IMPLICATIONS OF SEBI CATEGORISATION AND RATIONALISATION OF MUTUAL FUND SCHEMES

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ABSTRACT

The Securities and Exchange Board of India (hereinafter SEBI) has overhauled the structure of mutual funds in India vide its circular (hereinafter the Circular) dated October 6, 2017.[1] Prior to the Circular, fund houses were not bound by law to categorise mutual funds. This permitted fund houses to invest in a plethora of securities leaving the investor misinformed or lost in the clutter of investments. The Circular seeks to bring uniformity in the type of schemes offered by fund houses based on their market cap and risk arrangements. It attempts to make it easier for an investor in mutual funds to select and compare the various mutual funds in light of the number of open-ended schemes available (837 open-ended schemes as of February 2018) in the market prior to the Circular.[2] The paper attempts to analyse the changes in the law after the publication of the Circular, the impact on the mutual fund industry, and seeks to provide a comprehensive guide to investors post the re-categorisation of mutual funds.

THE BASICS OF MUTUAL FUNDS AND THE CIRCULAR

The SEBI (Mutual fund) Regulation 1996 defines Mutual Funds as:

"Mutual fund means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities including money market instruments or gold or gold related instruments or real estate assets."[3]

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[1] 'Categorization and Rationalization of Mutual Fund Schemes' (SEBI, 6 October 2017) <www.sebi.gov.in/legal/circulars/oct-2017/categorization-and-rationalization-of-mutual-fund-schemes_36199.html> accessed 14 May 2018.

[2] 'CRISIL Fund Insights: Monthly Funds Newsletter from CRISIL Research' (CRISIL, March 2018) <www.crisil.com/content/dam/crisil/our-analysis/views-and-commentaries/insights/2018/crisil-fund-insights-new-mutual-fund-reclassification-to-help-investors-choose-and-compare-funds-march-2018.pdf.> accessed 28 May 2018.

[3] SEBI (Mutual Fund) Regulations 1996, reg 2(q).

The Circular re-categorises mutual funds under five main open-ended schemes, namely; (i) Equity Schemes, (ii) Debt Schemes, (iii) Hybrid Schemes, (iv) Solution Oriented Schemes, and (v) Other Schemes. An open-ended scheme is a scheme that offers units for sale without specifying the duration for redemption.[4]

Prior to the Circular, mutual funds were not mandated to be categorised according to the rankings of the companies on the stock exchange. The Circular has now defined Large-Cap as 1st-100th company in terms of full market capitalisation of listed securities, Mid-Cap as 101st-250th company in terms of full market capitalisation of listed securities, and Small-Cap as 251st company onwards in terms of full market capitalisation of listed securities. The portfolio of the mutual funds has to be rebalanced according to the list of Large, Mid, and Small-Cap stocks published by the Association of Mutual Funds in India on a six-monthly basis.[5]

The benefit here is that the Circular adopts full market capitalisation in defining the market caps for the mutual funds. Full market capitalisation is the product of the outstanding shares of a company and the price of each share. This provides a greater market valuation as compared to the free float methodology, which excludes lock-in shares, shares held by promoters, shares acquired by Foreign Direct Investment, and shares held by the Government.

The Circular defines 10 Equity Schemes, 16 Debt Schemes, 6 Hybrid Schemes, 2 Solution Oriented Schemes and 2 other schemes. Only one scheme per category is permitted with the exceptions of Index Funds, Exchange Traded Funds (hereinafter ETFs), Fund of Funds (hereinafter FoFs), Sectoral and Thematic Funds.

The Equity Schemes are defined according to their market cap and minimum level of investment. The Debt Schemes are based on the risk level on their end investments by prescribing the Macaulay period i.e. the sensitivity of the portfolio of the fund to the change in interest rates per scheme, the maturity period, and the minimum level of investment. It should be noted that SEBI has amended the Circular vide its circular dated 4 December 2017,[6] which provides that fund managers in case of Medium Duration Funds (3-4 years Macaulay Duration) and Medium to Long Duration Funds

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[4] SEBI (Mutual Fund) Regulations 1996, reg 2(s).

