Outlook Money

Will Sebi's steps help?

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Pradeep Gupta, co-founder & vice chairman of Anand Rathi Financial Services says "If one has a closer look at the announcements regarding IPO's, the message seem quite clear that it is aimed towards a more transparent regime, encouraging retail investors to invest in primary market, protect & safeguard their interests. These measures will ensure quality public offerings, instill discipline amongst issuers / market intermediaries, make the issue process more transparent, provide a level playing field for all market participants and enhance investor confidence."

BY KUNDAN KISHORE & DEEPALI PENKAR

WILL SEBI'S STEPS HELP?

If the capital market reacts the way Sebi wants it to, it is likely to be more take for the investor than give

The Securities and Exchange Board in India (Sebi) is trying to bring retail investors back into the capital market, be it through the primary market for stocks or investments in mutual funds (MFs). To that end, at its recent board meeting, the regulator decided on a series of steps that, it hopes, will bring investors' money into stocks and MFs. While the approach looks balanced at first glance, it is worth checking whether the ostensible benefits to the investor stand up to scrutiny.

MUTUAL FUNDS

Sebi's regulatory remodeling would affect both the investor as well as the distributor.

AMCs will be able to charge additional TER up to 20 bps. For the retail investor, this development is a bit of a concern, if not a worry. That's because the ceiling on the total expense ratio (TER) has been increased by 20 basis points (1 basis point (bp) = one-hundredth of a percentage point) across existing slabs. Also, the regulation says: "To improve the geographical reach of MFs and bring in long-term money from smaller towns, AMCs are allowed to charge additional TER (up to a total of 30bps) depending upon the extent of new inflows from locations beyond the top 15 cities. AMCs will be able to charge 30 bps if the new inflows from these cities or towns are a minimum 30 per cent of the total inflows. In case of a smaller share of inflows, the proportionate amount will be allowed as additional TER". In fact, with this additional increase of 30 bps, for investors from other than the top 15 cities of the country, the TER may go up to 3 per cent if fund houses manage to garner 30 per cent of its total assets under management (AUM) from these areas. According to the Association of Mutual Funds of India's (AMFI) geographical distribution of MF June data, the top 15 cities contribute more than 80 per cent of the MF industry's assets under management (AUM). The combined contribution of just Mumbai and Delhi is more than 58 per cent. However, the maximum limit will be 2.70 per cent for investors residing in top 15 cities.

What higher TER means for you. Expense ratio is the charge a fund house puts on the investor for managing their money. Seen from a retail investor's point of view, it is truly a return rodent. We found that even a 20-50 bps difference in TER can substantially corrode the final corpus.

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Before getting into further details, we would like to tell you that if you are investing ₹10,000 per month in a fund with TER of 2.50 per cent for 20 years and the fund delivers 15 per cent, after this new regulation, if the TER rises to 2.70 per cent, you will get back around ₹2.30 lakh less than you would have earlier.

SEBI'S LATEST MOVES: THE UPSHOT

MUTUAL FUNDS

- Asset management companies will be able to charge additional total expense ratio, up to 20 basis points
- Fund houses will have to credit the entire exit load back to the scheme
- Mutual fund schemes will have separate direct investment options with lower expense ratios
- Investment advisors will also come within Sebi's ambit

STOCKS

- Banks have been advised to provide applications supported by blocked amount (ASBA) facility at all branches
- Minimum application size for all investors increased from ₹5,000-7,000 to ₹10,000-15,000

Let us consider three funds with TERs of 3.00 per cent, 2.25 per cent and 1.75 per cent into each of which ₹10,000 is being invested every month through systematic investment plans. Assume all the three funds generate returns of 15 per cent a year each year. Over 10 years, the returns from the fund with TER of 1.75 per cent can beat that from the one with TER of 3.00 per cent by more than ₹1.50 lakh. So, expense ratio is an important parameter to consider when choosing an MF. Typically, it is better to choose a fund with a bigger asset base as costs get spread thinner and reduce the TER.

