Detailed Comments on TER Review

Background

SEBI has initiated a review of the total expense ratio charged by mutual funds.

A meeting of the Mutual Fund Advisory Committee (MFAC) meeting was called on 13th January, 2023 with the Agenda to "Review of fees and expenses charged by Mutual Funds" and a detailed presentation on " Review of Total Expense Ratio" was made at that meeting .

The presentation covered :

1) The Present TER Limits , Changes made in 2012 and 2018
2) Objective of the present review
3) Industry Data : Growth in AUM , Contribution by Individuals & Corporate
4) Study on Base TER and Total TER
5) Observations on Fees, GST, Transaction Cost , Switches, NFOs and B30
6) Expenditure Analysis of Equity and Debt Schemes
7) Proposal and Points for deliberation with Proposed TER Limits
8) Performance based TER
9) Proposal for B30 Incentive and
10) Proposals related to Distributor Commission

In view of the need to allow members to study the proposal and respond, it was agreed that the Presentation would be shared and all attendees at the said meeting were requested to submit their comments on the proposals.

Thus, I submit my detailed comments on the Presentation on "Review of Total Expense Ratio" shared and on the Proposal made thereunder .

My Comments have been covered in 5 parts as under:

1) Part A Proposals on Revamping and restructuring of the TER
2) Part B Observations arising out of inspection.
3) Part C Agenda points and proposals
4) Part D Other points for deliberation
5) Part E Methodology for studying impact of the proposed changes in TER

PART A: REVAPMING AND RESTRUCTURING OF THE TER:

Significant Changes have been proposed on the limits for TERs

Shift of Slabs from Scheme level AUM to AMC Level AUM

TER limits for Equity and Debt based on AMC AUM

Change in method for Hybrid Funds

Clubbing various additional expenses under regulation 52(6A)

Before commenting on any of the proposal it would be necessary to quantify the impact of these proposals and do an Impact Analysis. A study to work out the impact of revised TER proposed by SEBI in the MFAC meeting has been done. The findings of the study indicate a significant reduction in the effective TER that can be charged based on the new proposals. The methodology of carrying out the impact analysis is given in PART E of the comments.

The Impact of the Proposals on the TER as per the study is given below:

(i) Impact on TER of Regular Plan:

Trend in TER of Regular Plans	Weighted Average TER		
Equity Funds	2018	2022	Proposed
Total with Transaction Cost	2.50	1.96	1.54
Less Transaction Cost	0.15	0.15	0.15
Total TER excluding transaction cost	2.35	1.81	1.39
Reduction in TER in bps		-0.54	-0.42
Reduction in % terms		-23%	-23%
Debt Funds	2018	2022	Proposed
Total TER excluding transaction cost	1.03	0.97	0.57
Reduction in TER in bps		-0.06	-0.4
Reduction in % terms		-6%	-41%

The impact :

Reduction in TER of Equity Oriented Funds by 44 bps (-23%);

Reduction in TER of Debt Funds by 40 bps (-41%);

(i) Impact on Total Expense Amount of Regular Plan:

Impact Analysis of Proposals on TER based on AMC Level AUM Slabs for Regular Plans of Open Ended Schemes Based on AAUM as on 31/12/22

Open Ended Schemes	WEIGHTED AVERAGE AAUM AND EXPENSE RATIO						IMPACT ANALYSIS FOR REGULAR PLAN						
	Direct		Regular		Total		Amount Rs Crores			%	TER on Regular Plan		
Asset Class	AAUM	Exp Ratio	AAUM	Exp Ratio	AAUM	Exp Ratio	Current	Proposed	Change	% Change	New	Change	% Change
Equity Oriented Funds	**4,40,055**	**0.76%**	**16,17,630**	**1.81%**	**20,57,685**	**1.59%**	**29,322**	**22,530**	**-6,792**	**-23.16%**	**1.39%**	**-0.42%**	**-23.16%**
Equity Scheme	3,41,679	0.81%	11,77,885	1.87%	15,19,563	1.63%	21,996	17,464	-4,532	-20.60%	1.48%	-0.38%	-20.60%
Hybrid Scheme	95,948	0.61%	4,10,186	1.64%	5,06,133	1.44%	6,717	4,727	-1,990	-29.63%	1.15%	-0.49%	-29.63%
Solution Oriented Scheme	2,428	1.00%	29,560	2.06%	31,988	1.98%	609	339	-270	-44.33%	1.74%	-0.32%	-15.43%
Debt	**3,10,648**	**0.38%**	**2,34,837**	**0.97%**	**5,45,485**	**0.63%**	**2,278**	**1,333**	**-945**	**-41.47%**	**0.57%**	**-0.40%**	**-41.47%**
Debt Scheme	3,10,648	0.38%	2,34,837	0.97%	5,45,485	0.63%	2,278	1,333	-945	-41.47%	0.57%	-0.40%	-41.47%
Grand Total	**7,50,703**	**0.60%**	**18,52,467**	**1.71%**	**26,03,170**	**1.39%**	**31,600**	**23,863**	**-7,737**	**-24.48%**	**1.29%**	**-0.42%**	**-24.48%**

