



# **STUDY ON EXPENSE RATIOS FOR MUTUAL FUNDS**



## Objective of the Study

- The primary aim was to to understand the total cost of owning Mutual Funds in India.
- To analyse the cost separately for 3 asset classes; Money Markets , Fixed Income and Equities
- To compare the costs In India relative to other countries across the globe.
- To understand whether the cost incurred by an Indian investor was high or low.
- To ascertain the veracity of the perception in some sections of the industry that the TER (Total Expense Ratio) of Mutual Funds in India is relatively high.



## Overview

- The 2015 edition of the Morning Star study “Global Fund Investor Experience Study June 2015” (hereinafter referred to as GFIE Report) covers fees and expenses for funds for 25 countries including India.
- This study led to a perception in some sections of the industry that the Expense Ratio of Mutual Funds in India is relatively high.
- However, the GFIE Report itself clarifies that annual expense ratios are not comparable because of varying bundled/unbundled fee arrangements across different countries. Differing load structures and taxes make it more complicated.
- The GFIE Report has compared cost across various countries without making these adjustments. Costs were not compared on an apple to apple basis and therefore obviously leading to incorrect conclusions.

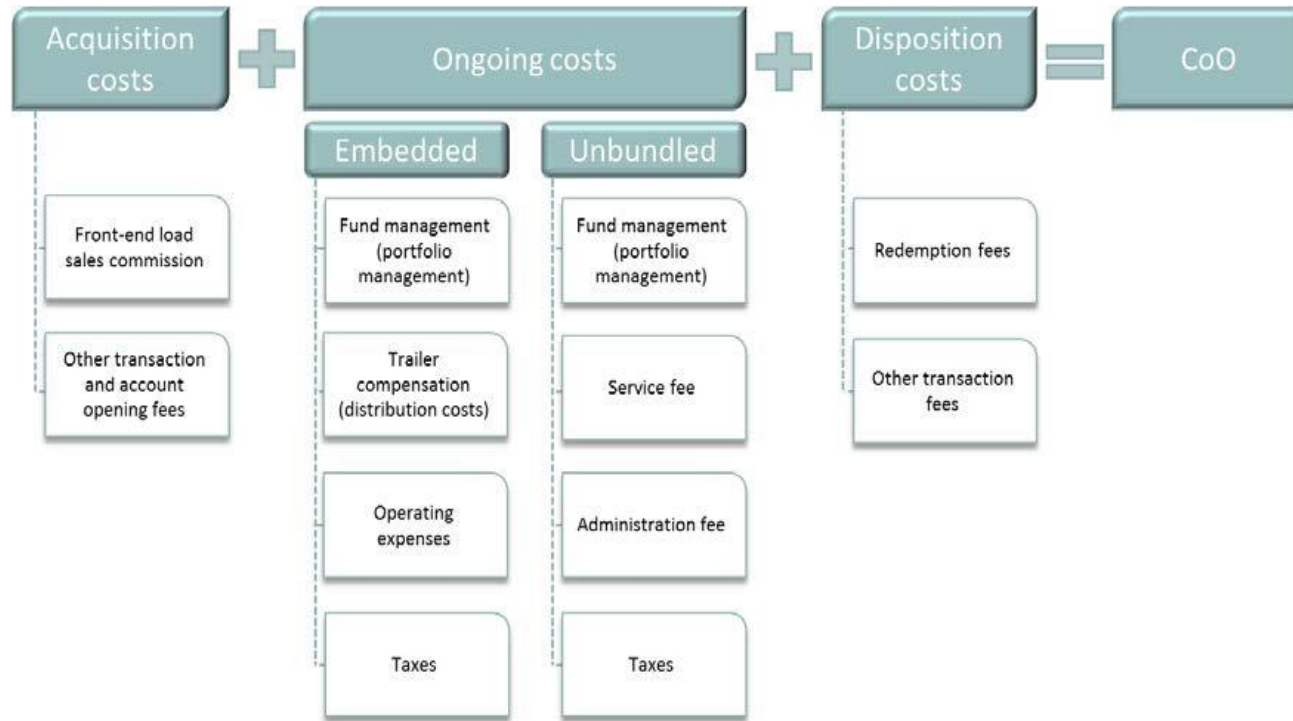


## Overview

*“One of the difficulties in comparing Annual Expense Ratios across countries has been development of unbundled fee arrangements, whereby an advisor is not paid sales commission by the Fund Company in the traditional model but rather is paid a separate fee by the Fund Investor. When taken, this action has the effect of lowering official fund expense ratios because funds no longer need to collect money from share holders to make advisor payments. It also has the effect of complicating expense ratio comparisons, because an investor in a lower cost fund may pay an additional fee to an advisor which is not considered in Morning Star calculations.”*  
(Page 21 of the GFIE Report)

