



ASSOCIATION OF MUTUAL FUNDS IN INDIA

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A. P. KURIAN

CHAIRMAN

135/BP/14/07-08

October 25, 2007.

To All Members.

Dear All,

AMFI Best Practices Guidelines Circular No. 14/2007-098

**Standardization of Fact Sheets and News Letters issued by
Mutual Funds.**

Mutual funds bring out Fact Sheets generally on a monthly basis containing general information, performance of funds, quantitative data and a brief presentation on portfolio. The Fund Houses also release a News Letter to investors which has the similar contents as in the Fact Sheets and sometimes market analysis and editorial comments. The News Letters are generally issued on a quarterly basis. Both the Fact Sheets and News Letters are issued by the Fund Houses voluntarily and they are not mandated by the Regulator.

In the course of our discussion with SEBI, it has been brought to our notice that in the Fact Sheets and News Letters that go to the investors, there is no uniformity in the content, presentation and treatment of various ratios and other parameters. SEBI therefore felt that it would be in the interest of investors to have some degree of standardization in the disclosures made to the investors. Therefore at the request of SEBI, AMFI has asked its Committee for standardizing key operational areas to examine both Fact Sheets and News Letters and make suitable recommendations with the objective of bringing in uniformity and standardization wherever required and to follow a standardized manner of calculating various ratios. The underlying objective is to help the investors make a meaningful and like to like comparison of schemes of different Fund Houses.

The report of the Committee headed by Mr. Vivek Pai of Franklin Templeton was circulated to all Members and based on the feedback received, the Committee finalized its report which has been presented to SEBI.

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SEBI desires that these recommendations be issued as AMFI guidelines. Accordingly, attached are the AMFI Best Practice guidelines in respect of standardizing Fact Sheets and News Letters. This may please be followed as Best Practice with immediate effect.

Thanks and regards,

Yours sincerely,

A. P. Kurian
Chairman

Encl.: As above.

Recommendations for standardizing FactSheets/Newsletters

by

AMFI Committee for Standardizing Key Operational Areas

Asset Management companies in India reach out to investors and distributors from time to time to give information about various open ended schemes and their performances. As per existing regulations, mutual funds are required to:

- disclosed the full portfolio on half yearly basis in one national and one regional daily
- send annual audited financials to all the investors

It may be noted that both Fact Sheets and Newsletters are voluntary disclosures made by Mutual Funds and not mandated by the regulations. The objective of the committee is not to make these disclosures mandatory but to standardize, whenever communicated. With that objective, parameters have been classified in three categories:

- A : Mandatory
- B : Optional for AMCs to follow, but if adopted should conform to specifications herein
- C : Optional for AMCs to follow using its own format / specifications

Type of communication	Classification
1. Fact Sheet -AMCs issue Fact Sheet to distributors. The fact sheet contains general information apart from performance of the fund, quantitative data and a brief on the portfolio. This should be disclosed on the mutual funds website on a Monthly basis, with reporting as of the month-end .	A
2. News Letter -AMCs issue newsletters to investors on quarterly basis, which has the similar data as that of fact sheet. This can be discontinued as long as monthly fact sheet is being disclosed on website. However, if the AMCs choose to disclose, they should give cumulative report on website on a Quarterly basis, with reporting as of the Calendar quarter –end .	B

The following minimum standard disclosures should be made in Fact Sheets and News Letters for all open ended schemes:

Particulars	Classification
1. Scheme Name	A
2. Investment Objective in brief ¹	C
3. Type of Scheme	A
4. Scheme data	
A. Name of fund managers	A
B. Experience in managing this fund & total experience ²	A

