



ASSOCIATION OF MUTUAL FUNDS IN INDIA

CHIEF EXECUTIVE

135/BP/ 57 /2015-16

Date: May 18, 2015

To All AMFI Members

AMFI Best Practices Guidelines Circular No. 57

Sub: Product Labelling in Mutual Fund Schemes – Revised Framework and Guidelines

As members would be aware, SEBI has decided to revise the regulatory guidelines governing product labelling of mutual fund schemes, vide circular no. CIR/IMD/DF/4/2015 dated April 30, 2015 wherein it is also stipulated that Mutual funds may 'product-label' their schemes on the basis of the best practice guidelines issued by Association of Mutual Funds in India (AMFI) in this regard.

Background:

SEBI, had vide Circular No. CIR/IMD/DF/5/2013 dated March 18, 2013 had mandated Product labeling of Mutual Funds Schemes indicating the level of risk, depicted by colour code boxes, so as to provide investors an easy understanding of the kind of scheme they were investing in and understand the suitability thereof. At the meeting of Mutual Fund Advisory Committee (MFAC) held on December 22, 2014, the members concurred that the existing 3-level classification of risk (i.e., High, Medium and Low depicted by brown, yellow and blue respectively) was inadequate to cover all degrees of risk and in conveying the risk profile of the Mutual Fund products appropriately and that there was a need to increase the degrees of risk to 5 levels. The committee also suggested that AMFI, being the association of the mutual fund industry, be advised to frame standards providing certain parameters to label the schemes based on 5 levels of risk. SEBI had therefore advised AMFI to frame the standards based on 5-levels of risk, providing certain parameters to be followed by the AMCs to label the schemes, taking into consideration the recommendations of MFAC and submit the same to SEBI.

Accordingly, AMFI constituted a Working Group to recommend the revised framework for product labelling of mutual fund schemes based on 5-levels of risk suggested by MFAC (and the corresponding colours thereof).



In their recommendations for the revised framework, the Working Group **also suggested a Visual Risk Grading picto-meter ('Riskometer'), that would allow retail investors to intuitively gauge relative risk associated with a mutual fund scheme and understand the risk representation easily, as an alternative to colour coding of schemes**, in addition to revised framework for product labelling of mutual fund schemes based on 5-levels of risk and the corresponding revised colour codes.

The Working Group's recommendations were discussed and duly approved by AMFI's Board at the Board Meeting held on February 23, 2015, after which the recommendations were submitted to SEBI.

Revision in Regulations on Product Labelling:

Vide the aforesaid circular, SEBI has accepted AMFI's recommendation to depict the level of risk for product labelling of schemes using a pictorial representation in lieu of colour coding and the parameters to be followed by the AMCs to label the schemes based on 5-levels of risk as per Annexure 1, attached herewith.

Accordingly, Members are requested to 'product-label' their existing schemes and all schemes to be launched on or after July 1, 2015 on the basis of the parameters / Framework detailed in Annexure 1. Members may choose to adopt the provisions of this circular before the effective date.

Members are also requested to confirm having noted the contents of this circular for due compliance and also to place this circular before their Trustees for information at the next meeting of the Trustees.

With regards,

A handwritten signature in blue ink, appearing to read 'H. N. Sinor', is written over a blue horizontal line that extends across the page.

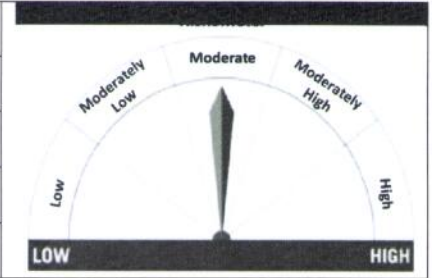
H. N. Sinor
Chief Executive



Annexure 1

A. The Five Risk Levels prescribed by SEBI¹:

i. Low	principal at low risk
ii. Moderately Low	principal at moderately low risk
iii. Moderate	principal at moderate risk
iv. Moderately High	principal at moderately high risk
v. High	principal at high risk



B. Criteria:

The risk grading criteria is intended to serve the following broad areas:

- ✓ Classify mutual fund schemes without ambiguity.
- ✓ Represent relative risk associated in terms of (a) probability of loss of capital (b) range of possible outcomes.
- ✓ Provide an intuitive feel of time frame for which investor intends to stay invested in a scheme.

The recommended **Risk Grades** with the Criteria is given in **Annexure 2**.

C. Classification of Schemes:

Mutual Fund schemes shall be classified based on the Asset Allocation Pattern specified in the Scheme Information Document (SID).

D. Basis of classification of the Scheme for the above criteria:

- 1) Classification shall be as per the SID, if the above criteria has been specifically stated in the SID.
- 2) Where there is a range specified in the SID, the maximum allocation to the riskiest asset category shall be considered while classifying the scheme.
- 3) In case the SID does not provide for the above mentioned criteria, the same needs to be monitored at the end of the Financial Year, based on annual maximum portfolio allocation to the riskiest asset class of the previous financial year.
(Rationale: the review timeline is in line with 'simple, performing schemes criteria')
- 4) Domestic Fund of Funds to be classified basis the risk category of the predominant (>65%) underlying funds
- 5) In case any scheme that does not exactly fit into the above criteria, a conservative risk classification would be expected based on applicable criteria.