## Costs of Ownership of Funds

Before an exercise is undertaken to decipher the expense ratios and rankings it would be pertinent to define the Cost of Ownership of Mutual Funds.





## Costs of Ownership of Funds

Typically total cost of ownership for the investor comprises of following costs:

- Front-end Loads charged at the time of investment.
- Asset Management fees, charged by Asset Management Companies (AMC).
- Trailer fees charged by AMC and paid to distributors for their services.
- Operating expenses such as custodian, trustee, audit, legal, filing record keeping etc.
- In case of unbundled services, Investment Advisory Fees charged by Investment Advisors, where the investors avail their services.
- Platform charges.
- Taxes such as service tax, HST and GST.
- Deferred Loads.



## Different Global Practices

Broadly the investors are charged the following expenses:

- Annual Expense Ratios
- Front load charges
- Deferred loads
- Performance Fees
- Advisor Fees
- Platform charges



## Bundled & Unbundled Fee Arrangements

- Bundled Fee Arrangement:
  - This is the traditional mode where the distributor is paid a sales commission by the fund company out of the TER charged by them. Some of the countries following this structure are India, Belgium, Canada, Germany, France, South Korea etc.
- Un-bundled Fee Arrangement:
  - Where an advisor is not paid a sales commission by the fund company as in the traditional model, but is rather paid a fee separately by the fund investor. Some of the countries following this structure are Australia, Denmark, Netherlands, New Zealand etc.





## Methodology

- We collated the data for 25 countries from the GFIE Report across the 3 categories: Money Market, Fixed Income and Equity.
- To independently verify the costs of Indian Mutual Funds we extracted scheme wise data of AAUM and annual expense ratio's & data from Crisil, Value Research, AMFI & Fact Sheets for all Mutual Fund Schemes.
- The AAUM data was extracted as of March 2016.
- We calculated the Weighted Average Expense Ratios for Equity Funds on account of the wide dispersion in expense ratio from as low as 0.25% to 3.30%. This would reflect the true cost incurred by an investor on an average.
- Adjustments for front load charges, advisory fees and platform charges paid by investors was made. Service tax was reduced so as to make the cost of equity funds comparable.



## Our Analysis

We have collated the data appearing in the GFIE Report 2015 and prepared tables to give a meaningful comparison of fees and expenses and country wise rankings:

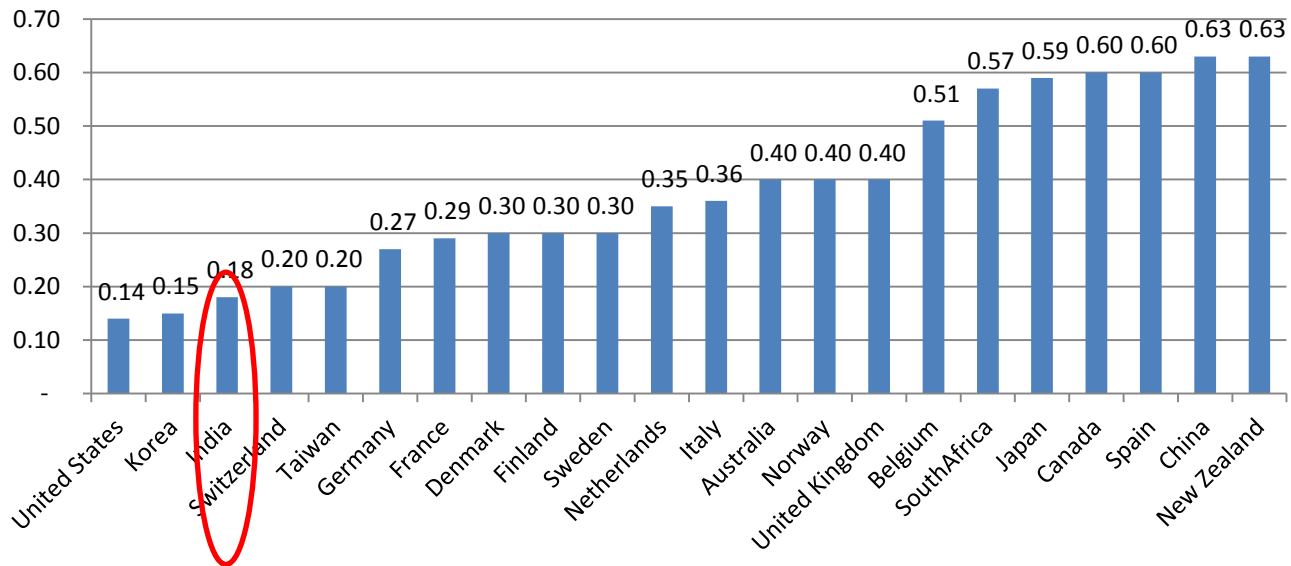
- Summary of Overall Grade and Expenses for Mutual Funds for 25 countries: Table 1 of the study;
- Summary of Fees and Expenses for Money Market and Fixed Income- Domiciled Funds for 25 countries with Ranking: Table 2 of the study;
- Summary of Cost of Ownership of Equity Funds for 25 countries with Rankings (Table 3 of the study). This report considers the cost of bundled funds and in case of unbundled funds the Total cost of ownership i.e. front load charges, fees for unbundled services + cost of advisory/services and platform charges;

As per GFIE Report, the TER for Equity Funds in India is 2.65%. However, our study indicates TER for Equity Oriented Funds as 2.07% (1.81% before Service Tax). To make TER comparable with GFIE Report, we have considered expenses for Equity Funds in India @ 2.14% in the tables 1 and 3 of the study.

# Our Analysis

## Fees and Expenses for Money Market - Domiciled Funds for 25 countries

Money Market: Expenses Ratio



\*Source: GFIE Study- June 2015, Morningstar Inc.



## Our Observations- Money Market

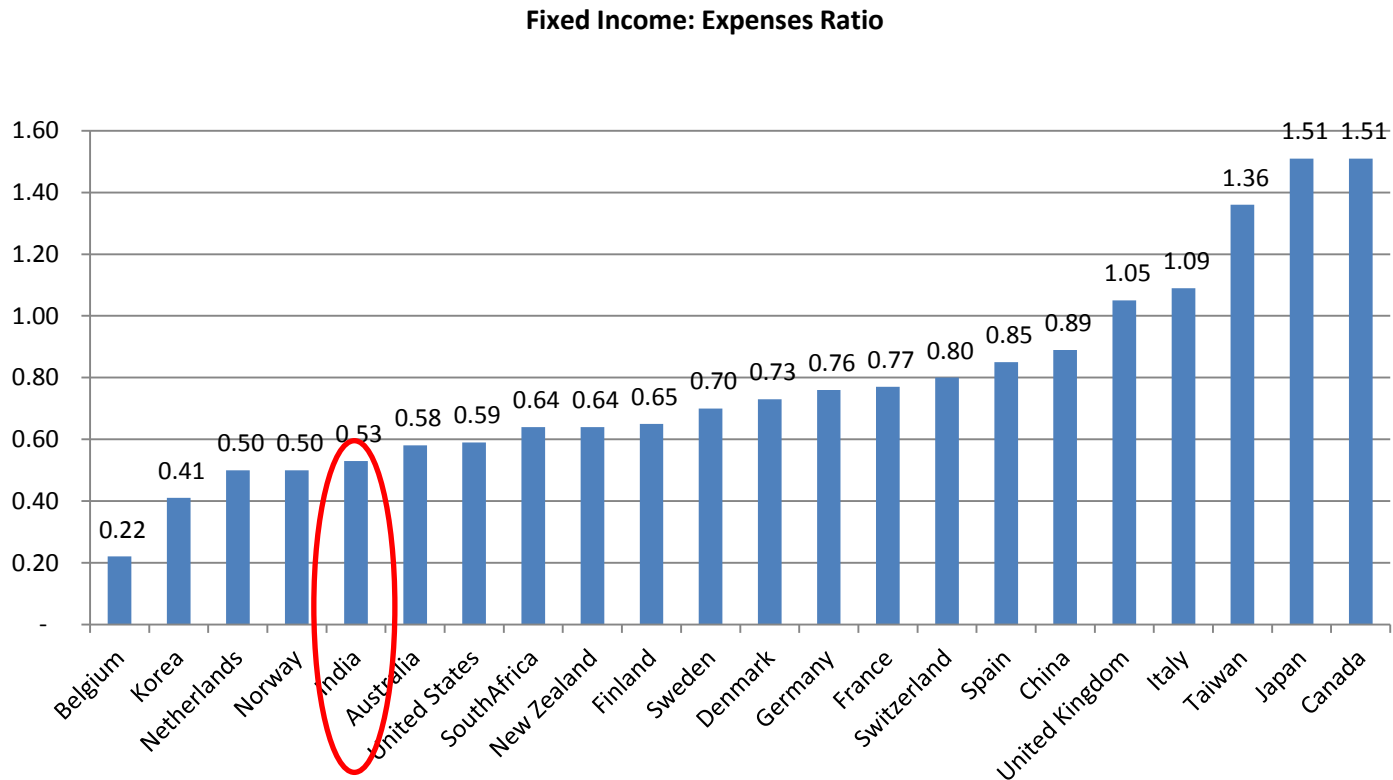
### 1. Money Market:

