PORTFOLIO MANAGEMENT SERVICES

Committee on Financial Markets & Investors' Protection

The Institute of Chartered Accountants of India

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FOREWORD

Indians, as compared to other investors, are considered to have high saving and investment rate. Further, they have been observed to be more comfortable with making investments which have low risk and content with the low returns on their money. Generally, the portfolio of an investor reflects his risk appetite. However, in the past few years, the financial markets have been swept with variety of financial products and services. Lack of information about the available options in one's periphery and access to the knowledge of the pros and cons of moving ahead in the direction are some more reasons of holding back the potential investors in taking the risk.

Portfolio Management facilitates an individual to make selections of various securities in their portfolio based on their investment objectives, risk tolerance, age and personal circumstances. As people invest in more than one security, there arises a need for its management. It clearly establishes the relation between securities and its diversification & explains their corresponding risks and rewards. It is the portfolio managers' ability to construct a portfolio conforming to the needs of the investors and also assure optimum returns to them. According to the concepts of portfolio management, one can reduce the investment risks by designing a diversified portfolio which includes a variety of types and classes of securities so as to generate sound returns.

In light of this and to bring a reasonable amount of understanding, the Institute of Chartered Accountants of India (ICAI) through its Committee on Financial Markets & Investors' Protection (CFMIP) has come out with a comprehensive publication on Portfolio Management. The objective of this publication is to broaden the knowledge base and generate ideas for the investors.

I compliment the Committee on Financial Market and Investors' Protection of the Institute of Chartered Accountants of India (ICAI) for bringing out this publication. I would also like to congratulate CA Rajkumar S Adukia, Chairman, CFMIP under whose guidance this publication has been brought out.

I wish the readers a very happy & fruitful reading.

Best Wishes

CA Subodh Kumar Agrawal
President,
The Institute of Chartered Accountants of India

PREFACE

Effective project portfolio management has become a significant factor in the long-term strategic success of organizations. The concept of Portfolio Management is fairly simple—one need to direct the right resources to efficiently deliver the desired project investments so as to meet the organization's strategic goals and objectives and at the same time one need to deliver the quality and benefits that were expected before the work begins.

Understanding Portfolio Management & practically doing it well is all together different. The goal of portfolio management is to bring together various securities and portfolios associated with it in order to achieve investment objectives. Effective asset management revolves around a portfolio manager's ability to assess and effectively manage the risks .

With the increase of technology, access to information has increased dramatically at all levels of the investment cycle. It is the job of the portfolio manager to manage the vast array of available information and to transform it into successful investments for the portfolio for which he/she has to manage. When used effectively, portfolio management ensures that projects are aligned with corporate strategies and priorities and optimizes resource allocation. It's the practice that bridges the gap between the executive decision process and project execution.

Portfolio Management is an upcoming area for the professionals like Chartered Accountants and therefore a guidance is required as to how the professionals should exercise due diligence while dealing with portfolio's. Therefore the Committee on Financial Markets decided to bring out this publication on Portfolio Management.

This publication aims to provide an overview of the day-to-day aspects with which a portfolio manager must be concerned. Theories and essential calculations are covered, along with a practical description of what is involved in managing portfolios.

I sincerely appreciate the efforts put in by CA Vaibhav Chirimar in preparing the publication.

I would also like to thank CA. Jay Ajit Chhaira, Vice-Chairman, CFMIP and all members of the CFMIP committee, CA Pankaj Inderchand Jain, CA Sanjeev Maheswari, CA S Santhana Krishnan, CA Anuj Goyal, CA Naveen N.D. Gupta, CA Sharad Kabra, Shri Sidharth K. Birla, Shri Sunil Kanoria, CA Vikas Jain, CA Murmuria Bijay, CA. Shyam Lal Agarwal who have extended their support and encouragement in all committee activities.

I am sure that this publication will certainly help the readers to understand the theoretical as well as the practical sides of portfolio management. I would also like to invite feedbacks from the readers for making this publication a great success. Have a happy reading.

CA Rajkumar S Adukia
Chairman,
Committee on Financial Market
& Investors' Protection

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Chapter 1
Introduction to Portfolio Management

Investing in securities such as shares, debentures and bonds is profitable as well as exciting. It is indeed rewarding, but it involves a great deal of risk and calls for scientific knowledge as well as artistic skill. In securities investments both – profit rationale and emotional responses – are involved. Investment in financial securities, on the other hand, is now considered to be one of the best avenues for savings. At the same time, it is acknowledged to be one of the most risky avenues of investment. **"It is rare to find investors investing their entire savings in a single security. Instead, they tend to invest in a group of securities. Such a group of securities is called portfolio".** Hence, creation of a portfolio helps investor to reduce risk without sacrificing returns. In principle, portfolio management deals with the analysis of individual securities as well as the theory and practice of optimally combining securities into portfolios. An investor who understands the fundamental principles and analytical aspects of portfolio management has a better chance of success.

An investor considering investment in securities is faced with the problem of choosing from among a large number of securities and how to allocate his funds to this group of securities. Next, he is faced with the dilemma of deciding which securities to hold on to and how much funds to invest in each of them. Then he considers the risk and return characteristics of portfolios. Thereafter the said investor tries to choose the optimal portfolio taking into consideration the risk return characteristics of all possible portfolios. As the risk return characteristics of individual securities as well as portfolios also change, this calls for a periodic review of investment portfolios of the investor. This gives rise to the need for a thorough portfolio study which can be done by professional portfolio managers. An investor invests his funds with the portfolio manager in anticipation of getting good returns, which is consistent with the risk that he has to bear. The return realized from the portfolio has to be measured and the performance of the portfolio has to be evaluated. It is evident that rational investment activity involves creation of an investment portfolio. The portfolio management comprises all the processes involved in the creation and maintenance of an investment portfolio. It deals specifically with the security analysis, portfolio analysis, portfolio selection, portfolio revision and portfolio evaluation. The portfolio management makes use of analytical techniques of analysis and conceptual theories vis-à-vis rational allocation of funds. The portfolio management is a complex process which tries to make investment activity more rewarding and less risky. Following are the broad characteristics of portfolio management:

Selection of Portfolio: The selection of portfolio depends upon the objectives of the investor. The selection of portfolio under different objectives is dealt with subsequently.

Objectives and Asset Mix: If the main objective is getting adequate amount of current income, 60% of the investment is made in debt instruments while remaining 40% in equity. However, proportion varies according to individual preferences.

Growth of Income and Asset Mix: This means the investor requires a certain percentage of growth as the income from the capital he has invested. The proportion of equity varies from 60 to 100% and that of debt from 0 to 40%. The debt may be included to minimize risk and to get tax exemption.

Capital Appreciation and Asset Mix: It means that value of the investment made increases over the year. Investment in real estate can give faster capital appreciation except liquidity problem. In the capital market, the value of the shares is much higher than the original issue price.

Safety of Principle and Asset Mix: Usually, the risk averse investors are very particular about the stability of principal, while old people are more sensitive towards safety

Risk and Return Analysis: The traditional approach of portfolio building has some basic assumptions: an investor wants higher returns at the lower risk. But the rule of the game is that the more the risk, the greater is the return. So while making a portfolio the investor must judge the risk taking capability and the returns desired.

Diversification: Once the asset mix is determined and risk-return relationship is analyzed the next step is to diversify the portfolio. The main advantage of diversification is to minimize the unsystematic risk.

Evolution of Portfolio Management: Portfolio management is essentially a systematic method of maintaining one‘s investment efficiently. Many factors have contributed to the existence and development of the concept. In the early years of the twentieth century, many analysts used financial statements to find the value of the securities. The first institution that analyzed using this criterion was Railroad Securities of the USA.

A booklet entitled "The Anatomy of the Railroad" using financial statements to find the value of the securities was published by Thomas F. Woodlock in 1900. As the time progressed this method became very important in the investment field although most of the analysts adopted different ways to publish their data. They generally advocated the use of different ratios for this purpose.

John Moody in his book "The Art of Wall Street Investing" strongly supported the use of financial ratios to know the worth of the investment. Later, the proposed analysis became the Common-size Analysis.

The other major method adopted was the study of stock price movement with the help of price charts. This method later on was known as Technical Analysis. It evolved during 1900-1902 when Charles H. Dow, the founder of the Dow Jones and Co., presented his view in a series of editorials in the Wall Street Journal of the USA. The advocates of Technical Analysis believed that stock prices movement is ordered and systematic whereby a definite pattern could be identified. Hence, the investment strategy was build around the identification of the trend and pattern in the stock price movement.

Another prominent author who supported the Technical Analysis was Ralph N. Elliot who published a book in the year 1938 titled "The Wave Principle". After analyzing 75 years data of share prices, he concluded that the market movement was quite orderly and followed a pattern of waves. His theory is known as Elliot Wave Theory. According to J. C. Francis the development of investment management can be traced chronologically through three different phases. First phase is known as Speculative Phase where investment was not a widespread activity but a cake for a few rich people. In this phase, the process was speculative in nature. Investment management was an art and needed skills while price manipulation was resorted to by the investors. During this time period, pools and corners were used for manipulation due to which the stock exchange crash in the year 1929. The individual speculative ventures of investors were declared illegal in the USA by the Securities Act of 1934.

Second Phase, known as Professionalism, began in the year 1930. After the promulgation of the Securities Act, the investment industry began the process of upgrading its ethics, establishing standard practices and generating a good public image. As a result, the investments market became safer place to invest and the people of different income group started investing. Moreover, investors began to analyze the security before investing. During this period the research work of Benjamin Graham and David L. Dood waswidely publicized and publicly acclaimed. They published a book "Security Analysis" in 1934, which was highly sought after. Their research was considered the first work in the field of security analysis and acted as the base for further study. They are considered as pioneers of security analysis as a discipline.

Third Phase was known as the scientific phase. The foundation of modern portfolio theory was laid by Markowitz. His pioneering work on portfolio management was described in his article in the 'Journal of Finance' in 1952 and subsequent books published later. He tried to quantify the risk. Markowitz showed how the risk can be minimized through proper diversification of investment which required the creation of the portfolio. He provided technical tools for the analysis and selection of optimal portfolio. For his work, he won the Noble Prize for Economics in the year 1990. The work of Markowitz was extended by William Sharpe, John Linter and Jan Mossin through the development of the Capital Asset Pricing Model (CAPM). At present the last two phases – of Professionalism and Scientific Analysis – are currently advancing simultaneously with investment in various financial instruments, which, with proper knowledge, has become safe for each and every investor.

With the advent of computers the whole process of portfolio management has become quite easy. The computer can absorb large volumes of data, which perform the computations accurately and quickly giving out the results in any desired form. Moreover, simulation, artificial intelligence, etc., provides means of testing alternative solutions. The trend towards liberalization and globalization of the economy has promoted free flow of capital across international borders. Now the portfolio not only includes domestic securities but also foreign ones too. So, financial investments cannot be reaped without proper management.

Another significant development in the field of investment management has been the introduction to Derivatives with the availability of Options and Futures. This has broadened the scope of investment management. Investment is no longer a simple process. It requires a scientific knowledge, a systematic approach and also professional expertise. The portfolio management, therefore, is the only way through which an investor can get good returns, while minimizing risk at the same time. Following are the objectives of the portfolio management:

- Risk minimization
- Safeguarding of capital

- Realizing capital appreciation
- Choosing optimal mix of securities
- Keeping track of investments etc.

Role of Portfolio Management in the Indian Context

There was a time when portfolio management was an exotic term, a practice which was beyond the reach of the small investor. But the time has changed now. The portfolio management is now a common term and is widely practiced in India. The theories and concepts relating to portfolio management now find their way into the front pages of the financial newspapers and magazines. In early 1990s' India embarked on economic liberalization and globalization with high participation of private players. This reform process has turned the Indian industry into an efficient enterprise with rapid computerization, increased market transparency, better infrastructure and customer services, closer integration and higher volume. The markets are dominated by large institutional investors possessed with diversified portfolios. A large number of mutual funds have come up in the market since 1990. With this development, investment in securities has gained considerable momentum.

The spread of the securities investment, among Indian investors, has lead to the development of the quantitative techniques. The professional portfolio management, backed by research, is now being adopted by mutual funds, investment consultants, individual investors and big brokers. The Securities Exchange Board of India (SEBI) is a regulatory body in India. It ensures that the stock market is free from fraud, ensuring that the investor‘s money is safe.

It is very difficult to allocate funds amongst these asset classes without proper understanding of the risk involved. It requires an expert to do the work for the investor. The whole process of investment is very exciting as well as rewarding if it is done by an expert. Otherwise, with little skill and expertise, one is sure to burn their fingers.

So, one question arises: how does one define Risk? In simple words, Risk is the probability of erosion in value of one's investment due to future events which may or may not occur. The next question would b:e how to tackle this Risk and also earn profit or income from the underlining investment in a given asset class? Investment nowadays have become a specialized subject. It calls for an expert to take care of one's investment. It can be either in the capacity of an advisor and/or in the capacity of a navigator who will take care of the entire investment portfolio. This navigator may be the Portfolio Manager.

A portfolio can be asset specific or can be a diversified one. Following are the common types of asset class:

- o Equity
- o Bonds
- o Deposits
- o Precious Metals
- o Real Estate (not a part of our study as it is a specialized subject on its own)

A typical portfolio should have at least 60% equity and balance 40% can be Debt and Precious Metals. Securities like bonds, debentures, and deposits are classified as Debt instruments. The weight-age of high risk class asset like equity will also depend upon the age of the investor, his risk appetite, market scenario, and state of the economy etc.

Portfolio Management is the professional asset management of various securities (e.g. shares, bonds and other securities) and assets (e.g., real estate) in order to meet specified investment goals for the benefit of the investors. Investors may be institutions (insurance companies, pension funds, corporations, charities, educational establishments etc.) or private investors.

The term Portfolio Management or Asset Management is often used to refer to the investment management or fund management of all forms of institutional investment as well as investment management for private investors. Investment managers who specialize in advisory or discretionary management on behalf of (normally wealthy) private investors may often refer to their services as money management or portfolio management, which is often within the context of so-called “private banking”.

The provision of investment management services includes elements of financial statement analysis, asset selection, stock selection, plan implementation and ongoing monitoring of investments. Under the remit of financial services many of the world’s largest companies are at least in part investment managers and employ millions of staff.

“Fund manager” (or investment adviser) refers to both a firm that provides investment management services and an individual who directs fund management decisions. According to a report titled “Capturing Growth in Adverse Times: Global Asset Management

2012" published by Boston Consulting Group in October 2012, the professionally managed assets of global asset management industry have remained flat-lined reaching US$58.3 trillion at year-end 2011, compared to US$58.8 trillion in 2007.

The investment business has several facets: the employment of professional fund managers, research (of individual assets and asset classes), dealing, settlement, marketing, internal auditing, and the preparation of reports for clients. The largest financial fund managers are firms that exhibit all the complexity their size demands. Apart from the people who bring in the money (marketers) and the people who direct investment (the fund managers), there are compliance staff (to ensure accord with legislative and regulatory constraints), internal auditors of various kinds (to examine internal systems and controls), financial controllers (to account for the institutions' own money and costs), computer experts, and "back office" employees (to track and record transactions and fund valuations for up to thousands of clients per institution).

Key Problems in Running Investment Businesses

The Key problem in running investment businesses include:

- revenue is directly linked to market valuations since a major fall in asset prices can cause a precipitous decline in revenues relative to costs;
- above-average fund performance is difficult to sustain, and clients may not be patient during times of poor performance;
- successful fund managers are expensive and may be headhunted by competitors;
- above-average fund performance appears to be dependent on the unique skills of the fund manager; however, clients are loath to stake their investments on the ability of a few individuals- they would rather see firm-wide success, attributable to a single philosophy and internal discipline; and
- analysts who generate above-average returns often become sufficiently wealthy that they avoid corporate employment in favor of managing their personal portfolios.

Representing the Owners of Shares

Institutions often control huge shareholdings. In most cases, they are acting as fiduciary agents rather than principals (direct owners). The owners of shares theoretically have great power to alter the companies via the voting rights the shares carry and the consequent ability to pressure managements, and if necessary out-vote them at annual and other meetings.

In practice, the ultimate owners of shares often do not exercise the power they collectively hold (because the owners are many, each with small holdings); financial institutions (as agents) sometimes do. There is a general belief that shareholders – in this case, the institutions acting as agents – could and should exercise more active influence over the companies in which they hold shares (e.g., to hold managers to account, to ensure Board's effective functioning). Such action would add a pressure group to those (the regulators and the Board) overseeing management.

However, there is the problem of how the institution should exercise this power. One way is for the institution to decide, the other is for it to poll its beneficiaries. Assuming that the institution polls, should it then: (i) vote the entire holding as directed by the majority of votes cast? (ii) split the vote (where this is allowed) according to the proportions of the vote? (iii) or respect the abstainers and only vote the respondents' holdings?

The price signals generated by large active managers holding or not the stock may contribute to management change. For example, this is the case when a large active manager sells his position in a company, leading to (possibly) a decline in the stock price, but more importantly a loss of confidence by the markets in the management of the company, thus precipitating changes in the management team.

Some institutions have been more vocal and active in pursuing such matters, for instance, some firms believe that there are investment advantages to accumulating substantial minority shareholdings (i.e. 10% or more) and putting pressure on management to implement significant changes in the business. In some cases, institutions with minority holdings work together to force management change. Perhaps more frequent is the sustained pressure that large institutions bring to bear on management teams through persuasive discourse and public relation. On the other hand, some of the largest investment managers such as BlackRock and Vanguard advocate simply owning every company and reducing the incentive to influence management teams. A reason for this last strategy is that the investment manager prefers a closer, more open and honest relationship with a company's management team than what would exist if they exercised control, thus allowing them to make a better investment decision.

The national context in which shareholder representation considerations are set is variable and important. The USA is a litigious society and shareholders use the law as a lever to pressure management teams. In Japan, it is traditional for shareholders to be low in the 'pecking order,' which often allows management and labour to ignore the rights of the ultimate owners. Whereas US firms generally cater to shareholders, Japanese businesses generally exhibit a stakeholder mentality, in which they seek consensus amongst all interested parties (against a background of strong unions and labour legislation).

Chapter 2

Global Fund Management Industry

The conventional assets under the management of the global fund management industry have increased by 10% in 2010 to US $79.3 trillion. Pension assets accounted for US $29.9 trillion of the total, with US $24.7 trillion invested in mutual funds and US $24.6 trillion in insurance funds. Together with alternative assets (sovereign wealth funds, hedge funds, private equity funds and exchange traded funds) and funds of wealthy individuals, assets of the global fund management industry totalled around US $117 trillion. Growth in 2010 followed a 14% increase for the previous year and was due both to the recovery in equity markets during the year and an inflow of new funds.

The US remained by far the biggest source of funds, accounting for around half of the conventional assets under management or US $36 trillion. The UK was the second largest centre in the world and by far the largest in Europe with around 8% of the global conventional assets under fund management industry. India, on the other hand, accounted for a little over a US$1.7 trillion in assets under management, but this includes investors like LIC, PSU and Public sector bankers.

Philosophy, Process and People

The 3-Ps' (Philosophy, Process and People) are often used to describe the reasons why the manager is able to produce above average results.

- **Philosophy** refers to the overarching beliefs of the investment organizations. It deals with the questions: (i) does the manager buy growth or value shares, or a combination of the two (and why)? (ii) do they believe in market timing (and on what evidence)? (iii) do they rely on external research or do they employ a team of researchers? It is helpful if any and all of such fundamental questions are supported by proof-statements.

- **Process** refers to the way by which the overall philosophy is implemented. It deals with the questions: (i) which universe of assets is explored before particular assets are chosen as suitable investments? (ii) how does the manager decide what to buy and when? (iii) how does the manager decide what to sell and when? (iv) who takes the decisions and are the decisions taken by a committee? (v) what controls are in place to ensure that a rogue fund (one very different from others and from what is intended) cannot arise?

- **People** refer to the staff, especially the fund managers. The questions are: (i) who are they? (ii) how are they selected? (iii) how old are they? (iv) who reports to whom? (v) how efficient is the team (and do all the members understand the philosophy and process they are supposed to be using)? And most important of all, (vi) how long has the team been working together? This last question is vital because whatever performance record was presented at the outset vis-à-vis the relationship with the client may or may not relate to (have been produced by) a team that is still in place. If the team has changed greatly (high staff turnover or changes to the team), then, arguably, the performance record is completely unrelated to the existing team (of fund managers).

Portfolio Managers and Portfolio Structures

At the heart of the investment management industry are the managers who invest and divest client investments. The investment advisor of a certified company should conduct an assessment of each client's individual needs and risk profile. Then he should recommend the appropriate investments.

Asset Allocation

The different asset class definitions are widely debated, but there are four common divisions that are: stocks, bonds, real-estate (not discussed in the study) and commodities (only precious metal like gold considered in this study). The exercise of allocating funds among these assets (and among individual securities within each asset class) is what investment management firms are paid for. The asset classes exhibit different market dynamics, including different interaction effects; thus, the allocation of money among asset classes will have a significant effect on the performance of the fund. Some research suggests that allocation among asset classes has more predictive power than the choice of individual holdings in determining portfolio return. Arguably, the skill of a successful investment manager resides in constructing the asset allocation, and separately the individual holdings, so as to outperform certain benchmarks (e.g., the peer group of competing funds, bond and stock indices).

Long-term Returns

It is important to look at the evidence on the long-term returns to different assets, including the holding period returns (the returns that accrue on average over different lengths of investment). For example, over very long holding periods (e.g. 10+ years) in most countries, equities have generated higher returns than bonds, while bonds have generated higher returns than cash. According to financial theory, this is because equities are riskier (more volatile) than bonds which are themselves riskier than cash.

Diversification

Against the background of the asset allocation, the fund managers consider the degree of diversification that makes sense for a given client (given its risk preferences) and construct a list of planned holdings accordingly. The list will indicate what percentage of the fund should be invested in each particular stock or bond. The theory of portfolio diversification was originated by Markowitz (and many others). Effective diversification requires management of the correlation between the asset returns and the liability returns, issues internal to the portfolio (individual holdings volatility), and cross-correlations between the returns.

Investment Styles

There are a range of different styles of fund management that the institution can implement. For example, growth, value, growth at a reasonable price (GARP), market neutral, small capitalization, indexed, etc. Each of these approaches has its own distinctive features, adherents and, in any particular financial environment, distinctive risk characteristics. For example, there is evidence that growth styles (buying rapidly growing earnings) are especially effective when the companies that are able to generate such growth are scarce; conversely, when such growth is plentiful, then there is evidence that value styles tend to outperform the indices particularly successfully.

Performance Measurement

The fund performance is often thought to be the acid test of fund management, and in the institutional context, accurate measurement is a necessity. For that purpose, institutions measure the performance of each fund (and usually for internal purposes components of each fund) under their management. The performance is also measured by external firms that specialize in performance measurement.

In a typical case (let us say an equity fund with the Portfolio Manager), the calculation would be made (as far as the client is concerned) every quarter and would show a percentage change compared with the prior quarter (e.g., +4.6% total return in Indian Rupees). This figure would be compared with other similar funds managed within the institution (for purposes of monitoring internal controls), with performance data for peer group funds, and with relevant indices (where available) or tailor-made performance benchmarks where appropriate. The specialist performance measurement firms calculate quartile and decile data and close attention would be paid to the (percentile) ranking of any fund.

