

Structure of Mutual Funds

Investors dealing with a mutual fund come in contact with so many entities associated with the fund, that they wonder who does what and why. The core function of a mutual fund is to provide the expertise of professional investment managers to small investors. The investment management service is provided by the Asset Management Company (AMC) for a fee. A mutual fund is structured to minimize the costs of managing money. The AMC is responsible for all activities related to creating a mutual fund product, bringing it to the investors, collecting funds from the investors, investing the funds and managing the operations of the fund. However, not all these functions are directly undertaken by the AMC. They appoint intermediaries who have the expertise to handle the specific functions under their control. They also save costs by outsourcing.

The AMC focuses its attention on the core function of investment management. The investment management team of the AMC evaluates investment opportunities, economic factors and policies and their impact on different assets, sectors and industries. They bring the benefit of a formal and research-oriented investment process to the investors in a mutual fund. They earn a fee from the mutual fund for this function, the limits for this fee being prescribed by SEBI.

Mutual funds operate in a competitive environment. Though SEBI Regulations allow an investment manager to charge up to 1.75% as fees, the actual fee charged is much lower, offering the investor the benefits of competitive rates. Similarly, though the overall annual expense that a mutual fund can charge can be up to 2.5%, in reality, mutual funds charge a much lower annual fee. This feature is perhaps unique to mutual funds as compared to other investment options where the annual fee is not only higher, but far from transparent to the investor.

AMCs would like to reach a large section of investors across geographies. But it is expensive for them to create a sales force or branch network that would span such a large area. AMCs appoint distributors who reach the mutual fund products to the investors. In order to ensure that only quality advisors take mutual fund products to investors, mutual fund distributors have to qualify in a certification examination prescribed by AMFI (Association of Mutual Funds in India). On clearing this exam, they apply for an AMFI Registration Number (ARN). They undertake to abide by a code of conduct, before being given the ARN. Without this registration, they cannot be empanelled by AMCs, nor can they receive any commissions.

In order to ensure that investors are serviced at a large number of locations with efficiency, mutual funds appoint Registrar & Transfer (R&T) agents. R&T agents maintain the records of the investors' transactions and also service investor requests for buying, selling and transacting in units, through their investment service centres (ISCs). The agreements that AMCs enter into with all these constituents and the fee that will be paid are subject to trustee approval. AMCs also enter into service level agreements (SLAs) binding the constituents to performance standards. For example, while SEBI Regulation requires mutual funds to process a request for redemption within 10 days, most funds process these requests in three to five working days. All constituents of a mutual fund, such as brokers, R&T agents, custodians and intermediaries, have to be registered with SEBI and are monitored by the regulator.

Mutual funds provide safety from the multiple levels of supervision and regulation. They combine this with the expertise in management and efficiency in costs. Mutual funds are thus a modern and ideal investment vehicle for investors.

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Mutual fund investments are subject to market risks. Please read the scheme information document carefully before investing.