¹ UTI MF wants this to be changed to A

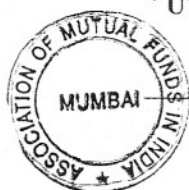
² UTI MF wants this to be changed to C



Particulars	Classification										
C. Date of allotment	A										
D. Latest Assets under Management (AUM)	A										
E. Latest NAV	A										
F. Entry/Exit Load	A										
G. Total Expense Ratios (TER) of the Scheme: Year-to-date Ratio to Average AUM (i.e. Financial year beginning to date). Disclosure to be at Plan level if there is a distinct TER charged)	A										
H. Amortization of Initial Issue Expenses: Where applicable (both closed-ended as well as open-ended Schemes) ³ : <ul style="list-style-type: none"> i. the TER inclusive of Amortization should be disclosed (Calculated after adding the Amortized Amount to the Total Expenses) ii. the Unamortized Amount should be disclosed 	C										
I. Bench Mark indices	A										
J. Any change in any of the above mentioned parameters from F to I with effective date since previous communication	C										
K. Dividend history (other than for Daily/Weekly dividend Schemes/Plans): <table border="1" data-bbox="370 1079 1091 1272"> <thead> <tr> <th>Frequency</th><th>Disclosure</th></tr> </thead> <tbody> <tr> <td>Monthly</td><td>For past 3 months</td></tr> <tr> <td>Quarterly</td><td>For past 3 quarters</td></tr> <tr> <td>Half yearly</td><td>For past 2 years</td></tr> <tr> <td>Yearly</td><td>For past 3 years</td></tr> </tbody> </table>	Frequency	Disclosure	Monthly	For past 3 months	Quarterly	For past 3 quarters	Half yearly	For past 2 years	Yearly	For past 3 years	A
Frequency	Disclosure										
Monthly	For past 3 months										
Quarterly	For past 3 quarters										
Half yearly	For past 2 years										
Yearly	For past 3 years										
5. Portfolio : <ul style="list-style-type: none"> A. Top 10 Scrips as %age of Net Assets B. Allocation by sector for equities C. Allocation - Asset as well as rating-class for debt. Sector should be as classified by AMFI for Indian securities. If AMFI classification is not available for a particular type of security (may be in case of foreign security?) then the MSCI industry classification can be followed. However, the Fund House should inform AMFI on the same with a due justification and AMFI should be able to apply for the MF Industry based on a recommendation by the Fund House with justification.	A										
6. Quantative data (as per AIMR standards – see details in annexure) ⁴											
A. Standard Deviation for equity fund	A										
B. Beta for equity fund	A										
C. R-Squared for equity fund	B										

³ Franklin Templeton MF wants this to be changed to A

⁴ UTI MF wants this to be changed to B



Particulars	Classification
D. Sharpe Ratio for equity fund	A
E. Portfolio turnover for equity fund	A
F. Modified Duration for debt fund or portion	A
G. Average maturity for debt fund	A
7. Performance period	
A. <u>Other than Liquid funds:</u> 6 months, 1 year, 3 year, 5 year & since inception	A
B. <u>Liquid funds:</u> 7 days, 15 days, 30 days, 3 months, 6 months, 1 year, 3 year, 5 year and since Inception	



Important points

1. Wherever different plans of the scheme have different structure or data, it should be disclosed separately. For example, expense ratio may be different for retail and institutional plan and as a result, it should be disclosed separately. Further, the avg expense ratio and the current ratio may be different.
2. All AMCs should use below mentioned standard formula for portfolio turnover.
Portfolio Turnover=Lower of sales or purchase divided by average AUM for last rolling 12 months.
3. Only standard industry classification should be used for portfolio disclosure which is same as that of half yearly regulatory portfolio disclosure.
4. In case of all fund types, NAV performance should be disclosed for Growth Plan with clear note mentioning the same. There should also be a statement below the performance table that the performance of the dividend plan for the investor would be net of the dividend distribution tax, as applicable.
5. Volatility ratio may not be calculated for debt or balance scheme with less than 3 years of duration except for liquid funds. Similarly, the equity scheme should be in existence for at least 1 year for disclosure of portfolio turnover.
6. Risk free rate of return for calculating Sharpe ratio should be uniform and disclosed in the fact sheet.
7. In case of equity schemes with targeted capital segment, the segment wise break up should be disclosed eg mid cap, large cap, small cap.
8. In case of scheme using derivative, it should be shown separately for each security.
9. These types of communication should remain optional for AMC.
10. Risk Factors: Only one liner is required.
11. Investment objective must be unambiguous and specific.



The following items were also discussed and it was decided that the disclosure of these may not be feasible:

1. Unambiguous Investment objective-The brief and specific investment objective can be given in the communication. While the detailed objective is available in Offer document of the concerned schemes and it would be unnecessary long repetition in this type of communication.
2. Is the fund manager invested in the scheme? It may not be good idea as
 - A. the AMC might have their own structure to incentivise performer
 - B. the AMC or Chief Investment Officer or other senior personal might have invested in the fund
 - C. he may not have enough money to put in all the scheme managed by him
 - D. he may have invested a token amount, which may not justify the confidence
 - E. he gets more AUM due to good performance while it generally reduces if he under performs
 - F. he gets good brand value when he consistently performs and manages large fund
3. Portfolio disclosure-Full portfolio disclosure on monthly or less than 6 months may not be a good practice as mutual fund investors are long term investor and shouldn't track what is being bought or sold by the fund manager on day to day basis. In other words, long term goal should not be measured by short term movement or performances. The same argument can be extended for the frequency of the communication. However, liquid fund can be an exception to this where money is invested for short term.

The internationally accepted formulas for the various ratios are attached in the annexure.



