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A STUDY ON MUTUAL FUND CATEGORISATION AND RATIONALISATION IN INDIA

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ABSTRACT :

Mutual funds is considered as a strategic tool for retail investors to invest and create their portfolio. Investors depend upon scheme information document and product attributes to get sufficient knowledge about investment avenues in the capital market. Mutual fund investment is predominately dominated by the mutual fund advisors and financial advisors to make investment decisions for their clients. The wealth managers take discretionary responsibility to create mutual fund investment products for their clients. Retail investors totally depend on the mutual fund company to provide valuable information for investment. Over the period of time, efforts have been taken by the regulator to provide policy directions to the mutual fund companies to disclose the needed information to the investors. The present study is undertaken to review the past and present changes brought under the regulator for simplifying information about mutual fund investment products. It would also help the mutual fund companies to align their product attributes to the current nomenclature.

KEYWORDS : *Mutual fund & Investment.*

INTRODUCTION

The growth of the Mutual fund industry has been simply remarkable. In the 10 years from 2006-07 to 2016-17 , assets under management (AUMs) jumped from Rs 3.26 trillion to Rs 17.55 trillion. Today mutual fund investors find it utmost difficult to select the mutual fund schemes from a plethora of schemes offered by the fund house. Each fund house is offering schemes under different categories of risk taking abilities of investors. Investors are confused to understand the skills needed to select the right type of mutual fund scheme for investment. Over the years the mutual fund industry has shown exponential growth in terms of participation from private sector, public sector, government sector and corporate sponsored mutual fund companies. This form of expansion has led to significant form of creation of assets in the financial services industry. Further some mutual fund companies even launched multiple schemes under a single category with portfolios that mirrored each other thereby defeating the very purpose of diversification. It is clear that diversification of mutual fund schemes did not create any value creation to the investors. There was also no uniformity in the way fund houses defined a stock in to categories of Large-cap, Mid-cap and Small-cap schemes. Fund managers would pick wrong stocks that would not match between a mutual fund scheme objective and composition of it's portfolio. This form of creating wrong portfolio will mislead investors to take wrong investment decisions in mutual fund products.

Mutual fund product labeling through colour codes:

Many changes have been made by SEBI (Securities and Exchange Board of India) with respect to growth of mutual fund industry and investor's benefits. Mutual fund colour coding is one such initiative of regulatory changes. Though, this standard mechanism of labelling has not produced desired result, it is aimed to provide investors an easy understanding of the mutual fund scheme with respective to the risk factor of investing. Investors often find the mutual funds as cumbersome and get confused with the paperwork. Thus, color coding comes to rescue them during this stage by simplifying the things using different colours, as few factors of mutual funds can be understood with colours. It came into effect on July 1, 2013. According to the new norms, the colour codes will have to be displayed on the front page of the application forms, next to the name of the scheme. These colour codes will also be disclosed in all advertisements and marketing materials. These colour code labels will also include a short one-line description on the objective of the scheme, the nature of the scheme, the kind of instruments it will invest in and the risk levels.

The various risk levels and the corresponding colour codes are:

Blue: The blue colour coded box will be used to indicate low risk. Instruments such as fixed maturity plans, gilt funds and income funds will carry a blue colour code as these are the safest MF instruments. These instruments are ideal for anyone looking for a fixed and safe source of income.

Yellow: The yellow colour coded box will indicate medium risk. All hybrid products such as monthly income plans (MIPs), balanced funds and unit-linked insurance plans which typically invest in both equity and debt products will be given a yellow colour. These instruments are ideal for those who seek diversification between debt and equity; a reduction in risk without a substantial reduction in the returns.

Brown: The brown colour coded box indicates that one's money is being put into a high-risk instrument. All equity funds such as diversified funds, sectoral funds, index funds, large-cap funds and small-cap funds will carry a brown colour code as these have a significant risk component and are prone to market fluctuations. Any person who wishes to benefit from potentially higher returns and has the risk appetite for the same can invest in such instruments. On the other hand, the brown colour serves as a warning to anyone who is risk averse.

Mutual fund product labeling through Riskometer :

To help investors be aware of the risks associated with mutual fund investments, SEBI has made it mandatory for all fund houses to display a riskometer depicting the five levels of risk with effect from July 1, 2015 to all the existing schemes and all schemes to be launched on or thereafter. The depiction of risk using colour codes would be replaced by pictorial meter named "Riskometer" and this meter would appropriately depict the level of risk in any specific scheme.

RISKOMETER LABEL	INVESTOR TYPE	INVESTOR PROFILE
Low	Conservative	Investor's top priority is the safety of capital. Investor is willing to accept relatively low returns against a low risk of principal.
Moderately Low	Moderately Conservative	Investor is willing to accept a small level of risk in exchange for some potential returns over a medium to long-term.
Moderate	Moderate	Investor can tolerate a moderate level of risk in exchange for

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		relatively higher potential returns over a medium to long-term.
Moderately High	**Moderately Aggressive**	Investor is keen to accept a relatively higher risk to maximize potential returns over the medium to long-term.
High	**Aggressive**	Investor is willing to accept a significant risk to maximize potential returns over the long terms and is aware that she/he may lose a significant part of the capital.