In general, it is probably appropriate for an investment firm to persuade its clients to assess performance over longer periods (e.g., 3 to 5 years) to smooth out very short term fluctuations in performance and the influence of the business cycle. This can be difficult however and, industry wide, there is a serious preoccupation with short-term numbers and the effect on the relationship with clients (and resultant business risks for the institutions).

An enduring problem is whether to measure before-tax or after-tax performance. After-tax measurement represents the benefit to the investor, but investors' tax positions may vary. Before-tax measurement can be misleading, especially in regimens that tax realized capital gains (and not unrealized). It is thus possible that successful active managers (measured before tax) may produce miserable after-tax results. One possible solution is to report the after-tax position of some standard taxpayer.

Risk-adjusted Performance Measurement

The performance measurement should not be reduced to the evaluation of fund returns alone, but must also integrate other fund elements that would be of interest to investors, such as the measure of risk taken. Several other aspects are also part of performance measurement: evaluating performance if managers have succeeded in reaching their objective, i.e. if their return was sufficiently high to reward the risks taken; how they compare to their peers; and finally whether the portfolio management results were due to the luck or the manager's skill. The need to answer all these questions has led to the development of more sophisticated performance measures, many of which originate in modern portfolio theory. In principle, modern portfolio theory has established the quantitative link that exists between portfolio risk and return. The Capital Asset Pricing Model (CAPM) developed by Sharpe (1964) highlighted the notion of rewarding risk and produced the first performance indicators, be it the risk-adjusted ratios (Sharpe ratio, information ratio) or differential returns compared to benchmarks (alphas). The Sharpe ratio is the simplest and the best known performance measure. It measures the return of a portfolio in excess of the risk-free rate, compared to the total risk of the portfolio. This measure is said to be absolute, as it does not refer to any benchmark, avoiding drawbacks related to a poor choice of benchmark. In addition, it does not allow the separation of the performance of the market in which the portfolio is invested from that of the manager. The information ratio is a more general form of the Sharpe ratio in which the risk-free asset is replaced by a benchmark portfolio. This measure is relative, as it evaluates portfolio performance with reference to a benchmark, making the result strongly dependent on this benchmark choice.

The portfolio alpha is obtained by measuring the difference between the return of the portfolio and that of a benchmark portfolio. This measure appears to be the only reliable performance measure to evaluate active management. In fact, we have to distinguish between normal returns provided by the fair reward for portfolio exposure to different risks and those obtained through passive management from abnormal performance (or outperformance) due to the manager's skill (or luck), or whether through market timing, stock picking, or good fortune. The first component is related to allocation and style investment choices, which may not be under the sole control of the manager, and depends on the economic context, while the second component is an evaluation of the success of the manager's decisions. Only the latter, measured by alpha, allows the evaluation of the manager's true performance (but then, only if you assume that any outperformance is due to skill and not luck).

The portfolio return may be evaluated using factor models. The first model, proposed by Jensen (1968), relies on the CAPM and explains portfolio returns with the market index as the only factor. It quickly becomes clear, however, that one factor is not enough to explain the returns very well and that other factors have to be considered. Multi-factor models were developed as an alternative to the CAPM, allowing a better description of portfolio risks and a more accurate evaluation of a portfolio's performance. For example, Fama and French (1993) have highlighted two important factors that characterize a company's risk in addition to market risk. These factors are the book-to-market ratio and the company's size as measured by its market capitalization. Fama and French therefore proposed three-factor model to describe portfolio normal returns (Fama-French three-factor model). Carhart (1997) proposed to add momentum as a fourth factor to allow the short-term persistence of returns to be taken into account.

Active Management (also called active investing) refers to a portfolio management strategy where the manager makes specific investments with the goal of outperforming an investment benchmark index. The Investors or Portfolio Managers who do not aspire to create a return in excess of a benchmark index will often invest in an index fund that replicates as closely as possible the investment weighting and returns of that index. This is called passive management. Active management, on the other hand, is the opposite of passive management because in passive management the manager does not seek to outperform the benchmark index.

Concept

Ideally, the active manager exploits market inefficiencies by purchasing securities (stocks etc.) that are undervalued or by short selling securities that are overvalued. Either of these methods may be used alone or in combination. Depending on the goals of the specific investment portfolio, hedge fund or mutual fund, active management may also serve to create less volatility (or risk) than the benchmark index. The reduction of risk may be instead of, or in addition to the goal of creating an investment return greater than the benchmark.

The active portfolio managers may use a variety of factors and strategies to construct their portfolio(s). These include quantitative measures such as price–earnings ratios and PEG ratios, sector investments that attempt to anticipate long-term macroeconomic trends (such as a focus on energy or housing stocks), and purchasing stocks of companies that are temporarily out-of-favour or selling at a discount to their intrinsic value. Some actively managed funds also pursue strategies such as risk arbitrage, short positions, option writing, and asset allocation.

Performance

The effectiveness of an actively managed investment portfolio not only depends on the skill of the manager and research staff but also on how the term active is defined. Many mutual funds purported to be actively managed stay fully invested regardless of market conditions, with only minor allocation adjustments over time. Other managers will retreat fully to cash, or use hedging strategies during prolonged market declines. These two groups of active managers will often have very different performance characteristics.

Approximately 20% of all funds are pure index funds. The balance is actively managed in some respect. In reality, a large percentage of actively managed funds rarely outperform their index counterparts over an extended period of time because 45% of all funds are "closet indexers" funds whose portfolios look like indexes and whose performance is very closely correlated to an index but call themselves active to justify higher management fees. The prospectuses of closet indexers will often include language such as "80% of holdings will be large cap growth stocks within the BSE30 and/or BSE500 or some active index" causing the majority of their performance to be directly dependent upon the performance of the growth stock index they are benchmarking, less the larger fees.

Research has shown that only a minority of actively managed funds have gains better than the Underlying Index which the fund manager tracks or is against the benchmark index. As the time period for comparison increases, the percentage of actively managed funds whose gains exceed the BSE-30 or NIFTY-50 benchmark declines further. This may be due to the preponderance of closet-index funds in the study.

Only about 30% of funds are active enough that the manager has the latitude to move completely out of an asset class in decline, which is what many investors expect from active management. Of these 30% of funds, there are outperformers and underperformers, but the group that outperforms is also the same group that outperforms passively managed portfolios over long periods of time.

Due to fund management fees and/or expenses, it is possible that an active or passively managed fund could underperform compared to the benchmark index, even though the securities that comprise the fund are outperforming the benchmark, because indexes themselves have no expenses whatsoever. However, since many investors are not satisfied with a benchmark return a demand for actively managed continues to exist. In addition, many investors find active management an attractive investment strategy in volatile or declining markets or when investing in market segments that are less likely to be profitable when considered as whole. These kinds of sectors might include a sector such as small cap stocks.

Advantages of Active Management

The primary attraction of active management is that it allows selection of a variety of investments instead of investing in the market as a whole. Investors may have the following variety of motivations for such a strategy:

- They may be skeptical of the efficient-market hypothesis, or believe that some market segments are less efficient in creating profits than others.
- They may want to manage volatility by investing in less-risky, high-quality companies rather than in the market as a whole, even at the cost of slightly lower returns.

- Conversely, some investors may want to take on additional risk in exchange for the opportunity of obtaining higher-than-market returns.
- Investments that are not highly correlated to the market are useful as a portfolio diversifier and may reduce overall portfolio volatility.
- Some investors may wish to follow a strategy that avoids or underweights certain industries compared to the market as a whole, and may find an actively managed fund more in line with their particular investment goals. (For instance, an employee of a high-technology growth company who receives company stock or stock options as a benefit might prefer not to have additional funds invested in the same industry.)

Several of the actively managed funds with strong long-term records invest in value stocks, while passively managed funds that track broad market indices such as the BSE500 have money invested in all the securities in that index i.e., both growth and value stocks.

The use of managed funds in certain emerging markets has been recommended by Burton Malkiel, a proponent of the efficient market theory, who normally considers index funds to be superior to active management in various markets.

Disadvantages of Active Management

The most obvious disadvantage of active management is that the fund manager may make bad investment choices or follow an unsound theory in managing the portfolio. The fees associated with active management are also higher than those associated with passive management even if frequent trading is not present. Those who are consider investing in an actively managed fund should evaluate the fund's prospectus carefully. Data from recent decades demonstrates that the majority of actively managed large and mid-cap stock funds fail to outperform their passive stock index counterparts.

Active fund management strategies that involve frequent trading generate higher transaction costs which diminish the fund's return. In addition, the short-term capital gains resulting from frequent trades often have an unfavourable income tax impact when such funds are held in a taxable account.

Passive Management (also called **Passive Investing**) is a financial strategy in which an investor (or a fund manager) invests in accordance with a pre-determined strategy that doesn't entail any forecasting (e.g., any use of market timing or stock picking would not qualify as passive management). The idea is to minimize investing fees and to avoid the adverse consequences of failing to correctly anticipate the future. The most popular method is to mimic the performance of an externally specified index. The retail investors typically do this by buying one or more 'index funds'. By tracking an index, an investment portfolio typically gets good diversification, low turnover (good for keeping down internal transaction costs), and extremely low management fees. With low management fees, an investor in such a fund would have higher returns than a similar fund with similar investments but higher management fees and/or turnover/transaction costs.

Passive management is the most common in the equity market where index funds track a stock market index, but it is becoming more common in other investment types, including bonds, commodities and hedge funds.

Rationale

The concept of passive management is counterintuitive to many investors. The rationale behind indexing stems from the following five concepts of financial economics:

1. In the long term, the average investor will have an average before-costs performance equal to the market average. Therefore the average investor will benefit more from reducing investment costs than from trying to beat the average.

2. The efficient-market hypothesis postulates that equilibrium market prices fully reflect all available information, or to the extent there is some information not reflected, there is nothing that can be done to exploit that fact. It is widely interpreted as suggesting that it is impossible to systematically "beat the market" through active management although this is not a correct interpretation of the hypothesis in its weaker form. Stronger forms of the hypothesis are controversial, and then there is some debatable evidence against it in its weak form too.

3. The principal–agent problem is that when an investor (the principal) who allocates money to a portfolio manager (the agent) must properly give incentives to the manager to run the portfolio in accordance with the investor's risk/return appetite, and must monitor the manager's performance.

4. The bull market of the 2003-08 helped spur the phenomenal growth in indexing observed over that decade. Investors were

able to achieve desired absolute returns simply by investing in portfolios benchmarked to broad-based market indices such as the BSE30 and NIFTY-50

In India, Index funds have outperformed during this period the majority of active managers, especially as the fees they charge are very much lower than active managers. They are also able to have significantly greater after-tax returns.

Some active managers may beat the index in particular years or even consistently over a series of years. Nevertheless the retail investor still has the problem of discerning how much of the outperformance was due to skill rather than luck, and which managers will do well in the future.

Implementation

At the simplest, an index fund is implemented by purchasing securities in the same proportion as in the stock market index. It can also be achieved by sampling (e.g. buying stocks of each kind and sector in the index but not necessarily some of each individual stock), and there are sophisticated versions of sampling (e.g. those that seek to buy those particular shares that have the best chance of good performance).

Investment funds run by Investment Managers who closely mirror the index in their managed portfolios and offer little "added value" as managers whilst charging fees for active management are called 'closet trackers'. This means they do not, in truth, actively manage the fund but furtively mirror the index.

Collective investment schemes that employ passive investment strategies to track the performance of a stock market index are known as index funds. Exchange-traded funds are never actively managed and often track a specific market or commodity indices.

The globally diversified portfolios of index funds are used by investment advisors who invest passively for their clients based on the principle that underperforming markets will be balanced by other markets that outperform. A Loring Ward report in 'Advisor Perspectives' showed how international diversification worked over the 10-year period from 2000 to 2010 with the Morgan Stanley Capital Index for emerging markets generating 10-year returns of 154% balancing the blue-chip S&P500 index, which lost 9.1% over the same period – a historically rare event. The report noted that passive portfolios diversified in international asset classes generate more stable returns, particularly if rebalanced regularly. There is room for dialogue on whether index funds are one example of or the only example of passive management.

Portfolio Managers and Investors

A close analysis of BSE30 index shows that during 1988-2008 the average stock market investor earned returns of 15% compounded annually. An analysis of the equity funds returns of the 15 biggest asset management companies worldwide from 2003 to 2008 showed that about 70% of the actively managed funds have returned below their respective benchmarks.

Following are the other important terms one must understand before getting into the specialized subject of Portfolio Management.

Exchange-traded Fund

An **exchange-traded fund (ETF) i**s an investment fund traded on stock exchanges, much like stocks. An ETF holds assets such as stocks, commodities, or bonds, and trades close to its net asset value over the course of the trading day. Most ETFs track an index, such as a stock index or bond index. ETFs may be attractive as investments because of their low costs, tax efficiency, and stock-like features. ETFs are the most popular type of exchange-traded product.

An ETF allows the valuation feature of a mutual fund which can be traded at the end of each trading day for its net asset value, with the tradability feature of a closed-end fund, which trades throughout the trading day at prices that may be more or less than its net asset value. The closed-end funds are not considered to be "ETFs", even though they are funds and are traded on an exchange. ETFs traditionally have been index funds, Gold Funds or other types of debt funds but during the last 5 years or since 2008 these funds have been the flavour of the season because of outperformance of the underlying asset like gold etc.

Structure

The ETFs offer public investors an undivided interest in a pool of securities and other assets and thus are similar in many ways to traditional mutual funds except that shares in an ETF can be bought and sold throughout the day like stocks on a securities exchange through a broker-dealer. Unlike traditional mutual funds, ETFs do not sell or redeem their individual shares at net asset value, or NAV. The ability to purchase and redeem creation units gives ETFs an arbitrage mechanism intended to minimize the potential deviation between the market price and the net asset value of ETF shares. The existing ETFs have transparent portfolios, so institutional investors will know exactly what portfolio assets they must assemble if they wish to purchase a creation unit, and the exchange disseminates the updated net asset value of the shares throughout the trading day.

If there is strong investor demand for an ETF, its share price will (temporarily) rise above its net asset value per share, giving arbitrageurs an incentive to purchase additional creation units from the ETF and sell the component ETF shares in the open market. The additional supply of ETF shares reduces the market price per share, generally eliminating the premium over net asset value. A similar process applies when there is weak demand for an ETF and its shares trade at a discount from net asset value.

Some ETFs invest primarily in commodities or commodity-based instruments, such as precious metals. Although these commodity ETFs are similar in practice to ETFs that invest in securities,

As of 2009, there were approximately 15-20 exchange-traded funds dealing only in gold as their underlying asset.

Investment Uses

In general, ETFs provide the easy diversification, low expense ratios and tax efficiency of index funds, while still maintaining all the features of ordinary stock, such as limit orders, short selling and options. Because ETFs can be economically acquired, held, and disposed of, some investors invest in ETF shares as a long-term investment for asset allocation purposes, while other investors trade ETF shares frequently to implement market timing investment strategies.

Following are the advantages of ETFs:

- **Lower Costs**: ETFs, in general, have lower costs than other investment products because most ETFs are not actively managed and because ETFs are insulated from the costs of having to buy and sell securities to accommodate shareholder purchases and redemptions. Typically, ETFs have lower marketing, distribution and accounting expenses, and most ETFs do not have heavy fees.

- **Buying and Selling Flexibility**: ETFs, unlike mutual fund, which can only be traded at the end of the trading day, can be bought and sold at current market prices at any time during the trading day. As publicly traded securities, their shares can be purchased on margin and sold short, enabling the use of hedging strategies, and traded using stop orders and limit orders, which allow investors to specify the price points at which they are willing to trade.

- **Tax Efficiency**: ETFs, in general, generate relatively low capital gains because they typically have low turnover of their portfolio securities. While this is an advantage they share with other index funds, their tax efficiency is further enhanced because they do not have to sell securities to meet the investor redemptions. This is true for most of the developed countries.
- **Market Exposure and Diversification**: ETFs provide an economical way to rebalance portfolio allocations and to "equitize" cash by investing it quickly. An index ETF inherently provides diversification across an entire index. ETFs offer exposure to a diverse variety of markets, including broad-based indices, broad-based international and country-specific indices, industry sector-specific indices, bond indices and commodities.
- **Transparency**: ETFs, whether index funds or actively managed, have transparent portfolios and are priced at frequent intervals throughout the trading day.

Some of these advantages derive from the status of most ETFs as index funds.

Types

Index ETFs

Most ETFs are index funds that attempt to replicate the performance of a specific index. Indexes may be based on stocks, bonds, commodities or currencies. An index fund seeks to track the performance of an index by holding in its portfolio either the contents of the index or a representative sample of the securities in the index e.g., NIFTY BEES.

Commodity ETFs

Commodity ETFs in India are mainly Gold ETFs which invest in underlying asset like gold and gold futures. The idea of a Gold ETF was first officially conceptualized by Benchmark Asset Management Company Private Ltd in India when they filed a proposal with the SEBI in May 2002. The first gold exchange-traded fund was Gold Bullion Securities launched on the ASX in 2003, and the first silver exchange-traded fund was iShares Silver Trust launched on the NYSE in 2006. As of November 2010, a commodity ETF, namely SPDR Gold Shares, was the second-largest ETF by market capitalization.

The earliest commodity ETFs (e.g., GLD and SLV) actually owned the physical commodity (e.g., gold and silver bars). Similar to these are NYSE: PALL (palladium) and NYSE: PPLT (platinum). However, most ETCs implement a futures trading strategy, which may produce quite different results from owning the commodity.

Commodity ETFs trade just like shares, and are simple and efficient and provide exposure to an ever-increasing range of commodities and commodity indices, including energy, metals, softs and agriculture. However, most of these ETF's are not available in Indian markets.

It is important for an investor to realize that there are other factors that often affect the price of a commodity ETF that might not be immediately apparent. For example, buyers of a GOLD ETF might think that as long as gold goes up, they will profit roughly linearly. What is not clear to the novice investor is the method by which these funds gain exposure to their underlying commodities. In the case of many commodity funds, they simply roll so-called front-month futures contracts from month to month. This does give exposure to the commodity, but subjects the investor to risks that are involved in different prices along the term structure, such as a high cost to roll.

Actively Managed ETFs

The actively managed ETFs are quite a recent phenomena. The first one was offered in early part of 2000s . The actively managed ETFs approved to date are fully transparent, and are publishing their current securities portfolios on their web sites on a periodic basis.

The actively managed ETFs have grown faster in their first three years of existence than index ETFs did in their first three years of their existence. However, as track records develop, many see actively managed ETFs as a significant competitive threat to actively managed mutual funds.

Chapter 3
Value Investing

Value Investing is an investment paradigm that derives from the ideas on investment that Ben Graham and David Dodd began teaching at Columbia Business School in 1928 and subsequently developed in their 1934 text '*Security Analysis*'. Although value investing has taken many forms since its inception, it generally involves buying securities that appear underpriced by some forms of fundamental analysis. Such securities may be stock in public companies that trade at discounts to book value or tangible book value, having high dividend yields, have low price-to-earning multiples or have low price-to-book ratios.

In the high-profile proponents of value investing, as Berkshire Hathaway Chairman Warren Buffett has argued, the essence of value investing is buying stocks at less than their intrinsic value. The discount of the market price to the intrinsic value is what Benjamin Graham called the "margin of safety". The intrinsic value is the discounted value of all future distributions. However, the future distributions and the appropriate discount rate can only be assumptions. Benjamin Graham never recommended using future numbers (only past ones). For the last 25 years, Warren Buffett has taken the value investing concept even further with a focus on "finding an outstanding company at a sensible price" rather than generic companies at a bargain price.

Note that "Value Investing" is a term that Benjamin Graham himself never used. The term was coined later for Graham's ideas and has resulted in a significant misinterpretation of his principles, the foremost being that Graham simply recommended cheap stocks.

Value Investing was established by Benjamin Graham and David Dodd, both professors at Columbia Business School and teachers of many famous investors. In his '*The Intelligent Investor*', Graham has advocated the important concept of margin of safety — first introduced in '*Security Analysis*', a 1934 book he co-authored with David Dodd — which calls for a cautious approach to investing. In terms of picking stocks, he recommended defensive investment in stocks trading below their tangible book value as a safeguard to adverse future developments often encountered in the stock market.

Further Evolution

The concept of value (as well as "book value") has evolved significantly since the 1970s. Book value is the most useful in industries where most assets are tangible, while intangible assets such as patents, software, brands or goodwill are difficult to quantify, and may not survive the break-up of a company. When an industry goes through the fast technological advancements, the value of its assets is not easily estimated. Sometimes, the production power of an asset can be significantly reduced due to competitive disruptive innovation and therefore its value can suffer permanent impairment. One good example of decreasing asset value is a personal computer. An example of where book value does not mean much is the service and retail sectors. One modern model of calculating value is the discounted cash flow model (DCF) where the value of an asset is the sum of its future cash flows and discounted back to the present.

Value Investing Performance

Performance of Value Strategies

Value Investing has proven to be a successful investment strategy. There are several ways to evaluate its success: one way is to examine the performance of simple value strategies, such as buying low PE ratio stocks, low price-to-cash-flow ratio stocks, or low price-to-book ratio stocks. Numerous academics have published studies investigating the effects of buying value stocks. These studies have consistently found that value stocks outperform growth stocks and the market as a whole.

Performance of Value Investors

Another way to examine the performance of value investing strategies is to examine the investing performance of well-known value investors. Simply examining the performance of the best known value investors would not be instructive because investors do not become well known unless they are successful. This introduces a selection bias. A better way to investigate the performance of a group of value investors was suggested by Warren Buffett, in his May 17, 1984 speech that was published as 'The Super investors of Graham-and-Doddsville'. In this speech, Buffett examined the performance of those investors who worked at Graham-Newman Corporation and thus were the most influenced by Benjamin Graham. Buffett's conclusion is identical to that of the academic research on simple value investing strategies. Value investing is, on average, successful in the long run, for example, if one looks at all the business owners and businesses like Microsoft, Oracle, Wal Mart, Mac Donalds, etc., one can find these businesses are economically successful in the long term.

During a 25-year period (1965–90), published research and articles in leading journals of the value ilk were few. Warren Buffett once commented, “You couldn’t advance in a finance department in this country unless you taught that the world was flat.”

Well-known Value Investors

Benjamin Graham is regarded by many to be the father of Value Investing. Along with David Dodd, he wrote ‘*Security Analysis*’, first published in 1934. The most lasting contribution of this book to the field of security analysis was to emphasize the quantifiable aspects of security analysis (such as the evaluations of earnings and book value) while minimizing the importance of more qualitative factors such as the quality of a company’s management. Graham later wrote ‘*The Intelligent Investor*’, a book that brought Value Investing to individual investors. Aside from Buffett, many of Graham’s other students, such as William J. Ruane, Irving Kahn and Charles Brandes have gone on to become successful investors in their own right.

Graham’s most famous student, however, is Warren Buffett, who ran investing partnerships successfully before closing them in 1969 to focus on running Berkshire Hathaway. Charlie Munger joined Buffett at Berkshire Hathaway in the 1970s and has since worked as Vice Chairman of the company. Buffett has credited Munger with encouraging him to focus on long-term sustainable growth rather than on simply the valuation of current cash flows or assets. The Columbia Business School has played a significant role in shaping the principles of the ‘*Value Investor*’, with professors and students making their mark on history and on each other. Benjamin Graham’s book, ‘*The Intelligent Investor*’, was Warren Buffett’s bible and he referred to it as “the greatest book on investing ever written.” A young Warren Buffett studied under Prof. Benjamin Graham, took his course and worked for his small investment firm, Graham Newman, from 1954 to 1956. Twenty years after Benjamin Graham, Prof. Roger Murray arrived and taught Value Investing to a young student named Mario Gabelli. About a decade or so later, Prof. Bruce Greenwald arrived and produced his own protégés, including Mr. Paul Sonkin—just as Benjamin Graham had Mr. Buffett as a protégé, and Roger Murray had Mr. Gabelli.

