



# ASSOCIATION OF MUTUAL FUNDS IN INDIA

135/BP/54/2014-15

March 26, 2015

## AMFI Best Practice Guidelines Circular No. 54/2014-15

### Distribution Cost - Commission Pay-out

Dear Members,

For the past several months, a debate has been raging within the Mutual Fund Industry over the trend in upfront commission and 'upfronting' of trail commission paid to the Distributors, particularly in close-ended schemes. Not only has this attracted adverse media reports, but also has raised concerns at the regulator's end.

In order to get a sense on some of the market practices, SEBI Officials held a series of meetings with several CEOs of AMCs individually. Based on their feedback, the issue was flagged at the level of SEBI Chairman who, in turn, convened a meeting of select CEOs on December 16, 2014. This was followed by the Mutual Fund Advisory Committee (MFAC) Meeting on December 22, 2014. In both these meetings, the SEBI had expressed concern about the unhealthy trend in upfront commission payment and upfronting of trail commission. The regulator also exhorted the Industry to eschew undesirable practice of commission-based mis-selling at a time when investors' interest in mutual fund products was reviving and advised the Industry players to lay down best practices for the healthy growth of the Industry. With the broad objective of cooling down such pay-outs, they suggested a simple and auditable formula at MFAC to bring reasonableness in payment of commission to Distributors. Under auspices of Association of Mutual Funds in India (AMFI), they desired the Industry to come up with guidelines which could be applied uniformly without compromising on the freedom of AMCs to manage their commercials.

AMFI is dedicated to developing the Indian Mutual Fund Industry on professional, healthy and ethical lines and to enhance and maintain standards in all areas with a view to protecting and promoting the interests of mutual funds and their unit holders.

Accordingly, acknowledging the moral suasion from the regulator, AMFI Board, after prolonged deliberations, has decided to lay down the following Best Practice Guidelines, largely in line with the formula suggested at MFAC, which would be **applicable for all transactions with effect from April 01, 2015 subject to review after three months.**



## 1. Definitions:

- a. "Upfront Commission" shall mean upfront commission paid as a percentage of gross sale or mobilization expressed as basis points at a transaction level. Transaction charge within the limits prescribed by SEBI shall not be construed as an Upfront commission. This shall include Trail Commission paid in advance or Upfronted Trail Commission or any such payments by whatever name called.
- b. "Trail Commission" shall mean trail or annualized commission paid as a percentage of average AuM (AAuM) expressed as basis points at a transaction level.
- c. "Marketing Support Expenses" shall mean any expense, other than Upfront Commission or Trail commission, reimbursed to the Distributor or incurred for or on behalf of the Distributor including gift vouchers, debit notes, event sponsorships (excluding meetings/ training programs for sub brokers/relationship managers of a Distributor held within India), overseas trips, outstation trips (excluding normal trips for training programs / Distributor meetings held within India), gift items (excluding customary gifts during festivals), advertisements (other than normal advertisements at arms-length rates on websites / publications of a Distributor or his associate which are widely accessed or have wide circulation; wide circulation/ access for this purpose would mean at least 1 lakh unique persons) , benefits under reward and recognition/loyalty program, per application incentives and any other marketing expenses which are designed to incentivise sales whether it is paid from the scheme(s) or the AMC.
- d. "Total Distributor Commission" shall be the aggregate of Upfront Commission, Trail Commission and Marketing Support Expenses as expressed in basis points at transaction level. All these shall be inclusive of Service Tax and any other applicable statutory levies.
- e. "Reference TER" shall mean Average TER of the scheme for the last monthly cycle ending on 15th starting from the 16th of the preceding month. Average TER shall exclude service tax on the management fee and additional B-15 TER accrued to the scheme.
- f. "Distributable TER" shall mean Reference TER as reduced by the Applicable Scheme operating expenses of the scheme, whether charged to the scheme or incurred by the asset management company (AMC), expressed in basis points.
- g. "Applicable Scheme Operating Expenses" shall mean expenses specified in Regulation 52 (4) (b) of the SEBI (Mutual Funds) Regulations, 1996 excluding expenses listed under sub clause numbers (i), (vii), (viii), (ix), (x), (xii), and (xiii), whether charged to the scheme or paid by the AMC.



- h. Reference to scheme in this circular shall mean the Indirect Plan i.e. Regular Plan of the scheme in which transactions are routed through an ARN holder.
- i. "Distributor" shall mean AMFI registered distributor or ARN holder.

## 2. Best Practice Guidelines:

### a. **Upfront Commission:**

- i. Members are free to decide payment of upfront commission to the Distributors for the first year of each transaction to enable them to meet the cost of acquisition of potential investors/servicing of existing investors. However, keeping in mind the requirement of reasonableness of charges, the Upfront Commission should not exceed 100 bps for the first year. Further, the Upfront Commission shall not exceed Distributable TER of the scheme if the same is below 100 bps.
- ii. While these guidelines will apply to payouts in B15 locations as well, the additional incentive payouts for B15 locations in accordance with SEBI circular no CIR/IMD/DF/21/2012 dated September 13, 2012 shall be excluded from the above mechanism. However, the total B15 commission paid at a scheme level for any financial year should be within the B-15 expenses accrued in the scheme.

