Changes in Mutual Fund Regulations – II

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Why in news?

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SEBI recently announced changes in rules governing mutual fund.

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How it serves as a pro-investor measure?

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- All the fees and costs chargeable to the investor are packed into a single Total Expense Ratio (TER), which is expressed as a percentage of a scheme's net assets.
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- **Investor savings** - TERs for equity and hybrid schemes start out at 2.5 % of daily average net assets for the first Rs. 100 crores and fall to 1.75 % for all assets beyond Rs. 700 crores.
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- However, in recent times there are some schemes that manage assets of over Rs. 22,000 crores, making these slabs obsolete.
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- Hence, to allow all schemes ranging from a Rs. 700-crore midget to a Rs. 22,000-crore giant to levy the same TER is quite unjust to investors.
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- The slab-based structure had not been revised from the time SEBI introduced its mutual fund regulations in 1996.
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- Under the new rules, the TER ratio will come down once the assets under management of a mutual fund arise.
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- Under the new slabs, open-end equity schemes can charge a maximum of 2.25% for the first Rs. 500 crores of assets, 2% for the next Rs. 250 crores and 1.75% for the next Rs. 1,250 crores.

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- TERs drop to 1.60 per cent once assets scale up beyond Rs. 2,000 crores.
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- This benefits investors in higher AUMs to make savings in TERs of 30 to 60 basis points under the new slabs.
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- It also curtails the disproportionate financial clout that the top AMCs enjoy over distributors and competitors.
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- **Close- ended funds** - They lock in investors irrespective of performance, operate to vaguely defined and duplicated mandates and often charge investors at the highest TER slab.
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- By capping the maximum TER for close-ended equity funds at 1.25%, SEBI has now provided strong disincentives for MFs to prefer close-end funds.
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- **Ban on upfront commissions** – Though forbidden, many AMCs do pay upfront commissions to intermediaries out of their own pocket to push products.
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- SEBI forces MFs to move to an all-trail model for their distributor commissions.
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- Under this, an advisor earns his fee as an annual percentage of his clients' assets.
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- Thus, if the investor sells funds or his net asset value slumps due to poor performance, the distributor takes a haircut on his earnings too.
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What are the negatives for the industry?

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- Ban on upfront commissions could prevent AMCs from using their own profit and losses to reward or incentivise their distribution partners.
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- Though SEBI has been keen to hold MFs to ultra-high standards on costs and transparency, regulators of competing financial products like IRDA still need regulatory tweaking.
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- In regular premium traditional insurance policies, first year commissions of more than 35% to agents are still commonplace.

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- Widening fee differentials between MFs and other products may nudge both AMCs and talented fund managers to abandon MF industry.
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- Also, reduction in TER can squeeze the already poor revenue of individual financial advisors(IFA) who services the retail investor.
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- Declining revenues can turn the business models of many IFAs unviable.
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- This may have direct implications for MF penetration and the quality of MF advice and services received by small investors.
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Source: Business Line

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