

A Practitioner's Guide to the Process Flow of Fund Management

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Abstract

Fund management, also known as asset management, involves professionally managing investment funds on behalf of clients to achieve specific financial goals. A fund manager oversees a pooled investment vehicle's cash flow, making strategic decisions about where and how to invest in securities like stocks, bonds, and other assets. The core goal is to maximize returns while managing risk. The process flow of fund management involves several key stages, including raising capital, sourcing and vetting investment deals, managing the portfolio of acquired assets, and executing exit strategies to return profits to investors. This process is a continuous cycle, as the disposal stage often leads back to the planning stage to address replacement needs. Effective asset management software and automated workflows help to manage this process efficiently and ensure compliance.

Keywords: *Fund Management, Asset Management, Wealth Management, Mutual Fund.*

1.Introduction

Mutual funds enable both individuals (like you and me) and institutions (such as corporations and foundations) to combine smaller investments into a larger pool of capital for investment purposes. Funds management, also known as asset management, refers to the process of overseeing and maintaining the value of an organization's assets. This applies to both intangible assets (such as intellectual property and goodwill) and tangible assets (such as real estate and equipment).

It involves systematically operating, deploying, maintaining, upgrading, and disposing of assets in the most cost-effective and profitable manner possible. A fund manager plays a key role in balancing cost and risk to maximize returns and maintain healthy cash flow(1). Because financial institutions rely heavily on their ability to extend credit to clients, maintaining adequate liquidity is essential. In broader terms, funds management encompasses the strategic management of all financial assets within a fund to ensure stability, growth, and profitability.

Fund Managers in turn manage this larger amount to allow:

- Investment strategies that would not otherwise be feasible (Such as buying bonds that only sell in very large denominations)
- Achieving economies of scale, such as paying low broker commissions, that are not attainable while investing smaller sums
- Reduction of risk by holding a diversified basket of securities

Due to the above advantages, mutual funds have gained an increasing share of nation's financial assets especially in developed countries.

2.Fund Management Process Flow

Step 1: Investment Advise

- The Investor (a retail investor or an institutional investor) with a particular financial need approaches the Financial Advisor.
- The Financial advisor is an individual or organization responsible for devising broad investment policies (a financial plan) depending on the risk and return expectations of the investors(2).
- The Financial advisor depending on the risk and return expectations of the investor devises a suitable financial plan. Typically the plan involves investing in one or more mutual funds, each with a different objective. A fee is charged by the advisor for the advisory services provided.
- The investor invests in a particular mutual fund by subscribing to units of the fund. This process is called subscription. He does so by contacting the Transfer Agent of the Fund. The Transfer Agent, a corporation appointed by the Fund, keeps the investors records, executes the buy, sell transactions the shareholders request.
- Later if the investor chooses, he/she can sell off the units in the fund. This process is called redemption.

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Step 2: Trade Execution and Settlement

- The Fund Manager, an individual responsible for investment decisions of the fund, generates a trade order, an order to buy or sell specific number of units of a security.
- Trading is done through one or more brokers, corporations that are responsible for executing trades on exchanges.
- A single trade order may be split into one or more trades to attain maximum benefit for the fund.
- The trade gets cleared and settled with the DTCC, an organization responsible for clearing and settlement
- The fund's custodian, an organization responsible for bookkeeping of fund's records, is also responsible for settling the trade(3).

Step 3: Reconciliation

- A tax lot is a long or short position on a given security traded on a given date at a particular price.
- One or more tax lots get aggregated to form the holding for a fund.
- The custodian is responsible for reconciling the trades and holdings for a fund. The custodian is also responsible for reconciling cash.
- This process can take place within what is called as the Fund Accounting System. In certain instances this process may take place in a separate Reconciliation System

