

## Innovative Investment Avenues: A Spotlight on NFOs

A new fund offer (NFO) is the initial sale of fund shares issued by an investment firm to potential investors, similar to an initial public offering (IPO) in the stock market. NFOs aim to raise capital for the fund and attract investors, offering potential for substantial gains postlaunch. Mutual funds, open-end and closed end, as well as exchange traded funds (ETFs), are common types of NFOs



### WHO LAUNCHES NFO IN INDIA?

In India, New Fund Offers (NFOs) are launched by **Asset Management Companies (AMCs) or mutual fund houses**. The primary purpose of an NFO is to introduce a **new mutual fund scheme** to the market, allowing investors to participate in the fund's inception.

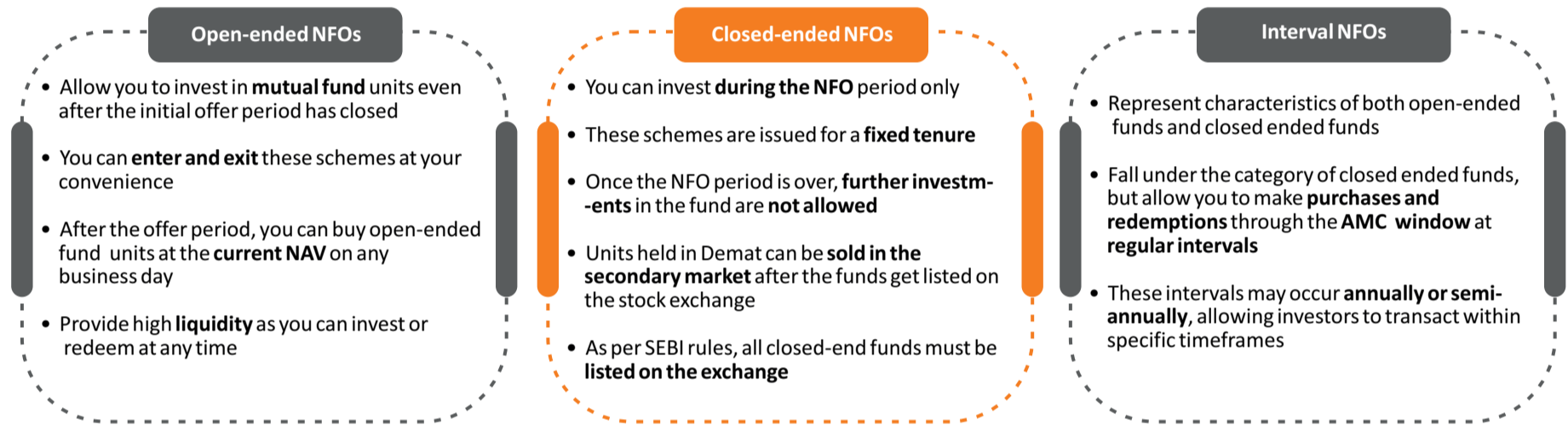
During an NFO, the fund house invites investors to subscribe to the units of the new scheme at an **initial offer price**, typically set at Rs. 10 per unit. The NFO period has a **fixed subscription duration**, after which the fund is officially launched, and investors can buy or sell units at the prevailing **Net Asset Value (NAV)** on stock exchanges.

These are often launched by **AMCs** fill gaps in their fund offerings or introduce innovative investment themes and strategies to the market. They provide an opportunity for investors to enter a new fund early with a low initial investment.

It is noteworthy that NFOs are different from Initial Public Offerings (IPOs) launched by companies. While IPOs aim to raise fresh funds for the company or allow promoters to **offload their stake**, NFOs are solely for **raising funds** for the new mutual fund scheme.

### WHAT ARE THE TYPES OF NFO AVAILABLE IN INDIA?

There are three main types of NFOs (New Fund Offers) in India based on the structure and features of the mutual fund schemes:



Interval funds blend features of both open ended and closed ended funds, operating as closed end funds but permitting investors to buy and sell through the asset management company's designated windows at set intervals, which could be either annually or semi-annually, enabling transactions within predefined time frames.

