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Indian IFAs call for fees ban rethink

By John Sedgwick

India's mutual fund industry has struggled in the past two or three years, with assets under management falling in 2010 and 2011. This is partly attributable to volatility in stock markets, both in India and worldwide.

But it can also be traced to the move by the Securities and Exchange Board of India (SEBI) in August 2009 to ban front-end load fees on mutual funds. A distributors' transaction fee introduced by the SEBI in August 2011 is considered too low to offer adequate reward, and distributors are hoping further initiatives will be considered to help stimulate the industry.

Sanjay Matai, promoter adviser of The Wealth Architects, an independent financial adviser based in Pune, west India, says education for both investors and distributors is needed. He suggests a central fund could be established to promote investor education and to train sales agents on business and ethics.

The fund could be funded by pooling together 0.1 per cent of assets under management of all asset management companies operating in India, adds Mr Matai.

He also calls for a reintroduction of entry loads, although not on direct investments, and proposes a closer monitoring of distributors in the industry.

"Nobody is monitoring the agents," he says. "I believe if there was some organisation in place that could monitor the agents on a regular basis and bring about some better ethical standards on the part of the agents, this would give investors better confidence in the industry."

SEBI's goal in introducing the ban on front-end load fees was to encourage a move to fee-based advice and improve the quality of advisory services to deter the mis-selling of products. However, the move had limited effect. Distributors stopped selling funds and shifted to other products, such as unit-linked insurance plans, which still provided commissions earnings.

Shiv Taneja, London-based managing director at Cerulli Associates, says the ban effectively killed off a significant section of the market that has yet fully to recover from several years of unsatisfactory sales.

"They were caught unprepared, and a significant proportion of the distribution market was put out of play almost overnight," he says. "I think they wanted to try and move 10 steps, and it would have been better to move more gradually."

Before the commission ban came into effect in August 2009, fund providers added upfront charges of 2.25-3 per cent to funds to pay commission to distributors. Many thought this led to a focus on short-term gains, misleading advice, unreliable new fund offers and churning or commission-seeking.

Mutual fund assets managed by India's fund management companies fell 2.4 per cent in 2011, from Rs6.263tn ($125.6bn) at the end of 2010 to Rs6.114tn at the end of 2011, according to a report by Morningstar. In 2010, AUM fell by 5.8 per cent, mainly due to net outflows of Rs907.1tn.

As for the transaction fee introduced last August as an incentive for distributors to sell funds, fund sellers say it is too low and want a system of variable loads involving bigger fees for higher-ticket transactions. Funds can charge a fee of Rs100 per subscription, with an additional one-time Rs50 charge for first-time mutual fund investors.

"It is not adequate, the commission was much higher," Mr Matai says, although he acknowledges it at least covers some of the administration costs incurred by distributors.

A survey by Cafemutual, an Indian mutual fund news and analysis service, in the month after the transactions fee was introduced showed just 9 per cent of the IFAs polled viewed the incentive as favourable, while 55 per cent saw it as too small.

However, the survey showed distributors were moving to a fee-based model, with 50 per cent charging a fee to some of their clients, while 42 per cent of those not charging fees said they would seriously consider doing so.

Mr Matai says the introduction of transaction fees was a move in the right direction, but agents have to start being suitably compensated or the fund industry will continue to suffer.

"The alternative that the agents negotiate a fee with the investor does not work in India," he says. "The concept of paying fees for financial advisory services is alien to India and, hence, there has been a lot of reluctance on the part of the investors to pay their agents for the advice and other services offered by them."

John Sedgwick is a reporter for Ignites Asia, a Financial Times publication, where this article first appeared

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