

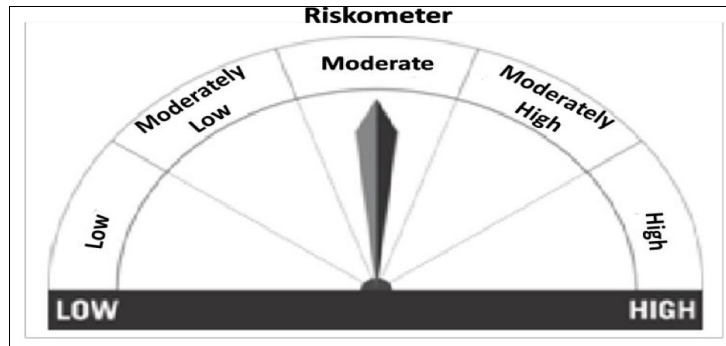
What is Riskometer?

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Executive Summary - SEBI has launched the riskometer to replace the existing colour codes to indicate the risk involved in investing in a mutual fund scheme. The riskometer has 5 levels of risk and every mutual fund house has to specify the risk level of each of its scheme as per the riskometer by July 1st, 2015. This will help in understanding the broad risk involved in investing in a scheme but a mutual fund investor still has to understand the underlying assets of the scheme, read the documentation and understand the risk-return ratio to make the investment decision. The riskometer alone is not enough to help him make that decision.

Mutual funds had to colour code their schemes to indicate the level of risk. There were 3 levels of ranking mutual funds by risk - Blue, Yellow and Brown. Generally liquid funds and ultra short term bond funds were colour coded “Blue” indicating low risk of capital loss. Debt oriented funds, Hybrid funds were colour coded “Yellow” indicating moderate risk of capital loss. and Equity funds, thematic funds, Sectoral ETFs, Gold ETFs were colour coded “Brown” meaning higher risk investment options. The earlier system of colour coding was not accurate and different AMCs had their interpretation of the colours and ranked the schemes as per their understanding which made it subjective. Three levels of risk are not enough for the variety of schemes available in the market. For example, an equity fund would be classified as brown indicating high risk but an equity fund which has a sectoral theme might be more risky than a general equity fund. A hybrid fund for example might be colour coded as yellow considering the assets that it invests in but hybrid funds have not performed very well and therefore the risk classification might be wrong. An amateur investor will not be aware of such things and can make investment decisions that are not suitable for him. Therefore risk grading just on 3 levels is not enough and a more detailed risk level hierarchy is required which resulted in defining the riskometer with more levels of risk.

SEBI, in a recent circular has announced that a riskometer will replace the colour codes. The riskometer is a pictorial representation of the level of risk of a specific scheme.



SEBI has mandated that all AMCs have to use the riskometer to categorize their products by July 1st, 2015 and replace the colour codes. The aim is to help investors understand and assess the risks involved in investing in a particular mutual fund scheme. It is aimed at streamlining the MF market. The riskometer has 5 levels -

Level	Inference	Which Mutual funds would be covered?
Low	Low risk Investment	Liquid Funds, Ultra Short-term funds
Moderately Low	Investment at moderately low risk	Gilt funds, Income funds, Short term and Medium term bond funds
Moderate	Investment at moderate risk	Balanced Funds, Long term Income Funds
Moderately High	Investment at a higher risk	Index Funds, Balanced Funds, Large Cap Funds
High	High risk investments	Thematic funds, Sectoral Funds, Small Cap Funds, Mid Cap Funds

The riskometer has more risk categories which forces Mutual funds to label their schemes more accurately. This is to try to ensure that there will be lesser subjectivity and investors will understand risks involved in mutual fund investments better.

Will the new riskometer help you?

The new riskometer definitely helps more than the existing colour codes as there are more categories of risk and AMCs will have to classify the schemes in a more detailed manner. The Association of Mutual Funds of India (AMFI) has formed a committee that will decide basic standards and guidelines to be used to classify the schemes.

But on the other hand, more risk levels might lead to more confusion for the retail investor. The risk levels will not help investors to determine the returns to decide if they want to invest in a particular scheme. The ranking of the schemes for their risk will still be largely subjective which does not help the investors too much. It also does not do much to protect investors from mis-selling fully.

For example, a mutual fund house might label a large cap equity fund as 'High risk' and another mutual fund house with a similar large cap equity scheme might label it as 'Moderately High'.

An investor will still have to read through the offer document, understand the risks involved, assess whether the scheme matches the assessment of his risk taking capacity and risk tolerance levels. The investor will have to understand the risk-return ratio before investing in a mutual fund scheme. It is good for a first time investor who will be able to understand categories of mutual funds and the relative risk involved in investing in them by following the riskometer. If an investor is not sure of his abilities to invest or is new to mutual fund investment, he should consult a financial planner or understand the product completely from all aspects and read all the related documentation before investing in it.

It is too early to give a verdict on it but we will be able to understand how helpful it is, once it is implemented and used for some time.

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Tags - Riskometer for Mutual Funds.