(Source: SEBI Circular)

Since the universe of mutual funds is vast with hundreds of funds out there, investors can use the new riskometer to choose schemes which resembles their risk appetite. This meter is especially useful to investors who are new to the world of mutual funds and usually depend on the advice of their financial advisors. However, it is important to note that although the riskometer can give an overall idea of the risk level there are many factors like fund attributes to be considered while selecting a fund and a riskometer should not be the only instrument to decide on investing in mutual fund scheme.

Mutual fund Reclassification and Categorisation of schemes:

The market regulator SEBI in a circular dated October 6,2017 directed all AMC's registered and functional in india to reclassify their fund schemes. The circular stated that the fund houses must ensure a mutual fund scheme is clearly distinct in terms of asset allocation and investment strategy. As per the circular the mutual fund schemes shall now be classified into following five major groups: Equity schemes, Debt schemes, Hybrid schemes, Solution oriented schemes and other schemes. The description of the said schemes are enlisted below:

Mutual fund schemes	Categorisation of schemes
Equity Scheme	Multi Cap Fund, Large Cap Fund, Large & Mid Cap Fund, Mid Cap Fund, Small cap Fund, Dividend yield Fund, Value Fund, Contra Fund, Focused Fund, Thematic Fund and ELSS
Debt Scheme	Overnight Fund, Liquid Fund, Ultra Short duration Fund, Low duration Fund, Money market Fund, Short duration Fund, Medium duration Fund, Medium to Long duration Fund, Long duration Fund, Dynamic Bond, Corporate Bond Fund, Credit Risk Fund, Banking and PSU Fund, Gilt Fund and Floater Fund.
Hybrid Scheme	Conservative Hybrid Fund, Balanced Hybrid Fund, Aggressive Hybrid Fund, Balanced Advantage, Multi Asset Allocation, Arbitrage Fund, Equity Savings
Solution Oriented Schemes	Retirement Fund and Children's Fund
Other Schemes	Index Funds and Fund of Fund's

(Source: SEBI Circular)

As shown in the classification chart, SEBI has defined 10 categories for equity funds, 16 for debt funds, 6 for hybrid funds and 2 for special situation funds. While hybrid funds combine equity and debt, the special situations funds offer goal-based solutions for retirement planning and for creating a children's fund. Each AMC can only have one scheme under each of these 34 categories shown in the above chart. However, there is a fifth category "Others", which will consist of all other funds like index funds, ETFs, gold funds and Fund of Funds . Funds can have any number of schemes under this category. SEBI's contention has been, and rightly so, that this classification gives greater clarity to the mutual fund investors about what is the investment portfolio that they are investing in. The communication is much clearer to the investor and comparison across funds becomes more meaningful for taking informed investment decisions. In order to ensure uniformity in respect of the investment universe for equity schemes, SEBI has classified equity schemes into Large Cap , Mid Cap and Small cap.

- Large Cap: 1st - 100th company in terms of full market capitalization
- Mid Cap: 101st - 250th company in terms of full market capitalization
- Small Cap : 251 st company onwards in terms of full market capitalization

Mutual Funds would be required to adopt the list of stocks prepared by AMFI in this regard and AMFI would adhere to the following points while preparing the list:

- If a stock is listed on more than one recognized stock exchange, an average of full market capitalization of the stock on all such stock exchanges, will be computed;
- In case a stock is listed on only one of the recognized stock exchanges, the full market capitalization of that stock on such an exchange will be considered.
- This list would be uploaded on the AMFI website and the same would be updated every six months based on the data as on the end of June and December of each year. The data shall be available on the AMFI website within 5 calendar days from the end of the 6 months period.

The new guidelines will apply to even fund houses considering mergers, acquisitions, and winding up. The regulator has also cautioned AMC's to strictly adhere to the mutual fund scheme characteristics stated above and ensure that the schemes so devised should not result in duplication of other schemes offered by them. As per the regulator, the AMCs would have to rebalance their portfolios inline with updated list within a period of one month. It would be the responsibility of the AMC to make modifications with regard to investment objective, investment strategy, and benchmark of each scheme to align them with the standardized scheme categories.

CONCLUSION :

The new SEBI measure cuts the clutter, resulting into less number of fund schemes, which in turn will result into less confusion in the minds of investors to choose mutual fund scheme . The new requirements will enable investors to evaluate schemes across AMCs, compare their performance, assess risk-return better, and take informed decision before investing in a mutual fund scheme. SEBI's objective behind the move to categorise and merge schemes is to avoid mis-selling and end the practice of launching many similar schemes just for asset mobilization by fund houses. Every year the regulator takes up initiatives to bring changes in the nomenclature of mutual fund schemes. Retail investors should consider factors like fund attributes to decide on the operational performance of the fund. This would allow them to take intelligent decisions on the choice of mutual fund investments.

REFERENCES :

1. SEBI circular dated March 18, 2013 "Product labeling in Mutual funds" pp 1-3.
2. SEBI circular dated April 30, 2015 "Product labeling in Mutual funds" pp 1-2.
3. Business Standard dated May 7, 2018 "Only some schemes will be affected by SEBI rule".

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