



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

Date: 12th July 2016

Shri Shaktikanta Das,
Secretary,
Department of Economic Affairs,
Ministry of Finance,
New Delhi

Dear Sir,

Subject: Disclosure of Commission paid to Distributors in CAS

Reference: SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

We thank you for giving us an opportunity to meet you today and for giving us a patient hearing.

We, Foundation of Independent Financial Advisors and United Forum, write on behalf of virtually the entire distribution community in relation to certain disclosures prescribed under the aforesaid circular. This representation is being made by United Forum (representing IFAs) and FIAI (representing National Distributors and Banks), in reference to SEBI's afore-referenced Circular,[1] dated March 18, 2016.

The said circular provides that the Consolidated Account Statement (**CAS**) issued to investors, for the half-year will now provide:

- (I) the amount of actual commission (monetary and otherwise, e.g., event sponsorships, gifts, trips) paid by AMCs/MFs to distributors (in absolute terms) during the half-year period against the concerned investor's total investments in each MF scheme, and
- (II) the scheme's average Total Expense Ratio (**TER**) for the half year period, of direct and regular plans for each scheme where the investor has invested.

More than 85% of long-term funds in India are distributed by distributors being banks, National Distributors and Independent Financial Advisors (**IFAs**). FIAI, established in 2009, is the largest

[1] Notice bearing Reference Number SEBI/HO/IMD/DF2/CIR/P/2016/42.



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distributors' association and contributes around 50% of the non-direct assets under management of the mutual fund industry. It has a huge geographical representation, comprising banks, national level distributors and associations. United Forum, established in August 2015, is a forum of several national, local and regional associations of IFAs, which has been working together with FIAI to present a common view representing the whole distribution community to the regulators and the government. The Foundation of Independent Financial Advisors (**FIFA**), one of the leading members of United Forum, was established in February 2012 as a pan-India body for the development of the mutual fund industry and IFAs.

SEBI, in its attempt to enhance transparency and provide greater information to investors, has prescribed certain additional disclosures in a manner that would unfortunately be detrimental to the investors. Therefore, we request you to consider the following:

- a) Instead of disclosing the amount of commission in absolute monetary terms in the half-yearly CAS, what needs to be disclosed is only the TER of the applicable plan in which the investor has invested, along with the percentage of the maximum TER that is permitted to be charged by the MF to the scheme as per SEBI (Mutual Funds) Regulations, 1996.
- b) The CAS can clarify by means of an additional note that commissions are paid to a distributor for the services rendered to investors from part of the TER charged by the AMC and comprises upfront commission and/or trail fees. Upfront commission is based on the investment made and the rate of upfront commission applicable as on the date of investment whereas trail commission depends on the amount of investment, period of holding, and value of the investments during the period.
- c) An option can be given to an investor if the investor so desires to request for the commission amount paid on account of the investor's investment. The investor can then request for the same for the respective MF. This would ensure that the investors would be able to get the information on commission paid against their investments by the MFs, if they desire.
- d) Direct plan expense disclosure should not be part of the CAS for investors coming through the regular plan.



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A copy of the detailed memorandum is attached herewith for your perusal.

Sir, we request your sympathetic consideration to our detailed representation attached herewith.

As an industry initiative, FIFA, one of the leading members of United Forum had recently done a study on Mutual Fund expense ratios globally to determine India's relative ranking across 25 countries. The study highlights that INDIA HAS AMONGST THE LOWEST EXPENSE RATIOS GLOBALLY. An in depth perusal of the study destroys the myth of India being one of the highest Total Expense Ratio (TER) countries. We believe that the findings of the study could be relevant while formulating policies relating to the mutual fund industry. A copy of this study is also enclosed herewith.

Thanking you,

Yours faithfully,

Dhruv Mehta

On behalf of FIAI and United Forum

12th July 2016

Shri Shaktikanta Das,
Secretary,
Department of Economic Affairs,
Ministry of Finance,
New Delhi

Dear Sir,

Subject: Disclosure of Commission paid to Distributors in CAS

Reference: SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2016/42 dated March 18, 2016

We, Financial Intermediaries Association of India (FIAI - representing National Distributors and Banks) and United Forum (representing IFAs), write on behalf of the virtually the entire distribution community in relation to certain disclosures prescribed under the aforesaid Circular which would thwart investor interest in investment through mutual funds and hamper SEBI's aim of financial inclusion. The disclosure mandated by SEBI would also create a wrong perception and would therefore defeat the purpose of improving transparency in the markets. Finally, the disclosures would have the impact of self-medication by investors. The disclosures as presented would cause investors to believe that they have two identical products before them, one cheaper and the other expensive. Given, a distributor's legal obligation imposed by a SEBI circular, no advice or planning is provided unless a product is suitable for clients. By creating a perception of a cheaper option, the referenced circular will push investors to buy products on their own, which can very well be highly unsuitable for them. Before we provide our comments, a brief introduction about us would give a little context to our expertise and locus in the subject.