a. The impact of the change in calculating TER of Equity Oriented Funds based on % of Total AUM as compared to the existing practice of calculating TER as a % of Scheme results in reduction in expenses of Equity Oriented Funds - Regular Plan by Rs. 6,792 crs (-23.16%);

b. The impact of the change in calculating TER of Debt Schemes based on % of Total AUM as compared to the existing practice of calculating TER as a % of Scheme results in reduction in expenses of Debt Funds Regular Plan by Rs. 945 crs (-41.47%);

(ii) AUM , Current TER, Proposed TER and impact

Open Ended Schemes	WEIGHTED AVERAGE AAUM AND EXPENSE RATIO				
	Current Regular Plan		Proposed	Change in Exp Ratio	
Asset Class	AAUM	Exp Ratio	Exp Ratio	Abs	In %
Equity Oriented Funds	**16,17,630**	**1.81%**	**1.39%**	**-0.42%**	**-23.16%**
Equity Scheme	11,77,885	1.87%	1.48%	-0.38%	-20.60%
Hybrid Scheme	4,10,186	1.64%	1.15%	-0.49%	-29.63%
Solution Oriented Scheme	29,560	2.06%	1.74%	-0.32%	-15.43%
Debt	**2,34,837**	**0.97%**	**0.57%**	**-0.40%**	**-41.47%**
Debt Scheme	2,34,837	0.97%	0.57%	-0.40%	-41.47%
Grand Total	**18,52,467**	**1.71%**	**1.29%**	**-0.42%**	**-24.48%**

The current weighted TER that an Indian investor pays for investing in Mutual funds in India are not high but low in the global context and the Indian MF industry has consistently delivered good returns post expenses over the last 2 decades and is delivering value to the investors . Hence there does not seem to be any need for a TER reduction at the moment.

Global comparison

I have already circulated the 2nd Study on the expense ratios titled "Study and Comparison of Expense Ratios for Mutual Funds Globally and in India" conducted by the Foundation of Independent Financial Advisors in June 2018 vide my email dated 16th January, 2023. The key conclusion arising out of the study is that India in 2018 was the third least expensive country for equity mutual funds across the globe. With a reduction in TER cost by a further 50 bps from 2019 to 2022 it would not warrant a further reduction of TER in India. India's TER for fixed income/debt funds are amongst the lowest in the world.

The current TER of Equity funds at 1.81 % includes a GST component 0.28%. Thus the net fees received are only 1.54%. This would have made the TER charged by Indian MF industry the lowest in the globe for retail investors

MFs penetration still lags, leaves scope for expansion

Notwithstanding the all-out effort by the market regulator SEBI and the industry, mutual fund penetration still remains low and opens up opportunity for fund houses to grow their base.

- Of the 43.34 crore individual PAN card holders, only 8 per cent or about 3.37 crore have invested in mutual fund schemes as of March-end.

- The industry had 2.28 crore investors registered with unique PAN in FY21, according to the Association of Mutual Funds in India (AMFI) data. The number of new investors added based on PAN increased 49 per cent to 3.32 crore last fiscal against 2.23 crore in FY21. **The investors addition based on PAN was up three per cent to 4.65 lakh (4.52 lakh).**

India is at penetration level of 15% of GDP and a long way to go to deepen the penetration. The proposed TER cuts would derail the healthy growth and development of the industry.

Mutual funds have huge scope to get more people to invest and efforts to add more distributors in rural regions will help spread the reach.

Customers in smaller cities are aspirational and have long-term goals but do not have access to right products and the industry has to create products and infrastructure for distribution and handholding for this section of the society.

Certain observations during the course of inspection related to:

1. Splitting and Churning of transactions for B30 incentives
2. Proliferation of NFOs and switches of NFOs
3. High Brokerage transaction cost as a % of Aum in some exceptional case
4. Some additional cost towards GST

Have led for the need to review and for proposal to Change of computation of TER.

I have given my views on the the observations arising out of inspection and the agenda items in in part B and C of this submission. Resolution of these observation does not require reduction in TER and can be dealt with at a case specific level.

