Multi-cap Mutual Funds

Why in news?

The Securities and Exchange Board of India (SEBI) has made a move to change the asset allocation in multi-cap mutual funds.

What is the aim of the move?

- It is aimed at making mutual funds (MFs) 'true to label' and broad-basing trading activity in the market.
- It is also aimed at improving volumes in small-cap stocks.

What is the problem?

- The **implementation** and **timing** leave much to be desired.
- It has been stipulated that the MFs should allocate 75% of the assets in equity of 25% each in large, mid and small-cap stocks as investments.
- Also, it wants the re-allocation to be done within a short timeframe.
- It is unfair to investors who have parked money in these funds based on their current investment strategy.
- Re-allocation of assets based on the new mandate would have resulted in spiking the demand for small-cap stocks, driving up their prices.
- However, the SEBI has assuaged sentiments, by showing willingness to reconsider its decision.

What SEBI could have done?

- If SEBI wanted multi-cap funds to invest according to their label, it should have laid down the sub-limits in 2017 when all other MF schemes were recategorised.
- At that time, SEBI had given ample flexibility to multi-cap schemes by not setting limits for each market cap.
- It stopped with the overall cap of 65% for equity investments.

What was the impact of this flexibility?

- Fund managers had used it to invest a bulk of the assets in large-cap stocks that appeared better placed to deliver sound returns to investors.
- Investors have also parked almost ₹1.5 lakh crore in these funds.

- They believed that the fund managers will allocate their money across market capitalisation, depending on the prospects of each segment.

What would the fund managers do now?

- A problem that fund managers will face is that small-cap stocks with good fundamentals and robust trading volume are limited.
- They are unlikely to be able to increase the allocation towards small-cap stocks to 25% of assets, without harming investors' interest.
- Also, the stock market is currently in a vulnerable state with high speculation driving up stock prices.
- This isn't the time to encourage trading activity in smaller stocks.

What did SEBI clarify?

- The SEBI has clarified that fund houses can allow investors to,
    1. Switch to other schemes,
    2. Merge their multi-cap scheme with their large-cap scheme or
    3. Convert their multi-cap scheme to another category.

What could SEBI do?

- The SEBI could introduce another equity fund category, **flexi-cap funds** that operate with the mandate of the present multi-cap funds.
- This would cause the least disruption to investors as it would involve only change in the fund name.
- If the SEBI intends to insist on asset re-allocation,
    1. A longer time should be given for re-balancing and
    2. The limit of 25% towards small-cap stocks should be lowered.

Source: Business Line

SHANKAR IAS PARLIAMENT
Information is Empowering