More than 85% of long-term funds in India are distributed by distributors through banks, National Distributors and Independent Financial Advisors (IFAs). FIAI, established in 2009, is the largest distributors' association and contributes around 50% of the non-direct assets under management of the mutual fund industry. It has a huge geographical representation, comprising banks, national level distributors and associations. United Forum, established in August 2015, is a forum of several national, local and regional associations of IFAs, which has been working

together with FIAI to present a common view representing the whole distribution community to the regulators and the government. The Foundation of Independent Financial Advisors (**FIFA**), one of the leading members of United Forum, was established in February 2012 as a pan-India body for the development of the mutual fund industry and IFAs.[Annexure 1 and Annexure 2 attached hereto provide the list of organisations constituting FIAI and United Forum, respectively. Annexure 3 provides an overview of some of our significant work.]

This representation is being made by United Forum (representing all IFAs)and FIAI (representing National Distributors and banks), in reference to SEBI's afore-referenced Circular,¹ dated March 18, 2016, according to which the Consolidated Account Statement (**CAS**) issued to investors, for the half-year will now provide: (i) the amount of actual commission (monetary and otherwise, e.g., event sponsorships, gifts, trips) paid by AMCs/MFs to distributors (in absolute terms) during the half-year period against the concerned investor's total investments in each MF scheme, and (ii) the scheme's average Total Expense Ratio (**TER**) for the half year period, of direct and regular plans for each scheme where the investor has invested.

While in principle we believe that greater disclosures seek to safeguard the interests of investors, we think that such disclosures have to be of information which is complete, relevant, and of the nature that would actually help investors in making informed decisions. In the instant case, we humbly submit that, the two disclosures as stated above may appear to increase transparency, however, they are not in line with the orderly development of the securities market for the following reasons:-

- i. The disclosures would provide misleading and inaccurate information to investors, which may result in them investing in inappropriate products.
- ii. The disclosures would be major stumbling blocks to mutual fund penetration in India, especially in B15 towns.
- iii. The disclosures would infringe upon the right to privacy of the distributors.
- iv. The Circular has been issued without due public consultation and taking into account concerns raised by stakeholders.

Our detailed response to the Circular is provided in the following paragraphs.

¹Notice bearing Reference Number SEBI/HO/IMD/DF2/CIR/P/2016/42.

Detailed Response

I. Detrimental to Investors' Interests

1. We believe that the disclosure of the actual commission paid by AMCs in absolute terms against a concerned investor's total investments in each MF scheme will not actually be in the interest of investors, for two reasons:-

a) Providing misleading information to investors

2. Firstly, the prescribed disclosure would present a distorted picture to investors for the following reasons:

- i. The total cost incurred in relation to an investment comprises not only the commission paid to distributors, but also consists of investment/asset management fees charged by AMCs, advisory fees, trustee fees, registrar and transfer agent charges, legal and audit fees, fund administration expenses, marketing and selling expenses etc.
- ii. The commission amount paid to distributors is a mix of upfront and trail commission. With the abolition of entry loads, the trail commission compensates the distributor for acquiring and bringing new customers/ households to invest in mutual funds. A distributor provides several services to a fund house which are at the fund level and at the specific investor/scheme level. Mandating disclosure of only the commission amount at the investor/scheme level will present an incorrect picture of the expenses incurred by the distributor for that investor/scheme as none of the other expenses described above will be broken up and presented.
- iii. The prescribed disclosure would require expenses incurred by the AMC/MF on travel and trips of a distributor to be apportioned and disclosed at the folio level of each investor for each scheme that a distributor is connected with. If an MF invites a distributor and considers it to be necessary for it to attend any of the seminars/ programmes and incurs costs to that effect, it would be considered as a form of commission paid to the distributor. The AMC/MF is doing so to enhance the quality of investor relations and to provide better service to the investors and is an actual expense in reaching out to the investor, sometimes in remote locations.

- iv. Similar issues arise in case of commission in the form of event sponsorships. For instance, in an investor meet of investors of a particular distributor which is sponsored by an AMC: how will the cost of such an event be bifurcated amongst the schemes/investors of the distributor? Will it be bifurcated in the proportion of number of investors attending the meet, or based only those investing in the scheme of the particular AMC thereafter? Or will it be on the basis of the new business generated out of such meet?
 - v. The disclosure mandated under the Circular would result in the gross commission being disclosed without recognizing that 15% of the revenue would directly be appropriated by way of service tax. Further, it does not incorporate the cost of operations and overheads of distributors.
 - vi. Measuring performance and costs based on any absolute amount of returns or expenses, rather than on a percentage basis, will result in a skewed and wrong assessment of service and performance. For instance, a return of Rs. 1000 would appear to be higher than a return of Rs. 100. However, if the amount invested is Rs. 1,00,000 in the first case and Rs. 1000 in the second case, the percentage returns realized are 1% and 10% respectively, and hence returns earned in the second case are better than the first one, although the absolute amount is lower.
3. Hence, disclosure of the commission paid to distributors in isolation, in the manner the Circular prescribes, is of no meaning and would be inaccurate and misleading. Changes, if any, have to be made in the disclosure and calculation of fund performance. In case of equity funds this has to be measured over longer periods of 3-5 years. Reviewing performance of equity funds over shorter periods will lead to wrong decisions by investors. Further, disclosure of absolute amount of expenses every 6 months would create a short term orientation towards the distributor; in case of what is essentially a long term relationship and investment.

b) Investors buying/selling inappropriate products

4. Secondly, disclosing a distributor's commission in a manner that the investor misunderstands and gets dissuaded from using the distributor's services, may translate into inferior returns for the investor from an uninformed and sub-optimal choice of asset class or investment instrument. This would be contrary to SEBI's goal of investors buying the right product, except for the most sophisticated investors who do not need

help with buying suitable investments. An investor uses the services of a distributor for various reasons, the primary being that the investor is unable either to make an informed decision or execute the transaction and keep track of it till he remains invested. Distributors facilitate investors in comprehending various MF schemes and products, comparing them and opting for those which are best-suited to the investors. In the absence of distributors, unsophisticated retail investors may purchase products that are inappropriate for them.

