Mutual Fund

Unlocking the Potential: Exploring Investment Opportunities for Viksit Bharat

August 2024

THE ASSOCIATED CHAMBERS OF COMMERCE AND INDUSTRY OF INDIA

Follow us on:

Mutual Fund

Unlocking the Potential: Exploring Investment Opportunities for Viksit Bharat

August 2024

The Associated Chambers of Commerce and Industry of India
4th Floor, YMCA Cultural Centre and Library Building
01, Jai Singh Road, New Delhi-110001
Tel: 011-46550500 (Hunting Line) | Fax: 011-23017008, 23017009
www.assocham.org

Table of Contents

Deepak Sood
Secretary General, ASSOCHAM

MESSAGE

The Indian financial system has always encouraged a robust mechanism for supporting individuals' investments and companies' funding requirements. Financial markets serve as a crucial platform for generating wealth for the economy, and India stands out as one of the world's fastest-growing wealth management markets. As the purchasing power of the average Indian continues to increase, the Indian mutual fund market is experiencing significant growth, diversity, maturity and modernization. This has made it one of the most attractive investment opportunities for investors in India.

The mutual fund industry in India has undergone a significant transformation over the past decade, emerging as a crucial player in the country's financial services sector. By pooling the savings of millions of individuals into equity and debt instruments, mutual funds have become a transparent and cost-effective investment option in today's ever-changing market landscape. This has sparked a notable increase in investor interest. By facilitating the channelization of savings into appropriate investment vehicles, mutual funds play a vital role in democratizing wealth creation and fostering financial inclusion across the nation. In a deposit-dominated market such as India, mutual funds must provide a unique risk-reward offerings. The development of new products in the mutual funds sector must align with consumer profiles, requirements, return expectations, and risk appetites. Furthermore, the mutual fund industry should prioritize increasing retail penetration by expanding its reach to a wider range of urban and rural areas with banking facilities.

The Securities and Exchange Board of India (SEBI) has consistently demonstrated foresight and prudence in its leadership. Regulatory mechanism have been centered on elevating governance standards, increasing transparency and aligning with international benchmarks. These reforms serve as crucial foundations that uphold the integrity of our financial markets, instilling confidence in investors and cultivating an environment conducive to sustainable growth. As we look ahead, the mutual fund industry in India is poised at the brink of unparalleled opportunities. Our nation's demographic dividend, marked by a growing middle class and rising financial literacy, provides a fertile environment for expanding our investor base. The ongoing transition from traditional savings options to professionally managed mutual funds creates avenues to direct long-term capital into vital sectors, thereby stimulating economic growth.

ASSOCHAM jointly with CareEdge Ratings has come out with this knowledge report on the subject highlighting various aspects of the Mutual Fund Industry. We hope that the report will provide valuable insights to policymakers, retail investors and industry stakeholders and the deliberations at the Summit will further help in laying the roadmap for future growth and development of the Indian mutual fund industry.

Deepak Sood

Mehul Pandya
Managing Director & Group CEO, CareEdge

Over the past decade, the Indian Mutual Fund Industry has witnessed substantial growth indicative of the vibrancy and potential of the mutual fund industry. From June 30, 2014, to June 30, 2024, the assets under management (AuM) in this sector have surged from Rs 9.75 lakh crore to a sizable Rs 61.16 lakh crore which represents a growth of over six times. Mutual funds provide an avenue for ordinary citizens to participate in equity and debt markets.

In the past decade, advancements in technology such as faster data speeds, sophisticated online platforms, and mobile apps have democratized access to investment opportunities. Today, an investor from anywhere can participate in the financial markets with just a few clicks. Systematic Investment Plans (SIPs) have gained widespread popularity, allowing investors to contribute regularly and benefit from the compounding effect, thereby fostering a culture of disciplined investing.

As we look to the future, the mutual fund industry must focus on innovation and expansion. Developing new products tailored to various investor profiles, risk appetites, and return expectations will be essential for capturing a larger share of retail investments. Moreover, deepening the reach of the mutual fund into urban and rural areas would be essential to drive growth. Further, by enhancing financial literacy and accessibility, more individuals can be empowered to make informed investment decisions.

As India continues its journey of economic development, the mutual fund industry is uniquely positioned to support and accelerate this growth. We have come out with this report highlighting various facets of the Mutual Fund Industry. We hope that the contents of the report will provide valuable insights to policymakers, retail investors and industry stakeholders and the deliberations at the summit will further help in laying the roadmap for future growth and development of the Indian mutual fund industry.

Introduction

The transformation of India's mutual fund landscape is indeed remarkable, driven by various factors such as digital adoption and increased focus on smaller cities. The widespread adoption of digital technologies and faster data speeds have played a pivotal role in reshaping the mutual fund industry. Retail contributions through systematic investment plans (SIPs) have surged, reflecting the pervasive digital presence across the nation.

Over the past decade, the Indian mutual fund industry has witnessed substantial growth in its assets under management (AuM). As of June 30, 2024, the AuM stands at Rs 61 lakh crores—a remarkable sixfold increase compared to Rs 8.25 lakh crores in 2014.

The India Mutual Fund Market has multiple significant trends that have been instrumental in shaping the industry's landscape. As the industry has focused on growth, diversification, and digitalization, it has experienced significant changes in asset size, investor behaviour, and the adoption of technology-driven solutions.

In May 2014, the industry surpassed Rs 100 lakh crores for the first time, signalling its growing importance. Within approximately three years, the AuM doubled, reaching Rs 200 lakh crores by August 2017. The upward trend continued, and in November 2020, the AuM crossed Rs 300 lakh crores, solidifying the industry's growth and influence.

The growth in equity-oriented mutual fund categories during FY24 has been impressive. Led by strong inflows and mark-to-market (MTM) gains, these funds expanded by 55%, reaching Rs 23.50 lakh crore. Net inflows surged to Rs 1.84 lakh crore in FY24, up from Rs 1.47 lakh crore in the previous fiscal year. In June 2024, monthly SIP contributions surged to Rs 21,262 crore, crossing the significant Rs 21,000 crore mark. This consistent inflow reflects investors' commitment to disciplined investing.

The number of folios (individual accounts) also increased significantly, reflecting greater retail participation. By May 2021, the industry had surpassed 10 crore folios. As of June 30, 2024, the total number of folios stands at 19.10 crore, with over 12 crore folios concentrated in Equity, Hybrid, and Solution Oriented Schemes—preferred choices for retail investments.

The mutual fund industry has grown materially over the last two decades and is currently slated to grow even further. Mutual funds present an attractive opportunity for wealth accumulation. However, amidst the positive outlook, the industry faces several challenges that demand attention. These range from market volatility to evolving investor preferences, increasing competition and distribution networks.

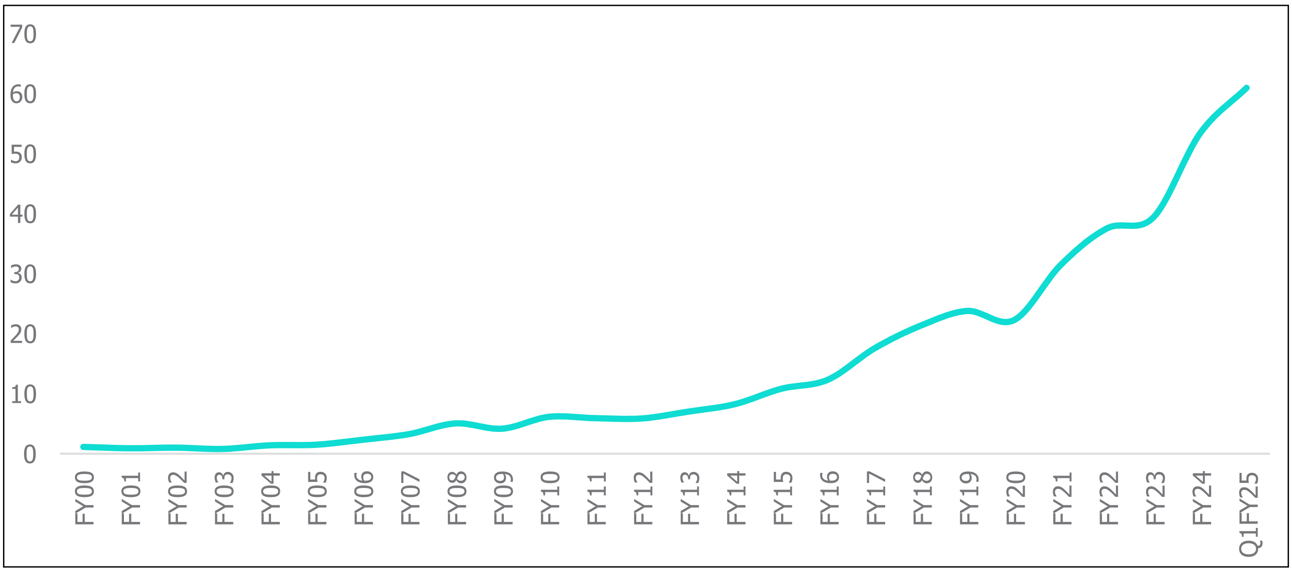
India's mutual fund industry has been growing rapidly and yet the penetration remains low compared to other countries. This highlights the immense opportunity available to the industry. As mentioned in an earlier section of this report, the industry faces challenges around distribution, regulatory supervision, etc. Some of the factors that could help grow the industry ahead include Collaborative Approach, Financial Inclusion and investor education, Corporate Governance and Transparency, Untapped Retirement Market, Technology and Innovation and Distribution Channels.

Industry Overview

A mutual fund is a collective investment vehicle that collects & pools money from a number of investors and invests the same in equities, bonds, government securities, and money market instruments. The money collected in a mutual fund scheme is invested by professional fund managers in stocks and bonds etc. in line with a scheme's investment objective. The income/gains generated from this collective investment scheme are distributed proportionately amongst the investors, after deducting applicable expenses and levies, by calculating a scheme's "Net Asset Value" or NAV. In return, mutual fund charges a small fee.

The Mutual Fund Industry Has Grown at a Rapid Clip

Figure 1: Growth in Domestic Mutual Industry AuM (In Rs lakh crore)



Source: CMIE

FY24 has been a remarkable year for the Indian mutual funds industry. The AuM surged by nearly Rs 14 lakh crore, reaching a record Rs 53.40 lakh crore as of March 2024, compared to Rs 39.42 lakh crore in March 2023. This impressive growth rate of over 35% is the highest since fiscal year 2021, when the industry had expanded by 41%. Furthermore, as of June 2024, the total AuM has increased even further to Rs 61.33 lakh crore, reflecting a robust market performance and investor confidence.

Historical Perspective

To ensure broad participation India's first mutual fund was established in 1963, namely, Unit Trust of India (UTI), at the initiative of the Government of India and Reserve Bank of India. The history of Mutual Funds in India can be broadly divided into five distinct phases[1] as follows:

1 Based on AMFI classification

Figure 2: Phase wise Timeline of Mutual Fund Industry

Phase	Period	Details
First	1964-1987	• The Mutual Fund industry in India started in 1963 with the formation of UTI. • In 1978, UTI de-linked from the RBI and IDBI took over the regulatory and administrative control in place of RBI. • Unit Scheme 1964 (US '64) is the first scheme launched by UTI. • By 1988 end, UTI had Rs 6,700 crores of AuM.
Second	1987-1993	• 1987 - Entry of public sector mutual funds set up by Public Sector banks and Insurance Companies. • SBI Mutual Fund was the first 'non-UTI' mutual fund established in June 1987, followed by Canbank Mutual Fund, Punjab National Bank Mutual Fund, Bank of India, and Bank of Baroda Mutual Fund. • LIC launched its mutual fund in June 1989, while GIC set up its mutual fund in December 1990. • By 1993 end, the MF industry had an AuM of ~Rs 47,000 crores.
Third	1993-2003	• SEBI was established in April 1992 • 1993 - The first set of SEBI Mutual Fund Regulations came into being for all mutual funds, except UTI. The erstwhile Kothari Pioneer was the first private-sector MF registered in July 1993. • 1996 - Initial SEBI MF Regulations revised and replaced with a comprehensive set of regulations, viz., SEBI (Mutual Fund) Regulation. • By January 2003 end, 33 MFs with a total AuM of Rs1,21,805 crores.
Fourth	2003-2014	• In February 2003, following the repeal of the Unit Trust of India Act 1963, UTI was bifurcated into two separate entities, viz., the Specified Undertaking of the Unit Trust of India (SUUTI) and UTI Mutual Fund which functions under the SEBI MF Regulations. • Bifurcation of the erstwhile UTI and several mergers between private sector funds.
Fifth	2014 onwards	SEBI introduced several measures in Sep. 2012 to increase penetration. Since May 2014, the Industry has witnessed steady inflows and increases in the AuM as well as the number of investor folios (accounts). • The Industry's AuM crossed the milestone of Rs10 Lakh Crore for the first time on 31st May 2014 and in a short span of about three years the AuM size crossed Rs 30 Lakh Crore in November 2020. • The no. of investor folios has gone up from 8.38 crore folios as 30-June-2019 of 30 June 2019 to 19.10 crore as on 30-June-2024, more than a 2-fold increase in a span of 5 years.

