial issue expenses including marketing & selling expenses, brokers/agents/distributors commission, advertising costs, printing of OD & Forms & bank charges
- There can be Entry load or Exit load or both
- Entry load is also called Front-end load.
- Exit load is also called Back-end load
- Load charged over a period of time is Deferred load

Advantage of No Load fund & effect of Load

- In a No load fund, marketing and selling expenses are absorbed by the AMC and the investor buys and sells units at net NAV calculated after accounting for management fees and recurring expenses
- Return on investment to the investor is reduced because of the loads
  - When the investor buys a unit from the MFs, he pays higher amount more than NAV (NAV + entry load)
  - When the investor sells the unit to the MF, he gets less amount than NAV (NAV – exit load)

ICICI PRUDENTIAL ASSET MANAGEMENT

Types of Funds classified by nature of Investments

EQUITY FUNDS

- **Pre-dominantly invest in equity markets**
  - **Diversified portfolio of equity shares**
  - **Select set based on some criterion**
- **Diversified equity funds(ELSS as a special case), Capitalisation based funds, Index funds, Sectoral funds, Value Funds, Equity Income or Dividend Yield Funds, Aggressive Growth Funds, Growth Funds etc**

DEBT FUNDS

- **Predominantly invest in the debt markets**
  - **Diversified debt funds**
  - **Select set based on some criterion**
- **Income funds or diversified debt funds,Gilt funds,Liquid and money market funds,Serial plans or fixed term plans, High Yield Debt Funds etc**

ICICI PRUDENTIAL ASSET MANAGEMENT

Hybrid Funds- Quasi Equity/Quasi Debt

BALANCED FUNDS

- **Growth & Income Funds(strike a balance between capital appreciation & income for the investor)**
- **Investment in more than one asset class**
  - **Debt and equity in comparable proportions**
  - **Pre-dominantly debt with some exposure to equity**
  - **Pre-dominantly equity with some exposure to debt**

    ICICI Prudential Balanced Fund
- **Education plans and children's plans**
  - **ICICI Prudential Child care Plan- Gift & Study**

ICICI PRUDENTIAL ASSET MANAGEMENT

Types of Funds classified by Investment Objectives

- **Growth Funds**
  - **ICICI Prudential Growth Fund**
- **Income Funds**
  - **ICICI Prudential Income Fund**
- **Value Funds**
  - **ICICI Prudential Discovery Fund**
- **Fund of Funds**
  - **ICICI Prudential Advisor Series**

Exchange Traded Funds

- **Exchange Traded Funds (ETFs) combine best features of Open-ended & Close-ended structure**
- **It tracks the market index & trades like a single stock on stock exchange**
- **Offers diversification & cost efficiency of an index**
- **Unlike Index Funds, unit price of this Fund is determined in the market & it keeps on varying during the day as per market movements**
- **ETFs are bought & sold through market makers who give two way quotes (Bid & Ask Price)**
- **Market makers allow unit holders to exchange units for underlying shares**

Ex: ICICI Prudential Spice Fund

ICICI PRUDENTIAL ASSET MANAGEMENT

Investment Options

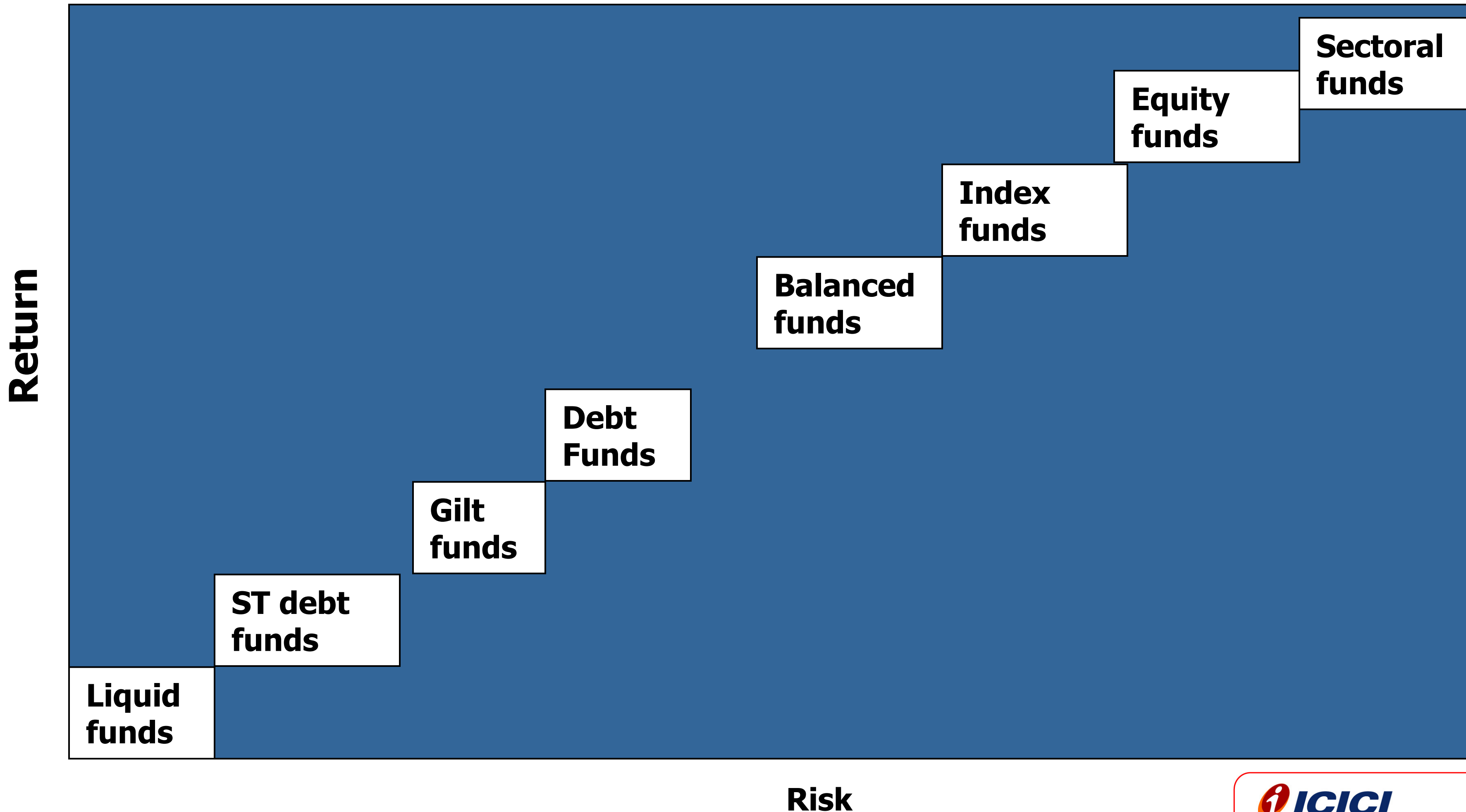
- Investors can achieve income and growth objectives in all funds
  - Dividend option
    - Regular dividend
    - Ad-hoc dividend
  - Growth option
  - Re-investment option
- Most funds provide multiple options and the facility to switch between options

ICICI PRUDENTIAL ASSET MANAGEMENT

Basis for Classification

- Risk
  - Sectoral funds are most risky; money market funds are least risky
- Tenor
  - Equity funds require a long investment horizon; liquid funds are for the short term liquidity needs
- Investment objective
  - Equity funds suit growth objectives; debt funds suit income objectives
- Return Expectation

Risk and Return



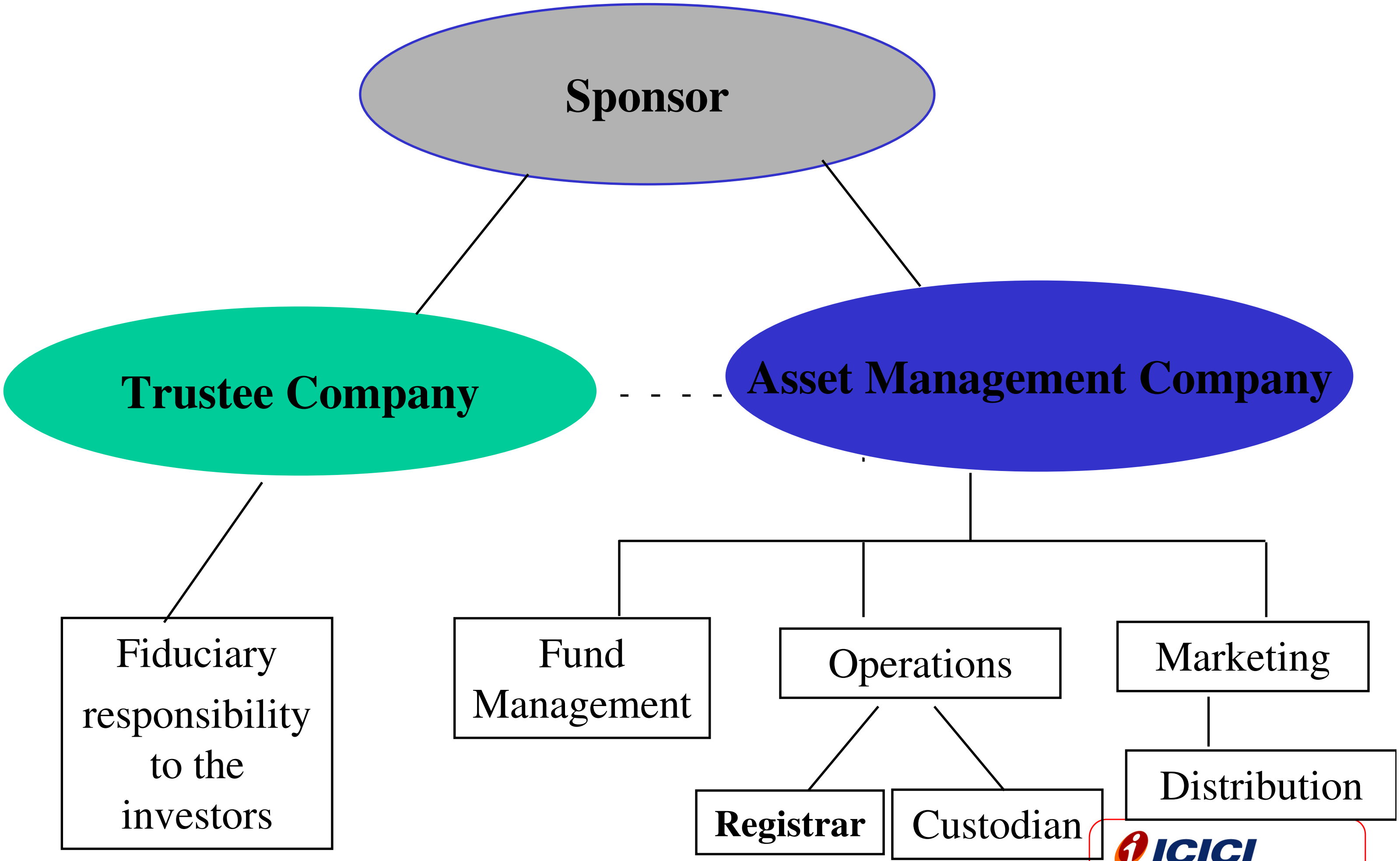
SESSION 2

FUND STRUCURE & CONSTITUENTS

ICICI PRUDENTIAL ASSET MANAGEMENT

MUTUAL FUND

Structural Framework



Structure & Constituents……

- Mutual Funds in India have a 3-tier structure
  - Sponsor , Trustee & AMC or Asset Management Co.
- The investor's money is held in a trust (the mutual fund)
- In India, the mutual fund is formed as a Trust under the Indian Trust Act, 1882
- The board of trustees is accountable to the Office of the Public Trustee, in turn reporting to Charity Commissioner
- The trust represents the investors themselves and is only a pass-through vehicle
- In US, mutual funds are formed as investment companies
- In the UK, MFs have two alternative structures: Open-ended in the form of Unit Trusts & Close-ended in the form of Corporate Entities

ICICI PRUDENTIAL ASSET MANAGEMENT

Structure & Constituents…..

SPONSOR

- **Sponsor is the promoter of the Mutual Fund**
- **Sponsor creates the AMC and the Trustee company and appoints the directors to these companies with SEBI approval**
- **Sponsor should have at least 5 years track record in the financial services business and should have made profit in at least 3 out of the 5 years**
- **Sponsor should contribute at least 40% of the capital of the AMC**
- **Sponsor could be a bank (SBI, PNB, ICICI) a financial institution (Fidelity, Franklin Templeton) or a Corporate (Reliance, Birla, Tata etc.)**

ICICI PRUDENTIAL ASSET MANAGEMENT

Structure & Constituents…..

TRUSTEES

- The role of the Trustees is to safeguard the interest of the investor/unit-holder of the fund – Fiduciary Capacity
- The trustees make sure that the funds are invested according to the investor's mandate and objective.
- The board of trustees is appointed by Sponsor with SEBI approval
- At least 4 trustees of which at least 2/3rd of the board of trustees should be independent
- Trustees of one mutual fund cannot be trustee of another mutual fund
- Right to seek regular information and remedial action
- All major decisions need trustee approval
- The board of trustees are required to meet at least 4 times in a year to review the AMC
- Trust created through a document called the 'Trust Deed', executed by the Fund Sponsor in favour of the Trustees.