These changes do not warrant a structural change in TER nor a reduction in TER

A uniform TER at an AMC level will reduce any wrongful switches but the quantum of switches is very low compared to the total flows in the industry. Hence it should not result in complete restructuring of the methodology of TER computation which would have greater implications.

I believe there are good reasons for keeping the additional expenses under regulation 52 (6 A) outside the TER limit as they are transaction dependant and not related to scale benefits. Also, there is adequate disclosure of these expenses.

In light of these facts, I believe there is no case for a revamp or reduction of fees.

PART B: OBSERVATIONS ARISING OUT OF INSPECTION:

(i) Splitting of applications and churning of investors portfolio for getting benefit of additional expenses for inflows from B-30.

B30 -Churn and Splitting Observed	Count	Rs Cr
Churning: Example	307	6
Splitting		2900
Total : Churn and Split		2906
Gross Mobilisation in B30 in CY 22		95000
Retail AUM/flows in B30 estimated	62%	58900
% of Churn/Splitting to total		3%
% of Churn/Splitting to Retail		5%

Gross mobilisation in CY 2022 from B30 cities is about 95,000 crores. Of this 62% should be retail flows i.e. 58,900 crores. Churn of Rs. 6 crores and splitting of around 2900 crores has been observed.

This is about 3% of total mobilisation and 5% of the retail mobilisation.

B30 incentives have been instrumental in the increase in retail penetration. However, the level of penetration is far away from the desired levels. B30 incentives should be given to all retail investors across the country irrespective of the pin codes.

As far as observations during inspection is concerned what needs to be kept in mind is whether the splitting of applications and churning is rampant or negligible. In case of such instances being few, relative to the volume and value of transactions, the same need to be dealt with at the individual level through the AMC. Action needs to be taken by AMC's against the respective distributors and the additional commission paid be reversed and action taken against the distributor

(ii) B-30 additional expenses calculated based on estimate and not actuals leading to excess commissions charged by AMCs.

The additional expenses on account of B 30 transactions should be charged on actuals.

(iii) No limit on the expenses towards transaction cost resulting in huge *pending* towards transaction cost.

Transaction Cost - no limit as a % of AUM	Cost as a % of AUM	
Nature of Scheme	**Average %**	**Median %**
Open ended Equtiy Oriented Schemes	0.2531%	0.1608%
Close ended Equtiy Oriented Schemes	0.3775%	0.1475%
Actively Managed FoFs	0.0057%	0.0001%
Open Ended Debt Scheme	0.0084%	0.0062%
Passive Fund	0.1762%	0.0457%
Interval & Close Ended - Other than Equity Scheme	0.0027%	0.0008%

There does exist a limit on brokerage and transaction cost under regulation 52(6A). The prescribed limits are based on the value of each transaction. The average cost of brokerage and transaction for debt funds is less than .01% of the AUM. The simple average transaction cost for actively managed open ended funds is 0.25%. The median cost is 0.16%The average transaction cost for passive funds is 0.17%. The median cost is 0.05%. Hence the transaction costs are reasonable.

The brokerage cost on transactions is part of the cost of acquiring securities. By limiting the brokerage and transaction cost as a percentage of the AUM, regulations will be indirectly prescribing the maximum portfolio turnover ratio. Purchase and sale of securities must be done based on mandate of the scheme and other investment considerations.

Certain schemes by their very nature (e.g. dynamic bond funds) would have a higher churn and therefore higher transaction costs relative to other debt funds (e.g. long term debt funds or FMP's). In case of equity funds there would be a difference in the costs of managing funds having different mandates (e.g. dynamic asset funds, arbitrage funds vis a vis long term diversified funds)

It would also be pertinent to take cognisance of the number of instances where such occurrences are deemed to be excessive. A few cases in isolation without appropriate reason cannot form the basis of overhauling the existing regulations which have worked well over time. In case, the same are not systemic then the same can be dealt with at the individual scheme level.

In view of the above the brokerage and transaction costs should remain outside purview of TER limit as per the existing regulations.

(iv) Cross subsidization across schemes. AND

(v) AMC instead of charging management fees to some schemes are bearing cost of running a scheme (in violation of MF Regulations)

The data relating to cross subsidisation is given hereunder to get a better perspective in the total scheme of things:

Category of Fund	Total No of Schemes	No of Schemes With -ve MGM Fees	No of Schemes With Zero MGM Fees	**Total No of Schemes Cross Subsidised**	% of Schemes violating
Passive	291	26		**26**	8.9%
A-FOF	55	1	3	**4**	7.3%
CE-Debt	672	9	18	**27**	4.0%
CE-Equity	68	1		**1**	1.5%
OE-Equity	374	1		**1**	0.3%
OE-Debt	321	2		**2**	0.6%
Total	1781	40	21	61	3.4%

The cases where instances of cross subsidisation have occurred is insignificant and does not warrant any systemic change. The issue can be addressed at the individual scheme level with the respective AMC.