5. SEBI's concerns regarding churning and mis-selling would have been well-founded had there been no transparency in the fees received by distributor. SEBI has issued various circulars pursuant to which distributors cannot simply recommend products/schemes which are in sync with the commissions received by them but are not otherwise well-suited for the investor. SEBI's circular dated August 22, 2011,² has categorized customer relationship and transactions in the following manner:

“a. Advisory – where a distributor represents to offer advice while distributing the product, it will be subject to the principle of ‘appropriateness’ of products to that customer category. Appropriateness is defined as selling only that product categorization that is identified as best suited for investors within a defined upper ceiling of risk appetite. No exception shall be made.

b. Execution Only – in case of transactions that are not booked as ‘advisory’, it shall still require: i.) The distributor has information to believe that the transaction is not appropriate for the customer, a written communication be made to the investor regarding the unsuitability of the product...”

Furthermore, through the aforesaid circular, SEBI has mandated that distributors, while selling MF products of their group/affiliate/associates, have to disclose to the customer regarding the conflict of interest arising from the distributors selling of such products. We would like to reiterate the following portion from our comments on the Sumit Bose Committee Report³ which we have submitted to the Ministry of Finance.

“The reality before the distributor is simple: the producer will pay provided there is a customer who buys. A customer will buy provided he trusts the

²Cir/IMD/DF/13/2011.

³“Report of the Committee to recommend measures for curbing mis-selling and rationalising distribution incentives in financial products”, appointed under the chairmanship of Sumit Bose, which was published in August, 2015

distributor. For a distributor, a satisfied customer not a satisfied producer is the key to sustainable business.”

[Our comments on the Sumit Bose Committee Report regarding “Fallacies on Mis-selling”, have been annexed hereto as Annexure 4.]

In any event, if a distributor engages in mis-selling, SEBI has sufficient powers under the SEBI Act, 1992 and the regulations made thereunder to take action against such distributor.

c) *Additional Information Not Relevant*

6. Thirdly, we believe that the additional disclosure regarding distributors’ commission would not help protect the investor’s investments by providing information which can facilitate him in making a rational decision. Rather it may create unnecessary confusion in the minds of an average investor. An investor invests in a particular scheme depending on his investment objective and the potential of returns from the fund. The distributors’ earnings does not have any co-relation with the decision to invest. Investors should have clear, meaningful and transparent reporting on performance and costs related to investments made by them.
7. Further, SEBI has already prescribed the maximum expense or costs (TER) that can be levied in any scheme in terms of the percentage of AUM. This information is disclosed in the offer document and there is complete transparency relating to the information. All mutual funds are adhering to the guidelines prescribed by SEBI and the expenses being charged to the investor do not exceed the limits prescribed by SEBI. It will be worth noting that in majority of the schemes, the total expense actually charged to the investors is below the maximum permissible TER prescribed by SEBI. We believe that of the total AUM of Rs. 13.50 lakh crores, the industry is charging lower expenses than the maximum allowable TER on approximately Rs. 8 lakh crores (60% of the AUM).
8. A CAS provides convenience in keeping track of investment portfolio by providing a single account statement that consolidates financial transactions in all portfolios of an investor, across all schemes of all mutual funds. A CAS should enable an investor to assess how its investments have grown. Currently a CAS provides information in terms of name of scheme/s where the investor has invested, number of units held and its market value, among other details. We believe that given of the purpose of a CAS and the requirement of investors, the CAS already provides the necessary information, and any additional disclosures in the CAS should be on investment values and performance.

Hence we support the additional disclosure of total cost of the scheme besides the existing information of the investors holding, namely the number of units and market value of the investments. A comparison of cost and market value will help the investor in monitoring the investment performance.

9. Hence, the disclosure of absolute commission paid to distributors against a particular investor's total investments in each MF scheme would be selective, provide information which is incomplete, not relevant, and lead to misleading conclusions, thereby resulting in the investor making incorrect investment decisions.
10. At this juncture it may be noted that the disclosure of the TER of both Direct Plan and Regular Plan as mandated under the Circular would also present a misleading picture for the investors. Investors have the option of not using the services of a distributor and when an investor chooses a Regular Plan, the investor has made a conscious choice of using the services of the distributor despite the higher TER. The Direct Plan is specified in the offer document and the fact sheets mention the NAVs of both Regular and Direct Plans.
11. Disclosure of TER of Direct Plan and Regular Plan is not a correct comparison and would result in an investor buying unsuitable products. The fundamental problem of absolute number disclosure is that it suggests that the distributor is being paid some free money which is avoidable. The fact is that the distributor is performing several functions, including making investors understand the effectiveness of MF schemes for investments compared to other competitive products like bank fixed deposits, ULIPs, equity shares, and bonds etc. Distributors perform critical functions of selling the right product and there is a possibility of regulatory action if they do not. Distributors make investors aware about various schemes of the mutual fund houses and help them undertake transactions relating to switching, redemption and guide them periodically on the performance of their investments. In other words, comparing direct plans which entail lower costs but are of lower value, with distributed plans which have a value addition, would be comparing apples with oranges and the two are not comparable. Investors might get lured with the lower costs of the Direct Plans, without having a thorough understanding of the product, and hence disclosure of TER of Direct Plans and Regular Plans as envisaged under the Circular would be detrimental to the average investor.

