# Mutual Funds Advisory Service - FAQs



## Mutual Funds in General

**What is a Mutual Fund?**

A Mutual Fund, otherwise known as an investment company, is a corporation, which pools together investor's money generally to purchase stocks and bonds.

Investors participate in the Mutual Fund by purchasing shares of the entire pool of assets, thus diversifying their investment. Professional managers who buy and sell securities on behalf of the investors invest the pooled assets. Because Mutual Funds pass all gains, losses and tax obligations/benefits through investors, they receive preferential tax treatment.

**What are the types of Mutual Funds?**

There are two basic types of Mutual Funds, Closed-ended and Open-ended. Further classification can be made with loads and no-loads. Again based on investment objective it can be further classified into: - 1) Growth funds 2) Income funds 3) Balanced funds 4) Money Market funds 5) Tax Savings funds 6) Specialized funds and 7) Assured Return funds etc.

**Why do people use Mutual Funds?**

Many people purchase Mutual Funds because they are a convenient and cost effective method of obtaining diversification and professional management.

Investors can invest the money in stocks, bonds, short-term money-market instruments, other securities or assets, or some combination of these investments; hence spreading the risk over a number of investments.

Additionally, Mutual Funds generally buy and sell securities in volume, which allows investors to benefit from lower trading, management and research costs.

Another advantage the Mutual Funds offer is that fund performance is subject to frequent reviews by various advisors and rating agencies, making it possible for investors to conduct direct comparisons between funds.

**Are there any disadvantages to using a Mutual Fund?**

Although what one person may view as a disadvantage another may see as a desirable quality, below are some factors which may be disadvantages depending on your point of view:

a. All Mutual Funds charge expenses. Whether they are marketing, management or brokerage fees fund expenses are generally passed back to the investors.
b. Investors exercise no control over what securities the fund buys or sells.
c. The buying and selling of securities within the Mutual Fund portfolio generates capital gains and losses which are passed back to investors even if they have not sold any of their Mutual Fund shares.

**What are typical expenses of a Mutual Fund?**

Stock funds tend to be the most expensive. Small company and international funds tend to be more expensive. Bond fund and money market expenses range from 0.2% to 2.0%, with most around 1.0%. Note that some funds, particularly money market funds, waive expenses for a limited time to boost yield (and make good ad copy).

**Can Mutual Fund performance be guaranteed?**

No. As many funds state, past performance is no guarantee of future results and the fund shares are not backed or guaranteed by the SECP or other government agency. Note that while some funds buy government backed securities, that is not the same as backing the market value of the fund shares.

**How are Mutual Funds structured?**

Mutual Funds in their most basic form are like corporations. Investors are the shareholders in the company and the assets of the company are the pooled investments of all the shareholders (investors). The board of directors of a Mutual Fund acts just as a board of directors for any company. They are elected representatives of the investors, who owe shareholders a fiduciary responsibility. The most important function of the board is to select the fund's manager. The fund manager is in a way, the president of the company/fund. The manager traditionally makes all the investment decisions for the fund and supervises the day-to-day operations. Managers are paid a management fee, which is usually a percentage of the assets under management. Managers may also have incentive clauses in their contracts that reward superior performance. Because the manager is paid a percentage of the assets s/he is responsible for, there is an incentive to do well for investors in the hopes of attracting more investors and in turn, more money to manage.

# Closed-end Vs Open-end Mutual Funds

**What are "Closed-end fund" and "Open-end fund"**

A Closed-end fund has a fixed number of shares outstanding and is traded just like other stocks on an exchange or over the counter.

The more common Open-end funds sell and redeem shares at any time directly to shareholders.

Sales and redemption prices of Open-end funds are fixed by the sponsor based on the fund's net asset value; Closed-end funds may trade at a discount (usually) or premium to net asset value.

**A fund is "Closed". Is that the same as a Closed-end fund?**

No. Some Open-end funds are closed to new investors because the fund manager feels that it cannot be as effective with a very large amount of money. This typically happens with funds that invest in small companies. The Open-end format remains the same, but investments are not accepted from those who do not already have accounts.