Source: AMFI

Types of Mutual Funds[2]

Mutual Funds can be broadly classified into various categories based on

Figure 3: Classification of Mutal Fund Types

Categories	Organisation Structure
	Portfolio Management Style
	Investment Objective
	Underlying Portfolio
	Thematic / solution oriented
	Exchange Traded Funds
	Overseas funds
	Fund of funds

By Organisation Structure

- **Open-ended schemes** are perpetual, and open for subscription and repurchase continuously on all business days at the current NAV.
- **Close-ended schemes** have a fixed maturity date. The units are issued at the time of the initial offer and redeemed only on maturity. The units of close-ended schemes are mandatorily listed to provide an exit route before maturity and can be sold/traded on the stock exchanges.
- **Interval schemes** allow purchase and redemption during specified transaction periods (intervals). The transaction period has to be for a minimum of 2 days and there should be at least a 15-day gap between two transaction periods. The units of interval schemes are also mandatorily listed on the stock exchanges.

Portfolio Management Style

- **Active Funds:** In an Active Fund, the Fund Manager decides on stock selection and when to Buy, Hold, or Sell underlying securities. Active funds adopt different strategies and styles to create and manage the portfolio.
- **Passive Funds:** Passive Funds hold a portfolio that replicates a stated Index or Benchmark

By Investment Objectives

Mutual funds offer schemes which cater to multiple investment objectives of the investors e.g.:

- **Capital Appreciation (Growth):** Growth Funds are schemes that are designed to provide capital appreciation which invest in growth-oriented assets, such as equity and have a medium to long-term investment horizon.
- **Regular Income:** Income Funds aim to provide regular income to investors and invest in fixed-income securities such as Corporate Bonds, Debentures and Government securities. These funds generate returns from the interest income earned as well as capital gains from any change in the value of the securities. The funds distribute the income (with no guarantee of any income) provided the portfolio generates the required returns.

2 Classification based on AMFI data

- **Liquidity:** Liquid Schemes, Overnight Funds and Money market mutual funds are investment options for investors seeking liquidity and principal protection, with commensurate returns. Such funds invest in money market instruments with maturities not exceeding 91 days.

By Underlying Portfolio

Mutual fund products can be classified based on their underlying portfolio composition.

- The first level of categorization will be based on the asset class the fund invests in, such as equity/debt/ money market instruments or gold.
- The second level of categorization is because of strategies and styles used to create the portfolio, such as Income fund, Dynamic Bond Fund, Infrastructure fund, Large-cap/Mid-cap/Small-cap Equity fund, Value fund, etc.

By Thematic/ solution oriented, the schemes can be classified into categories such as Tax saving, Retirement benefit, Child welfare, and Arbitrage.

Exchange Traded Funds: An ETF, or exchange-traded fund, is a marketable security that tracks an index, a commodity, bonds, or a basket of assets like an index fund. In simple terms, ETFs are funds that track indexes such as CNX Nifty or BSE Sensex, etc. When you buy shares/units of an ETF, you are buying shares/units of a portfolio that tracks the yield and return of its native index. The main difference between ETFs and other types of index funds is that ETFs don't try to outperform their corresponding index, but simply replicate the performance of the Index. They don't try to beat the market; they try to be the market.

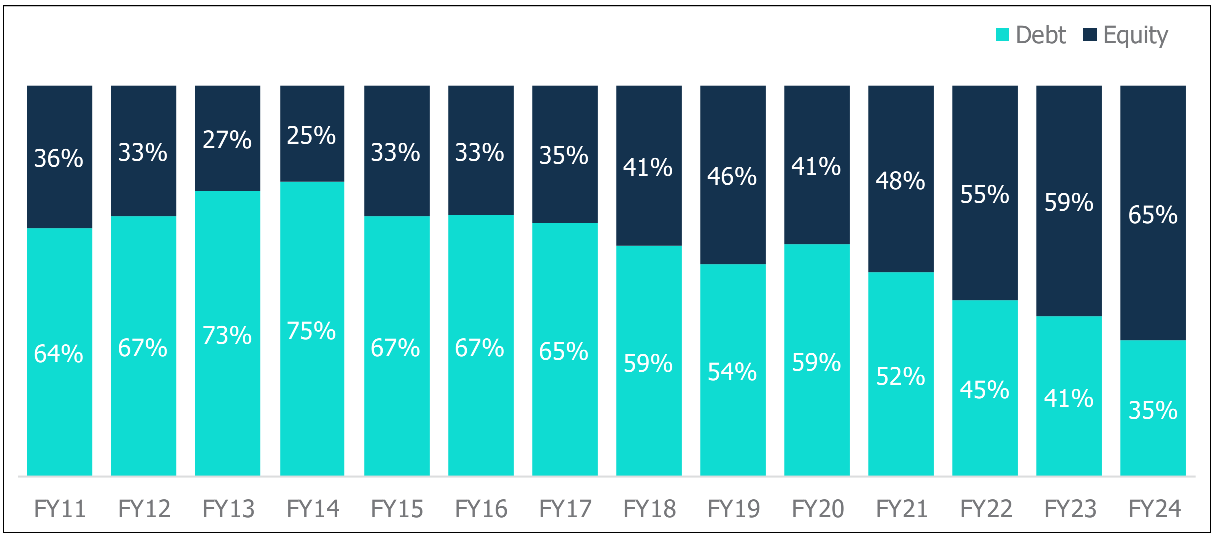
Fund of Funds: A 'Fund of Funds' (FOF) is an investment strategy of holding a portfolio of other investment funds rather than investing directly in stocks, bonds or other securities. A FOF Scheme primarily invests in the units of another Mutual Fund scheme. This type of investing is often referred to as multi-manager investment. These schemes offer the investor an opportunity to diversify risk by spreading investments across multiple funds. The underlying investments for a FoF are the units of other mutual fund schemes either from the same mutual fund or other mutual fund houses.

These categories had created some confusion as funds with similar characteristics would be classified into various buckets. Hence, in October 2017, SEBI issued guidelines on Categorization and Rationalization of schemes under which mutual fund schemes are classified as:

- Equity Schemes.
- Debt Schemes:
- Hybrid Schemes
- Solution Oriented Schemes – For Retirement and Children
- Other Schemes – Index Funds & ETFs and Fund of Funds

Notes: Large, Mid and Small-cap stocks are defined in equity schemes. The naming convention of schemes would be as per the risk level of the underlying portfolio (e.g., the erstwhile 'Credit Opportunity Fund' is now called "Credit Risk Fund"). Balanced/ Hybrid funds are further categorised into conservative hybrid funds, balanced hybrid funds and aggressive hybrid funds.

Figure 4: Equity vs Debt: Share in Deployment of AuM



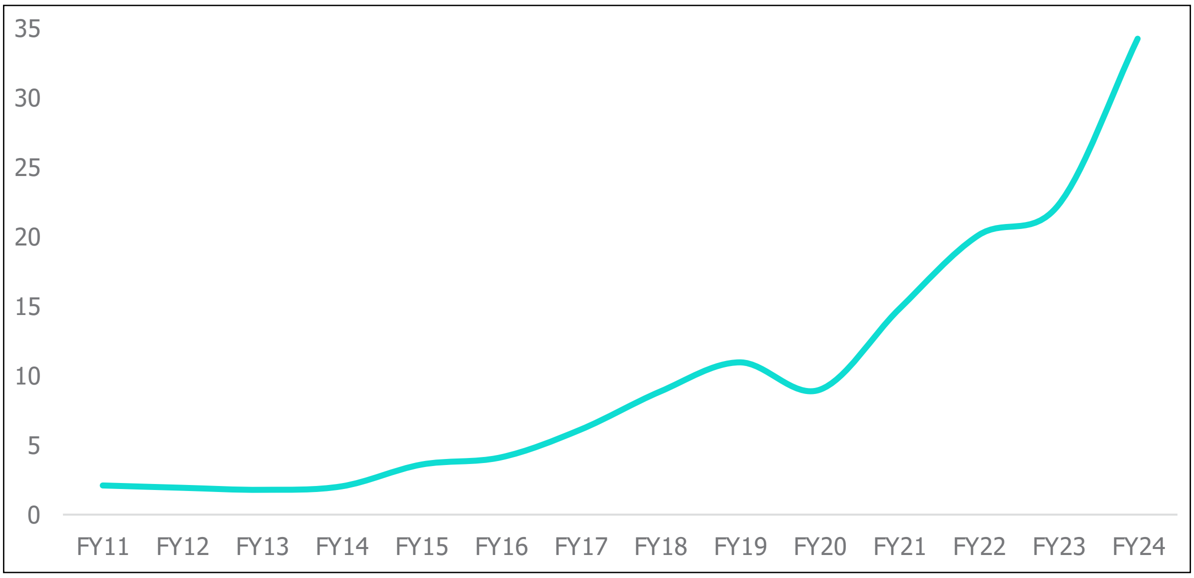
Source: CMIE

As can be seen in the above figure, in FY11 debt dominated the MF portfolio (share of 64%), with equity accounting for the balance 36% share. The share of debt rose till FY14 and then has been on a downward trajectory. In the case of equity, it has been exactly in reverse with the share on the rise. Barring FY20, when the share dipped due to the Covid-19 pandemic. Coincidentally, the share has ended exactly in reverse with equity now accounting for a 65% share and debt accounting for the balance 35%.

Equity Funds

An equity fund is a mutual fund scheme that invests predominantly in equity stocks. In the Indian context, as per current SEBI Mutual Fund Regulations, an equity mutual fund scheme must invest at least 65% of the scheme's assets in equities and equity-related instruments. An Equity Fund can be actively managed or passively managed. Index funds and ETFs are passively managed. Equity mutual funds are principally categorized according to company size, the investment style of the holdings in the portfolio and geography. The size of an equity fund is determined by market capitalization, while the investment style, reflected in the fund's stock holdings, is also used to categorize equity mutual funds.

Figure 5: AuM growth of Equity (In lakh Crores)



Source: CMIE

Equity funds are also categorized by whether they are domestic (investing in stocks of only Indian companies) or international (investing in stocks of overseas companies). These can be broad-market, regional or single-country funds. Some specialty equity funds target business sectors, such as health care, commodities and real estate and are known as Sectoral Funds.