In the alternative the regulations may provide for a minimum charge based on certain parameters just as there is a maximum limit prescribed to prohibit zero or negative management fees.

(vi) Proliferation of NFOs and switches from existing scheme to the NFO (to get benefit of higher TER and Commission)

Switches in NFOs Period Apr 01,2021 to September 30, 2022				
		Active	Passive	Total
No of NFOs		47	39	86
Amount garnered in Nfos in Crs		82,733	2,552	85,285
Garnered thru switches in Regular Plan		22,437	386	22,823
% of Switch by distributors		27.12%	15.13%	1.00%
Difference in commission				181.54
Comparison with Total Flows				
Gross Flows mobilised during the period				8,67,346
% of Amount garnered thru NFOs to total flow garnered				10%
% of Amount garnered thru switches in NFO to total amounts mobilised				3%
Comparison with Total Commission on Equity Oriented Funds - Estimate				Amount /%
AUM in Equity Oriented Funds -Regular Plan-1st April 2021				10,22,923
Aum in Equity Oriented Funds - Regular plan -30 July 2022				14,50,306
Average Aum during the Period 1st April 21 to 30th Sep 22				12,36,615
Average Distribution Commission paid @ 1% p.a. for 1 year				12,366
NFO Difference in Commission				181.54
% of NFO Difference in Commission to total Commission				1.47%
NB : Aum in regular plans is estimated at 75% of total Aum based on data shared in MFAC				

The amount garnered through NFOs is 10% of the total gross mobilisation of equity funds and the amounts garnered by way of
switches of Rs 22,823 is less than 3% of the on the total gross equity mobilisation.

There is a presumption that all switches are done with a view to get the benefit of higher TER slabs which would be in the interest of the AMC and the distributors Investments, including switches in NFO's may have been done because there is a bonafide case for investing in the scheme for the investor, for partial or total booking of profits in the existing scheme, expectation of better returns from schemes having a smaller AUM etc. Hence whilst there is a higher pricing for new schemes, it cannot be presumed that switches are done only for higher TER's. It will also be observed that switches have been done in passive schemes which would have a lower TER.

Based on the above facts & reasons this does not require a change in TER structure.

(vii) GST paid on management fees charged to the scheme and AMCs crediting back some amount to the scheme (Additional cost incurred towards GST)

It is presumed that the observation is related to instances where in the first place AMC's charge a certain amount of management fees on which GST is charged. Thereafter the management fees are either partly or fully reversed and the scheme is left to bare the GST on the amount reversed. In the first place the scheme would benefit on account of reversal of management fess resulting eventually in a lower management fee. Further it appears to me that the GST on the reversal can also be claimed and there is no need to charge the GST on the amount of management fees reversed.

In the analysis it has been mentioned that in some cases the GST charged is more than 19%. Such cases should be looked into and remedial steps taken.

Other Observations on TER

	Based TER		Add Exp Reg 52(6A)		Total	
Particular	**Average %**	**Median %**	**Average %**	**Median %**	**Average %**	**Median %**
Open Ended Debt Scheme	0.5638%	0.4374%	0.0576%	0.0459%	0.6214%	0.4833%
Open ended Equtiy Oriented Schemes	1.7203%	1.7576%	0.4221%	0.3699%	2.1424%	2.1275%
Close ended Equtiy Oriented Schemes	0.9730%	1.2074%	0.4926%	0.2289%	1.4656%	1.4363%
Interval & Close Ended - Other than Equity Scheme	0.1601%	0.0958%	0.0156%	0.0096%	0.1757%	0.1054%
Actively Managed FoFs	0.7807%	0.8416%	0.0842%	0.0631%	0.8649%	0.9047%
Passive Fund	0.2863%	0.1750%	0.2027%	0.1500%	0.4890%	0.3250%

In case of Debt funds the TER for India is among the lowest across the world.

In case of TER for Equity Funds based on total cost of ownership again India is amongst the lowest amongst the world. Also, GST cost is not controllable by AMC.