ICICI PRUDENTIAL ASSET MANAGEMENT

Structure & Constituents…..

ASSET MANAGEMENT COMPANY

- Registered with SEBI
- The AMC is also formed as a private limited company
- Responsible for operational aspects of the MF
- Investment management agreement with trustees
- The AMC gets fee for managing the funds according to the mandate of the investors.
- An AMC's net worth (Share Capital + Reserves & Surplus) should be at least Rs.10 crores at all times
- At least 40% of AMC capital must be contributed by the Sponsor
- At least half (50%) of the directors of the AMC must be independent
- Appoints other constituents - Custodian , Registrar & Transfer Agent
- Cannot have any other business interest
- AMC of one MF cannot be trustee/AMC of another MF
- Quarterly reporting to Trustees
- An AMC cannot engage in any business other than portfolio advisory and management

ICICI PRUDENTIAL ASSET MANAGEMENT

Structure & Constituents…..

CUSTODIAN / DEPOSITORY

- The custodian is appointed for safekeeping of securities and participating in the clearing process
- The custodian is the guardian of the funds and assets of investors
- The custodian maintains the accounts of securities, their transaction and balance sheet etc.
- The custodian and sponsor cannot be the same entity

Registrar and Transfer agent

- manage the sale and purchase of units and keep unit-holder accounts Ex: Karvy and CAMS

Broker

- Purchase and sale of securities
- 5% limit per broker

Auditor

- Separate auditor for AMC and Mutual fund

ICICI PRUDENTIAL ASSET MANAGEMENT

Session 3

Legal & Regulatory Framework

Regulators in India

- **SEBI is Capital Market Regulator with legal powers**
  - **SEBI regulates Mutual Funds.**
  - **All Mutual Fund's to be registered with SEBI**
- **Stock exchanges (for listed Mutual Funds)**
- **RBI is Money Market Regulator & issues concerning ownership of AMC by banks**
- **SEBI is regulator for Liquid Funds Investing in MM instruments**
- **MOF supervisory body for RBI & SEBI**
- **Security Appellate Tribunal setup in 2003 to hear appeal against SEBI decisions**
- **Registrar of Companies(ROC) ensures compliance by AMC & by Trustee Company with the Indian Companies Act 1956**
- **ROC supervised by Department of Company Affairs (DCA)**
- **Mutual Fund Trustees accountable to Public Trustees**
- **Public Trustee reports to Charity Commissioner**

ICICI PRUDENTIAL ASSET MANAGEMENT

Self-regulatory Organisations(SRO)

- SROs are second tier in the regulatory structure
- SRO is an association of Market Participants empowered by apex regulatory authority to exercise pre-defined authority over the regulation of their members.
- Approval of SRO given by MOF
- All Stock Exchanges are SROs and are supervised by SEBI
- Close Ended Funds listed on SE observe listing Agreement Requirements of SE's
- AMFI was incorporated in 1995 and is not an SRO. Has the power to deny registration to distributors for violating AMFI Code of Conduct(AGNI)

Mergers & Takeover

	APPROVAL			
	Trustees	**SEBI**	**High Court**	**Unit Holders**
Merger of Two AMCs	Yes	Yes	Yes	Consent(75% voting rights)
Takeover of AMC	Yes	Yes	No	Intimation
Takeover of scheme of AMC	Yes	Yes	No	Intimation (option to redeem)

PRUDENTIAL ASSET MANAGEMENT

Session 4

OFFER DOCUMENT

The Offer Document

- Offer Document of a MF scheme is like a Prospectus issued by AMC inviting public to subscribe to units of MF scheme
- Contains vital information about Fund and schemes
- SEBI approved format
- SEBI does not approve or certify the contents of the OD
- KIM is a mandatorily enclosed to application forms
- Investor has no recourse for not having read the OD/KIM
- Close-ended funds issue an OD at the time of the IPO
- Open-ended funds have to update OD at least once in 2 yrs
- Trustees approve the contents of the OD and KIM

ICICI PRUDENTIAL ASSET MANAGEMENT

Period of Validity

- Updated every 2 years for OEFs
- Regular Addendum for results
- Updated for every major change
  - Change in the AMC or Sponsor of the mutual fund.
  - Change in the load structures.
  - Changes in the fundamental attributes of the schemes.
  - Changes in the investment options to investors; inclusion or deletion of options.
- Contents of Offer Document
  - Management of Funds
  - Offer related information
  - Borrowing policy,NAV and valuation, procedure for redemption
  - Accounting policies, tax treatment, investors rights &services
  - Redressal mechanism for investor grievances,penalties,pending litigations or proceedings

ICICI PRUDENTIAL ASSET MANAGEMENT

Contents of Offer Document

- **Preliminary information**
  - **Summary information about the mutual fund, the scheme and the terms of offer.**
  - **Mandatory disclaimer clauses as required by SEBI.**
  - **Glossary of terms in the offer document, which defines the terms used.**
  - **Standard and scheme specific risk factors pertaining to the scheme being offered**
- **Fund specific information**
  - **Constitution of fund, details of sponsor, trustees and AMC.**
  - **Financial history of sponsor(s) for 3 years, in summary form.**
  - **Director of Boards of the trustees and the AMC.**
  - **Details of key personnel of the AMC.**
  - **Details of Fund constituents**

ICICI PRUDENTIAL ASSET MANAGEMENT

Contents of Offer Document Contd..

- **Scheme Specific Information**
  - Details regarding IPO, sale and Repurchase
  - Minimum subscription and face value
  - Initial issue expenses
  - current scheme and the past schemes
  - Special facilities to investors
  - Eligibility for investing
  - documentation required.
  - Procedure for applying, and subsequent operations relating to transfer, redemption, nomination, pledge and mode of holding
- **Loads and the annual recurring expenses**
  - Proposed as well as other schemes for last 3 years
  - Comparison with OD numbers
  - Condensed Financial information for last 3 years

Other Contents in OD

- **Policy on dividend and inter-scheme transfers**
- **Procedure for redemption**
- **Disclosure of Valuation of Securities norms and NAV calculation**
- **Description of Accounting Policies**
- **Tax treatment of Investments as per existing laws**
- **Investors rights & Services.**
- **Redressal mechanism for investors grievances**
- **Penalties, Pending litigations & proceedings**

ICICI PRUDENTIAL ASSET MANAGEMENT

SESSION 5

FUND DISTRIBUTION & SALES PRACTICES

Who can invest in a Mutual Funds.

- Residents
  - **Resident Individuals / HUF**
  - **Indian companies**
  - **Partnership Firms**
  - **Indian Trusts / Charitable Institutions**
  - **Insurance Companies**
  - **Banks**
  - **Financial Institutions**
  - **NBFCs**
  - **Provident Funds**
  - **Mutual Funds**
- **Non Residents**
  - **NRI's & Persons of Indian Origin**
  - **Overseas Corporate Bodies (OCBs)**
- **Foreign Entities**
  - **FII's registered with SEBI**
- **Foreign citizens / entities cannot invest in MF**

Different Distribution Channels

1. **Direct Marketing By Sales Officers**
2. **Sending Mailers to existing investors & promoting the schemes, through branch networks & call centers for retail investments**
3. **Individual Agents as Distributors and Advisors**
4. **Institutional Intermediaries**
   - **Fund distribution companies**
   - **Finance Companies**
   - **Investment Advisory Companies**
   - **Banks and Institutions**
   - **Post Offices to cover wider geographical area**

Process of Effective Selling of M F Schemes prescribed for Distributors

- **Know the important characteristics of scheme**
- **Know your client profile (age, risk tolerance, income level, etc.)**
- **Understand client's needs (investment objective, return expectation, cash flow requirement, etc.)**
- **Assist in making the right choice**
- **Encourage regular investment & commitment to invest**
- **Personalised after- sales service**

ICICI PRUDENTIAL ASSET MANAGEMENT

AMFI Code of Ethics for MF’s

- **Funds to be managed in the interest of unit holders**
- **Unit holders to be treated equally & fairly**
- **Ensure adequate disclosures**
- **Avoid conflict of interest**
- **Management of fund in accordance with stated investment objective**
- **Stick to ethical standards and fairness in dealings**
- **High standards of care, diligence, services and professional selling practices**

SEBI Advertisement Code for MF's

- **Standard measures to compare such as Compounded Annualised Yield, CAGR etc. for scheme in existence for more than 1 year.**
- **Annualised yields for at least one, three, five years & since launch**
- **For less than 1 year performance, Absolute Return without annualisation except for Liquid Mutual Funds**
- **Dividend declared to be mentioned in rupees per unit with face value of each unit and the prevailing NAV at the time of declaration**
- **Risk factors prominently stated**
- **For comparing performance against benchmarks, appropriate benchmark to be used and identical time periods to be used**
- **No add-ons during offer**
- **Any ranking of fund to be explained appropriately**

Session 6

ACCOUNTING, VALUATIION & TAX ASPECTS

ICICI PRUDENTIAL ASSET MANAGEMENT

- Investor’s subscription to a mutual fund are accounted as unit capital, not liabilities or deposits
- The unit capital account is maintained at face value
- Assets of a mutual fund are the investments made by the fund
- Liabilities of a mutual fund are strictly short term in nature
- The day on which NAV is calculated is called as valuation date
- All Mutual Funds have to disclose their NAVs everyday, by posting it on the AMFI website by 8:00pm
- Open ended Funds are required to compute and disclose NAV daily
- Close-ended funds can compute NAVs every week (usually Wed) but disclosures have to be made everyday

ICICI PRUDENTIAL ASSET MANAGEMENT

Net Asset Value

$$\text{The NAV of a fund} = \frac{\text{(Assets + Income – Liabilities – Expenses)}}{\text{no of units outstanding}}$$

- Assets = Market value of investments+ Receivables + Accrued income + Other Assets ie: (income due but not received)
- Liabilities = Accrued expenses + Payables + other Liabilities

ICICI PRUDENTIAL ASSET MANAGEMENT

Factors Impacting NAV

- Sale and purchase of investment securities
  - Cannot impact NAV by more than 2%
- Sale and repurchase of units
  - Cannot impact NAV by more than 2%
- Valuation of assets(all investments)
- Accrual of income and expenses
  - Cannot impact NAV by more than 1%

Annualizing the Rate of Return

If NAV on

Jan 1, 2001 was Rs. 12.75

June 30, 2001 was Rs. 14.35

% age change in NAV = (14.35 – 12.75)/12.75 x 100 = 12.55%

Annualised return = 12.55 x 12/6 = 25.10%

Percentage Change in NAV

- **Assume that change in NAV is the only source of return.**
- **Example:**
  - **NAV of a fund was Rs. 23.45 at the beginning of a year**
  - **Rs. 27.65 at the end of the year.**
- **%age change in NAV = (27.65 – 23.45)/23.45 *100 = 17.91%**

LOAD

- **Load is the adjustment to the NAV, to arrive at price**
- **Load is used to meet expenses related to sale and distribution of units**
- **Load is charged to investor when the investor buys or redeems units**
- **Load that is charged when investor buys (or fund sells) units is the entry load or sale load. Entry load increases the price for the investor.**
- **To arrive at the sale price, given NAV and entry load, the load is calculated as NAV X (entry load/100) and added to NAV**
- **Load that is charged when investor redeems (or fund repurchases) units is the exit load or repurchase load. Exit load reduces the proceeds to the investor**
- **An exit load that varies with the holding period of investor is the CDSC (Contingent Deferred Sales Charge). CDSC is lower for longer holding period.**
- **To arrive at the repurchase price, given NAV and exit load, the load is calculated as NAV X (exit load/100) and deducted from NAV**

ICICI PRUDENTIAL ASSET MANAGEMENT

Example on Loads and Returns

Date	Action	NAV (Rs)	Entry Load	Exit Load
1/1/1999	Entry	10.00	2%	-
31/12/1999	Exit	11.00	-	1%

ROI with Loads

Amount invested = 10 + 0.20= Rs.10.20

Amount received = 11 – 0.11= Rs.10.89

Gain = Rs. 0.69

ROI = (0.69 x 100) /10.20 = 6.76%

ROI without loads

Amount invested = Rs.10

Amount received = Rs.11

Gain = 1 Rs.