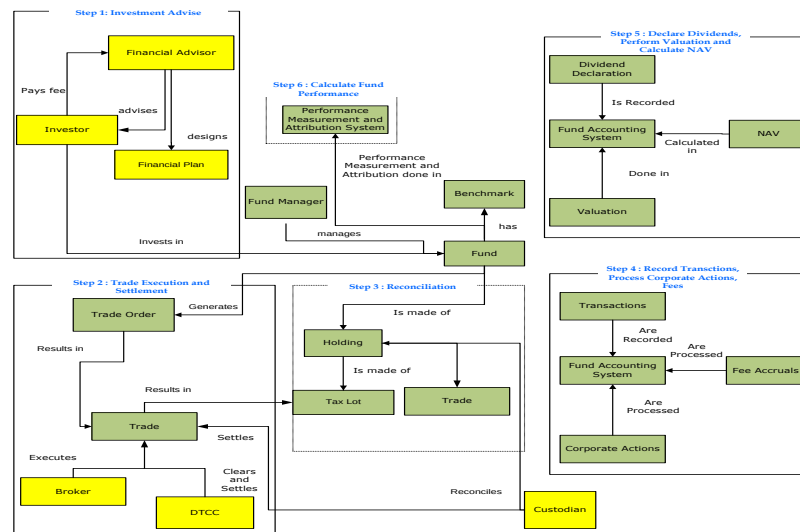


FIGURE 1 Fund Management Process

Step 4: Record Transactions, Corporate Actions and Fees

- The trades done for the fund on a given date (T) are recorded on the next date (T +1) in the fund accounting system.
- Transactions such as subscriptions and redemptions done on a given date (T) are also recorded on the next date (T +1) in the Fund Accounting System.
- Corporate Actions that need to be processed on the Entitlement date are processed in the Fund Accounting System
- The fund will charge fees that needs to be accrued in the Fund Accounting System

Step 5: Declare Dividends, Perform Valuation and Calculate NAV

- Most funds declare dividends to investors. This may be done at frequent intervals such as quarterly, half-yearly or annual. When a dividend is declared, the same is processed in the Fund Accounting System
- Valuation involves marking the holdings of the fund to market. This involves receiving the best prices for each security from the pricing system, and using the same to perform the valuation(4).
- The last step in the fund accounting process is to calculate the NAV. The following formula is used to calculate the NAV.
$$NAV = \frac{\text{Total Assets} - \text{Total Liabilities}}{\text{Fund Units Outstanding}}$$

Steps 3, 4 and 5 are typically Fund Accounting activities that are done in a Fund Accounting System. Fund Accounting forms a very critical part of the back office operations of the Fund. This process has been explained in detail the slides to follow.

Step 6: Calculate Fund Performance

- The returns the fund generated is calculated to assess its performance.
- The returns the fund generated is compared to that of a benchmark. A benchmark is an appropriate standard portfolio against which the returns of the fund could be compared. This process is called Performance attribution.

3.Fund Accounting Process

At the start of each day, fund accountants begin by reconciling the fund's cash and securities records with those maintained by the custodian. Any discrepancies identified during this process are corrected by adjusting the fund's cash and securities inventory within the accounting system.

Next, the fund accountant updates the fund's records to account for the previous day's investor transactions, including subscriptions and redemptions. These transactions, known collectively as Capital Stock Activity, reflect investor orders placed to buy or sell fund shares, which are processed based on the previous day's Net Asset Value (NAV).

The fund manager's trading activity that is, all buy and sell transactions executed the previous day is then recorded in the fund's books. This data is automatically imported into the fund accounting system from the trade order or portfolio management systems. In addition, cash settlements related to these trades are processed using information supplied by the custodian(5).

Finally, any corporate actions (such as dividends, stock splits, or mergers) that are due are also processed and recorded within the fund accounting system to ensure the fund's financial position accurately reflects all events affecting its holdings.