Entire exit load to be credited back to the scheme. Sebi has made sure that even investors benefit from the upcoming recommendations. It has suggested that the exit load charged from investors withdrawing within a year of making their first investments would now be added back to the scheme. Earlier, they were directed either into the fund house's treasury, or passed on to distributors. This move should help investors cushion the impact of the potential hike in the expense ratio and the service tax on it. "This will help existing investors of a scheme to gain from the premature withdrawal by other investors of the scheme," says Waqar Naqvi, CEO, Taurus Mutual Fund. Currently, fund houses charge investors exit loads of 0.25-1.00 per cent if they redeem their investments before schedule. For exiting before one year, an equity fund typically charges 1per cent of the investment, while for a debt fund, it is 0.25-0.75 per cent, depending on the time frame and type of scheme.

Schemes to have separate direct investment options with lower expense ratios. Sebi's circular says: "To avoid differential treatment in the same scheme to different classes of investors, it was decided that all new investors will be subjected to single expense structure under a single plan. However, to be fair to direct investors and promote direct investment, it was decided to have a separate plan for direct investments, with a lower expense ratio." A provision of direct investment plans has also been introduced to allow investors to deal directly with the fund house, thereby lowering expenses. This proposal has become a contentious issue, with distributors seeking clarity on the matter. However, it's likely to benefit the investor. So, if you are a savvy investor, choose a direct investment plan.

Investment advisors to be regulated. In this landmark move, Sebi has clearly differentiated between fee-based advisory services and commission-based distribution of financial products. The Sebi circular says: "All individuals, body corporates and partnership firms engaged in the business of providing investment advice to investors for consideration are required to be registered and regulated under these regulations. Any person who holds himself as an investment advisor shall also fall under the purview of these regulations." Experts believe that with this rule, investors will have to decide whether they want only advice, or somebody to help in a transaction, and pay accordingly.

"From now on, for investment advisors, the need of the investor will be of top priority rather than the commission

Special Report

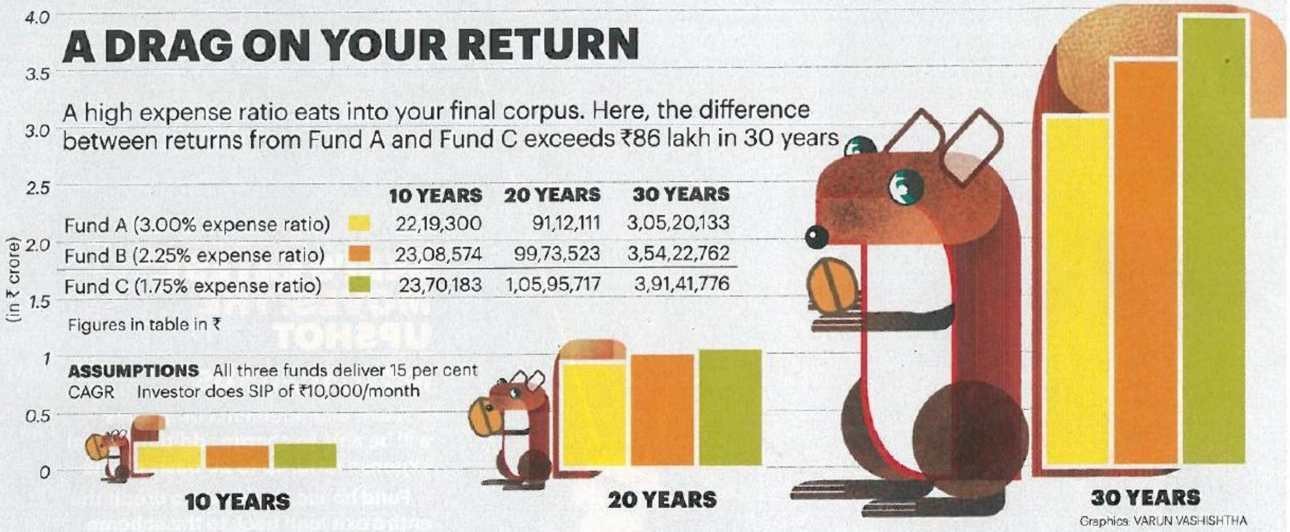
A DRAG ON YOUR RETURN

A high expense ratio eats into your final corpus. Here, the difference between returns from Fund A and Fund C exceeds ₹86 lakh in 30 years

