Regulatory Framework of Capital Markets and Mutual Fund Governance : A Critical Appraisal of SEBI Initiatives

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ABSTRACT

Mutual funds provide the opportunities to a common man to be a part of the capital markets in an indirect manner as the common man does not directly buy shares or securities from the markets but does so through the route of mutual funds in case of equity or hybrid category. The role of SEBI in regulation of mutual funds and subsequent changes by it in the regulatory framework of capital markets has evolved over a period of time which this paper aims to highlight.

Keywords: Assets under Management (AUM), Investments, SEBI, Capital Markets

Introduction

India’s Mutual Fund Industry total Assets Under Management (AUM) as on April 30, 2018 stood at ₹23.26 trillion as compared to just ₹ 5.05 trillion as on March 31, 2008 which is more than a four fold increase.(Source:Amfiindia.com). Securities Exchange Board of India (SEBI) which is the regulator of capital markets has been undertaking lot of changes in the rules and regulations governing the capital markets.

Objective

The paper will discuss in detail the changes proposed by SEBI in the capital market in the recent past spread across banning of shell companies, harmonization of mutual fund schemes, electronic transformation of national payment system, permission to mutual funds for participating in derivatives for the promotion of mutual funds.

With effect from 14 March, 2017 SEBI suspended trading in 331 suspected shell companies' shares by bringing them under stage VI of Graded Surveillance Measure framework. A shell company is the one that exists only on paper but with no physical office. The basic purpose of the creation of shell companies is tax evasion or tax avoidance. As per SEBI, the decision was driven by the abnormal price rise not commensurate with the fundamental of the company like earnings, book value, P/E ratio etc. The decision of the SEBI adversely affected the mutual funds and small investors, who had shares worth nearly Rs 9000 crores in such companies.(Source: SEBI). It is clearly evident from Table 1, where details of the companies with small market capitalization is listed below as per the report of SFIO, ITD which were banned for trading in the exchanges.

Table 1:Small- cap companies banned by SEBI order

Name of the Company	*Market Cap (in Rs Crore)*	*Public Shareholding*	*Identifier*
J Kumar Infra projects	*2150*	*56*	*SFIO*
Prakash Industries	*2124*	*58*	*SFIO*
Parsvnath Developors	*1036*	*29*	*SFIO*

Gallantt Ispat	*604*	*36*	*ITD*
SQS India BFSI	*535*	*46*	*SFIO*
Adhunik Industries	*487*	*25*	*ITD*
Signet Industries	*328*	*30*	*SFIO*

Source :NSE,BSE

For sure, the decision of the SEBI has caused a downfall in the market value of the investors capital.The AMC should be liable for making up the downfall of the investor money even it is short term because of the failure of the AMC for selecting such shell companies for parking public money. For the purpose of making sure that an investor is in a position to properly study various mutual fund schemes available in the market and thereby arrives at the best investment decision , SEBI issued circular dated October 6,2017 and December 4, 2017 on Categorization and Rationalization of Mutual Fund Schemes. As per the directions of SEBI, mutual fund houses have combined some of the existing schemes with the similar nature of schemes.The recategorization of mutual fund schemes was started by SEBI way back in 2015 but aggressively the action has been taken in last 2 years. Since the mutual fund schemes being managed by the fund managers have similar sounding names as well as similar strategies,it causes lot of confusion to the investors while choosing amongst the available schemes . Further, the comparison amongst such similar mutual fund schemes is not very transparent at times. SEBI has mandated that all the mutual fund schemes should be divided into five categories namely equity schemes, debt schemes, hybrid schemes, solution oriented schemes and others. All the mutual fund schemes are now required to carry tag lines under scheme names which will help the investor to know what sort of fund it is, what is the investment objective?

Banks which hold the major portion of institutional business have successfully used the electronic mandate (E-mandate) with API (Application Programming Interface). Application Programming Interface is an interface for the purpose of communication between different programs. APIs have been providing this service since long. The basic objective of E-mandate is the creation of customer authentication which is being transferred by customer bank to the beneficiary bank of the Asset Management Company (AMC). The facility of bulk processing offered by National Payments Corporation of India (NPCI) to banks, financial institutions is done through NACH. The initiative of the government for strengthening the payment platforms through NPCI has proved to be useful for the growth of mutual fund industry in specific and capital markets in general. Even in case of New Fund Offer wherein the existing as well as new companies raise capital for the first time from public, there has been reduction in listing of Initial Public Offer (IPO) to six days with effect from January 1, 2016.SEBI which is the market regulator is already in consultation with National Payments Corporation of India for further reduction in IPO listing.

All the AMC's (Asset Management Companies) need to mention the investment objective of every mutual fund scheme in the SID (Scheme Information Document). SID provides the basic information about a particular scheme which can help the investor to take best investment decision. Further, to help the AMC's in hedging their portfolios, SEBI has relaxed the norms for the participation of mutual funds in derivatives vide circular SEBI/HO/IMD/DF2/CIR/P/2017/13 dated February 20,2017 to protect the interests of investors in secondary market and to promote the development the securities market with the use of hedging. The term hedging is fairly clear. It would cover derivative market positions that will help in countering the potential losses from available cash market positions. Also, the use of derivatives can be used for portfolio rebalancing also where a particular desired portfolio position can be achieved in a more efficient manner as compared to the portfolio returns in cash market.

SEBI in consultation with Reserve Bank of India (RBI) and Insurance Regulatory and Development Authority (IRDA) is also planning to consider relaxing the dir for bodies under their respective jurisdictions. The initiatives taken by SEBI with regards to derivatives is indeed appreciable as in the year 2016, it had relaxed the combined futures and options position limit of stock brokers, foreign portfolio investors and mutual funds in equity derivatives to 20 per cent of the applicable Market Wide Position Limit.

Critical Appraisal & Conclusion

It is being said that investments in equity or hybrid mutual funds over a longer period of time yield greater returns than traditional avenues of investment. The decision of SEBI to ban the shell companies is laudable, but at the same time due care should have been taken to protect the interests of the investor. The move of shell companies trading ban may sound harsh for the retail investors, but if some of the companies which can prove their genuineness should be spared from the trading ban. Rather, they can be fined for accepting fictitious loans under Income Tax Act. In the long run, it is a very healthy sign for the capital market and economy where the regulator is able to convey a very stern message to the tax evaders but at the same time the small investors' interests' should be protected with some kind of relief since they are indirectly investors in these shell companies through the route of mutual funds. After all, it is based on the prudence of the Asset Management Company that the investors money is parked in the companies whether small cap, mid cap or large cap. It is the prime responsibility of the fund managers looking after the AUMs (Asset Under Management) to ensure that in the event of any red signal given by SEBI with respect to capital market regulations, the AMC should provide the capital protection or some kind of compensation for loss of investor money.

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