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**EDITORIAL ANALYSIS**

# SEBI's Mutual Fund Overhaul — Can New Rules Fix India's Retail Investor Problem?

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**SUBJECTS COVERED****ECONOMY****GS PAPERS****GS3****GS2****CURATED & WRITTEN BY****Bharat Choudhary**

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The Indian Express 17 January 2026

GS3

GS2

IE The Indian Express

MAINS RELEVANCE:

GS Paper 3

GS Paper 2



## INTERVIEW ANGLE

"SEBI has revamped mutual fund regulations after 30 years. But India's retail investor participation in capital markets remains low compared to developed economies. Is regulatory architecture the binding constraint, or is it financial literacy and trust? What more needs to be done?"

## WHY IN NEWS

SEBI notified the SEBI (Mutual Funds) Regulations, 2026 on January 16, replacing the 1996 framework that governed India's Rs 68 lakh crore mutual fund industry for nearly three decades. The overhaul introduces Base Expense Ratio transparency, expands fund categories to 40, and imposes a True-to-Label discipline on fund managers.

## WHY THE 1996 FRAMEWORK NEEDED REPLACING

India's mutual fund industry has grown from ~Rs 50,000 crore in AUM in 1996 to **Rs 68 lakh crore (~\$800 billion) in January 2026** — a 1,360-fold increase. In 1996:

- No internet; no SIP (Systematic Investment Plan) culture; no demat accounts for most investors

- Fund categories were informal conventions, not regulatory definitions

- Expense ratios were uncapped and opaque

- Retail participation was negligible — institutional investors and high-net-worth individuals dominated

The 1996 regulations were patched with dozens of circulars (SEBI issued 180+ MF-related circulars between 2000 and 2025) — creating a patchwork legal framework that was difficult to understand. The 2026 regulations consolidate this into a unified, coherent structure.

## THE BASE EXPENSE RATIO (BER): THE TRANSPARENCY REVOLUTION

The most significant change is structural transparency in how fund costs are disclosed.

**The current problem:** The Total Expense Ratio (TER) — the only metric investors see — bundles together:

- AMC management fee (the actual cost of fund management)
- Brokerage paid for executing trades (variable)
- Securities Transaction Tax (STT)
- Stamp duty on transactions
- Marketing and distribution commissions (now capped by SEBI’s “direct plan” rules)

This bundling makes it impossible for investors to compare what different AMCs actually charge for managing money, versus what they pay for transaction costs (which vary by trading frequency and are not the fund manager’s choice).

**BER under the 2026 Regulations:**

- AMC management fee must be disclosed separately as the **Base Expense Ratio (BER)**
- Transaction costs (brokerage, STT, stamp duty) disclosed as a separate component
- Investors can now compare AMC management fees across funds on an apples-to-apples basis

This mirrors the approach taken in the EU’s MiFID II regulations and the US SEC’s requirement to separately disclose advisory fees from transaction costs.

## TRUE-TO-LABEL: PREVENTING STYLE DRIFT

**The problem:** A “large-cap fund” that buys mid-cap stocks for better returns may outperform peers in a bull market — but exposes investors to higher risk than they signed up for. This is **style drift** — and it was common in India.

**SEBI’s 2017 categorisation** circular attempted to fix this by defining fund categories. But it left room for manoeuvre at the margin.

**2026’s True-to-Label rule:** Portfolio must **strictly** align with the stated investment objective. Overlap between similar schemes of the same AMC must be eliminated (merged or differentiated). SEBI can conduct portfolio composition audits.

This is pro-investor — retail investors choosing a fund should be able to trust the label. A “balanced advantage fund” should actually balance between equity and debt based on market conditions, not remain 80% equity regardless.

## NEW FUND CATEGORIES: LIFE-CYCLE FUNDS AND SECTORAL DEBT

The expansion from 36 to 40 categories adds:

**Life-Cycle Funds (Target Date Funds):** Common in the US (Vanguard’s Target Retirement series), these funds automatically shift asset allocation from high-equity to high-debt as the investor approaches a target year (retirement date). India’s EPFO and NPS already follow lifecycle principles — SEBI’s new category allows market-based retirement investing.

**Sectoral Debt Funds:** Allow AMCs to offer debt funds concentrated in specific sectors (e.g., infrastructure debt, green bonds, MSME debt). This can channel capital into priority sectors that struggle with market-rate financing.

## THE UNRESOLVED PROBLEM: INDIA’S RETAIL PARTICIPATION GAP

Despite Rs 68 lakh crore AUM and 21 crore SIP accounts, India’s equity mutual fund penetration remains **~6% of GDP** versus:

USA: ~80% of GDP

UK: ~50% of GDP

Brazil: ~35% of GDP

The SEBI regulations can fix transparency and architecture — but they cannot fix:

**Financial literacy deficit:** Over 50% of India’s adult population cannot compute compound interest or understand inflation-adjusted returns. They cannot evaluate fund performance meaningfully. Better TER disclosure means nothing to someone who cannot read a factsheet.

**Trust deficit in financial institutions:** The 2018-19 IL&FS crisis, Franklin Templeton debt fund wind-up (2020), and the history of unit-linked insurance plan (ULIP) mis-selling have created lasting suspicion of financial products among first-generation investors in Tier-2/3 cities.