II. Compromises Financial Inclusion

12. There is a huge and pressing need for expanding mutual fund investments in India, and the independent fund distributor is a crucial part of realising this potential. The Sumit Bose Committee Report highlighted the role and significance of distributors in educating the customer about modern finance and financial products. It may be noted that investors guided by distributors have invested in the markets when foreign investors were exiting during the period August 2015 to February 2016. This has given the markets considerable stability and benefitted the investors. However, the prescribed disclosure of distributors' commission under the Circular would highlight the costs in an unfair and inaccurate manner and would send the wrong signal to investors regarding the actual work done by small scale individual distributors, especially in B15 towns.
13. Further, unlike pull products which have been long available, are well understood and widely distributed, push products, especially mutual funds are in an underdeveloped stage. Most retail investors need help, guidance and service for savings and investing, and as discussed distributors play a crucial role in that regard. The additional disclosure regarding distributors' commission would lead to a drastic fall in the reach of financial products to households across the country.
14. As such retail penetration in financial assets is abysmal and is worse in the equity segment. Most households are as yet cut-off from large parts of the financial system. It is often stated that small investors should take exposure to the stock markets only through the mutual fund route. SEBI, in order to enable people with small savings potential and increase reach of MF products in urban areas and smaller towns, had issued a circular dated August 22, 2011, stating that a transaction charge per subscription of Rs.10,000/- and above would be allowed to be paid to the distributors of the MF products. The transaction charge, if any, would be deducted by the AMC from the subscription amount and paid to the distributor; and the balance would be invested.⁴ However, the Circular in the instant case may eventually reduce the reach of MF products to small investors.

⁴Cir/ IMD/ DF/13/ 2011.

15. To enable the investor to have a proper choice, a level playing field is essential. However, the disclosure contemplated under the Circular would not create a level playing field for mutual fund products vis-à-vis other savings products, in so much as such disclosure is not required to be made for other financial products. Investment-linked life insurance plans, bank deposits and mutual funds compete for the same investor funds. The requirement on commission disclosure in the CAS under the Circular would widen the regulatory arbitrage, and thereby be detrimental to the development of the MF industry. This would harm not just the distributors but also investors. Investors who invest in instruments such as fixed deposits are likely to see negative returns post inflation and tax, and investing a sum of money in equity funds is critical to a fair investment return.
16. Absence of a large distribution network will see households savings once again shift to unproductive physical assets as most investors do not think beyond real estate and gold. Mutual fund penetration is still low compared to other economies. To reach out to more people we need expansion of both distribution network and IFAs. It is humbly submitted that SEBI should focus on measures to increase penetration of mutual fund products and to energise the distribution network while protecting the interest of investors.

III. Violation of Right to Privacy

17. A disclosure of the distributor commission amount in the manner envisaged under the Circular would violate the privacy of information as regards the distributor, without providing any necessary assistance to the investor. Financial information in relation to a person has been accorded legislative recognition as being sensitive personal data. Regulation 3(ii) of the Information Technology (Reasonable security practices and procedures and sensitive personal data or information) Rules, 2011 recognises data pertaining to financial information such as bank account or credit card or debit card or other payment instrument details as sensitive personal data or information.⁵ The Privacy (Protection) Bill, 2013 also recognises the need to protect privacy of all persons and their personal data from Governments, public authorities and private entities.

⁵The proviso to the said regulation states that information that is furnished under the Right to Information Act, 2005 or any other law for the time being in force shall not be regarded as sensitive personal data or information.

18. Various international conventions, to which India is a signatory, also recognise the cardinal principle of protection of privacy of individuals. Article 12 of the Universal Declaration of Human Rights and Article 17 of the International Covenant on Civil and Political Rights state that “*No one shall be subjected to arbitrary interference with his privacy, family, home or correspondence, nor to attacks upon his honour and reputation. Everyone has the right to the protection of the law against such interference or attacks.*”
19. We understand that there is a conflict between the right to receive information (and thereby achieve greater transparency in public life) and the right to privacy of certain people. Although neither of the rights is specifically spelt out in the Constitution of India, the rights have been read into Article 14 (right to equality), Article 19(1)(a) (right to freedom of speech and expression) and Article 21 (right to life).⁶Hence we believe that it is necessary to harmoniously construct both rights and strike a balance between the two. At this juncture we may refer to the Right to Information Act, 2005 where the conflict and the attempt to balance it is the clearest. Section 8(1)(j) of the RTI Act states that there is no obligation to disclose information which relates to personal information, the disclosure of which has no relationship to any public activity or interest, or which would cause unwarranted invasion of the privacy of the individual unless the larger public interest justifies the disclosure of such information.
20. A similar logic and the underlying principle may be applicable to the situation at hand. The information sought to be disclosed falls within the scope of personal information. Hence in light of the right to privacy of a distributor, such information should be accorded protection from disclosure, unless there is a public interest (in this case investors’ interests) being served. We believe that such disclosure is not only irrelevant for investors but is also inaccurate and misleading, as discussed in paragraph [2-9]. Investors are already aware of the commission being paid to distributors and there is no further need to make disclosure of distribution commission in the CAS as contemplated under the Circular. To provide investors with a right in deciding the extent of payment for services rendered to them by the distributor, SEBI enabled investors to pay the upfront commission directly to the distributors, based on an assessment of various