ROI=(1 x 100) /10 = 10%

ICICI PRUDENTIAL ASSET MANAGEMENT

Contingent Deferred Sales Charge (CDSC)

- **Exit Charge depending upon how many years investor has stayed with the fund is called Contingent Deferred Sales Charge. <u>Redemption during the first five years from the date of investment</u>**

First Year	**Maximum CDSC 4%**
Second Year	**Maximum CDSC 3%**
Third Year	**Maximum CDSC 2%**
Fourth Year	**Maximum CDSC 1%**
Fifth Year	**Nil**

ICICI PRUDENTIAL ASSET MANAGEMENT

Initial Issue Expenses

- The initial issue expenses of a scheme cannot exceed 6% of the funds mobilized. Any amount above this has to be borne by the sponsor or the AMC
- Initial issue expenses are charged as follows:
  - For Close-Ended Schemes – charged over the life of the scheme, on a weekly basis until maturity
    - Eg. if a scheme for 5 years has expenses of INR 5 cr, the weekly expenses are Rs 5 cr / (5 X 52) = Rs. 192,308/-
  - For Open-Ended Schemes, the initial issue expenses used to be carried in the balance sheet as "deferred revenue expenses" and written off over a period not exceeding 5 years
  - Current position: OEFs cannot charge Initial Issue Expenses;
    - OEFs can charge higher loads
- Expenses incurred in floating schemes
- No-load fund: Additional mgmt. Fee upto 1 % of weekly

average net assets outstanding in the accounting year

- 'unamortized portion of initial issue expenses shall be included for NAV calculation- considered as 'Other assets'

The limit on expenses that can be charged to income from a fund are:

Average Weekly Net Assets	For Equity Funds	For Bond Funds
On the first Rs.100 crs	2.50%	2.25%
On the next Rs.300 crs	2.25%	2.00%
On the next Rs.300crs	2.0%	1.75%
On the Balance Average Weekly Assets	1.75%	1.50%

ICICI PRUDENTIAL ASSET MANAGEMENT

- The Investment management fee are regulated by SEBI as follows:
  - For the 1st 100 cr of net assets – 1.25%
  - For net assets exceeding 100 cr – 1%

- The rates are applied to weekly average net assets of the mutual fund scheme, to determine the AMC's fee.

- unamortized portion of initial issue expenses shall be included for NAV calculation, considered as 'Other assets' . The Investment Advisory Fee cannot be claimed on this asset, hence have to be excluded while determining the chargeable investment mgmt/ advisory fee.

- Mutual Funds incur the following expenses in carrying out its operations
  - Investment Management fee to the AMC
  - Custodian's fee
  - Trustees fee
  - R&T Agent's fee
  - Marketing & distribution expenses
  - Brokerage and transaction costs
  - Audit Fee
  - Legal fee
  - Costs related to funds transfer
  - Costs related to investor communication
  - Cost of providing account statements and cheques/warrants etc
  - Costs of mandatory advertising and communication

ICICI PRUDENTIAL ASSET MANAGEMENT

Expenses that cannot be charged

- Penalties and fines for infraction of laws.
- Interest on delayed payments to unit holders.
- Legal, marketing and publication expenses not attributable to any scheme.
- Expenses on investment and general management.
- Expenses on general administration, corporate advertising and infrastructure costs.
- Expenses on fixed assets and software development expenses.
- Such other costs as may be prohibited by SEBI.

ICICI PRUDENTIAL ASSET MANAGEMENT

Sources of Income

- Interest
- Dividend
- Profit from sale of investments
- Other income
- Extra-ordinary income

VALUATION OF EQUITY SECURITIES

- **Valuation of equity shares is done on the basis of traded price (Mark to Market), provided the price is not more than 30 days old. at the last quoted closing price on the stock exchange where it is 'principally traded'**

  - **Non-traded and thinly traded equity are to be valued in good faith.**
    - Traded value in a month is less than Rs. 5 lakhs; and
    - Total volume of shares traded is less than 50,000 shares a month

  - **Illiquid securities cannot be more than 15% of the portfolio's net assets in OEF and 20% in CEF. Any holding above this limit are to be valued at zero.**

- **If individual / illiquid securities are more than 5% of the portfolio, independent valuation to be done**

ICICI PRUDENTIAL ASSET MANAGEMENT

VALUATION OF DEBT SECURITIES

- Valuation of debt securities with :
  - less than 182 days to maturity is done on accrual basis. The accrual is calculated as follows:
  - A security issued at Rs. 90 and redeemable at rs. 100 after 364 days, the accrued interest per day is
  - 10/364 = 0.02747
  - The value of the security is increased by 2.75 paise every day, so that the security is worth Rs. 100 on the date of maturity
  - If it has to be valued 200 days after issuance, its value is

    90+(0.02747*200)= 95.494

ICICI PRUDENTIAL ASSET MANAGEMENT

VALUATION OF DEBT SECURITIES

- **Valuation of other securities(>182d)**
  - **G-Secs are valued at market prices or using the CRISIL Gilt valuer.**
  - **Corporate bonds are valued at market prices or using the CRISIL Bond valuer.**
  - **Both these methods use duration to classify bonds and assign a rate for each duration bucket.**

- **A debt security(other than G-Sec) is considered as a thinly traded security if on the valuation date, there is no individual trade in that security in marketable lots(currently Rs.5Cr) on the principal stock exchange / or any other stock exchange**

Yield To Maturity (Y T M)

- **YTM is the Internal Rate of Return an investor would realize if he bought a bond at a particular price, received all the coupon payments, reinvested the coupons at this same YTM rate and received the principal at maturity.**

- **Internal Rate of return is computed based on :**
  i. **Coupon Rate**
  ii. **Purchase Price**
  iii. **Period to Maturity**

- **If purchase price is the same as Face Value of Bond,**
  - **YTM will be the same as Coupon Rate.**

- **If purchase price is more than the Face Value,**
  - **YTM will be lower than the Coupon Rate.**

- **If purchase price is less than the Face Value,**
  - **YTM will be more than the Coupon Rate.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Reporting Requirements

- Audited accounts within 6 months of closure of accounts.
- Publish within 30 days of the closure of the half-year, unaudited abridged accounts.
- Summary of the accounts has to be mailed to all unit holders.
- File with SEBI:
  - A copy of the annual report
  - Six monthly unaudited reports
  - Quarterly movement in net assets of the fund
  - Quarterly portfolio statements

Specific Disclosures

- Complete portfolio to be disclosed every six months.
  - Industry practice: monthly disclosure.
- Any item of expenditure which is more than 10% of total expenses
- NPAs, provisioning, NPAs as % of total assets.
- Number of unit holders holding more than 25% of unit capital.

Non Performing Asset

An asset shall be classified as an NPA, if the interest and/or principal amount have not been received or have remained outstanding for one quarter**, from the day such income/installment has fallen due.**

Such assets will be classified as NPAs, soon after the lapse of a quarter from the date on which payments were due.

Treatment of NPAs

- **Accrual to be stopped.**
- **Income accrued until date of classification to be provided for.**
- **Provisioning for principal due**
  - **In graded manner after 3 months of classification.**
  - **Complete write off in 15 months from classification**

Accounting Policies

- Investments to be marked to market according to SEBI Guidelines.
- Unrealised appreciation cannot be distributed.
- Profit or loss on average cost basis.
- Dividend on ex-dividend date.
- Sale and purchase accounted on trade date.
- Brokerage and stamp duties are capitalised and added to cost of acquisition or sale proceeds

Taxation

- Mutual fund is exempt from paying taxes (Section 10 (23D))
- Income for investors
  - Dividend
  - Capital gain
- Present position (AMFI examination)
  - Dividend exempt from tax
  - Fund pays dividend distribution tax at
  - Open end funds with >65% in equity, fully exempt.
  - Tax arbitrage for investors
- Security Transaction Tax (STT) is charged as applicable for sale / purchase of units of equity oriented schemes of MF
- 80 C benefit under ELSS upto Rs. 1 Lac
- Restriction on dividend stripping
  - Within 3 months prior to record date of dividend distribution and
  - within 9 months after record date for dividend distribution

ICICI PRUDENTIAL ASSET MANAGEMENT

Treatment of Capital Gains

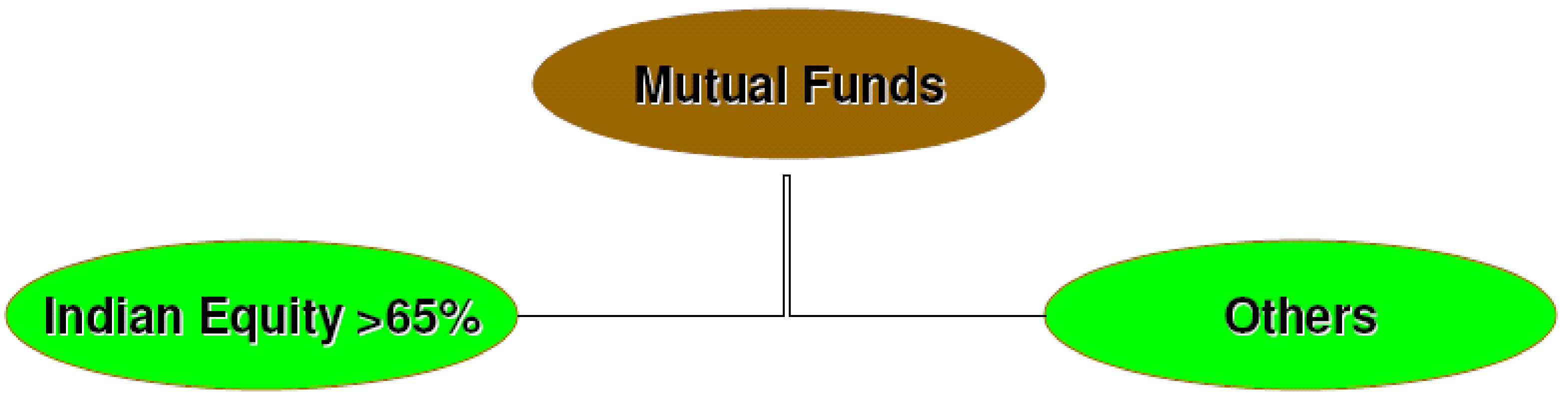
- Long term: > 12 months, Short term: < 12 months
- Long term capital gains subject to indexation benefit
  - 20% +surcharge after indexation
  - 10% + surcharge without indexation
- Short term capital gains taxed at marginal rate of taxation.
- No Capital Gain tax payable if entire Capital gain invested within 6 months of transfer in Capital Gain Bonds of NABARD, NHAI, REC U/S 54 EC of I.T Act with a lock-in period of 3 years
- Long Term Capital Gains are exempt from tax U/S 54 ED if amount invested within 6 months in Equity Shares issued by companies formed & registered in India & offered for subscription to public with a lock-in period for 1 year for Sale / Transfer

MF Taxation

	Equity	Debt
Short Term Capital Gains	10%	Added to Individuals Income, therefore as per Individuals tax bracket
Long Term Capital Gains	**No capital gains tax payable**. However, Securities Transaction Tax payable at 0.20 percent of the redemption price.	20 percent* with the cost inflation index benefit or 10 percent* without the cost inflation index benefit, whichever is beneficial;
Dividend Income	Nil	Nil
Dividend Distribution Tax	NA	14.025% - Individual/HUF 22.44% - Others (Corporate) (Including a surcharge of 10% & education cess of 2% on the amount of tax plus surcharge)
Tax Deducted at Source	Nil	Nil