The Mutual Series has a well known reputation of producing top value managers and analysts in this modern era. This tradition stems from two individuals: the late great value mind Max Heine, founder of the well regarded value investment firm Mutual Shares fund in 1949 and his protégé legendary value investor Michael F. Price. The Mutual Series was sold to Franklin Templeton Investments in 1996. The disciples of Heine and Price quietly practice Value Investing at some of the most successful investment firms in the country.

Seth Klarman is a Mutual Series alum and the founder and president of The Baupost Group, a Boston-based private investment partnership, authored '*Margin of Safety: 'Risk Averse Investing Strategies for the Thoughtful Investor*', which since has become a Value Investing classic. This book has sold on Amazon for US$1,200 and eBay for US $2,000. Another famous value investor is John Templeton.

Michael Larson is the Chief Investment Officer of Cascade Investment, which is the investment vehicle for the Bill & Melinda Gates Foundation and the Gates personal fortune. Cascade is a diversified investment shop established in 1994 by Gates and Larson. Larson, a well-known value investor, graduated from Claremont McKenna College in 1980 and the Booth School of Business at the University of Chicago in 1981, whose specific investment and diversification strategies are not known. Larson has consistently outperformed the market since the establishment of Cascade and has rivalled or outperformed Berkshire Hathaway's returns as well as other funds based on the value investing strategy.

Martin J. Whitman is another well-regarded value investor. His approach is called 'safe-and-cheap', which was hitherto referred to as 'financial-integrity approach'. Martin Whitman focuses on acquiring common shares of companies with extremely strong financial position at a price reflecting meaningful discount to the estimated NAV of the company concerned. Martin Whitman believes it is ill-advised for investors to pay much attention to the trend of macro-factors (like employment, movement of interest rate, GDP, etc.) because they are not as important and attempts to predict their movement are almost always futile. Martin Whitman's letters to shareholders of his Third Avenue Value Fund (TAVF) are considered valuable resources "for investors to pirate good ideas" by another famous investor Joel Greenblatt in his book on special-situation investment '*You Can Be a Stock Market Genius*'.

Joel Greenblatt achieved annual returns at the hedge fund Gotham Capital of over 50% per year for 10 years from 1985 to 1995 before closing the fund and returning his investors' money. He is known for investing in special situations such as spin-offs, mergers, and divestitures.

Charles de Vaulx and Jean-Marie Eveillard are well known global value managers. For a time, these two were paired up at the First

Eagle Funds, compiling an enviable track record of risk-adjusted outperformance. For example, Morningstar designated them the 2001 "International Stock Manager of the Year" and de Vaulx earned second place from Morningstar for 2006. Eveillard is known for his Bloomberg appearances where he insists that securities investors should never use margin or leverage. The point made is that margin should be considered the anathema of value investing since a negative price move could prematurely force a sale. In contrast, a value investor must be able and willing to be patient for the rest of the market to recognize and correct whatever pricing issue created the momentary value. Eveillard correctly labels the use of margin or leverage as speculation, the opposite of value investing.

Christopher H. Browne of Tweedy, Browne was well known for value investing. According to the *Wall Street Journal*, Tweedy, Browne was the favorite brokerage firm of Benjamin Graham during his lifetime; also, the Tweedy, Browne Value Fund and Global Value Fund have both beat market averages since their inception in 1993. In 2006, Christopher H. Browne wrote *The Little Book of Value Investing* in order to teach ordinary investors how to value invest.

Peter Cundill was a well-known Canadian value investor who followed the Graham's teachings. His flagship Cundill Value Fund allowed Canadian investors access to fund management according to the strict principles of Graham and Dodd. Is is to be noted that Warren Buffett had indicated that Cundill had the credentials he was looking for in a chief investment officer.

Other notable value investors include: Mason Hawkins, Whitney Tilson, Mohnish Pabrai, Li Lu, Guy Spier and Tom Gayner who manages the investment portfolio of Markel Insurance.

Criticism

The value stocks do not always beat growth stocks, as demonstrated in the late 1990s. Moreover, when value stocks perform well, it may not mean that the market is inefficient though it may imply that value stocks are simply riskier and thus require greater returns.

An issue with buying shares in a bear market is that despite appearing undervalued at one time, prices can still drop along with the market. Conversely, an issue with not buying shares in a bull market is that despite appearing overvalued at one time, prices can still rise along with the market.

Also, one of the biggest criticisms of Value Investing is that it could potentially mislead retail value investors; this is because a low priced stock, or a stock that saw a drop in its price significantly, could be due to a fundamental change in the company's financial health. To that end, a Stanford accounting professor by the name of Joseph Piotroski developed a collection of metrics which he termed the 'F-Score' that is designed to help weed out the under performers and winners in advance.

To determine which companies are in the best financial health, Professor Piotroski screens each stock based on an accounting-based checklist, awarding one point if the company met the pre-determined criteria. The results of this 'F-Score' proved interesting. In his paper, Professor Piotroski showed that over a 20-year test period, the returns earned by a value investor could be increased by 7.5% each year. These results were also validated by an external source. According to the American Association of Individual Investors, Piotroski's 'F-Scor'e was the only one amongst its 56 screening methodologies that had positive results during the financial crisis of 2008.

Another issue is the method of calculating the "intrinsic value". Some analysts believe that two investors can analyze the same information and reach different conclusions regarding the intrinsic value of the company, and that there is no systematic or standard way to value a stock. But there is no ambiguity in the calculated value in value investing as taught by Benjamin Graham. The stock selection procedures given by Benjamin Graham himself are very specific and are intended to avoid exactly this kind of subjectivity by focusing on documented and objective past numbers, instead of subjective and predicted future ones. The ambiguity arises only when investors use formulas not given by Graham or use subjective predicted numbers against his recommendations.

Value investing & Contrarian Investing

In finance, a contrarian is one who attempts to profit by investing in a manner that differs from the conventional wisdom when the consensus opinion appears to be wrong.

A contrarian believes that certain crowd behaviour among investors can lead to exploitable mispricings in securities markets. For example, the widespread pessimism about a stock can drive a price so low that it overstates the company's risks and understates its prospects for returning to profitability. Identifying and purchasing such distressed stocks and selling them after the company recovers can lead to above-average gains. Conversely, the widespread optimism can result in unjustifiably high valuations that will eventually lead to drops, when those high expectations do not pan out. Avoiding (or short-selling) investments in over-hyped investments reduces the risk of such drops. These general principles can apply whether the investment in question is an individual stock, an industry sector, or an entire market or any other asset class.

Some contrarians have a permanent bear market view, while the majority of investors bet on the market going up. However, a contrarian does not necessarily have a negative view of the overall stock market, nor does he have to believe that it is always overvalued, or that the conventional wisdom is always wrong. Rather, a contrarian seeks opportunities to buy or sell specific investments when the majority of investors appear to be doing the opposite to the point where that investment has become mispriced. While more "buy" candidates are likely to be identified during market declines (and vice versa), these opportunities can occur during periods when the overall market is generally rising or falling.

Similarity to Value Investing

The Contrarian Investing is related to value investing in that the former also looks for mispriced investments and buys those that appear to be undervalued by the market. Some well-known value investors such as John Neff have questioned whether there is such a thing as a "contrarian", seeing it as essentially synonymous with value investing. One possible distinction is that a value stock, in finance theory, can be identified by financial metrics such as the book value or P/E ratio. A contrarian investor may not only look at those metrics, but is also interested in measures of "sentiment" regarding the stock among other investors, such as sell-side analyst coverage and earnings forecasts, trading volume, and media commentary about the company and its business prospects.

Given a stock that has dropped because of excessive pessimism, one can see similarities to the "margin of safety" that value investor Benjamin Graham sought when purchasing stocks, essentially being able to buy shares at a discount to their intrinsic value. Arguably, that margin of safety is more likely to exist when a stock has fallen a great deal, and that type of drop is usually accompanied by negative news and general pessimism.

Along with this, more dangerous is shorting overvalued stocks. This requires 'deep pockets' so that an overvalued security may continue to rise due to over-optimism for quite some time. Eventually, the short-seller believes that the stock will 'crash and burn'.

Notable Contrarian Investors

- Warren Buffett is a famous contrarian, who believes that the best time to invest in a stock is when shortsightedness of the market has beaten down the price.
- Jim Rogers is an investor and an author who is bullish on contrarian investing in Asian markets.
- Marc Faber is a contrarian investor who publishes the Gloom Boom & Doom Report.
- David Dreman is a money manager often associated with contrarian investing. He has authored several books on the topic and writes the "Contrarian" column in *Forbes magazine*.
- John Neff, who managed the Vanguard Windsor fund for many years, is also considered a contrarian though he has described himself as a value investor (and questioned the distinction).
- Mark Ripple is a money manager often rated as a contrarian. He has authored a book covering the topic in detail.

Examples of Contrarian Investing

The commonly used contrarian indicators for investor sentiment are Volatility Indexes (informally also referred to as "Fear indexes"), like VIX, which by tracking the prices of financial options, gives a numeric measure of how pessimistic or optimistic market actors at large are. A low number in this index indicates a prevailing optimistic or confident investor outlook for the future, while a high number indicates a pessimistic outlook. By comparing the VIX to the major stock-indexes over longer periods of time, it is evident that peaks in this index generally present good buying opportunities.

Another example of a simple contrarian strategy is Dogs of the Dow. When purchasing the stocks in the Dow Jones Industrial Average that have the highest relative dividend yield, an investor is often buying many of the "distressed" companies among those 30 stocks. These "Dogs" have high yields not because dividends were raised, but rather because their share prices fell. The company is experiencing difficulties, or simply is at a low point in their business cycle. By repeatedly buying such stocks, and selling them when they no longer meet the criteria, the "Dogs" investor is systematically buying the least-loved of the Dow 30, and selling them when they become loved again.

When the Dot com bubble started to deflate, an investor would have profited by avoiding the technology stocks that were the subject of most investors' attention. Asset classes such as value stocks and real estate investment trusts were largely ignored by the financial press at the time, despite their historically low valuations, and many mutual funds in those categories lost assets. These investments experienced strong gains amidst the large drops in the overall US stock market when the bubble unwound.

Relationship to Behavioural Finance

The contrarians are attempting to exploit some of the principles of behavioral finance, and there is significant overlap between these fields. For example, studies in behavioral finance have demonstrated that investors as a group tend to overweight recent trends when predicting the future; a poorly-performing stock will remain bad, and a strong performer will remain strong. This lends credence to the contrarian's belief that investments may drop "too low" during periods of negative news, due to incorrect assumptions by other investors, regarding the long-term prospects for the company.

Chapter 4
Portfolio Management : Indian Context

Introduction

In India, Portfolio Management is still in its infancy. Barring a few Indian banks, and foreign banks and UTI, no other agency had professional Portfolio Management until 1987. After the success of Mutual Funds 1987, Professional Portfolio Management, backed by competent research staff, became the order of the day. After the success of Mutual Funds in Portfolio Management, a number of brokers and Investment consultants, some of whom are also professionally qualified, have become Portfolio Managers. They have managed the funds of clients on both discretionary and non-discretionary basis. It was found that many of them, including Mutual Funds have guaranteed a minimum return or capital appreciation and adopted all kinds of incentives which are now prohibited by SEBI. They resorted to speculative over trading and insider trading, discounts, etc., to achieve their targeted returns to the clients, which are also prohibited by SEBI.

The recent CBI probe into the operations of many market dealers has revealed the unscrupulous practices by banks, dealers and brokers in their Portfolio Operations. The SEBI has then imposed stricter rules, which included their registration, a code

of conduct and minimum infrastructure, experience and expertise etc. It is no longer possible for any unemployed youth or retired person or self-styled consultant to engage in Portfolio Management without the SEBI's licence. The guidelines of SEBI are in the direction of making Portfolio Management a responsible professional service to be rendered by experts in the field.

In principle, Portfolio Management involves:

a. a proper investment decision-making of what to buy and sell;

b. proper money management in terms of investment in a basket of assets so as to satisfy the asset preferences of investors; and

c. reducing the risk and increasing returns.

Investment Strategy

In India, there are a large number of savers, barring the population who are below the poverty line. In a poor country like India, it is surprising that its saving rate is as high as 27% of GDP per annum and investment at 28% of GDP. But the return in the form of output growth is as low as 5-7% per annum. One may ask why is it that high levels of investment could not generate comparable rates of growth of output. The answer is poor investment strategy, involving high capital output ratios, low productivity of capital and high rates of obsolescence of capital. What is true of the nation at that Macro level is also true at Micro level of individuals and institutions. The use of capital in India is wasteful and inefficient, despite the fact that India is a labour rich and capital poor country. Thus, the Portfolio Managers in India lack the expertise and experience, which will enable them to have proper strategy for investment management.

Secondly, the average Indian household saves around 60% in financial form and 40% in physical form. Of those in financial form, nearly 42% is held in cash and bank deposits, as per the latest RBI data and they have negative real returns or return less than the inflation rates. Besides, a proportion of 35% of financial savings is held in the form of insurance, PF, Pension Funds, etc., while another l2% is in government instruments and certificates like Post Office Deposits, NS Certificates, Public Provident Funds, National Saving Scheme. etc. The real returns on Insurance, PF, etc., are low and many times lower than the average inflation rates. With the removal of many tax concessions for investments in Post Office savings instruments, certificates, etc., they also become less attractive to small and medium investors. The only investments, satisfying all their objectives are capital market instruments. These objectives are income, capital appreciation, safety, marketability, liquidity and hedge against inflation, and investment by average household in shares and debentures is only around 5% of the total financial savings.

Objectives of Investors

The return on equity investments in the capital market, particularly if proper investment strategy is adopted, would satisfy the above mentioned objectives and the real returns would be higher than any other saving instruments. It is in this context, the art and science of investment and of Portfolio Management became the sine-qua-non of success. All investments involve risk taking. However, some risk free investments are available like bank deposits or Post Office Deposits whose returns are called risk free returns of about 5-12%. So the returns on more risky investments are higher than that, having risk premium. Risk is variability of return and uncertainty of payment of interest and repayment of principal. Also, risk is measured by standard deviation of the returns over the mean for a given period. And risk varies directly with return: the higher the risk taken the greater is the return under normal market conditions.

Although Indian markets are imperfect and are developing, "all the basic principles and theory of Portfolio Management would apply and these are recapitulated below.

Risk and Beta

Risk contains two components: systematic market related risk and unsystematic risk or company specific risk. The former cannot be eliminated but managed with the help of Beta (b), which is explained as follows:

% age change of Scrip return

% age change of Market return

If Beta=1, the risk of the company is the same as that of the market and if Beta > 1, the company's risk is more than the market risk. If Beta < 1, then the reverse is the position.

Security Analysis and Portfolio Management

Types of Risk

Specific Risk: If the risk is company specific risk it can be reduced by diversification into different industries and companies of different types and nature and whose covariances are different and whose performances are disparate.

Unsystematic Risk/Systematic Risk: This is company related risks due to higher costs, mismanagement, defective sales or inventory strategy, insolvency, fall in demand and company specific recession, labour problems, etc. Market related risk is due to demand problems, interest rates, inflation, raw materials, import and export policy, tax policy, etc. there are other risks including business risk, market risk, financial risk, interest rate risk, inflation risk, etc.

Modem Portfolio Theory (MPT): This postulates that public, in general, are risk averse. In a perfect market, information is free and quickly absorbed by the market. Given the return, risk can be reduced by diversification of investment into a number of Scrips. Each Scrip has its own risk profile. The risks of any two Scrips are different from the risk of a group of two companies together. Thus, if the risk of Reliance (b) is say 1.90 and that of Dr. Beck is 0.70, the total of these two units is 1.30 as the average. But the actual 'b' may be less at say 1.00, reason being that the covariance of these two may be zero or negative (less than 1).

Capital Asset Pricing Model and Security Market Line (CAPM & SML)

The Capital Asset Pricing Model (CAPM) postulates that in a perfect market, where shares are correctly priced, every security will give a return commensurate with its risk. "b" is a measure of the risk. The market risk is different from the risks of individual Scrips comprising the market. The Security Market Line (CML) relates to the total risk of the market. But SML refers to the risk, which is undiversifiable market related risk. Total risk is measured by the standard deviation, while the undiversifiable risk is measured by Beta (13). CML is Capital Market Line and SML is Security Market Line. Risk premium of portfolio is the excess of the expected portfolio return over the risk free return. Similar is the definition of risk premium of the market, namely, expected Market Return minus Risk Free Return. CML passes through the risk free rate, which represents the true time value of money or the reward for waiting by savers.

In Portfolio Management and investment decision-making, time element and time value of money are very relevant. Savings are automatic or induced. If savings are induced, it requires a return enough to induce them to part with liquidity. Thus, savings and liquidity will be parted by the investors if only their time preference is satisfied by proper return.

Why Time Preference? Why Savers Prefer Today's Return to Tomorrows Return?

"A bird in hand is better than two in the bush", as the adage goes.

1. More money is to be received after a year, if he has to lend to the user of funds today. He forgoes consumption which has to be compensated.

2. Money lent today can produce something more than before and hence present money is more valuable than future money. This premium is needed for waiting.

3. Money is losing in value due to rise in prices. Hence, moneylenders lose and borrowers gain in times of inflation. Premium given is to compensate the lenders against loss due to fall in value of money.

Compounding

Future Value Factor (FVF) is (1+ r)” is the rate of interest required and (n) is the period of years of waiting.

Fn = P (1+ r)”, or

Future Value = Present Value x (Future Value Factor)

So the return required by savers is related to the waiting period, loss of consumption at present, or liquidity and risk of loss of money or variance of returns.

Discounting

If the future flow of money is known as C1, C2, C3, etc., then what is the present value of them and how much is he prepared to pay for them? If he deposits today Rs. 100 he gets Rs. 110 at the end of 1 year and Rs. 121 at the end of 2 years, the interest rate is 10%. This process of finding the present value for future money flows is called discounting. Present value of future amounts is:

The multiplier is called PVF or Present Value Factor.

We should know the amounts of cash flows, (Fn) number of years (n) are the required rate of return (r).

Perpetuity

When we receive a fixed sum of money every year up to infinity, it is called perpetuity. Suppose we want to receive Rs. 100 every year for infinity and interest rate is 10%, we have to deposit Rs. 1,000 and the equation is PV = where PV is present value of perpetuity, fixed periodic cash flow and r is rate of interests.

Annuity

Annuity is a constant cash flow for a finite time period of say 5 years (n). Examples of annuity are found in the case of lease rentals, loan repayments, Recurring deposits, etc. More detailed discussion is given on time element in a separate chapter.

Application to Portfolio Management

The Portfolio Management involves time element and time horizon. The present value of future returns/cash flows by discounting is useful for share valuation and bond valuation. The investment strategy in portfolio construction should have a time horizon, say 3 to 5 years, to produce the desired results of say 20-30% return per annum. Besides, Portfolio Management should also take into account tax benefits and investment incentives. As the returns are taken by investors net of tax payments, and there is always an element of inflation, returns net of taxation and inflation are more relevant to tax paying investors. These are called net real rates of returns, which should be more than other returns. It should encompass risk free return plus a reasonable risk premium, depending upon the risk taken on the instruments/assets invested.

Portfolio Construction, Revision and Evaluation

The Portfolio Manager has to use all the tools of research like fundamental analysis and technical analysis in addition to Risk Return analysis to decide on the investment, buying and selling etc. After the design of the Portfolio Strategy, the construction and allocation of funds will lead to the building up of the portfolio. Thereafter, the portfolio thus built requires a constant review and revision with the result that operations on it are a continuous process. This is also called Monitoring. Finally, once in a quarter or half year, the portfolio performance is evaluated, for its success by comparing the actual achievements with the targets fixed. This throws light on the efficiency of the investment strategy of the Portfolio Manager and helps the revision of portfolio.

MPT and Dominance Concept

The Modern Portfolio Theory (MPT) is based on assumptions of 'free and perfect information' flow and the notion of dominance. This means that if the market is able to absorb the information fully and efficiently, price reflects the risks involved given the same return the investor can choose the Scrips with the lowest possible risk. This is possible by diversification into a number of companies of, say 10 to 15, which have diverse characteristics of risk. Thus, when any two Scrips behave differently to given changes in the economy and industry and when the co- efficient of correlation between them is less than 1, such Scrips can be joined in a portfolio so as to reduce the combined risk of the portfolio. The notion of dominance tells us that no investor should invest in one company alone and if there are two or more companies with the same risk, then he has to choose the one with higher return, and if both have the same return he has to choose the One with lower risk. The investor can reduce the risk by distributing his funds in a diverse variety of companies with varying risks and returns which do not have much auto correlation. Thus, the investor has not only to make proper investment decision of what to buy and when to buy, but has a proper investment strategy through diversification and choice of a proper 'b' for the Scrips selected so that the total risk of portfolio is the lowest possible.

Diversification Process

The process of diversification has various phases involving investment into various classes of assets like equity, preference shares, CDs, NCDs, PSU Bonds and shares, money market instruments like commercial paper, inter-corporate investments, deposits etc. Within each class of assets, there is further possibility of diversification into various industries, different companies etc. The proportion of funds invested into various classes of assets, instruments, industries and companies would depend upon the objectives of investor, under the Portfolio Management and his asset preferences, income and asset requirements. This topic is further elaborated in another chapter.

A portfolio with the objective of regular income would invest a proportion of funds in bonds, debentures and fixed deposits. For such investments, duration of the life of the bond/debenture, quality of the asset as judged by the credit rating and the expected yield are the relevant variables. Bond market is not well developed in India but debentures, partly or fully convertible into equity, are in good demand both from individuals and Mutual Funds. The Portfolio Manager has to use his analytical power and discretion to choose the right debentures with the required duration, yield and quality. The duration and immunization of expected inflows of funds to the required quantum of funds have to be well planned by the Portfolio Manager. Research and high degree of analytical power in investment management and bond portfolio management are necessary.

The bond investments are thus equally challenging as equity investments and more so in respect of money market instruments. All these facts bring out clearly the needed analytical powers and expertise of the Portfolio Manager. Bond market is discussed in a separate chapter elaborately.

It is thus clear that the Portfolio Management has become a complex and responsible job which requires an in-depth training and expertise. It is in this context that the regulations of SEBI on the Portfolio Management become necessary so that the minimum qualifications and experience are also ensured for those who are registered with it. Nobody can do Portfolio Management without SEBI registration and licence. The SEBI has given permission to Merchant Bankers to do Portfolio Management. As per the guidelines of September 1991, a separate category of Portfolio Managers is also licensed by SEBI for which guidelines were given in January 1993. A code of conduct was also laid down for this category, as is the case with all categories of capital market players and intermediates.

Portfolio Management Service

As per the SEBI norms, it refers to the professional services rendered for management of portfolio of others, namely, clients or customers with the help of experts in Investment Advisory Services. The latter renders the advice regarding the worthiness of any particular investment or advice of what to buy and sell. Investment management, on the other hand, involves continuing relationship with client to manage investments with or without discretion for the client as per his requirements.

Who can be a Portfolio Manager?

