

REGULATORY UNCERTAINTY

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

Last week, the Securities and Exchange Board of India (SEBI) issued a circular specifying that multi-cap schemes of mutual funds must invest a minimum of 25 per cent of their total assets in each large, mid and small-cap category. Until now, there was no such allocation criteria. The guidelines had only prescribed that at least 65 per cent of the investments of such schemes be directed towards equities, giving fund managers the flexibility to allocate funds across large, mid or small-cap firms as per their discretion. A few days later, SEBI clarified that apart from rebalancing their portfolio, these multi-cap funds had other options, ranging from, merging with existing large-cap schemes, to converting these schemes to other categories. While SEBI's directive may have been driven by the desire to ensure that these funds are "true-to-label", its decision raises several questions: Why curb fund manager flexibility? Won't changing the character of the fund heighten the risk and uncertainty for existing investors? Moreover, are there enough quality small-cap firms to absorb this inflow? If there were such companies available in this segment, wouldn't they have been attractive proposition for fund managers to begin with?

Mutual fund data from various fund houses shows that put together, the total assets of these multi-cap schemes stand at around Rs 1.45 lakh crore. Of this, the mid-cap and small-cap exposure stands at 16.4 per cent and 6.25 per cent respectively. These numbers imply that in order to meet the requirements imposed by the SEBI circular, roughly Rs 40,000 crore will have to be directed from these funds towards mid and small-cap firms. Considering that most of these multi-cap funds, especially the bigger ones, are largely geared towards large-cap companies and that finding liquid enough quality stocks in these segments will be challenging in the present circumstances, it is possible that these schemes, rather than opting for rebalancing, will opt for one of the other options available.

Multi-cap funds were created to provide the fund manager the freedom to move across stock classifications, depending on the opportunity presented. If they have gravitated towards large-caps it is because of the possibility of greater returns. If the [pandemic](#) is likely to lead to greater economic concentration, benefitting the bigger firms, then surely fund managers and their investors should have the flexibility to take advantage of these trends. This degree of control by the regulator is odd. It was an avoidable move, that only heightened market uncertainty.

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