

**MEPL CLASSES
CS EXECUTIVE
CMSL – MUTUAL FUND**

TIME ALLOTTED – 1 HOUR**MARKS ALLOTTED – 30 MARKS****Question 1.**

“While evaluating the performance of a mutual fund, one must not be led by the mutual fund return in isolation.” In this context, elucidate how performance of mutual fund is evaluated ?

Answer –

While looking at a mutual fund scheme's performance, one must not be led by the scheme's return in isolation. A scheme may have generated 10% annualised return in the last couple of years. But then, even the market indices would have gone up in similar way during the same period. Under-performance in a falling market, i.e. when the NAV of the scheme falls more than its benchmark (or the market), is the time when one must review his/her investment.

One must compare the scheme's return as against its benchmark return. It is better to be rid of investment in a scheme that consistently under-performs as compared to its benchmark over a period of time, from one's portfolio. It is important to identify underperformers over the longer time horizon (as also out-performers).

In addition, one may also consider evaluating the category average returns as well. Even if a scheme has outperformed its benchmark by a decent margin, there could be better performers in the peer group. The category average returns will reveal how good (or bad) is one's investment is against its peers which help in deciding whether it is time to shift the investment to better performers.

One may be holding a too little or too much-diversified portfolio. Even the expense ratio of some of the schemes that one could be holding may be high compared to others within the same category.

Question 2.

“Expense Ratio for a mutual fund should be as low as possible.” Explain how increase or decrease in Total Expense Ratio (TER) shall be disclosed by Asset Management Company under SEBI (Mutual Funds) Regulations, 1996?

Answer

The expense ratio is calculated as a percentage of the Scheme's average Net Asset Value (NAV). The daily NAV of a mutual fund is disclosed after deducting the expenses. Thus, the Total Expense Ratio (TER) has a direct bearing on a scheme's NAV- the lower the expense ratio of a scheme, the higher the NAV.

According to the SEBI Circular No. SEBI/ HO/IMD/DF2/CIR/P/2018/91 dated June 05, 2018, the Asset Management Companies (AMCs) shall predominantly disclose on a daily basis, the TER (Scheme-wise, date-wise) of all schemes under a separate head – “Total Expense Ratio of Mutual Fund Schemes” on their website and on the website of Association of Mutual Funds of India (AMFI).

Any change in the base TER (i.e. TER excluding additional expenses provided in SEBI (Mutual Funds) Regulations, 1996 and Goods and Services Tax on investment and advisory fees) in comparison to previous base TER charged to any scheme/plan shall be communicated to investors of the scheme/plan through notice via email or SMS at least three working days prior to effecting such change. Further, the notice of change in base TER shall be updated in the aforesaid section of website at least three working days prior to effecting such change. However, any decrease in TER in a mutual fund scheme due to various regulatory requirements, would not require issuance of any prior notice to the investors.

Question 3.

Write short notes on – Real Estate Mutual Fund Scheme.

Answer

“Real Estate Mutual Fund Scheme” means a mutual fund scheme that invests directly or indirectly in real estate assets or other permissible assets in accordance with SEBI (Mutual Funds) Regulations, 1996. [Regulation 2(sc)of SEBI (Mutual Funds) Regulations, 1996]

Salient Features of REMFs –

Some of the salient features of REMFs are as under:

1. An Existing Mutual Funds are eligible to launch real estate mutual funds if they have adequate number of experienced key personnel/directors having adequate experience in real estate.
2. Sponsors seeking to set up new Mutual Funds, for launching only real estate mutual fund schemes, shall be carrying on business in real estate for a period not less than five years. They

shall also fulfill all other eligibility criteria applicable for sponsoring a MF.

3. Every real estate mutual fund scheme shall be close-ended and its units shall be listed on a recognized stock exchange.

4. Net asset value (NAV) of the scheme shall be declared daily.

Question 4.

Explain – Mutual Fund Costs.

Answer

There are two broad categories of mutual fund costs, namely –

(a) Operating expenses

(b) Sales charges.

These terms are explained below:

(a) Operating Expenses: Costs incurred in operating mutual funds include advisory fees paid to investment managers, custodial fees, audit fees, transfer agent fees, trustee fees, agents' commission etc. The break-up of these expenses is required to be reported in the schemes offer document. When the operating expenses are divided by the average net asset, the expense ratio is arrived at.

(b) Sales Charges: These are otherwise called as sales loads and are charged directly to the investors. Mutual funds use the sales loads for payment of agent's commission and expenses for distribution and marketing.

Question 5.

Recently the SEBI has mandated the formation of Audit Committee for Asset Management Company (AMCs) of mutual funds. Briefly explain the Role and Composition of Audit Committee.

Answer –

To ensure that the employees of AMC(s), Board members of AMC(s) and Board members of Trustees, including Access Persons shall not take undue advantage of any sensitive information that they may have about any company or its securities or about the AMC's schemes or its units, a category of "access persons" has been created.

Access person shall mean the Head of the AMC (designated as CEO/Managing Director/ President or by any other name). Executive Director, Chief Investment Officer, Chief Risk Officer, Chief Operation Officer, Chief Information Security Officer, Fund managers, Dealers, Research Analysts, all employees in the Fund Operations Department, Compliance officer and Heads of all divisions and/or departments or any other employees as decided by the AMC(s) and/or Trustees. Non-executive Directors of the AMC/trustee company or trustees who are in possession of/have access to any non-public information which could materially impact the price of the securities, NAV of the schemes or interest of the unit holders, shall also be deemed as Access Person.

Question 6.

Explain the various risks involved in investing in mutual funds.

Answer

Risks Involved in Mutual Funds

The following events may result into non- satisfactory performance of Mutual Funds:

- Excessive diversifications of portfolio, losing focus on the securities of the key segments;
- Too much connection on blue-chip securities;
- Poor planning of investment returns;
- Un-researched forecast on income, profits and government policies;
- Fund managers being unaccountable for poor results;
- Failure to identify clearly the risk of the scheme as distinct from risk of the market;
- Under performance in comparison to peers;
- Necessity to effect high turnover through liquidation of portfolio resulting in large payments of brokerage and commission.