Only those experts who are registered and pay the required licence fee are eligible to operate as the Portfolio Managers. An applicant for this purpose should have necessary infrastructure with professionally qualified persons and with a minimum of two persons with experience in this business and a minimum net worth of Rs. 200 lakhs. The certificate once granted is valid for three years.

The SEBI has imposed a number of obligations and a code of conduct for them. The Portfolio Manager should have a high standard of integrity, honesty and should not have been convicted of any economic offence or moral turpitude. He should not resort to rigging up of prices, insider trading or creating false markets, etc. Their books of accounts are subject to inspection and audit by SEBI. The observance of the code of conduct and guidelines given by the SEBI are subject to inspection and penalties for violation are imposed. The Manager has to submit periodical returns and documents as may be required by the SEBI from time-to-time.

Method of Operation

The Professional Portfolio Manager can be approached by any individual or organization with a minimum amount of investible funds or portfolio of Rs.25 lakhs. If the Manager is willing to accept him as his client, a contract is entered into for management of his funds either on discretionary basis or non-discretionary basis, specifying the objectives, risk to be tolerated, composition of assets/securities in the portfolio and their relative proportion, fees payable and time period of management, as per the preference of the client, etc. The client’s data base is collected, namely, his available income and assets, his needs, his risk preferences, his choice for income or growth or both and host of personal details of the client so as to enable the Manager to design a Proper Investment Strategy for him.

SEBI Norms

SEBI has prohibited the Portfolio Manager to assume any risk on behalf of the client. The Portfolio Manager cannot also assure any fixed return to the client. The investments made or advised by him are subject to risk which the client has to bear. The investment consultancy and management has to be charged at rates which arc fixed at the beginning and transparent as per the contract. No sharing of profits or discounts or cash incentives to client are permitted. The Portfolio Manager is prohibited to do lending, badla financing and bills discounting as per SEBI norms. He cannot put the clients' funds in any investment not permitted by the contract entered into with the client. Normally, investments can be made in both capital market and money market instruments.

Client's money has to be kept in a separate account with the schedule bank and cannot be mixed up with his own funds or investments. All the deals done for a client's account are to be entered in his name and Contract Notes; Bills, etc., are all passed in his name. A separate ledger account is maintained for all purchases/sales on client's behalf, which should be done at the market price. Final settlement and termination of contract is as per the contract and for the time period agreed upon. Notice of termination of contract is also as per the contract. During the period of contract, the Portfolio Manager is only acting on a contractual basis and on a fiduciary basis. No contract for less than a year is permitted by the SEBI.

Chapter 5
SEBI Regulations

The Portfolio Managers are governed by the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993. As per these regulations:

"Act" means the Securities and Exchange Board of India Act , 1992 (15 of 1992);]

"body corporate" shall have the meaning assigned to it in or under clause (7) of section 2 of the Companies Act, 1956 (1 of 1956);

"certificate" means a certificate of registration issued by the SEBI Board;

"change of status or constitution" in relation to a portfolio manager:

(i) means any change in its status or constitution of whatsoever nature; and

(ii) without prejudice to generality of sub-clause (i), includes–

  (A) amalgamation, demerger, consolidation or any other kind of corporate restructuring falling within the scope of section 391 of the Companies Act, 1956 (1 of 1956) or the corresponding provision of any other law for the time being in force;

  (B) change in its managing director or whole-time director; and

  (C) any change in control over the body corporate; "change in control", in relation to a Portfolio Manager being a body corporate, means:—

    (i) if its shares are listed on any recognized stock exchange, change in control within the meaning of regulation 12 of the Securities and Exchange Board of India (Substantial Acquisition of Shares and Takeovers) Regulations, 1997;

    (ii) in any other case, change in the controlling interest in the body corporate;

Explanation.— For the purpose of sub-clause (ii), the expression "controlling interest" means an interest, whether direct or indirect, to the extent of at least fifty one percent of voting rights in the body corporate;]

"chartered accountant" means a chartered accountant as defined in clause (b) of sub-section (1) of section 2 of the Chartered Accountants Act, 1949 (38 of 1949) and who has obtained a certificate of practice under sub-section (1) of section 6 of that Act;]

"discretionary portfolio manager" means a portfolio manager who exercises or may, under a contract relating to portfolio management, exercise any degree of discretion as to the investments or management of the portfolio of securities or the funds of the client, as the case may be;

"portfolio" means the total holdings of securities belonging to any person;

"portfolio manager" means any person who pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise) the management or administration of a portfolio of securities or the funds of the client, as the case may be;

"principal officer" means an employee of the portfolio manager who has been designated as such by the portfolio manager;

"securities lending" means the securities lending as per the Securities Lending Scheme, 1997 specified by the Board;

Words and expressions used and not defined in these regulations but defined in the SEBI Act shall have the meanings respectively assigned to them in the SEBI Act.

1. The Portfolio Managers are registered and regulated under the SEBI (Portfolio Managers) Regulations 1993.

Registration of Portfolio Managers

Registration as Portfolio Manager: No person shall act as Portfolio Manager unless he holds a certificate granted by SEBI under these regulations:

Provided that a merchant banker acting as a portfolio manager immediately before commencement of the Securities and Exchange Board of India (Portfolio Managers) (Second Amendment) Regulations, 2006 may continue to do so for a period of six months from such commencement or, if he has made an application for registration under these regulations within the said period of six months, till the disposal of such application.

Application for Grant of Certificate: An application by a Portfolio Manager for the grant of a certificate shall be made to SEBI in Form A and shall be accompanied by a non-refundable application fee to be paid in the manner specified in Part B thereof.

Notwithstanding anything contained in above, any application made by a Portfolio Manager prior to coming into force of these regulations containing such particulars or as near thereto as mentioned in Form A shall be treated as an application made in pursuance of these sub regulation and dealt with accordingly.

Furnishing of Further Information, Clarification and Personal Representation: The Board may require the applicant to furnish further information or clarification regarding matters relevant to his activity of a Portfolio Manager for the purposes of disposal of the application.

The applicant or, its principal officer shall, if so required, appear before the Board for personal representation.

Consideration of Application: For considering the grant of certificate of registration to the applicant, SEBI shall take into account all matters which it deems relevant to the activities relating to the Portfolio Management.

Without prejudice to the generality of the foregoing provisions, the Board shall consider whether-

(a) the applicant is a body corporate;

(b) the applicant has the necessary infrastructure like adequate office space, equipments and the manpower to effectively discharge the activities of a Portfolio Manager;

(c) the principal officer of the applicant has either–

 (i) a professional qualification in finance, law, accountancy or business management from a university or an institution recognized by the Central Government or any State Government or a foreign university; or

 (ii) an experience of at least ten years in related activities in the securities market including as a portfolio manager, stock broker or as a fund manager.

(d) the applicant has in its employment minimum of two persons who, between them, have at least five years experience in related activities in the Portfolio Management or stock broking or investment management or in the areas related to fund management;

(e) any previous application for grant of certificate made by any person directly or indirectly connected with the applicant has been rejected by the Board;

(f) any disciplinary action has been taken by the Board against a person directly or indirectly connected with the applicant under the Act or the Rules or the Regulations made thereunder.

Explanation.— For the purposes of sub-clauses (e) and (f), the expression "person directly or indirectly connected" means any person being an associate, subsidiary, inter-connected company or a company under the same management within the meaning of section 370(1B) of the Companies Act,1956 or in the same group;

(g) the applicant fulfills the capital adequacy requirements specified in regulation 7;

(h) the applicant, its director, principal officer or the employee as specified in clause (d) is involved in any litigation connected with the securities market which has an adverse bearing on the business of the applicant;

(i) the applicant, its director, principal officer or the employee as specified in clause (d) has at any time been convicted for any offence involving moral turpitude or has been found guilty of any economic offence;

(j) the applicant is a fit and proper person;

(k) grant of certificate to the applicant is in the interest of investors.

Capital Adequacy Requirement: The capital adequacy requirement shall not be less than the net worth of two crore rupees, Provided that a Portfolio Manager, who was granted a certificate under these regulations prior to the commencement of the Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2008, shall raise its net worth to not less than one crore rupees within six months from such commencement and to not less than two crore rupees within six months thereafter Provided further that the Portfolio Manager shall fulfill capital adequacy requirement under these regulations, separately and independently, of capital adequacy requirements, if any, for each activity undertaken by it under the relevant regulations.

Explanation.— For the purposes of this regulation, "net worth" means the aggregate value of paid up equity capital plus free reserves (excluding reserves created out of revaluation) reduced by the aggregate value of accumulated losses and deferred expenditure not written off, including miscellaneous expenses not written off.

Procedure for Registration: The Board after being satisfied that the applicant fulfils the requirements specified in above regulation shall send an intimation to the applicant and on receipt of the payment of registration fees as specified then grant a certificate in Form B.

9. Renewal of Certificate

(1) A Portfolio Manager may, three months before the expiry of the validity of the certificate, make an application for renewal in Form A along with fees specified in Schedule II.

(2) The application for renewal shall be dealt with in the same manner as if it were an application for grant of a certificate made under the above regulation.

(3) The Board, on being satisfied that the applicant fulfills the requirements specified above, shall send an intimation to the applicant and on receipt of payment of renewal fees as specified in Schedule II, grant a renewal of the certificate.

Conditions of Registration

(1) Any registration granted under these regulations or renewal granted shall be subject to the following conditions, namely:-

(a) where the portfolio manager proposes to change its status or constitution, it shall obtain prior approval of the Board for continuing to act as such after the change;

(b) it shall pay the fees for registration or renewal, as the case may be, in the manner provided in these regulations;

(c) it shall take adequate steps for redressal of grievances of the investors within one month of the date of the receipt of the complaint and keep the Board informed about the number, nature and other particulars of the complaints received;

(d) it shall maintain capital adequacy requirements specified in the regulation at all times during the period of the certificate or renewal thereof;

(e) it shall abide by the regulations made under the Act in respect of the activities carried on by it as portfolio manager.

(2) Nothing contained in these regulations shall affect the obligation to obtain a fresh registration in cases where it is applicable.

Period of Validity of Certificate: The certificate of registration granted and its renewal granted shall be valid for a period of three years from the date of its issue to the applicant.

Procedure Where Registration Is not Granted

(1) Where an application for grant of a certificate or of renewal does not satisfy the requirements set out in these regulation, the Board may reject the application after giving an opportunity of being heard to the applicant.

(2) The refusal to grant registration shall be communicated by the Board within thirty days of such refusal to the applicant stating therein the grounds on which the application has been rejected.

(3) Any applicant may, being aggrieved by the decision of the Board may apply within a period of thirty days from the date of receipt of such intimation, to the Board for reconsideration of its decision.

(4) The Board shall reconsider an application made under this sub regulation and communicate its decision as soon as possible in writing to the applicant.

Effect of Refusal to Grant Certificate: Any Portfolio Manager whose application for a certificate has been refused by the Board shall on and from the date of the receipt of the communication under the sub regulation cease to carry on any activity as portfolio manager.

Payment of Fees, and the Consequences of Failure to Pay Fees

(1) Every applicant eligible for grant of a certificate shall pay fees in such manner and within the period specified in Schedule II.

(2) Where a Portfolio Manager fails to pay the fees as provided in Schedule II, the Board may suspend the certificate, whereupon the portfolio manager shall forthwith cease to carry on the activity as a portfolio manager for the period during which the suspension subsists.

General Obligations and Responsibilities

Code of Conduct: Every Portfolio Manager shall abide by the Code of Conduct as specified in Schedule III.

Contract with Clients and Disclosures

(1) (a) The Portfolio Manager shall, before taking up an assignment of management of funds or portfolio of securities on behalf of a client, enter into an agreement in writing with such client clearly defining the inter se relationship, and setting out their mutual rights, liabilities and obligations relating to management of funds or portfolio of securities containing the details as specified in Schedule IV.

(b) The agreement between the Portfolio Manager and the client shall, inter alia, contain:

(i) the investment objectives and the services to be provided;

(ii) areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry;

(iii) type of instruments and proportion of exposure;

(iv) tenure of portfolio investments;

(v) terms for early withdrawal of funds or securities by the clients;

(vi) attendant risks involved in the management of the portfolio;

(vii) period of the contract and provision of early termination, if any;

(viii) amount to be invested subject to the restrictions provided under these regulations;

(ix) procedure of settling client's account including form of repayment on maturity or early termination of contract;

(x) fees payable to the portfolio manager;

(xi) the quantum and manner of fees payable by the client for each activity for which service is rendered by the

Portfolio Manager directly or indirectly (where such service is out sourced);

(xii) custody of securities;

(xiii) in case of a discretionary Portfolio Manager a condition that the liability of a client shall not exceed his investment with the Portfolio Manager;

(xiv) the terms of accounts and audit and furnishing of the reports to the clients as per the provisions of these regulations; and

(xv) other terms of portfolio investment subject to these regulations.

(2) (a) The Portfolio Manager shall provide to the client, the Disclosure Document as specified in Schedule V, along with a certificate in Form C as specified in Schedule I, at least two days prior to entering into an agreement with the client as referred to in sub-regulation (1).

(b) The Disclosure Document, shall inter alia contain the following:

(i) the quantum and manner of payment of fees payable by the client for each activity for which service is rendered by the Portfolio Manager directly or indirectly (where such service is out sourced);

(ii) portfolio risks;

(iii) complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard;

(iv) the performance of the Portfolio Manager:

Provided that the performance of a discretionary Portfolio Manager shall be calculated using weighted average method taking each individual category of investments for the immediately preceding three years and in such cases performance indicators shall also be disclosed;

(v) the audited financial statements of the Portfolio Manager for the immediately preceding three years.

(c) The contents of the Disclosure Document shall be certified by an independent chartered accountant.

(d) The Portfolio Manager shall file with the Board, a copy of the Disclosure Document before it is circulated or issued to any person and every six months thereafter or whenever any material change is effected therein whichever is earlier, along with the certificate in Form C as specified in Schedule I.

(3) (a) The Portfolio Manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both.

(b) The Portfolio Manager may, subject to the disclosure in terms of the Disclosure Document and specific permission from the client, charge such fees from the client for each activity for which service is rendered by the Portfolio Manager directly or indirectly (where such service is out sourced).

General Responsibilities of a Portfolio Manager

(1) The discretionary Portfolio Manager shall individually and independently manage the funds of each client in accordance with the needs of the client in a manner which does not partake the character of a Mutual Fund, whereas the non-discretionary Portfolio Manager shall manage the funds in accordance with the directions of the client.

The Portfolio Manager shall not accept from the client, funds or securities worth less than twenty five lacs rupees (applicable from 10-2-2012 after coming into force of SEBI (Portfolio Managers) (Amendment Regulations) 2012.

Provided that the minimum investment amount per client shall be applicable for new clients and fresh investments by existing clients:

Provided further that existing investments of clients, as on date of notification of Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2012, may continue as such till maturity of the investment.

(2) The Portfolio Manager shall act in a fiduciary capacity with regard to the client's funds.

(2A) The Portfolio Manager shall keep the funds of all clients in a separate account to be maintained by it in a Scheduled Commercial Bank.

Explanation.— For this purposes the expression 'Scheduled Commercial Bank' means any bank included in the Second Schedule to the Reserve Bank of India Act, 1934 (2 of 1934).

(3) The Portfolio Manager shall transact in securities within the limitation placed by the client himself with regard to dealing in securities under the provisions of the Reserve Bank of India Act, 1934 (2 of 1934).

(4) The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities.

(4A) The Portfolio Manager shall not borrow funds or securities on behalf of the client.

(5) The Portfolio Manager shall not lend securities held on behalf of clients to a third person except as provided under these regulations.

(6) The Portfolio Manager shall ensure proper and timely handling of complaints from his clients and take appropriate action immediately.

Investment of Clients' Moneys and Management of Clients' Portfolio of Securities

(1) (a) The money or securities accepted by the Portfolio Manager shall not be invested or managed by the portfolio manager except in terms of the agreement between the portfolio manager and the client.

(b) Any renewal of portfolio fund on maturity of the initial period shall be deemed as a fresh placement.

(2) Notwithstanding anything contained in the agreement referred to in regulation 14, the funds or securities can be withdrawn or taken back by the client before the maturity of the contract under the following circumstances, namely-

(a) voluntary or compulsory termination of portfolio management services by the Portfolio Manager or the client.

(b) suspension or cancellation of the certificate of registration of the Portfolio Manager by the Board.

(c) bankruptcy or liquidation of the portfolio manager.

(3) The Portfolio Manager shall invest funds of his clients in money market instruments or derivatives or as specified in the contract:

Provided that leveraging of portfolio shall not be permitted in respect of investment in derivatives:

Provided further that the Portfolio Manager shall not deploy the clients' funds in bill discounting, badla financing or for the purpose of lending or placement with corporate or non-corporate bodies.

Explanation.— For the purposes of this sub-regulation: "money market instruments" includes commercial paper, trade bill, treasury bills, certificate of deposit and usance bills.

(4) The Portfolio Manager shall not, while dealing with clients' funds, indulge in speculative transactions, i.e., he shall not enter into any transaction for purchase or sale of any security which is periodically or ultimately settled otherwise than by actual delivery or transfer of security except the transactions in derivatives.

(5) The Portfolio Manager shall, ordinarily purchase or sell securities separately for each client. However, in the event of aggregation of purchases or sales for economy of scale, inter se allocation shall be done on a pro rata basis and at weighted average price of the day's transactions. The Portfolio Manager shall not keep any open position in respect of allocation of sales or purchases effected in a day.

(6) Any transaction of purchase or sale including that between the Portfolio Manager's own accounts and client's accounts or between two clients' accounts shall be at the prevailing market price.

(7) The Portfolio Manager shall segregate each client's funds and portfolio of securities and keep them separately from his own funds and securities and be responsible for safekeeping of clients' funds and securities.

(8) The Portfolio Manager shall not hold the listed securities or unlisted securities, belonging to the portfolio account, in its own name on behalf of its clients either by virtue of contract with clients or otherwise:

Provided that any Portfolio Manager holding the listed securities belonging to the portfolio account in its own name on behalf of its clients on the date of commencement of the Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2008 shall segregate each clients' listed securities and keep them separately within six months from such commencement:

Provided further that the Board may in the interest of investors or for the development of securities market, on an application made in this behalf by a portfolio manager with respect to any specific investment existing on the date of commencement of the Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2008, relax the strict enforcement of this regulation:

Provided further that the Portfolio Manager shall segregate each client's holding in unlisted securities in separate accounts in respect of investment by new clients and fresh investments by existing clients:

Provided further that existing investments in unlisted securities of clients, as on date of notification of Securities and Exchange Board of India (Portfolio Managers) (Amendment) Regulations, 2012 may continue as such till maturity of investment.

(9) The Portfolio Manager may, subject to authorization by the client in writing, participate in securities lending.

FORM A
Securities and Exchange Board of India
(Portfolio Managers) Regulations, 1993

APPLICATION FOR GRANT OF CERTIFICATE/RENEWAL OF CERTIFICATE

Name of Applicant: ____________________________________

Name of Person to Contact: ____________________

Designation: ____________________

Telephone No: ____________________

INSTRUCTIONS: -

1. Applicants must submit a completed application form together with appropriate supporting documents to the Board.
2. It is important that this application form should be filled in accordance with the regulations.
3. Application for registration will be considered provided it is complete in all respects.
4. Answers must be typed/printed.
5. Information which needs to be supplied in more details may be given on separate sheets which should be attached to the application form.
6. All signatures must be original.

PART: I GENERAL INFORMATION

1. PARTICULARS OF THE APPLICANT

1.1 Name of the Applicant:

1.2 Address - Principal place of business/registered office:

Pin code: ______________ Telephone No: ______________

Telex No: ________________ Fax No: ________________

1.3 Address for Correspondence:

Pin code: ________________ Telephone No: ______________

Telex No: __________________ Fax No: ________________

Address of Branch Offices (in India & Abroad):

1.4 Application to Board for any other intermediary activity: ______________

2. ORGANIZATION STRUCTURE:

(Organization chart separately showing functional responsibilities of Portfolio Management activities to be enclosed)

2.1 Objectives: - In brief.

(Memorandum and Articles of Association to be enclosed)

2.2 Date and Place of Incorporation/Establishment:

Day Month Year Place

2.3 Status of the Applicant: (e.g. limited company -private/public, unlimited company, partnership, others. If listed, names of the stock exchanges and latest share price: to be given.)

2.4 Organization Chart: General Organization & specific Activity.

(i.e., Applied for registration) also state the functional responsibility.

2.5 Particulars of all Directors and key management personnel: -

[Name; Qualification; Experience; (General and specific Intermediaries activity)

Ownership details; (Date of Appointment) Other directorship; (Name & Date of Appointment);

Previous positions held.]

2.6 Number of employees

(General and for specific Intermediaries activity)

2.7 Name and activities of associate companies/concerns

Name of company/ firm	Address/ phone-numbers	Type of activity handled	Ownership details	Nature/ Quantum of financial dealing	Nature of interest of promoter/ director	Nature of interest of Applicant Company

2.8 List of major shareholders (holding 5% or more voting shares)

Name; Share holding pattern i.e., no of share to its % to total capital)

3.0 DETAILS OF INFRASTRUCTURAL FACILITIES

3.1 Office Space

3.2 Office Equipment

3.3 Furniture & Fixtures

3.4 Communication Facilities

3.5 Data Processing Capacity

(a) In-house:

(b) Others:

3.6 Computer Facility

(a) Hardware configuration:

(b) Software Environment:

4.0 BUSINESS PLAN (FOR THREE YEARS)

(a) History, Major events and present activities

(b) Proposed business plan & means of achieving the same.

(c) Projected Profitability (Next three years)

(Physical targets, Modus operendi to achieve targets, Resultant Income)

5.0 FINANCIAL INFORMATION

5.1 Capital Structure (Rs. in lakhs)

	Year prior to the preceding year of current year	preceding year	current year
(a) Paid-up capital			
(b) Free reserves (excluding revaluation reserves)			
(c) Total (a) + (b)			

5.2 Deployment of Resources (Rs. in lakhs)

	Year prior to the preceding year of current year	preceding year	current year
(a) Fixed Assets			
(b) Plant & Machinery and office equipment			
(c) Investments (Details should be given separately)			
(d) Others			

5.3 Major Sources of Income: (Rs. in lakhs)

	Year prior to the preceding year of current year	preceding year	current year

* Fees charged as % of issue

5.4 Net Profit (Rs. in lakhs)

	Year prior to the preceding year of current year	preceding year	current year

5.5 Name and Address of the Principal Bankers

5.6 Name and Address of the Auditors

6. OTHER INFORMATION

6.1 Details of all settled and pending disputes:

Nature of dispute	Name of the party	Pending/settled

6.2 Indictment of involvement in any economic offences in the last three years.

6.3 Indicate Dealing/trading with any Intermediary who has defaulted with or suspended by any stock exchange authorities or any other authorities.

6.4 Any other information considered relevant to the nature of services rendered by the company.

6.5 Names of two references from bankers (For applicants other than financial institutions & banking companies)

PART II SPECIFIC INFORMATION

7.0 BUSINESS INFORMATION

7.1 Indicate Type of Activity carried on/proposed to be carried on.

7.2 Indicate the facilities for making decision on portfolio Investment.

7.3 Enclose a copy of list of approved share brokers, involved for Portfolio Management activities and state whether any of them were suspended/had defaulted with any Stock Exchange authority.