⁶Right to information through cases such as *Bennet Coleman v. Union of India*, *Tata Press Ltd. v. Maharashtra Telephone Nigam Ltd.*; the right to privacy through cases such as *Kharak Singh v.State of U.P.*, *Govind v. State of M.P.*,

factors including the service rendered by the distributor.⁷ Thus after the abolition of entry loads, investors compensate distributors directly, depending on the quality of advice and service the distributor provides, every time the investor makes an investment. Through the same circular, SEBI also mandated distributors to disclose all commissions (in the form of trail commission or any other mode) payable to them for different competing schemes of various mutual funds from amongst which the scheme is being recommended to the investor.

21. Further, through a circular dated August 22 2011,⁸ SEBI mandated MFs/AMCs to disclose on their respective websites the total commission and expenses paid to distributors who satisfy one or more of the conditions stated therein with respect to non-institutional (retail and HNI) investors.⁹ Through another circular dated September 13, 2012,¹⁰ SEBI stated that MF/AMCs shall, in addition to the total commission and expenses paid to distributors, make additional disclosures regarding distributor-wise gross inflows (indicating whether the distributor is an associate or group company of the sponsor(s) of the mutual fund), net inflows, average assets under management and ratio of AUM to gross inflows on their respective website on a yearly basis. In the same circular, SEBI mandated AMCs to conduct additional due-diligence of such distributors, whose data suggests that the distributor has an excessive portfolio turnover ratio, i.e., more than two times the industry average.
22. Thus there is adequate and significant transparency and disclosure in relation to the commission paid to distributors. Hence no larger interest would be served by the disclosure of the commission in the manner prescribed under the Circular, but the disclosure would be an unwarranted violation of the privacy of information in relation to the distributor.
23. The contract for managing the investor's money is between the investor and the MF/AMC. The cost of services charged by the MF/AMC is known to the investor. On the other hand, the distributor is an agent of the MF/AMC. The commissions and incentives paid to a distributor by the AMC depend on the scale of business procured by the AMC through the concerned distributor. Apart from payments made by the

⁷Circular dated June 30, 2009, SEBI/IMD/CIR No. 4/ 168230/09.

⁸Cir/ IMD/ DF/13/ 2011.

⁹i. Multiple point of presence (More than 20 locations) ii. AUM raised over ` 100 crore across industry in the non-institutional category but including high networth individuals (HNIs). iii. Commission received of over Rs. 1 crore p.a. across industry iv. Commission received of over Rs. 50 lakh from a single Mutual Fund/AMC.

¹⁰CIR/IMD/DF/21/2012.

AMC from the funds collected from the investors, AMCs can pay distributors from their own account through various forms, including, cash and sponsorship for training programmes. Such payment to the distributor should be decided between individual AMCs and the distributor entity within the framework of SEBI mandated pricing norms.¹¹ The upfront commission and the trail commission paid by the AMC vary across AMCs and different categories of mutual funds. A framework for disclosure of distributors' commission in a manner that is transparent and helpful to investors is already in place. The disclosure of distributors commission in absolute terms in the CAS in the manner prescribed in the Circular would be an unwarranted invasion into privacy of the distributors and for the reasons discussed herein would not actually be in the interest of investors.

IV. Due Procedure

24. The “Handbook on adoption of governance enhancing and non-legislative elements of the draft Indian Financial Code” (**FSLRC Handbook**) was released by the Ministry of Finance, Government of India on December 26, 2013. The FSLRC Handbook states that, all financial sector regulators are required examine the non-legislative recommendations of the FSLRC and lay down a roadmap and timeline for the adoption of the non-legislative recommendations. One such important non-legislative aspect pertains to greater transparency in the regulation making process by means of mandatory public consultations and incorporation of cost benefit analysis etc. Section 52(2) of the Indian Financial Code under the FSLRC Report¹² requires all regulators to first publish a draft of the regulations to be made, along with a statement of objectives.¹³ The statement of objectives has to clearly state the reason and purpose of the regulation, the problem the regulator seeks to solve, which would help the regulator in getting better feedback on how best to frame effective regulations.
25. Further, the FSLRC has recommended a mandatory public consultation process before the framing of regulations. Section 52 of the Indian Financial Code requires that the draft of the proposed regulations needs to be released along with the procedure through which any person may make a representation in relation to the proposed regulations.

¹¹Such as- caps on transaction fee, TER for various kinds of MF products.

¹² Report of the Financial Sector Legislative Reforms Commission, submitted in March 2013.

¹³Paragraph 4.3, Chapter 4- Framing Regulations, FSLRC Handbook.

The regulator has to consider these representations before drafting the final regulations and has to publish all representations received, and at least provide a general account of the response to the representations while publishing the final regulations. The necessity and benefits of soliciting public comments are manifold; it increases the transparency in the regulation-making process and enhances the legitimacy of regulatory intervention by engaging with different stakeholders.