Figure 6: Equity Fund Categories as per SEBI guidelines

Fund Category	Description
Multi Cap/ Diversified Equity	At least 75% investment in equity & equity related instruments
Flexi Cap	At least 65% investments in equity & equity related instruments
Large Cap	At least 80% investment in large-cap stocks
Large & Mid Cap	At least 35% investment in large-cap stocks and 35% in mid-cap stocks
Mid Cap	At least 65% investment in mid-cap stocks
Small cap	At least 65% investment in small-cap stocks
Dividend Yield	Predominantly invest in dividend-yielding stocks, with at least 65% in stocks
Value	Value investment strategy, with at least 65% in stocks
Contra	The scheme follows a contrarian investment strategy with at least 65% in stocks
Focused	Focused on the number of stocks (maximum 30) with at least 65% in equity & equity related instruments
Sectoral/ Thematic	At least 80% investment in stocks of a particular sector/ theme
ELSS	At least 80% in stocks in accordance with Equity Linked Saving Scheme, 2005, notified by the Ministry of Finance

Source: AMFI

Large-cap equity Funds invest a large portion of their corpus in companies with large market capitalization are called large-cap funds. This type of fund is known to offer stability and sustainable returns, over a period of time. Large-cap companies are generally very stable and dominate their industry. Large-cap stocks tend to hold up better in recessions, but they also tend to underperform small-cap stocks when the economy emerges from a recession. Large-cap tend to be less volatile than mid-cap and small-cap stocks and are therefore considered less risky.

Mid-Cap Equity Funds invest in stocks of mid-size companies, which are still considered developing companies. Mid-cap stocks tend to be riskier than large-cap stocks but less risky than small-cap stocks. Mid-cap stocks, however, tend to offer more growth potential than large-cap stocks.

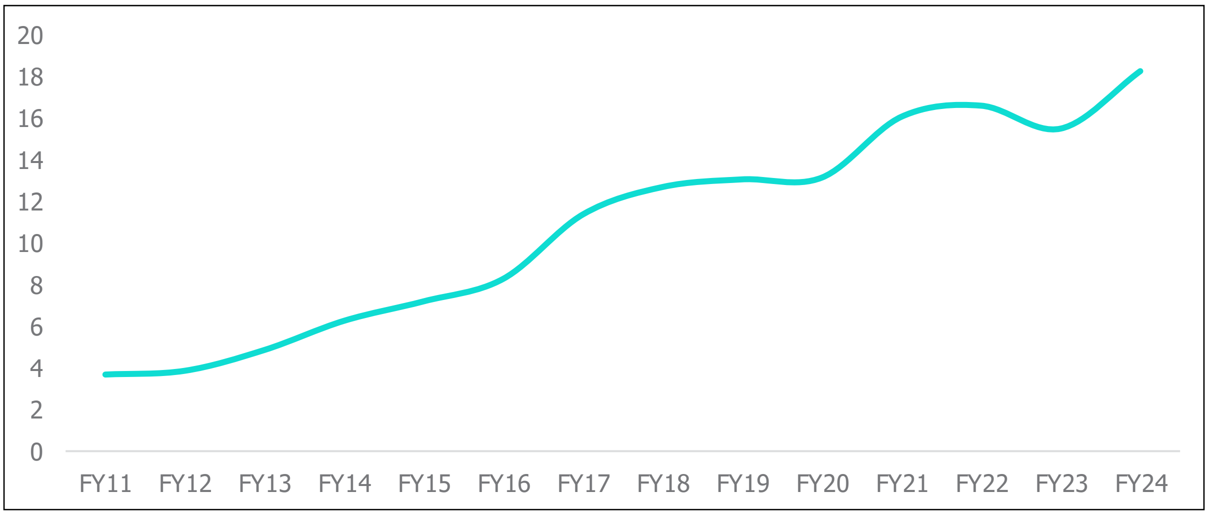
Small Cap Funds invest in stocks of smaller-sized companies. Small cap is a term used to classify companies with a relatively small market capitalization. However, the definition of a small cap can vary among market intermediaries, but it is generally regarded as a company with a market capitalization of less than Rs. 100 crores. Many small caps are young companies with significant growth potential. However, the risk of failure is greater with small-cap stocks than with large-cap and mid-cap stocks. As a result, small-cap stocks tend to be more volatile (and therefore riskier) than large-cap and mid-cap stocks. Historically, small-cap stocks have typically underperformed large-cap stocks during recessions but have outperformed large-cap stocks as the economy has emerged from recessions.

Multi Cap Equity Funds or **Diversified Equity Funds** invest in stocks of companies across the stock market regardless of size and sector. These funds provide the benefit of diversification by investing in companies spread across sectors and market capitalisation. They are generally meant for investors who seek exposure across the market and do not want to be restricted to any particular sector. They invest in companies across different market caps and hence reduce the amount of risk in the fund. Diversification helps prevent events that could affect a single sector from affecting the fund, and hence reduce risk.

Debt Mutual Funds

A Debt Mutual Fund is an investment avenue, which primarily invests in fixed-income securities like treasury bills, bonds, government securities and other debt instruments. These funds offer an opportunity for investors to earn stable returns with lower risk compared to equity investments. Debt funds pool money from multiple investors and are managed by professional fund managers who make investment decisions on behalf of the investors.

Figure 7: Growth of Debt in Mutual Funds Folio (In lakh Crores)



Source: CMIE

Debt Funds function by investing in a diversified portfolio of fixed-income securities.

- **Diverse Portfolio:** Debt Funds spread investments across various debt instruments, reducing the risks associated with individual bonds.
- **Professional Management:** Expert fund managers make investment decisions based on the market conditions and the fund's objectives.
- **Risk and Returns:** Debt Funds offer a predictable income stream as interest or dividends. The interest rates and credit quality of the underlying securities influence the returns.
- **Liquidity:** Investors can buy or sell units in Debt Funds quickly, providing high liquidity

Figure 8: Debt Fund Categories as per SEBI guidelines

Fund Category	Description
Overnight	Overnight securities having maturity of 1 day
Liquid	Debt and money market securities with maturity of up to 91 days only
Ultra Short Duration	Debt & Money Market instruments with Macaulay duration of the portfolio between 3 months - 6 months
Low Duration	Investment in Debt & Money Market instruments with Macaulay duration portfolio between 6 months- 12 months
Money Market	Investment in Money Market instruments having maturity of up to 1 Year
Short Duration	Investment in Debt & Money Market instruments with Macaulay duration of the portfolio between 1 year - 3 years
Medium Duration	Investment in Debt & Money Market instruments with Macaulay duration of portfolio between 3 years - 4 years
Medium to Long Duration	Investment in Debt & Money Market instruments with Macaulay duration of the portfolio between 4 - 7 years

Long Duration	Investment in Debt & Money Market Instruments with Macaulay duration of the portfolio greater than 7 years
Dynamic Bond	Investment across duration
Corporate Bond	Minimum 80% investment in corporate bonds only in AA+ and above rated corporate bonds
Credit Risk	Minimum 65% investment in corporate bonds, only in AA and below-rated corporate bonds
Banking and PSU	Minimum 80% in Debt instruments of banks, Public Sector Undertakings, Public Financial Institutions and Municipal Bonds
Gilt Fund	Minimum 80% in G-secs, across maturity
Gilt with 10-year constant Duration	Minimum 80% in G-secs, such that the Macaulay duration of the portfolio is equal to 10 years
Floater	Minimum 65% in floating rate instruments (including fixed rate instruments converted to floating rate exposures using swaps/ derivatives)

Source: AMFI

- **Income Funds:** These funds are suited for regular income and invest in a mix of government and corporate securities.
- **Short-Term and Ultra Short-Term Funds:** Aimed at investors with a short-term horizon, these funds invest in debt instruments with shorter maturities.
- **Gilt Funds:** These invest primarily in government securities and are considered low-risk.
- **Dynamic Bond Funds:** Managed actively to adapt to the changing market conditions, they have the potential to offer higher returns.
- **Credit Opportunity Funds:** Invest in debt instruments with varying credit qualities, potentially providing higher returns with higher risk.
- **Fixed Maturity Plans (FMPs):** Close-ended funds with a fixed maturity date, providing a clear investment horizon.
- **Corporate Bond Funds:** Potentially offering higher returns than government securities

Liquid Funds: Liquid Funds, as the name suggests, invest predominantly in highly liquid money market instruments and debt securities of very short tenure and hence provide high liquidity. They invest in very short-term instruments such as Treasury Bills (T-bills), Commercial Paper (CP), Certificates of Deposit (CD) and Collateralized Lending & Borrowing Obligations (CBLO) that have residual maturities of up to 91 days to generate optimal returns while maintaining safety and high liquidity. Redemption requests in these Liquid funds are processed within one working (T+1) day. Most retail customers prefer to keep their surplus cash in Savings Bank deposits as they consider the same to be safest and they could withdraw the money at any time. Liquid Funds and Money Market Mutual Funds provide a more attractive option. Surplus cash invested in money market mutual funds earns higher post-tax returns with a reasonable degree of safety of the principal invested and liquidity.

Balanced Funds: A balanced fund combines an equity stock component, a bond component and sometimes a money market component in a single portfolio. Generally, these hybrid funds stick to a relatively fixed mix of stocks and bonds that reflects either a moderate, or higher equity, component, or conservative, or higher fixed-income, component orientation. Balanced funds are suitable for a medium-term horizon and are ideal for investors who are looking for a mixture of safety, income and modest capital appreciation. The amounts this type of mutual fund invests into each asset class usually must remain within a set minimum and maximum.

Figure 9: Hybrid Fund Categories as per SEBI guidelines

Fund Category	Description
Conservative Hybrid	10% to 25% investment in equity & equity related instruments; and 75% to 90% in Debt instruments
Balanced Hybrid	40% to 60% investment in equity & equity related instruments; and 40% to 60% in Debt instruments
Aggressive Hybrid	65% to 80% investment in equity & equity related instruments; and 20% to 35% in Debt instruments
Dynamic Asset Allocation or Balanced Advantage	Investment in equity/ debt that is managed dynamically (0% to 100% in equity & equity related instruments; and 0% to 100% in Debt instruments)
Multi-Asset Allocation	Investment in at least 3 asset classes with a minimum allocation of at least 10% in each asset class
Arbitrage	Scheme following arbitrage strategy, with a minimum 65% investment in equity & equity related instruments
Equity Savings	Equity and equity-related instruments (min.65%); debt instruments (min.10%) and derivatives (min. for hedging to be specified in the SID)

Source: AMFI

Figure 10: Solution-oriented & Other Funds Categories as per SEBI guidelines

Fund Category	Description
Retirement	Lock-in for at least 5 years or till retirement age whichever is earlier
Children	Lock-in for at least 5 years or till the child attains the age of majority whichever is earlier
Index Funds/ ETFs	Minimum 95% investment in securities of a particular index
Fund of Funds (Overseas/ Domestic)	Minimum 95% investment in the underlying fund(s)

Source: AMFI

Trends in Mutual Fund Investments

The India Mutual Fund Market has multiple significant trends that have been instrumental in shaping the industry's landscape. As the industry has focused on growth, diversification, and digitalization, it has experienced significant changes in asset size, investor behaviour, and the adoption of technology-driven solutions.

Equity Funds have grown rapidly driven by inflows and MTM Gains

Figure 11: Growth in Equity Funds

Equity mutual fund category	AuM as of March 2024 (Rs crore)	AuM as of March 2023 (Rs crore)	% change
Flexi Cap Fund	2,41,683	3,50,186	44.9%
Large Cap Fund	2,35,760	3,14,155	33.3%
Sectoral/Thematic Funds	1,72,819	2,97,358	72.1%
Mid Cap Fund	1,83,256	2,96,986	62.1%
Small Cap Fund	1,33,384	2,43,368	82.5%
ELSS	1,51,751	2,13,760	40.9%
Large & Mid Cap Fund	1,27,842	2,05,737	60.9%
Value Fund/Contra Fund	90,584	1,49,099	64.6%
Focused Fund	98,673	1,29,704	31.4%
Multi Cap Fund	67,338	1,24,682	85.2%
Dividend Yield Fund	13,994	23,915	70.9%

Source: AMFI

The growth in equity-oriented mutual fund categories during FY24 has been impressive. Led by strong inflows and mark-to-market (MTM) gains, these funds expanded by 55%, reaching Rs 23.50 lakh crore. Net inflows surged to Rs 1.84 lakh crore in FY24, up from Rs 1.47 lakh crore in the previous fiscal year.