Other Observations: Reconciling Base TER and Total TER

Equity Funds		
Expenditure Analysis	**2021-22**	**As % of NAV**
Brokerage and transaction Cost	**7%**	**0.15%**
Distribution Commission Paid	**45%**	**0.96%**
Management Fees Charged	**37%**	**0.79%**
Other Expenses	**11%**	**0.24%**
Total	**100%**	**2.14%**
Less GST @ 18%		**0.33%**
Net of GST		**1.82%**

Reconcilaition of Total Cost including Brokerage with Base TER		
Items of Expense	Additional	**% of NAV**
Total TER with transaction cost - Average		**2.14**
Average transaction Cost - Brokerage		**0.15**
TER without transaction cost subject to Limit		**1.99**
Brokerage in lieu of exit load	**0.05**	
GST on Magm Fees	**0.12**	
Additional TER for B30	**0.10**	**0.27**
Base TER		**1.72**

PART C: AGENDA POINTS AND PROPOSALS:

a. Measures that needs to be taken to bring in more transparency on additional expenses permitted to be charged to schemes under Regulation 52 (6A) :

Proposal is that the TER Limits may be inclusive of all additional expenses under regulation 52(6A) and GST on Investment Management Fees except the additional expense charged for investments from B30 cities.

Regulation 52(6A) provides for the following additional expenses in addition to the maximum limit of TER prescribed:

- Brokerage and transaction costs
- B 30 incentive
- 0.05% for exit load

Brokerage and Transaction Costs:

Bringing brokerage and transaction costs within TER limits is not appropriate as the brokerage and transaction costs are in any case capped at 12 bps on the value of the transaction.

The brokerage cost on transaction is part of cost of acquiring securities.

The fact sheet discloses the portfolio turnover ratio which will indicate the level of transaction and brokerage costs. By limiting the Brokerage and transaction costs the regulations will be indirectly prescribing the portfolio turnover ratio.

Purchase and Sale of securities must be done based on mandate of the scheme and investment considerations and should remain outside purview of TER limit.

It may be better that each scheme can be asked to disclose the brokerage and transaction cost as a % of Nav.

Exit Loads:

Exit loads should be charged to the scheme at actual.

GST on Investment Management Fees:

GST on investment advisory fees should remain outside the TER limits as it is a tax and not an expense. In fact, GST on all expenses should be outside the TER limits.

Today, the total expense ratio excluding brokerage and transaction cost is already being disclosed in the fact sheets. The TER on a daily basis is been disclosed on the website too. As a measure of further transparency, the base TER and the additional expenses prescribed in Regulation 52(6A) as well as GST on management fees maybe be disclosed component wise. This would address the need to bring in more transparency on the additional expenses charged.

If the additional expenses have to be built into the base TER, then the base TER should be increased by the same amount.

b. Analyse the impact of additional expenses permitted to be charged to the scheme for financial inclusion (new inflows from B-30 cities) and measures that needs to be taken to bring in transparency.

Proposal is to limit the incentive to only a new investor from B30 cities and provide for a flat amount amongst other modifications.

B-30 incentives have been instrumental in greatly improving the financial inclusion in the B 30 cities/towns. It has been observed that 400 out of 1430 pin codes in the Top 30 cities had an AUM of less than 100 crores, whereas around 1000 pin codes in the B 30 pin codes had an AUM of more than 100 crores. This itself establishes that B30 incentives should be converted into an incentive for retail mobilisation across the country and not based purely on B 30 pin codes. The target should be to have as many individual mutual fund investors as there are individual bank account holders. In the USA, out of a population of 333 million, 102.6 million people own mutual funds, which is roughly 33% of the population. In India we have 3.36 crores mutual fund investors out of a population of 140.76 crores and if we have to reach 33%, 46.92 crore individuals should be individual mutual fund investors. The retail penetration has increased but far away from the desired levels, I suggest that not only should the incentives be continued, but also that the incentive be given to all retail investors. In case a flat amount is being considered, then besides the lump sum per transaction, an incentive of 2 % can be paid to distributor only on completion of 3 years holding period.

As far as transparency is concerned, adequate disclosures should be made in the fact sheets and on the web site.

As far as splitting of applications and churning is concerned what needs to be kept in mind is whether the same is rampant or negligible. In case of such instances being few, relative to the volume and value of transactions, the same need to be dealt with at the individual level through the AMC. Action needs to be taken by the AMC's against the respective distributors.

The additional expenses should be charged on actuals.

c. **Whether GST on investment and advisory fees which is charged over and above the TER limit should be brought in within the TER limit?**

Proposal is that the TER Limits may be inclusive of all additional expenses under regulation 52(6A) and GST on Investment Management Fees except the additional expense charged for investments from B30 cities.