**What expenses are there for a Mutual Fund?**

1. Closed-end funds charge annual expenses for research and trading. To buy and sell Closed-end fund shares, the investor must usually pay additional brokerage fees, unless the investor finds someone to buy from or sell to directly.
2. Open-end funds charge annual expenses for research and trading expenses. In addition, they sometimes charge the following:
    a. A front-end load or sales charge. These vary from fund to fund and are subtracted from the amount paid and are usually used to pay commissions to brokers and financial advisors who sell the funds.
    b. A redemption fee, deferred sales charge, or back end load. These work the same way as front end loads, but are charged when you redeem shares. In many cases, they decline or disappear after a long enough holding period.

A Mutual Fund that has neither (a) or (b) is generally referred to as a no-load fund. All of the above expenses for Open-end funds are described on the prospectus or offering document in a standardized form. Brokerage fees paid by the fund in its trading activity are not normally included in such expense tables as they are usually accounted for in the cost of securities bought.

## Account Statement

### What is an Account Statement?

It is a statement summarizing all the transactions and other details like unit balance, value of units etc. of the Investor. It also records all his / her registration attributes and records changes therein as and when they occur. It is a conclusive proof of their investments and shows the financial standing on a given date.

### How do I get a duplicate account statement?

- An account statement can be obtained from the following sources: -
- Requesting the IGI Investment Bank office
- Writing / email / phone to IGI Investment Bank head offices at Karachi, Lahore, Islamabad, Faisalabad
- Requesting through IGI Investment Bank Website under Feedback form
- Email / physical account statement would be sent to the Investor at their registered address

### I have changed my residence. What should I do?

You have to inform in writing the concerned AMC at IGI Investment Bank's head office in Karachi or the relevant branch office in other major cities. The request must be appropriately signed, so that the change is recorded in the database. Alternatively, you can also submit a request at the IGI Investment Bank website through the Feedback form. An acknowledgement will be sent shortly reflecting the change.

### I have a new bank account. What should I do?

You have to inform the concerned AMC in writing at IGI Investment Bank's head office in Karachi or the relevant branch office in other major cities. The request must be appropriately signed, so that the change is recorded in the database. Alternatively, you can also submit a request at the IGI Investment Bank website through the Feedback form. An acknowledgement will be sent shortly reflecting the change.

# About Investments

**What do Mutual Funds invest in?**

Almost anything; there are funds that invest in almost anything an investor could want to invest in. The most common types are described below:

1. Money Market Funds: these try to maintain a constant NAV per share (though they cannot guarantee that), while yielding dividends from their investments in short term debt securities. They offer very low risk but usually low long term return. Most also invest in repurchase agreements (repos) collateralized by short-term debt securities; these are subject to credit or fraud risk of the other party in the repo (regardless of the credit risk of the securities being repoed). Their market value is NOT insured by government agency. Enough defaults in the fund's securities can cause it to be unable to maintain its constant NAV.

    a. Regular funds: invest in short term debt of all types
    b. Government funds: invest only in national government or government agency debt or repos involving such debt. Slightly lower credit risk than regular funds
    c. Treasury funds: invest only in direct obligations of the national government or repos involving these securities. Lowest credit risk and dividend distributions are exempt from state income taxes in most states

2. Bond Funds: These invest in longer-term debt securities. Thus the short-term risk is greater than the infinitesimal risk of the money market. But returns are usually higher. Their NAVs may fluctuate due to both interest rate risk and defaults. Unlike individual bonds, most bond funds do not mature; they trade to maintain their stated future maturity. The types of debt are similar to those of money funds (but longer term); however, futures and options are sometimes used for hedging purposes. The other classifications are described below:

    Time to maturity, interest rate risk:

    a. Short term: usually less than 5 years maturity. Interest rate risk is low. Long term: up to 30-year average maturity. Interest rate risk is high. Mortgage Backed Securities (MBS): have some unusual interest rate risks. When interest rates rise, they lose value like other bonds. When interest rates fall, homebuyers refinance, causing them to prepay old mortgages, which in turn causes bonds backed by these mortgages to be called.
    b. In addition, when rates rise, the MBSs extend due to slower prepayments --- thus their duration goes up with interest rates and the bonds lose money at an accelerating rate. When rates fall the prepayments speed up and the bond gains money at an ever-slower rate. This property is called Negative Convexity. It is also a gross over-simplification. There are MBSs with positive convexity. The compensation paid to MBS holders for the negative convexity is in higher yield. Basically the buyer of a mainstream MBS is betting that rates will not change too much (that interest rate volatility will be lower than the volatility implicit in the price). Over time this is true.
    c. Adjustable rate: this type of fund is like other mortgage backed funds, but it invests in adjustable rate mortgages. Therefore, the two-sided interest rate risk faced by fixed rate mortgage backed bonds in considerably reduced. However, the interest income will fluctuate widely, even though the principal value is more stable. Since most adjustable rate mortgages have caps on how high the rate can go, risk increases if interest rates increase quickly or by a large amount.