Equity markets, as represented by the Nifty 50 Total Return Index (TRI) and Nifty 500 TRI, performed remarkably well. The Nifty 50 TRI gained approximately 33%, while the Nifty 500 TRI saw an even higher growth rate of around 44%.

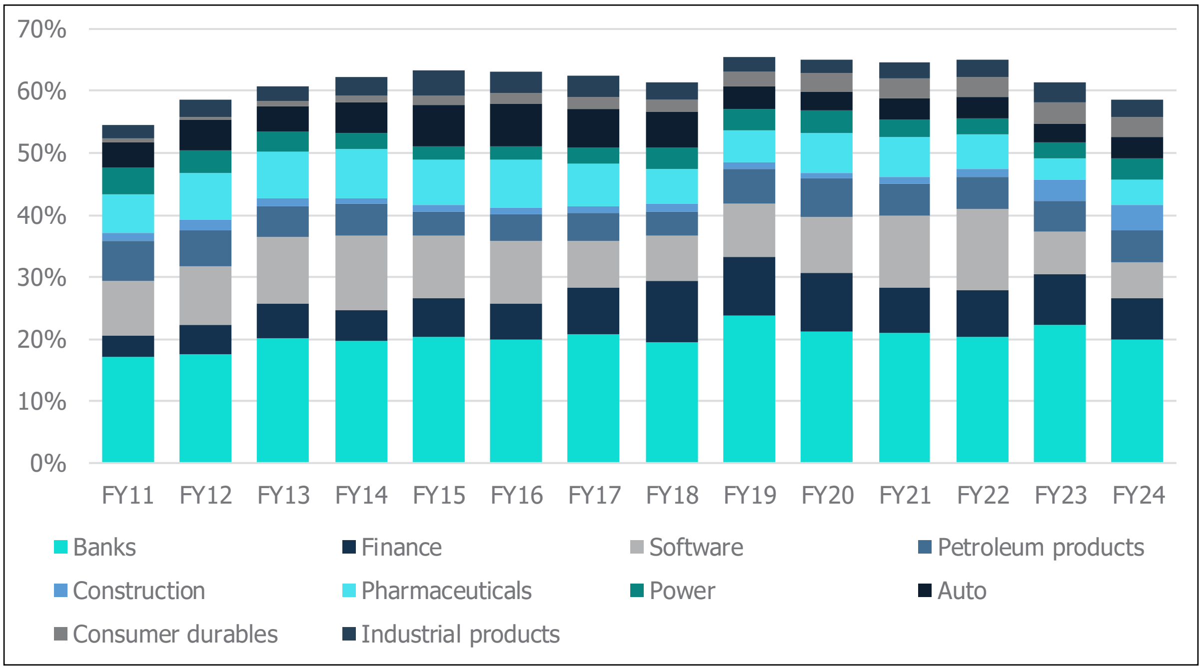
Among the fund categories, the Flexi Cap category emerged as the largest, boasting assets exceeding Rs 3.50 lakh crore as of March 2024. Large Cap funds followed closely, managing assets worth Rs 3.14 lakh crore.

- **Multi Cap Funds:** The multi-cap fund category experienced remarkable growth, expanding by an impressive 85% during FY24. These funds invest across companies of varying market capitalizations, providing diversification and flexibility to investors.

- **Small Cap Funds Surge:** Small cap funds were not far behind, with a growth rate of 82% in the same period. These funds focus on smaller companies, often considered high-risk but with the potential for substantial returns. Despite facing marginal outflows in the last month of the fiscal due to profit booking and regulatory stress tests, the small-cap fund category still managed net inflows exceeding Rs 40,000 crore. This resilience underscores investor confidence in smaller companies.
- **Sectoral/Thematic Inflows:** The sectoral/thematic category witnessed the highest asset inflows during FY24, totalling over Rs 46,000 crore. These funds invest in specific sectors (such as technology, healthcare, or infrastructure) or follow thematic investment themes (like ESG or digitalization).

BFSI Segment continues to dominate the allocations

Figure 12: Top 10 Sectoral Allocation of Equity Funds



Source: CMIE

The top 10 segments continue to account for around 60% share of the equity fund exposure. The BFSI segment has remained the largest segment of the equity allocation followed by software and petroleum products.

Debt Funds Post Moderate Gains

Figure 13: Growth in Debt Funds

Debt mutual fund category	AuM as of March 2023 (Rs crore)	AuM as of March 2024 (Rs crore)	% change
Liquid Fund	3,32,498	3,63,510	9.3%
Money Market Fund	1,08,468	1,48,893	37.3%
Corporate Bond Fund	1,30,767	1,47,361	12.7%
Short Duration Fund	91,239	99,004	8.5%
Low Duration Fund	86,693	90,212	4.1%
Ultra Short Duration Fund	79,123	83,561	5.6%
Banking and PSU Fund	80,517	80,891	0.5%
Overnight Fund	95,626	61,314	-35.9%
Floater Fund	52,989	51,469	-2.9%
Dynamic Bond Fund	29,287	31,617	8.0%
Gilt Fund	21,458	27,268	27.1%
Medium Duration Fund	27,091	25,976	-4.1%
Credit Risk Fund	24,776	23,141	-6.6%
Long Duration Fund	8,798	12,769	45.1%
Medium to Long Duration	8,895	10,497	18.0%
Gilt Fund with 10-year constant duration	3,760	4,742	26.1%

Source: AMFI

Moderate Growth in Debt Funds: Debt funds experienced a moderate growth rate of approximately 7% during FY24, reaching a total asset size of Rs 12.62 lakh crore. This growth comes after contractions of 2% and 9% in fiscal years 2022 and 2023, respectively.

Folio Growth Despite Challenges: Despite facing challenges, such as the removal of indexation benefit, the debt fund category gained in folios during FY24. Over 5,000 new folios were added, indicating investor confidence in this segment. This positive trend followed degrowth in the previous two fiscal years.

Money Market and Liquid Funds: Money market funds and liquid funds saw the highest absolute asset gains during FY24. Money market funds added Rs 40,000 crore, while liquid funds increased by Rs 31,000 crore.

Long-Duration Funds: Among other debt fund categories, long-duration funds stood out with the highest percentage growth rate of 45%. These funds invest in longer-term debt instruments and ended the fiscal year with assets worth ~Rs 12,700 crore.

Figure 14: Debt Allocation by Category (FY24)

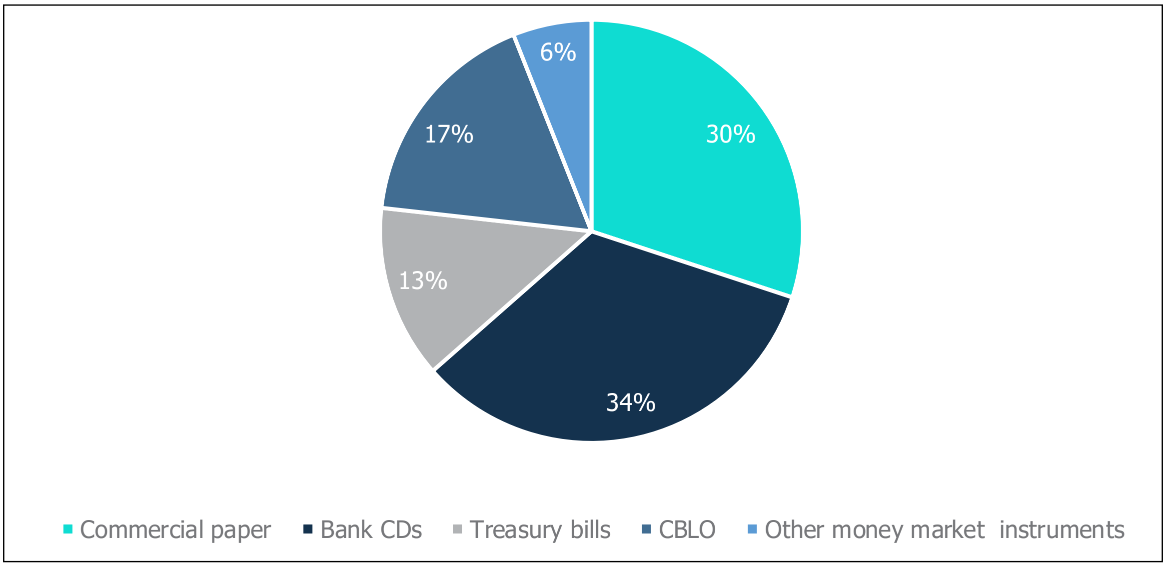
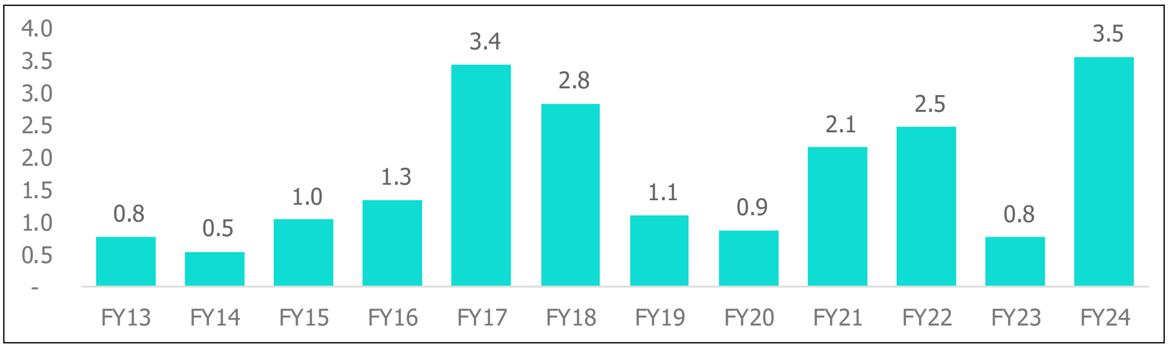


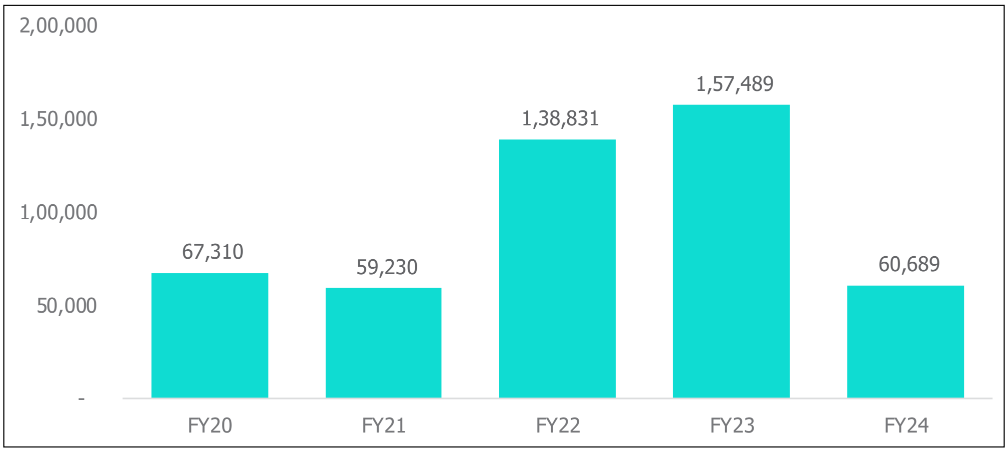
Figure 15: Net Inflows into Mutual Funds (Rs lakh crore)



Source: CMIE

The net inflows have remained positive especially in equity funds due to investors' confidence in the equity market despite fluctuations and uncertainties and new fund offerings.