7.4 Describe Accounting system followed/to be followed for Portfolio Management Services.

7.5 Indicate various research & database facilities provided.

8.0 EXPERIENCE

8.1 Experience in Portfolio management activities. Indicate period also.

8.2 Experience in other financial services rendered:- (Period, Area and Date of Commencement of Activity).

8.3 Business handled during the last year:

(a) PORTFOLIO MANAGEMENT

(DISCRETIONARY NATURE)	For Resident/ Non-Resident	Individual Client	Corporate Client:
1. Types of services offered			
2. No of portfolio clients			
3. Total amount of funds managed			
4. Average size of portfolio			
5. Average return to the client			

(NON-DISCRETIONARY NATURE)	For Resident/ Non-Resident	Individual Client	Corporate Client:
1. Types of services offered			
2. No of portfolio clients			
3. Total amount of funds managed			
4. Average size of portfolio			
5. Average return to the client			

(b) Only Portfolio Advisory Services

(Indicate for both Resident/Non-resident clients)

(c) List of Clients (Corporate clients only)

Name	Amount of portfolio fund managed	Services Rendered

DECLARATION

This declaration must be signed by two directors

I/We hereby apply for REGISTRATION. I/We warrant that I/We have truthfully and fully answered the questions above and provided all the information which might reasonably be considered relevant for the purposes of my/our registration.

For and On behalf of:

(Name of Applicant)

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Director Director

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Name in Block Letters Name in Block Letters

PLACE PLACE

Date Date

FORM B
Securities and Exchange Board of India
(Portfolio Managers) Regulations, 1993
[Regulation 8]

Certificate of Registration

I. In exercise of the powers conferred by sub-section (1) of section 12 of the Securities and Exchange Board of India Act, 1992, read with the regulations made thereunder for the portfolio managers the Board hereby grants a certificate of registration to _____________ as a portfolio manager subject to the conditions in the rules and in accordance with the regulations.

II. Registration Code for the portfolio manager is PM//

III. Unless renewed, the certificate of registration is valid from ________ to _________.

Place:

Date:

By Order
For and on behalf of
Securities and Exchange Board of India
Authorized signatory

FORM C
Securities and Exchange Board of India
(Portfolio Managers) Regulations, 1993
Regulation 14

(Name of the Portfolio Manager)

(Address of the Portfolio Manager (including phone numbers, fax, email etc.)

We confirm that:

i) the Disclosure Document forwarded to the Board is in accordance with the SEBI (Portfolio Managers) Regulations, 1993 and the guidelines and directives issued by the Board from time to time;

ii) the disclosures made in the document are true, fair and adequate to enable the investors to make a well informed decision regarding entrusting the management of the portfolio to us/investment in the Portfolio Management ;

iii) the Disclosure Document has been duly certified by an independent chartered accountant (Indicate name, address, phone number and registration number of the chartered accountant) on ________ (date).

(Enclose a copy of the chartered accountants' certificate to the effect that the disclosures made in the document are true, fair and adequate to enable the investors to make a well informed decision)

Date: Signature of the Principal Officer

Place: Name and address of the Principal Officer]

SCHEDULE II
Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993

Regulation 12

FEES

1. Every portfolio manager shall pay a non-refundable fee of one lakh rupees along with the application for grant or renewal of certificate of registration.

(1A) Every portfolio manager shall pay a sum of ten lakh rupees as registration fees at the time of the grant of certificate by the Board.

2. Every portfolio manager shall pay a renewal fee of five lakh rupees upon grant of renewal.

3. (a) The fee referred to in paragraph (1) shall be paid by the portfolio manger within fifteen days from the date of receipt of intimation from the Board under regulation 8.

   (b) The fee referred to in paragraph (2), shall be paid by the portfolio manager within fifteen days from the date of receipt of intimation from the Board under sub-regulation (3) of regulation 9

4. The fees specified in paragraphs (1) and (2) above, shall be payable by the portfolio manager by a demand draft in favour of “Securities and Exchange Board of India” payable at Mumbai or at the respective regional office.

SCHEDULE III
Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993

Regulation 13

CODE OF CONDUCT- PORTFOLIO MANAGER

1. A portfolio manager shall, in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers.

2. The money received by a portfolio manager from a client for an investment purpose should be deployed by the portfolio manager as soon as possible for that purpose and money due and payable to a client should be paid forthwith.

3. A portfolio manager shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment. The portfolio manager shall either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers. He shall disclose to the clients, possible source of conflict of duties and interests, while providing unbiased services. A portfolio manager shall not place his interest above those of his clients.

4. A portfolio manager shall not make any statement or become privy to any act, practice or unfair competition, which is likely to be harmful to the interests of other portfolio managers or is likely to place such other portfolio managers in a disadvantageous position in relation to the portfolio manager himself, while competing for or executing any assignment.

5. A portfolio manager shall not make any exaggerated statement, whether oral or written, to the client either about the qualification or the capability to render certain services or his achievements in regard to services rendered to other clients.

6. At the time of entering into a contract, the portfolio manager shall obtain in writing from the client, his interest in various corporate bodies which enables him to obtain unpublished price-sensitive information of the body corporate.

7. A portfolio manager shall not disclose to any clients, or press any confidential information about his client, which has come to his knowledge.

8. The portfolio manager shall where necessary and in the interest of the client take adequate steps for registration of the transfer of the clients' securities and for claiming and receiving dividends, interest payments and other rights accruing to the client. He shall also take necessary action for conversion of securities and subscription/renunciation of/or rights in accordance with the clients' instruction.

9. A portfolio manager shall endeavour to –

   (a) ensure that the investors are provided with true and adequate information without making any misguiding or exaggerated claims and are made aware of attendant risks before any investment decision is taken by them;

   (b) render the best possible advice to the client having regard to the client's needs and the environment, and his own professional skills;

   (c) ensure that all professional dealings are effected in a prompt, efficient and cost effective manner.

10. (1) A portfolio manager shall not be a party to -

   (a) creation of false market in securities;

   (b) price rigging or manipulation of securities;

   (c) passing of price sensitive information to brokers, members of the stock exchanges and any other intermediaries in the capital market or take any other action which is prejudicial to the interest of the investors.

   (2) No portfolio manager or any of its directors, partners or manager shall either on their respective accounts or through their associates or family members, relatives enter into any transaction in securities of companies on the basis of unpublished price sensitive information obtained by them during the course of any professional assignment.

11. (a) A portfolio manager or any of his employees shall not render, directly or indirectly any investment advice about any security in the publicly accessible media, whether real-time or non-real-time, unless a disclosure of his long or

short position in the said security has been made, while rendering such advice.

(b) In case an employee of the portfolio manager is rendering such advice, he shall also disclose the interest of his dependent family members and the employer including their long or short position in the said security, while rendering such advice.

12. (a) The portfolio manager shall abide by the Act, and the Rules, Regulations made thereunder and the Guidelines/ Schemes issued by the Board.

(b) The portfolio manager shall comply with the model code of conduct specified in the SEBI (Prohibition of Insider Trading) Regulations, 1992.

(c) The portfolio manager shall not use his status as any other registered intermediary to unduly influence the investment decision of the clients while rendering portfolio management services.

SCHEDULE IV
Contents of Agreement Between the Portfolio Manager and his Clients

Regulation 14

The following shall be mentioned in the agreement -

1. Appointment of Portfolio Manager.

2. Scope of services to be provided by the portfolio manager subject to the activities permitted under SEBI (Portfolio Managers) Regulations, 1993, viz, advisory, investment management, custody of securities, keeping track of corporate benefits associated with the securities. The Portfolio Manager shall act in a fiduciary capacity and as a trustee and agent of the clients' account.

3. Functions, obligations, duties and responsibilities (as discretionary and non discretionary to be given separately) with specific provisions regarding instructions for non discretionary portfolio manager, inter alia –

(i) terms in compliance with the Act, SEBI (Portfolio Managers) Regulations,1993, rules, regulations, guidelines made under the Act and any other laws/rules/regulations/ guidelines etc.;

(ii) providing reports to clients;

(iii) maintenance of client wise transaction and related books of accounts;

(iv) provisions regarding audit of accounts as required under the SEBI (Portfolio Managers) Regulations, 1993;

(v) settlement of accounts and procedure therefore including the provisions for payment on maturity or early termination of the contract.

4. Investment objectives and guidelines -

(i) Types of securities in which investment would be made specifying restrictions, if any.

(ii) Particulars regarding amount, period of management, repayment or withdrawal.

(iii) Taxation aspects such as Tax Deducted at Source etc., if any.

(iv) Condition that the portfolio manager shall not lend the securities of the client unless authorized by him in writing.

5. Risk factors

(i) A detailed statement of risks associated with each type of investment including the standard risks associated with each type of investment.

6. Period of agreement: minimum period if any, and provision for renewal, if any.

7. Conditions, under which agreement may be altered, terminated and implications thereof, such as settlement of amounts invested, and repayment obligations etc.

(i) Voluntary/mandatory termination by the portfolio manager;

(ii) Voluntary/mandatory termination by the client;

(iii) Suspension by the Board or other regulatory authority.

8. **Maintenance of Accounts**: Maintenance of accounts separately in the name of the client as are necessary to account for the assets and any additions, income, receipts and disbursements in connection therewith, as provided under SEBI (Portfolio Managers) Regulations, 1993.

9. **Change in the quantum of funds to be managed**: The conditions under which the client may withdraw cash or securities from the portfolio account or bring in additional cash to be managed as per the terms and conditions that apply. The portfolio manager shall not change any terms of the agreement without prior consent of the client.

10. **Access to information**: (Subject to the provisions of SEBI (Portfolio Managers) Regulations,1993) - Provisions enabling client to get the books of accounts of the portfolio manager relating to his transactions audited by a chartered accountant appointed by him and permitting the client an access to relevant and material documents of portfolio manager, provisions listing the documents for inspection along with timings for such inspection, furnishing of reports to the client subject to furnishing at least once in six months and the reports to be made available on the web site of the portfolio manager with restricted access to each client and other rights of clients etc. The provision that the statements/documents/ report furnished by the Portfolio Manager to the client present a true and fair picture of the actual transactions.

11. **Terms of Fees**: The quantum and manner of payment of fees and charges for each activity for which services are rendered by the portfolio manager directly or indirectly (where such service is outsourced) such as investment management, advisory, transfer, registration and transaction costs with specific references to brokerage costs, custody charges, cost related to furnishing regular communication, account statement, miscellaneous expenses (individual expenses in excess of 5% to be indicated separately) etc. The provision that the Portfolio Manager shall take prior permission from the client in this respect.

12. **Billing**: Periodicity of billing, whether payment to be made in advance, manner of payment of fees, whether setting off against the account etc., type of documents evidencing receipt of payment of fees.

13. **Liability of Portfolio Manager**: Liability of portfolio manager in connection with recommendations made, to cover errors of judgment, negligence, willful misfeasance in connection with discharge of duties, acts of other intermediaries, brokers, custodians etc.

14. **Liability of Client**: restricting the liability of the client to the extent of his investment.

15. **Death or Disability**: providing for continuation/termination of the agreement in event of client's death/disability, succession, nomination, representation etc. to be incorporated.

16. **Assignment**: Conditions for assignment of the agreement by the client.

17. **Governing Law**: The law/jurisdiction of country/state which governs the agreement to be stated.

18. Settlement of grievances/disputes and provision for arbitration- (Provisions to cover protection of act done in good faith, Risks and losses, redressal of grievances, dispute resolution mechanism, reference for arbitration and the situations under which such rights may arise, may be made).

SCHEDULE V
Disclosure Document

[Regulation 14]

General Instructions

1. This Disclosure Document is to be given to the prospective client along with the account opening form (as per Format I) at least two days in advance of signing of the agreement.

2. This Disclosure Document is to be filed with the Board before it is circulated or issued to any person and every six month thereafter or whenever any material changes are effected therein.

3. This model Disclosure Document enumerates the minimum disclosure requirements to be contained in the disclosure document. The portfolio manager may make any other disclosures, which in its opinion are material for the investor, provided that such information is a statement of fact and is not presented in an incomplete, inaccurate or misleading manner. It should also be ensured that inclusion of such information does not, by virtue of its nature or manner of presentation, hamper understanding of any information that is required to be included under the model disclosure document The model Disclosure Document specifies only the nature of the disclosures that should be contained under various heads in the disclosure document, and is not intended to describe the layout or language to be contained therein.

Model Disclosure Document for Portfolio Management

The minimum disclosures to be given in the Disclosure Document shall be as under and due care shall be taken to present the information in simple language and in a clear, concise and easily understandable manner –

I. Front page

(i) The Document has been filed with the Board along with the certificate in the prescribed format in terms of Regulation 14 of the SEBI (Portfolio Managers) Regulations, 1993.

(ii) The purpose of the Document is to provide essential information about the portfolio services in a manner to assist and enable the investors in making informed decision for engaging a Portfolio Manager.

(iii) The necessary information about the portfolio manager required by an investor before investing, and the investor may also be advised to retain the document for future reference.

(iv) The name, phone number, e-mail address of the principal officer so designated by the Portfolio Manager is………… (Give details).

II. Index page giving item number, contents and page number

III. Contents of the Document

1) Disclaimer clause

A statement to the effect that the particulars have been prepared in accordance with the SEBI (Portfolio Managers) Regulations,1993 and filed with SEBI. This Document has neither been approved nor disapproved by SEBI nor has SEBI certified the accuracy or adequacy of the contents of the Document.

2) Definitions

All terms used in the Disclosure Document be defined. The language and terminology used in the Disclosure Document shall be as provided in the Regulations. Any new term if used shall be clearly defined. All terms shall be used uniformly throughout the text of the Disclosure Document.

3) Description

(i) History, Present Business and Background of the portfolio manager

(ii) Promoters of the portfolio manager, directors and their background

(iii) Top 10 Group companies/firms of the portfolio manager on turnover basis (latest audited financial statements may be used for this purpose)

(iv) Details of the services being offered: Discretionary/Non discretionary/Advisory.

4) Penalties, pending litigation or proceedings, findings of inspection or investigations for which action may have been taken or initiated by any regulatory authority.

(i) All cases of penalties imposed by the Board or the directions issued by the Board under the Act or Rules or Regulations made thereunder.

(ii) The nature of the penalty/direction.

(iii) Penalties imposed for any economic offence and/or for violation of any securities laws.

(iv) Any pending material litigation/legal proceedings against the portfolio manager/key personnel with separate disclosure regarding pending criminal cases, if any.

(v) Any deficiency in the systems and operations of the portfolio manager observed by the Board or any regulatory agency.

(vi) Any enquiry/adjudication proceedings initiated by the Board against the portfolio manager or its directors, principal officer or employee or any person directly or indirectly connected with the portfolio manager or its directors, principal officer or employee, under the Act or Rules or Regulations made thereunder..

5) Services Offered

(i) The present investment objectives and policies including the types of securities in which it generally invests shall be clearly and concisely stated in the document for easy understanding of the potential investor.

(ii) The policies for investments in associates/group companies of the portfolio manager and the maximum percentage of such investments therein subject to the applicable laws/regulations/guidelines.

6) Risk factors

(i) Statement to the effect that securities investments are subject to market risks and there is no assurance or guarantee that the objective of the investments will be achieved.

(ii) Statement to the effect that past performance of the portfolio manager does not indicate its future performance.

(iii) Risk arising from the investment objective, investment strategy and asset allocation.

(iv) Risk arising out of non diversification, if any.

(v) If the portfolio manager has no previous experience/track record a disclosure to that effect shall be made.

7) Client Representation

(i)

Category of clients	No. of clients	Funds managed (Rs. Cr.)	Discretionary/ Non-Discretionary (if available)
Associates/ group companies Last 3 years			
Others (last 3 years)			
Total			

(ii) Complete disclosure in respect of transactions with related parties as per the standards specified by the Institute of Chartered Accountants of India.

8) The Financial Performance of the portfolio manager (based on audited financial statements)

9) Portfolio Management performance of the portfolio manager for the last three years, and in case of discretionary portfolio manager disclosure of performance indicators calculated using weighted average method in terms of Regulation 14 of the SEBI (Portfolio Managers) Regulations, 1993.

10) Nature of expenses

(i) Investment management and advisory fees

(ii) Custodian fee

(iii) Registrar and transfer agent fee

(iv) Brokerage and transaction cost

A brief explanation shall be given to assist the investor in understanding the various costs and expenses that an investor may have to bear directly or indirectly. Additionally, appropriate cross-references may be given to the relevant sections of the offer document for more complete description in this regard.

11) Taxation

Disclose the implications of investments in securities and the tax provisions on Income/Loss or Tax Deduction at Source on various investors.

12) Accounting policies

Disclose the accounting policy followed by the portfolio manager while accounting for the portfolio investments of the clients.

13) Investors services

(i) Name, address and telephone number of the investor relation officer who shall attend to the investor queries and complaints.

(ii) Grievance redressal and dispute settlement mechanism.

Date: Name and signature of at least two Directors of Portfolio Manger

Place:

FORMAT I (Account Opening Form)

Information about the Client

1) General information about the client

   (a) Name, primary mailing address, secondary (back up) mailing address, identity information such as photograph, Permanent Account Number (PAN), driving license etc.

   (b) Occupation __________

   (c) Introduced by________________ (name and full address)

   (d) Annual incomes for the last 3 financial years and the net worth as on the last date of the respective years. (optional)

2) Investment profile of the client

   (a) Investment experience regarding securities.

   (b) Indicative percentage of total investment portfolio proposed to be invested with the portfolio manager (optional).

   (c) Overall investment goals such as capital appreciation, capital appreciation & regular income or regular income.

(d) Risk tolerance i.e. low, medium or high.

(e) Time period for which investments are proposed to be made with the portfolio manager.

(f) Provisions for systematic withdrawal on a monthly, quarterly, annual basis etc.

3) Detailed investment objectives of the client

   (a) Equity: Nature of equities in which investments are desired, may be indicated.

   (b) Balanced: Percentage of debt/equity.

   (c) Debt: Government Bonds, corporate debt etc.

   (d) Mutual funds, venture funds etc.

   (e) Others.

Date:

Place:

Signature of the client

Subject: Compliance with Regulation 16(8) of SEBI (Portfolio Managers) Regulations, 1993.

1. This is further to SEBI Circular No. IMD/PMS/2/2009/11/05 dated May 11, 2009 regarding compliance with Regulation 16(8) of SEBI (Portfolio Managers) Regulations, 1993.

2. In this regard, it is hereby informed that portfolio managers may undertake new clients subject to the following:

   a. Portfolios of non-compliant client accounts shall be frozen;

   b. Fresh purchases on behalf of such clients shall not be made;

   c. Selling of securities, however, from such frozen portfolios may be undertaken;

   d. Transfer of securities from such frozen portfolios to respective client's account may also be effected.

3. The portfolio manager may discontinue the services to those clients who are not co-operating for opening separate client accounts, after serving at least three notices, and return the securities/funds to the client. The portfolio manager shall maintain such client-wise records for a period of eight years.

Chapter 6

Nature of Expenses and Fees

In order to bring about greater uniformity, clarity and transparency with regard to fees and charges, the Portfolio Managers are advised to take the following measures in respect of all client agreements:

Fees and Charges

a) **Profit Sharing:**/performance related fees are usually charged by the Portfolio Managers upon exceeding a hurdle rate or benchmark as specified in the agreement. However, there is no uniformity in practice on how the profit/performance of the portfolio computed. It is advised that, henceforth, profit/performance shall be computed on the basis of high water mark principle over the life of the investment, for charging of performance/profit sharing fee.

High Water Mark Principle: High Water Mark Principle shall be the highest value that the portfolio/account has reached. Value of the portfolio for computation of high watermark shall be taken to be the value on the date when performance fees are charged. For the purpose of charging performance fee, the frequency shall not be less than quarterly. The Portfolio Manager shall charge performance based fee only on increase in portfolio value in excess of the previously achieved high water mark.

Illustration: Consider that frequency of charging of performance fees is annual. A client's initial contribution is Rs.10,00,000, which then rises to Rs.12,00,000 in its first year; a performance fee/profit sharing would be payable on the Rs.2,00,000 return. In the next year, the portfolio value drops to Rs.11,00,000 hence no performance fee would be payable. If in the third year, the portfolio rises to Rs.13,00,000, a performance fee/profit sharing would be payable only on the Rs1,00,000 profit which is portfolio value in excess of the previously achieved high water mark of Rs.12,00,000, rather than on the full return during that year from Rs.11,00,000 to Rs.13,00,000.

b) All fees and charges shall be levied on the actual amount of clients' assets under management.

c) High Water Mark shall be applicable for discretionary and non-discretionary services and not for advisory services.

d) In case of interim contributions/withdrawals by clients, performance fees may be charged after appropriately adjusting the high water mark on proportionate basis.

Maximum Liability

e) Regulation 14(1)(b)(xiii) of the SEBI (Portfolio Managers) Regulations, 1993 provides that the agreement between the Portfolio Manager and the client shall, *inter alia*, contain, in case of a discretionary portfolio manager, a condition that the liability of a client shall not exceed his investment with the portfolio manager.

f) Portfolio Managers shall strictly comply with the aforesaid Regulation.

Disclosure of fees and charges

g) To ensure transparency and adequate disclosure regarding fees and charges, the client agreement shall contain a separate Annexure which shall list all fees and charges payable to the Portfolio Manager. The Annexure shall contain details of levy of all applicable charges on a sample portfolio of Rs.10 lacs over a period of one year. The fees and charges shall be shown for 3 scenarios viz. when the portfolio value increases by 20%, decreases by 20% or remains unchanged. An illustration of the same is enclosed as Annexure-1.

h) All text and figures in the Annexure on fees and charges shall be at least in size 11 font.

i) All existing clients may be sent a letter as an addendum to the agreement about the applicability of the new high-water mark principle and the resultant new fees/charge structure. This annexure has to be signed by the client and sent back to the portfolio manager.

j) New clients shall be required to separately sign the annexure on fees and charges and add in their own handwriting that they have understood the fees/ charge structure.

Disputes

k) Regulation 14(1) read with clause 18 of Schedule IV of the SEBI (Portfolio Managers) Regulations, 1993 provides for settlement of grievances/disputes and provision for arbitration in the portfolio manager – client agreement.

l) In case of any dispute regarding fees and charges, the same shall be referred to arbitration for settlement as per the terms of the agreement, under the Arbitration and Conciliation Act, 1996.