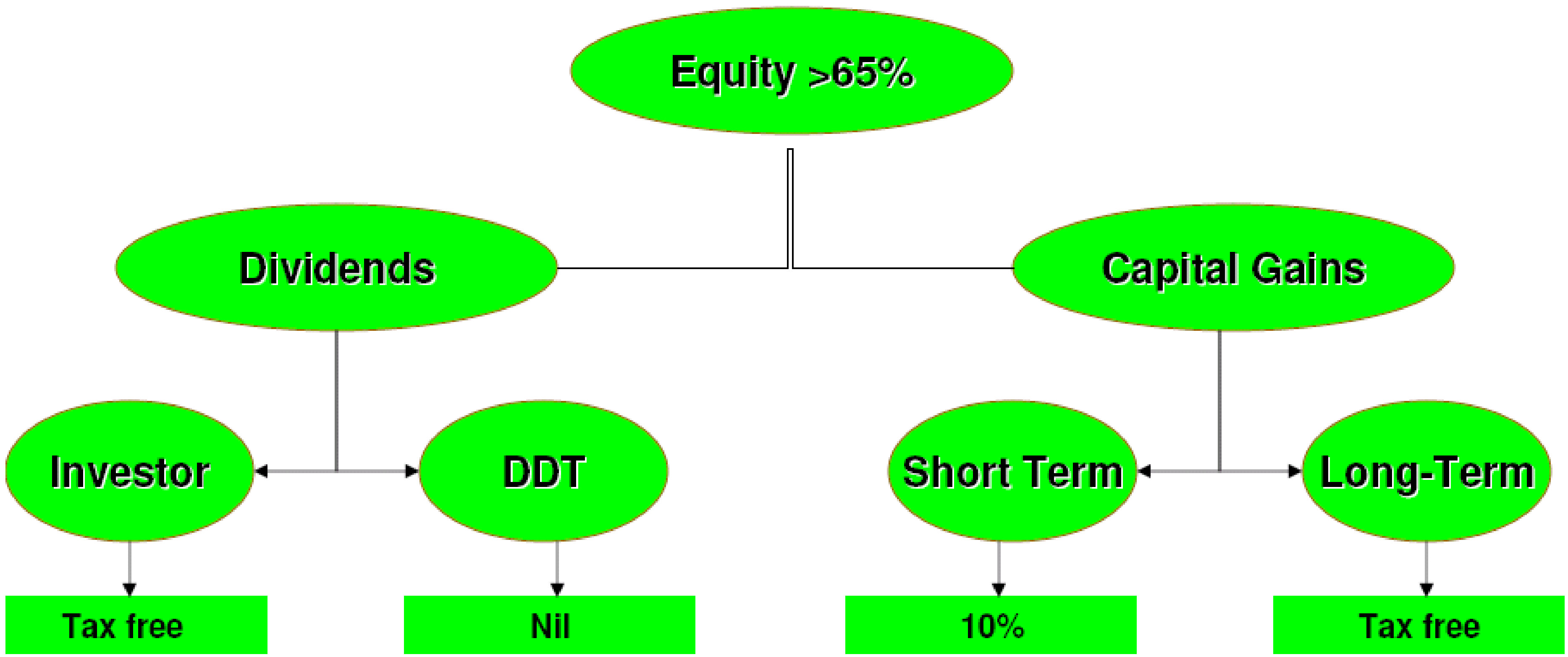
ICICI PRUDENTIAL ASSET MANAGEMENT

Classification of Mutual funds for taxation

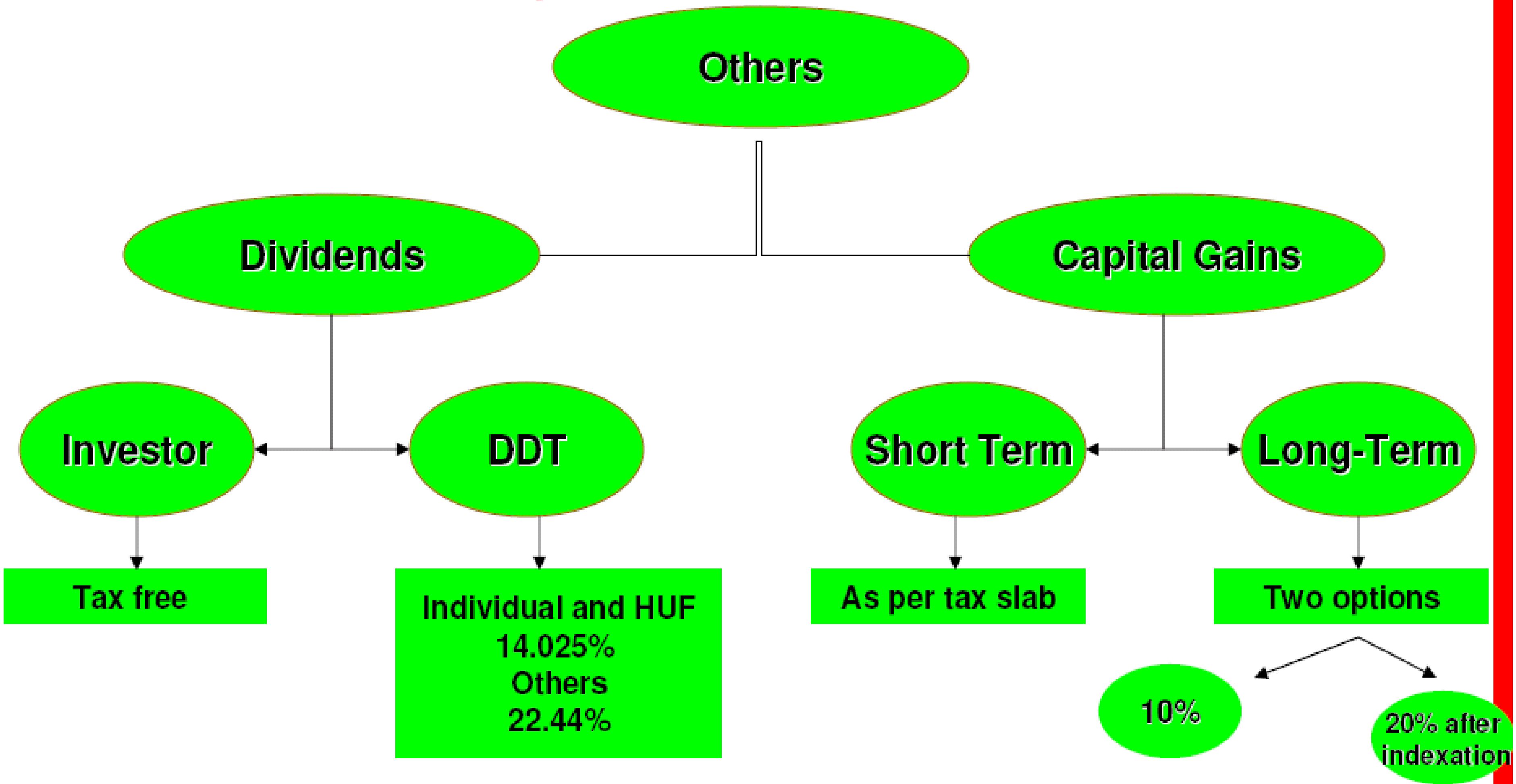


ICICI PRUDENTIAL ASSET MANAGEMENT

Tax provision for equity



Tax provision for other funds



Indexation - An Example

- **Investor buys on March 31, 1999 and sells on April 1, 2000. What is the indexation adjustment factor?**
- **(1998-99 - 351, 1999-2000 - 386, 2000-01 - 406)**
- **Investor buys on April 1, 1998 and sells on March 31, 2001. What is the indexation adjustment factor?**

ICICI PRUDENTIAL ASSET MANAGEMENT

Session 7

Investor Services

Application Procedure for Purchase of MF Units

- **PAN no. to be given if investment is Rs. 50,000/- or more**
- **Joint Account can be operated jointly by all**
- **NRIs can pay**
  - **from FCNR/NRE accounts by demand drafts or cheques to avail the facility with repatriation benefits.**
  - **payment can be made from NRO/NRNR A/c. without repatriation benefits.**
- **FIIs can remit directly from abroad or pay from special Non Resident Rupee account**
- **Offer Documents contains procedure purchasing and redeeming of units**
- **Introduction of** Multi purpose Application Form
  - **dispenses with the need for existing Investors to fill up full Application Form**
  - **for making further investments**

Investment Plans and Services

Investment Plans

- **Systematic Investment plan (SIP)**
  - **Regular Investment of fixed amount periodically (Rupee Cost Averaging Advantage)**
- **Automatic Reinvestment Plan (ARP)**
  - **Reinvestment of Dividend at Ex dividend NAV**
- **Systematic Withdrawal plans (SWP)**
  - **Systematic withdrawals on periodic basis**
- **Systematic Transfer Plans (STP)**

Transferring a specific amount on periodic basis from one scheme to another of the same fund family by Selling units of one scheme & buying units of another scheme

ICICI PRUDENTIAL ASSET MANAGEMENT

Other Services available under Mutual Funds

- **Phone Transactions**
- **Internet / Email transactions**
- **Cheque writing facility for Liquid Funds**
- **Periodic statements**
- **Periodic statement of Investment Portfolio disclosures**
- **Mutual Funds cannot give loan against units**
- **Banks can give loan against MF units**
- **Nomination facility allowed**
- **Units of Close End Schemes can be transferred to another person**
- **Transfer in Open Ended Fund happens upon**
  - **death of unit-holder or**
  - **when units are pledged or**
  - **by operation of law i.e insolvency or**
  - **winding up of the corporate investor**

Unit Holder Rights

- Rights of unit holders
  - services & information
  - protection of rights and problem resolution.
- Details of information disclosure and their periodicity.
- Right of proportionate ‘beneficial’ ownership of schemes assets
- Documents available for inspection
- Details of pending litigation and penalties
- Cannot sue the mutual fund
- 75% unit holders can
  - wind up a scheme
  - seek AMC termination
- Prospective investor has no rights
- Right to redeem for fundamental changes
- Investors can’t sue the Trust but Investor can sue the Trustee
- In the case of assured return schemes, if the offer document has provided guarantee by a named sponsor, investor can sue the sponsor

ICICI PRUDENTIAL ASSET MANAGEMENT

Investor Rights to Services

- **Open ended Fund must reopen within 30 days after the NFO period**
- **Allotment of units & dispatch of a/c statement within 30 days from the closure of NFO**
- **Nomination facility allowed**
- **Redemption proceeds to be sent to investor within 10 working days otherwise Penal interest at the rate specified by SEBI for the full period**
- **Dividend Warrants to be dispatched within** 30 days **of dividend declaration by MF**

Investor Rights to Information

- Right of any information that may have adverse bearing on their investment
- Investor's right to inspect documents such as
  - Trust deed,
  - AMC Agreement, Custodian services agreement, Registrars & Transfer agents agreement
  - Balance Sheets of MF Schemes and
  - Balance Sheet of AMC
- Complete statement of schemes portfolio before one month from the close of each half year unless published.

Investor Rights to approve changes in fundamental attributes of the scheme

- **Fundamental attributes –**
  - **Type of scheme**
  - **Investment objective**
  - **Terms of issue**
- **Also changes in fees and expenses**
- **Any other changes which would modify the scheme and affect the interest of the unit holders.**
- **This cannot be done unless unit holders are individually informed in writing and given option to redeem their holding without any exit load**
- **Advertisement given in English news paper , with nation wide circulation and regional news paper where head office of mutual fund is situated**

Investor's Obligations & Complaint Redressal

- **Investor should:**
  - **Read Offer Documents**
  - **Understand Risk factors**
  - **Monitor performance of his investments**

- **Complaint Redressal**
  - **Through SEBI intervention**

- **Investors cannot seek redressal under Companies Act since fund investors are neither share holders nor depositors in AMC**

SESSION 8

INVESTMENT MANAGEMENT

ICICI PRUDENTIAL ASSET MANAGEMENT

What is Investment Management ?

Investment or Portfolio Management is a “specialist” function. After collecting and investing an investor’s money effective portfolio management will have to give acceptable returns to the investor, in order to keep him satisfied and prevent him from moving to any other competitor fund

Equity Portfolio Management

An equity portfolio manager's task consists of two major steps :

- **Constructing a portfolio of equity shares or equity-linked instruments consistent with the investment objective**
- **Managing or constantly rebalancing the portfolio**
- **Stocks will be chosen in accordance with**
  - **a) Nature of equity instruments or a stocks unique characteristics**
  - **b) Investment style or philosophy adopted by fund manager**

Types of Equity Instruments

- **Ordinary Shares**
- **Preference Shares**
- **Equity Warrants**
- **Convertible Debentures**
- **Equity Classes**

ICICI PRUDENTIAL ASSET MANAGEMENT

Equity Portfolio Management

Market Capitalisation

Market Capitalisation is equivalent to the current value of a company. There are Large Capitalisation companies, Mid-Cap companies and Small-Cap companies

Classification in Terms of Anticipated Earnings

- Price Earning Ratio
- Dividend Yield
- Cyclical Stocks
- Growth Stocks
- Value Stocks

ICICI PRUDENTIAL ASSET MANAGEMENT

Equity Portfolio Management

Investment Strategies:

- Growth and value
- Active and passive
- Large and small cap
- Cyclical stock
- Stock selection
  - P/E ratio
  - Dividend yield
  - Undervalued companies
- Fundamental analysis
- Technical analysis
- Quantitative analysis

ICICI PRUDENTIAL ASSET MANAGEMENT

Role of Security Research in Active Fund Management

- **Fundamental Analysis**
  - **Research inputs based upon Operations & finances of the company, to estimate future earnings.**
- **Technical Analysis**
  - **Analysis of share market price and traded volumes to recognize market sentiments &trends in supply/demand**
  - **Recognize pattern in market price behavior & predict the future course of market price of the share.**
- **Quantitative Analysis**
  - **Analysis of Sectors and Industries based upon macroeconomic factors**

Equity Portfolio Management Organisation Structure

- **Fund Manager**
  - **Focuses on Asset Allocation, Industry Exposure**
  - **Selects stocks & ensure investment remains inline with schemes objective**
  - **Fixes price range for purchase & sale**
- **Analyst**
  - **Researches funds Target sectors, companies and overall market**
  - **recommends buy & sell**
- **Dealer**
  - **Executes buy and sell orders with brokers**

ICICI PRUDENTIAL ASSET MANAGEMENT

For Successful Equity Portfolio Management

- **Set realistic returns based on a Benchmark**
- **Be aware of the flexibility in managing a portfolio**
- **Decide on investment philosophy**
- **Develop an investment strategy based upon objectives & time horizons**
- **Avoid over diversification of portfolio & have well diversified portfolio**
- **Develop a flexible approach to investing**

Use of Equity Derivatives

- **Mutual Funds were allowed to make use of Futures & Option contracts in Equities for**
  - **Portfolio risk management**
  - **Portfolio Rebalancing**

- **Since September 2005 SEBI has** also **allowed Mutual Funds to trade in Derivative Contracts.**
  - **To enhance portfolio returns**
  - **To launch schemes which invest mainly in Futures & Options**

ICICI PRUDENTIAL ASSET MANAGEMENT

What are Equity Derivatives?

