Business Standard

Investors can do without solution-oriented funds

Now that solution-oriented funds will have a lock-in of five years, most investors will be better off investing in open-end diversified equity funds to achieve similar investment outcomes

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The Securities and Exchange Board of India (Sebi) has through a circular introduced a new classification of funds. All open-end mutual fund schemes will now fall under one of the following five categories: equity, debt, hybrid, solution-oriented, and others (which will include index funds, exchange-traded funds or ETFs, and fund of funds). Asset management companies (AMCs) will be allowed one scheme in each category, thereby reducing the number of funds and making it easier for investors to select the right funds. Goal-oriented schemes, such as children's plans and retirement plans, will fall under the solution-oriented category. All funds under this category will now have a lock-in of five years. In a child plan, for instance, investors will not be allowed withdrawal either for five years or until the child attains the age of majority, whichever comes earlier. Retirement funds will similarly not allow withdrawal either for five years or until the investor retires, whichever comes earlier.

These funds that come with a five-year lock-in are suitable only for a certain type of investor. "These products with a lock-in may be suitable for conservative investors, or those with little knowledge of the investment landscape who are looking for easy solutions," says Suresh Sadagopan, founder, Ladder7 Financial Advisors. In particular, these funds may be suitable for investors who lack the discipline to stay invested in equities when the markets are passing through a bear phase. The lock-in will force them to stay invested, and not pull their money out at a loss.

Financial planners, however, argue that objectives such as saving for retirement or for children's education can be achieved equally, or perhaps more effectively, by investing in open-end funds. One issue with funds that have a lock-in is that in case the fund underperforms, investors cannot exit them and move their investments to a better-performing fund. They will have no option but to put up with the underperformance until the lock-in period ends. This could even prevent them from achieving their investment objective on schedule. In an open-end fund, it is usually advisable to wait for three or four quarters, allowing the fund adequate time to recover. If it fails to do so, investors can switch to another fund. This option is not available in funds with a lock-in.

At the same time, investors who have already put their money in such funds should avoid exiting them as soon as the lock-in period gets over. "Investors need to stay invested for the long term to reap the benefit of these funds," says Vishal Dhawan, chief financial planner, Plan Ahead Wealth Advisors. In equity funds, an investment horizon of at least seven years is a must.

RETURNS OF CHILD PLANS

Fund	Returns (%) 1-year	3-year	5-year
HDFC Children's Gift Fund (Lockin)	15.72	10.64	19.24
ICICI Pru Child Care Plan-Gift Plan	6.91	8.57	17.88
SBI Magnum Children Benefit Plan	16.78	14.49	15.98
ICICI Pru Child Care Plan-Study Plan	7.24	8.98	14.95
LIC MF Children's Gift Fund (G)	-1.09	3.69	10.51
Axis Children's Gift Fund-Compulsory Lockin-Reg (G)	16.07	–	–

Source: Ace MF

Instead of investing in these branded funds, investors can achieve the same objectives with other generic funds. "In the new categorisation of funds, the aggressive hybrid fund, which earlier used to be called balanced fund, is similar in its asset allocation to various children's funds, with a similar level of equity exposure," adds Dhawan. Knowledgeable investors can use an appropriate mix of diversified equity funds to meet their long-term investment goals. "If young investors are planning for retirement, and have the necessary risk appetite, they should opt for diversified-equity schemes to plan for their long-term goals, rather than use solution-oriented schemes," says Dhawan. More conservative investors may use aggressive hybrid funds, earlier known as balanced funds.