Portfolio performance: Gain of 20%

Nature of Fees	*Amount in Rs.*	*Amount in Rs.*
Capital Contribution	1000000	
Less: Upfront fees (If any)	20000	
Less: Any other fees (please enumerate)	XX	
Assets under management	980000	
Add: Profits on investment during the year @ 20% on assets under management 1,96,000	196000	
Gross Value of the portfolio at the end of the year 11,76,000		1176000
Less: Brokerage/DP charges/any other similar charges (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Performance fees (if any)(e.g. 20% of Rs.98,000 – working given below) 19,600	19600	
Less: Any other fees (please enumerate) XX	XX	
Total charges during the year 58,800		58800
Net value of the portfolio at the end of the year 11,17,200		1117200
% change over capital contributed		11.72%

Calculation of Performance Fees for above

Serial No.	*Nature of Fees*	*Amount in Rs.*
A	Profit for the year	1,96,000/-
B	Less : Minimum profit level (Hurdle rate @10% on Rs.98000/-)	98,000/-
C	Amount on which profit sharing to be calculated (B-A)	98,000/-
D	Performance Fees (20% on C)	19,600/-

Portfolio Performance: Loss of 20%

Nature of Fees	*Amount in Rs.*	*Amount in Rs.*
Capital Contribution	1000000	
Less: Upfront fees (If any)	20000	
Less: Any other fees (please enumerate)	XX	
Assets under management	980000	
Less : Loss on investment during the year @ 20% on assets under management 1,96,000	196000	
Gross Value of the portfolio at the end of the year		7,84,000/-
Less: Brokerage/DP charges/any other similar charges (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Performance fees	XX	
Less: Any other fees (please enumerate) XX	XX	
Total charges during the year		39,200/-
Net value of the portfolio at the end of the year		7,44,800/-
% change over capital contributed		-25.52%

Change of Portfolio Performance : No Change

Nature of Fees	*Amount in Rs.*	*Amount in Rs.*
Capital Contribution	1000000	
Less: Upfront fees (If any)	20000	
Less: Any other fees (please enumerate)	XX	
Assets under management	980000	
Add: Profit/Loss on investment during the year @0% on asset under management	0	
Gross Value of the portfolio at the end of the year		9,80,000/-
Less: Brokerage/DP charges/ any other similar charges (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000) 19,600	19600	
Less: Performance fees	0	
Less: Any other fees (please enumerate) XX	XX	
Total charges during the year		39,200/-
Net value of the portfolio at the end of the year		9,40,800/-
% change over capital contributed		-5.92%

Chapter 7
SEBI Regulations

Online Process for Fresh Registrations

a. A log-in ID and Password will be generated on receipt of a fresh application for registration as a Portfolio Manager.

b. The URL of the SEBI portal, the log-in ID and Password will be e-mailed to the Compliance Officer or the Principal Officer only.

c. On receipt of the log-in ID and Password the applicant should fill up all the details by clicking "Fresh Registration" under the tab "Portfolio Manager" given on the SEBI portal.

d. All instructions on how to fill the details under every tab should be read before filling the online form. The same can be accessed by clicking the "Blue Question Mark" on the top right hand corner of every page.

e. The details filled under every tab should be saved by clicking on the "Saved Draft" button as soon as a particular tab is completely filled up.

f. Once all the details are filled up, the applicant should submit the online application form by clicking the "Final Submit" button.

g. After SEBI approval, the applicant will be required to fill the fee details. The same will be sent through a mail which can be accessed by clicking the link "My Worklist" on the home page of SEBI portal.

h. Inside the mail, there will be a link "Enter Fee Details" through which the applicant has to enter the fee details and save it.

i. Once the details relating to fees are entered and saved, it must be adjusted against the outstanding amount as per the instructions given in the "blue question mark" on the top right hand corner of the page.

j. Once the fees are adjusted, the fee details must be saved and then submitted, by clicking the "Submit" button in the e-mail, to SEBI for final approval.

2. Online Process for Renewal of Registrations

a. After making the physical application for renewal of registration at least three months prior to expiry of registration, the applicant should also initiate the process for renewal of online registration.

b. The same can be done by clicking "Renewal of Registration" under the tab "Portfolio Manager" given on the SEBI portal.

c. Renewal of online registration should be initiated at least 3 months before the expiry of registration. If such online process is not initiated before 3 months, then the applicant will not be allowed to update any information or renew the application.

d. Any changes in information previously submitted can be done here.

e. All instructions to fill the details under every tab can be accessed by clicking the "Blue Question Mark" on the top right hand corner of every page.

f. The details filled under every tab should be saved by clicking on the "Saved Draft" button as soon as a particular tab is completely filled up.

g. Once all the details are filled up, the applicant should submit the renewal form by clicking the "Final Submit" button.

h. On receipt of the renewal form, the online renewal shall be approved by SEBI.

i. After SEBI approval, the applicant will be required to fill the fee details. The same will be sent through a mail which can be accessed by clicking the link "My Worklist".

j. Inside the mail, there will be a link "Enter Fee Details" through which the applicant has to enter the fee details and save it.

k. Once the details relating to fees are entered and saved, it must be adjusted against the outstanding amount as per the instructions given in the "blue question mark" on the top right hand corner of the page.

l. Once the fees are adjusted, the fee details must be saved and then submitted, by clicking the "Submit" button in the e-mail, to SEBI for final approval.

3. Online Process for Updation of Information

a. There can be any change in information that a registered PMS can undergo during its operations.

b. Apart from sending the physical copy of such changes in information to SEBI, the same should be updated on the SEBI portal.

c. It can be done by clicking " Updation of Registration" under the tab "Portfolio Manager" given on the SEBI portal.

d. All instructions to fill the details under every tab can be accessed by clicking the "Blue Question Mark" on the top right hand corner of every page.

e. The details changed under every tab should be saved by clicking on the "Saved Draft" button.

f. Once the changed details are updated, the applicant should submit the updation form by clicking the "Final Submit" button.

g. On receipt of the updation form, the online updation shall be approved by SEBI.

h. A mail will be sent to the applicant intimating SEBI approval.

i. The applicant can see SEBI approval by clicking the link "My Worklist".

b) To ensure compliance with regulation 14(2)(b)(iv) of SEBI (Portfolio Managers) Regulations, 1993, Portfolio Managers shall disclose the performance of portfolios grouped by investment category for the past three years as per the enclosed prescribed tabular format. Portfolio Managers shall also ensure that the disclosure document is given to all clients along with the account opening form at least two days in advance of signing of the agreement. In order to ensure that the clients have access to updated information about the Portfolio Manager, Portfolio Managers shall place the latest disclosure document on their website, wherever possible.

c) Portfolio Managers shall not organize investment portfolios as „Schemes" akin to Mutual Fund Schemes while marketing their services to clients. – difference vis-à-vis Mutual Fund.

Annexure
Format for disclosure of Performance of the Portfolio Manager for the last 3 years

(Regulation 14(2)(b)(iv) of SEBI (Portfolio Managers) Regulations, 1993)

	Current Year (April 01 – as on date)	**Year 1** (Financial year)	**Year 2** (Financial year)	**Year 3** (Financial year)
Portfolio Performance (%), Net of all fees and charges levied by the portfolio manager.				
Benchmark Performance %				

The format for the monthly report on Portfolio Management activity has been revised as per enclosed Annexure. All Portfolio Managers are advised to upload the report in the revised format on SEBI Portal by the 5th of the following month with effect from the report for the month of October 2010 onwards.

Annexure
Portfolio Management Monthly Report

1. DISCRETIONARY SERVICES

Sr. No	Types of Clients		No. of Investors as on month end	Net Assets Under Management as on month end (in Rs. crores)							
				Equity		Debt		Equity Derivatives	Mutual Funds	Others	Total
				Listed	Unlisted	Plain Debt	Structured Debt*				
	Individual	Resident									
		Non-resident									
	Corporate	Resident									
		Non-resident									
		FII									
		Grand Total									

*Such as equity linked notes, equity linked debentures etc.

Sr. No.	Particulars	Amount/ Ratio etc.
1	Gross Sales in the month (Amount in Rs. crores)	
2	Gross Purchases in the month (Amount in Rs. crores)	
3	Portfolio Turnover Ratio =(Cumulative Purchases in the Month/Funds under portfolio)	
4	Performance of the portfolio manager during the month (on weighted average basis for all clients)	
5	Value of Assets Managed under PF/EPFO (Amount in Rs. crores) (if any)	

2. NON-DISCRETIONARY SERVICES

Sr. No	Types of Clients		No. of Inves-tors as on month end	Net Assets Under Management as on month end (in Rs. crores)							
				Equity		Debt		Equity Deriva-tives	Mutual Funds	Others	Total
				Listed	Un-listed	Plain Debt	Struc-tured Debt*				
	Individual	Resident									
		Non-resident									
	Corporate	Resident									
		Non-resident									
		FII									
		Grand Total									

*Such as equity linked notes, equity linked debentures etc.

Sr. No.	Particulars	Amount/ Ratio etc.
1	Gross Sales in the month (Amount in Rs. crores)	
2	Gross Purchases in the month (Amount in Rs. crores)	
3	Portfolio Turnover Ratio =(Cumulative Purchases in the Month/Funds under portfolio)	
4	Performance of the portfolio manager during the month (on weighted average basis for all clients)	
5	Value of Assets Managed under PF/EPFO (Amount in Rs. crores) (if any)	

3. ADVISORY SERVICES

Sr. No.	Particulars	
1	Number Individual clients	
2	Number of Corporate Clients	
3	Total Number of clients	
4	Value of the Asset for which Advisory Services are being given (Amount in Rs. crores)	

3. DETAILS OF COMPLAINTS

Sr. No.	*Types of Clients*		*Total No. of complaints pending at the beginning of the month*	*No. of complaints received during the month*	*No. of complaints resolved during the month*	*Total no of complaints pending at the end of the month*
	Individual	Resident				
		Non-resident				
	Corporate	Resident				
		Non-resident				
		FII				
		Grand Total				

Half Yearly Reporting by Portfolio Managers

2. The format for the half yearly report on portfolio management activity has been revised as per enclosed Annexure. All portfolio managers are advised to submit the half yearly report to SEBI in the revised format within 30 days after the end of respective period ended 30/9 & 31/3 of each year.

Annexure
Half Yearly Reporting Requriements
for Portfolio Management Activities

(To be submitted within 30 days, for the period ended 30/9 & 31/3 of each year after the end of respective period)

1. GENERAL INFORMATION

1.1 Name

1.2 Registration no:-

1.3 Address (Registered and Correspondence office address with email id.)

2. CAPITAL ADEQUACY

Net worth as on 30/9 or 31/3 as the case may be;

The statement of net worth of ……….. based on audited/ unaudited accounts as on ………….

	Amount (in Rs. lakhs)
Paid up equity capital	
Add: Free reserves (excluding reserves created out of revaluation)	
Less: Accumulated losses	
Less: Deferred expenditure not written off (including miscellaneous expenses not written off)	
Less: Minimum Capital Adequacy/net worth requirement for any other activity undertaken under other SEBI regulations.	
Net worth	

3. OTHER INFORMATION

3.1 Details of all settled and pending disputes against applicant/its directors/associates

Sr. No	Names of the Party	Nature of dispute	Pending/settled

3.2 Indictment or involvement in any economic offence during the period.

3.3 Any other information considered relevant to the nature of services rendered by the Portfolio Manager.

3.4 List of approved share brokers whose services were utilized for PMS activities and whether any of them were suspended for more than one week/had defaulted with any Stock Exchange authority.

4. List of Corporate Clients - (with Name and Amount of portfolio fund managed).

Sr. No.	Name of Client	Amount of portfolio fund managed (in Rs. lakhs)

5. Performance of Portfolio Manager in comparison to relevant benchmark indices during the period – (for the categories – Individual clients & corporate clients).

6. Enclosures:

(1) A certificate duly signed by the Principal Officer stating that the information required under Regulation No. 23(ii) of SEBI (Portfolio Managers) Regulations, 1993 has been reported to SEBI.

(2) A certificate from the auditors relating to Portfolio Management activities as required under Regulation No. 20(2) of SEBI (Portfolio Managers) Regulations, 1993 and management's comments on the adverse remarks if any, made by the auditor.

(3) Corporate Governance report as required under the PMS Circular IMD/PMS/CIR/1/21727/03 dated November 18, 2003.

Place: Authorized Signatory

Date:

Chapter 8

Assets Under Management

REPORT OF PORTFOLIO MANAGERS - AS on October 31, 2012			
	Discretionary	**Non-Discretionary**	**Advisory**
No. of Clients	57782	7315	10889
AUM (Rs. in crore)			
Listed Equity	16452.46	4162.46	
Unlisted Equity	1612.61	49.44	
Plain Debt	428785.93	15057.312	
Structured Debt	1401.70	760.22	74,852.83
Equity Derivative	116.94	0.00	
Mutual Fund	3996.12	3495.58	
Others	11899.44	299.95	
Total	**464265.19**	**23824.96**	

Notes:

1. *Value of Assets for which Advisory Services are being given.
2. #Of the above AUM Rs. 4,26,715 crore is contributed by funds from EPFO/PFs.
3. The above data is based on the monthly reports received from portfolio managers.

Source: SEBI

Chapter 9

Frequently Asked Questions

1. Who is a Portfolio Manager?

A Portfolio Manager is a body corporate who, pursuant to a contract or arrangement with a client, advises or directs or undertakes on behalf of the client (whether as a discretionary portfolio manager or otherwise), the management or administration of a portfolio of securities or the funds of the client.

2. What is the difference between a discretionary Portfolio Manager and a non- discretionary Portfolio Manager?

The ***discretionary portfolio manager*** individually and *independently manages* the funds of each client in accordance with the needs of the client.

The ***non-discretionary portfolio manager*** manages the funds *in accordance with the directions of the client.*

3. What is the procedure of obtaining registration as a Portfolio Manager from SEBI?

For registration as a portfolio manager, an applicant is required to pay a non-refundable application fee of Rs.1,00,000/- by way of demand draft drawn in favour of 'Securities and Exchange Board of India', payable at Mumbai.

The application in Form A along with additional information (Form A and additional information available on SEBI Website : www.sebi.gov.in.) submitted to the at the below mentioned address

Investment Management Department - Division of Funds- 1
Securities and Exchange Board of India
SEBI Bhavan, 3rd Floor A Wing,
Plot No. C4-A, 'G' Block,
Bandra-Kurla Complex,
Bandra (E), Mumbai - 400 051.

4. What is the capital adequacy requirement of a Portfolio Manager?

The portfolio manager is required to have a minimum net worth of Rs. 2 crore.

5. Is there any registration fee to be paid by the Portfolio Managers?

Yes. Every Portfolio Manager is required to pay Rs. 10 lakhs as registration fees at the time of grant of certificate of registration by SEBI.

6. How long does the certificate of registration remain valid?

The certificate of registration remains valid for three years. The Portfolio Manager has to apply for renewal of its registration certificate to SEBI, 3 months before the expiry of the validity of the certificate, if it wishes to continue as a registered Portfolio Manager.

7. How much is the renewal fee to be paid by the Portfolio Manager?

The portfolio manager is required to pay Rs. 5 lakh as renewal fees to SEBI.

8. Is there any contract between the Portfolio Manager and its client?

Yes. The Portfolio Manager, before taking up an assignment of management of funds or portfolio of securities on behalf of the client, enters into an agreement in writing with the client, clearly defining the inter se relationship and setting out their mutual rights, liabilities and obligations relating to the management of funds or portfolio of securities, containing the details as specified in Schedule IV of the SEBI (Portfolio Managers) Regulations, 1993.

9. What fees can a Portfolio Manager charge from its clients for the services rendered by him?

SEBI Portfolio Manager Regulations have not prescribed any scale of fee to be charged by the portfolio manager to its clients.

However, the regulations provide that the Portfolio Manager shall charge a fee as per the agreement with the client for rendering portfolio management services. The fee so charged may be a fixed amount or a return based fee or a combination of both. The Portfolio Manager shall take specific prior permission from the client for charging such fees for each activity for which service is rendered by the Portfolio Manager directly or indirectly (where such service is outsourced).

10. Is there any specified value of funds or securities below which a Portfolio Manager can't accept from the client while opening the account for the purpose of rendering portfolio management service to the client?

The Portfolio Manager is required to accept minimum Rs. 25 lakhs or securities having a minimum worth of Rs. 25 lakhs from the client while opening the account for the purpose of rendering portfolio management service to the client. Portfolio Manager can only invest and not borrow on behalf of his clients.

11. Are investors required to open demat accounts for PMS services?

Yes. For investment in listed securities, an investor is required to open a demat account in his/her own name.

12. What kind of reports can the client expect from the Portfolio Manager?

The Portfolio Manager shall furnish periodically a report to the client, as agreed in the contract, but not exceeding a period of six months and as and when required by the client and such report shall contain the following details, namely:-

(a) the composition and the value of the portfolio, description of security, number of securities, value of each security held in the portfolio, cash balance and aggregate value of the portfolio as on the date of report;

(b) transactions undertaken during the period of report including date of transaction and details of purchases and sales;

(c) beneficial interest received during that period in respect of interest, dividend, bonus shares, rights shares and debentures;

(d) expenses incurred in managing the portfolio of the client;

(e) details of risk foreseen by the Portfolio Manager and the risk relating to the securities recommended by the portfolio manager for investment or disinvestment.

This report may also be available on the website with restricted access to each client. The Portfolio Manager shall, in terms of the agreement with the client, also furnish to the client documents and information relating only to the management of a portfolio. The client has right to obtain details of his portfolio from the Portfolio Managers.

13. What is the disclosure mechanism of the Portfolio Managers to their clients?

The Portfolio Manager provides to the client the Disclosure Document at least two days prior to entering into an agreement with the client.

The Disclosure Document contains the quantum and manner of payment of fees payable by the client for each activity, portfolio risks, complete disclosures in respect of transactions with related parties, the performance of the portfolio manager and the audited financial statements of the portfolio manager for the immediately preceding three years.

Please note that the disclosure document is neither approved nor disapproved by SEBI nor does SEBI certify the accuracy or adequacy of the contents of the Documents.

14. Does SEBI approve any of the services offered by Portfolio Managers?

No. SEBI does not approve any of the services offered by the Portfolio Manager. An investor has to invest in the services based on the terms and conditions laid out in the disclosure document and the agreement between the portfolio manager and the investor.

15. Does SEBI approve the disclosure document of the Portfolio Manager?

The Disclosure Document is neither approved nor disapproved by SEBI. SEBI does not certify the accuracy or adequacy of the contents of the Disclosure Document.

16. What are the rules governing services of a Portfolio Manager?

The services of a Portfolio Manager are governed by the agreement between the portfolio manager and the investor. The agreement should cover the minimum details as specified in the SEBI Portfolio Manager Regulations. However, additional requirements can be specified by the Portfolio Manager in the agreement with the client. Hence, an investor is advised to read the agreement carefully before signing it.

17. Is premature withdrawal of Funds/securities by an investor allowed?

The funds or securities can be withdrawn or taken back by the client before the maturity of the contract. However, the terms of the premature withdrawal would be as per the agreement between the client and the Portfolio Manager.

18. Can a Portfolio Manager impose a lock-in on the investor?

Portfolio managers cannot impose a lock-in on the investment of their clients. However, a portfolio manager can charge exit fees from the client for early exit, as laid down in the agreement.

19. Can a Portfolio Manager offer indicative or guaranteed returns?

Portfolio manager cannot offer/promise indicative or guaranteed returns to clients.

20. On what basis is the performance of the Portfolio Manager calculated?

The performance of a discretionary Portfolio Manager is calculated using weighted average method taking each individual category of investments for the immediately preceding three years and in such cases performance indicator is also disclosed.

21. Where can an investor look out for information on Portfolio Managers?

Investors can log on to the website of SEBI www.sebi.gov.in for information on SEBI regulations and circulars pertaining to portfolio managers. Addresses of the registered portfolio managers are also available on the website.

22. How can the investors redress their complaints?

Investors would find in the Disclosure Document the name, address and telephone number of the investor relation officer of the portfolio manager who attends to the investor queries and complaints. The grievance redressal and dispute mechanism is also mentioned in the Disclosure Document. Investors can approach SEBI for redressal of their complaints. On receipt of complaints, SEBI takes up the matter with the concerned portfolio manager and follows up with them.

Investors may send their complaints to:

Office of Investor Assistance and Education,
Securities and Exchange Board of India,
SEBI Bhavan
Plot No. C4-A, 'G' Block,
Bandra-Kurla Complex, Bandra (E),
Mumbai - 400 051

23. What is a PMS?

The Portfolio management service (PMS) is a method of investing used by wealthy investors and companies who want exposure to a variety of products such as equities, fixed income, gold and structured products. There are several advantage and disadvantages of a PMS over mutual funds.

The portfolio management service providers advise clients on buying or selling shares, derivatives or other type of securities. Depending on the type of PMS, the manager can also buy or sell securities on behalf of the clients. An entity needs to be registered with the Securities and Exchange Board of India as a Portfolio Manager. An investor individually owns the securities in a PMS portfolio, unlike a mutual fund where investors only own units of the fund and not the actual securities.

24. What are the Types of PMS?

In a discretionary PMS, the decision to select, buy or sell stocks is taken by the portfolio manager. The trades are also executed by him. But in a non-discretionary PMS, an investor can take the trading decisions advised by the portfolio manager, which are then executed by the manager. In an advisory PMS, a manager gives only investment ideas, and the trades can be executed by the investor.

25. What are the Fees in a PMS?

The portfolio management services either have a fixed, profit-sharing or hybrid fee structure. In a fixed-fee structure, the manager charges a set fee every quarter or on the corpus. It is levied irrespective of the returns generated by a portfolio. Then, there is the profit-sharing model, where the fee paid by an investor is a percentage of profits. This is usually a large chunk, around 20-25% of profits. A hybrid model combines both, although charges are less.

26. What are the Advantages of PMS?

PMS trade in a wide range of securities, including structured products, which is not available to a mutual fund. PMS regulations are less strict than MF regulations. A PMS is a more personalized investment solution; some investors may ask their portfolio managers to allocate a large part of corpus to non-equity products like fixed income, gold, etc.

27. What are the Disadvantages of PMS?

PMS do not disclose the portfolio as much as MFs. There have also been cases where PMS Managers have misused the money.

Chapter 10
Sample Disclosure Document

XYZ SECURITIES (INDIA) PRIVATE LIMITED

DISCLOSURE DOCUMENT FOR

PORTFOLIO MANAGEMENT SERVICES

Dated

DISCLOSURE DOCUMENT FOR PORTFOLIO MANAGEMENT SERVICES

UNDER REGULATION 14 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (PORTFOLIO MANAGERS) REGULATIONS, 1993

(1) This Disclosure Document ("Document") has been filed with the Securities and Exchange Board of India ("SEBI") along with the certificate in the prescribed format pursuant to regulation 14 of the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 as amended till date ("Regulations").

(2) The purpose of this document is to provide essential information about the Portfolio Management Services in a manner to assist and enable the clients in making an informed and considered decision in relation to engaging XYZ Securities (India) Private Limited (XYZ India) as a Portfolio Manager ("Portfolio Manager").

(3) Information about the Portfolio Manager is provided on page 8 of this document.

(4) Clients should carefully read this entire document prior to making a decision to avail the portfolio management services (as hereinafter defined). Clients are advised to retain this

document for future reference. Any other relevant information may be provided upon request. Clients may also wish to seek further clarifications after the date of this document from the Portfolio Manager.

(5) The Portfolio Manager is permitted to provide Portfolio Management Services pursuant to its registration as a Portfolio Manager with SEBI under the regulations. The Portfolio Manager holds a valid registration, registration no. INP00000XXXXX, dated XX January 2011.

(6) All intermediaries involved in providing the Portfolio Management Services are registered with SEBI as of the date of this document.

(7) The Portfolio Manager is a member of the Capital Market (Equity) and Futures & Options segment of the National Stock Exchange of India Limited bearing SEBI registration number no. CM INB230XXXXXX AND INF 2309XXXXX and also holds SEBI registration no. CM INB010XXXXXX AND INF 010XXXXXX for the Capital Market (Equity) and Futures and Options Segment of the Bombay Stock Exchange Limited. On February 0X, 200X, the Portfolio Manager acquired the clearing membership (No. INF230XXXXXX) of the Futures & Options/ Derivatives segment of the National Stock Exchange of India Limited (NSE). The company is eligible to carry out activities of Clearing and Settlement of Derivatives trades for its clearing clients on the NSE. The Portfolio Manager will purchase, sell or otherwise deal in securities through its broker dealer division which shall be entitled to charge brokerage in respect of such transactions. Furthermore, the Portfolio Manager may also purchase securities from time to time for and on behalf of the client, which securities may be sold by the clients of the broker dealer division of the Portfolio Manager, as mentioned above. The Portfolio Manager shall ensure that there would be segregation of the operations and management in day-to-day functioning of the Portfolio Manager and the Broker-Dealer Division.