[5] 'Average Market Capitalization of Listed Companies during the Six Months Ended 31-Dec-2017' (AMFI) <www.amfiindia.com/Themes/s/downloads/Avg.%20Market%20Capitalization%20of%20listed%20companies%20during%20-Jul-Dec%202017.pdf> accessed 31 May 2018.

[6] 'Categorization and Rationalization of Mutual Fund Schemes' (SEBI, 4 December 2017) <www.sebi.gov.in/legal/circulars/dec-2017/categorization-and-rationalization-of-mutual-fund-schemes_36804.html> accessed 2 June 2018 ("Rationalization").

(4-7 years Macaulay Duration) can reduce the portfolio duration upto 1 year in case of an anticipated adverse situation with respect to interest rate movements.

For Hybrid Schemes, the Circular prescribes the minimum level of investment in equity and debt instruments per scheme depending on the type of scheme (equity and debt). It also includes funds that adopt Multi-Asset Allocation, Arbitrage, and Dynamic-Asset Allocation investment strategy. Solution Oriented Schemes include the retirement and children's fund, and other schemes include Index Funds, ETFs and FoFs.

CHANGE IN FUNDAMENTAL ATTRIBUTES: A GUIDE TO INVESTORS

As mutual funds recategorise, the potential effects of the recategorisation on investors are only if the fundamental attributes of the mutual fund changes after recategorisation. This may occur when one mutual fund merges with one or more mutual funds in order to be accommodated in one of the categories of the Circular. The Circular maintains that for the purpose of alignment of the existing schemes with the provisions of the Circular, change in type of scheme alone, would not be considered as a change in fundamental attribute. Similarly, a mere change in the name of the mutual fund does not change the fundamental attributes of the mutual fund.

Regulation 18 (15A) of the SEBI (Mutual Funds) Regulations, 1996, provides that the trustees of a mutual fund must ensure that there is no change in the fundamental attributes of the scheme, unless –

1. each unit holder is communicated about the change and the proposed change is published in a nationally circulated English newspaper and a newspaper in the regional language, and
2. the unit holder is permitted to exit the scheme at Net Asset Value without an exit load.

In the Regulation above, the Net Asset Value (hereinafter NAV) is the ratio of the difference between the assets and liabilities, and the total number of units in a fund.[7]

The Circular maintains that in case of any merger or change in the fundamental attributes of the scheme, compliance with Regulation 18(15A) is required. Thus, in case of a change in a fundamental attribute of a scheme post-recategorisation of a mutual fund, the unit holder would either have the option of exiting without an exit load subject to the grant of such permission by the trustee or exit by payment of the exit load.

[7] SEBI (Mutual Fund) Regulations 1996, reg 48(1).

For example, Unit Trust of India (hereinafter UTI) Mutual Fund has provided for an exit period for its investors without exit load from 28 March 2018 to 2 May 2018, for the merger of its schemes UTI Monthly Income Scheme, UTI Smart Woman Savings Plan & UTI - Unit Scheme for Charitable & Religious Trusts & Registered Societies (UTI-CRTS) into UTI-MIS Advantage Plan.[8]

If the fundamental attribute of a fund changes post recategorisation, the investor may have to bear the cost of shifting the fund portfolio into a higher market cap category that shares the investment objective of its portfolio pre-recategorisation. For example, the minimum level of investment in the total assets (Corpus) for a Mid-Cap company stocks is 65% and in Large-Cap company stocks is 80%. If upon recategorisation, a Mid-Cap company is shifted into the Large-Cap company category, and the fund manager has 65% of the total assets of what is now Large-Cap company stocks, the investor would have to bear the cost of the minimum level of investment from 65% to 80% of the total assets of the Large-Cap company.

Furthermore, mutual funds no longer enjoy the freedom of boosting performance of the fund by investing in a plethora of equity or debt options. For example, a corporate bond fund is restricted to a minimum level of investment of 80% of the total assets only in AA+ rated instruments. Alternatively, a credit risk fund is restricted to a minimum level of investment of 65% of the total assets in below than AA+ rated instruments.[9] A corporate bond fund is not permitted to invest in anything below AA+ rated instruments merely to boost performance or enlarge the corpus of the fund. This provides certainty to the investors with respect to the management of their portfolios in a corporate bond fund ensuring the risk security of an AA+ rating.

