Changes in Mutual Fund Regulations

Why in news?

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SEBI has unleashed a set of fundamental changes to the regulations governing mutual funds in India.

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What are the proposed measures?

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- Assets under management(AUM) of the industry are at a record of Rs 25 lakh crore, resulting in a revenue of about Rs 13,000 crore.
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- The market regulator has decided to lower expenses paid by investors of equity mutual fund schemes.
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- **Total Expense ratio** - TER is a percentage of a scheme's corpus that a mutual fund house charges towards expenses including administrative and management.
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- TER for equity-oriented mutual fund schemes were capped at 1.25 per cent and for other schemes at one per cent.
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- The cap for fund of funds will be 2.25 per cent for equity-oriented schemes and two per cent for other schemes.
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- Also, the TER will go down as the AUM slab increases.
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- For instance, the TER ranges between 0.8 and 1.05 per cent for the for the highest AUM slab (over Rs 500 billion), whereas it ranges between 2 and 2.25 per cent for the lowest AUM slab (0 to Rs 5 billion).
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- **Transparency** - SEBI has mandated that commissions and expenses shall be paid from the scheme only and not by any other route.
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- Further, the mutual fund industry has to adopt the full trail model of

commission in all schemes without paying any upfront commission.
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- **Disclosure** - SEBI requires category-wise disclosure of all schemes' returns with respect to its total returns to be made available on the Association of Mutual Funds of India's website.
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- **Borrowings** – Companies with outstanding borrowings above Rs 1 billion shall raise 25 per cent of their incremental borrowings for the year through the bond market.
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What could be the effects?

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- A mutual fund has a certain fixed cost and after a certain fund size, the extra cost of managing extra money is marginal.
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- Hence, Lowering of TER for higher AUM companies avoids the chances of any unfair pricing.
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- An upfront commission is an amount that fund distributors receive for getting investors to put money into a fund.
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- This means that the distributor's interest lies in getting a transaction done, hence they try to keep moving the money and creating more transactions.
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- Hence, SEBI has outlawed it and instead go for trail commission.
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- With this, as long as the investor is invested, the distributor gets a steady stream of revenue.
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- This avoids the need for switching money merely to get as many transactions as possible.
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- SEBI's move to bar mutual funds from paying fees to distributors from their books is also seen as an effort to prevent mis-selling.
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- This is because the commissions come from the underlying schemes and not the asset management companies.
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- SEBI's move to promote corporate bond market is difficult to implement in the absence of any real reforms.

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- This is witnessed by the share of corporate bond market to GDP at around 17%, way lower than the equity market at 80 per cent.
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- Also, there are concerns that advisers could push financial products with higher costs and fees on account of lower expenses and commissions.
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- Hence it is necessary to ensure that lowering of expenses leads to passing on the benefits of efficiencies to investors.
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Source: Business Standard

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