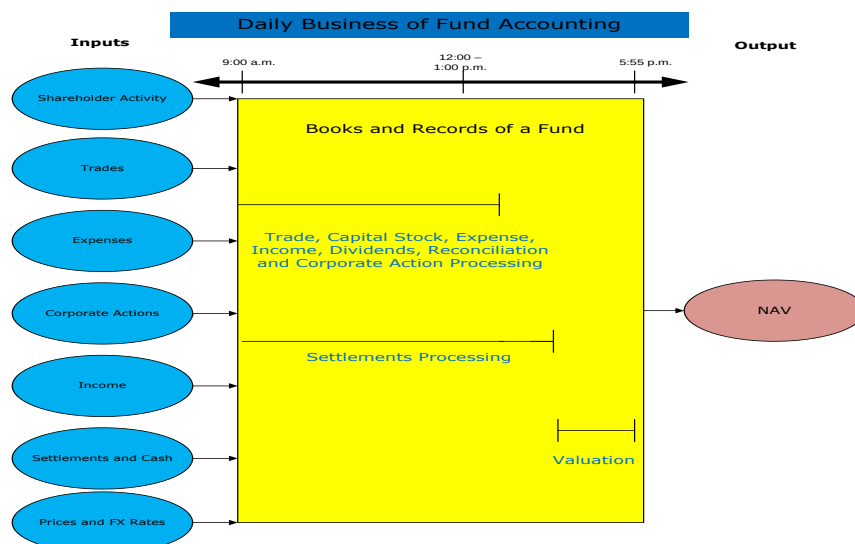


FIGURE 2 Fund Accounting Process

- The expenses of the fund, typically fees, are accrued by the fund. These would add to the liabilities of the fund, until paid out in cash. On days when dividends are provided by the funds (typically monthly, quarterly, half yearly or yearly), the transaction needs to be recorded.
- Before the end of day, the securities and cash in the fund needs to be valued (also called as Marked to Market). This would involve getting the prices and FX rates from data vendors, validating them, and choosing a best price and FX rate for valuation.
- The day ends with the calculation of the Net Asset Value (NAV) of the fund. This is sent to multiple stakeholders such as Fund Manager, Transfer Agent, Data Vendors and Exchanges. The NAV is calculated using the following formula.

$$\text{NAV} = (\text{Total Assets} - \text{Total Liabilities}) / \text{Fund Units Outstanding}$$

4.Fund Management - Entity Relationships

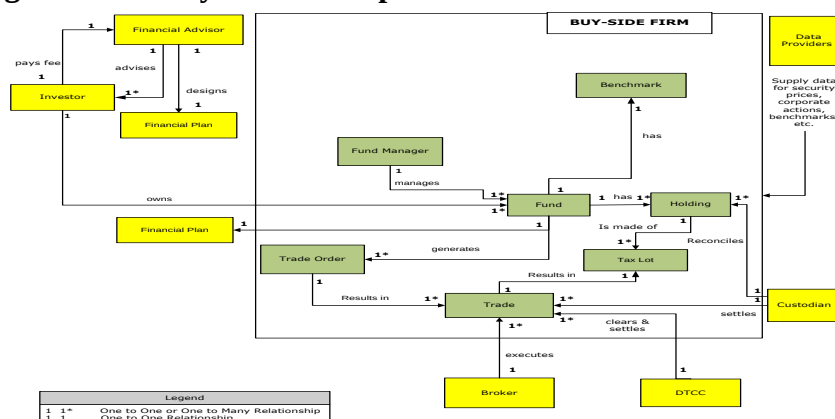


FIGURE 3 Fund Management - Entity Relationships

5.Trades, Tax Lots and Holdings

Consider Fund A, whose base currency is USD, that has done multiple trades in the Reliance Communications Ltd Common Stock. Assume that trades are done in the same order as mentioned below. Also assume that lots are disposed using the FIFO method.

