29th August 2012

Mr. Prashant Saran
Whole Time Member
Securities & Exchange Board of India
Plot No C4-A, "G" Block, BKC
Bandra (East), Mumbai 400 051

Dear Sir,

Sub: Re-Energisation of the mutual fund industry

Mutual funds have been globally acknowledged as an ideal vehicle to attract the retail and household savings and investments into productive assets. For any product to reach its targeted customers a strong and a vibrant distribution network is essential. In India such networks are being provided by Banks, stock brokers, National distributors and Independent Financial Advisors (IFA's).

A large amount of household savings are channelised through IFA's whose business model thrives on personal relationship with investors, understanding their needs, identifying investment avenues based on such needs, providing essential ancillary services and being there with the investors for handholding during the vagaries of volatility and turbulence in the financial markets. It is an acknowledged fact that IFA's are the only ones who are personally involved in continuous investor interaction, awareness and education. This handholding and interaction goes far beyond the time the initial investment is made.

The Foundation of Independent Financial Advisors (FIFA) a pan India organization of the IFA community would like to play a constructive role in any consultative processes leading to regulations concerning the mutual fund industry.

We express our sincere gratitude to you Sir for giving us an opportunity to intereact with you.

Since 2009, the mutual fund industry has seen a dramatic decline in inflows resulting in a degrowth of the industry. The Hon'ble Prime Minister, Dr. Manmohan Singh, and the Finance Minister Mr P Chidambram have both expressed the need to re-energise the mutual fund industry.

With a view to reenergize the Mutual Fund industry SEBI has recently announced a number of steps through its press release No. 77/2012.

The measures announced for increasing the penetration of mutual fund products, enhancing the reach of mutual fund products in smaller cities\towns, alignment of the interest of various stakeholders, protection of investors from issues of mis-selling and churning, steps to be taken for regulatory framework of mutual funds shall indeed provide a fillip to the mutual fund industry. We broadly welcome these measures. We believe that the steps for increasing penetration of mutual fund products and improving reach beyond the top 15 cities are pathbreaking and could really encourage inflows from such cities.

However we are very apprehensive that one of the measures proposed could negate all the positive impact of all the other measures; namely the proposal for the introduction of a separate plan for direct investments with a lower expense ratio.

We give below our comments and suggestion on the same for your kind consideration.

Comments:

On the one hand it is proposed that there will be no differential treatment for different classes of investor in the same scheme and all investors will be subjected a single expense structure. On the other hand, it is proposed to have a separate plan for direct investments with a lower expense ratio. These measures run contrary to each other.

The proposal for introduction of a Direct Plan is contrary to SEBI's own stand of doing away with differential treatment under the same scheme and insisting on a single expense structure.

While the first measure seeks to eliminate differentiation based on the on the size of investment, the Direct Plan now seeks to introduce distributor based differentiation.

Worldover, quantity discounts are the basis for differential pricing. Quantity in mutual funds is investment size and therefore differential pricing in Mutual Funds worldover is based on the size of investment.

Worldwide manufacturers use a Model of Direct Sales or Thru Distribution. In India while most Fund houses have used the distribution model for sales you do have fund houses that does not use distributors. It is well established that a direct sales model would be more expensive than a distribution led model. It would therefore be appropriate for the

Fund house to decide on the distribution model it chooses Direct vs Distribution. Having chosen a distribution model a Manufacturer never offers the same product at differential price. Introduction of differential prices for the same product will shift all sales to the lower priced.

Is it fair or is it an unfair trade practice to allow mutual funds to sell the same product at two different pricing points? Even in other industries where direct sales is prevalent, the product offered directly by the manufacturer is never priced lower than the price at which the same product is available through the distribution network.

Even where manufacturers adopt dual marketing channels, direct and through distributors, the manufactures ensure not to undercut distributors. The reason for such care being taken is undercutting distributors, would infact result in overall sales DECLINING.

DIRECT will be detrimental to the business of the IFA, especially the business he has brought into the industry and nurtured for several years. IFAs who have taken years to build client relationships, some of them over a decade, would suddenly find their existing clients wanting to switch to a plan with a lower expense ratio. A cheaper option for a product if not today but sometime down the line always entice an Investor and which would bring in uncertainty in the business of an IFA and thereby restricting him to grow his business and look for newer Investors.

Distributor based differential pricing would, similarly, IMPEDE the growth of the mutual fund industry. With distributors adversely affected an outcome similar to that following the ban on entry loads can be envisaged leading, infact to a reduction of 'feet on street'.

Direct Plans would also induce unhealthy investor behavior wherein distributors are used for advise but circumvented when investments are actually done. This can be done through various modes :-

1. Shifting existing distributor advised investments to the Direct Plan of the same scheme.

2. Making additional investments in the same scheme through the Direct Plan.

3. Making only a small portion of the intended investments through the distributor while channeling the major portion in the same scheme through the Direct Plan.

4. Investing through the distributor in one of his recommended schemes while using the Direct Plan to invest in other schemes recommended by the distributor.

5. Using the folios of different family members for normal and direct plans.

6. Investors may also use the alternative of Direct Plans to demand rebating of trail commissions thus engendering unhealthy practices.

We believe that Direct Plans, through undercutting distributors, would weaken the distributor community, endanger its viability, and vitiate the atmosphere of trust between the distributor and the investor and infact result in impeding the growth of the Mutual Fund industry.

The proposed introduction of a direct plan would lead to a significant remodeling of the business of IFA's and have a deep impact on distribution, similar to the outcome after the ban on entry loads. Eventually it may have the unintended result of the "feet on street" reducing. This will not lead to retail penetration and increase in the investor base.

When investments are sold under the direct plan, the manufacturer has complete control over the sales process. Products are not sold alongside products offered by other manufacturers. Is this mode of selling in the interest of the investor?

Allowing Investment through the direct plan is tantamount to the Manufacturer offering a discount to an investor. Before asking Manufacturers to do so it would be better to allow the distributors to offer discounts from the commission received by them.

We believe that the introduction of a direct plan would have a deep and far reaching adverse impact on the whole industry and particularly the IFA community. IFAs across the country have been shocked with this sudden announcement of a separate plan for direct investments

Recommendation: **Do not introduce the Direct Plan with lower expense ratio**

Sir, in conclusion we would like to humbly submit that introducing such a regulation without properly understanding the impact on various stakeholders, will result in complete chaos for many IFAs and impact their livelihood. IFAs will struggle to maintain their source of income and many may consider changing their professions and the new regime will make it unattractive to attract new people to the profession. This will clearly adversely affect the goals of retail and widespread penetration that the other steps SEBI has announced.

FIFA would be happy to be part of a consultative process before the final guidelines/circular are issued in connection with the decisions taken on 16th August to avoid any hardships in the implementation and consider giving appropriate transition time to the IFAs to get accustomed to the various proposed steps.

We would like to bring to you one other concern we have on allowing fungibility. The purpose of increase in TER is to improve penetration and reach of the Mutual fund and encourage long term holding and therefore should be used to be spent on distribution and expansion of the market to enable channel zing of household savings to the mutual fund industry. It should not happen that the additional TER is charged to investors but the same is being used by AMCs to increase the Management fees under the guise of fungibility.

We thank you Sir, for giving us an opportunity to express our views and look forward to working towards Investor Protection, Retail penetration and overall development of the Industry under your guidance.

Thanking you.

Yours truly,
For Foundation of Independent Financial Advisors

Dhruv L Mehta
Chairman

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