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NEW SEBI REGULATION: CATEGORIZATION AND RATIONALIZATION OF MUTUAL FUND SCHEMES AND ITS IMPACT

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Abstract: - The capital market regulator Security Exchange Board of India (SEBI) has proposed a regulation for categorization and rationalization of Mutual Fund scheme. There are around 1200 plus open ended mutual fund schemes out of these, one third are equity fund; and one fourth are debt funds. These mutual fund schemes are confusing to an investors. So the Mutual Fund industry desperately needed guidelines to categorize and rationalized their scheme. The SEBI issued a circular in October 2017 on the same. This contains a set of regulations for all the mutual fund schemes to bring uniformity in the characteristics of similar scheme. This will have an impact not only to the fund houses that is Asset Management Companies but also to investors.

Keywords: Asset Management Company, scheme categorization, rationalization, SEBI

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INTRODUCTION

The Securities and Exchange Board of India, or SEBI, introduced a circular on October 6, 2017 for categorization and rationalization of mutual fund schemes. The market regulator defined various categories of funds, along with the scheme characteristics for each fund category. Since long time the mutual fund industry has been accused of starting an unnecessarily large number of similar schemes. This has created a lot of confusion for investors who are unable to understand what their mutual fund schemes really stand for. For example a large cap fund is expected to invest primarily in large cap companies. But in search for higher returns, many large cap funds took unnecessary exposure to smaller caps. This works well to boost returns when markets are rising. But this is not work when market has down trends. Investors at their end practically are not getting what they are promised. A large cap fund having more money invested in small and mid-caps is not fair to the investors. The industry regulator had been asking the AMCs (those who run mutual funds) to rationalize and categorized different mutual fund scheme. So SEBI was forced to put out a circular on **'Categorization and Rationalization of Mutual Fund Schemes**'in October 2017 to ensure that the clean-up of mutual funds is done by force now. The Securities and Exchange Board of India (SEBI) has asked fund houses to classify their schemes into clearly defined categories. SEBI wants to bring uniformity within the characteristics of similar schemes to make sure investors can evaluate various options before making any investment decisions.

Objectives of Study:

- To Study the different rules and regulation laid down in India to regulate the Mutual Funds.
- To study the working of SEBI in regulating Mutual Fund
- To analyze and study the impact of new SEBI regulations on different stake holders of mutual fund industry.

Research Methodology:

The study is based on the secondary data which has been collected through various journals, periodicals, News Papers, Newsletters of MF Companies and SEBI's documents, Mutual Fund Companies report etc.

Review of the Literature:

According to an Article in, "The Role of Securities & Exchange Board of India (SEBI) towards Regulating Indian Mutual Funds." *by* G. Umamaheswararao CMR Institute of Technology, Hyderabad , published in journal -ijrdmr Vol. 4, Issue

Mutual funds are financial intermediaries which collect the savings of investors and invest them in a large and well diversified portfolio of securities. The advantages for the investors are reduction in risk, expert professional management, diversified portfolio, liquidity of investment and tax benefit. This fast grown industry is regulated by the Securities and Exchange Board of India (SEBI). Today there are around 40 mutual funds and over 300 schemes with total assets of around Rs. 6.4 lacs crores. Since the mutual funds involve a huge amount of retail investors, therefore, this paper attempts to analyse whether SEBI is able to regulate the activities in Mutual Fund Market and whether its regulatory role is capable to protect the interest of huge investors. This study also attempts to analyse the shortcomings (if any) in the regulatory regime and suggest some measure to increase its effectiveness.

According to an Article in, "Mutual Funds and SEBI Regulations.".by R .M.Kamble Teaching Assistant, KUSSK Law College, Karnatak University., International Journal of Computational Engineering Research Vol, 03 Issue 5

A Mutual Fund is a form of collective in investment that pools money from many investors and invests the money in stocks, bonds, short term money market instruments, and/or other securities. Now a day's these Mutual funds are very popular because they provide an excellent way for anyone to direct a portion of their income towards a particular investment. In order to help the small investors, mutual fund industry has come to occupy an important place. Mutual funds provide an easy way for small investors to make long term, diversified, professionally managed investments at a reasonable cost. The purpose and objective of this article is to study meaning and nature of Mutual funds, procedure, importance of SEBI and its mechanism in India, and also examine the growth of mutual funds and analyze the operations of mutual funds and suggest some measures to make it a successful scheme in India

New Mutual Fund Categories:

The new rules state that mutual fund houses can only have one mutual fund offering under each category. As a result in early 2018, all mutual fund schemes are being renamed, re-categorized or merged/ terminated.

The important points related to categorization and rationalization of mutual fund scheme is as follows.