TABLE 1 Security Trades

Fund	Trade Date	Settlement Date	Transaction Type	Issue Name	Units	Price (INR)
Fund A	14-Jan-2025	16-Jan-2025	BUY	Reliance Communications Ltd Common Stock	40	100
Fund A	14-Jan-2025	16-Jan-2025	BUY	Reliance Communications Ltd Common Stock	45	90
Fund A	15-Jan-2025	17-Jan-2025	SHORT	Reliance Communications Ltd Common Stock	10	87
Fund A	15-Jan-2025	17-Jan-2025	SHORT	Reliance Communications Ltd Common Stock	20	95
Fund A	16-Jan-2025	18-Jan-2025	SELL	Reliance Communications Ltd Common Stock	30	80
Fund A	16-Jan-2025	18-Jan-2025	BUY COVER	Reliance Communications Ltd Common Stock	15	45

The following are the Tax lots and Holdings from 14-Jan-2025 to 16-Jan-2025. It is assumed that no Cash Balance and Holdings exists as on 13-Jan-2025 End of Day.

On 14-Jan-2025:

TABLE 2 Tax Lots

Fund	Issue Name	Lot Id	Units
Fund A	Reliance Communications Ltd Common Stock	1	40
Fund A	Reliance Communications Ltd Common Stock	2	45
Fund A	INR	3	-4000
Fund A	INR	4	-4050

TABLE 3 Holdings

Fund	Currency	Long/Short	Issue Name	Units
Fund A	INR	Long	Reliance Communications Ltd Common Stock	85
Fund A	INR	Short	INR	8050

On 15-Jan-2025:

TABLE 4 Tax Lots

Fund	Issue Name	Lot Id	Units
Fund A	Reliance Communications Ltd Common Stock	1	40
Fund A	Reliance Communications Ltd Common Stock	2	45
Fund A	INR	3	-1230
Fund A	INR	4	-4050
Fund A	Reliance Communications Ltd Common Stock	5	-10
Fund A	Reliance Communications Ltd Common Stock	6	-20

TABLE 5 Disposal Lots

Fund	Issue Name	Lot Id	Units
Fund A	INR	3	-870
Fund A	INR	3	-1900

TABLE 6 Holdings

Fund	Currency	Long/Short	Issue Name	Units
Fund A	INR	Long	Reliance Communications Ltd Common Stock	85
Fund A	INR	Short	Reliance Communications Ltd Common Stock	30
Fund A	INR	Short	INR	5280

On 16-Jan-2025:

TABLE 7 Tax Lots

Fund	Issue Name	Lot Id	Units
Fund A	Reliance Communications Ltd Common Stock	1	10
Fund A	Reliance Communications Ltd Common Stock	2	45
Fund A	INR	4	-2880
Fund A	Reliance Communications Ltd Common Stock	6	-15
Fund A	INR	7	-675

TABLE 8 Disposal Lots

Fund	Issue Name	Lot Id	Units
Fund A	INR	3	-870
Fund A	INR	3	-1900
Fund A	INR	3	-1230
Fund A	INR	4	-1170
Fund A	Reliance Communications Ltd Common Stock	1	30
Fund A	Reliance Communications Ltd Common Stock	5	-10
Fund A	Reliance Communications Ltd Common Stock	6	-5

TABLE 9 Holdings

Fund	Currency	Long/Short	Issue Name	Units
Fund A	INR	Long	Reliance Communications Ltd Common Stock	55
Fund A	INR	Short	Reliance Communications Ltd Common Stock	15
Fund A	INR	Short	INR	3555

6.Cash Activities

Cash Transactions and Cash Balances:

Cash Transactions are those transactions on a Fund that result in a cash Inflow or Outflow. The following are certain typical transactions that result in movement of cash into or out of the fund.

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Capital Stock Transactions:

- Subscriptions
- Withdrawals

Security Trades:

- Buy
- Sell
- Short Sell
- Buy Cover

Corporate Actions:

- Cash Dividend

Foreign Currency Transactions:

- Buying a foreign currency

The following are various transactions that have been done on Fund A whose base currency is USD.

Capital Stock:

The following are various transactions that have been done on Fund A whose base currency is USD.