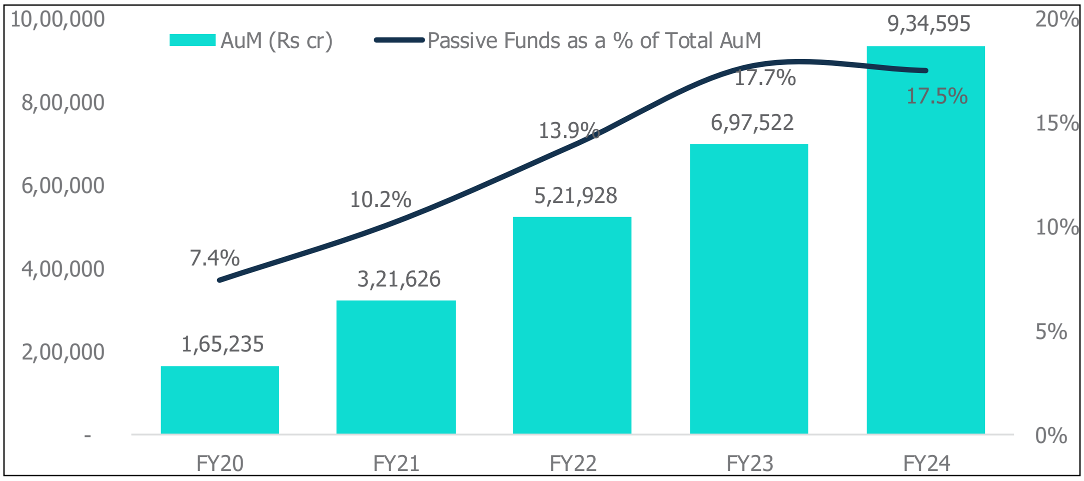
Figure 16: Passive Funds continue to witness strong inflow (Rs crore)



Source: AMFI, CMIE; Note; Includes Gold ETFs, Other ETFs, Index Funds and FoF investing overseas

Passive funds have continued to witness significant inflows due to institutional investment flows into exchange traded funds (ETFs) from investors such as provident funds. ETFs received inflows of ~Rs 42,000 crore in FY24, while FoF investing overseas actually witnessed outflows of ~Rs 3000 crores compared with aggregate inflows of ~Rs 61,000 crore for the entire segment.

Figure 17: Leading to Robust AuM Growth and Increased Share of Aggregate AuM



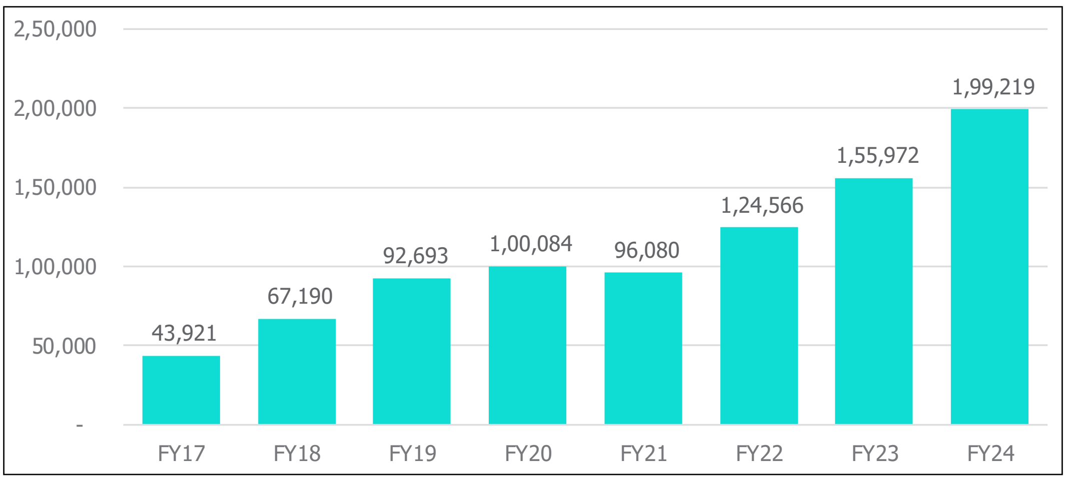
Source: AMFI, CMIE

Over the FY2-FY24 period, AuM of the passive segment has increased at a CAGR of 54% or by ~6 times enabling the category to increase its share from 7.4% of the mutual fund industry to 17.5% share. While EPFO participation has been a key driver, other factors include investments by individual investors into index funds, while Gold ETFs have also benefited from a rise in the price of underlying gold.

Eve as the other ETFs continue to be the largest segment, its share has reduced from 89% in FY20 to 71% in FY24, while the share of index funds has increased from 5% in FY20 to 23% in FY24.

SIP Adoption Improves and Supports Growth of Equity Funds

Figure 18: SIP fiscal year-wise contribution (Rs crore)



Source: AMFI, CMIE

The growing popularity of systematic investment plans (SIPs) can be analysed across the following parameters.

Net Inflows:

- For the entire fiscal year 2024, SIPs attracted net inflows of nearly Rs 2 lakh crore, a significant increase from the Rs 1.55 lakh crore seen in the previous fiscal year. In March 2024, SIPs witnessed robust monthly net inflows of approximately Rs 19,300 crore. This consistent investment approach has gained favour among investors. This surge reflects investor confidence in SIPs as a disciplined investment method.
- In June 2024, monthly SIP contributions surged to Rs 21,262 crore, crossing the significant Rs 21,000 crore mark.

Figure 19: SIP Statistics

	Jan 2024	Feb 2024	Mar 2024	Apr 2024	May 2024	Jun 2024
SIP assets (Rs lakh crore)	10.27	10.53	10.72	11.26	11.53	12.44
SIP assets as % of industry assets	19%	19%	20%	20%	20%	20%
SIP accounts (crore)	7.92	8.2	8.4	8.7	8.76	8.99
SIP accounts as % of total folios	47%	47%	47%	48%	47%	47%

Source: AMFI

SIP Assets:

- As of March 2024, SIP assets reached Rs 10.71 lakh crore, constituting more than 20% of the total industry assets. This substantial pool of funds underscores the impact of SIPs on the mutual fund landscape.
- During June, SIP assets increased by 8%, reaching Rs 12.43 lakh crore. This growth was driven by both mark-to-market (MTM) gains and fresh inflows.

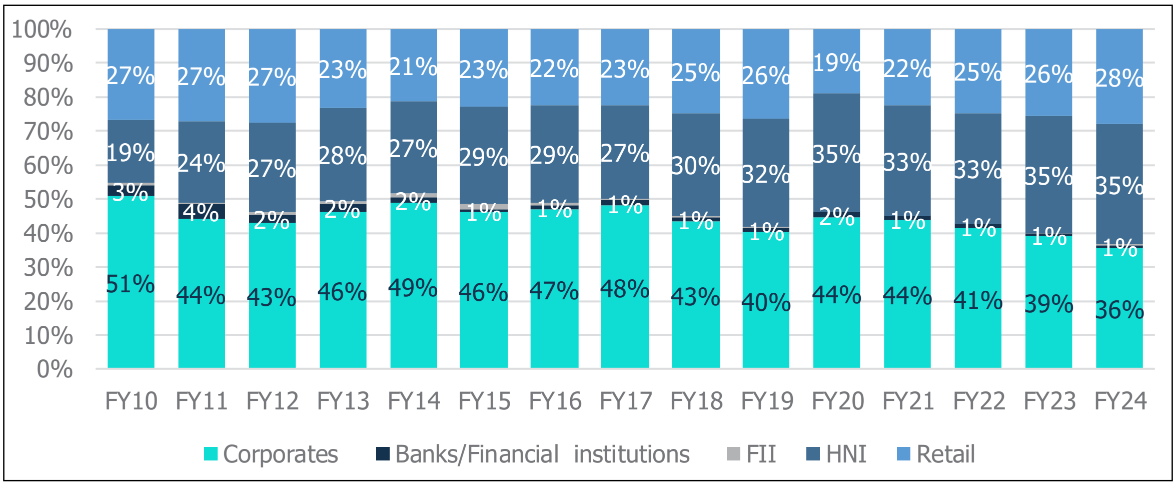
Growing SIP Accounts:

- The number of SIP accounts surged to nearly 8.4 crore. Approximately seventeen lakh new SIP accounts were added each month, highlighting the widespread adoption of this investment strategy.
- Over the last four years, another point to be noted is that SIP account closures are roughly half of the new SIPs registered for that year.

MFs' Share in Household Savings:

- Despite the overall decline in household savings, mutual funds (MFs) witnessed a positive trend. The share of MFs in household savings increased from an average of 3.4% during FY11 to FY20 to 4.8% during FY21 to FY23.

Figure 20: Share of Mutual Funds by Investor Type (as a % of AuM)



Source: AMFI, CMIE

Individual Investors' Asset Growth:

- The value of assets held by individual investors in mutual funds surged from Rs 25.67 lakh crore in June 2023 to Rs 37.47 lakh crore in June 2024. This remarkable increase represents a growth rate of 45.94%. Individual investors continue to play a significant role in the industry.

Institutional Assets Rise:

- Institutional assets also witnessed growth, albeit at a slightly lower rate. From Rs 19.15 lakh crore in June 2023, they increased to Rs 23.87 lakh crore in June 2024, reflecting a rise of 24.62%.

Share of Industry Assets:

- Individual investors maintained a relatively higher share of industry assets, accounting for 61.1% in June 2024 (compared to 57.3% in June 2023). Their confidence in mutual funds remains strong.
- Institutional investors, including corporates, hold the remaining 38.9% of assets. Corporates alone constitute 95% of this institutional share, while the rest comprises Indian and foreign institutions and banks.

Asset allocation patterns between individual investors and institutions in the mutual fund industry:

Individual Investors:

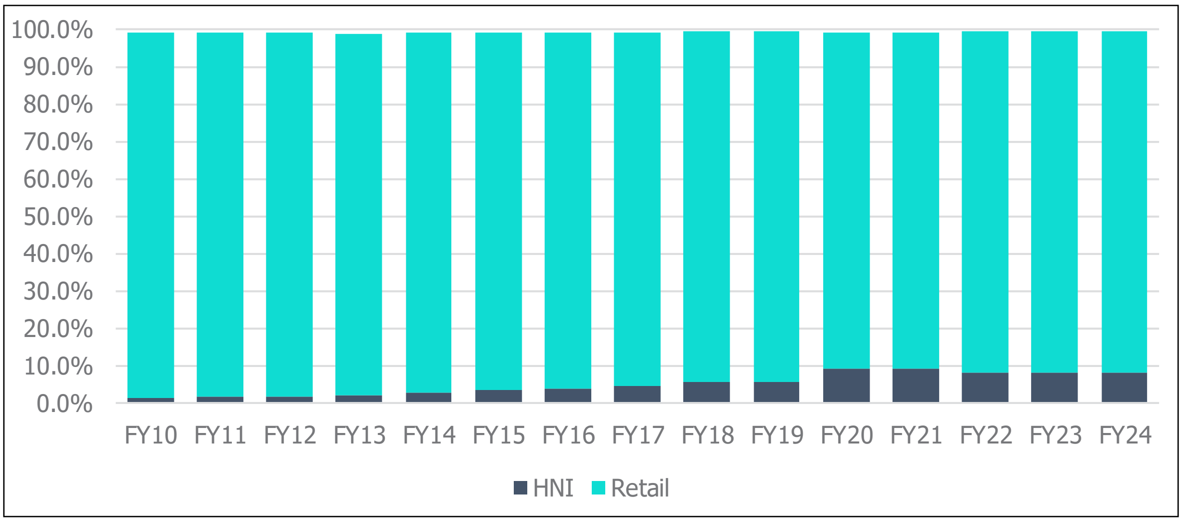
- Equity-Oriented Schemes: Approximately 85% of individual investor assets are held in equity-oriented schemes. These include funds that invest primarily in stocks, providing exposure to the equity market.
- Other Categories: The remaining portion of individual investor assets is allocated to various other fund types.

Institutions:

- Liquid and Money Market Schemes: Institutions allocate around 53% of their assets to liquid and money market schemes. These funds focus on short-term debt instruments and provide liquidity.

- Debt-Oriented Schemes: The rest of the institutional assets are invested in debt-oriented schemes. These funds primarily hold fixed-income securities.