- According to the GFIE Report the Asset Weighted Median Expense Ratio for money market funds in India is 0.18%. Based on this India is ranked as the 3rd least expensive country out of 25 countries reviewed in GFIE Report as can be seen from Table 2
- Out of the total funds of Rs. 13 trillion under management in India (AAUM) as on 31st March 2016, Rs. 3.27 trillion- 24.15% of the funds are being managed within an expense ratio of 0.18%.



# Our Analysis

## Fees and Expenses for Fixed Income- Domiciled Funds for 25 countries



\*Source: GFIE Study- June 2015, Morningstar Inc.



## Our Observations-Fixed Income

### 2. Fixed Income:

- According to the GFIE Report the Asset Weighted Median Expense Ratio for Fixed Income funds in India is 0.53%. India is ranked as the 6th least expensive country out of 25 countries reviewed in GFIE Report.
- Out of the total funds under management in India (AAUM) as on 31st March 2016, Rs. 5.87 trillion- 43.38% of the funds are being managed within an expense ratio of 0.53%.
- Money Market and Fixed Income Funds comprise of Rs. 9.14 trillion that is almost 2/3rd of the total assets managed by the Indian Mutual Fund Industry which is being managed at a weighted average cost of 0.40%.



## Making Cost of Equity Funds Comparable

To make expense ratios of all the countries in the GFIE Report comparable we had to make the following adjustments:

1. Front Load Charges.
2. Advisor and Platform fees paid by investor in countries with unbundled arrangements
3. Service Tax

## Adjustments - Front Load Charges

As per GFIE		Our Analysis (FIFA)
Country	Funds Reporting Front Load %	Front Load Charges
Australia	15	0.08
Belgium	87	0.44
Canada	4	0.02
China	66	0.33
Denmark	94	0.47
Finland	69	0.35
France	86	0.43
Germany	85	0.43
HongKong	71	0.36
India (Note iv)	0	0.00
Italy	43	0.22
Japan	81	0.41
Korea	11	0.06
Netherlands	59	0.30
New Zealand	37	0.19
Norway	48	0.24
Singapore	88	0.44
South Africa	28	0.14
Spain	15	0.08
Sweden	14	0.07
Switzerland	81	0.41
Taiwan	95	0.48
Thailand	46	0.23
United Kingdom	52	0.26
United States	15	0.08

- The GFIE Report has indicated the Funds Reporting Front Load %. Funds Reporting Front Load % indicates % of cases where front load charges have been paid by investors. For e.g. In Belgium Front Load charges have been reported in 87% of the funds sold and in Singapore in 88% cases.
- The Front Load % paid by the investor has not been mentioned in the Report. Internationally Front Load charges are in the range of 0% to 5%. We have assumed Front Load charges @ 1.50% and amortised it over a period of 3 years being average holding period of the funds. The annual front load charges have therefore been taken to be 0.50%.
- To arrive at the Front Load Charge, we have multiplied Front Load Charges assumed @ 0.50% with Funds Reporting Front Load %.





