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The Growth of Mutual Funds and Regulatory Challenges

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ABSTRACT Mutual funds are one of the most innovative financial products introduced in India during the period 1964. It becomes popular and the market size has been increased after 1990 by allowing public sector companies entered into mutual funds. The original mutual funds were simple, low risk and easy to understand and recent mutual funds have additional dimensions of risk. The additional risks, complexity, and reduced transparency have resulted in heightened attention by regulators. Concerns related to systemic risk and excess volatility, suitability for retail investors, lack of transparency and liquidity have been raised. These concerns are being addressed by a shift towards multiple counterparties, overcollateralization, and disclosure of collateral holdings and index holdings. The appropriate regulatory and market reforms can ensure the continued success of mutual funds.

Introduction

Investors can sell and buy mutual fund units through intermediaries or directly from fund houses. The units of mutual funds are often trade at net asset value (NAV) of the scheme, rather than at discounts or premiums. Mutual funds are one of the most innovative and successful products introduced in India in the 1964. The original mutual funds were simple, providing diversification benefits at a low cost and required minimum investment of Rs. 500, it may vary from scheme to scheme. More recently, complex products with additional risks have been introduced, attracting the attention of regulators. Regulatory concerns have focused around the issues of risks, transparency, lack of liquidity, complexity and suitability in mutual funds. This paper aims to closely examine the enormous growth in market size and complexity of mutual funds as well as the regulatory concerns raised by them.

Mutual funds: Evolution and Recent Trends

Mutual funds provide an alternative to stocks and related investments. It is suitable to the investor who is looking to risk low, security market related area without keen observation. Fund managers manage the investors fund and makes return out of the diversified investment. Mutual fund companies named Asset Management Companies invest the collected funds into various sectors such as bank, software, pharmaceuticals, Consumer Non Durables, Industrial Capital Goods, Petroleum, Finance, Auto, Power, Gas, Ferrous Metals, Textile Products, Cement, Media & Entertainment, Construction, Fertilisers, Industrial Products , Construction Project , Pesticides, Non - Ferrous Metals, Auto Ancillaries, Consumer Durables, Transportation, Engineering Services, Retailing.

Every day, AMC publishes its portfolio in publicly accessible media. It makes the investor to know about the company movements and make analysis about it performance. This transparency can contribute to the efficiency of the performance of the mutual funds. Arbitrage activity in mutual fund units is also affected by the liquidity of the securities in a mutual fund's portfolio. The number of investors and assets accumulated by mutual fund industries in Mumbai is very high (42.96%) followed by Delhi(15.3), Bangalore(5.74), Kokata(5.46) and Chennai(4.8) during the month December 2012. An average asset under management was Rs. 786,543.56 crore during the period December 2012.

Growth in Mutual fund Market

Mutual Funds industry has its birth in the year 1963. At the end of millennium marks 49 years of existence in this country. It passes so many phases in its existence. Unit Trust of India (UTI) was the first player In mutual funds industry. It was established in 1963 by an ACT of parliament. It was set up by the Reserve Bank of India (RBI) and functioned under the regulatory and administrative control of the RBI with a view of encouraging savings and investment and participation in the income profits and gains accruing to the corporation from the acquisition, holding, management and disposal of securities. In 1978 UTI was de-linked from the RBI and Industrial Development Bank of India (IDBI) took over the regulatory and administrative control in place of RBI. The industry was one-entity till 1986 the UTI monopoly was broken when SBI and canbank mutual fund entered into the same arena in December 1987. Followed by this Punjab National Bank in August 1989, Indian Bank Mutual Fund in November 1989, Bank of India in January 1990, Bank of Baroda Mutual fund in October 1992, Life Insurance Corporation (LIC) in 1989 and General Insurance Corporation (GIC) in 1990 were entered into the market. When the private sector made their entry to the market, the industry growth has been increased. It creates the necessity of Mutual Fund regulations came into being under which all Mutual Funds except UTI were to be registered and governed.

Kothari pioneer was the first private sector Mutual Fund registered in the year 1993. In 1996 SEBI Mutual Fund regulations were made to organize the private mutual funds and the regulations were revised to help private parties. The opening up of the asset management business to private sector allows international players like Morgan Stanly, Jardine Fleming, JP Morgan, George Soros and capital international to enter into the industry by joining with domestic players. Number of mutual fund intermediaries in are 51, 49 and 51 during the year 2010-11, 2011-12 and 2012-13 respectively.