This proposal is emanating from the observations during inspection wherein it was found that additional cost was incurred at the time of reversal of management fees as GST thereon was already paid on management fees before the same were reversed. It would probably be more relevant to understand why management fees need to be reversed in the first place. However, if the management fees are being reversed, it also needs to be determined whether this a normal practice or not. This issue can be addressed by looking into each specific case rather than having to tweak the well-established method of determining TER. Further, GST on investment advisory fees should remain outside the TER limits as it is a tax and not an expense. In fact GST on all expenses should be outside the TER limits.

d. **If yes, is there a need for upward revision of TER limits?**

No proposal stated

In case the GST on investment advisory fees is included in the TER, the TER should be increased by the same amount.

In fact, the GST on the total TER should be a pass through.

e. **Ways to partly pass on the benefit of economies of scale to investors also.**

Proposal for deliberation is to prescribe TER limits at the AMC level instead of at the scheme level and also to revise downwards the TER limits based on AUM at the AMC level.

The economies of scale are being continuously passed on to the investors. In this regard, it would be appropriate to look at the trend of TER over the past 4 years. The data on the trend in the TER of the Regular Plan excluding brokerage and transaction cost over the last 4 years.

Trend in TER of Regular Plans	Weighted Average TER	
Equity Funds	**2018**	**2022**
Total TER excluding transaction cost	2.35	1.81
Reduction in TER in bps		-0.54
Reduction in % terms		-23%
Debt Funds	**2018**	**2022**
Total TER excluding transaction cost	1.03	0.71
Reduction in TER in bps		-0.32
Reduction in % terms		-31%

The 2018 numbers are based on the Study of expense ratio done by Foundation of Independent Financial Advisors (FIFA) and 2022 numbers are arrived at by applying the similar methodology to Dec 2022 Quarterly Average AUM and the latest available expense ratios.

Between 2018 and 2022, there is a decline in Weighted Average TER for Equity Funds by 54 bps (-23%) and for Debt Fund 32bps (-31%). There has already been a substantial decrease in TER and the same has been passed on as benefits of economies of scale to the investors over the years.

By virtue of the revision in the structure of the TER in April 2019, the benefits of economies of scale has already been passed on to the investors and the same continues to be passed on as the revised structure has provided for a sliding scale whereby the economies of scale would continue to flow to the investors with the increase in size of the AUM.

To consider ways to **further pass** on the benefits of economies of scale needs a deep study to be done to measure the benefits of scale with the rise in AUM. One has to consider amongst many other parameters, impact of the proposed changes, the value provided to the investor, at what level does the economy of scale actually kick in, development of the industry, level of financial inclusion, importance of the growth of the mutual fund industry for stability of the capital markets and the advantages there from, global practices and ranking etc.

The impact of such a sharp change could be quite disastrous.

In 2018, regulations also introduced a drastic reduction in TER for close ended funds and reduced them to 1.25 for equity-oriented schemes and 1.0 % for other than equity oriented schemes.

The drastically lower TER in case of close ended schemes led to stoppage of launch of close ended funds. Close funds which had a corpus of Rs. 2,00,000 crores fell to Rs. 30,000 crores.

Trend in AUM of Open End and Close Ended Funds :

YEAR	Mar-19		Dec-22		Change	
	No	Crs	No	Crs	No	Crs
Open Ended Funds	894	21,67,650	1220	39,58,270	36.47%	82.61%
Close Ended Funds	1119	2,09,342	143	29,629	-87.22%	-85.85%
Interval Funds	29	2,492	12	836	-58.62%	-66.45%
Total	2042	23,79,484	1375	39,88,735	-32.66%	67.63%

The current proposal for revision in the TER for equity oriented funds indicates a fall of 44 bps to a TER of 1.37%. This could result in a drastic reduction in net flows and negatively affect the development and growth of the industry and the related benefits.

In USA, out of a population of 333 million, 102.6 million people own mutual funds, roughly 33% of the population. In India we have 3.36 crores mutual fund investors out of a population of 140.76 crores and if we have to reach 33%, 46.92 crore individuals should be individual mutual fund investors. The retail penetration and financial inclusion has increased but far away from the desired levels.

The growth of the mutual fund industry and the retail penetration and financial inclusion is largely due to the untiring efforts over the years of the asset management companies and the mutual fund distribution community. Any cut in TER which will lead to reduction in the remuneration payable to the AMC's as well as the distributors. This will in turn impact the mobilisation of retail flows into the industry as it will impact the viability of the business of a large no of small distributors. Needless to say it will affect the growth of the industry and related benefits.

