



16th July 2012

FIFA Representation on proposed changes in TER

There is a consensus across the country for the need to revitalize and reenergize the Mutual Fund Industry with no less than the Prime Minister expressing the need to have growth in the Mutual Fund industry and spread it to Tier II and Tier III cities.

It may be noted that the penetration of mutual funds is less than 3% of household savings and penetration needs to be increased across all cities including metros and Tier 1 cities

FIFA has already submitted its representation to SEBI highlighting the current issues and suggesting possible solutions. We strongly believe that reduction in distributor's remuneration post banning of entry load which has significantly impacted the economic viability of the mutual fund distribution and has created a huge disincentive to sell mutual funds products.

It is generally agreed that increasing distributor's compensation is the need of the hour.

AMFI has, we believe, suggested an increase in the total expense ratio and removal of the cap on investment management fees within the expense ratio (allowing fungibility).

We believe that the following suggestions made by AMFI are under consideration of SEBI:

1. Increase in the Total Expense Ratio by 0.25%.
2. Remove the ceiling on AMC Fees of 1.00%/1.25% (allowing fungibility).
3. Credit the exit load to the scheme instead of using it to pay distribution expenses as is currently being done. This is currently 0.22% as reported by AMFI.
4. Service tax to be borne by investor by suitably increasing the expense ratio.



The above proposals are analysed on two parameters:

Impact on Investor – MARGINAL NEGATIVE

The increase in Expense ratio by 0.25% and the credit of exit load to the scheme of 0.22% offset each other. On account of service tax the expense ratio would increase by 0.1031%. Thus the net increase on investor will be a marginal 0.1331%.

Impact on AMCs – POSITIVE

Removal of ceiling on AMC fees:

- AMCs will now have the discretion and liberty of increasing their AMC fees to any extent within the overall expense ratio.

Crediting of exit load to scheme:

- Instead of using it to pay distribution expenses fungibility will allow the AMC to infact use it to increase its own fees.
- Similarly the increase in expense ratio on account of service tax coupled with fungibility will again give them leeway to increase their fees.

Impact on Distributors – ADVERSE

- Currently the exit load can be used only to pay distribution and marketing expenses.
- Crediting of this amount to the scheme and the corresponding increase in total expense ratio will result in removal of this dedicated use for distribution and marketing expense with a discretionary use in the hands of the AMC between distribution and AMC fees.
- The distributors, in our opinion , will thus be worse off than before

It can be seen the reason behind the AMFI proposals is to maximize the benefit to AMCs rather than to distributors. They defeat the very purpose for which various proposals are being considered today viz. measures to re-incentivize distributors. We believe that of the above AMFI proposals, the proposal to remove the ceiling on AMC fees and to credit the exit load to the scheme would be extremely detrimental, would militate against and would thwart the achievement of the entire purpose of your present exercise.



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

We therefore suggest

- 1) The ceiling on AMC fees, be retained thereby removing the option with the AMC to use the higher expense ratio for increasing their own fees.
- 2) For exit loads the status quo should be retained and that there should be no change in the norm on the use of exit loads.

Further, we believe that an increase of 0.25% (as against the loss of 2.25% entry load), is inadequate to sufficiently compensate and incentivize distributors to achieve the goal of widespread penetration of mutual fund products amongst households across the country.

It may be noted that the AMC business has tremendous economies of scale. Over the last decade the Equity AUM of the industry has grown 20 times from 7,000 crore to 140,000 crore i.e. over 20 times.

While AMC continued to get their fees on this vastly increased AUM it is only the distributors who suffered with the abolition of entry load. What has happened is that the distribution amount of 2.25% charged to customer has got abolished and it is this loss of revenue that needs to be compensated.

We hope our suggestions will be suitably considered. We request we be granted a personal audience to more fully explain our views.