### HOW DOES A NFO WORK IN INDIA?

The NFO procedure involves the following steps:

#### Scheme Announcement

When an **Asset Management Company (AMC)** wants to launch a new mutual fund scheme, it announces the details of the scheme to potential investors. This announcement includes information about the scheme's **investment objective, asset allocation, fund manager, benchmark index**, and other key features. The AMC also provides the scheme's information document, which outlines the risks, costs, and other important aspects of the fund.

#### NFO Period

The NFO period is the fixed subscription period during which investors can invest in the new scheme. This period typically ranges from **15 to 30 days**, depending on the AMC's discretion and market conditions. During the NFO period, investors can place their orders to **subscribe** to the scheme through various channels, such as **online investment platforms, brokers, or directly through the fund house's online or offline modes**.

During the NFO, the units of the new scheme are usually offered at a **fixed price of INR 10 per unit**, irrespective of the underlying net asset value (NAV) of the portfolio. This pricing is done to ensure fairness and accessibility for all investors, as the actual **NAV** may not be known at the time of launch.

#### Pricing

The AMC sets a minimum investment amount for investors to participate in the NFO. This minimum investment is commonly **INR 5,000** or more, depending on the scheme's features and the AMC's policies. Investors must invest at least this minimum amount to be eligible for allotment of units.

#### Minimum Investment

### After NFO closes:

#### Allotment of Units

After the NFO period ends, the mutual fund company **allots the units** to the investors who subscribed during the NFO. This allotment is typically done within **5 business days** of the NFO closure. The number of units allotted to each investor depends on the total amount invested and the final NAV of the scheme on the allotment date.

#### Refunds

If an investor's application during the NFO is **unsuccessful** due to reasons like incomplete KYC or **errors**, the fund house **promptly refunds** the application money. The refund is usually processed within the same **5-day** window as the unit allotment. The refund is made directly to the investor's bank account used for the NFO subscription.

#### Listing

Once the units are allotted, the new mutual fund scheme is **listed** on the stock exchanges. This allows investors to start **trading the units** on the exchanges. For **open-ended schemes**, the listing enables investors to buy and sell units at the prevailing NAV, while for closed-ended schemes, the listing allows investors to **trade the units on the exchange**.

#### NAV Calculation

After the listing, the **NAV** of the scheme is **calculated and published daily**, based on the **market value** of the **underlying securities** in the portfolio. The NAV reflects the **scheme's performance** and is used to determine the value of each unit held by investors. The AMC calculates and publishes the NAV daily, and investors can track the **scheme's performance** using this information.

#### Ongoing Subscriptions

For open-ended mutual fund schemes, investors can continue to **subscribe** to the units even after the **NFO period**. They can buy and sell the units at the prevailing NAV, which reflects the **scheme's performance**. The ongoing subscription allows investors to **enter the scheme at any time** and benefit from the fund's potential growth.

#### Closed-ended Schemes

For closed-ended mutual fund schemes, the NFO period is the only time when investors can subscribe to the units. After the NFO, the units are listed on the exchanges, and investors can trade them. Closed-ended schemes have a **fixed maturity period**, and investors can only exit the scheme by selling their units on the exchange or waiting for the **scheme to mature**.

By understanding these steps, investors can better navigate the NFO process and make informed decisions about investing in new mutual fund schemes.

## WHAT ARE THE MANDATORY SEBI GUIDELINES FOR NFO?

### Scheme Information Document (SID)

- o The mutual fund house must file a comprehensive Scheme Information Document (SID) with **SEBI** before launching an NFO.
- o The SID provides investors with crucial details about the new scheme, including its investment **objective, asset allocation, risk factors, fees and expenses, and performance history.**
- o SEBI scrutinizes the SID to ensure that all **material information** is disclosed to investors in a **clear and transparent** manner.