**Distribution gap:** 80% of retail investments go to **direct plans** (bought through online platforms like Zerodha, Groww, Kuvera) or through large distributors in metro cities. The “advised” investment model in rural and semi-urban areas relies on bank relationship managers and insurance agents who have incentive to push commission-generating products.

**The FOMO-driven behaviour problem:** SIP stoppage rate during market corrections remains high (India saw 40 lakh SIP cancellations per month during the 2022 market downturn). Regulations cannot fix behavioural risk — investor education must.

## WHAT THE 2026 REGULATIONS GET RIGHT — AND WHAT THEY DON'T ADDRESS

### **Gets right:**

- BER transparency enables meaningful cost comparison
- True-to-Label reduces information asymmetry
- Consolidation of 180+ circulars into a unified framework

### **Does not address:**

- Mis-selling through insurance channels (ULIPs vs. mutual funds — IRDAI domain, not SEBI)
- ESOP mutual fund structures for startup employees
- Municipal bond funds and sub-national debt instruments
- Deepening of debt markets beyond G-Secs and AAA corporate bonds

The 2026 reform is necessary but not sufficient. India needs parallel reforms in investor education (SEBI's Investor Education and Protection Fund — IEPF — needs 10x budget), distribution infrastructure in rural areas, and cross-regulatory coordination between SEBI, IRDAI, and PFRDA to prevent product mis-comparison.

**UPSC RELEVANCE**

SEBI MF Regulations 2026 (effective April 1, 2026; 36→40 categories; BER; True-to-Label; supersedes 1996 regulations); Life-Cycle Funds (Target Date Funds); Base Expense Ratio (BER); Total Expense Ratio (TER); SEBI SCORES; SIP (Systematic Investment Plan); IEPF (Investor Education and Protection Fund); MiFID II (EU capital markets regulation); Alternative Investment Fund (AIF) — Category I/II/III

**MAINS GS-3:**

“Critically evaluate the significance of SEBI (Mutual Funds) Regulations 2026. Do the reforms adequately address the structural challenges of deepening retail investor participation in India’s capital markets?” | “India’s capital markets have grown significantly — but retail investor participation remains thin. Analyse the regulatory, literacy, and trust barriers and suggest a comprehensive reform agenda.”

**MAINS GS-2:**

“Examine SEBI’s regulatory evolution from a disclosure-based regulator to a conduct-based regulator. Has India’s financial sector regulation kept pace with market complexity?”

**INTERVIEW:**

“India has 21 crore SIP accounts but mutual fund AUM is only 6% of GDP. Compare India’s retail investment culture with the USA and identify what policy lever would have the highest impact.”

**★ FACTS CORNER — KNOWLEDGE PEDIA**
**SEBI (MUTUAL FUNDS) REGULATIONS 2026:**

Notified: January 16, 2026; effective April 1, 2026

Replaces: SEBI (Mutual Funds) Regulations 1996 (30 years old)

Key change 1: Base Expense Ratio (BER) — AMC management fee disclosed separately

Key change 2: Fund categories: 36 → 40 (adds Life-Cycle Funds, Sectoral Debt Funds)

Key change 3: True-to-Label — portfolio must match stated investment objective

Key change 4: Solution-Oriented Schemes closed to fresh investments; to be merged

Key change 5: Intraday borrowing permitted (from April 1, 2026)

**INDIA MUTUAL FUND INDUSTRY (2026):**

Total AUM: ~Rs 68 lakh crore (~\$800 billion)

SIP accounts: ~21 crore

Monthly SIP inflows: ~Rs 25,000 crore

Equity MF AUM as % of GDP: ~6% (vs. USA ~80%, UK ~50%)

SEBI MF circulars (2000-2025): 180+

**KEY MUTUAL FUND CONCEPTS:**

TER (Total Expense Ratio): All-in annual cost charged to the fund (as % of AUM)

BER (Base Expense Ratio): AMC management fee only (excludes transaction costs)

Direct Plan: No commission; lower TER; for informed investors (post-2013 SEBI rule)

Regular Plan: Distributor commission included; higher TER

Style Drift: Fund investing outside stated mandate (e.g., large-cap fund buying mid-caps)

Target Date Fund (Life-Cycle Fund): Shifts equity→debt as target date approaches

**SEBI CATEGORISATION 2017 (PRIOR REFORM CONTEXT):**

Standardised fund categories for the first time

Mandated each AMC have one fund per category (no duplicate schemes)

Resulted in merger of 300+ schemes

**INVESTOR PROTECTION INFRASTRUCTURE:**

SEBI SCORES: Online complaint redressal platform

IEPF (Investor Education and Protection Fund): Under Companies Act 2013

SEBI Investor Education Fund: Financial literacy initiatives

**OTHER REGULATORY BODIES — FINANCIAL PRODUCTS:**

SEBI: Mutual funds, stocks, bonds, AIFs

IRDAI: Insurance policies (ULIPs, endowment plans)

PFRDA: NPS (National Pension System)

RBI: Fixed deposits, savings accounts, RBI bonds

Sources: SEBI, The Indian Express, PIB, AMFI



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