Annexure

Explanations and International Practice of Various Risk Statistics Disclosures

Return

Return calculation is fairly known to all of us. However, for the sake of standardization in line with international practice, following points are worth noting:

- On last working day of the month, return for 1 month, 2 months..., "x" months should be based on Calendar months and should not be based on same date of prior month. For e.g. 1 month return for February should be from 31st Jan to 28th Feb and should not be for 28th Jan to 28th Feb.
- Same rule applies for return calculation for 1 year, 2 year or ... "x" no. of years, if calculation is done on last working day of the month.

Monthly or Annualized Figure – International Practice:

- Any Return for a time period of 12 months or more should be annualized. For a time period of less than 12 months, the return should be shown as point to point without annualizing it.
- For time periods less than one year, other Risk Ratios like Sharpe, Information, and Volatility should not be annualized, if period is less than 12 months. It is advisable to have these ratios shown in Monthly rather than Annualized / Daily. If individuals insist on getting annualized Sharpe and Information Ratios for shorter time periods than one year, it is advisable to add a disclaimer that the figures are annualized based on less than 12 months of data and so do not conform to AIMR presentation standards.

**Standardized Input Guidelines for Risk Ratio
(Sharpe, Information, Volatility, Tracking Error, Beta, R-Sq)**

- Input data for below calculation should be Month End NAV of Growth series / Dividend Adjusted series. On index side, Month end index values will be input data (Please note that these parameters are not ratios as logically interpreted)

Volatility
TE
Beta
R-Squared

- Below parameters are Ratios. Numerator of these ratios may be worked out by directly using Annualized Return, if period is more than 1 year. Monthly Return should be used if period is less than a year :

Sharpe Ratio
Information Ratio

- Length of History – by default, for Equity, last 36 month end data may be considered. For Fixed Income / Index Funds / Hybrid Funds, last 12 month end data may be



considered. However, if funds are using month end data for any other period, that should be shown along with output / final disclosure.

- Using Monthly data as input, Output will be Monthly and not Annualized for the following ratios :

Volatility	-	To annualize, multiply by square root of 12 i.e. 3.46
Tracking Error	-	To annualize, multiply by square root of 12 i.e. 3.46
Sharpe Ratio	-	To annualize, multiply by square root of 12 i.e. 3.46
Information Ratio	-	To annualize, multiply by square root of 12 i.e. 3.46

- Using above raw data, Beta and R-Square is not defined as monthly / annual. Beta / R-Square can fairly be presumed to be for the period equal to length of data history.

Standardized Output / Final Disclosure Guidelines for Risk Ratio (Sharpe, Information, Volatility, Tracking Error, Beta, R-Sq)

- Following should ideally be shown in Percentage rather than Decimal (along-with time period) :

Volatility (e.g. 2% p.m. and not 0.02)

Tracking Error (e.g. 1% p.a. and not 0.01)

- Following may be shown as simple number with 1 or 2 post decimal points (along-with time period) :

Sharpe Ratio - e.g. 1.25 monthly

Information Ratio - e.g. 0.90 annual

- Following may be shown as simple number with 1 or 2 post decimal points (Length of history to be shown)

Beta - 1.1

R-Squared - 0.90

(Figures based on 3 years monthly data history)

Standardized Formula for calculating Risk Ratios

(Input – Output guidelines already shown above. Process / formula is shown below)

VOLATILITY (VOL)

Monthly VOL = Standard Deviation of monthly return history

Annual VOL = Monthly VOL x 3.4641 (i.e. square root of 12 “months”).

Standard Deviation (SD) = Square root of Variance (V)

Variance = (Sum of squared difference between each monthly return and its mean / number of monthly return data – 1).

The SD function is directly available on excel file.

Volatility indicates the standard deviation of each monthly return data vis-à-vis its mean.



SHARP RATIO (SR)

$$SR = (TOTAL\ RETURN - RISK\ FREE\ RATE) / RISK$$

SR INDICATES RETURN PER 1% TOTAL VOLATILITY.

The *Sharpe Ratio* is calculated by taking the return of the portfolio and subtracting the risk-free return, then dividing the result (the excess return) by standard deviation of the portfolio returns. Basically, it is measuring excess return (over risk-free rate) per unit of risk. If Sharpe ratio is 1.25 p.a., then it implies 1.25%p.a. excess return for 1% annual volatility.

$$\text{Monthly Sharpe Ratio} = (R_p - R_f) / SD.$$

$$\text{Annual Sharpe Ratio} = \text{Monthly Sharpe Ratio} \times 3.4641.$$

R_p = Return of Portfolio

R_f = Risk Free Rate

SD = Standard Deviation.