26. Like certain other regulators, SEBI too has already recognised the role of public consultation in framing regulations. However, in case of the present Circular, no such public consultation was undertaken by SEBI. No draft of the proposed disclosures was published and no public comments were invited. There was no description of what specific problem SEBI sought to address through the Circular. The Circular was issued without taking into account the legitimate concerns which market participants to whom the Circular extends might have. The requirement of soliciting public comments is a non-legislative recommendation of the FSLRC, which as per the government, all regulators have to seek to implement.
27. Different SEBI regulations empower SEBI to issue clarifications and guidelines in the form of notes or circulars to remove any difficulties in the application or interpretation of the provisions of the concerned regulations. Regulation 77 of the MF Regulations provides SEBI with the power to issue such circulars and states that they shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians.¹⁴ Undoubtedly, the Circular will have the force of law, and in light of the Finance Ministry's mandate, the regulator should not have issued the Circular without due public consultation.
28. At this juncture it may be pertinent to take note of the manner in which the Retail Distribution Review (RDR), a programme which made a number of changes¹⁵ to the way investment products are distributed to retail consumers in the United Kingdom, came into place. The Financial Services Authority (FSA), the predecessor body of the Financial Conduct Authority (FCA) in UK launched the RDR in 2006. In 2007, the FSA published a discussion paper based on the working of different groups of

¹⁴ Regulation 77 Power of the Board to issue clarifications- In order to remove any difficulties in the application or interpretation of these regulations, the Board shall have the power to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians.

¹⁵The RDR sought to improve service levels, enhance transparency and establish a resilient and effective retail investment market that consumers had confidence in.

practitioners, consumer representatives and other stakeholders, and held several public meetings to discuss the proposed regulations. In April 2008, FSA published an Interim Report summarising the feedback received and indicating how it had modified its thoughts on account of the feedback. In June 2010, FSA, post consideration of the feedback received, drafted a consultative paper on ‘Retail Distribution Implementation Programme’. The FSA held further meetings with different stakeholders, and only after making the concerned public aware of the proposals, did the FSA finally implement the regulations on December 31, 2012.

29. Similarly, Canada recently introduced the requirement to disclose commission amounts,¹⁶ after widely circulating the proposal, giving a three years’ notice, and considering the feedback received from industry participants. The proposal for introducing performance and cost disclosures was introduced on June 22, 2011. The proposal was revised in light of the first round of feedback and published again for public comments on June 14, 2012. The Canadian Securities Authority published the final proposal on March 28, 2013, along with a summary of the comments and the regulator’s response.
30. The aforesaid examples highlight the necessity and importance of having a public consultation process, particularly with respect to laws which have a far reaching impact on the stakeholders. In case a regulation seeks to make significant changes in the existing legal framework, it becomes all the more essential to hold detailed consultations and provide an adequate transition period that would enable the stakeholders to better deal with the changes and effectively comply with the new provisions. It may be noted that the ‘*Objectives and Principles of Securities Regulations*’ issued by the International Organization of Securities Commissions in May 2003, requires that a regulator should have a process for consultation with the public, including those who may be affected by the policy.¹⁷ SEBI being a signatory to the same ought to abide by the said principles.
31. While it may be understandable that in case of a grave and impending threat to the orderly functioning of the securities market, SEBI may take urgent measures to protect the investors’ interests, there was no such urgency in the instant case for SEBI to have not called for public comments and undertaken due public consultation. It was not

¹⁶ The scheme would be implemented w.e.f. 01 January, 2017.

¹⁷ Available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD154.pdf>

incumbent on SEBI to issue the Circular as an immediate measure. It is humbly submitted that SEBI ought to have published a discussion/consultation paper soliciting public comments on the proposals and engaged with the concerned market participants/industry stakeholders before issuing the Circular, as is required by the mandate of the Ministry of Finance, as stated in the FSLRC Handbook.

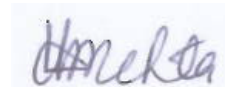
Conclusion/Prayer

32. United Forum and FIAI are whole heartedly committed to assisting the regulator to promote financial literacy and achieve financial inclusion. We are not against the prescribed additional disclosures as presented in certain sections of the media. However, it is our genuine belief that the disclosure in relation to the distributors' commission and the TER for both Direct and Regular Plans in the CAS, as mandated under the Circular, are more likely to be counterproductive rather than achieve the end objective of an investor who is assisted in making the right choice of the right product at a transparent cost.
33. While we understand and agree that it is necessary to empower investors in mutual funds through transparency in payments of commission and the loads borne by the investors, any information disclosed to them should be clear, complete and accurate to enable them to take informed investment decisions. The disclosures would provide an inaccurate and incomplete picture about the commission paid to distributors and the costs incurred through the Regular Plan, thereby adversely affecting investors' interests and investors' appetite for MF products. Further, the Circular was issued without following the mandatory procedure of soliciting public comments and taking into account the representations made by industry stakeholders. Moreover, the disclosure of the commission in the manner envisaged under the Circular infringes on the privacy rights of distributors, without providing any actual benefit to the investors.
34. We believe that the regulator should work with the AMCs and distributors to prescribe disclosures which actually help investors gain confidence in their mutual fund investments, understand the suitability of investments with their own investment objectives, question their advisor/distributor in case of fund performance/expense mismatch, fund objective/their investment objective mismatch, risk profile mismatch and so on, increase longevity of their assets and inspire them to allocate more savings/investments towards financial assets/mutual funds.