## Adjustments - Advisory + Platform Charges and Service Tax

	Morning Star Report (GFIE)	Adjustment (FIFA)
	Expense Ratio for Equity*	Advisory+ Platform Charges for Unbundled Funds
Country		
Australia	1.18	1.25
Denmark	1.54	1.25
Netherlands	0.80	1.25
New Zealand	1.46	1.25
South Africa	1.43	1.25
Switzerland	1.32	1.25
United Kingdom	1.65	1.25
United States	0.84	1.25

	GFIE Expense Ratio for Equity*	Less: Service Tax	Adjusted expense ratio (FIFA)
Country			
Canada	2.35	0.21	2.14
India	2.14	0.27	1.87

- In Unbundled fee arrangements an advisor is not paid a sales commission by the fund company in the traditional model but rather is paid a separate fee by the fund investor.
- We have assumed Advisory and Platform Charges @ 1.25%.
  
- In India, TER includes service tax @ 14.50% as on March 2016. We have worked out the expense ratio before Service Tax. We have done the same adjustment for Canada where the rate of tax is considered @ 10%. In USA the TER does not include service tax/ HST.

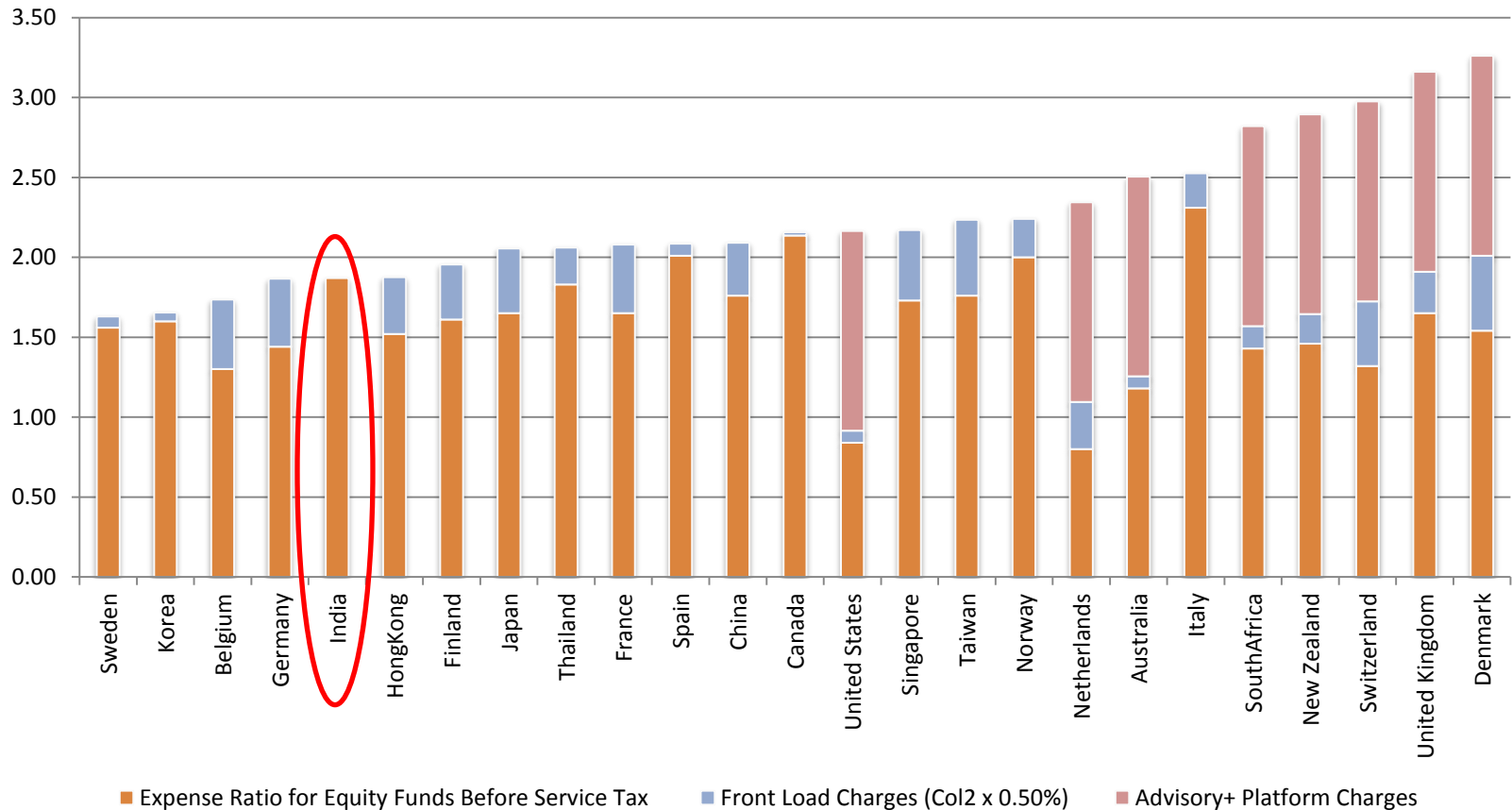


**Table 3: Summary of Cost of Ownership of Equity Funds for 25 countries**

Country	Morning Star Report (GFIE)					Total Cost of Ownership				Revised Ranking
	Funds Reporting Front Load %*	Expense Ratio for Equity*	Less: Service Tax (Note i)	Expense Ratio for Equity Funds Before Service Tax	Rank	Expense Ratio for Equity Funds Before Service Tax (Col 5)	Front Load Charges (Col2 x 0.50%)	Advisory+ Platform Charges for Unbundled Funds	Total Cost (Col 7+8+9)	