Figure 21: Share of Mutual Funds by Investor Type (as a % of # Folios)



Source: CMIE, AMFI

The surge in mutual fund folios between December 2014 and March 2024 is remarkable, with a nearly 340% increase, reaching a total of 17.79 crore folios. Interestingly, this growth contrasts with the post-2008-09 global financial crisis period when folio numbers declined. As of March 2024, here's the breakdown:

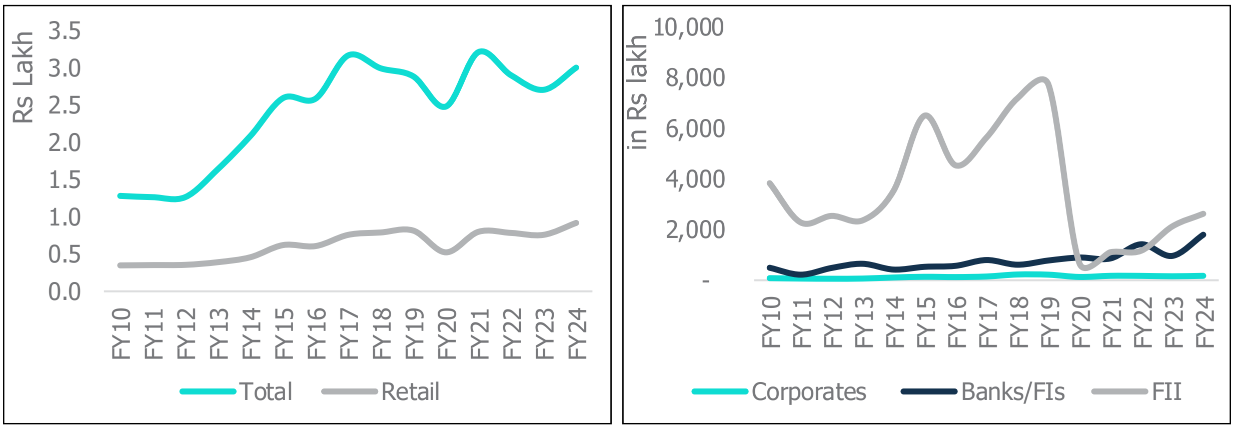
Investor Composition:

- Retail Investors: They account for a significant 91.4% of the total folios. These individual investors play a crucial role in the mutual fund industry.
- High Net Worth Individuals (HNIs): HNIs represent around 9% of the folios. Their participation is notable, albeit in smaller numbers.
- Institutions: The remaining folios belong to institutional investors.

Debt-Oriented Schemes:

- Retail investors hold 68.7% of the total accounts in debt-oriented schemes. This category has the lowest retail investor participation.
- HNIs, on the other hand, are concentrated in debt-oriented (29.0%), liquid/money market (19.6%), and hybrid (23.8%) schemes.

Figure 22: Average ticket size per folio by Investor Type



Source: CMIE

Average Ticket Size:

- Equity-Oriented Funds: The average ticket size for equity-oriented funds increased to Rs 1,91,149, representing a 24% growth from March 2023.
- Debt-Oriented Funds: For debt-oriented funds, the average ticket size reached Rs 16,02,145, showing a 10% increase from March 2023.
- Institutional Investors: Institutional investors had the highest average ticket size at Rs 18.17 crore per account.
- Retail Investors: Retail investors, on the other hand, had an average ticket size of Rs 84,178 per account.

Asset Holding Periods:

- Equity Assets: Equity assets tend to have a longer average holding period. Approximately 53.3% of equity assets have been held for periods greater than 24 months.
- Retail Investors and Equity Assets: Retail investors hold 58.9% of equity assets for periods exceeding 24 months, emphasizing their long-term investment approach.

Figure 23: Geographical Mix

	Rs crore		Equity Oriented Schemes		Non-Equity Oriented Schemes	
	May 2024	June 2024	May 2024	June 2024	May 2024	June 2024
T30	4,810,681	5,020,375	53%	54%	47%	46%
B30	1,049,270	1,112,852	85%	85%	15%	15%

Source: AMFI

The growing interest in equity and equity funds from smaller towns and cities reflects a positive trend toward financial inclusion. These trends highlight the evolving landscape of mutual fund participation across different city tiers and investor segments. The key points include:

B30 Cities (Beyond Top 30):

- Assets from B30 cities increased significantly, rising from Rs 7.58 lakh crore in June 2023 to Rs 11.13 lakh crore in June 2024—a remarkable 47% growth.
- B30 cities now account for 18% of the overall AuM in mutual funds. This growth can be attributed to factors like increased awareness, rising income levels, and incentivized distribution efforts.

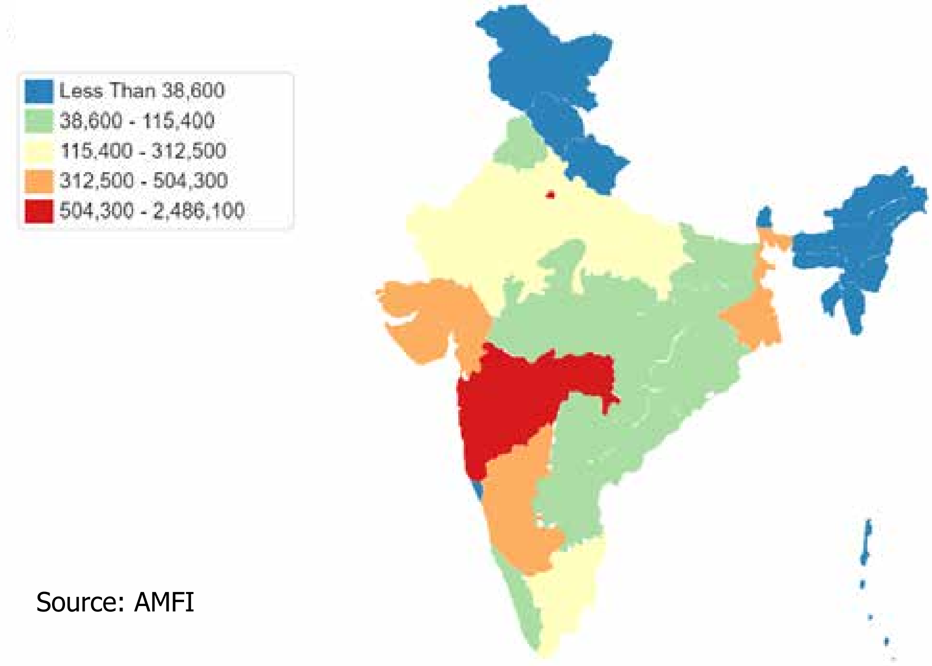
Equity in B30 Cities:

- B30 cities seem to have a higher inclination toward equity assets compared to the T30 cities (top 30 cities). However, it's essential to consider that T30 cities house most institutional treasuries, which may skew the overall equity fund AuM mix.

Asset Distribution:

- In June 2024, 26.63% of assets held by individual investors came from B30 locations, emphasizing their active participation.
- Institutional assets, on the other hand, are concentrated in T30 locations, accounting for 95.17% of the total. Only 4.83% of institutional assets originate from B30 cities.
- Approximately 24% of retail investors choose to invest directly, while 27% of high-net-worth individual (HNI) assets are invested directly.
- Notably, 45% of the mutual fund industry's assets come directly from investors. Direct investments are prevalent in non-equity-oriented schemes, where institutional investors dominate.
- Specifically, 81% of liquid/money market scheme assets (where institutional investors dominate) are direct, while 64% of debt-oriented scheme assets and 27% of equity scheme assets follow a direct investment approach.

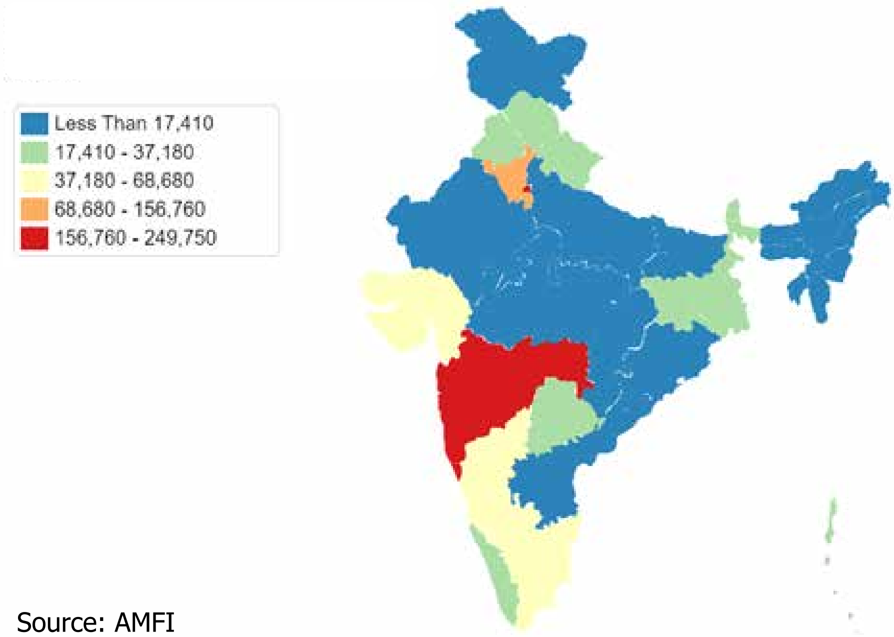
Figure 24: State-wise Average AuM June 2024



Source: AMFI

Maharashtra accounts for a significant chunk of the Industry's AAuM, followed by Gujarat, Karnataka and other southern states. Meanwhile, the north-eastern part of India has the smallest share of the industry AAuM with Central and eastern regions falling on the lower side of the size scale. This is also reflected in the Penetration levels with a similar trend being observed along with the fact that Rajasthan is amongst the states that have the lowest mutual fund penetration levels.

Figure 25: State Wise Penetration June 2024



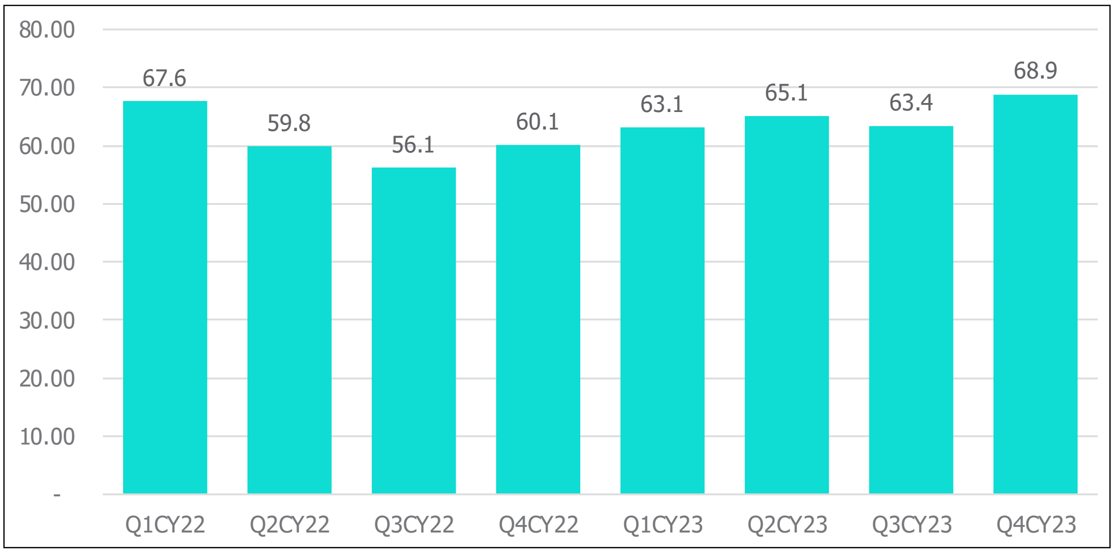
Source: AMFI

International Mutual Fund Industry

Global Overview

As per data released by the International Investment Funds Association, globally regulated open-end fund assets increased by 8.6% to $68.85 trillion at the end of CY2023, excluding funds of funds. Worldwide net cash inflow to all funds was $700 billion in the fourth quarter, compared with $403 billion of net inflows in the third quarter of 2023.