	10 YEARS	20 YEARS	30 YEARS
Fund A (3.00% expense ratio)	22,19,300	91,12,111	3,05,20,133
Fund B (2.25% expense ratio)	23,08,574	99,73,523	3,54,22,762
Fund C (1.75% expense ratio)	23,70,183	1,05,95,717	3,91,41,776

Figures in table in ₹

ASSUMPTIONS All three funds deliver 15 per cent CAGR Investor does SIP of ₹10,000/month



Graphics: VARUN VASHISHTHA

on a particular product," says Rajesh Krishnamoorthy, managing director, iFAST Financial India. Not everybody agrees. Mumbai-based financial planner Gaurav Mashruwala says: "The new guidelines are meant to regulate investment advisors, but exempt those selling products. As a planner, when I suggest a product to any client, it is entirely up to him whether he buys it or not. The move is not a forward step. It does nothing to curb mis-selling."

The Sebi regulations very clearly say that "Financial planners will be required to be registered as investment advisors". This means a financial planner can't act both as an investment advisor as well as a distributor. Currently, most financial planners are into investment advisory and investment execution. Many distributors, meanwhile, feel that the proposed direct investment plan is a threat to the current distribution model as an investor can move to a lower-cost plan at any time. So, notwithstanding the higher TER, with the direct investment option and segregation of advisory and distribution fees, it should be good for aware investors.

STOCKS

The primary market for stocks also saw steps to help it get back on its feet. Sebi has made it easier and more cost-effective to invest and raise funds through initial public offers (IPOs). It approved the detailed architecture of e-IPOs, which will utilise the secondary market structure for extending the reach of IPOs. With this, an investor will be able to fill out the form at brokers' terminals. To ease the application process further, banks have been advised to provide applications supported by blocked amount (ASBA) facility at all branches.

Sebi has also provided additional routes, including rights and bonus issues, for companies to reach the minimum public shareholding requirements, which is 25 per cent at present and has to be complied with by June 2013. That should force a few companies to bring public issues on the market and add to the numbers of investible shares. Also, with the number of days before the issue the price band is disclosed being increased to five from the current two, investors should also be in a position to take a better informed decision on whether they want to apply in the IPO or not.

Sebi has advised banks to provide the ASBA facility at all branches

Sebi has increased the minimum application size for all investors from ₹5,000-7,000 to ₹10,000-15,000. According to Prithvi Haldea, chairman and managing director, Prime Database, this should increase the size of the minimum allotment to individual applicants making their efforts worthwhile. Currently, many investors do not bother with IPOs as they often get too few shares to make the effort worthwhile.

Sebi has also allowed a 20 per cent variation (10 per cent earlier) in the size of public issues, giving issuers greater flexibility. The regulator also modified the share allotment system so that every retail applicant gets allotted a minimum bid lot, depending on the aggregate availability of shares.

After noticing some manipulations in the public offering process, Sebi has proposed that listed companies should file a comprehensive annual disclosure statement with Sebi. This will provide updated information to investors. This measure will definitely bring some more transparency.

Pradeep Gupta, co-founder and vice-chairman, Anand Rathi Financial Services, says: "If one has a closer look at Sebi's announcements, the message seems quite clear that it is aimed towards a more transparent regime, encouraging retail investors to invest in the primary market, as well as protect and safeguard their interests. It's a clear-cut directional move to make capital markets more robust and increase retail equity penetration levels". ❒

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