### Minimum Number of Investors

- o SEBI requires a minimum of 20 investors to subscribe to the NFO.
- o This **"20-investor rule"** is aimed at preventing concentration of investments in the hands of a few investors.

### Skin-in-the-Game

- o SEBI has recently increased the **"skin-in-the-game"** requirement for fund houses launching NFOs.
- o The **Asset Management Company (AMC)** must invest its own money in the scheme, with the minimum investment amount based on the **scheme's risk profile.**
- o For riskier schemes like equity funds, the AMC must invest a **higher proportion** of its own money in the NFO.
- o This **"skin-in-the-game"** rule aligns the interests of the fund house with that of the investors.

### Minimum Subscription

- o SEBI mandates a minimum subscription amount for NFOs - usually **INR 20 crores** for debt-oriented and balanced hybrid schemes, and at least **INR 10 crores** for other schemes.
- o If the minimum subscription is **not achieved** during the NFO period, the scheme will be automatically **wound up** and the money refunded to investors.
- o This rule ensures that only **viable schemes** with sufficient investor interest are launched.

### Maximum Holding Limit

- o SEBI also enforces the **"25% holding limit"** - no single investor can hold more than **25%** of the scheme's **total corpus.**
- o This rule promotes **wider participation** and **diversification** of investments in the scheme.
- o If the 25% holding limit is **breached**, the NFO will be automatically **wound up.**

### Ongoing Compliance

- o Even after the NFO, mutual funds must comply with the **"20-25 rule"** - maintaining a minimum of **20 investors** and ensuring no single investor holds **more than 25%** of the scheme's corpus.
- o SEBI monitors compliance with these guidelines on an **ongoing basis** to **protect the interests** of mutual fund investors.

## WHAT IS THE DURATION OF NFO?

The NFO period in India generally lasts for **15-30 days**, during which investors can subscribe to units of a new mutual fund scheme at the initial offer price, usually INR 10 per unit. SEBI regulations state that an NFO can remain active for up to 30 days, providing a limited window for investors to acquire units at the low subscription price before the fund is officially launched and traded based on its **Net Asset Value (NAV).** For **open-ended** mutual fund schemes, investors can purchase units even **after the NFO period**, while close-ended funds only allow unit purchases during the **specific NFO duration.**

## WHO SHOULD INVEST IN NFO?

### Risk-Tolerant

Investing in NFOs requires a **higher tolerance for risk**, as these funds lack a performance track record. Investors should be comfortable with the potential for short-term underperformance or even losses before the fund can potentially generate better returns over the long run. This risk tolerance is crucial, as the fund's success is not guaranteed.

### Portfolio Diversifiers

Investing in an NFO can provide diversification to an investor's portfolio by exposing them to **new investment strategies** or **asset classes.** This diversification can help reduce overall portfolio risk and potentially enhance returns through exposure to different market segments. Investors looking to broaden their exposure may find NFOs appealing.

### Manager-Focused

Some NFOs are managed by **experienced professionals** with a proven track record of generating consistent returns across market cycles. Investors who believe in the manager's expertise and ability to navigate market conditions may find NFOs managed by such professionals more attractive. This belief in the fund manager's skills is crucial, as the fund's success is closely tied to their performance.

### Informed Investors

Before investing in an NFO, investors should carefully **evaluate** how the fund aligns with their financial goals. The fund's investment **objective, underlying strategy, and risk profile** should be compatible with the investor's own goals and risk tolerance. Misalignment can lead to disappointment and potential losses in performance.

Thus, NFOs are most suitable for investors with a **higher risk appetite, longer investment horizons, and a desire to diversify or capitalize on emerging market trends.** Careful evaluation of the fund's merits and alignment with the investor's goals is crucial before investing in an NFO. **Regular monitoring and periodic rebalancing** are also important to manage the risks associated with these investments.