Figure 26: Movement in Global Total net assets excluding funds of funds (in $ tr)



Source: International Investment Funds Association

The growth rate of total regulated open-end fund assets reported in US dollars was increased by US dollar depreciation over Q4CY2023. On a US dollar–denominated basis, fund assets in Europe increased by 9.3% in the fourth quarter, compared with an increase of 4.7% on a euro-denominated basis.

Figure 27: Net Assets of Worldwide Regulated Open-End Funds (In $ tr)

	2022				2023			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
All funds	67.6	59.8	56.1	60.1	63.1	65.1	63.4	68.9
Long-term	59.0	51.4	47.8	51.3	53.6	55.4	53.4	58.4
Equity	31.6	26.6	24.8	27.0	28.4	29.8	28.6	31.8
Bond	13.0	11.9	11.3	11.5	12.0	12.2	12.0	12.9
Balanced/ Mixed	8.2	7.2	6.6	7.0	7.3	7.3	6.9	7.3
Real Estate	1.4	1.3	1.3	1.4	1.4	1.4	1.3	1.4
Other	4.7	4.3	4.0	4.4	4.5	4.7	4.6	5.0
Money market	8.6	8.5	8.3	8.8	9.5	9.7	9.9	10.4

Source: International Investment Funds Association

Equity fund assets increased by 11.0% to $31.79 trillion at the end of 2023. Meanwhile, bond fund assets increased by 7.7% to $12.89 trillion in the fourth quarter. Balanced/mixed fund assets increased by 5.8% to $7.30 trillion in the fourth quarter, while money market fund assets increased by 5.0% globally to $10.44 trillion. At the end of the fourth quarter of 2023, 46% of worldwide regulated open-end fund assets were held in equity funds. The asset share of bond funds was 19%, while the asset share of balanced/mixed funds was 11%. Money market fund assets represented 15% of the global total. Meanwhile, 54% of worldwide assets were in the Americas followed by 31% in Europe, and the balance was in Asia-Pacific and the Africa (with the smallest share) regions. India has quite a small share at 0.9% of the global pie, highlighting the relatively modest size and the distance yet to be travelled.

As seen above, the penetration of Mutual Funds in India is quite low compared to other countries. Below are the rankings of countries where the AuM to GDP percentage is the highest in the world.

Figure 28: Country AuM to GDP (%) Rank in the World

Rank	Country	Year: 2020
1	Luxembourg	8,330.59
2	Singapore	998.32
3	Ireland	957.79
4	Hong Kong SAR, China	575.72
5	Australia	185.10
6	United States	140.16
7	Netherlands	126.62
8	Sweden	104.54
9	Switzerland	99.61
10	Canada	97.56
11	France	96.43
12	Brazil	79.91
13	United Kingdom	77.61
14	Germany	74.96
15	Jamaica	69.91
16	South Africa	61.54
17	Austria	50.59
18	Denmark	49.76
19	Norway	48.28
20	Japan	48.09
36	India	15.84

Source: World Bank

Indian open-ended mutual fund assets log the highest growth versus global peers

However, as per data disclosed by the International Investment Funds Association, as of March 2024, India has seen the highest growth in its assets under management in the last 5 years, 10 years and 15 years.

Figure 29: Global regulated open-end funds: Total net assets excluding FoF (in %)

Country	5 years	10 years	15 years
Brazil	13	14	15
China	14	22	19
Germany	5	6	7
India	20	24	20
Japan	11	11	11
South Africa	8	9	12
UK	4	7	11
US	9	8	9

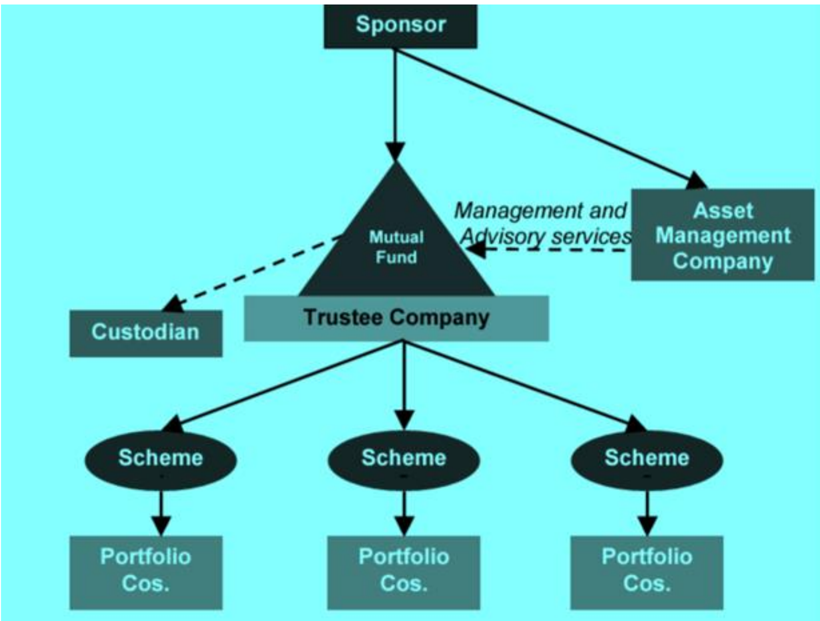
Source: AMFI

India can gain valuable insights from other countries when it comes to shaping its mutual fund industry. Europe has a well-established mutual fund industry with a strong emphasis on investor protection and regulatory oversight. The implementation of the Undertakings for the Collective Investment in Transferable Securities (UCITS) framework across European Union member states demonstrates the commitment to uniform regulations for investment funds. India can continue to strengthen its framework from Europe's focus on investor protection and the importance of a robust regulatory framework. This comparative analysis serves as a reference point to gauge the growth potential and the distance it has yet to travel compared to other countries.

Policy Measures

The regulation of mutual funds in India is undertaken by the Securities and Exchange Board of India ("SEBI"). Any anybody who proposes to establish a mutual fund in India is required, under the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 ("Mutual Fund Regulations"), to be registered with the SEBI. The Mutual Fund Regulations lay down several criteria that need to be fulfilled to be granted registration as a mutual fund. Every mutual fund must be registered with SEBI and must be constituted in the form of a trust in accordance with the provisions of the Indian Trusts Act, 1882. The instrument of trust must be in the form of a deed between the sponsor and the trustees of the mutual fund duly registered under the provisions of the Indian Registration Act, 1908. SEBI and the government of India have implemented a series of measures aimed at establishing a robust and trustworthy regulatory framework for the mutual fund industry. SEBI's proactive approach has significantly contributed to the development of a comprehensive and reliable ecosystem for mutual fund investments.

A typical mutual fund structure in India can be represented as below:



Some of the recent regulatory initiatives undertaken by SEBI include:

- Implementation of a new categorization and rationalization system for mutual fund schemes to make it easier for investors to understand and compare different schemes.
- Measures to Reduce Total Expense Ratio (TER) in Mutual Fund Schemes
- Stress Testing of Smallcap and Midcap Equity Schemes
- Establishing a formalized institutional framework for recognition and prevention of market abuse, such as front-running and fraudulent securities transactions

- Improving AMC management's accountability and responsibility for the Institutional Mechanism
- Consultation Paper for introduction of Mutual Funds Lite Regulations (MF LITE) for passively managed Mutual Funds Schemes
- Consultation Paper on Flexibility in Participation by Mutual Funds in Credit Default Swaps (CDS)
- Consultation Paper on Facilitating Investments by Indian Mutual Funds in such Overseas Funds that invest certain portion of their assets in Indian securities

Stress Testing of Mutual Funds

Debt Schemes

SEBI has mandated AMCs to conduct monthly stress testing of all open-ended debt schemes (except overnight schemes) for evaluating the impact of various risk parameters such as interest rate risk, credit risk and liquidity risk on the net asset values (NAVs) of their respective schemes for over a decade and these norms were updated in 2022. AMFI and the AMCs have specified the impact thresholds of these risk parameters. In April 2024, 28 open-ended debt schemes with total AUM of Rs 1.76 lakh crore had reported risk above the AMFI/AMC prescribed threshold. Consequently, all the relevant mutual funds have initiated remedial action which would be completed in the prescribed timeframe.

Figure 30: Stress Testing of Open-Ended Debt Schemes of Mutual Funds – Summary Findings – April 2024

	Risk above Threshold	Risk below Threshold	Total
No. of AMCs	12	32	44
No. of Schemes	28*	273	301
AUM (Rs lakh crore)	1.76	13.29	15.05

Source: RBI Financial Stability Report June 2024; Note: * The # of schemes which show interest rate risk, credit risk and liquidity risk above the threshold are 20, 4, and 6 respectively while total # of unique schemes remain 28.

Additionally, as part of liquidity risk management for open-ended debt schemes, two liquidity ratios, namely 1) redemption at risk (LR-RaR), which represents likely outflows at a given confidence interval, and 2) conditional redemption at risk (LR-CRaR), which represents the behaviour of the tail at the given confidence interval, are used. All AMCs are required to maintain these liquidity ratios above the threshold limits which are derived from scheme type, scheme asset composition and potential outflows. Mutual funds (MFs) are required to carry out back-testing of these liquidity ratios for all open-ended debt schemes (except overnight funds, gilt funds and gilt funds with 10-year constant duration) monthly. The LR-RaR and LR-CRaR calculated by top 10 mutual funds (based on AuM) for 13 categories of open-ended debt schemes for March 2024 were above the threshold limits baring a few mutual funds. A few instances of the ratios falling below the threshold limits were addressed by the respective AMCs in a timely manner.

Stress Testing of Smallcap and Midcap Equity Schemes

With significant inflows into the smallcap and mid cap equity schemes due to the significant MTM gains, these schemes had increased in size prompting concerns over their portfolio liquidity and ability to return capital to investors in case of any significant market fluctuations. In this regard, mutual funds were advised to conduct on an ongoing monthly basis, stress test the number of days that will be required to liquidate 50% and 25% of the portfolio respectively on a pro-rata basis, under stress condition along with concentration analysis of liability and asset sides. These tests provide investors with objective data on the liquidity of mutual fund assets. Additionally, it also enables mutual funds to be aware of the liquidity levels and prepare for sudden redemptions.

In the recent Union Budget, following are some of the changes which have been proposed that could impact the industry:

- Short-term gains on certain financial assets to attract a tax rate of 20%, while all other financial assets and all non-financial assets are to be taxed at an applicable tax rate.
- Long-term gains on all financial and non-financial assets to attract a tax rate of 12.5%. The limit of exemption of capital gains on certain financial assets increased to Rs 1.25 lakh per year.
- Listed financial assets held for more than a year will be classified as long-term. While unlisted financial assets and non-financial assets held for more than 2 years from the date of purchase are to be classified as long-term. However, Unlisted bonds and debentures, debt mutual funds and market-linked debentures, irrespective of the holding period, will attract tax on capital gains at applicable rates.
- Indexation benefit removed for calculation of any long-term capital gains for property.
- Increase the rates of Securities transaction tax (STT) on the sale of an option in securities to 0.1% of the option premium, and on the sale of a futures in securities to 0.02%.
- Eliminate the 20% TDS rate on mutual funds or UTI unit repurchases.

Risk Factors

Broadly risk factors for mutual fund investments can be divided into standard risk factors and specific risk factors.

Standard Risk Factors

- No guarantee or assured return of products.
- Includes investment risks such as trading volumes, settlement risk, liquidity risk, and default risk.
- Value of investments in a mutual fund may change based on underlying securities.
- The NAV may fluctuate with movements in the broader equity and bond markets and may be influenced by factors affecting capital and money markets.
- Past performance does not guarantee future performance of any Mutual Fund Scheme.

Specific Risk Factors

Equities

- Risk of loss of principal
- Price Risk: volatile and prone to daily price fluctuations
- Liquidity Risk for listed securities: The liquidity of investments made in the equities may be restricted by trading volumes and settlement periods.
- Event Risk: Price risk due to company or sector specific event.