### b. **Trail Commission:**

- i. Advancing of Trail Commission (other than any advance trail commission included as part of the Upfront Commission defined above) in any manner is not a desirable practice and hence should be avoided.
- ii. Trail Commission during the first year should not exceed the Distributable TER of the scheme as reduced by the Upfront commission
- iii. Members are free to decide rate of Trail Commission for the subsequent years. However, the same should not be higher than the first year Trail Commission (excluding advance trail commission paid in the first year which is categorized as Upfront Commission above). This is to prevent trail commission being used as a surrogate for Upfront Commission for new transactions done after the aforesaid Best Practice Guidelines come into effect.

### c. **Marketing Support Expenses:**

This shall include all expenses as per the definition above and shall be computed on a financial year basis. Expenses shall first be identified / allocated by Distributor. If the expense incurred is identifiable to a particular scheme it shall be divided by the gross mobilization of the Distributor for that scheme to arrive at the basis point spent for that scheme. If not, this shall be divided by the gross mobilization of the Distributor across schemes (excluding Liquid Schemes and Ultra Short Term Bond Scheme category) to arrive at the basis point spent for each such scheme.



For avoidance of doubt, Liquid Scheme(s) shall mean scheme(s) categorized as "liquid scheme" as per SEBI (Mutual Funds) Regulations, 1996 and Ultra Short Term Bond Scheme shall mean schemes (other than liquid schemes) with Modified Duration of less than or equal to 90 days.

**d. Total Distributor Commission:**

Total Distribution Commission as defined above shall not exceed the Distributable TER of the scheme in any financial year for all new subscriptions after implementation of this circular.

**e. No Upward revision**

There shall be no upward revision in any rates of Upfront Commission or Trail Commission for assets under management existing as on the date of the circular. This is to ensure that the spirit of the circular is adhered to.

**3. Audit of Total Distribution Expenses**

SEBI circular dated November 28, 2002 states that the empanelment of intermediaries with mutual funds and payment of commissions, brokerage/sub-brokerage etc. shall be in accordance with parameters and guidelines specified by SEBI and AMFI from time to time. Compliance with this circular shall be annually audited by the statutory auditors of the Mutual Fund. They may rely on the certification provided by the statutory auditor of the AMC on Marketing Support expenses and applicable scheme operating expenses incurred by the AMC. The statutory auditors of the Mutual Fund will then provide the Certification to the Board of the AMC.

**4. The above Best Practice Guidelines shall be applicable to –**

- a. All Open Ended, Close Ended Schemes as well as Interval Schemes, including Liquid Schemes, Debt Schemes and Equity Schemes, etc. but would exclude Exchange traded Funds.
- b. All transactions effected on or after 1 April 2015
- c. NFOs launched on or after 1 April 2015
- d. All Marketing Support Expenses accrued and payable on or after 1 April 2015 for all schemes.

**5. Exceptions and Exclusions:**

- a. In respect of Liquid Scheme(s) the Reference TER shall be the current prevailing TER of the scheme till 31 May 2015. Effective from 1 June 2015, the Reference TER as specified under "Definitions" herein above shall be followed.
- b. New Fund Offer (NFO): In the absence of actual Reference TER for NFO transactions, Distributable TER shall be reckoned as 225 bps or the TER as per Scheme Information Document (SID) of the concerned scheme if it is lower than 225 bps.



- c. Fund-of-Funds (FoF): Reference TER and Distributable TER shall be the aggregate of the feeder FoF scheme and its underlying scheme(s).
- d. Marketing support expenses pertaining to commitments made for the business done and NFOs launched prior to the date of this circular and honoured within 30 days from the date of this circular shall be excluded from the purview of this circular.
- e. Systematic Investment Plans (SIP) and Systematic transfer plans (STP) requests registered prior to 1 April 2015 shall be excluded from the purview of the aforesaid Best Practice Guideline.

You are requested to place this Best Practice Guidelines Circular before your Board of Trustees and the Board of AMC.

Please note that, based on the certification by the auditors, the Board of Directors of AMC will have to confirm to AMFI on a half-yearly basis that –

- a) Commission paid to the Distributors or on behalf of Distributors including all types of payments, are within the prescribed limit;
- b) Commission paid to Distributors include payments made to group entity of Distributors in adherence to the spirit of the Best Practice Guidelines; and
- c) All other guidelines in this circular are adhered to.

Please acknowledge receipt of this circular.

Sincerely,

A handwritten signature in black ink, appearing to read 'H. N. Sinor', is written over a horizontal line.

H. N. Sinor

Chief Executive