E. Improvements:

The above risk grading mechanism has the following advantages -

- 1) It increases the number of risk grades from three to five, thereby accommodating a finer categorization across the spectrum of MF products to cover various degrees of risk.
- 2) The risk classification is unambiguous, as it clearly segregates schemes on the basis of underlying securities as prescribed by the SID.
- 3) The classification is in accordance with the Regulations and draws from them to make an easily understandable framework.
- 4) The framework classifies Sectoral and Thematic funds to be of Very High Risk, so that they are not confused with Diversified Equity funds. At the same time, it also provides a distinct labeling of Liquid Funds in order to highlight their lower risk profile as compared to other fixed income funds.
- 5) While classifying the products, the framework takes into consideration both (a) Probability of loss of principal, and (b) the range of possible returns.
- 6) The framework also tries to indicate "Typical Investment Horizon" for categorizing the funds.
- 7) In such media, where visual/pictorial representation is not possible (i.e. radio/SMS), a textual mention of risk grade should be considered an adequate measure.

¹ SEBI circular no. CIR/IMD/DF/4/2015 dated April 30, 2015



The Five Risk Levels

Degree of Risk	Nature of Scheme / Criteria	Rationale	Typical Investment Horizon
1. Low	<ol style="list-style-type: none"> 1) Liquid schemes as per SID 2) Such other schemes that invests in debt securities having maturity of 91 days or less 3) Guaranteed Returns schemes 	<p>As per the Regulations liquid schemes are prohibited from investing in securities having residual maturity beyond 91 days. This ensures that, they are accrual based products and are least exposed to mark-to-market fluctuations.</p> <p>This implies that an investor investing even for a day faces very low risk of capital loss. Also, the range of expected returns is extremely narrow.</p>	1 Day+
2. Moderately Low	<ol style="list-style-type: none"> 1) All Fixed Income schemes with <ol style="list-style-type: none"> (a) \leq 3 years Average Maturity AND (b) 65% or above portfolio exposure in AAA/A1+ rated securities, including Gilts, Collateral Borrowing Lending Obligations and Short Term Deposits / Bill Re-Discounting of AAA rated banks as per SID. 2) FMPs with <ol style="list-style-type: none"> (a) \leq 1100 Days Average Maturity/ Tenure AND (b) 65% or above portfolio exposure in AAA/A1+ rated securities, including Gilts, Collateral Borrowing Lending Obligations and Short Term Deposits / Bill Re-Discounting of AAA rated banks as per SID. 3) Capital Protection Oriented schemes. 4) Perfect Equity Arbitrage schemes as per SID. 	<p>These schemes are exposed to a low risk on duration and being a debt fund it would invest only in such securities that have a contractual right of payback of capital.</p> <p>Minimum 65% high credit exposure (AAA/A1+ or Gilts) could provide sufficient secondary market liquidity in volatile times.</p> <p>As per the Regulations, Capital Protection Funds are required to aim for capital protection. There are various regulatory guidelines such as mandatory credit rating, quarterly report to trustees etc. to ensure that the portfolio structure is oriented towards capital protection.</p> <p>Arbitrage Fund - In such scheme perfect hedge strategy is used to minimize the risk.</p>	<p>90 Days onwards</p> <p>Or</p> <p>Exit Load / Lock-in Period</p> <p>(Whichever is higher)</p>



Degree of Risk	Nature of Scheme / Criteria	Rationale	Typical Investment Horizon
3. Moderate	1) All Fixed Income schemes and Gilt schemes with > 3 Years Average Maturity, not fulfilling condition for "Moderately Low". 2) All FMPs with > 1100 Days Average Maturity/ Tenure, not fulfilling condition for "Moderately Low". 3) All Fixed Income-oriented schemes having provision for net equity allocation up to 20% of Net Assets as per SID. 4) Equity Arbitrage Funds with marginal net equity exposure upto 20% as per SID.	<p>These schemes are exposed to duration risk, and are exposed to market volatility over different time frames. In addition credit quality visibility deteriorates in very long time frames.</p> <p>Regulatory restrictions to exposure at security level, issuer level and credit rating do provide an element of diversification. Hence, Moderate risk needs highlighting.</p> <p>Technically, upto 20% of the portfolio can be invested into equity or equity related instruments that provide no legal recourse in case of permanent loss of capital. Further, the range of expected returns can be quite wide as equity securities get included in the portfolio.</p>	3 Years Or Exit Load Period (Whichever is higher)
4. Moderately High	1) All schemes with Equity exposure greater than 20% (Balanced, Diversified Index & Diversified ETF) 2) Diversified Equity schemes (including ELSS) 3) Single Commodity schemes including Gold Funds/Gold ETFs	<p>Owing to high equity exposure, there is a reasonable possibility of permanent loss of capital without recourse. However, the fund manager has the flexibility to diversify and mitigate risks in the long run.</p> <p>Schemes investing predominantly in Gold are exposed to risks associated with commodities market and hence there is a possibility of loss of capital.</p>	5 Years
5. High	1) Non-diversified schemes (Sectoral Funds / Sectoral ETFs and Thematic Funds) 2) International Funds – At least 65% in Diversified / Sectoral / Thematic international securities / underlying funds	<p>As risk of capital loss is highest owing to high concentration risk. There is an element of unpredictable market cycles that could run for extended periods. Loss of value due to obsolescence, or regulatory changes coupled with structural rigidity of the fund can lead to permanent loss of capital.</p> <p>In case of international funds, there is an element of foreign exchange risk.</p>	Tactical