(8) Further, The Portfolio Manager is registered with SEBI as a merchant banker permitted to undertake merchant banking and underwriting activities. The SEBI registration number of the merchant banking registration held by the Portfolio Manager is INM 0000XXXXX.

(9) The details of the Principal Officer of the Portfolio Manager are as follows:

Name: ABCD EFGH

Address: Dr. Annie Besant Road, Worli, Mumbai 400018, India.

Phone: +91 22 XXXX XXXX

Email: xyz@xyz.com

SECTION I

DISCLAIMER

THE PARTICULARS CONTAINED IN THIS DOCUMENT ARE IN ACCORDANCE WITH THE REGULATIONS AND HAVE BEEN FILED WITH SEBI. THIS DOCUMENT HAS NEITHER BEEN APPROVED OR DISAPPROVED BY SEBI NOR HAS SEBI CERTIFIED THE ACCURACY OR ADEQUACY OF THE CONTENTS OF THIS DOCUMENT.

SECTION II

DEFINITIONS

Unless the context or meaning thereof requires otherwise, the following expressions shall have the meaning assigned to them hereunder respectively:-

"Agreement" means the Discretionary Portfolio Management Services Agreement, or the Non-Discretionary Portfolio Management Services Agreement, or the Investment Advisory Services Agreement, as the case may be, entered into between the Portfolio Manager and the Client, and shall include all schedules and annexures attached thereto and shall also include all modifications, alterations, additions or deletions made thereto in accordance with the terms thereof.

"Application" means the application made by the Client to the Portfolio Manager to avail of the Portfolio Management Services from the Portfolio Manager. Upon execution of an Agreement between the Portfolio Manager and the Client, the Application shall be deemed to form an integral part of the Agreement, provided that, in case of any conflict between the contents of the Application and the provisions of the Agreement, the provisions of the Agreement shall prevail.

"Assets" means (i) the Portfolio and/or (ii) the Funds, details of which are set forth in the respective Agreements.

"Client" means anybody corporate, partnership firm, individual, Hindu undivided family, association of persons, body of individuals, statutory authority, or any other person who enters into an Agreement with the Portfolio Manager for the purpose of availing of the Portfolio Management Services. 5

"Disclosure Document", or "Document" means this document disclosing inter-alia the following in accordance with Schedule V of the Regulations: (i) performance of the Portfolio Manager; (ii) portfolio risks; (iii) the quantum and manner of payment of fees payable by a Client for each activity comprising the Portfolio Management Services rendered by the Portfolio Manager directly or indirectly; (iv) complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard; (v) audited financial statements of the Portfolio Manager for the immediately preceding three years.

"Discretionary Portfolio Management Services Agreement" means the discretionary portfolio management services agreement entered into between a Client and the Portfolio Manager pursuant to which the Portfolio Manager has agreed to provide Discretionary Portfolio Management Services to the Client.

"Discretionary Portfolio Management Services" means the discretionary portfolio management services rendered to a Client by the Portfolio Manager pursuant to the terms and conditions contained in the Discretionary Portfolio Management Services Agreement, where under the Portfolio Manager exercises absolute and unfettered discretion, with regards to the investments and management of the Assets of a Client.

"Funds" means the monies managed by the Portfolio Manager for and on behalf of the Client pursuant to the Agreement and includes any further monies placed by the Client with the Portfolio Manager to be managed pursuant to the Agreement, the proceeds of the sale or realization of the Portfolio and any interest, dividend or other monies arising from the Assets, so long as the same is being managed by the Portfolio Manager.

"Investment Advisory Services Agreement" means the investment advisory services agreement entered into between a Client and the Portfolio Manager pursuant to which the Portfolio Manager has agreed to provide Investment Advisory Services to the Client. 6

Investment Advisory Services" means the non-exclusive, non-binding investment advice to be rendered to a Client by the Portfolio Manager on the terms and conditions pursuant to the Investment Advisory Services Agreement. Investment advisory services include services pertaining to advising clients on any or all of the following types of assets: "securities" as defined under the Securities Contracts (Regulation) Act, 1956; (ii) shares, Scrips, stocks, bonds, warrants, convertible and non-convertible debentures, fixed return investments, equity linked instruments, negotiable instruments, deposits including Fixed Deposits with scheduled commercial banks, money market instruments, commercial papers, certificates of deposit, units issued by the Unit Trust of India and/or by mutual funds, mortgage backed or other asset backed securities, derivatives, derivative instruments, options, futures, currency future, foreign currency commitments, hedges, swaps or netting off arrangements, venture capital funds, private equity fund and art funds, any other securities issued by any company or other body corporate, any trust, any entity, the Central Government, any State Government or any local or statutory authority and all rights or properties that may at any time be offered or accrue (whether by rights, bonus, redemption, preference, option or otherwise) and any other instrument of similar nature listed on a stock exchange regulated by SEBI or unlisted security of like nature and whether in physical or dematerialized form in respect of any of the foregoing or evidencing or representing rights or interest therein; (iii) precious metals, non-precious metals, commodities, structured products, alternative investments, time deposits, futures, traded options; and (iv) any other instruments or investments (including borrowing or lending of securities, subject to the terms and conditions of the Agreement) as may be permitted by applicable law/regulations from time to time.

"Investment Profiles" means the investment profiles as offered by the Portfolio Manager from time to time as described in the Agreement.

"Net Asset Value" or "NAV" means the market value of the Assets managed by the Portfolio Manager, as calculated by the Portfolio Manager from time to time, depending on the Investment Profiles chosen by the Client.

"Non-Discretionary Portfolio Management Services Agreement" means the non-discretionary portfolio management services agreement entered into between a Client and the Portfolio Manager pursuant to which the Portfolio Manager has agreed to provide Non-Discretionary Portfolio Management Services to the Client.

"Non-Discretionary Portfolio Management Services" means the non-discretionary portfolio management services to be rendered to a Client by the Portfolio Manager on the terms and conditions pursuant to the Non-Discretionary Portfolio Management Services Agreement, where under the Portfolio Manager renders investment advice to the Client in relation to the investment and management of the Assets of the Client, and based on the instructions of the Client, the Portfolio Manager invests and manages the Assets of the Client.

"Portfolio Management Services" means the Discretionary Portfolio Management Services, and/or the Non-Discretionary Portfolio Management Services, and/or the Investment Advisory Services, as the case may be.

"Portfolio" means the Securities managed by the Portfolio Manager for and on behalf of the Client, pursuant to an Agreement, and includes any further Securities placed by the Client with the Portfolio Manager to be managed pursuant to an Agreement, including Securities acquired by the Portfolio Manager through investment of Funds and/ or pursuant to the issue of any bonus and rights shares in respect of the Securities forming a part of the Portfolio, so long as the same are being managed by the Portfolio Manager.

"Regulations" means the Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993, including any circulars, directions or clarifications issued by SEBI and/or any government authority and as applicable to the Portfolio Manager.

"SEBI" means Securities and Exchange Board of India established under sub-section (1) of Section 3 of the Securities and Exchange Board of India Act, 1992.

"Securities" means and includes (i) "securities" as defined under the Securities Contracts (Regulation) Act, 1956; (ii) shares, Scrips, stocks, bonds, warrants, convertible and non-convertible debentures, fixed return investments, equity linked instruments, negotiable instruments, deposits including Fixed Deposits with scheduled commercial banks, money market instruments, commercial papers, certificates of deposit, units issued by the Unit Trust of India and/or by mutual funds, mortgage backed or other asset backed securities, derivatives, derivative instruments, options, futures, currency future, foreign currency commitments, hedges, swaps or netting off arrangements, units issued by venture capital funds, private equity fund and any other securities issued by any company or other body corporate, any trust, any entity, the Central Government, any State Government or any local or statutory authority and all rights or properties that may at any time be offered or accrue (whether by rights, bonus, redemption, preference, option or otherwise) and any other instrument of similar nature listed on a stock exchange regulated by SEBI or unlisted security of like nature and whether in physical or dematerialized form in respect of any of the foregoing or evidencing or representing rights or interest therein; (iii) precious metals, non-precious metals, commodities, structured products, alternative investments, time deposits, futures, traded options; and (iv) any other instruments or investments (including borrowing or lending of securities, subject to the terms and conditions of the Agreement) as may be permitted by applicable law/regulations from time to time.

Any references to laws and regulations in this Document shall be deemed to include such laws and regulations as may be amended, revised, updated and/or supplemented from time to time. Words importing the singular include the plural and vice-versa. Words importing a gender include the other gender.

SECTION III

DESCRIPTION OF THE PORTFOLIO MANAGER

1. HISTORY, PRESENT BUSINESS & BACKGROUND OF THE PORTFOLIO MANAGER

   a) The Portfolio Manager was incorporated in Mumbai, India on 10 December 1996.

   b) The Portfolio Manager is registered as a member of the National Stock Exchange Of India Limited bearing SEBI Registration No. INBxxxxx and INF xxxxxxx for the capital market (equity) and futures and options segment respectively and the Bombay Stock Exchange Limited bearing SEBI Registration No. INB xxxxxx and INF xxxxxxx for the capital market (equity) and futures and options segment respectively. On February XX, 200X, the Portfolio Manager acquired the clearing membership (no. INF230xxxxxx) of the futures & options/derivative segment of the National Stock Exchange of India limited (NSE).

   c) The Portfolio Manager is registered with SEBI as a merchant banker and is permitted to undertake both merchant banking and underwriting activities. The merchant banking registration number of the Portfolio Manager is INM 0000xxxxx.

   d) The Portfolio Manager is registered with SEBI as a Portfolio Manager under the portfolio management services licence.

   xyz India is part of the XYZ AG and is an indirect subsidiary of XYZ AG.

   XYZ AG

   XYZ AG is one of the world's leading financial services providers and is part of the XYZ group of companies (referred to here as 'XYZ'). As an integrated bank, XYZ offers clients its combined expertise in the areas of private banking, investment banking and asset management. XYZ provides advisory services, comprehensive solutions and innovative products to companies, institutional clients and high-net-worth private clients globally, as well as to retail clients in Switzerland. XYZ is headquartered in ________ and operates in over __ countries worldwide. The group employs approximately _______ people. The registered shares (xyzw) of XYZ's parent company, XYZ Group AG, are listed in ____________ and, in the form of American Depositary Shares (__), in New York. Further information about XYZ can be found at www.XXXXX.com.

PRIVATE BANKING

In Private Banking, we offer comprehensive advice and a broad range of financial solutions to private, corporate and institutional clients. Private Banking comprises the Wealth Management Clients and Corporate & Institutional Clients businesses. In Wealth Management Clients, we serve more than two million clients, including ultra-high-net-worth and high-net-worth individuals around the globe and private clients in ________, making us one of the largest global players. Our network comprises ___ office locations in __ countries. Our Corporate & Institutional Clients business serves the needs of over 100,000 corporations and institutions, mainly in _________, and is an important provider of financial products and services.

Investment Banking

Investment Banking provides a broad range of financial products and services, with a focus on businesses that are client-driven, flow-based and capital-efficient. Our products and services include global securities sales, trading and execution, prime brokerage, capital raising and advisory services, as well as comprehensive investment research. Our clients include corporations, governments, pension funds and institutions around the world. We deliver our global investment banking capabilities via regional and local teams based in all major developed and emerging market centers. Our integrated business model enables us to gain a deeper understanding of our clients and deliver creative, high-value, customized solutions based on expertise from across XYZ.

Asset Management

Asset Management offers products across a wide range of asset classes, including alternative investments such as hedge funds, private equity, real estate and credit, and multi-asset class solutions, which includes equities and fixed income products. The division manages portfolios, mutual funds and other investment vehicles for governments, institutions, corporations and private clients worldwide. With offices in __ countries, we collaborate with clients to develop and deliver innovative investment products and solutions to meet their specific needs. Asset Management operates as a global integrated network in close collaboration with Private Banking and Investment Banking.

2. PROMOTERS OF THE PORTFOLIO MANAGER

XYZ Investment Holdings (Mauritius) Limited ("Promoter") is incorporated in Mauritius having its registered office at c/o ABCD Services Limited, RST louis, Mauritius and is a wholly owned subsidiary of XYZ AG, a joint corporation registered in the ____________________

The Promoter is ultimately owned by XYZ Group AG, a corporation with its registered office in ____________and a leading global financial services provider with operations, subsidiaries and affiliates in the European, the Americas and the Asia Pacific regions.

SHARE HOLDING PATTERN of XYZ SECURITIES (INDIA) PVT. LTD.

As on 31/JUL/2012

EQUITY: Sr No.	Name	Number of shares held	Face value per share (Rs.)	Amt Paid up (Rs. In lakh)	% of total
1	XYZ Investment Holdings (Mauritius) Limited (IHM)	221,476,244	10	22147.6244	100.00
2	XYZ (Holdings) Hong Kong Limited^ (^(as nominee for and on behalf of IHM)	1	10	0.0001	0.00
TOTAL		221,476,245		22147.6245	100%

4. GROUP COMPANIES

The XYZ Group AG has a significant number of group/ subsidiary and associate companies domiciled in numerous overseas jurisdictions. Disclosure on group companies of the Portfolio Manager is limited to the companies domiciled in India as listed below and which are part of XYZ Group AG.

1 XYZ Services (India) Private Limited

2 XYZ Consulting (India) Private Limited

3 XYZ Finance (India) Private Limited

4 XYZ Business Analytics (India) Private Limited

5 XYZ AG, Mumbai Branch

6 XYZ Business Management (India) Private Limited

5. DETAILS OF THE SERVICES BEING OFFERED

At present the Portfolio Manager is offering the following services:

(a) Discretionary Portfolio Management Services;

(b) Non-Discretionary Portfolio Management Services; and

(c) Investment Advisory Services.

SECTION IV

DETAILS OF PENALTIES/PENDING LITIGATION

SEBI has taken the following action against XYZ Securities (India) Private Limited (xyzwPL) in the capacity of a stock broker:

- Interim order dated April 00, 200X debarring the XYZWPL from undertaking any new business as a stock broker until further orders were passed by SEBI.
- Order dated June 00, 200X bearing reference IES/IXX/ RXX/2002 suspending XYZWPL’s broking operations for a period of two years.
- Order dated December 00, 200X bearing reference IVD/IXX/ RXX/XXXX/200X issuing a warning to XYZWPL with regard to its proprietary transactions in a variety of stocks.
- Order dated March 00, 200X bearing reference ISD-X/RM/ XXXX/200X with regard to transactions in the shares of AAA

LTD suspending XYZWPL's broking operations for a period of one month from March 00.

1. SERVICES OFFERED

(a) Discretionary portfolio management services to be rendered to a Client by the Portfolio Manager pursuant to the terms and conditions contained in the Discretionary Portfolio Management Services Agreement, where under the Portfolio Manager exercises absolute and unfettered discretion, with regards to the investment and management of the Assets of a Client.

(b) Non-discretionary portfolio management services to be rendered to a Client by the Portfolio Manager pursuant to the terms and conditions contained in the Non-Discretionary Portfolio Management Services Agreement, where under the Portfolio Manager renders investment advice to a Client in relation to the investment and management of the Assets of such Client, and based on the instructions of the Client, the Portfolio Manager invests and manages the Assets of the Client.

The Portfolio Manager may from time to time, at a Client's instruction, refer a Client over to external portfolio managers. For the avoidance of doubt, all such referrals by the Portfolio Manager to external portfolio managers and any subsequent investments into the financial products and services by a Client with the external portfolio managers are conducted solely at the Client's absolute discretion. Such referrals by the Portfolio Manager are not to be construed as a solicitation and/or an offer to buy or sell any security or other financial instrument and is not based on any legal, accounting and/or tax advice offered by the Portfolio Manager. The Client would also consult with such advisor(s) as the Client considers necessary before making any investment decisions with any referred external portfolio managers.

(c) The Portfolio Manager shall purchase, sell or otherwise deal in Securities for and on behalf of the Client through its broker dealer division (details of registration of the same are as mentioned in Section III above), which shall be entitled to charge brokerage in respect of such transactions. The Portfolio Manager may also purchase Securities from time to time for and on behalf of the Client, which Securities may also be sold by the clients of the broker dealer division of the Portfolio Manager (as mentioned in Section III above).

(d) Non-exclusive, non-binding investment advisory services to be rendered to a Client by the Portfolio Manager pursuant to the terms and conditions contained in the Investment Advisory Services Agreement.

2. INVESTMENT PROFILES AND INVESTMENT OBJECTIVES

(a) **India Developing Equities**: This is an actively managed equities based discretionary mandate investing primarily in the Indian equities markets. The asset allocation is composed of liquidity and money market instruments, equities, and derivatives. Derivatives are used only for the purpose of hedging and portfolio rebalancing through the use of index futures. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/ SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates.

Investment objective: The aim of the India Classic Equities discretionary mandate is to offer long-term capital growth through greater emphasis on capital gains. The portfolio is expected to have a high risk tolerance and greater fluctuations of asset value.

(b) **India Classic Balanced**: This is an actively managed discretionary mandate which offers a mix of both Indian equities and fixed income securities. The asset allocation is composed of liquidity and money market instruments, fixed income securities, equities, and derivatives. Derivatives are used only for the purpose of hedging and portfolio rebalancing through the use of index futures. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates.

Investment objective: The aim of the India Classic Balanced discretionary mandate is to offer real-term capital preservation and long-term capital growth though steady income and capital gains. The portfolio is expected to have average risk tolerance and fluctuation of asset value.

(c) **India Funds Equities**: This is an actively managed discretionary mandate composed of various Indian mutual funds. The asset allocation is composed of liquidity and money market funds, fixed income funds, and equities funds, with a greater emphasis on equities funds. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates.

Investment objective: The aim of the India Funds Equities discretionary mandate is to offer long-term capital growth through investments in line with client expectations. The portfolio is expected to have a higher risk tolerance and greater fluctuations of asset value.

(d) **India Equity Balanced**: This is an actively managed discretionary mandate composed of various Indian mutual funds. The asset allocation is composed of liquidity and money market funds, fixed income funds, and equities funds, with a greater emphasis on a balanced mix of fixed income and equities funds. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates

Investment objective: The aim of the India Funds Balanced discretionary mandate is to offer capital preservation with recurring interest income and long-term capital growth through steady income. This portfolio is expected to have average risk tolerance and fluctuation of asset value.

(e) **Funds Fixed Income**: This is an actively managed discretionary mandate composed of various Indian mutual funds. The asset allocation is composed of liquidity, money market funds, short term and long term corporate debt and Government Securities Funds. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates

Investment objective: The aim of India Funds Fixed Income discretionary mandate is to offer capital preservation with recurring interest income. The portfolio is expected to have low to moderate risk tolerance and fluctuation of asset value.

(f) **India Growth Equities**: This is an actively managed equities based discretionary mandate investing primarily in the Indian equities markets. The portfolio will take an exposure to equities across the capitalization range, including mid and small cap stocks. The asset allocation is composed of liquidity and money market instruments, equities, and derivatives. Derivatives are used only for the purpose of hedging and portfolio rebalancing through the use of index futures. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates

Investment objective: The aim of the India Opportunities Equities discretionary mandate is to offer long-term capital growth through greater emphasis on capital gains. The portfolio is expected to have a high risk tolerance and greater fluctuations of asset value. Furthermore, given the greater allocation to mid and small cap stocks the portfolio is likely to carry a higher degree of risk as compared to investments in “India XXXXXX”.

(g) **India EQDT Funds**: This is an actively managed discretionary mandate composed of various Indian mutual funds. The asset allocation is composed of liquidity and money market funds, and equities funds, with a greater emphasis on equities funds. The portfolio will take an exposure to equity funds across the capitalization range, including mid and small cap funds. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates

Investment objective: The aim of the India Opportunities Funds discretionary mandate is to offer long-term capital growth through investments in line with client expectations. The portfolio is expected to have a higher risk tolerance and greater fluctuations of asset value. Furthermore, given the greater allocation to mid and small cap funds the portfolio is likely to carry a higher degree of risk as compared to investments in “India XXXX Funds “.

(h) **Premium Mandate**: This is an actively managed, tailor made discretionary mandate customized to the client’s requests. Asset allocation provision and client restrictions can be incorporated to such a mandate. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2,500,000 will be computed at client level aggregating investments across different mandates

Investment objective: The aim of the premium mandate is to offer returns in line with client expectations.

(i) **Sectoral Portfolio of ETFs - XYZ**: Is an actively managed discretionary mandate investing primarily in Exchange Traded Funds (ETFs) trading on the Indian Exchanges. The asset allocation is composed of liquidity and money market instruments, ETFs and derivatives.

Derivatives are used only for the purpose of hedging and portfolio rebalancing through the use of index futures. The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates

Investment objective: The objective of the Sectoral Portfolio of ETFs is to outperform the equity markets through superior sector selection. Sector exposure shall be provided through investment corresponding sector ETF. Using the Core/ Satellite approach to investing, the Portfolio Manager shall ensure strategic exposure to equity markets, and attempt outperformance through tactical sector rebalancing.

(j) **India Debt Portfolio XYZ – Structured Products**

Investment Objective: The objective of this product is to deploy funds in various debt securities i.e. Debentures, Non convertible debentures, Bonds, Government Securities, Mutual Funds, etc. The Portfolio Manager may launch different series under this product.

Asset Allocation

Debt allocation will be between 80% - 100% of the Portfolio. The products launched may have a combination of various kinds of Debt securities i.e. Debentures, Non convertible debentures, Bonds, Government Securities, Mutual Funds, etc. The balance idle cash will be invested either in debt, liquid mutual funds or short term instruments. Investment in such securities can be between 0% to -20% of the portfolio.

Investment Style

For this discretionary mandate, Portfolio Manager would undertake investment in various debt securities. These investments will be reviewed on a periodic basis. Allocation to various debt securities including liquid will be up to 100%. 18

Working of Debt Portfolios - Structured Products

This mandate will invest in various debt and liquid securities, i.e. call money instruments, MIBOR linked securities, government securities, corporate debentures, Non convertible debentures, bonds, etc. Debt Portfolio-Structured Products will invest in Non Convertible debentures that may be linked to performance of Equity markets (such as Index, Basket of stocks) or Interest rates or commodities.. This in turn imply that payments to investors will not be fixed, and could be linked to one or more external variables such as commodity prices, equity indices, basket of stocks or interest rates. This could result in variability in payments—including possible material loss of principal because of adverse movement in value of the external variables.

Funds may be invested in liquid schemes or short term paper, till deployment is pending in various debt securities.

Other Features

The minimum investment threshold is INR 2,500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates. The Portfolio Manager will provide periodical reports as required under the Regulations.

The Client may withdraw whole or part of the funds or securities from the Portfolio Account by giving advance notice and the Portfolio Manager will endeavor to liquidate the securities and return the funds to the Client within reasonable time. In case the Portfolio Manager is not able to sell the securities, the Portfolio Manager has the discretion to return the securities to the Client.