d. (e) Target maturity: the few funds in this category buy only bonds of the given maturity date. Thus one can actually hold these to maturity. Credit risk:
    i. Investment grade: restricted only to bonds with low to medium-low credit risk (government bonds are usually considered lowest risk).
    ii. High yield or junk: buys bonds of any credit rating, seeking maximum interest yield at a greater risk of default.

3. Stock Funds: These invest in common and/or preferred stocks. Stocks usually have higher short-term risk than bonds, but have historically produced the best long-term returns. Stock funds often hold small amounts of money market investments to meet redemptions; some hold larger amounts of money market investments when they cannot find any stock worth investing in or if they believe the market is about to head downward. Some of the possible investment goals are described below. They are not necessarily mutually exclusive.
    a. Growth. These funds seek maximum growth of earnings and share price, with little regard for dividends. Usually tend to be volatile.
    b. Aggressive growth. Similar to growth funds, but even more aggressive; tend to be the most volatile.
    c. Equity income. These funds are more conservative and seek maximum dividends.
    d. Growth and income. In between growth funds and income funds, they seek both growth and a reasonable amount of income.
    e. Small company. Focuses on smaller companies. Usually of the growth or aggressive growth variety, since smaller companies usually don't pay much dividends.
    f. Country or regional funds. These funds buy stocks primarily in the designated country or region.
    g. Index funds. These funds do no management, but just buy some index. Expenses are usually very low.
    h. Sector funds. These funds buy stocks only in one industry. Usually considered among the riskiest stock funds, though different sectors tend to have different levels and types of risk.

4. Balanced Funds: By mixing stocks and bonds (and sometimes other types of assets) a balanced fund is likely to give a return between the return of stocks and bonds, usually at a lower risk than investing in either alone, since different types of assets rise and fall at different times.

    a. Regular balanced funds: These funds usually hold a fixed or rarely changed allocation between stocks and bonds.
    b. Asset allocation funds: These funds may switch to any allocation, usually based on market timing to some degree.

5. Fund of Funds: These funds buy primarily other Mutual Funds. They choose other funds based on one or more of the investment goals outlined above.

    a. No-management Funds: These funds hold fixed proportions of other funds. Fund companies as cheap balanced funds offer these—the underlying funds are other funds managed by the same company. There are generally little or no expenses other than those of the underlying funds.
    b. Managed Funds: In these funds, a manager picks which other funds s/he believes are managed well. Sometimes these funds are market-timing funds that prefer to leave the stock picking to other managers. These funds have expenses above and beyond those of the underlying funds.

**What are the Tax and Zakat implications of Mutual Funds?**

Like shares of any stock, selling Mutual Fund shares may cause you to realize a capital gain or loss. Mutual Funds also distribute dividends received and their own realized capital gains, usually at the end of the year; these distributions, if in cash are taxable.

- Annual profits are distributed in the form of bonus units. Bonus units are not considered as income under the Income Tax Ordinance 2001.
- Incase of encashment of units, capital gains arising on disposal are exempted from tax till June 2007 under clause 110 of part 1 of the second schedule of Income Tax Ordinance 2001.
- As under Section 62 of income Tax Ordinance, 2001 provides for tax credit on investments in unit trust schemes (Mutual Funds).
- Individuals will be subject to withholding tax of 10% on dividends and Income tax of 10% (excluding the amount of payout from capital gains.) Public and Insurance Company will be subject to withholding tax of 5% on dividends and Income tax of 5% (excluding the amount of payout from capital gains.) However unit holders will be allowed a tax credit on the purchase of units as per the prevailing tax law.
- It is highly recommended that investors should take advice on tax from independent sources.
- The units will be liable to zakat just like any other financial instrument; however if the unit holder provides an affidavit then no zakat will be deducted.

**How do I apply for Investments in a fund?**

By making an application to the Mutual Fund; the same can be submitted to the IGI Investment Bank's office.