35. SEBI, in its attempt to enhance transparency and provide greater information to investors, has prescribed certain additional disclosures in a manner that would unfortunately be detrimental to the investors. Therefore, we request you to consider the following:

- a) Instead of disclosing the amount of commission in absolute monetary terms in the half-yearly CAS, what needs to be disclosed is only the TER of the applicable plan in which the investor has invested, along with the percentage of the maximum TER that is permitted to be charged by the MF to the scheme as per SEBI (Mutual Funds) Regulations, 1996.
- b) The CAS can clarify by means of an additional note that commissions are paid to a distributor for the services rendered to investors from part of the TER charged by the AMC and comprises upfront commission and/or trail fees. Upfront commission is based on the investment made and the rate of upfront commission applicable as on the date of investment whereas trail commission depends on the amount of investment, period of holding, and value of the investments during the period.
- c) An option can be given to an investor if the investor so desires to request for the commission amount paid on account of the investor's investment. The investor can then request for the same for the respective MF. This would ensure that the investors would be able to get the information on commission paid against their investments by the MFs, if they desire.
- d) Direct plan expense disclosure should not be part of the CAS for investors coming through the regular plan.

Yours faithfully,



Dhruv Mehta

On behalf of FIAI and United Forum

Annexure 1

LIST OF MEMBERS OF FIAI

1. Karvy Stock Broking Ltd.
2. NJ India Invest Private Ltd.
3. Bajaj Capital Ltd.
4. IFAN Financial Services Private Ltd.
5. Capital First Ltd.
6. IIFL Wealth Management
7. Axis Capital Ltd.
8. JM Financial Services Ltd.
9. SPA Capital Services Private Ltd.
10. Standard Chartered Bank
11. Aditya Birla Money Mart Ltd.
12. Reliance Money Solutions Private Ltd.
13. Prudent Corporate Advisory Services Ltd.
14. Geojit BNP Paribas Financial Services Ltd.
15. Motilal Oswal Wealth Management Pvt. Ltd.
16. Wealth India Financial Services Pvt. Ltd.
17. Next Financial Advisers Pvt. Ltd.
18. Kotak Mahindra Bank
19. Edelweiss Global Wealth Management Ltd.
20. Axis Bank Ltd.
21. Religare Wealth Private Ltd.
22. Anand Rathi Financial Services Ltd.
23. Citibank N.A.
24. Ambit Capital Pvt Ltd
25. Trust Plutus Wealth Managers (India) Pvt Ltd
26. Pioneer Client Associates Pvt Ltd
27. SMC Global Securities Ltd.

Annexure 2

LIST OF MEMBERS OF UNITED FORUM

S No	Associations Name	State	Area Represented
1	Foundation Of Independent Financial Advisor	All India	All India
2	Voice of Mutual Fund Distributor Associations	All India	All India
3	IFA Galaxy	All India	India
4	Independent Financial Advisors Association	Delhi	Delhi
5	DFDA IFA Network	Delhi	North India
6	Mutual Funds Distributors Association	Gujarat	Ahmedabad
7	South Gujarat IFA Association	Gujarat	South Gujarat
8	Vadodara IFA Association	Gujarat	Vadodara
9	Karnataka Association of Mutual Fund Advisors	Karnataka	Karnataka
10	All Kerala IFA Association	Kerala	State of Kerala
11	Gwalior Division Mutual Fund Distributors & Welfare Association	Madhya Pradesh	Gwalior Division (M.P.)
12	Individual Financial Advisor Association	Madhya Pradesh	Jabalpur (M.P)
13	Insurance and Investment Advisors Association	Madhya Pradesh	Indore
14	Warangal Mutual Funds Advisors Association	Maharashtra	Warangal
15	Jalgaon Dhule IFA Association	Maharashtra	Jalgaon Dhule and Nandurbar
16	Pune IFA Association	Maharashtra	Pune & Around
17	Western Maharashtra Rural IFA Association	Maharashtra	Kolhapur,Sangli,Satara,Ratnagiri
18	North India Mutual Fund Association	North India	North India
19	Odisha Mutual Fund Advisors Association	Orissa	Bhubanewar
20	Rourkela Individual Financial Advisors Association	Orissa	Rourkela
21	Pondicherry Individual Financial Advisors Association	Pondicherry	Pondicherry
22	Financial Advisors Association of Rajasthan	Rajasthan	Rajasthan
23	Independent Financial Professionals Association	Tamil Nadu	Chennai
24	Salem IFA Association	Tamil Nadu	Salem
25	Financial Associates Of Coimbatore Team	Tamil Nadu	Coimbatore & nearby
26	Madurai IFAs	Tamil Nadu	Madurai
27	Trichy IFA Association	Tamil Nadu	Trichy
28	ARN Holders Welfare Association Karimnagar	Telangana	Karimnagar dist.
29	Association of Professional Independent Financial Advisors	Telangana	Telangana
30	Ghaziabad Financial Advisor Association	Uttar Pradesh	Ghaziabad
31	Financial Advisors Association Meerut	Uttar Pradesh	Meerut
32	Mutual Fund Distributor Association of Varanasi	Uttar Pradesh	Varanasi
33	ASK CIRCLE	West Bengal	Kolkata

Annexure 3

OUR WORK

FIAI has been engaged in undertaking various activities for the development of the financial products distribution industry, for instance, organizing financial literacy drives such as the renowned Arthik Gyan program and events such as Distribution Conclaves, making representations to SEBI, the Ministry of Finance, AMFI and preparing industry reports. United Forum has made representation to the Government and SEBI on the Sumit Bose Committee Report and Service Tax.