TABLE 10 Capital Stock

Fund	Trade Date	Settlement Date	Transaction Type	Units	NAV (INR)
Fund A	21-Jan-2025	22-Jan-2025	SUBSCRIPTION	100	25
Fund A	24-Jan-2025	25-Jan-2025	REDEMPTION	40	22

TABLE 11 Security Trades

Fund	Trade Date	Settlement Date	Transaction Type	Issue Name	Units	Price (INR)
Fund A	22-Jan-2025	24-Jan-2025	BUY	Reliance Industries Ltd Common Stock	20	100
Fund A	22-Jan-2025	24-Jan-2025	SHORT	Reliance Communications Ltd Common Stock	25	99
Fund A	23-Jan-2025	25-Jan-2025	SELL	Reliance Industries Ltd Common Stock	10	96
Fund A	23-Jan-2025	25-Jan-2025	BUYCOVER	Reliance Communications Ltd Common Stock	10	95

TABLE 12 Corporate Action

Corp Act Ex Date	Corp Act Record Date	Issue Name	Corp Act Type	Corp Act Pay Date	Value
24-Jan-2025	26-Jan-2025	Reliance Industries Ltd Common Stock	CASH DIVIDEND	26-Jan-2025	10 Per Share

TABLE 13 Foreign Currency

Fund	Trade Date	Settlement Date	Buy Currency	Buy Currency Units	Sell Currency	Sell Currency Units
Fund A	24-Jan-2025	25-Jan-2025	USD	10	INR	450

The following is the Cash Activity and Cash Balances from 21-Jan-2025 to 26-Jan-2025. It is assumed that no Cash Balance exists as on 20-Jan-2025 End of Day.

On 21-Jan-2025:

No Cash Activity and hence zero cash balance

On 22-Jan-2025:

TABLE 14 Cash Activity

Fund	Settlement Date	Transaction Type	Currency	Value
Fund A	22-Jan-2025	SUBSCRIPTION	INR	+2500

TABLE 15 Cash Balance

Fund	Currency	Value
Fund A	INR	+2500

On 23-Jan-2025:

Cash Activity – No Cash Activity

TABLE 16 Cash Balance

Fund	Currency	Value
Fund A	INR	+2500

On 24-Jan-2025:

TABLE 17 Cash Activity

Fund	Settlement Date	Transaction Type	Currency	Value
Fund A	25-Jan-2025	BUY	INR	-2000
Fund A	25-Jan-2025	SHORT	INR	+2475

TABLE 18 Cash Balance

Fund	Currency	Value
Fund A	INR	+2975

On 25-Jan-2025:

TABLE 19 Cash Activity

Fund	Settlement Date	Transaction Type	Currency	Value
Fund A	25-Jan-2025	REDEMPTION	INR	-880
Fund A	25-Jan-2025	FX	USD	+10
Fund A	25-Jan-2025	FX	INR	-450
Fund A	25-Jan-2025	SELL	INR	+960
Fund A	25-Jan-2025	BUY COVER	INR	-950

TABLE 20 Cash Balance

Fund	Currency	Value
Fund A	INR	+1655
Fund A	USD	+10

On 26-Jan-2025:

TABLE 21 Cash Activity:

Fund	Settlement Date	Transaction Type	Currency	Value
Fund A	26-Jan-2025	CASH DIVIDEND	INR	+100

TABLE 22 Cash Balance:

Fund	Currency	Value
Fund A	INR	+1755
Fund A	USD	+10

7. Conclusion

This paper concludes by giving a decent overview of all the phases such as Investment Advice, Trade Execution and Settlement, Recon, Corporate Actions, Fees, NAV process and calculating Fund Performance of the the fund management. The research conducted through analysis of the fund life cycle, fund accounting process, major entities in the fund management and other strategies that are critical in determining investor behavior. The paper provides a detailed case study of the fund management process to understand even if a new investors or anyone interested in the fund management. In conclusion, this article reiterates that Fund Management, when supplemented with quality knowledge, technological means and investing principles, can become a revolutionary force when it comes to building wealth and the financial system as a whole.

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Conflicts of interest

The authors have no conflicts of interest to declare

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