Any cut of the TER, which is passed on the distributor hits the small distributor. A 20 bps reduction in Equity TER increases the return of the investor marginally (where one expects a long term return of 10%, the return to the investor would increase to 10.2% which is a 0.20% improvement in his return. However, for a distributor a 20 bps reduction in TER results in a 30% reduction in his gross income and a 50% reduction of his net income.

In case of debt where the most of the scheme expenses are below the prescribed limits there is no need to consider any changes. The industry dynamics itself is ensuring that the TERs are low.

In case of hybrid /asset allocation funds, the maximum TER limit should continue to be in line with those of Equity Funds. These funds require higher fund management skills and efforts of deciding the appropriate asset allocation besides appropriate security selection and also requires greater marketing efforts. These schemes could also require multiple fund managers to manage the funds.

Within an Asset Class there are various Categories of Funds and prescribing one TER based on an Asset Class may not be appropriate. It will be appropriate to continue to have the TER limits at the scheme level. If the TER has to be calculated based on the AUM at AMC level, the revised TER structure should not lead to any effective reduction in TER.

In my opinion the existing sliding scale TER slabs based on scheme level AUM is appropriate and adequate to pass on benefits of economies of scale to investors

f. **Whether AMCs should be permitted to have a limited purpose membership with stock exchanges for executing trades for Mutual Fund schemes?**

Proposal is to permit AMC's to have a limited purpose membership with stock exchanges to execute trades for mutual funds

The same may be permitted but not made mandatory. It is for the individual asset management company to assess the merits and demerits of the same and take a decision. If it is made mandatory many advantages like viability of sale side research reports, market making of securities, better pricing etc. could be lost.

g. **Should distributors be allowed to receive any payment/commission directly from investors over and above the commission paid from the scheme.**

Proposal : Distributors are agents of AMC and should be paid commission /fees only by AMC from schemes. Nothing over and above TER should be charged to the investor

Distributors should not be permitted to charge / receive commission from investors.

As Distributors are agents of AMC – the contractual arrangement should be between AMC and Distributor and hence distribution commission should technically be paid by the AMC and not from the schemes.

h. **Measures need to be taken to eliminate incentive(s) paid to distributors so as to discourage frequent churning of the investor's portfolio**

Proposal for Uniform Trail Commission for all years . Proposal for % of distribution commission for NFO should not be more than % of distribution commission for existing schemes

Frequent wrongful churning needs to be discouraged. As the extent of churning based on the data shared it does not require change in the current TER structure.

Churning can be addressed by a carrot and stick policy adopted by the AMCs

1) Penalising the errant distributors
2) Incentive AMCs/Distributors who encourage long-term holding period in equity as well as debt products. For example, to prevent churn and to encourage long term holdings distributors could be given incentives of additional trail (an increasing trail option) on investment completing of 5/10/ 15 / 20 years holding in a scheme.

Correspondingly AMC's should be also be given higher trail on the their investor AUM greater than 5/10/15/20 years. This may be an alternative to a performance incentive. Good performance would lead to longer holding period. While AMC are required to reduce TER as AUM rise they must be given incentive to encourage long term holding by investors.

Manufacturers need to be allowed to price different products differently even within an asset class. NFOs need to be given the flexibility to charge higher as there is cost for developing, innovating, launching and marketing new products

i. **Whether Management Fees should be linked to the performance of the scheme?**

Proposal is to consider 2 options given or any other option to calculate the basis of charging performance based TER

A simpler structure of a percentage of AUM has worked well for the mutual fund industry. Performance linked structures are more appropriate for PMS, AIF's, managed accounts etc. and for institutional and corporate investors.

Focus of fund management can be biased towards chasing returns and prove to be detrimental to the investor specially the retail investor

PART D: OTHER POINTS FOR DELIBERATION

1) **Distribution commission:**

a) **Percentage of Commission Payable on NFOs**

Manufacturers need to be allowed to price different products differently even within an asset class. NFOs need to be given the flexibility to charge higher as there is cost for developing, innovating, launching and marketing new products.

There is a perception that all switches from schemes with high AUM to NFO's are done with a view to get the benefit of higher TER slabs which would be in the interest of the AMC and the distributors. Investment including switches in NFO's are done because there is a bonafide case for investing in the scheme for the investor, for partial or total booking of profits in the existing scheme, expectation of better returns from schemes having a smaller AUM etc. Further, distributors should be allowed to be paid higher commissions than in case of existing schemes as the efforts put in to offer a new scheme to the investors is more.

The data on the amount of switches of Rs 22,823 works out to less than 1% of the total Equity AUM. Given the quantum and all of the above, this does not require a systemic change. At an AMC level some funds have restricted commission on Switches

b) **Uniform Trail:**

I suggest a step up trail to improve the incentive long term investment holding period and reduce churn.