## HOW TO CHOOSE WHICH NFO IS BEST FOR INVEST?

Choosing the best New Fund Offer (NFO) to invest in requires a careful analysis of several factors. The following are the considerations that one should keep in mind before making any investment decision-

### • Understand the Investment Objective

#### o Read the Offer Document

The NFO's offer document outlines the fund's **investment objective, strategy, asset allocation, and risk factors.** Understand what the fund aims to achieve and whether it aligns with your own investment goals.

#### o Fund Type

Identify whether it's an **equity fund, debt fund, balanced fund, thematic fund, or any other type.** Choose the type that fits your risk appetite and investment horizon.

### • Analyse the Asset Management Company (AMC)

#### o Reputation and Track Record

Research the **AMC's reputation, history, and track record in managing funds.** An AMC with a strong performance history and good market standing is generally a safer bet.

#### o Fund Manager Expertise

Check the **experience and track record** of the fund manager. An experienced manager with a good performance history can be a significant advantage.

### • Evaluate the Fund's Strategy

#### o Investment Strategy

Understand the **fund's investment strategy.** This includes the sectors, industries, or themes the fund will focus on and the criteria for selecting investments.

#### o Differentiation

Determine what makes the NFO unique compared to existing funds. **Unique strategies or new market opportunities** can be advantageous, but they should be backed by thorough research and a sound rationale.

### • Consider the Costs

#### o Expense Ratio

Compare the expense ratio of the NFO with other existing funds. Lower costs can enhance net returns.

#### o Entry and Exit Loads:

Check for any entry or exit loads (fees) associated with buying or selling the fund units. Lower or no loads are preferable.





• **Assess Market Conditions and Timing**

o **Current Market Environment**

Evaluate the **market conditions** at the time of the NFO launch. Market trends, economic conditions, and sectoral performance can influence the fund's potential performance.

o **Investment Timing**

Consider whether the timing of the NFO fits well with your **own investment plan** and market outlook.

• **Look for Regulatory Compliance and Transparency**

o **Regulatory Adherence**

Ensure the NFO complies with **regulatory standards and guidelines** set by financial regulatory authorities.

o **Transparency**

Look for transparency in terms of **investment strategy, fees**, and reporting. Trustworthy AMCs provide clear and regular updates about their funds.

• **Check the Fund's Size and Liquidity**

o **AUM (Assets Under Management)**

While NFOs start with no assets, understanding the AMC's ability to attract investments can give you an idea of the fund's **potential size**.

o **Liquidity**

Ensure the fund's strategy allows for **adequate liquidity**, enabling you to buy and sell units without significant price impact.

• **Seek Expert Opinions and Ratings**

o **Financial Advisors**

Consult with financial advisors or investment professionals. Their expertise can provide **valuable insights** into the potential of the NFO.

o **Independent Ratings**

Check if the NFO has received any **ratings or reviews** from independent financial research firms. While ratings are not definitive, they can provide an additional layer of information.

• **Understand the Risk Factors**

o **Risk Assessment:**

Review the **risk factors** mentioned in the offer document. Understand the specific risks associated with the fund's strategy, sectors, or asset classes.

o **Your Risk Tolerance**

Ensure the fund's risk profile aligns with your own **risk tolerance** and investment objectives.

• **Review Peer Comparisons**

o **Benchmarking**

Compare the NFO with similar **existing funds and benchmarks**. Analyse how the NFO's strategy and potential returns stack up against peers and industry standards.

By thoroughly evaluating these factors, you can make a more informed decision about which NFO is best suited for your investment needs. It's crucial to balance potential rewards with the associated risks and ensure the NFO aligns with your overall investment strategy and financial goals.