1	2	3	4	5	6	7	8	9	10	11
Australia	15	1.18		1.18	3	1.18	0.08	1.25	2.51	19
Belgium	87	1.30		1.30	4	1.30	0.44		1.74	3
Canada	4	2.35	0.21	2.14	24	2.14	0.02		2.16	13
China	66	1.76		1.76	18	1.76	0.33		2.09	12
Denmark	94	1.54		1.54	10	1.54	0.47	1.25	3.26	25
Finland	69	1.61		1.61	13	1.61	0.35		1.96	7
France	86	1.65		1.65	14	1.65	0.43		2.08	10
Germany	85	1.44		1.44	7	1.44	0.43		1.87	4
HongKong	71	1.52		1.52	9	1.52	0.36		1.88	6
<b>India</b>	<b>0</b>	<b>2.14</b>	<b>0.27</b>	<b>1.87</b>	<b>21</b>	<b>1.87</b>	<b>0.00</b>		<b>1.87</b>	<b>5</b>
Italy	43	2.31		2.31	25	2.31	0.22		2.53	20
Japan	81	1.65		1.65	14	1.65	0.41		2.06	8
Korea	11	1.60		1.60	12	1.60	0.06		1.66	2
Netherlands	59	0.80		0.80	1	0.80	0.30	1.25	2.35	18
New Zealand	37	1.46		1.46	8	1.46	0.19	1.25	2.90	22
Norway	48	2.00		2.00	22	2.00	0.24		2.24	17
Singapore	88	1.73		1.73	17	1.73	0.44		2.17	15
South Africa	28	1.43		1.43	6	1.43	0.14	1.25	2.82	21
Spain	15	2.01		2.01	23	2.01	0.08		2.09	11
Sweden	14	1.56		1.56	11	1.56	0.07		1.63	1
Switzerland	81	1.32		1.32	5	1.32	0.41	1.25	2.98	23
Taiwan	95	1.76		1.76	18	1.76	0.48		2.24	16
Thailand	46	1.83		1.83	20	1.83	0.23		2.06	9
United Kingdom	52	1.65		1.65	14	1.65	0.26	1.25	3.16	24
United States	15	0.84		0.84	2	0.84	0.08	1.25	2.17	14