Current AMFI best practice Circular does not allow repricing of brokerage upwards on old assets – this restriction needs to be removed.

PART E:
METHODOLOGY FORSTUDYING IMPACT ANALYSIS OF THE PROPOSED CHANGE IN TER

For doing the Impact Analysis, we have calculated the Weighted Average TER instead of using a simple average or a median. As the weighted Average (Weighted by AUM) truly represents the real cost that all investors in aggregate incur.

We have calculated the Weighted Average TER for Equity Oriented Funds and Debt Funds.

Calculation of TER as per the existing TER structure

The Scheme wise AAUM as on 31st December 22 has be taken from the AMFI website.
The latest Scheme wise TERs have been taken as under:

Source for Equity Oriented Funds : Morningstar Advisor Workstation
Source for Debt Funds : MFI Explorer from ICRA

For calculating the Current weighted TER the QAAUM is multiplied by the latest Scheme TER.

Calculation of TER as per the proposed TER structure

The proposed TER structure is based on the TER slabs at AMC Aum's.

For Equity Schemes: TER slabs based on total AUM of AMC in equity related instruments
For Debt Funds : TER slabs based on total AUM of AMC in debt related instruments

For Hybrid Schemes and Solution Oriented Schemes - TER will be based on the equity and debt allocation and the respective Equity and debt TER for the AMC

The AUM for open ended Equity Funds is taken as 100% Equity instruments.

In respect of Hybrid Schemes it is assumed 65% allocation to Equity Instruments and 35% allocation to debt instruments. For Solution Oriented Funds it is considered that 50% allocation to Equity and 50% allocation to debt.

The Total AUM of Equity Instruments at AMC level has been worked out and applied the TER based on slabs proposed by SEBI on Total AUM of Equity Oriented Funds for an AMC.

Similarly the total AUM of non-equity instruments at AMC level has been worked out to arrive at the TER slabs for an AMC and the applicable TER for debt funds

AAUM in Other category mentioned in AMFI AUM Report has not been considered for arriving at AMC level AUM for degerming slabs .This includes Index Funds, Gold Funds, Other ETF's and fund of funds investing overseas.

It is assumed that the revised TER rated proposed for Equity Oriented Funds includes 15 bps on account of brokerage and transaction costs which is the weighted average as per the expenditure analysis of Equity funds for FY 21-22

The Summary results are as under :

Impact Analysis of Proposals on TER based on AMC Level AUM Slabs for Regular Plans of Open Ended Schemes Based on AAUM as on 31/12/22

Open Ended Schemes	WEIGHTED AVERAGE AAUM AND EXPENSE RATIO						IMPACT ANALYSIS FOR REGULAR PLAN						
	Direct		Regular		Total		Amount Rs Crores			%	TER on Regular Plan		
Asset Class	AAUM	Exp Ratio	AAUM	Exp Ratio	AAUM	Exp Ratio	Current	Proposed	Change	% Change	New	Change	% Change
Equity Oriented Funds	**4,40,055**	**0.76%**	**16,17,630**	**1.81%**	**20,57,685**	**1.59%**	**29,322**	**22,530**	**-6,792**	**-23.16%**	**1.39%**	**-0.42%**	**-23.16%**
Equity Scheme	3,41,679	0.81%	11,77,885	1.87%	15,19,563	1.63%	21,996	17,464	-4,532	-20.60%	1.48%	-0.38%	-20.60%
Hybrid Scheme	95,948	0.61%	4,10,186	1.64%	5,06,133	1.44%	6,717	4,727	-1,990	-29.63%	1.15%	-0.49%	-29.63%
Solution Oriented Scheme	2,428	1.00%	29,560	2.06%	31,988	1.98%	609	339	-270	-44.33%	1.74%	-0.32%	-15.43%
Debt	**3,10,648**	**0.38%**	**2,34,837**	**0.97%**	**5,45,485**	**0.63%**	**2,278**	**1,333**	**-945**	**-41.47%**	**0.57%**	**-0.40%**	**-41.47%**
Debt Scheme	3,10,648	0.38%	2,34,837	0.97%	5,45,485	0.63%	2,278	1,333	-945	-41.47%	0.57%	-0.40%	-41.47%
Grand Total	**7,50,703**	**0.60%**	**18,52,467**	**1.71%**	**26,03,170**	**1.39%**	**31,600**	**23,863**	**-7,737**	**-24.48%**	**1.29%**	**-0.42%**	**-24.48%**