Mutual Fund and its slow growth

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Manifest Pedagogy

Mutual funds and alternative investments be it in money market or the capital market is in focus for both prelims and mains. While the preims would focus on definitions and aspects related to dividend and taxation, mains would be more focused on the behaviour of the market and stakeholders (Participants, DII,FII etc).

In news

Mutual fund assets growth slowest in 7 years

Placing it in the syllabus

Financial Sector Reforms- LPG

Current dimensions

- How do they work and role in the economy
- Reasons for slow growth; Long term capital gains and Essel group default
- Solutions

Content

What is a mutual fund?

A mutual fund is a type of financial vehicle that consists of a pool of money that many investors have collected to invest in securities such as stocks, bonds, money market instruments, and other assets.

Mutual funds are operated by professional money managers, who allocate the fund’s assets and attempt to produce capital gains or income for the fund’s investors.

Mutual funds provide access to professionally managed portfolios of equity, bond and other securities for small or individual investors. Therefore, each shareholder is proportionally involved in the fund’s gains or losses.

Regulations of Mutual funds

- In India, Mutual funds are regulated by the Securities exchange board of India (SEBI).
- Mutual funds are required to be registered with SEBI, which also acts as the first wall of defence for all investors in these funds.
- SEBI notified regulations in 1993 and issues guidelines from time to time. Mutual funds, either promoted by public or by private sector entities including one promoted by foreign entities are governed by these regulations.
- Thereafter, mutual funds sponsored by private sector entities were allowed to enter the capital market.
- The regulations were fully revised in 1996 and have been amended thereafter from time to time. SEBI has also issued guidelines through circulars to mutual funds from time to time to protect the interests of investors.
- All mutual funds whether promoted by the public sector or private sector entities including those promoted by foreign entities are governed by the same set of Regulations. There is no distinction in regulatory requirements for these mutual funds and all are subject to monitoring and inspections by SEBI.
- Along with SEBI, mutual funds are regulated by RBI, Companies Act, Stock exchange, Indian Trust Act and Ministry of Finance. RBI acts as a regulator of Sponsors of bank-sponsored mutual funds, especially in case of funds offering guaranteed returns.

- In order to provide a guaranteed returns scheme, the mutual fund needs to take approval from RBI. The Ministry of Finance acts as supervisor of RBI and SEBI and appellate authority under SEBI regulations. Mutual funds can appeal to the Ministry of finance on the SEBI rulings.

How do mutual funds work?

- A group of investors pool in money to form a mutual fund
- The asset management company(AMC) is appointed to manage the money according to various goals, The AMC has professional people who understand how markets and money work.
- Then there will be trustees of the mutual fund who keep monitoring the AMCs activities to ensure the investors' interests are protected.
- The AMCs take the pooled money and invest in stocks and fixed-income investments. To ensure proper returns the AMCs invest in various stocks.
- For debt investments, they invest in various securities to spread the risk.
- One's money invested in mutual fund the investors are then given the units that represent the money invested in the fund, these units are easily redeemable to get back ones money and they are generally mentioned along with the NAV or Net Asset Value of a mutual fund that represents the value of one unit of one's investment after all spend expenses and management fees are paid.
- One can invest in mutual fund in lump sum manner or through smaller scale investment plan(SIP). This makes mutual funds accessible to anyone. Hence mutual funds can offer the diversification, liquidity, professional management, and low charges

Role in the economy

The power granted to the purchaser of investing in a dozen different securities without burning a hole through the pocket as well as the reduced dependency on a specific source of income makes for a very lucrative investment option. All the benefit without the anxiety! This unique advantage of mutual funds over other investment choices gives them a place of particular importance in the economy.

As the term suggests, a 'financial intermediary' is any entity that acts as a middleman in financial transactions, between the relevant parties. This can be anything, a bank, mutual funds, pensions funds, investment companies, etc. The principal advantage of a financial intermediary is that it is able to circulate funds as necessary, distributing the available funds based on the financial need of the company. Consequently, the market remains stable and reduces the chances of financial extremes.

Reasons for slow growth:

Long term capital gains (LTCG)

- The 2018 Union Budget announced the return of the long – term capital gains tax, which was much feared. Long Term Capital Gains tax levies a 10% tax on any gains that have been made by a long term investment (more than one year) in the equity market (direct equity or equity-linked mutual funds).
- This announcement has led people to change their course of investments (slow growth of mutual funds)and turn to tax saving schemes, like Unit Linked Insurance Plans(ULIPs).

Essel group default

- Kotak MF and nine other asset management companies (AMCs) – including some of the brand names such as Aditya Birla, ICICI, HDFC, and Reliance – face default prospects on loans given to Essel Group. The past few months have been difficult for debt fund managers, thus it has led to slow growth of mutual funds.

Exposure to IL & FS

- Market has already suffered a blow due to exposure of many funds to IL&FS

Election Related Uncertainties are also adding to fear of good returns from mutual funds going forward.