Lastly, SEBI has provided for disclosure of past performance of mutual funds post-merger vide its circular dated 12 April 2018.[10] The said circular has provided four illustrations, namely; (i) If A (Transferor Scheme) and B (Transferee Scheme) having similar features merge to form a surviving scheme, the Weighted Average Performance (hereinafter WAP) of both prior schemes needs to be disclosed, (ii) If A and B merge and if the features of B is retained then only the WAP of B needs to be disclosed, (iii) If A and

[8] 'Categorization and Rationalization of UTI Mutual Fund Schemes and Merger of UTI Mutual Fund Schemes-Hybrid Schemes' (UTI Mutual Fund, 23 March 2018) <www.utimf.com/documents/documents/forms-and-downloads-2/all-addendums-forms-and-downloads-2/2017-2018-all-addendums-2/54-17-18-categorisation-and-rationalisation-of-hybrid-schemes20180326-112551.pdf> accessed 5 June 2018.

[9] Rationalization (n 6).

[10] 'Performance Disclosure Post-Consolidation/Merger of Schemes' (SEBI, 12 April 2018) <www.sebi.gov.in/legal/circulars/apr-2018/performance-disclosure-post-consolidation-merger-of-schemes_38674.html> accessed 10 June 2018.

B merge and if the features of A is retained then only the WAP of A needs to be disclosed, and (iv) if A and B merge such that a new scheme C is formed, past performance need not be disclosed. In case of (iv), adequate disclaimer needs to be given for the information regarding past performance to be provided.

The impact on recategorisation vitiates past performance in case of (iv) as neither the features of the transferor scheme nor the transferee scheme is retained. For example, post-recategorisation, if a Mid-Cap fund merges to become a Large and Mid-Cap fund, past performance would be relevant as one of the prior scheme's features are retained. However, if a Mid-Cap fund merges to form a Large-Cap fund, past performance is irrelevant.[11]

Disclosure requirements still apply if either/both of the features of the prior schemes are retained. However, past performance may be futile in light of a newly created scheme post-merger. No doubt, past performance was not a definite yardstick to evaluate the returns of a scheme, but it was a parameter to consider in selecting schemes.[12]

In effect, investors are now at the behest of the unpredictable performance of the scheme without prior consistency shown in the returns of the scheme. Even if information is procured regarding the WAP's of the prior schemes, the fundamental attributes of the newly merged scheme may change to the extent that the WAP's of the prior schemes are no reflection on the performance of the newly merged scheme. The absence of past performance may be a disincentive to investors to invest in newly merged schemes or may lead to exit options due to uncertainty.

TAX IMPLICATIONS ON THE INVESTOR

Section 10(38) of the Income Tax Act, 1961, (hereinafter the Act) maintains that Long-term Capital Gains (hereinafter LTCG) arising from transfer of long term capital assets, being equity shares of a company or a unit of equity oriented fund or a unit of business trusts, is exempt from income-tax. This section has been omitted and substituted by Section 112A which provides a 10% long term capital gain tax over 12 months and above INR 1,00,000 for a domestic company/ Individual/HUF.[13] This applies to equity-

[11] Kayezad E Adajania, 'Will Past Returns of Mutual Funds Matter after Schemes are Merged' (Livemint, 18 April 2018) <https://www.livemint.com/Money/AiOoDnGopTeoO2CW5vxt1N/Will-past-returns-of-mutual-funds-matter-after-schemes-are-m.html> accessed 25 June 2018.

[12] Sanjiv Bajaj, 'Mutual Fund Re-Categorization: Checking Past Performance of Schemes will be Futile now' (Financial Express, 22 May 2018) <www.financialexpress.com/money/mutual-fund-re-categorisation-checking-past-performance-of-schemes-will-be-futile-now/1176094/> accessed 1 July 2018.