- **Equity derivatives instruments are specially designed contracts**
- **They derive their value from an underlying asset**
- **They are traded separately in F & O segment of Exchange**
- **Main derivative instruments are**
  - **Futures,**
  - **Options**

ICICI PRUDENTIAL ASSET MANAGEMENT

What are Equity Derivatives?

- **In a future contract**
  - **you can buy & sell the underlying equity**
  - **at a specified future date**
  - **at agreed price**

  Contract can be liquidated before maturity date without taking or giving delivery of underlying asset
- **In option contract**
  - **the buyer of option contract** gets the right **to buy or sell**
  - **the underlying equity**
  - **at agreed price**
  - **on a future date**
  - **only if he exercises the option &**
  - **for this right he pays a price called Premium.**
- **Option contracts are of two types**

Using Derivatives for Hedging Portfolio Risk

- **If Fund manager expects the equity market to decline**
  - **he may not sell the equity in the Cash Market.**
  - **But can sell the Index Future at the current price for future delivery.**

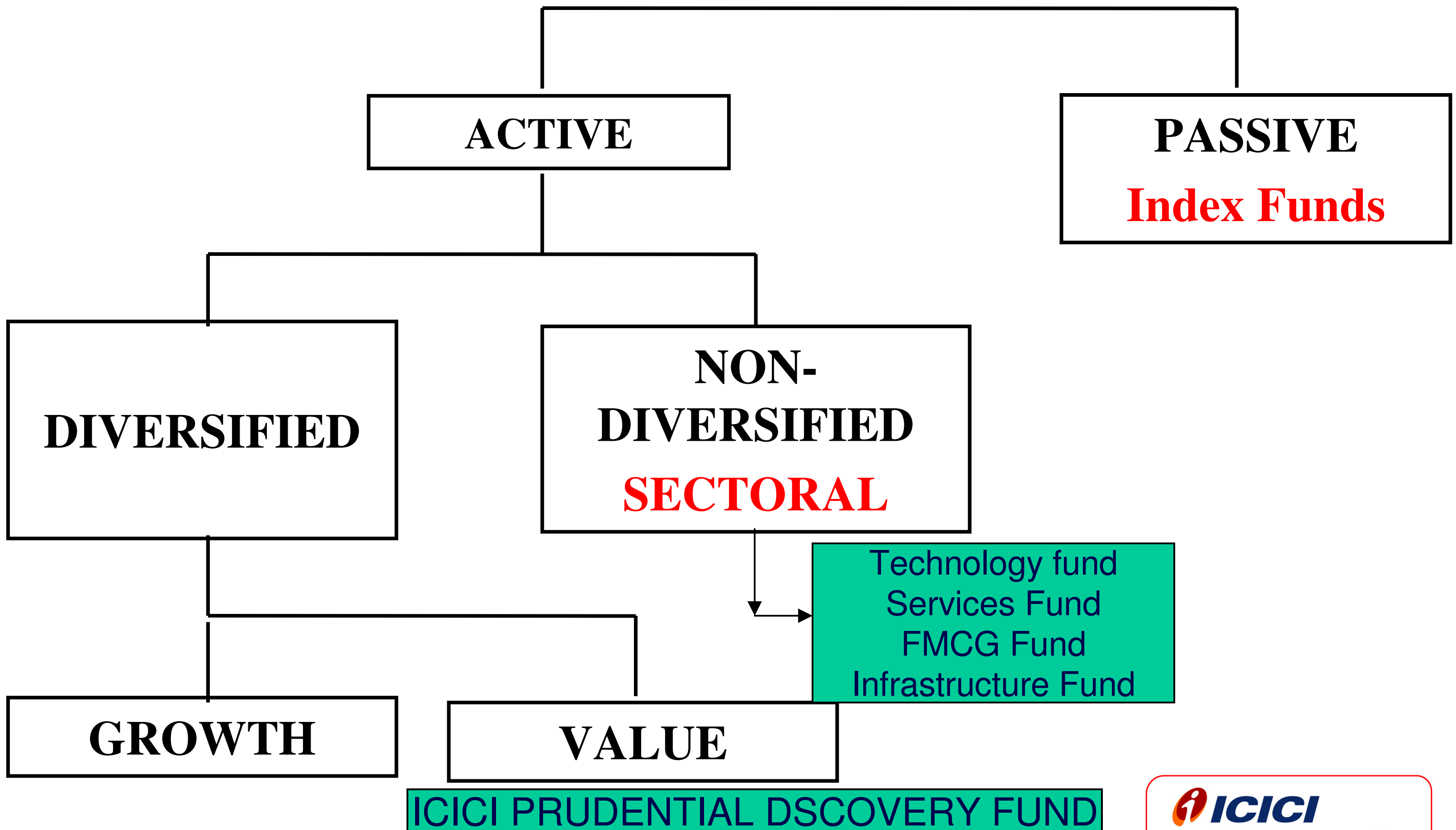
- **If markets fall the equity portfolio value will decline,**
  - **but future contract will show a corresponding profit,**
  - **since fund manager has sold future contract at a higher price.**
  - **If market rises equity portfolio value will rise but future contract will show corresponding loss, since fund manager has sold future contract at lower price**
  - **This is called <u>Hedging Portfolio Risk</u>**

Using Derivatives for Hedging Portfolio Risk

- **Other method of hedging investment portfolio risk is by buying a Put Option (an option to sell the underlying equity at an agreed price) by paying premium.**
- **A fund manager can execute the option only if the price falls, since he has right to sell at a higher price.**
- **If the price rises he will not execute the option and forgo the premium**

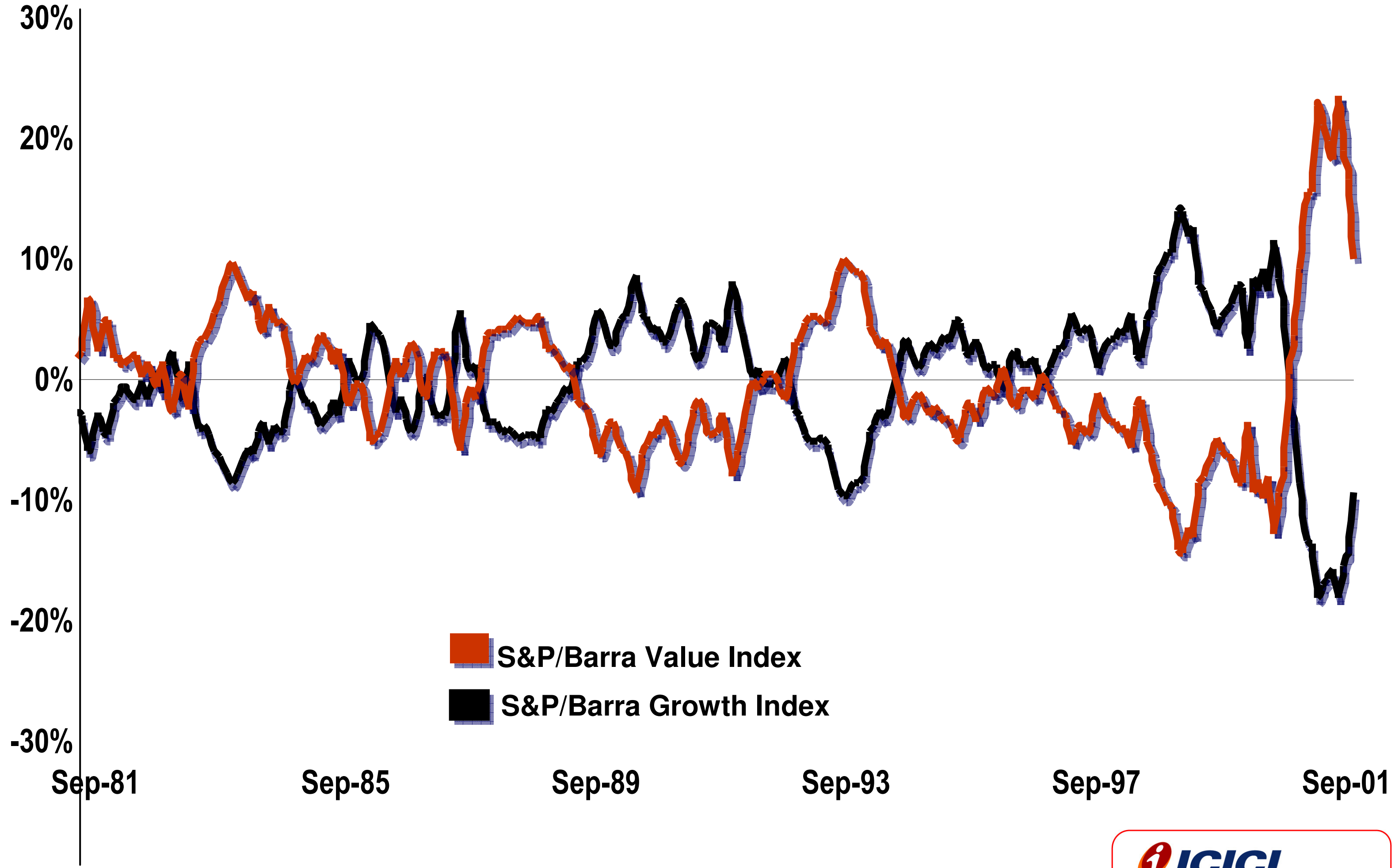
ICICI PRUDENTIAL ASSET MANAGEMENT

INVESTMENT MANAGEMENT EQUITY FUNDS



ICICI PRUDENTIAL ASSET MANAGEMENT

Value vs Growth : Winners Rotate



ICICI PRUDENTIAL ASSET MANAGEMENT

Dealer Use Only

Debt Securities: Types

- **Debt Securities**
  - **Government Securities**
  - **PSU Bonds**
  - **FI Bonds**
  - **Bank Bonds**
  - **Corporate Debentures**
- **Features**
  - **Market traded instruments**
  - **Secured / Unsecured Bonds**
  - **Interest bearing / discounted or zero coupon bond**
  - **Fixed rate / Floating rate Debt Securities**
  - **Rated / Un-rated Debt Securities**
  - **Listed / Un-listed Debt Securities**

ICICI PRUDENTIAL ASSET MANAGEMENT

Money Market Securities

- **All Debt Securities** maturing within one year **are called Money Market Securities**
- **Money Market Securities (Instruments) are:**
  - **T-Bills**
  - **CDs**
  - **CPs**
  - **Call Money**
  - **Repos**
- Basic Characteristics of a Debt Security / Bond
  - **Face Value, Par Value**
  - **Coupon**
  - **Maturity Date**
  - **Put/Call options**

Debt Portfolio Management

- Tenor
  - short and long
  - put and call options
- Interest payment
  - Fixed and floating
  - Periodic v/s Discounted
- Credit quality
  - Gilt, guaranteed, and others
- Traded and non-traded

ICICI PRUDENTIAL ASSET MANAGEMENT

Risks of Investing in Debt Securities / Bonds

- **Interest rate risk**
- **Re-investment risk**
- **Call risk**
- **Default risk**
- **Inflation risk**
- **Liquidity risk**

Measures of Bond Yields, Yields Spreads & Credit Risk

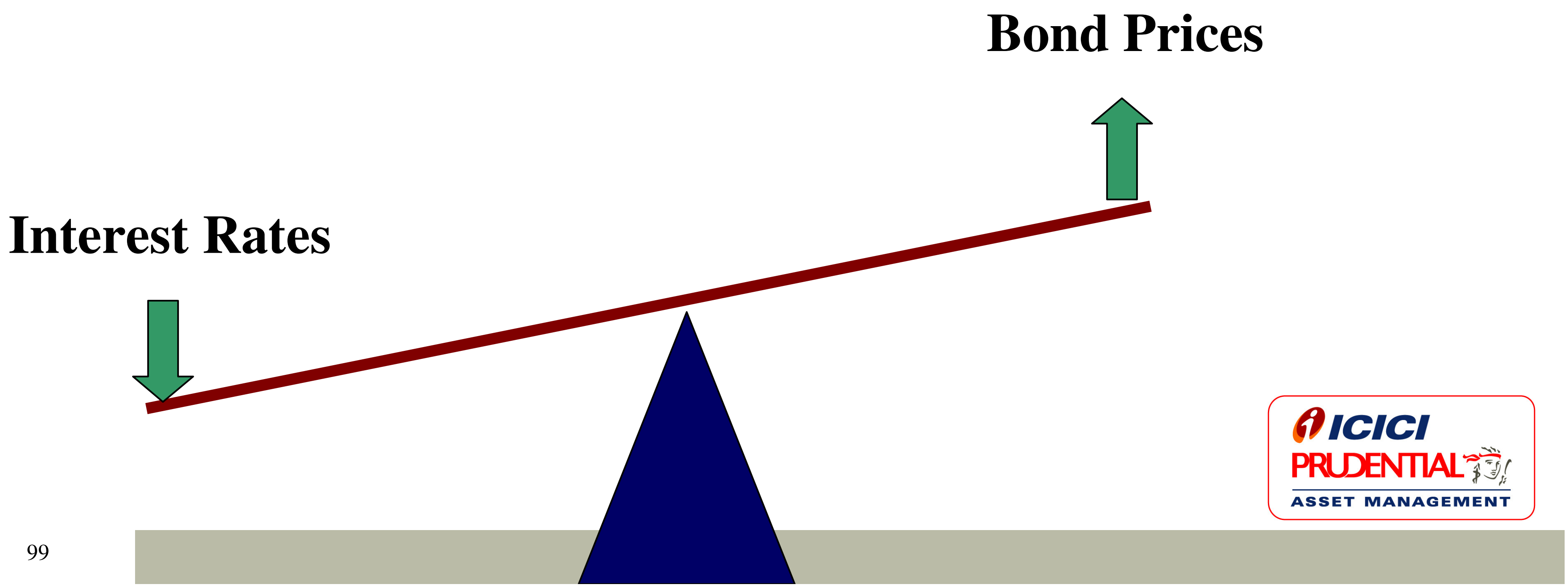
- Measures of Bond yields are
  - Current Yield
  - Yield to maturity (YTM)

- Yield curve is the graph showing yields for bonds of various maturities. using a benchmark group of bonds, such as GOI Securities
- Yield Spread is the additional yield over G-sec yield paid by borrower to account for risk of default by borrower.
- Credit risk is assessed using the ratings by credit rating agencies.
- Higher the credit rating, lower the spread and vice-versa

ICICI PRUDENTIAL ASSET MANAGEMENT

Price and Yield

- Increase in rates reduces value of existing bonds.
- Decrease in rates increases value of existing bonds
- Price and yield are inversely related
- The relationship between yield and tenor can be plotted as the yield curve.