- Grouping of schemes into five categories: Equity, debt, hybrid, solution-oriented and others
- Naming convention of schemes, especially debt schemes, as per the risk level of end investments
- Categorization of balanced funds into three types: Conservative hybrid, balanced hybrid and aggressive hybrid

The market regulator SEBI has demarcated a total of 36 categories under five broad groups to enable investors to select mutual funds with greater ease The first thing that has been done is to define 5 very clear groups to classify all the schemes. These 5 mutual fund categories are:

1. **Equity Schemes –** will invest in equity and equity related instruments
2. **Debt Schemes –** will invest in debt instruments
3. **Hybrid Schemes –** will invest in a mix of equity, debt and other assets related instruments
4. **Solution Oriented Schemes –** will have schemes like retirement schemes or children savings scheme
5. **Other Schemes –** will have **index funds,** Fund-of-Funds and ETFs

.Impact of SEBI's mutual fund Categorization and Rationalization:

Impact on fund houses:

- **Re-categorization of mutual fund schemes makes Simplification of choice and fewer options**

As per the SEBI mandate, a fund house can offer 10 types of equity funds, 16 categories of bond schemes, and six of hybrid funds. In addition to this, they can also have index funds, fund of funds and other solution-based schemes.
Mutual funds will now be classified as equity, debt, hybrid, solution-oriented, and 'other'. Equity schemes will have 10 sub-categories, including multicap, large-cap, mid-cap, large- and mid-cap, and small-cap, among others. Those of companies ranked between 1st and 100th will be termed as Large Cap. Those of companies ranked between 101 and 250 will be termed mid-

caps, and stocks of firms beyond the top 250 by market cap will be categorized as small-caps. Debt and hybrid schemes will similarly be grouped into 16 and six sub-categories respectively.

- **Adherence to fund mandate**

With strict classification of schemes, fund houses may not be able to alter the investing style or focus of their schemes, as they did earlier. For instance, mid-cap funds stray into the large-cap territory or across market caps, in response to market conditions, which dramatically alters their risk profile. Now, funds will be forced to maintain their investing focus. Any drastic change in style will constitute a change in the fundamental attributes of the scheme, which would have to be communicated to the investors.

For investors, this means they won't have to worry about their chosen schemes altering mandates to something which doesn't suit their needs or risk profile.

- **Sharp rise in fund corpus**

Since fund houses will now be forced to merge duplicate schemes within the same categories, it may sharply increase the size of certain funds. This could hurt the scheme's performance. Some larger fund houses with multiple schemes will have to opt for mergers. This may lead to a sudden, sharp rise in the corpus of schemes, which could dent the fund's returns .There could also be an impact cost on the investor, as fund may rebalance. For instance, both HDFC Balanced and HDFC Prudence are aggressive hybrid funds, with a corpus of Rs 14,767 and Rs 30,304 crore. Merging the two will create a Rs 45,000 crore fund. However, it is more likely that the fund house may instead reposition one of the schemes in another category.

- **Short-term performance might be impacted**

As the funds have to reshuffle their portfolios, it will lead to higher turnover. Higher portfolio turnover may directly impact fund returns in the short- term.

Impact on Investors:

For an investor, this means that some of the mutual funds in their portfolio could be re-categorized and/or merged with another scheme of that Mutual Fund House. The names of their schemes could change due to such mergers. Following points states the impact on investors.

- **Better comparison with peers**

The biggest advantage of this classification is that it will make mutual fund schemes comparable in a much better way. That is to say that comparison within their category and also provide decent relative comparison across category which would make sense Distinct categorization of schemes will also enable a better comparison of funds within the same category. While the earlier large cap funds category had schemes with pure large-cap focus as well those with a sizeable mid-cap exposure, now such distinctly varied schemes won't be clubbed together. This will further help investors identify the right schemes by facilitating a like-for-like comparison of funds. "All schemes of different AMCs within a similar category will have similar characteristics, which will enable customers to make a better 'apples to apples' comparison

- **Eliminate cap-related confusion to some extent**

Earlier, for most investors it was difficult to gauge which is large cap and which isn't. So with all funds having their own definitions, it was difficult to carry out comparisons correctly. A large-cap fund could easily have stocks that would be counted as mid-cap for a different fund. So this definition-setting will help eliminate cap-related confusion to some extent.

- **Portfolio shuffle and better understanding of risk**

Changes in the portfolio of existing schemes will be required. There will be greater clarity on the different levels of risk associated with each scheme. Uniform scheme characteristics will help investors match return expectations and risk-taking ability with the type of fund to invest in.

- **Reduction in misselling**

A lot of investors are misled into buying schemes which are not as per their requirement SEBI's circular comes as a boon to investors who receive advice that is not suitable for them, based on vested interests of the advising financial entities. Categorization will help even layman investors in identifying and understanding schemes. Some of the scheme names were very misleading. And at times and to the uninitiated, it gave the wrong impressions of some kind of guarantees. With the restriction on the choice of name that the funds can have, the regulator has done its part to ensure that investors do not misunderstand the product.

6. Advantages of new SEBI regulations of Categorization and Rationalization

This change will lead to a long overdue de-cluttering of the Mutual Fund industry. Misnomers and confusing naming conventions used by Mutual Fund Houses will be a thing of the past and mutual fund scheme names will now reflect an investor's underlying objective. Investors will thus have a better grasp and understanding of what they're investing in. This serves to offer them flexibility on both the nature and the risk exposure of these investments. Reduction of the no. of schemes will also lead to more compact portfolios, ease of scheme comparison across AMCs and enhanced transparency.

CONCLUSION:

There will always be new ways to improve the classification in each iteration. But this is a good start and a step in the right direction. Categorization of schemes may lead to short-term turbulence due to changes that need to be made in each scheme. But, in the long run, this move will have a positive growth effect for the industry as a whole. With more and more investors preferring investment in mutual funds, this initiative is a step in the right direction. To be fair, this is a new development and that too a big one. **Investors will** thus have a better grasp and understanding of what they're investing in. This serves to offer them flexibility on both the nature and the risk exposure of these investments. Reduction of the no. of schemes will also lead to more compact portfolios, ease of scheme comparison across AMCs and enhanced transparency.

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