[13] Income Tax Act 1961, s 112A(2)(i) (ITA 1961).

oriented schemes and hybrid schemes. Within 12 months, short-term capitals gains tax is 15%. For non-equity oriented schemes, the long-term capital gains tax is 20% after 36 months for a domestic company/Individual/HUF. Within 36 months, for non-equity oriented schemes the short-term capital gains is calculated according to the personal tax rate. However, the Finance Act, 2018 maintains a grandfather clause with respect to cost of acquisition i.e. the cost of acquiring the units of the mutual funds. The rationale for the above same was mentioned in the Budget speech of 2018-19:

"The total amount of exempted capital gains from listed shares and units is around INR 3,67,000 crores as per returns filed for AY17-18. Major part of this gain has accrued to corporates and LLPs. This has also created a bias against manufacturing, leading to more business surpluses being invested in financial assets. The return on investment in equity is already quite attractive even without tax exemption. There is therefore a strong case for bringing long-term capital gains from listed equities in the tax net. However, recognising the fact that vibrant equity market is essential for economic growth, I propose only a modest change in the present regime. I propose to tax such long-term capital gains exceeding INR1 lakh at the rate of 10% without allowing the benefit of any indexation. However, all gains up to 31st January, 2018 will be grandfathered."[14]

The cost is now calculated as the closing price on 31 January 2018. The cost of acquisitions in respect of long term capital assets acquired by the assesse before the 1 February, 2018 is the higher of – (a) the actual cost of acquisition of such asset; and (b) the lower of – (I) the fair market value of such asset; and (II) the full value of consideration received or accruing as a result of the transfer of the capital asset.[15]

Below are five illustrations of the impact of the grandfathered cost of acquisition and the LTCG tax:

1. Shares are bought before 1 February 2018 at INR 200 and the closing price of the units (Fair Market Value, FMV) on 31 January 2018 was INR 300. If the shares are sold before 1 April 2018, the Capital Gains of INR 100 (300-200) is tax free.
2. Shares are bought before 1 February 2018 at INR 200 and the FMV on 31 January 2018 was INR 300. After 31 March 2018, the full value of consideration received or accruing as a result of the transfer of the capital asset (Selling Price) is INR 350. Out of the total capital gains of INR 150 (350-200), INR 100 (300-200) is not taxable. The remaining of the Capital Gains at INR 50 is Taxable at 10%.

[14] Arun Jaitley, 'Budget 2018-19 Speech of Arun Jaitley, Minister of Finance' (IndiaBudget, 1 February 2018) <www.indiabudget.gov.in/ub2018-19/bs/bs.pdf> accessed 10 July 2018.

[15] ITA 1961, s 55(ac).

3. Shares are bought before 1 February 2018 at INR 200 and the FMV on 31 January 2018 was INR 300. After 31 March 2018, the selling price is lesser than the FMV but higher than the actual cost of acquisition at INR 250. The lower figure between the FMV and the selling price shall be taken as the cost of acquisition. In this case, the cost of acquisition will be the sale value of the share itself. Thus, the Capital Gains will be nil (250-250). If the FMV was INR 250 and the selling price was INR 300. The Capital Gains Tax will be 10% of INR 50 (300-250).

4. Shares are bought before 1 February 2018 at INR 200 and the selling price after 31 March 2018 was INR 350. The FMV on 31 January 2018 is lesser than the selling price and the actual cost of acquisition at INR 150. In this case, the figure that is higher than the actual cost of acquisition shall be taken as the cost of acquisition. The Capital Gains Tax will be 10% of INR 150 (350-200). Similarly, after 31 March 2018, if the selling price is less than the FMV on 31 January 2018 and the actual cost of acquisition at INR 100, the Capital Gains Tax will be 10% of INR 100 (300-200). If both, the FMV and the selling price are below the actual cost of acquisition, the actual cost of acquisition will be taken as the cost of acquisition. In this case, the Capital Gains Tax will be 10% of INR 150 (350-200).

5. Shares are bought after 1 February 2018 at INR 200 and the selling price after 31 March 2018 was INR 350. The Capital Gains Tax will be 10% of INR 150 (350-200).

Further, for Individuals and HUF's, Dividend Distribution Tax (hereinafter DDT) of 10% (11.648% including Surcharge and Cess) on equity-oriented schemes and DDT of 25% (28.84% including surcharge and Cess)[16] on non-equity-oriented schemes are applicable.[17] For Domestic Companies, DDT of 10% (11.648% including Surcharge and Cess) on equity-oriented schemes and DDT of 30% (34.944% including Surcharge and Cess)[18] on schemes non-equity oriented schemes are applicable.