Current Yield and YTM

- **Coupon as a percentage of current market price**
- **If we bought a 10% bond at Rs. 120, the current yield = (10/120)*100 = 8.33%**

Yield to Maturity

- **Rate at which present value of future cash flows equals the current market price.**
- **Given price, YTM can be calculated through iteration.**
- **Given YTM, price can be computed, using the YTM rate to discount the future cash flows**

ICICI PRUDENTIAL ASSET MANAGEMENT

Duration of a Bond – A Measure of Interest Rate Risk

- **Duration of a Bond is the average maturity period of a Bond as distinguished from the term of the Bond**
- **Duration helps to measure the sensitivity to changes in the interest rate**
- **Duration measures the % change in Bond Price with a change in yield by 1%**
- **If duration is 3 years, and interest changes by 1%, price of the bond will change in the opposite direction, by 3%.**

- **Higher the duration of a Debt Portfolio, higher the risk of loss of value of the Portfolio if the rates of interest go up & vice-versa**
- **Duration of Bond is less than its term, except for zero coupon bonds**

- **Example: Duration of a bond is 4 years. Yield spreads increases by 1.5%. what is the change in price?**
- **Change in the Price = 1.5 *4 = -6%**

Using Derivatives for Debt Portfolio Management

- **Debt Portfolio Risk arising out of Interest Rate increase can be hedged through interest rate derivatives.**
- **Interest rate derivatives are either exchange traded or privately traded in OTC market**
- **A Debt Portfolio Manager can sell interest rate futures or buy interest rate put options on an exchange to protect Debt Portfolio Value**
- **He can also buy and sell Forward Contracts or Swaps bilaterally with other market players in OTC.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Using Derivatives for Debt Portfolio Management

- **In India Interest Rate Futures are available for trading at NSE since 2004**
- **Interest rate options are not introduced in India in the Exchange**
- **Through Swaps fund managers can hedge interest rate risk to Debt Portfolios**
- **Since June 2003 SEBI has permitted Mutual Funds to trade in Exchange Traded Debt Derivatives**
- **A portfolio manager can sell interest rate futures or buy Interest rate ' put ' options, usually on an exchange to protect the value of his debt portfolio. He can also buy or sell forward contracts or swaps bilaterally with other market players on OTC Market.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Investment Restrictions

- Invest only in marketable securities.
- Investment only on delivery basis
- A mutual fund under all its schemes, cannot hold more than 10% of the paid-up capital of a company
- Not more than 10% of its NAV in a single company
  - Exceptions: Index Funds and Sectoral funds
- Rated investment grade issues of a single issuer cannot exceed 15% of the net assets
  - Can be extended to 20%, with the approval of the trustees

ICICI PRUDENTIAL ASSET MANAGEMENT

Investment Restrictions Contd……

- Investment in unrated securities of one company cannot exceed 10% of the net assets of a scheme and not more than 25% of net assets of a scheme can be in such securities
- Investment in unlisted shares cannot exceed
  - 5% of net assets for an open-ended scheme,
  - 10% of net assets for a close-ended scheme
- Mutual funds can invest in ADRs/GDRs (As per May 07 Circular)
  - up to a maximum limit of 10% of net assets managed by them as on March 31st of each relevant year or $200 million, whichever is lower.
  - The limit for the mutual fund industry as a whole is $4 billion
- Mutual funds can also invest in a limited manner in treasury bonds and AAA rated corporate debt issued outside India.

ICICI PRUDENTIAL ASSET MANAGEMENT

Inter-scheme Transfer

- Such transfers happen on a delivery basis, at market prices.
- Such transfers should not result in significantly altering the investment objectives of the schemes involved.
- Such transfer should not be of illiquid securities, as defined in the valuation norms.
- One scheme can invest in another scheme, up to 5% of net assets. No fee is payable on these investments (Limit does not apply to FOF scheme).

Investment in Sponsor Company

- A mutual fund scheme cannot invest in unlisted securities of the sponsor or an associate or group company of the sponsor.
- A mutual fund scheme cannot invest in privately placed securities of the sponsor or its associates.
- Investment by a scheme in listed securities of the sponsor or associate companies cannot exceed 25% of the net assets of the scheme

Other Limits

- Mutual funds cannot make loans
- Mutual funds can borrow upto 20% of net assets for a period not exceeding 6 months.
- Derivatives can be used only after informing investors
- Any change in investment objectives requires information to investor, and provision of option to exit at NAV, without exit load.

SESSION 9

MEASURING & EVALUATING PERFORMANCE

ICICI PRUDENTIAL ASSET MANAGEMENT

Risk in Mutual Fund Returns

- Risk arises when actual returns are different from expected returns.
- Historical average is a good proxy for expected return.
- Standard deviation is an important measure of total risk.
- Beta co-efficient is a measure of market risk.
- Ex-marks is an indication of extent of correlation with market index.

ICICI PRUDENTIAL ASSET MANAGEMENT

Computing Returns

- Sources of return
  - Dividend
  - Change in NAV
- Return = Income earned for amount invested over a given period of time
- Standardise as % per annum
- Computing return

  -Percentage change in NAV.

  -Simple total return

  -ROI or Total return with dividend re-investment

  -Compounded rate of growth

Total Return

Investor bought units of a mutual fund scheme at a price of Rs.12.45 per unit. He redeems the investment a year later, at Rs. 15.475 per unit.

During the year, he also receives dividend at 7%.

The rate of return on his investment can be computed as

=((15.475 – 12.45) + 0.70)/12.45 x 100

= (3.725/12.45) x 100

= 29.92%

$$\frac{\text{Dividend distributed + Change in NAV}}{\text{NAV at the beginning}} \times 100$$

Total Return or ROI Method

- (Value of holdings at the end of the period - value of holdings at the beginning of the period)/ value of holdings at the beginning of the period x 100
- Value of holdings at the beginning of the period = number of units at the beginning x begin NAV.
- Value of holdings end of the period = (number of units held at the beginning + number of units re-invested) x end NAV.
- Number of units re-invested = dividends/ex dividend NAV.

ICICI PRUDENTIAL ASSET MANAGEMENT

ROI Method: Example

An investor buys 100 units of a fund at Rs. 10.5 on January 1, 2001. On June 30, 2001 he receives dividends at the rate of 10%. The ex-dividend NAV was Rs. 10.25. On December 31, 2001, the fund's NAV was Rs. 12.25.

What is the total return on investment with dividends re-invested?

ROI Method: Solution

- The begin period value of the investment =10.5x100= Rs. 1050
- Number of units reinvested

= 100/10.25 = 9.756 units

- End period value of investment

= 109.756 x 12.25 = Rs. 1344.51

- The ROI =[(1344.51-1050)/1050]x 100 = 28.05%

ICICI PRUDENTIAL ASSET MANAGEMENT

Compounded Average Growth Rate

CAGR is the rate at which investment has grown from begin point to the end point, on an annual compounding basis.

$$V_0(1+r)^n = V_1$$

$$r = ((V_1/V_0)^{1/n})-1$$

Where n is the holding period in years.

CAGR: Example

An investor buys 100 units of a fund at Rs. 10.5 on January 6, 2001. On June 30, 2001 he receives dividends at the rate of 10%. The ex-dividend NAV was Rs. 10.25. On March 12, 2002, the fund's NAV was Rs. 12.25. Compute the CAGR.

CAGR: Solution

The initial value of the investment= 10.5 x 100 = Rs. 1050

Number of units reinvested = 100/10.25 = 9.756 units

Final value of investment = 109.756 x 12.25 = Rs. 1344.51

Holding period = 6/01/01 - 12/3/02 = 431 days

The CAGR is $=[(1344.51/1050)^{365/431} - 1\ ]\text{x } 100 = 23.29\%$

Returns: Industry Practice

- Growth Option: CAGR implicit in the change in holding period NAVs.
- Dividend Option: CAGR implicit in the change in value over the holding period, assuming reinvestment of dividend at ex-dividend NAV.
- Less then 1 year, simple return without compounding or annualisation.
- Some funds use simple annualised return, without compounding.

SEBI Regulations

- **Standard measurements and computation**
- **Compounded annual growth rate for funds over 1 year old.**
- **Return for 1,3 and 5 years, or since inception, which ever is later.**
- **No annualisation for periods less than a year except for liquid funds.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Benchmarks

- Relative returns are important than absolute returns for mutual funds.
- Comparable passive portfolio is used as benchmark.
- Usually a market index is used.
- Compare both risk and return, over the same period for the fund and the benchmark.
- Risk-adjusted return, is the return per unit of risk.

Type of Equity Fund	Name of Benchmark
Index Funds	BSE Sensex Index or S&P CNX Nifty Index
Diversified Equity Funds	BSE 100 or 200 Index
Sector Funds	Sector Specific Index
Mid cap & Small cap funds	Mid cap & Small cap index

Benchmarks For Debt Funds & Money Market Funds

Type of Debt Fund	Name of Benchmark
Gilt Fund	Government Security Index
Debt Fund	Composite Bond fund Index
Money Market Fund	Liquid fund Index of CRISIL NSE's G Sec & Treasury bill index

Benchmarks For Debt Funds & Money Market Funds

- **There are various Indicies for benchmarking of Debt Funds**
- **I-Bex Index of I-SEC is used**
  - **for tracking Govt. Security performance of various maturities**
- **CRISIL has 8 Debt Indices – 4 primary & 4 derived**

  a) primary indices cover:
  - **AAA & AA rated Corporate Bonds,**
  - **Money Market & Commercial Paper**

  b) Derived indices :
  - **Liquid fund index for call market & CP**
  - **Balanced fund index**
  - **Composite index tracks return on call G-Sec, AAA, AA Securities & CP**

ICICI PRUDENTIAL ASSET MANAGEMENT

Benchmarks For Debt Funds & Money Market Funds

- **NSE has**
  - **Govt. Security Index &**
  - **Treasury Bill Index**
- **SEBI requires MF to specify Benchmark for each scheme in OD & KIM**

ICICI PRUDENTIAL ASSET MANAGEMENT

SEBI Guidelines

- Benchmark should reflect the asset allocation
- Same as stated in the offer document
- Growth fund with more than 60% in equity to use a broad based index.
- Bond fund with more than 60% in bonds to use a bond market index.
- Balanced funds to use tailor-made index
- Liquid funds to use money market instruments.

Other Measures of Performance

- Tracking error
  - Tracking error for index funds should be nil.
- Credit quality
  - Rating profile of portfolio should be studied
- Expense ratio
  - Higher expense ratios hurt long term investors
- Portfolio turnover
  - Higher for short term funds and lower for long term funds
- Size and portfolio composition

ICICI PRUDENTIAL ASSET MANAGEMENT

SESSION 10

FINANCIAL PLANNING

Concept of Financial Planning

Financial planning identifies all the financial needs of an investor and translates the needs into monetarily measurable goals. These goals can be short term, medium term and long term. A Financial Planner plans the financial investments that will allow these goals to be met.

