Date 31st March 2015

Representation on Best Practice Circular on Commission Pay-out

Observations :

1. In developed market like Singapore, Canada & USA they still have share classes where upfront is paid in lieu of trail. This is helping them in penetrating and expanding the market.
2. Capping & Restricting commissions are in the regulatory domain and is not advisable for a trade body to decide the same as it could lead to charges of unfair trade practices.
3. Development of the industry is also one of the areas sensitive to the regulators.
4. We believe it would be better if best practice circulars encourage development of commission structure based on category of distributor, size of investments , longevity of assets rather than enmass capping upfront and trail.
5. This capping could lead to unintended outcomes leading to the possible degrowth of the industry and eventually disservice to the investor and the aim of financial inclusion.
6. One has to accept that commission structures do not necessarily lead to mis-selling and all mis-selling is not on account of commission structures only.
7. While there is a need to prevent Mis-selling , we need to first punish the offenders rather than changing rules of the game every time on an assumption that it would end all mis-selling.
8. We also need to keep in mind that incentives are needed to encourage Right Selling .
9. Each Manufacturer has a choice between Growth and Profitability : Rules to restrict commissions are in a way dictating the business model to be followed and in a way restricts competition.
10. For eg : The proposed rules to Cap upfront commission to 1% and to restrict first year commission to be less than Distributable TER (expense ratio minus operating expenses) will ensure that even if an AMC has intent to spend capital to expand the industry to make last mile connectivity it will not be able to do so.
11. It is also not appropriate to ban higher trail commissions in subsequent years than the first year as this will not allow AMC to incentivize longer term holding and reduce churn. Infact this may encourage churn.
12. A blanket ban on any upward revision in any rates for assets under management existing as on the date is clearly restrictive and counter productive.
13. The proposed rule on clubbing other expenses may take away some of the well-established practices out of industry like that of yearly IFA conventions (Forum to share best practices across India and also to gain from each other insights), and recognize good performance , right selling and adoption of best practices.
14. An IFA catering to retail client and acquiring clients having size of Rs. 1 Lac investment will take more than 3 years to get 100 clients. His earnings will be not more than Rs. 6000 per month. It will be impossible for him to look at this as a career choice. This will reduce the talent pool available for distribution business.
15. In our opinion last mile connectivity specially retail is very expensive. If industry has to grow from 4 crore investors to 20 crores investors we will need lot more advisors and also lot more capital needs to be spent to create distribution reach. The best practices circular may restrict that and also may hamper long term growth and sustainability of Industry.

We request you to consider the following specific measures while finalizing the best practices

Suggestions:

1. If at all upfronts are to be capped it should be applicable on applications above 5 Lac. Higher Upfront in lieu of Trail for retail investments can be paid to encourage newer players in the industry. It will also help improve penetration. In smaller ticket sizes, there is typically lesser churn and less mis-selling.
2. For ticket higher than 5 Lacs capping of upfront can be done @ 2% but there should be no restrictions on trail Income. Upfront capping will reduce mis-selling by large extent.
3. Training & development of Intermediaries should be outside commission cap as it is more of capital expenditure for long term development of Industry.
4. Best practices like IFA convention and annual training should be allowed. As this has helped greatly in sharing best practices to develop the industry. Any scheme specific contest can be avoided.
5. Joint meet by IFA & AMC to attract and educate new clients should be allowed outside commission as once again it is capital cost and will push longer term growth in the industry.
6. The need for segmentation of Banks/National Distributors/IFAs while issuing such circulars
7. A number of close ended schemes are launched to benefit few select distributors – this should be discouraged. This would probably the one of the best practices that the industry should follow -
8. Exemption for ongoing schemes like ELSS and Retirement Products which have minimum holding period and are typically used for retail savings.
9. We would also urge AMFI to come out with best practices in areas regarding deployment of capital by AMC's which will help them to develop industry.

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