**Where do I get applications?**

The applications can be obtained from IGI Investment Bank's offices or branches.

**Are there any minimum amount limits for subsequent purchases in the same scheme?**

Yes, limits of minimum amount are applicable for additional purchases for schemes and will be mentioned in the Offer Document.

**How do I transfer money between various Schemes? Do loads prevail?**

Making a switch of units from a Scheme to another Scheme can transfer money. A Source Scheme is one from where you want to switch out and a Target scheme is one where you want to switch in. A switch can be affected by applying through the transaction slip available in the Account Statement or by a request letter, appropriately signed. Yes, Switches are subject to loads depending upon the Scheme details

**Is there a limit to transfer of money from one scheme to another?**

Yes, the target scheme should have the minimum subscription amount as specified in the Offer Document.

**What is a lock-in period?**

This is a pre-defined period during which the investments cannot be redeemed. This could be due to a legal implication (erstwhile 54 EA & 54 EB or ELSS sections of Income Tax Act) or due to a restriction levied by the AMC (this could be for a short period of say, 7 / 10 days depending upon the AMC). This short restriction is to ensure that the Units are not redeemed before encashment of the Investment cheque.

## About Repurchase (Redemptions)

**When and how can I redeem my investments?**

Investments can be redeemed after the expiry of the lock-in period, if any, either by submitting a physical request to IGI Investment Bank's head office or any branch / concerned AMC or requesting the same through the on-line services available under Feedback section at the IGI Investment Bank website.

**What is a Systematic Withdrawal Plan? Do loads prevail?**

This plan enables the Unit holders to withdraw fixed sums from their Unit Accounts at periodic intervals. Any Unit holder can avail of this facility subject to the terms and conditions contained in the application form / Offer Document, to include exit loads if applicable.

**I have not received my redemption proceeds? What should I do?**

You may write / email to IGI Investment Bank's head office in Karachi or branch offices or to the AMC concerned addressing the same for further course of action.

## About Dividends

**How do I get dividends?**

Dividends would be paid by cheques, drawn in the name of the sole holder /first-named holder (as determined by the account and mailed to the last address recorded in the books). The Bank name and the Account no. as specified in the records will also be mentioned in the cheque. The cheque will be payable at par in all the cities designated by the Fund. In case of other cities, you will be paid by a Demand Draft after deducting the demand draft charges (if any and depending upon the concerned AMC).

**What is dividend reinvestment? Do loads prevail?**

Creation of Units in lieu of the amounts due as dividends is termed as dividend reinvestment. There is no outflow of money here. Normally, loads are not applicable. However, the terms are clearly specified in the Offer Document.

**I have not received my dividend? What should I do?**

You may write / email to IGI Investment Bank's head office or any branch offices to the AMC concerned addressing the same for further course of action.

## General Information

**How accurate are the Mutual Fund prices in the newspaper?**

Mutual Funds are required to submit to the Mutual Fund Association of Pakistan (MUFAP) a daily pricing of the fund's NAV. MUFAP then distributes this information to the press and news/quote services. Occasionally a fund may err in pricing the securities in the portfolio, which results in an inaccurate NAV being distributed to the press. Fortunately, even the rare mis-pricing is usually detected and corrected prior to any processing of Mutual Fund buy and sell orders.

**How do Minors apply?**

Parents / Lawful Guardians can apply on behalf of a Minor. They can sign the application on behalf of the Minor and status of the Investor in the Account Statement would also reflect the same.

**How to apply under Power of Attorney (POA)?**

A POA holder can operate upon any investment made. This is possible after receipt of the POA by the Registrar, duly attested in original. Once the POA is registered, the POA holder steps into the shoes of the Investor. The right of operating the account reverts back to the Investor only after the POA is revoked.

**What is Nomination and how does it work?**

Nomination is a process whereby the Units get transferred to a nominee's favor upon the demise of the Investor. A form needs to be submitted with relevant particulars of the Nominee by an investor duly signed, to IGI Investment Bank for recording the same.

**Can I get a loan against my fund units? What is the process?**

If allowed, loans can be obtained against Units. The process flow is as follows: -

- The Financial Institution would instruct IGI Investment Bank to mark the Units under lien with prior consultation, so as to ensure that they are not pledged already.
- Subsequent to confirmation by IGI Investment Bank about marking of lien, loan amount would be released to the Investor by the Financial Institution.
- Lien would be released by IGI Investment Bank, upon receipt of a letter to that effect from the concerned Financial Institution so as to enable the Investor to redeem as per their requirement.
- Alternatively, the Financial Institution can exercise their right of recovering the loan amount, in the case of any default by the Investor.