## HOW CAN YOU INVEST IN NFO?

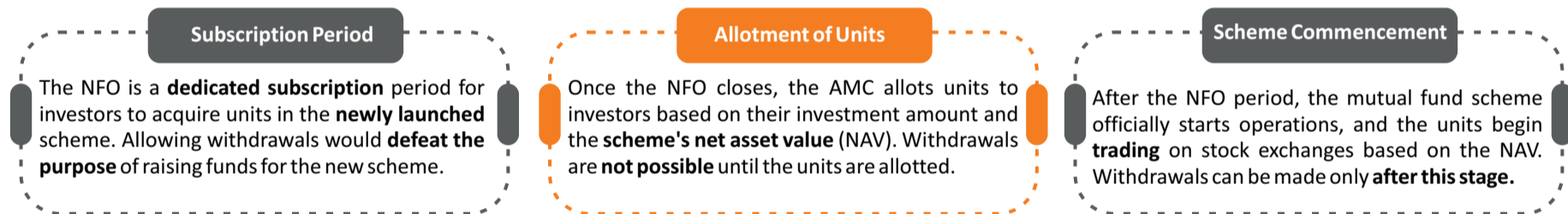
There are two main ways to invest in an NFO:

OFFLINE MODE	ONLINE MODE
<ul style="list-style-type: none"> <li>o Fill out a <b>physical application</b> form provided by the mutual fund house.</li> <li>o The form will include details like your <b>personal information, investment amount, and payment mode</b>.</li> <li>o You can submit the completed <b>form and payment</b> at the fund house's office or through an authorized broker.</li> <li>o If you already have a <b>folio number</b> with the fund house, you can simply provide that to complete the application.</li> </ul>	<ul style="list-style-type: none"> <li>o You can invest in the NFO <b>directly</b> through the <b>website or mobile app</b> of the mutual fund house.</li> <li>o First, ensure your <b>KYC</b> (Know Your Customer) is complete and up to date.</li> <li>o Log in to your online investment account or <b>register</b> for a new one.</li> <li>o Look for the NFO listing on the platform and <b>review</b> the details.</li> <li>o Enter the investment amount and complete the online application and <b>payment process</b>.</li> </ul>

## CAN YOU WITHDRAW MONEY FROM NFO IN INDIA?

**No**, it is not possible to **withdraw money** from an NFO (New Fund Offer) in India during the NFO period. Here's a detailed explanation:

The main reasons why withdrawing money is not allowed during the NFO period are:



However, once the NFO period ends and the **scheme commences**, investors can exit the fund based on the scheme's terms and conditions. Open-ended schemes allow investors to redeem units at any time, while closed-ended schemes have a fixed maturity period.

## WHAT ARE THE MYTHS ABOUT NFOs PREVAILING IN THE MARKET?

There are a few common myths surrounding NFOs (New Fund Offers) in India. Here's a breakdown to help you separate fact from fiction:

### Myth 1: NFOs Are Cheaper Than Existing Funds

This misconception stems from the initial **low NAV** (Net Asset Value) of INR 10 (common starting point). However, NAV doesn't reflect the actual value of the investment. It's the **performance** of the **underlying** holdings that determines returns.

### Myth 2: Guarantee Good Returns

NFOs are new, so there's no past performance to rely on. You trust the fund manager's skills and the chosen **investment strategy**. This inherently carries more risk than established funds with a track record.

### Myth 3: NFOs Are Similar to IPOs (Initial Public Offerings).

While both **raise capital**, they function differently. IPOs involve new companies issuing shares, while NFOs collect money from investors to invest in existing securities (stocks, bonds, etc.) based on a specific strategy.

### Myth 4: Automatically Better Than Existing Funds

Not necessarily. Existing funds with a **strong track record** might be a safer option for some investors. Evaluate the NFO's investment objective, manager's experience, and market outlook before investing.

### Myth 5: Diversification Automatically Occurs in NFOs

While NFOs claim **diversification benefits**, it's crucial to assess the fund's actual holdings. Not all NFOs automatically provide diversification. Evaluate the portfolio and align it with your investment goals

### Myth 6: Low Net Asset Value (NAV) Is Better

It's a common misconception that NFOs with **lower NAVs** are more attractive. However, the NAV merely reflects the unit value of the underlying portfolio. Existing funds with higher NAVs may have performed well over time. Comparing NAVs between an existing fund and an NFO isn't straightforward because the value of your investment depends on both the number of units and the NAV. In the end, it's the overall investment value that matters most.