Thus, the unit holder is now taxed on dividend and growth options. However, the incentive of reinvesting the returns from an investment in a growth option is still available over dividend options. The return in both options will diminish by virtue of the new tax rates, however, by the said reinvesting, the NAV of the mutual fund increases leading to a greater return from an investment in a Growth option compared to a dividend option. Investors looking for a steady flow of income may opt for a dividend option.

[16] ITA 1961, s 115O.

[17] ITA 1961, ss 115R(2)(i) and 115R(2)(ii).

[18] ITA 1961, s 115O.

However, it should be noted that Securities Transaction Tax (hereinafter STT) rates[19] are applicable only on growth options and not dividend options. However, the meager STT rates on growth options do not raise the cost of investment over the returns from the said investment.

Further, the Equity oriented schemes and Hybrid Fund Schemes over 1 year are subject to a 10% LTCG Tax but without indexation. This may incentivize selling of the said funds in the short-term period and attracting a 15% Capital Gains tax rate if in case the loss in indexation is greater than the loss accrued to the 10% LTCG. However, debt oriented schemes attract a higher LTCG tax of 20% but with indexation.

In case of Non-Resident Indians (hereinafter NRI's), 10% LTCG tax over 12 months and above INR 1,00,000 from investments in equity-oriented schemes is now applicable.[20] In case of schemes non- equity oriented schemes; LTCG is 20% for listed securities and 10% for unlisted securities.[21] However, a 10% Tax Deducted at Source (hereinafter TDS)[22] is applicable on LTCG from equity-oriented schemes which was previously exempt. 10% (unlisted securities)[23] and 20% (listed securities)[24] TDS is applicable on non-equity-oriented schemes. Within 36 months, 30% TDS is charged on non-equity oriented schemes if the investor falls in the highest tax bracket. This is applicable only to NRIs. The DDT for equity oriented schemes is 10% (11.648% including surcharge and cess) and DDT for schemes non-equity oriented schemes 25 % (28.84% including surcharge and cess) even for NRIs. STT is also applicable to investment in equity-oriented funds by NRIs.[25]

The 10% TDS on LTCG of NRIs may prove a disincentive for investment in mutual funds as NRIs are given a lesser return at an earlier stage as it is deducted at source as compared to a resident who is to pay the 10% LTCG at the time of assessment. Further, the 10% TDS on equity/non-equity oriented schemes is without any indexation benefit. However, in case of non-equity oriented schemes, indexation benefit is provided for listed securities. This provides an NRI with an incentive to list the securities in non-equity oriented schemes. If the units of the fund are held over a considerable period of time, the 20% TDS may be welcomed if the indexation benefit justifies the 20% tax rate.

[19] Finance Act 2004, cl VII.

[20] ITA 1961, ss 112A(1)(i) and 111A(2)(i).

[21] ITA 1961, ss 112(1)(c)(ii) and 112(1)(c)(iii).

[22] ITA 1961, s 112A.

[23] ITA 1961, ss 112(1)(c)(iii) and 115 E.

[24] Finance Act 2018, s 2(5) and sch 1, pt 2, s 1(b)(D).

[25] ITA 1961, ss 115R(2)(ii) and 115R(2)(iii).

IMPACT ON FUND MANAGERS: A CAUSE FOR CAUTION?

Mutual fund houses are required to analyse each of their existing schemes in light of the list of categories stated in the Circular and submit their proposals to SEBI after obtaining due approvals from their Trustees. This has to be completed within 2 months from the date of the Circular. Subsequent to the observations issued by SEBI on the proposals, mutual funds would have to carry out the necessary changes in all respects within a maximum period of 3 months from the date of such observation.

A possible challenge for fund managers is if upon re-categorisation the Asset Under Management (hereinafter AUM) and NAV of a mutual fund changes. As defined above, the NAV of a mutual fund is the ratio of the difference between the assets and liabilities and the total number of units in a fund. Thus, upon merger, the increase in the number of assets that are merged would increase the NAV. The AUM is the Total Market Value of Assets that an Investment Company or AMC manages on behalf of its clients.