**When should I sell a Mutual Fund?**

You should consult your Investment Planner to understand the timings for selling funds.

**How are monies transferred in the event of Unit holder's death?**

The following procedure needs to be adopted in case of transmission and in the absence of any nomination: -
In case of Joint-holding and demise of the First holder: -

- Original / Attested (in original) Death Certificate
- Letter from any of the other holders requesting the change in the ownership of holding
- Units are transferred to the joint-holder's name

In case of Joint-holding and demise of the joint-holder: -

- Original / Attested (in original) Death Certificate
- Letter from First / Joint-holder requesting us to change according to the Mode of holding
- Deletion of deceased person's name

In case of Single Holding: -

- Original / Attested (in original) Death Certificate
- Request letter for Transmission of Units to the legal heir
- List of legal heirs of the deceased person, if more than one
- No objection letter from other legal heirs, in favor of the named legal heir in the request
- Letter of Indemnity from all legal heirs
- Notarized Affidavit by the Successor(s), if required

# Glossary of Relevant Terms

**What is "Net Asset Value"?**

The Net Asset Value (NAV) is the value of the fund's underlying securities. It is calculated at the end of the trading day. Any open-end funds buy or sell order received on that day is traded based on the Net Asset Value calculated at the end of the day. A few funds calculate net asset value at more frequent intervals and process trades at those values.

**What is a "prospectus" or an Offering Document?**

This necessary document is provided to investors of an open-end fund, or newly issued closed-end fund. It is advisable that investors read it carefully before investing or sending money. A prospectus contains descriptions of:

1. Fees, in a standardized format
2. Investment objective
3. Some financial data
4. Investment methods, risk description
5. Investment manager and compensation
6. How to buy units
7. How to sell units, including signature guarantee requirements
8. Dividend and capital gain distributions
9. Other services

**What are "dividend distributions"?**

A Mutual Fund may receive dividend or interest income from the securities it owns; it is required to pay out this income to its investors. Most open-end funds offer an option to purchase additional shares (bonus shares) with the distributions. Dividend distributions are often made monthly or quarterly, though many funds make distributions only yearly.

**What are "capital gain distributions"?**

A Mutual Fund may, in the process of trading, realize capital gains. These must be distributed to investors. As with dividends, there is usually the option to reinvest in additional fund shares. Capital gain distributions generally occur late in the year, but some funds make additional distributions at other times. Funds with high turnover of securities often make significant capital gain distributions every year, while funds with low turnover of securities may accumulate unrealized gains for several years before making a large capital gain distribution. Also, funds that are increasing in size tend to make smaller capital gain distributions because they buy more than they sell, while funds decreasing in size tend to make larger capital gain distributions because they sell more than they buy.

**What else is there to know about distributions?**

A distribution lowers the net asset value of the fund by the amount of the distribution. The shareholder does not actually lose money because of the distribution, since s/he gets cash or additional shares to compensate for the lower net asset value. Distributions have important tax consequences as detailed later.

**What is the difference between yield and return?**

Do not confuse the two terms. Return is sometimes called total return. The formula for total return (ignoring any taxes paid on gains and income during the holding period) is:

**TR= ((Ending Market Value) / (Beginning Market Value)) -1**

Yield is a very different number --- it is prospective not retrospective. It is a measure of income not capital gains. It is usually associated with debt not equity. For instance, the yield quoted on a bond will almost never be the same as the total return realized after the bond matures or is sold.

**Trustee**

Central Depository Company of Pakistan Limited (CDC) has been appointed as the trustee of most of the Mutual Funds. The duty of the Trustee is to ensure that each fund is managed in accordance with the agreed Trust Deed, the Regulations and the Prospectus. All the assets of a fund are securely held by the Trustee and thus separate from the assets of the investment management company itself.

**Transfer Agent / Registrar**

The transfer agent will process all the investor applications. In addition, its responsibilities would be to maintaining the register of unit holders, issue account statements and certificates to the holders, and issuing and dispatching of cheques in respect of residual amount left after allocation and issue of units. In some cases, the asset management company itself performs the role of a Transfer Agent / Registrar.