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Cos, HNIs Set to Bypass MF Distributors, Invest Directly from January 1

Direct plans likely to be cheaper by 50-75 bps as customers won't have to pay for distributors' charges

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Three years after the then Sebi chief CB Bhave shook up Indian fund houses, the mutual fund industry is now in the cusp of another big change.

Come January, several bank and corporate treasuries that comprise the largest investor group in MFs will sidestep intermediaries and invest directly to earn higher returns. A fortnight ago, many such big ticket investors who regularly park surplus funds in liquid MF schemes, have communicated their decision to leading distributors, sources told ET.

These investors will subscribe to 'direct plans' which will be cheaper by 50-75 basis points as customers have the flexibility to invest directly without incurring any incidental costs. According to a Sebi decision taken earlier this year, every fund and scheme must have a direct plan for investors who do not want distributor support and the net asset values of such plans will be given separately.

"We have informed our distributor about our decision. Some of the banks have also done it. While it's unclear whether fund houses will serve us like distributors, there will be a cost benefit and higher return for us," said the treasurer of a large financial institution.

Meanwhile, asset management companies are facing a test of loyalty with fund distributors requesting them to go slow on their roll-out of direct plans while market regulator Sebi has directed them to introduce the facility by January 1. The regulator, said a fund manager, has been informally asking fund houses to start getting approvals for their "direct plan" fund variants. Fund houses will have to file their scheme information document by December 5, if they have to meet the January 1 deadline. The regulator typically takes 21-25 days to approve new plans.

It could be a matter of time before HNIs and smart retail investors, lured by a higher return, figure out the way to invest directly. Fund distributors are apprehensive about the whole idea. "I think the time has come for the distributor community to fend for itself and start looking at alternate sources of businesses like insurance and real estate. The regulator thinks that the industry can survive and thrive without the participation of distributors who have actually brought the industry to the current stage," said Sunil Jhaveri, the founder of MSJ Capital & Corporate Services, a leading advisor. According to another Mumbai-based distributor, the new arrangement will result in many existing investors shifting to the direct plan after taking the advice. Most institutional investors may have to compulsorily shift their fund allocation to direct plans with their respective boards nudging them to invest surpluses at lower cost. Currently, investors putting money directly with MFs have no cost advantage; it's the AMCs that gain. The Indian MF industry manages over . 5 lakh crore in fixed income schemes. Over 90% of these investors are corporate treasuries and banks. As on September 30, corporate treasury investments account for nearly 82% of the liquid fund/money market fund pool, 64% of the gilts fund pool and 54% of the intermediate bond fund pool.

"The entire institutional chunk will move into direct plan once it is launched. They cannot be blamed as institutions are bound by certain corporate governance norm which mandates them to invest surpluses at lower cost," said Dhirendra Kumar, MD of fund research firm Value Research. "Direct plan is a good option for investors who have expertise to invest on their own. The problem now is that even Sebi is desirous of bringing in new investors into the industry. Direct plans are not good for new investors. They need expert handholding for some years before they could start doing it themselves," said Kumar who has tracked the sector for years. He felt that it's a bit unfair from distributors' point of view as investors, whom they helped all along, will move out on their own and shift to direct plans once they get a hang of fund investments. This is not the first time when Sebi has come out with a direct investment route for mutual fund investors. Under chairman M Damodaran, Sebi had introduced the "direct application route" as a freeway for investors who did not want to pay the 2.25% entry load. The industry receives nearly 7% of the SIP investments – that is about . 61 crore spread over 3.15 lakh folios –through the direct application route. "But direct plans will have more impact than direct application route as the former passes benefits of unassisted investing to investors in the form of higher NAVs. Investors will lap up direct plans," said a Mumbai-based independent financial advisor.

Foundation of Independent Financial Advisors (FIFA) had written to Sebi expressing its displeasure over direct plans. "Such a step could lead to a lot of existing investors who have taken advice shifting to the direct class after taking advice," said Dhruv Mehta, chairman of FIFA, in his letter to Sebi. “This move could benefit very large Institutional investors, FII investors and super HNIs who can do investments on their own. The introduction of a direct plan would have a deep impact on the IFA community as a whole,” he said in his letter.

The distributors had sought the support of Amfi to take up the matter of direct plan with Sebi. Amfi members, in its board meeting, had decided to form a committee to discuss the matter with the regulator. However, there has not been any concrete move on the part of Amfi after that, both distributors and fund executives said. “We’re left with no option now. We sympathise with distributors, but we can’t do anything about it. We’ll have to seek approvals to launch direct plans. We plan to file next week,” said the CEO of mid-sized fund house.

Distributors, in all probability, may toe Sebi’s line. The savvier ones will re-work their product profile to include more of insurance and fixed income products . Insurance and fixed income products quote higher upfront commission for distributors. “First, Sebi took away upfront brokerage by abolishing entry loads, now it is doing away with trail as there are no brokerage payouts for direct investments. What do advisor earn? Nothing,” said Jhaveri.

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