Financial Planning provides direction and meaning to financial decisions. It helps to understand how each financial decision effects other areas of one's finances

By viewing each financial decision as part of a whole one can consider its short and long term effects on one's life goals

ICICI PRUDENTIAL ASSET MANAGEMENT

MFs in Financial Planning

- Forms the core foundation and building block for any type of FP
- Variety of products available to suit any need or combination of needs
- Barring life and property insurance, rest of the product portfolio can be created out of bouquet of MFs

- A Good Financial Planner
  Understands:
  - The universe of investment products
  - Risk-return attributes
  - Tax and estate Planning
  - Has the ability to convert life cycles of investors into need and preference based financial products
  - Organised approach to work
  - Excellent communication and interpersonal skills

Classification of Investors

- Wealth cycle based classification
- Life cycle based classification

ICICI PRUDENTIAL ASSET MANAGEMENT

Wealth Cycle Stages of Investors

- **Another method of classifying investors is Wealth Cycle Stage (as against Life Cycle Stage**
- **There are 3 Wealth Cycle Stages for Investors**
  - **Accumulation Stage**
  - **Transition Stage**
  - **Reaping Stage**
- **<u>Intergenerational Transfer Stage</u> refers to transferring wealth to be done in favour of clients grown up children(balanced combination of growth & income funds), grand children (growth funds)or to a family or to charitable trusts (Income Funds)**
- **<u>The Sudden Wealth Stage</u> refers to winning lotteries, inheritance,sale of business.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Categories of Affluent Investors

- **Affluent investors do not need financial planning for life goals. They can be classified into 2 categories**

- **Wealth-Creating Affluent Investors(70-80% allocation to diversified equity & sector funds)**
  - **Build further wealth**
  - **Willing to take a risk to make net- worth grow**

- **Wealth-Preserving Affluent Investors(conservative portfolio with 70-80% exposure to income, gilt & liquid funds, remaining in low risk diversified equity or balanced fund.)**

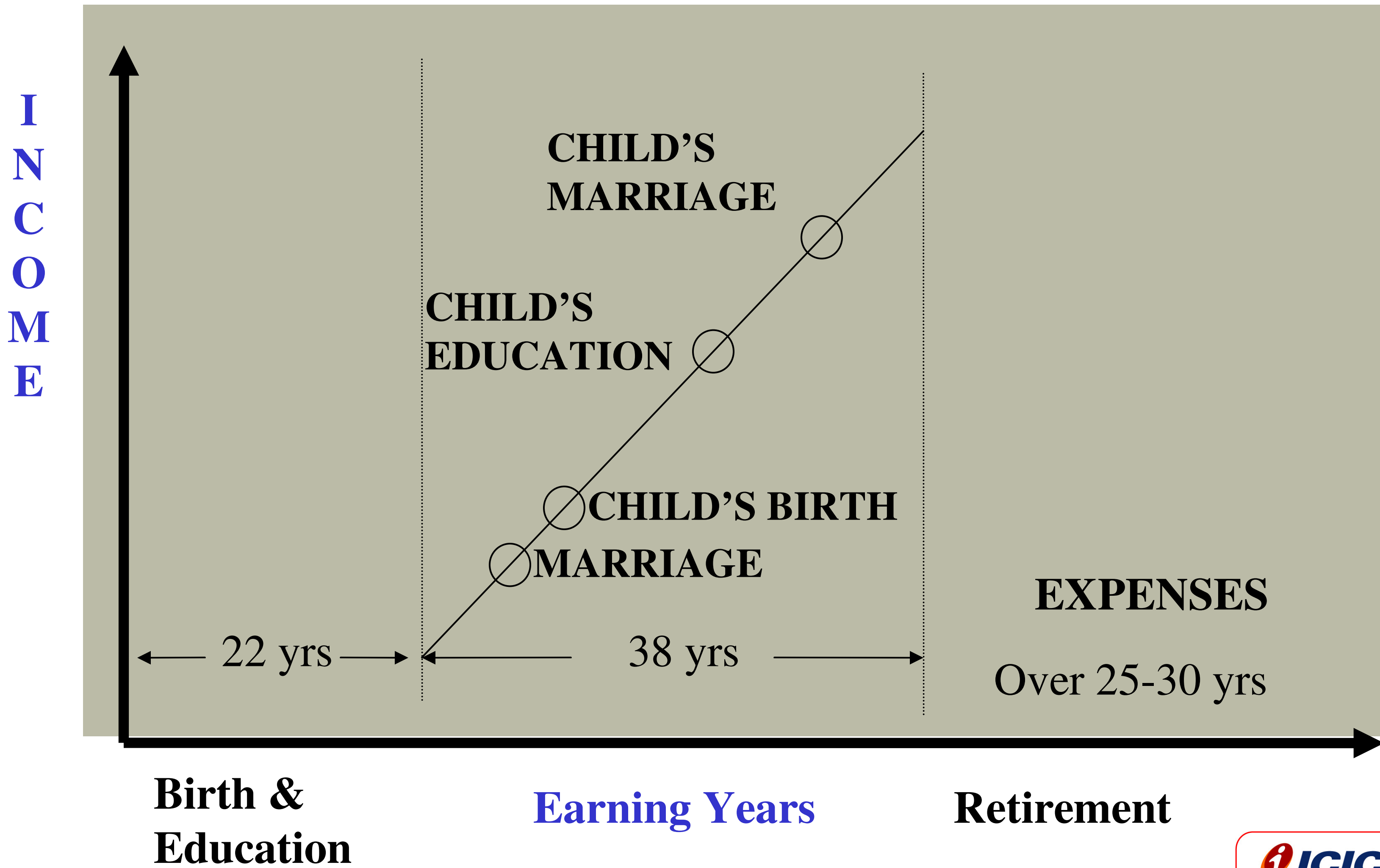
ICICI PRUDENTIAL ASSET MANAGEMENT

Life Cycle Stages of an Individual

- **Childhood Stage**
- **Young Unmarried Stage**
- **Young Married Stage**
- **Young Married with Children Stage**
- **Married with Older Children Stage**
- **Post-family/ Pre-retirement Stage**
- **Retirement Stage**

ICICI PRUDENTIAL ASSET MANAGEMENT

Life Cycle Stages



ICICI PRUDENTIAL ASSET MANAGEMENT

Process of FP in Practice

- Step I: Establish and define the relationship with the client
- Step II: Define the client's goals
- Step III: Analyse and evaluate client's financial status
- Step IV: Determine and shape the client's risk tolerance level
- Step V: Ascertain client's tax situation
- Step VI: Recommend the appropriate asset allocation and specific investments
- Step VII: Executing the plan
- Step VIII: Periodic Review

ICICI PRUDENTIAL ASSET MANAGEMENT

Products Available

- Physical Assets – Gold & Real Estate
- Bank Deposits
- Corporate –Shares, Bonds, Debentures & Fixed Deposits
- Government – G. Secs, PPF, RBI Relief Bonds and other personal Investments
- Financial Institutions – Bonds, Shares
- Insurance Companies – Insurance Policies

ICICI PRUDENTIAL ASSET MANAGEMENT

Bank Deposits

- Available since a long period of time
- Large geographical network – transactions made easy & convenient
- Fund transfer mechanism available
- Perception of bank deposits being free of default; Deposits guaranteed up to Rs 1 lakh per depositor
- Electronic facilities make it liquid and easy to use

ICICI PRUDENTIAL ASSET MANAGEMENT

Public Provident Fund

- 15-year product
- Risk-free government obligation
- Open to individuals and HUFs
- Only one account permitted per entity
- Offers tax-free interest of 8% p.a. and contribution up to Rs. 70,000 (min Rs. 500) are eligible for deduction under sec 80C
- Option to withdraw 50% of 4th year balance in the 7th year
- Restriction on withdrawal reduces liquidity.

ICICI PRUDENTIAL ASSET MANAGEMENT

RBI Relief Bonds

- Issued by RBI on behalf of the Government of India
- A 5-year investment product with 8% interest offering
- Interest is currently taxable (used to be tax-free earlier)
- Free of risk of default
- Government Securities
- Long-term government paper
- Risk-free government obligation
- Low-return and define the benchmark rate of return on the yield curve
- Specially appointed Primary dealers deal in G-Secs
- Generally high ticket investments
- Best accessible to small investors through mutual funds.

ICICI PRUDENTIAL ASSET MANAGEMENT

Other Government Schemes

- **Indira and Kisan Vikas Patra**
  - Introduced as post office scheme to tap savings in rural India
  - Very popular with urban investors also
  - Current yield is 8% over 6 years, fully taxable
  - IVP permits cash investment and protection of identity
  - Easily transferable and liquid.

Life Insurance

- **Viewed more for investment and tax purposes than a vehicle for risk protection**
- **•Premium qualify for deduction under section 80C**
- **•Important to assess need for life insurance with respect to earning potential**
- **•A Without Profits policy offers the Sum Assured in the event of death only**
- **•A With Profit policy pays not only the Sum Assured but also bonus declared from time to time**
- **•In case a policy is discontinued during its tenure, the policy's surrender value is paid which is a proportionate value based on premiums paid so far**
- **•A 'convergence' of insurance and mutual funds is the development of Unit-Linked Insurance products – which offers investors choice of asset allocation between debt and equity.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Instruments issued by Corporates

- Commercial Paper
- Debentures
- Equity Shares
- Preference Shares
- Fixed Deposits
- Bonds of FI

How to Compare Products

- Compare options by nature of investments – Characteristics, benefits and risks.
- Current performance and suitability – Taxability, age, risk profile.

Why MF is the Best Option?

- Mutual funds combine the advantages of each of the investment products
- Dispense the short comings of the other options
- Returns get adjusted for the market movements

ICICI PRUDENTIAL ASSET MANAGEMENT

Strategies for Investors

- Harness the power of compounding
- Start early
- Have realistic expectations
- Invest regularly

Useful Strategies

- Rupee Cost Averaging
- Value Averaging
- Jacob’s rebalancing strategy
- Graham’s 50:50 rebalancing strategy

ICICI PRUDENTIAL ASSET MANAGEMENT

Rupee Cost Averaging

- Invest regularly a predetermined amount
- Invests in more units when the market is low; less when the markets are high.
- Reduces the average cost of purchase

Value Averaging

- Invest regularly to achieve a predetermined value
- Books profits at a high, and adds units at the low, and enables meeting financial goals.
- Reduces the average cost of purchase

ICICI PRUDENTIAL ASSET MANAGEMENT

Rupee Cost Averaging

Amount Invested (Rs)	NAV per unit	Number of units bought	Cumulative number of units	Value of holding
1000	12.5	80.00	80.00	1000.00
1000	11.25	88.89	168.89	1900.00
1000	10.75	93.02	261.91	2815.56
1000	11	90.91	352.82	3881.03
1000	12.75	78.43	431.25	5498.47
1000	13.35	74.91	506.16	6757.22
1000	13.85	72.20	578.36	8010.30
1000	14.45	69.20	647.57	9357.32
1000	13.85	72.20	719.77	9968.78
1000	13.5	74.07	793.84	10716.86
		Average cost	**12.60**	

Value Averaging

Target Value	NAV Per Unit	Value Of Holding	Units To Invest	Cumulative Balance
1000	12.5	0.00	80	80
2000	11.25	900.00	97.78	177.78
3000	10.75	1911.11	101.29	279.07
4000	11	3069.77	84.57	363.64
5000	12.75	4636.36	28.52	392.16
6000	13.35	5235.29	57.28	449.44
7000	13.85	6224.72	55.98	505.42
8000	14.45	7303.25	48.22	553.63
9000	13.85	7667.82	96.19	649.82
10000	13.5	8772.56	90.92	740.74