The impact of re-categorisation on AUM and NAV can *inter alia* lead to two possible outcomes; (i) due to mergers, investors may pursue exit options reducing the number of subscriptions to the units of the fund thereby reducing the NAV and the AUM, and (ii) it may lead to mergers of mutual funds increasing the assets to the newly formed fund, thus increasing the NAV and the AUM.

The impact of re-categorisation is indicative of the second outcome. *Firstly*, the total number of folios as on April 30 2018 stands at 7.22 crore[26] as compared to 5.54 crore[27] in FY 2016-17. As of August 2018, the total number of folios has risen to 7.66 crore.[28] *Secondly*, the rates of change in the average AUM show an incremental trend. The rate of change of the average AUM in equity schemes excluding Equity Linked Saving Schemes (hereinafter ELSS) from the quarter end in June 2017 to the quarter end in September 2017 is 11%, from the quarter end in September 2017 to the quarter end in December 2017 has risen by 12%, from the quarter end in December 2017 to the quarter end in March 2018 has risen by 8%, and from the quarter end in March 2018 to the quarter end in June 2018 has risen by 2%. Similarly, the rate of change in the AUM for Debt schemes for the aforementioned years is -1.8%, 3%, 10%, and 6%. Further, the

[26] 'Indian Mutual Funds Industry's Average 'Assets under Management' (AUM) stood at INR 23.21 Lakh Crore (INR 23.59 trillion)' (Association of Mutual Funds in India) <www.amfiindia.com/indian-mutual> accessed 5 July 2018 ("AUM").

[27] 'Mutual Fund Folios Jump to record 7 Crore' (Economic Times, 1 May 2018) <https://economictimes.indiatimes.com/mf/mf-news/mutual-fund-folios-jump-to-record-7crore/articleshow/63982221.cms> accessed 15 July 2018.

[28] AUM (n 26).

average AUM for Balanced Schemes for the aforementioned years is 27%, 20%, 13% and -5%.[29]

Though the rates of change are incremental, the extent of change falls each quarter, with the exception of balanced schemes, which show a decreasing average AUM. However, this may not be a cause for alarm as the corpus of the fund may fall due to fund de-mergers in the process of re-categorisation.

Lastly, the mergers have not impacted NAV or AUM drastically. For example, Reliance Focused Large Cap Fund and Reliance Mid and Small Cap Fund merged to become the Reliance Focused Equity Fund on April 27 2018. The average NAV for the Reliance Focused Equity Fund (average of the NAV of the Reliance Focused Large Cap Fund and the Reliance Mid and Small Cap Fund) for April 2018 was INR 49.28. The average NAV for the Reliance Focused Equity Fund for May 2018 was INR 48.97.[30] As of August 2018, average NAV for the Reliance Focused Equity Fund is INR 50.34.[31]

The Average AUM for March 2018 for the Reliance Focused Large Cap Fund was INR 1,271.91 crore and for the Reliance Mid and Small Cap Fund was INR 3,168.76 crore. The Average AUM for the Reliance Focused Equity Fund for April 2018 was INR 3,390 Crore.[32] As on 14 September 2018, the AUM for the said merged fund stands at INR 4530.50.[33] Thus, Asset Management Companies (hereinafter AMC's) may not face withdrawal of subscriptions or fall in the total value of the fund as the NAV of the units and the AUM of the fund changes meagerly post-merger. This, however, differs in case of each fund. The extent of change in the fundamental attribute of the fund needs to be taken into consideration in case of each fund.