(k) **Indian Consumer- XXXX**

This is an actively managed equities based discretionary mandate investing primarily in the Indian equities markets. The portfolio will take an exposure to equities across the capitalization range, including mid and small cap stocks. The asset allocation is composed of liquidity and money market instruments, equities, and derivatives. Derivatives are used only for the purpose of hedging and portfolio rebalancing through the use of index futures. The minimum investment threshold is INR 2'500'000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2'500'000 will be computed at client level aggregating investments across different mandates

Investment objective: the aim of the India Consumer Megatrend discretionary mandate is to offer long-term capital growth through greater emphasis on capital gains. The portfolio will invest primarily in sectors which are direct or indirect beneficiaries of the rising demographic dividend being experienced by the Indian economy in its growth trajectory. The demographic dividend is a set of certain factors like increasing participation of younger workforce, increasing urbanization and increasing discretionary spend to name a few.

The portfolio is expected to have a high risk tolerance and greater fluctuations of asset value. Furthermore, given the greater allocation to mid and small cap stocks the portfolio is likely to carry a higher degree of risk as compared to investments in "XXXX Equities"/other equity mandate offered by the Portfolio Manager as detailed above.

(l) **India Fixed Income Fund**

Investment Objective and Benchmarks: The objective of this product is to generate total return through coupon inflows and Capital Gains by deploying funds in a range of debt instruments comprising but not limited to Commercial papers, Certificates of deposits, Debentures, Bonds, Government Securities, Money market/Bond/Gilt Mutual Funds, etc. The portfolio benchmarks will be decided based on the risk profile of the specific portfolios spread across the risk-return spectrum. The Portfolio Manager may launch different portfolios across the risk-return spectrum under this product.

Asset Allocation

Allocation to debt and debt related instruments will be up to 100% of the Portfolio. No exposure will be taken in equity and equity linked securities. The products launched may invest in a range of debt instruments comprising but not limited to Commercial paper, Certificates of deposits, Debentures, Bonds, Government Securities, Money market/Bond/Gilt Mutual Funds, etc.

Investment Style

For this discretionary mandate, Portfolio Manager would actively manage the investment in various debt securities based on yield, credit spreads, term structure, duration etc. These investments will be reviewed on a periodic basis and changes will be made based on the fundamental variables like Macro economic indicators, Fiscal Policy, Monetary Policy and technical variables like Demand/Supply of Bonds, Positioning of market participants etc.

Other Features

The minimum investment threshold is INR 2’500’000 or such higher amount as specified by the Portfolio Manager/SEBI from time to time. The investment threshold of INR 2’500’000 will be computed at client level aggregating investments across different mandates.

The Portfolio Manager will provide periodical reports as required under the Regulations.

The Client may withdraw whole or part of the funds or securities from the Portfolio Account by giving advance notice and the Portfolio Manager will endeavor to liquidate the securities and return the funds to the Client within reasonable time. In case the Portfolio Manager is not able to sell the securities, the Portfolio Manager has the discretion to return the securities to the Client. 20

3. **Types of Securities**

The Portfolio Manager shall invest in all types of Securities as defined herein (please refer to the definition).

4. **Investment in Group/Associate Companies**

At present, the Portfolio Manager is not proposing to have any investments in any associates/group companies.

SECTION VI

Risk Factors

1. **No Assurance of Guarantee**: Investments are subject to market and other risks and therefore the Portfolio Manager

does not give any guarantee regarding profit of its investments and/or the avoidance of losses.

2. **No Reliance on Past Performance**: Any past performance of the Portfolio Manager does not indicate and/or guarantee the future performance of the Portfolio Manager and/or the Investment Profiles offered by the Portfolio Manager. The Portfolio Manager has started its activities by mid 2008. A track record for discretionary portfolio clients is from January, 2009 onwards.

3. **Risk arising from the investment objective/investment strategy and asset allocation:**

   a. The liquidity of the Portfolio may be restricted by trading volumes and settlement periods. Different segments of the Indian financial markets have different settlement periods and such periods may be extended significantly by unforeseen circumstances. Delays and/or other problems in settlement of transactions could result in temporary periods when the Securities comprising the Portfolio are un-invested and no return is earned thereon. The inability of the Portfolio Manager to make intended Securities purchases due to settlement problems could cause the Portfolio to miss certain investment opportunities. Similarly, the inability to sell Securities held in the Portfolio due to the absence of a well developed and liquid secondary market for debt securities would result at times, in potential losses to the portfolio.

   b. Certain investment vehicles, in particular alternative investments instruments, can include Securities with a long-term investment horizon. The Securities comprising the portfolio may therefore be subject to lock-up periods or be redeemable only periodically or on certain dates, i.e. not be liquid at all times. In such cases, early redemption can result in a lower price and additional charges.

   c. The value of the portfolio, to the extent invested in fixed income securities, will be affected by changes in the general level of interest rates. When interest rates decline, the value of a portfolio containing fixed income securities can be expected to rise. Conversely, when interest rates rise, the value of a portfolio containing fixed income securities can be expected to decline.

d. As with any investment in Securities, the value of the portfolio could fluctuate depending on various factors that may affect the value of the Securities comprising the portfolio. In addition to the factors that affect the value of individual Securities, the value of the portfolio can be expected to fluctuate with movements in the broader equity and bond markets and may be influenced by factors affecting capital markets in general, such as, but not limited to, changes in interest rates, currency exchange rates, changes in governmental policies, taxation, political, economic or other developments and increased volatility in the stock and bond markets.

4. **Risk Arising out of Non Diversification**: The investment objectives of one or more of the Investment Profiles could result in concentration of a specific asset/asset class/sector/ issuer etc., which could expose the Assets to improper and/or undesired concentration of investment risks.

5. **Risk of Loss in Value of Investments**: The investment of the Assets and resultant investments are subject to a very wide range of risks which include, amongst others, and by way of illustration, loss in value of the investments due to, inter alia, overall economic slowdown, unanticipated bad corporate performance, environmental or political problems, changes in monetary or fiscal policies (including changes in tax laws and rates), changes in government policies and regulations with regards to industry and exports, acts of state, sovereign action, acts of God, acts of war, civil disturbance etc.

6. **Market Risk**: The value of the portfolio may increase or decrease depending upon varying market forces and factors affecting the capital markets such as the de-listing of Securities, market closure, relatively small number of Scrips accounting for large proportion of trading volume etc. The Clients could lose money over short periods due to the fluctuations in the value of the Portfolio in response to factors such as economic and political developments, changes in interest rates and perceived trends in stock market movements and over longer periods due to market downturns. Consequently, the Portfolio Manager makes no assurance of any guaranteed returns on the Assets.

7. **Asset Class Risk**: The returns from the types of Securities in which the Portfolio Manager invests may underperform when compared with returns in the general Securities market

or different asset classes. Different types of Securities tend to go through different cycles of out-performance and under-performance in comparison to the general securities market.

8. **Risks Associated with Overseas Investments**: Subject to necessary approvals as may be required, and within the Investment Profiles identified by the Client, the Portfolio Manager may invest in overseas markets in which investments therein are subject to a very wide range of risks, which include amongst others and by way of illustration, risks on account of fluctuations in foreign exchange rates, nature of the Securities market of the country concerned, repatriation of capital due to exchange controls, political circumstances etc. Further, before entering into any Agreement and/or making an investment, the Client should enquire about any rules and/or regulations relevant to the Client's Agreement and/or investment. It may be noted that the Client's local regulatory authority will be unable to compel the enforcement of rules of the regulatory authorities or markets in other jurisdictions where the Client's investments have been effected. The Client should enquire about the type of redress available in both the Client's home jurisdiction and other relevant jurisdictions before the Client enters into any Agreement.

9. **Risk of Insolvency**: Assets deposited by the Clients shall be subject to insolvency risks in relation to the Portfolio Manager, issuers, custodians, and other intermediaries. The extent to which a Client will be able to recover its/his/her Assets will depend upon local law, rules and regulations.

10. **No Liability**: The Portfolio Manager shall not be responsible or liable for any losses resulting from the operations of the Investment Profiles.

11. **Risks Associated with investments in Mutual Funds**: In the event that the Portfolio Manager invests the Assets of the Client in mutual funds registered with SEBI, scheme specific risk factors of such underlying schemes would be applicable to the Portfolio. All risks associated with such underlying schemes, including but not limited to performance of their underlying stocks, derivative instruments, stock-lending, off-shore investments etc., would therefore be applicable to the Assets. Clients are required to and deemed to have received, read and understood the risk factors of the underlying schemes. Risk factors inherent to equities and debt securities are also applicable to investments in mutual fund units.

In addition, events like change in the fund manager of a scheme, takeovers and mergers of mutual funds, foreclosure of schemes or plans, change in government policies etc., could affect the performance of investments in mutual fund units.

12. **Liquidity Risk**: Liquidity of investments in equity and equity related Securities are often restricted by factors such as trading volumes, settlement periods and transfer procedures. If a particular security does not have a market at the time of sale, then the Client may have to bear the impact depending on its/his/her exposure to that particular security. While Securities that are listed on a stock exchange generally carry a lower liquidity risk, the ability to sell these securities is limited by overall trading volume on the stock exchange. Money market securities, while fairly liquid, lack a well developed secondary market, which may restrict the selling ability of such securities thereby resulting in a loss to the Assets until such Securities are sold. Further, the liquidity and valuation of the Portfolio may be affected by the value of unlisted securities which are a part of the Portfolio, and specifically, by the sale of such securities prior to the target date of their disinvestment.

13. **Equity and Equity Related Risks**: Equity related securities carry both company specific and market risks and hence no assurance of returns can be made for investments made in such securities. While the Portfolio Manager shall take all reasonable steps to invest the funds in a prudent manner in such instruments, such decisions may not always prove to be profitable and/or correct. Consequently, the Client shall bear any loss arising from such decisions.

14. **Reinvestment Risk**: This risk arises from the uncertainty in the rate at which cash flows from an investment may be reinvested. This is because the returns from reinvestment would depend upon prevailing market rates at the time that the proceeds from an existing investment are received by the Portfolio Manager.

15. **Risk of Arbitrage Strategies**: The success of an Investment Profile depends on the Portfolio Manager’s ability to identify investment opportunities and to exploit price discrepancies in the capital and derivative markets. Identification and exploitation of the strategies to be pursued by the Portfolio Manager involves uncertainties. No assurance can be given that the Portfolio Manager will be able to locate investment

opportunities, or correctly exploit price discrepancies in the capital markets. A reduction in the pricing inefficiency of the markets in which the Portfolio Manager seeks to invest will reduce the scope for the Portfolio Manager's investment strategies. Also in the event that the perceived mispricing underlying the Investment Profile's position were to fail to converge towards or diverges further from relationships expected by the Portfolio Manager, the Investment Profile may incur a loss. Further, the Portfolio Manager's investment strategies may result in high portfolio turnover and consequently, high transaction cost.

16. **Stock Exchange Related Risks**: Indian stock exchanges have in the past experienced substantial fluctuations in the prices of their listed securities. They have also experienced problems such as temporary exchange closures, broker defaults, settlement delays and broker strikes that, if they occur again in the future, could affect the market price and liquidity of the securities in which the Funds are invested. In addition, the governing bodies of the various Indian stock exchanges have from time to time imposed restrictions on trading in certain Securities, limitations on price movements and margin requirements. Disputes have also occurred from time to time among listed companies, the stock exchanges and other regulatory bodies, and in some cases those disputes have had a negative effect on overall market sentiment. Recently, there have been delays and errors in share allotments relating to initial public offerings. In addition, SEBI has recently imposed heavy fines on market intermediaries in relation to manipulations by some investors of the allotment process in several recent initial public offerings with a view to cornering large allotments of shares in the "retail investor" category. Such events in turn may affect overall market sentiment and lead to fluctuations in the market prices of the Securities in which the Funds have been invested.

17. **Credit Risk**: Debt securities are subject to the risk of the issuer's inability to meet the principal and interest payments on the obligations and may also be subject to price volatility due to factors such as interest sensitivity, market perception, or the credit worthiness of the issuer and general market risk. The Portfolio Manager will endeavour to manage credit risk through in-house credit analysis. The Portfolio Manager may also use various hedging products from time to time to reduce the impact of undue market volatility on the portfolio.

18. **Risk of Indirect Investments**: The Client agrees and acknowledges that in implementing specific Investment Profiles, and if it considers this to be appropriate, the Portfolio Manager may replace direct investments almost completely by indirect investment instruments derived from direct investments and combinations thereof (e.g. certificates, structured products, managed investment schemes, and similar products, etc.). These indirect investment instruments are largely issued by financial institutions/corporates, which could lead to a concentration of the Client's Assets on these issuers and the financial sector in general.

    Structured product portfolio may have a fixed tenor. If investors seek liquidity before maturity, the Portfolio Manager will attempt to sell the security. However, there is no certainty that the security can be sold and in such cases, the Portfolio Manager will transfer the security to the investor. Any sale prior to maturity may result in capital loss. In case the Security is not listed/listed but illiquid, the buyer including the issuer may offer an unwind price which may be lower than the Face Value/Valuation Price of the Security. The Portfolio Manager although will attempt to assist the client to sale the security before maturity; but is not bound to interact with Issuer to offer an unwind price at all times or for all amounts.

19. **Transfer and Price Risk**: The Client stands a risk of loss due to lack of adequate external systems for transferring, pricing, accounting and safekeeping or record keeping of securities. Transfer risk may arise due to the process involved in registering securities, physical and demat, in the Portfolio Manager's name, while price risk may arise on account of the availability of the price of such securities from the relevant stock exchanges during the day and at the close of the day.

20. **Risks Associated with Derivatives**: Derivative products are specialized instruments that require investment technique and risk analysis different from those associated with stocks. The use of derivatives requires an understanding not only of the underlying instrument but also of the derivative itself. Derivatives require the maintenance of adequate controls to monitor the transactions entered into, the ability to assess the risk that a derivative adds to the Assets and the ability to forecast price. There is a possibility that loss may be sustained by the Client as a result of the failure of another party (usually referred as the counterparty) to comply with the terms of the derivative contract. Other risks in using

derivatives include but are not limited to (a) credit risk - this occurs when a counterparty defaults on a transaction before settlement and therefore, the Portfolio Manager is compelled to negotiate with another counterparty, at the then prevailing (possibly unfavorable) market price, in order to maintain the validity of a hedge. For exchange traded derivatives, the risk is mitigated as the stock exchange provides the guaranteed settlement but the Client would still be subject to the performance risk on the relevant stock exchange; (b) market liquidity risk - where the derivatives cannot be sold (unwound) at prices that reflect the underlying assets, rates and indices; (c) model risk - the risk of mispricing or improper valuation of derivatives; (d) basis risk - arises when the instrument used as a hedge does not match the movement in the instrument/ underlying asset being hedged.

The risks may also be inter-related. For instance, interest rate movements can affect equity prices, which could influence specific issuer/industry assets. The risk of loss associated with futures contracts is potentially unlimited due to the low margin deposits required and the extremely high degree of leverage involved in futures pricing. As a result, a relatively small price movement in a derivative contract may result in an immediate and substantial loss or gain. There may be a cost attached to buying derivative instrument. Further there could be an element of settlement risk, which could be different from the risk in settling physical shares. The possible lack of a liquid secondary market for a derivatives contract may result in inability to close the derivatives positions prior to their maturity date. The cost of hedge can be higher than adverse impact of market movements. An exposure to derivatives can also limit the profits from a genuine investment transaction. Efficiency of the derivatives market depends on the development of a liquid and efficient market for underlying securities and also on the suitable and acceptable benchmarks. It may be noted that the Portfolio Manager will not use derivative instruments, options or swap agreements for speculative purposes or to leverage its net assets and will comply with the Regulations with regard to investments in derivatives.

21. **Macro Economic Risks**: Overall economic slowdown, unanticipated corporate performance, environmental or political problems, changes to monitory or fiscal policies, changes in government policies and regulations with regard to industry and exports may have direct or indirect impact on the investments, and consequently on the value of the Assets.

22. **Tax Risks**: Before deciding to avail of the Portfolio Management Services, the Client should understand the tax implications (including the implications of any applicable income tax, goods and service or value added taxes, stamp duties and other taxes) of acquiring entering into, holding and disposing of the relevant Assets. Different investments made by the Portfolio Manager may have different tax implications. The tax implications of any investment are dependent upon the nature of the Client's business activities and the investment in question. The Client should, therefore, consult an independent tax advisor to understand the relevant tax considerations of availing of the Portfolio Management Services.

23. **Risk of Conflicts**: The Portfolio Manager is part of a large international financial group and acts simultaneously for a large number of Clients, as well as for its own account. Accordingly, conflicts of interest cannot be completely avoided. Accordingly, the Client acknowledges that the Portfolio Manager and its affiliates may (subject to applicable laws and regulations): (a) be the issuer of any investments; (b) combine the Client's orders with its/their own orders or the orders of other Clients; (c) make investments or effect transactions for the Client through the agency of and/or with a counterparty which is a related organization or a person otherwise associated with it/them; (d) have a position or a direct or indirect interest in any investments or transaction even if the position is opposite to that taken by the Client; (e) have bought or sold any investments or entered into any transactions as principal or for its/their other Clients; or (f) have other banking, advisory or any other corporate relationships with companies whose investments are held for Client's account or are purchased and sold for the Client and its/their officers and directors may be officers and directors of such companies. The Portfolio Manager and its affiliates shall not be liable to account or specifically disclose to the Client any profit, charge or remuneration made or received from any such transaction or other connected transactions. The Portfolio Management Services provided by the Portfolio Manager to the Client are non-exclusive and the Portfolio Manager shall be under no obligation to account to the Client for any benefit received for providing services to others or to disclose to the Client any fact or thing which may come to the notice of the Portfolio Manager in the course of

providing services to others or in any other capacity or in any manner whatsoever otherwise than in the course of providing the Portfolio Management Services to the Client pursuant to any Agreement.

24. **Transaction Cost**: Before entering into an Agreement and/or making any transaction or investment, the Client should obtain a clear explanation of all commissions, fees and other charges for which the Client will be liable. The Client's net returns from any investment would also be affected by the transaction costs (i.e. commission, fees and other charges) charged by the Portfolio Manager and/or third parties and any relevant tax liabilities. These costs must be considered in any risk assessment made by the Client. In some cases, managed accounts may be subject to substantial charges for management and advisory fees. It may be necessary for those accounts that are subject to these charges to make substantial trading profits to avoid depletion or exhaustion of their Assets.

25. **Risk of Emerging Markets Investments**: Emerging Markets are located in countries that possess one or more of the following characteristics: A certain degree of political instability, relatively unpredictable financial markets and economic growth patterns, a financial market that is still at the development stage or a weak economy. Emerging markets investments usually result in higher risks such as: political risks, economical risks, credit risks, exchange rate risks, market liquidity risks, legal risks, settlement risks, market risks, shareholder risk and creditor risk.

26. **General Risk**: The Client understands and accepts the risk of total loss of value of its Assets or recovery thereof only through an expensive legal process due to factors which by way of illustration include default or non performance of a third party, a company's refusal to register a Security due to legal stay or otherwise, disputes raised by third parties etc.

27. **Specific Risk Factors Pertaining to Structured Products:**

    Debt Portfolio: Structured Products will invest in Non Convertible debentures that may be linked to performance of equity markets or Interest rates or commodities. In case of equity linked debentures, such debentures are subject to risks applicable to debt and equity securities. The value of these debentures would vary depending on the volatility of stock prices/indices; interest rates and the credit risk profile of the issuer(s). In addition, the liquidity of these securities could be limited as there is currently no well developed secondary market in India for hybrid instruments. This in turn imply that payments to investors will not be fixed, and could be linked to one or more external variables such as commodity prices, equity indices, or interest rates. This could result in variability in payments—including possible material loss of principal—because of adverse movement in value of the external variables.

28. Specific Risk Factors Pertaining to Small and Mid-cap Stocks:

The small and mid cap stocks could be more volatile as compared to large cap stocks. Thus the risks associated with investing in such stocks could be relatively higher. The reasons for the greater price volatility in case of small cap stocks are the less certain growth prospects of small cap companies, the lower degree of liquidity in the markets for such securities, and the greater sensitivity of small cap stocks to changing economic conditions. Further, the small and mid cap stocks also carry relatively higher liquidity risk compared to the large cap stocks, as the ability to sell is limited by overall trading volume in the securities.

The volatility of medium/small-capitalization stocks may be higher in comparison to liquid large capitalization stocks. Trading volumes, settlement periods and transfer procedures may restrict the liquidity of these investments. Different segments of financial markets have different settlement periods and such periods may be extended significantly by unforeseen circumstances.

The inability to make intended securities' purchases due to settlement problems could cause this mandate to miss certain investment opportunities. The mid and small cap stocks carries higher liquidity risk as they are less extensively researched compared to large cap stocks. This may lead to abnormal illiquidity and consequent higher impact cost.

The small cap stocks are generally illiquid in terms of trading volumes on stock markets. Investors therefore should assume that illiquidity risks are higher in these securities than in a normally blue chip stocks. This may result in higher impact costs. Impact costs are those costs that are incurred for acquiring and disposing off the stocks. These are different from 28 brokerage and custodian charges. While smaller size companies may offer substantial opportunities for capital appreciation, they also involve substantial risks. Historically, these companies have been more volatile in price than larger company securities, especially over the short term. Among the reasons for the greater price volatility are the less certain growth prospects of smaller companies, the lower degree of liquidity in the markets for such securities, and the greater sensitivity of smaller companies to changing economic conditions. Smaller Companies carries large amount of liquidity risk compared to the Large Cap companies, as the ability to sell is limited by overall trading volume in the securities, which it invests. In addition, smaller companies may lack depth of management, be unable to generate funds necessary for growth or development, or be developing or marketing new products or services for which markets are not yet established and may never become established. They could also suffer from disadvantages such as outdated technologies, lack of bargaining power with suppliers, low entry barriers and inadequate management depth. Overall, the risks of investing in small companies are (a) transparency/liquidity levels may not be on par with established, large companies; (b) corporate governance may be an issue with some companies; and (c) they may not be resilient enough to withstand shocks of business/economic cycles.

SECTION VII

CLIENT REPRESENTATION & FINANCIAL PERFORMANCE

1. CLIENT REPRESENTATION

Category of clients	No. of clients (As of Mar 31, 2010)	Funds managed (Rs. cr) (As of Mar 31, 2010)	No. of clients (As of Mar 31, 2011)	Funds managed (Rs. cr) (As of Mar 31, 2011)	No. of clients (As of Mar 31, 2012)	Funds managed (Rs. cr) (As of March 31, 2012)	No. of clients (As of August 31, 2012)	Funds managed (Rs. cr) (As of August 31, 2012)
Associates/ group companies (Last 3 years)								
Discretionary	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Non-discretionary	Nil	Nil	Nil	Nil	Nil	Nil	Nil	Nil
Others (last 3 years)								
Discretionary								
Non-discretionary								
Total								

2. TRANSACTIONS WITH RELATED PARTIES

(a) Ultimate Holding Company: XYZ Group AG

(b) Holding Company: XYZ Investment Holdings (Mauritius) Limited (CIHM)

(b) Other related parties with whom transactions have taken place:

Fellow Subsidiary companies: 1	XYZ Finance (India) Private Limited (CSFIPL)	11	XYZ Securities (Japan) Ltd. (CSSJL)
2	XYZ Business Analytics (India)	12	XYZ Principal Investments Ltd.

(c) Details of Transactions:

Broking commission income

Reimbursement of expenses

Recoveries of expenses

Fees for service rendered