SR may be calculated directly as Annual as follows:

$$(\text{Annualized } R_p - \text{Annualized } R_f) / (\text{Standard Deviation of Monthly } R_p * 3.4641)$$

Tracking Error (TE)

TE is advanced version of SD. SD considers deviation of absolute return history. TE considers deviation of Relative Return history. Following is the formula of TE vis-à-vis formula of SD:

TE = Square root of Variance for TE (VTE)

Variance for TE (VTE) = (Sum of squared difference between each monthly data (D)* and mean of data (D)* series / number of monthly data - 1).

*(D) = "Fund's monthly Return - Benchmark's monthly Return"

*Data (D) = A historical series showing "D" for each month i.e. differential return of fund for each month.

For quick reference, formula for SD was as below (based on Absolute return & not differential return)

Standard Deviation (SD) = Square root of Variance (V)

Variance = (Sum of squared difference between each monthly return and its mean / number of monthly return data - 1).

Step by step process to calculate TE:

1. Subtract the benchmark index return from the portfolio return for each month: ($R_p - R_i$).
2. The tracking error is the population standard deviation (STDEVP in Excel) of the monthly differences (which may be annualized by multiplying by the square root of 12 - the same as for the denominator of the Information Ratio):

$$\text{Standard Deviation of Monthly } (R_p - R_i) * \text{square root of 12 or 3.4641}$$



TE measures the degree of deviation between portfolio and benchmark. (Typically, an index fund has a lower TE upto 2% p.a. while actively managed diversified fund has TE of 5% - 20% p.a.)

Information Ratio (IR)

IR is advanced version of Sharpe Ratio (SR). SR calculated Risk Adjusted Return. SR works out absolute excess return per 1% VOL.

IR calculates Risk Adjusted Out performance. IR works out Relative Return per 1 % of TE.

The *Information Ratio (IR)* is the return of the portfolio less the return of the benchmark (not the risk-free rate) divided by TE (the risk associated with being different from the benchmark). An average manager that adds no real value would be expected to have an IR of zero. An excellent manager would have an IR of above 0.50. Any IR above zero means that the portfolio manager is generating return that is better than the benchmark and is not being gained by taking undue risks relative to that benchmark. The calculation methodology is as follows:

1. Calculate the annualized return for the portfolio (R_p).
2. Calculate the annualized return for the benchmark index (R_i).
3. Subtract the annualized return for the benchmark index from the annualized return for the portfolio ($R_p - R_i$) – this becomes the numerator for the Information Ratio.
4. Calculate the differences each month between monthly returns for the portfolio (R_p) and the benchmark index (R_i).
5. Calculate the population standard deviation (STDEVP in Excel) of the monthly differences ($R_p - R_i$).
6. Multiply the monthly standard deviation by the square root of 12 (3.4641) – this becomes the denominator for the Information Ratio.
7. The Information Ratio is:

$$(\text{Annualized } R_p - \text{Annualized } R_i) / \text{Standard Deviation of Monthly } (R_p - R_i) * 3.4641$$

Beta

Beta is a standardized measure of systematic risk

Following are 2 approaches to calculate Beta, both will give same results. 1st approach is easy to understand and interpret the figure:

1st Approach: It is ratio of Deviation of funds and benchmark, further diluted by the market risk factor.

$$\text{Beta} = \frac{\text{SD of Fund}}{\text{SD of Benchmark}} \times$$



2nd Approach: Solved 1st approach after inserting statistical formula of SD / R-square:

$$\text{Beta} = \frac{n \cdot (\sum(x \cdot y)) - ((\sum x) \cdot (\sum y))}{n \cdot (\sum y^2) - (\sum y)^2}$$

In Excel, the formula is:

$$\text{Beta} = \text{SLOPE}(<\text{portfolio returns minus } R_F>, <\text{benchmark returns minus } R_F>)$$

Raw Data / Input Data will be Monthly Return series of Fund and Benchmark.

R-Squared

The R^2 or *Coefficient of Determination*, describes the fraction of investment risk in a portfolio that can be associated with market or systemic risk. The R-squared is the square of the correlation and measures the strength of association between the fund returns benchmark return. R-squared indicates the percentage of a portfolio's total risk (i.e. standard deviation) that is market-related (i.e. ratio of movement tied to beta thereafter). Values range from 1 (returns are explained 100% by the market) to 0 (returns bear no association with the market). The calculation for correlation and for the co-efficient of determination or R-squared is as follows:

1. R-Squared = Square of Correlation ®
2. Formula for Correlation ® :

$$\text{Correlation}_{xy} = \frac{\text{Covariance between index and portfolio}}{\text{Standard deviation of portfolio} * \text{standard deviation of index}}$$

In Excel, the formula is directly available as :

$$\text{R-Squared} = \text{RSQ}(<\text{portfolio returns minus } R_F>, <\text{benchmark returns minus } R_F>)$$