## Summary of Cost of Ownership of Equity Funds for 25 countries



**TABLE 3: -Summary of Cost of Ownership of Equity Funds for 25 countries:**

<b>Country</b>	<b>Expense Ratio for Equity Funds Before Service Tax</b>	<b>Front Load Charges (Col2 x 0.50%)</b>	<b>Advisory+ Platform Charges</b>	<b>Total Cost</b>	<b>Unbundled Funds Total Cost (6)/Bundled Cost (2)</b>
Sweden	1.56	0.07		1.63	1.63
Korea	1.60	0.06		1.66	1.66
Belgium	1.30	0.44		1.74	1.74
Germany	1.44	0.43		1.87	1.87
<b>India</b>	<b>1.87</b>	<b>0.00</b>	<b>0</b>	<b>1.87</b>	<b>1.87</b>
Hong Kong	1.52	0.36		1.88	1.88
Finland	1.61	0.35		1.96	1.96
Japan	1.65	0.41		2.06	2.06
Thailand	1.83	0.23		2.06	2.06
France	1.65	0.43		2.08	2.08
Spain	2.01	0.08		2.09	2.09
China	1.76	0.33		2.09	2.09
Canada	2.14	0.02		2.16	2.16
United States	0.84	0.08	1.25	2.17	2.17
Singapore	1.73	0.44		2.17	2.17
Taiwan	1.76	0.48		2.24	2.24
Norway	2.00	0.24		2.24	2.24
Netherlands	0.80	0.30	1.25	2.35	2.35
Australia	1.18	0.08	1.25	2.51	2.51
Italy	2.31	0.22		2.53	2.53
SouthAfrica	1.43	0.14	1.25	2.82	2.82
New Zealand	1.46	0.19	1.25	2.90	2.90
Switzerland	1.32	0.41	1.25	2.98	2.98
United Kingdom	1.65	0.26	1.25	3.16	3.16
Denmark	1.54	0.47	1.25	3.26	3.26



## Our Observations-Equity

According to AMFI classification of assets, our study indicates the average weighted expense ratio for Equity Oriented Funds for March 2016 is 2.07% as per table below and If service tax of 14.50% is reduced from Total Cost of 2.07%, the TER before service Tax in India is 1.81 %:

Expense Ratio for Equity Oriented Funds	Avg AUM for March 16	Total Expense Ratio (%)
Growth	302120	2.21%
ELSS	38788	2.24%
Balanced	51784	2.21%
Other ETFs	12926	0.25%
Arbitrage	26157	0.76%
Fund of Funds - Overseas	1918	1.79%
Grand Total	433694	2.07%

*All figures in Crs*

## Our Observations-Equity

To make TER comparable with GFIE Report, If we were to exclude the Balanced Funds, Fund of Funds (FOF), Arbitrage Funds from Equity Oriented Funds, the average weighted expense ratio for Equity Funds for March 2016 is 2.14% as per table below and If service tax of 14.50% is reduced from Total Cost of 2.14%, the TER before service Tax in India is 1.87%.

Expense Ratio for Equity Oriented Funds	Avg AUM for March 16	Total Expense Ratio (%)
Growth	302120	2.21%
ELSS	38788	2.24%
Other ETFs	12926	0.25%
Grand Total	353834	2.14%

*All figures in Crs*



## Our Observations-Equity

Our analysis indicate:

- According to the Report the Weighted Average Expense Ratio for Equity Funds in India is 2.07% and 1.81% before Service Tax.
- India is ranked as the 5<sup>th</sup> least expensive country out of 25 countries reviewed in GFIE Report. Refer–TABLE 3.
- The long term returns post expenses earned by investors in Indian equity funds are far superior to returns earned in funds in other countries. An analysis of the TER as a percentage to the returns earned would be the best in India.



## Average TER Across All Asset Types

- The Average TER for all Asset class during 2015 was less than 1%

Asset Type	AUM for March 16 in Rs. Trillion	Total Expense Ratio (%)
Money Market	3.27	0.18
Fixed Income	5.87	0.53
Equity	4.33	2.14
<b>Grand Total</b>	<b>13.47</b>	<b>0.96</b>





***Thank you***