[29] 'AUM/ AAUM Report for the Quarter Ended 30-Jun-2017'(Association of Mutual Funds in India) <http://portal.amfiindia.com/spages/QDACVolQ1-2017-2018.pdf> accessed 24 July 2018; 'AUM/ AAUM Report for the Quarter Ended 30-Sep-2017' (Association of Mutual Funds in India) <http://portal.amfiindia.com/spages/QDACVolQ2-2017-2018.pdf> accessed 24 July 2018; 'AUM/ AAUM Report for the Quarter Ended 31-Dec-2017'(Association of Mutual Funds in India) <http://portal.amfiindia.com/spages/QDACVolQ3-2017-2018.pdf> accessed 24 July 2018; 'AUM/ AAUM Report for the Quarter Ended 31-Mar-2018' (Association of Mutual Funds in India) <http://portal.amfiindia.com/spages/QDACVolQ4-2017-2018.pdf.> accessed 24 July 2018; 'AUM/ AAUM Report for the Quarter Ended 30-June-2018' <http://portal.amfiindia.com/spages/QDACVolQ1-2018-2019.pdf.> accessed 24 July 2018.

[30] 'NAV History' (Reliance Mutual Funds) <www.reliancemutual.com/InvestorServices/Pages/NAVs.aspx?SPID=10> accessed 1 August 2018.

[31] ibid.

[32] ibid.

[33] 'Reliance Focused Equity Fund-Growth Factsheet' (Economic Times, 14 September 2018) <https://economictimes.indiatimes.com/reliance-focused-equity-fund/mffactsheet/schemeid-3900.cms> accessed 15 September 2018.

COST-BENEFIT ANALYSIS FOR THE INVESTOR

Firstly, in the short run, the cost of investing in mutual funds for residents may rise on the following counts with the applicability of; (i) LTCG, (ii) DDT, and (iii) STT. A further cost may be incurred for acquiring assets post re-categorisation for re-aligning the investor's portfolio within the categories of the Circular. Further, loss may accrue to the investor owing to non-indexation in equity-oriented schemes. However, due to the grandfathered cost of acquisition, the investor is guaranteed a price over and above the actual cost of acquisition on sale of the units of the fund.

Secondly, the irrelevance of past performance in newly formed schemes post-merger of mutual funds may lead to investor reluctance towards mutual funds. However, the average AUMs suggest an increasing trend in the total value of the fund despite mergers. This is indicative of the ability of the AMCs and fund houses in maintaining the value of the fund. Further, the increasing rate of folios indicates that exit options are not being pursued.

Thirdly, in the long-run, recategorisation provides investment feasibility by limiting the comparability of options to 36 categories of schemes. While investors may take recourse to exit options due to change in the fundamental attribute of the mutual fund, the number of mergers that have taken place due to the Circular remains limited. Most changes in mutual funds are only with respect to the name and not the fundamental attribute of the mutual fund.[34]

Lastly, equity oriented schemes come with tax benefits like ELSS. Under Section 80C of the Income Tax Act, 1961, the said scheme provided a tax deduction of INR 1,50,000 with a lock-in period of 3 years. After 1 April 2018, even Equity Linked Savings Schemes are subject to a 10% capital gains tax. Hence, the post-tax returns may work out to be lower for holding periods of three years or more. However, despite the diminished rate of return due to taxation, it is the only equity-oriented scheme that provides for the said deduction.

CONCLUSION: PENDING CLARIFICATIONS

It is still early to make an assertion that the recategorisation is a long term benefit with a short-term price. Certain clarifications are still to be made. *Firstly*, in case of past performance, the circular mandates disclosure only in cases of mergers and not in case

[34] Ankit Jain, 'Name Change, Category Change, and Merger of Mutual Funds: The Complete List' (Groww, 6 April 2018) <https://groww.in/blog/name-change-category-change-merger-mutual-funds/> accessed 15 September 2018.

of a change in a scheme category or type. To illustrate, if a fund house changes the category of a scheme from an equity scheme to a hybrid Scheme or a Mid-Cap to a Large-Cap fund, disclosure norms are not required. This is because the Circular maintains that mere change in the type of scheme is not a fundamental change in the attribute of the scheme.

Secondly, exceptions are drawn in favour of sectoral and thematic funds where more than one scheme in the said categories can be provided. However, whether multiple schemes can be offered in one sector or theme requires clarification.

Lastly, the recategorisation may cause inconveniences but the data is promising. The greater certainty or clarity in mutual funds provided to investors due to the recategorisation, the grandfathered cost of acquisition, increased disclosure compliances on fund houses, and the increasing number of folios, represents fruitful prospects for the mutual fund industry generally and the investors specifically.