### Myth 7: More Units in NFOs Are Beneficial

Some investors believe that getting more units in an NFO is advantageous. While it's true that NFOs offer more units at a lower price, this doesn't necessarily benefit you. The value of your investment depends on both the **number of units and the NAV**. Even if an NFO gives you more units, the overall investment value remains the same when compared to an existing fund with fewer units but a higher NAV.

### Myth 8: Exposure To New Strategies Is Always Adventurous

NFOs often market themselves as offering exposure to new investment strategies. While this can be appealing, it's essential to remember that new **strategies are untested**. Existing funds have a performance history, whereas NFOs lack that track record. It's essential to evaluate the strategy, fund manager, and risk factors before investing. Therefore, consider the risk associated with unproven strategies before investing.

### Myth9: Diversification Through NFOs

Investors sometimes assume that NFOs **automatically diversify** their portfolios. However, diversification depends on the fund's underlying assets, not whether it's an NFO or an existing fund. Always evaluate the fund's investment strategy and asset allocation to ensure proper diversification.

*While NFOs may seem appealing, it's crucial to analyse each claimed benefit carefully and consider your investment goals and risk tolerance. Remember that past performance and a fund's strategy matter more than its NAV or the number of units offered in an NFO.*

## ARE NFO'S TAX-FREE?

No, NFOs (New Fund Offers) themselves are **not tax-free** in India. The taxation on your investment in an NFO depends on the type of NFO and how long you hold your investment (holding period).

### Taxation of Equity NFOs

- For equity-oriented NFOs, where the equity allocation is **65% or more**, the taxation of capital gains is as follows:
  - Short-term capital gains (gains on units held for less than 1 year) are taxed at a flat rate of **15%**.
  - Long-term capital gains (**gains on units held for more than 1 year**) are completely **exempt** from tax.
  - This favorable tax treatment for long-term capital gains on equity-oriented NFOs is in line with the tax regime for other **equity-linked investments** in India.

### Taxation of Debt NFOs

- For debt-oriented NFOs, the **taxation of capital gains** is based on the holding period of the investment:
  - Short-term capital gains (**gains on units held for less than 3 years**) are added to the investor's total income and taxed as per their applicable tax slab rate, which can range from **5% to 30%**.
  - Long-term capital gains (**gains on units held for more than 3 years**) are taxed at a concessional rate of **20%**, with the benefit of indexation.
  - Indexation** adjusts the **purchase price** for inflation, thereby reducing the taxable capital gains.
  - The higher tax rate on short-term gains from debt NFOs is intended to discourage short-term trading and promote long-term investment in these funds.

### Tax Deductions

- Investments in NFOs can be eligible for **tax deductions** under Section 80C of the Income Tax Act, subject to an overall limit of **₹1.5 lakhs** per financial year.
  - This **deduction** can help investors reduce their **taxable income** and, consequently, their tax liability.

### Dividend Taxation

- Dividends received from NFOs are taxed in the hands of the investor as per their applicable **tax slab rate**.
  - There is **no additional tax** on the dividends at the fund level, as the dividend distribution tax (DDT) has been abolished in India.

## WHAT ARE THE PROS AND CONS OF INVESTING IN NFO IN INDIA?

### Pros of Investing in NFOs

#### Diversification Opportunity

- NFOs can provide exposure to **new sectors, themes, or investment strategies** that may not be available in existing mutual fund schemes.
  - This can help **diversify** an investor's portfolio and reduce overall risk by spreading investments across different asset classes or sectors.
  - For example**, an NFO focusing on emerging technologies, or a specific geographical region can add a new dimension to a portfolio dominated by large-cap or domestic stocks.

#### Lower Costs

- NFOs typically have **lower expense ratios** compared to established funds, as the fund house aims to attract investors during the initial launch phase.
  - Lower costs** can translate into higher net returns for investors, especially in the early years of the fund's existence.
  - However, as the fund **grows and complexity**, the expense ratio may increase over time.