ICICI PRUDENTIAL ASSET MANAGEMENT

SESSION 11

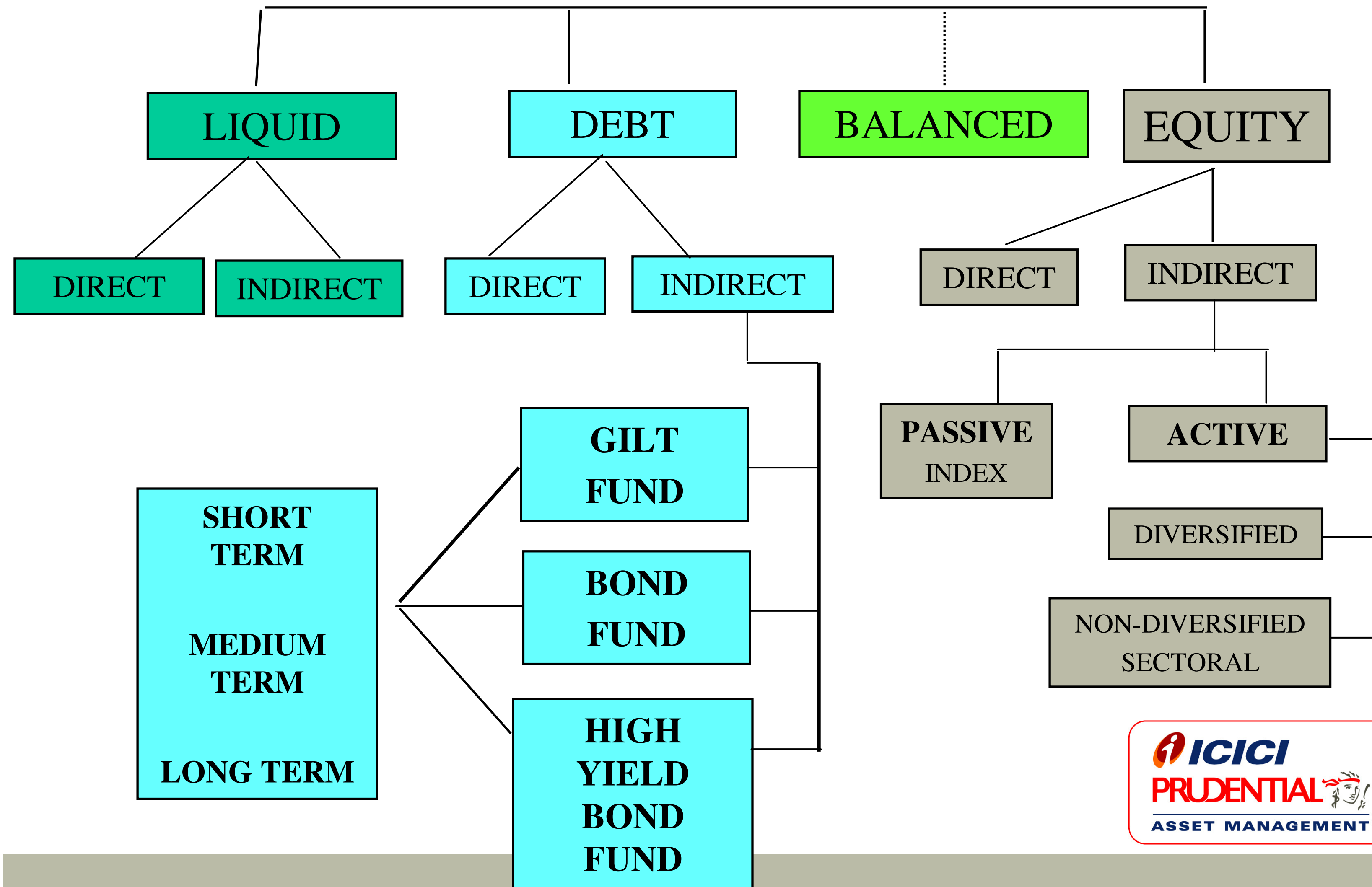
ASSET ALLOCATION, FUND SELECTION & MODEL PORTFOLIO

Asset Allocation and Model Portfolios

- Deciding the allocation of funds amongst equity, debt and money market.
- Incorporating product, investor profile and preferences in the portfolio
- Equity, debt and money market products are called asset classes. Allocating resources to each of these is called asset allocation.

ICICI PRUDENTIAL ASSET MANAGEMENT

ASSET ALLOCATION



ICICI PRUDENTIAL ASSET MANAGEMENT

Fixed and Flexible Asset Allocation

- **Fixed ratio between asset classes**
  - **Portfolio has to be periodically re-balanced**
  - **Disciplined approach**
  - **Enables investor to book profits in a rising market and invest more in a falling market**
- **Flexible allocation**
  - **No re-balancing; asset class proportions can vary when prices change.**
  - **If equity returns are higher than debt returns, equity allocation will go up at a faster rate**
  - **Low Risk Funds(Money Market & G-Sec Funds), Moderate Risk Funds(Income, Balanced, Growth & Income, Growth,Short Term & Intermediate Bond Funds, Index Funds) & High Risk Funds(Aggressive Growth, International, Sector, Specialized, Precious Metals, High Yield Bond & Commodity Funds)**

Developing a Model Portfolio

Jacob's Four Step Program

- **Develop long term goals**
  - **Investment avenues, time horizon, return and risk**
- **Determine asset allocation**
  - **Allocation to broad asset classes**
- **Determine sector distribution**
  - **Allocation of sectors of the mutual fund industry**
- **Select specific fund schemes for investment**
  - **Compare products and choose actual funds to invest in**

ICICI PRUDENTIAL ASSET MANAGEMENT

Jacob's Model portfolio

	PHASE		
	Accumulation	Transition	Distribution or Reaping
Diversified Equity, Sector & Balanced Funds	65-80%	Equity To Cash	15-30%
Income & Gilt Funds	15-30%		65-80%
Liquid Funds & Bank Deposits	5%		5%

Model Portfolios for Client's Recommended by Jacobs

	Conservative Equity	Aggressive Equity	Emerging Growth Equity	Income /Bond	MMF	Municipal Bond
Young Unmarried Professional		50%		25%	25%	
Young couple with 2 incomes		30%		25%	10%	35%
Older Couple		25%	10%			ST-30%
						LT-35%
Recently retired	35%	25%			40%	

Graham's Model Portfolio

- Based on the 50:50 rule.
- Basic managed portfolio.
- Basic indexed portfolio.
- Simple managed portfolio.
- Complex managed portfolio.
- Readymade portfolio.

Bogle's Strategic Asset Allocation

- Combines age, risk profile and preferences in asset allocation
- Older investors in distribution phase
  - 50% equity;50% debt
- Younger investors in distribution phase
  - 60% equity; 40% debt
- Older investors in accumulation phase
  - 70% equity; 30% debt
- Younger investors in accumulation phase
  - 80% equity; 20% debt

ICICI PRUDENTIAL ASSET MANAGEMENT

Fund Selection

- Equity funds: Characteristics
  - Fund category
    - Suitability to investor objective
  - Investment style
    - Growth vs Value
  - Age of the fund
    - Experience preferred to new fund
  - Fund management experience
  - Size of the fund
    - Larger funds have lower costs
  - Performance and risk

Equity Funds: Selection Criteria

- Percentage holding in cash.
- Concentration in portfolio.
- Market capitalisation of the fund.
- Portfolio turnover.
- Risk Statistics
  - Beta
  - Ex-Marks
  - Gross dividend yield
  - Funds with low beta, high ex-marks and high gross dividend yield is preferable

ICICI PRUDENTIAL ASSET MANAGEMENT

Debt Funds: Selection Criteria

- A smaller or new debt fund may not necessarily be risky
- Total return rather than YTM is important
- Expense very important
  - High expense ratios lead to yield sacrifice
- Credit quality
  - Better the rating of the holdings, safer the fund
- Average maturity
  - Higher average maturity means higher duration and interest rate risk

ICICI PRUDENTIAL ASSET MANAGEMENT

Money Market Funds

- Liquidity and high turnover rate
  - Shorter term instruments are turned over more frequently.
- Protection of principal invested
  - NAV fluctuation limited due to low duration and low levels of interest rate risk.
- Credit quality of portfolio
- Low expense ratio

Session 12

Business Ethics for Mutual Funds

ICICI PRUDENTIAL ASSET MANAGEMENT

What is meant by Business Ethics ?

It means rules of acceptable and good conduct Rules may be set my those who own and run a business or by an agency

Need for Business Ethics

In a civilised society business must be conducted in an ethical, disciplined, organized and fair manner. Good ethics is good business. Ethical practices ensure that the customer remains a long term and satisfied buyer

"Honesty is the Best Policy"

ICICI PRUDENTIAL ASSET MANAGEMENT

Objectives

- Simply be honest, open and transparent with all your current and potential clients
- Protect customers from being cheated and exploited
- Ensure a level field playing among all categories of business participants
- Key Terms of Business Ethics
  - Fair Business Practices
  - Ethical Standards
  - Ethical norms or guidelines
  - A Code of Conduct
  - Ethical Business Practices
  - Conflict of interest in a mutual fund business

Business Ethics & Mutual Fund Regulations in India

- **The main role of SEBI is to protect the interest of the investors.**
- **SEBI encourages development of ethical standards among the Mutual Funds**
- **SEBI guidelines require Mutual Funds and AMFI to develop Code of Conduct for**
  - **Distributors**
  - **Fund Managers**
  - **All employees**
  - **Associated persons of AMC & Trustee Company**
- **SEBI also lays down its own rule of ethics for certain matters incorporated in the Mutual Fund regulations**

ICICI PRUDENTIAL ASSET MANAGEMENT

Business Ethics & Mutual Fund Regulations in India

- **SEBI mandates that all activities are done in the best interest of the investors and it monitors 3 areas**
  - **Fund structure and governance**
  - **Exercise of Voting Rights by Funds**
  - **Fund operations**

Fund Structure

- **The Mutual Fund structure in India is**
  - **a 3 tier structure**
  - **with sponsor, trustees & AMC as independent bodies**
- **AMC's are supervised by independent Trustees**
  - **who have fiduciary responsibility towards the investors.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Fund Governance

Separation of Functions

- **There is a separation of functions,**
  - **AMC charged with investment of funds and they don't hold asset of the fund.**
  - **The Trust holds investment assets in fiduciary capacity since beneficial owners are investors.**
  - **Trustees actually don't hold the trusts assets – investment assets are held by the custodians**

Independence of Organizations & Personnel

- **By separating ownership, management & custody of assets fraudulent use of assets is prevented.**
- **Board of trustees have at least 2/3rd independent directors**
  - **thus ensuring independence of organization**
- **AMC board has at least 50% independent directors**
  - **thus reducing the influence of the promoter.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Exercise of Voting Rights by Funds

- **The Mutual Funds have to exercise voting rights in the companies**
  - **in the interest of fund investors and**
  - **not in the interest of fund managers or promoters or employees.**
- **It is an ethical but not a legal requirement**

Ethics in Fund Operations

- **SEBI expects day to day fund managements to observe ethical business practices.**
  - **Insider trading regulations**
  - **No preferential treatment to selected investors**
  - **Uniform cut off time for accepting subscription application & for determining applicability of uniform NAVs to all customers**
  - **Control over Personal Trading by Fund Managers and employees**
  - **Personal trades to be disclosed by the Fund Managers and the Directors**

ICICI PRUDENTIAL ASSET MANAGEMENT

Ethics in Fund Publicity & Advertisement

- **All forms of advertisements to be as per SEBI Regulations**
  - **To ensure that they don't mislead the investors. Covered in ethics related regulations, the 6th Schedule to SEBI (MF) Regulations, 1996**
- **Regulations require AMC to file with the trustees**
  - **A quarterly statement of dealing in securities by the key personal of AMC**
  - **Directors of AMC to file quarterly details of transactions in securities which exceed value of Rs. 1 lakh**
  - **Directors of trustee company also have to file details of transactions in securities with MF when they exceed value of Rs. 1 lakh**

Ethics in Fund Publicity & Advertisement

- **Regulations require the trustees of the mutual fund to certify**
  - **that the personnel of the AMC do not indulge in Front Running or self dealing.**
- **SEBI has made it mandatory for the AMC to appoint a Compliance Officer**
  - **to ensure implementation of laws and Mutual Fund Regulation & voluntary Code of Conduct.**
- **SEBI requires all distributors to follow a Code of Conduct.**
- **AMFI has put in place amore detailed Code of Conduct called AGNI (AMFI Guidelines & Norms for Intermediaries**
- **Mutual funds have to report any violation of all these regulations**

ICICI PRUDENTIAL
ASSET MANAGEMENT

Business Ethics & Fund Regulations in the U.S

Fund Governance

- The U.S Regulator (Security Exchanges Commission) require at least 75% of the funds board to be independent directors including the Chairman.
- Independent directors are required meet separately every quarter and make self assessment of their effectiveness

Codes of Ethics for Investment Advisors

- SEC requires registered investment advisors to adopt and enforce codes of ethics applicable to their supervised persons, including personal trading
- Supervised persons have to acknowledge in writing receipt of copy of the Code of Ethics.

Codes of Ethics for Investment Advisors

- An advisor's code will require the advisor's supervised persons to comply with applicable Federal Securities Laws.
  - There is requirement of reporting of personal securities holding & transactions, including transactions in Mutual Funds advised by the advisor.
  - The Code requires access persons to pre clear any personal investments in IPOs
  - Prevention of Disclosure of material non public information about the advisors buy and sell recommendations.
  - Reporting of code violations to the compliance officer

ICICI PRUDENTIAL ASSET MANAGEMENT

Ethical Issues & Responsible Investing

- **The law requires institutional investors to invest as a Prudent Man would invest.**
- **The Mutual Fund managers have also to follow 'Prudent Man Approach' & 'Responsible Investing Approach' even though there is no law.**
- **Prudent investment , which refers to quality and safety of investment**
- **Responsible Investing means funds manager must invest with a sense of responsibility towards the interest of the investor.**

ICICI PRUDENTIAL ASSET MANAGEMENT

Ethical Issues & Responsible Investing

Tools for responsible investing are :

- Screening of investment

  a) Investment may pass the business criteria & regulatory norms, yet may be rejected on ethical grounds.

  b) Some funds in US will not invest in companies manufacturing Cigarettes or alcohol.

- Share holder activism by fund advisors /managers

  In the share holders meetings of companies in which the fund has invested , the fund managers & trustees are expected to actively vote for or against the management resolution ,but in interest of the investor

- Community investing

  special investment programs aimed at helping small communities or cities in need of development ie: underprivileged communities & cities.

ICICI PRUDENTIAL ASSET MANAGEMENT

Business Ethics & Fund Regulations in the U.S

- **New Regulations & Fair Business Practices require**
  - **AMCs to avoid making special payments to distributors and brokers in return for favourable treatment of specific funds by brokers who advice the investors**
  - **Uniform cut off time for all funds for NAV calculations**

ICICI PRUDENTIAL ASSET MANAGEMENT

Thank you and all the very best!!