Table 1 Growth of Mutual Fund Intermediaries in India

S.No	Year	Number of Intermediaries	Assets Under Management
1.	1999-00	41	1,07,946
2.	2000-01	38	90,587
3.	2001-02	39	1,00,594
4.	2002-03	38	1,09,299
5.	2003-04	38	1,39,616
6.	2004-05	37	1,49,600
7.	2005-06	39	2,31,862

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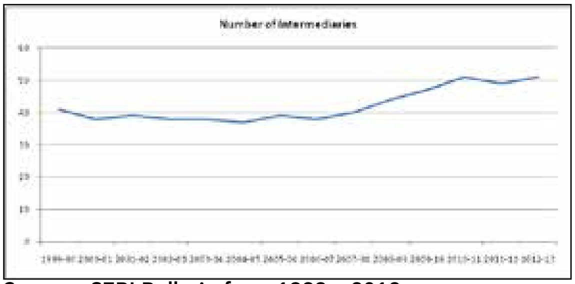
8.	2006-07	38	3,26,292
9.	2007-08	40	5,05,152
10.	2008-09	44	4,17,300
11.	2009-10	47	6,13,979
12.	2010-11	51	5,92,250
13.	2011-12	49	5,87,217
14.	2012-13	51	8,13,530

Chart 1 Growth of Mutual Fund Intermediaries India



Source : SEBI Bulletin from 1999 – 2012

Table 1 shows the growth of mutual fund industries over a period of time. The total assets under the managements have been increased from Rs. 1 million in 1999-2000 to 5 million in 2011-12. Number of intermediaries has been increased from 41 in 1999-2000 to 49 in 2011-12. Chart 1 graphically represents the development of mutual funds.

There are fund managers appointed by AMCs who is taking care of the investors money and making return out of that.

Mutual fund performance can be affected by many different factors such as inflation, Natural disasters, Market positions, company growth and development of the company, National and International events, political factors including the individual investments that are chosen by the mutual fund manager. The asset allocation of the fund also plays a big role in mutual fund performance.

Table 2 Asset Management Companies

S.No	Mutual Funds	Assets Under Management (Rs.Cr)	
		Dec-12	Mar-13
1	HDFC Mutual Fund	101,393	101,720
2	Reliance Mutual Fund	90,636	94,580
3	ICICI Prudential Mutual Fund	81,394	87,835
4	Birla Sun Life Mutual Fund	76,890	77,046
5	UTI Mutual Fund	70,638	69,450
6	SBI Mutual Fund	53,311	54,905
7	Franklin Templeton Mutual Fund	40,869	41,564
8	Kotak Mahindra Mutual Fund	31,773	35,361
9	IDFC Mutual Fund	30,002	32,886
10	DSP BlackRock Mutual Fund	30,838	32,342

Source : http://www.moneycontrol.com/mutual-funds/amc-assets-monitor

Table 2 shows the top 10 AMCs based on its asset as on March 2013. HDFC mutual fund with 101,720 cr asset and leads first position. DSP BlackRock Mutual fund maintains 32,342 crore assets and being in the 10th position. There are 51 AMCs in the year 2013. It can also be seen that HDFC Mutual Fund place first position in the year December 2012 and March 2013. It is noted that all the 10 companies remains its same position in the period December 2012 and March 2013.

Invariably all the AMCs launched mutual funds in various schemes such as Income, Equity, Balanced, Liquid/Money Market, Gilt, Equity linked Savings Scheme (ELSS), Gold Exchange Traded Fund (ETF) and Funds of funds.

Regulatory Concerns in Developed Markets

Regulators around the world have been showing concerns about the risks associated with the securities market that may have additional risks associated with the construction and performance of the securities market. The major concerns are related to:

- Systemic risk and excess volatility
- Suitability of complex securities and mutual funds for retail investors
- Lack of transparency and liquidity of the securities in the portfolio

Securities and Exchange Board of India (SEBI) was established in the year 1992 through SEBI Act 1992 to regulate the securities and mutual fund market in India.

Association of Mutual Funds in India (AMFI) was incorporated on 22nd August, 1995 to regulate the mutual funds in particular. It was established to promote the mutual fund market, to protect the mutual fund investors and to ensure the transparency among the investors. AMFI Consider investor's interest as paramount and take necessary steps to ensure that the investor's interest is protected in all circumstances.

SEBI (Mutual Funds) Regulations, 1996 provided the guidelines and criteria to the mutual fund companies. It ensures the about transparent, payment of fee and administration of the mutual fund companies.

SEBI issued Mutual Fund Regulations and guidelines from time to time related to distributors, selling, distribution and advertising practices. SEBI has taking all kind of necessary steps to enhance the fraudulent free environment and transparency among the mutual fund companies and investors. Regulations can be maintained by educating the investor properly. Along with the AMCs and AMFI SEBI organizing many investor awareness campaign, workshop and seminars.

Observing high standards of ethics, integrity and fairness in all its dealings with all parties such as investors, Mutual Funds/ AMCs, Registrars & Transfer Agents and other intermediaries are big challenge of regulators.

Conclusion

Mutual fund has enormous growth in the recent past after 1997. Hence, regulators are keeping close watch on any potential impact of these products on financial stability and market volatility.

Intermediaries do not indulge in fraudulent or unfair trade practices of any kind while selling units of Schemes of any mutual fund. Selling of units of schemes of any mutual fund by any intermediary directly or indirectly by making false or misleading statement, concealing or omitting material facts of the scheme, concealing the associated risk factors of the schemes or not taking reasonable care to ensure suitability of the scheme to the investor will be construed as fraudulent / unfair trade practice.

The growth of mutual fund has been accompanied by innovation and complexity in some of the mutual funds. Regulators will need to treat carefully to manage risks and yet not impose necessary unnecessary regulation. Regulators tries to render at all times high standards of service, exercise due diligence, and ensure proper care.

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