Debt and Money Market

- Interest Rate Risk: The value of a scheme's underlying portfolio could reduce if the interest rate rises and appreciates when the interest rate reduces.
- Credit Risk: It is associated with default/ non-payment of interest and /or principal amounts by companies which have issued fixed-income securities.
- Spread Risk: The value of fixed-income securities in the portfolio may depreciate if the credit spreads widen and vice versa.
- Liquidity Risk: Indicates the ease with which securities can be sold at or near its valuation.
- Counterparty Risk: It means the failure of the other party to a transaction to deliver securities against consideration received or to pay consideration against securities delivered.
- Prepayment Risk
- Re-investment Risk

Challenges

The mutual fund industry has grown materially over the last two decades and is currently slated to grow even further. Mutual funds present an attractive opportunity for wealth accumulation. However, amidst the positive outlook, the industry faces several challenges that demand attention. These range from market volatility to evolving investor preferences, increasing competition and distribution networks.

1. Becoming a Pull Product:

- Mutual funds need to transition from being pushed onto investors through sales efforts to becoming a product that investors actively seek out. The popularity of systematic investment plans (SIPs) is a positive step in this direction, but there's room for further growth.

2. Competition from Other Instruments:

- Mutual funds face competition from various financial instruments, including Unit-Linked Insurance Plans (ULIPs) and alternative investment categories (such as Portfolio Management Services and Alternative Investment Funds). Striking the right balance between risk and returns is crucial.

3. Navigating Regulatory Norms:

- The industry operates within a robust regulatory framework. Keeping up with changes in rules, taxation, and compliance requirements is essential. These factors significantly impact fund managers' decisions.

4. Distribution Challenges:

- Expanding into smaller towns and rural areas (B30 markets) requires substantial investments in marketing and distribution networks. While urban participation has been strong, reaching a wider audience necessitates strategic efforts.

Outlook and Recommendations

Outlook

The mutual fund industry's Compound Annual Growth Rate (CAGR) of 17.5% over the past five years underscores its robust expansion. This growth is fuelled by increasing investor participation and MTM gains. The confluence of these factors is anticipated to propel the mutual fund industry forward.

Investor Participation:

- Burgeoning investments from retail and institutional investors highlight the growing preference for mutual funds. These funds have become a favoured investment avenue.

Distribution Landscape Transformation:

- Digital investment platforms and fintech firms are reshaping the distribution landscape. Asset managers are adapting their retail strategies to leverage these emerging channels.
- While digital avenues provide new opportunities, sales teams—both retail and institutional—must also consider external platforms for greater transparency.

Digital Convenience:

- Escalating digital penetration and user-friendly online platforms have made mutual fund investments seamless. Investors can access and engage with ease.

Government Support:

- Government initiatives aimed at financial inclusivity have contributed to an expansive investor base. The industry benefits from the government's unwavering support.
- The regulatory environment overseen by the Securities and Exchange Board of India (SEBI) has significantly bolstered investor confidence. Transparency reforms have played a pivotal role in this regard. Opportunities abound, especially in pension and insurance fund management, where mutual funds can leverage their expertise to offer reliable returns and address retirement planning and insurance requirements.

Product Diversification and Innovation:

- Mutual funds offer diverse risk-return profiles. Innovations like Exchange-Traded Funds (ETFs) and sector-specific funds provide enticing options for investors.

With these multifaceted factors at play, the Indian mutual fund industry is well-positioned for upward growth, ushering in a promising era of investment prospect

Recommendations

India's mutual fund industry has been growing rapidly and yet the penetration remains low compared to other countries. This highlights the immense opportunity available to the industry. As mentioned in an earlier section of this report, the industry faces challenges around distribution, regulatory supervision, etc. Some of the factors could help grow the industry ahead.

Collaborative Approach: Encouraging collaboration among market participants, regulators, and industry associations is crucial for a thriving mutual fund ecosystem. Regular dialogue, knowledge sharing, and collective efforts can drive growth, address challenges, and promote best practices. By working together, we can create a robust and investor-friendly environment.

Financial Inclusion and investor education: Regulatory and government efforts to enhance financial awareness play a crucial role in boosting mutual fund participation. Investor education, robust risk management practices, and transparency within the industry foster investor confidence, ultimately driving increased investments and industry growth. The statistics underscore significant untapped potential, particularly in Tier 2 and 3 cities (the B30 category) across India. These cities house nearly 90% of the country's population and contribute around 16% to the overall market. Industry leaders must prioritize extending their reach and support to these smaller cities, integrating them into mutual fund operations and initiatives.

Corporate Governance and Transparency: Strengthening corporate governance practices and transparency is essential for maintaining investor trust and confidence in the mutual fund industry. Here are some key steps India can take: 1) Disclosure Requirements: Enhance disclosure norms to ensure that investors receive clear and comprehensive information about fund portfolios, risks, and performance. Transparency builds trust. 2) Ethical Conduct: Promote ethical behaviour among fund managers, distributors, and other industry participants. Adherence to high ethical standards is critical 3) Clear Communication: Communicate fund performance, investment strategies, and fees transparently. Investors should have a clear understanding of what they are investing in.

Untapped Retirement Market: With the growing number of senior citizens, addressing retirement needs has become critical. Rising life expectancy, lack of social security, and increasing medical expenses necessitate robust retirement solutions. Retirement planning remains an untapped market, offering significant potential for mutual funds to enhance household penetration. Channelling retirement savings through mutual funds can effectively tap into this segment. Meanwhile, the National Pension System may be a challenger for this opportunity.

Technology and Innovation: Embracing technology and innovation is pivotal for the mutual fund industry's growth. Here are some ways India can leverage these advancements: 1) Digital Platforms and Mobile Apps: Mutual funds can enhance accessibility by leveraging digital platforms, mobile applications, and online investment portals. These tools make investing more convenient for users. 2) Robo-Advisory Services: Robo-advisors provide automated investment advice based on algorithms. Integrating such services can streamline decision-making for investors. 3) Online Transactions and Data Analytics: Online transaction capabilities simplify investment processes. Data analytics can offer personalized insights and improve customer experience. 4) Unified Payments Interface (UPI): UPI adoption has reshaped payment experiences. Mutual funds should align with this trend to facilitate seamless fund transfers. and 5) Streamlining KYC Processes: Imagine a scenario where successful KYC with one fintech company extends to others. This cohesive approach eliminates redundant procedures and enhances convenience.

Distribution Channels: Expanding the reach of mutual fund investments in India involves strategic distribution efforts. Here are some key channels to explore: 1) Technology-Driven Platforms: Leveraging digital platforms, mobile apps, and online portals can enhance accessibility. Investors can conveniently explore and invest in mutual funds through these channels. 2) Partnerships with Financial Institutions: Collaborating with banks, insurance companies, and other financial institutions allows mutual funds to tap into existing customer bases. These partnerships provide a wider distribution network. 3) Engaging Independent Financial Advisors (IFAs): IFAs play a crucial role in educating and guiding investors. Building strong relationships with IFAs can help reach diverse segments of the population. 4) Digital Channels for Remote Areas: Emphasizing digital channels ensures that even investors in remote areas have access to mutual funds. Mobile-based solutions and simplified processes are essential. 5) Promoting Financial Inclusion: By reaching out to underserved populations, mutual funds can contribute to financial inclusion. Educating investors about the benefits of mutual funds is vital. A multifaceted approach, combining these channels, will help expand mutual fund participation across India.

Accumulation and Decumulation Solutions: Mutual funds can offer accumulation solutions to millennials (building wealth) and decumulation solutions to seniors (managing retirement income).

Cost-effectiveness: Offering cost-effective mutual fund options is crucial for enhancing investor participation. Here are some steps India can take: 1) Minimizing Expense Ratios: Mutual funds should aim to keep expense ratios low. Lower fees benefit investors by maximizing their returns. 2) Reducing Transaction Costs: Streamlining transaction processes and minimizing associated costs can make investing more affordable. 3) Low-Cost Investment Opportunities: Introducing low-cost investment options, such as index funds or exchange-traded funds (ETFs), provides accessible choices for retail investors. 4) Attracting Small Investors: Competitive pricing will attract small investors, encouraging them to participate in mutual funds. By prioritizing affordability, India can foster broader participation in mutual funds.

****

About CareEdge Ratings

Since its inception in 1993, CareEdge Ratings (CARE Ratings Ltd) has established itself as one of India's leading credit rating agencies.

CareEdge Ratings provides ratings for a variety of industries, such as manufacturing, infrastructure, and the financial sector, which includes banking, and non-financial services. The company has played a pivotal role in the development of bank debt and capital market instruments, such as commercial papers, corporate bonds and debentures, and structured credit.

With over three decades of experience in the analytics business and a deep understanding of the operations of various industries and sectors, the company is in a sound position to offer itself as a knowledge hub and publishes insightful reports on the Indian and global economy, and industry research papers regularly.

The wholly-owned subsidiaries of CareEdge Ratings are:

- CARE Analytics & Advisory Private Ltd, previously known as CARE Risk Solutions Pvt Ltd
- CARE ESG Ratings Ltd, previously known as CARE Advisory Research and Training Ltd
- CareEdge Global IFSC Ltd

CareEdge Ratings' other international subsidiary entities include CARE Ratings (Africa) Private Ltd in Mauritius, CARE Ratings South Africa (Pty) Ltd, and CARE Ratings Nepal Ltd.

CareEdge Ratings is also a partner in ARC Ratings, an international credit rating agency. The business has a strategic alliance with the Japan Credit Ratings Agency (JCR) and a memorandum of understanding with the Russian credit rating agency ACRA.

About ASSOCHAM

The Associated Chambers of Commerce & Industry of India (ASSOCHAM) is the country's oldest apex chamber. It brings in actionable insights to strengthen the Indian ecosystem, leveraging its network of more than 4,50,000 members, of which MSMEs represent a large segment. With a strong presence in states, and key cities globally, ASSOCHAM also has more than 400 associations, federations and regional chambers in its fold.

Aligned with the vision of creating a New India, ASSOCHAM works as a conduit between the industry and the Government. The Chamber is an agile and forward looking institution, leading various initiatives to enhance the global competitiveness of the Indian industry, while strengthening the domestic ecosystem.

With more than 100 national and regional sector councils, ASSOCHAM is an impactful representative of the Indian industry. These Councils are led by well-known industry leaders, academicians, economists and independent professionals. The Chamber focuses on aligning critical needs and interests of the industry with the growth aspirations of the nation.

ASSOCHAM is driving four strategic priorities - Sustainability, Empowerment, Entrepreneurship and Digitisation. The Chamber believes that affirmative action in these areas would help drive an inclusive and sustainable socio-economic growth for the country.

ASSOCHAM is working hand in hand with the government, regulators and national and international think tanks to contribute to the policy making process and share vital feedback on implementation of decisions of far-reaching consequences. In line with its focus on being future-ready, the Chamber is building a strong network of knowledge architects. Thus, ASSOCHAM is all set to redefine the dynamics of growth and development in the technology-driven 'Knowledge-Based Economy. The Chamber aims to empower stakeholders in the Indian economy by inculcating knowledge that will be the catalyst of growth in the dynamic global environment.

The Chamber also supports civil society through citizenship programmes, to drive inclusive development. ASSOCHAM's member network leads initiatives in various segments such as empowerment, healthcare, education and skilling, hygiene, affirmative action, road safety, livelihood, life skills, sustainability, to name a few.

NOTES

The Associated Chambers of Commerce and Industry of India

ASSOCHAM Corporate Office:
4th Floor, YMCA Cultural Centre and Library Building
01, Jai Singh Road, New Delhi-110001

Tel: 011-46550500 (Hunting Line)
Fax: 011-23017008, 23017009
E-mail: assocham@nic.in
Website: www.assocham.org

CARE Ratings Limited

4th Floor, Godrej Coliseum, Somaiya Hospital Road,
Off Eastern Express Highway, Sion (East),
Mumbai - 400 022

Tel: +91-022- 6754 3456
Fax: +91-022- 6754 3457
E-mail: corp.comm@careedge.in
Website: www.careratings.com