#### Potential for Higher Returns

- Some NFOs may have the potential to generate **higher returns** if they are able to identify and capitalize on emerging investment opportunities.
  - Investors can benefit from the fund's **outperformance** in the initial years, as the fund manager has a clean slate to implement their investment strategy without the constraints of an existing portfolio.
  - However, it's important to note that **higher returns also come with higher risks**, and not all NFOs may be able to sustain their performance over the long term.

#### Tax Benefits

- Investments in certain NFOs may be eligible for tax deductions under Section 80C of the Income Tax Act, up to a limit of **INR 1.5 lakhs** per financial year.
  - This can help investors **reduce their taxable income** and, consequently, their tax liability.
  - However, it's important to note that the **tax benefits** are subject to changes in tax laws and the investor's individual circumstances.

### Cons of Investing in NFOs

#### Lack of Track Record

- NFOs do not have a **performance history**, making it difficult for investors to assess the fund manager's capabilities and the fund's potential to deliver consistent returns.
  - Without a track record, it's challenging to evaluate the fund's risk-adjusted returns, volatility, and ability to outperform its benchmark or peers over different market cycles.

#### Higher Risks

- Since NFOs are new and untested, they carry **higher risks** compared to established mutual fund schemes.
  - The underlying investments may be more **volatile or speculative** in nature, as the fund manager may be experimenting with **new strategies or exploring uncharted territories**.
  - Higher risks can lead to greater fluctuations in the fund's net asset value (NAV) and potential losses for investors.

#### Uncertainty in Market Conditions

- The timing of an NFO launch can be **crucial**, as the fund's performance may be affected by prevailing **market conditions**.
  - Investing in an NFO during a **market downturn** may not be optimal, as the fund may struggle to generate positive returns in the short term.
  - Conversely, investing in an NFO during a market rally may lead to **higher valuations and lower future returns**.

#### Potential for Underperformance

- Studies have shown that a **significant number** of NFOs launched in recent years have underperformed their benchmarks or broader market indices.
  - This **underperformance** can be attributed to various factors, such as inexperienced fund managers, poor stock selection, or unfavourable market conditions.
  - Investors may end up with **lower returns** compared to investing in established funds or index funds.

## WHAT ARE THE DIFFERENCES BETWEEN IPO AND NFO

Aspect	IPO (Initial Public Offering)	NFO (New Fund Offer)
Definition	A company's first sale of shares to the public	A mutual fund's launch of a new scheme to investors
Issuer	Company issuing shares	A mutual fund's launch of a new scheme to investors
Purpose	Raise capital for business expansion or other purposes	Launch a new mutual fund scheme
Regulation	Regulated by SEBI (Securities and Exchange Board of India)	Regulated by SEBI (Securities and Exchange Board of India)
Investment	Equity shares of a company	Units of a mutual fund scheme
Market Listing	Shares listed on stock exchanges	Units are not listed on stock exchanges (except ETF NFOs)
Risk	Investors bear market risk of the company's performance	Investors bear market risk of the mutual fund's performance
Returns	Potential capital appreciation and dividends (if any)	Returns from fund performance, dividends (if any)
Investment Objective	Investors seek ownership and potential profit	Investors seek returns based on fund's investment strategy
Lock-in Period	Lock-in periods may apply for certain categories	No mandatory lock-in period (except for ELSS NFOs)
Subscription Period	Typically shorter, often a few days	Usually, open for a longer duration (weeks to months)
Minimum Investment	Minimum lot size determined by the company	Minimum investment amount set by the mutual fund
Allotment Basis	Allotment based on oversubscription and price bidding	Allotment typically at NAV (Net Asset Value) at end of NFO
Information Availability	Detailed prospectus (DRHP/Prospectus) available	Scheme Information Document (SID) available
Secondary Market Trading	Shares can be traded on secondary market	Units can be bought and sold through AMC or secondary
Taxation	Capital gains tax and other taxes apply	Capital gCapital gains tax based on type of fund (equity/debt)