Over the last four years, FIFA has conducted more than 100 Knowledge Sharing and Investor Awareness Programs across the country. FIFA has also published a book and organised mentoring programs for upcoming IFAs. FIFA was invited by SEBI and the Ministry of Finance for providing suggestions for re-energising the mutual fund industry in the year 2013. FIFA has also submitted a number of representations to SEBI on areas including (i) SEBI's Concept Paper for Investment Advisor – 2011, (ii) Public Disclosure of Aggregate Commission of Distributors and (iii) Non-transmission of Service Tax on Distributor's Commission to the Recipient of Service.

Annexure 4

FIFA'S COMMENTS ON THE SUMIT BOSE COMMITTEE REPORT REGARDING "FALLACIES ON MIS-SELLING"

Undoubtedly consumer protection in finance has taken centre stage post the 2008 global financial crisis. However the committee attributes the global financial crisis "was essentially a MIS-selling episode at a massive scale." We would like to humbly differ.

A number of causes have been identified for the global financial crisis. Dr Raghuram Rajan, currently Governor, Reserve Bank of India, in his book "Fault Lines" shows how the individual choices - made by bankers, government officials and ordinary homeowners - that collectively brought about the economic meltdown. In fact to quote from his book "One set of fault lines stems from domestic political stresses especially in United States. The second set of fault lines emanates from the trade imbalances between countries stemming from prior patterns of growth. The final set of fault lines develops when different types of financial systems come into contact to finance the trade imbalances...". He further states "We should resist the temptation to round up the most proximate suspects and pin blame on them". Credit rating agencies have also been blamed for the role they played.

We would also very strongly like to rebut the committee's observation that "The overwhelming evidence from the household finance points towards agents maximising their own income at the cost of selling unsuitable products to households"

No source or empirical evidence has been quoted for this statement.

Out of over 1 lakh distributors: (Source- <http://tinyurl.com/nmtnutl>)
Only 19 have been suspended and only 12 have been terminated (as per AMFI data)

We believe the overwhelming majority of agents are focused on providing the appropriate product / solution for household and ensuring favourable outcomes.

In India we believe there is a tendency to blame all ills related to the financial savings industry to the distributor/agent and to Mis-selling.

The report contains a number of other fallacies and false impressions on mis-selling.

Para 1.2 states that "agents are remunerated directly by the product provider and this could often lead them to represent the interest of the product provider."

Para 2.1 states, "This means that agents do not have to focus on serving the customer, but on meeting volume based targets. In the olden days, the agent may have lost her reputation, but in this new world order, the agent does not have much to lose if the trust with the customer gets broken."

It further states, "The customer also does not pay the distributor directly, the distributor therefore has no incentive to service the customer. The distributor's incentive is to maximize her income by selling the product that provides the highest commission regardless of whether it is in the interest of the customer."

The above fallacies are apparent.

The reality before the distributor is simple: the producer will pay provided there is a customer who buys. A customer will buy provided he trusts the distributor.

For a distributor, a satisfied customer not a satisfied producer is the key to sustainable business.

The report presents evidence of its own fallacies. On pg.19 it states that in the case of mutual funds “the direct channel now accounts for more than 30 percent of the AUM.” Surely, if mis-selling were the norm the reverse should have been the case. It further adds, “However, it (direct channel) seems to be more popular with corporate and institutional clients, than with retail investors who still seem to prefer to invest through distributors.” The continued reliance of the retail investor on the distributor is a mark of the level of trust and satisfaction that he has in the distributor.

The report, thus, presumes mis-selling and ignores the contrary evidence it itself contains.

Not only are there false presumptions but also false deductions – convenient inferences.

In para 1.3 it talks about the low percentage of household savings in the MF, insurance and provident and pension funds. To explain it states, “Low access to finance cannot have one simple answer. And yet, one factor that can potentially explain the reluctance of households to engage in the financial markets is low trust.”

It conveniently ignores the regulatory hindrances to invest in these product compared to investing in gold/real estate namely the KYC requirements; compulsory investment in Cheque (versus Cash) ; requirement of PAN card , caps on investment, restrictions on withdrawals, etc . Additionally the low levels of financial literacy also have limited the penetration of these products. We would therefore like to humbly submit that blaming low penetration on lack of trust is inappropriate.

The fact that established distributors have long standing clients indicates high levels of client satisfaction and trust. In Mutual Funds the fact that Institutional investors accounted for 51.5% of MF AUM (pg.16) but only 30% of MF AUM was invested through the direct channel (pg.19) clearly shows that even sophisticated investors trust distributors and believe that distributors add value. The report itself adds that retail investors still seem to prefer to invest through distributors clearly indicating the trust they have in distributors.

The report refers to consumer surveys and anecdotal “evidence” of mis-selling.

Anecdotal “evidence” lacks scientific rigor and cannot be the basis for policy making. It may also be mentioned that the results of consumer surveys on the subject always refer to perceived mis-selling rather than actual mis-selling. Consumers have a tendency to perceive an honest sale to be mis-selling if the outcome is adverse. **The government/regulators need to study independently the extent of mis-selling in India which could then form the basis of the need for making any changes.**