

**JOINT RESPONSE TO SEBI CIRCULAR
No. SEBI/HO/IMD/DF2/CIR/P/2016/42,
DATED March 18, 2016 BY
UNITED FORUM AND
FINANCIAL INTERMEDIARIES ASSOCIATION OF
INDIA (FIAI)**



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

16A, 16th Floor, Nirmal Nariman Point, Mumbai 400021

List of Associations forming the United Forum:

S No	Associations Name	State	Area Represented
1	Foundation of Independent Financial Advisor (FIFA)	All India	All India
2	ASK CIRCLE	Kolkata	
3	DFDA	Delhi	Delhi
4	KAMFA	Karnataka	Karnataka
5	IFA Galaxy	All India	India
6	Voice of Mutual Fund Distributor Associations	All India	All India
7	IFAA	Delhi	Delhi
8	Mutual Funds Distributors' Association	Gujarat	Ahmedabad
9	Ghaziabad Financial Advisor Association	Ghaziabad	
10	South Gujarat IFA Association	Gujarat	South Gujarat
11	Vadodara IFA association	Gujarat	Vadodara
12	All Kerala IFA Association	Kerala	State of Kerala
13	Gwalior Division Mutual Fund Distributors & Welfare Association	Madhya Pradesh	Gwalior Division (M.P.)
14	Individual Financial Advisor Association	Madhya Pradesh	Jabalpur (M.P)
15	Insurance and Investment Advisors Association	Madhya Pradesh	Indore
16	Warangal Mutual funds Advisors Association	Maharashtra	Warangal
17	Jalgaon Dhule IFA Association	Maharashtra	Jalgaon Dhule and Nandurbar
18	Pune IFA Association (PIFAA)	Maharashtra	Pune & Around
19	Western Maharashtra Rural IFA Association	Maharashtra	Kolhapur, Sangli, Satara, Ratnagiri
20	NIMFA	North India	North India
21	Odisha Mutual Fund Advisors Association(OMFAA)	Orissa	Bhubanewar
22	Rourkela Individual Financial Advisors Association.	Orissa	Rourkela
23	PIFAA	Pondicherry	Pondicherry
24	Financial Advisors Association of Rajasthan (FAAR)	Rajasthan	Rajasthan
25	IFPA	Tamil Nadu	Chennai
26	Salem IFA Association	Tamil Nadu	Salem
27	Financial Associates Of CoimbatoreTeam	Tamil Nadu	Coimbatore & nearby
28	Madurai IFAs	Tamil Nadu	Madurai
29	Trichy IFA Association	Tamil Nadu	Trichy
30	ARN Holders Welfare Association Karimnagar	Telangana	Karimnagar dist.
31	Association of Professional Independent Financial Advisors	Telangana	Telangana
32	FAAM	Uttar Pradesh	Meerut



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

**JOINT RESPONSE TO SEBI CIRCULAR No.
SEBI/HO/IMD/DF2/CIR/P/2016/42, DATED March 18, 2016
BY UNITED FORUM AND
FINANCIAL INTERMEDIARIES ASSOCIATION OF INDIA (FIAI)**

Table of Contents

EXECUTIVE SUMMARY:	3
OUR DETAILED REPOSENSE TO SEBI CIRULAR:	6
1. Disclosure should be for total cost and performance and not of any one element of cost	6
2. Disclosure of the costs of the direct plan unfair to distributors after investor has taken a conscious decision to use the services of a distributor:	7
3. Inappropriate for Regulator to Push Direct Plans:	9
4. Unfair Treatment to Mutual Fund Industry – No level playing field:	10
5. Privacy of Information should not be violated:	11
6. Consultative Process not followed in India, as is the Global Experience:	11
7. Regulation will lead to promotion of unethical practices, corruption and rebating:	13
8. Additional disclosures are being introduced on the presumption of mis-selling. However there is no evidence of the same:	13
9. Regulations not in line with government vision:	14
10. Circular will have Negative Impact on Retail investors and Growth of Industry:	15
11. Inappropriate Disclosures, Impractical Calculations will lead to misleading conclusions:	17
12. Need to Focus on Financial Literacy and long term orientation:	19
13. The Regulations are Unfair:	20
14. Conclusion:	21
ANNEXURE:	22
NOTE ON FALLACIES OF MIS-SELLING:	22



EXECUTIVE SUMMARY:

The Circular SEBI/HO/IMD/DF2/CIR/P/2016/42 dated 18th March 2016 is issued u/s 11(1) of SEBI Act,1992 read with Regulation 77 of SEBI (MF) Regulations,1996 which aim to protect the interest of investors in securities and to promote the development of and to regulate the securities market.

Currently a Consolidated Account Statement (CAS) is issued to investors. The CAS currently discloses the name of the scheme where the investor has invested, number of units held and its market value amongst other details.

This circular provides for the following additional disclosures in the (CAS) issued to investors:

- (i) Total cost of investment in each scheme.
- (ii) Further the CAS issued every half year (September/March) shall also provide:
 - a. The amount of actual commission paid to distributors (in absolute terms) during the half year period against the concerned investor's total investment in each scheme.
 - b. The scheme's average Total Expense Ratio (TER) in % terms for the half year period of both direct plan and regular plan for each scheme where the investor has invested.

In principle, we endorse the enactments and regulations which aim to protect the interests of investors in securities and to promote the development of and to regulate the securities market. However the disclosure has to be of information which is necessary and relevant and assist the investor in making informed decisions.



On behalf of the entire distribution community we would like to humbly submit that the proposed disclosures in the CAS statement pertaining to commission amount and the TER for the Direct and Regular Plan might increase transparency but as these disclosures are selective they will provide information which is incomplete and not relevant and which will mislead the investor to make wrong choices. This will be harmful to the investor, detrimental to the growth of the industry and have outcomes against the government's stated policies.

We explain below our reasons for the same.

The question that needs to be asked is what information does an investor need to know about his investments in a CAS? And do the additional disclosures protect his investments by providing information which can assist him in making a rational decision?

Every investor should be aware of the benefits that could accrue to him after the total costs he will incur. We believe that investors must have clear, meaningful and transparent reporting on performance and costs related to investments made by them. Currently all distributors servicing the investors do provide them with this information on performance and costs. The total costs does not comprise only of commission paid to distributors but equally if not more, asset management fees charged by the asset management companies, trustee fees, registrar charges, audit fees etc. Disclosure of distributor commission in isolation is of no meaning, misleading and unjust.

A CAS statement should enable an investor to assess how his investments have grown. We believe that any additional disclosures in the CAS statement should be on investment values and performance.

Hence we support the additional disclosure of total cost of the scheme besides the existing information of the investors holding namely the number of units



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

and market value of investments. A comparison of Cost and Market Value will help the investor in monitoring the investment performance. The contract for managing money is between the investor and Fund/AMC. The cost of services charged by the Fund/AMC is known to the investor.

On the other hand, the distributor is an agent of the Asset Management Company/Fund. Why should the commission earned by a distributor from the Fund/ AMC be disclosed to each individual investor?

Disclosure of distributor commissions on an ongoing basis will lead to unethical practices of pass backs. Pass back of commission is not allowed by the regulator. The regulation will lead to use of corrupt and illegal practices. Should regulations encourage unethical practices?

Disclosure on an ongoing basis of the difference between the direct plan v/s the regular plan to an investor who has already opted for the regular plan also does not seem to add any benefit to the investor -- other than creating a rift between investor and distributor and the promotion of pass back to the investor, a practice which is prohibited by the regulator.

Some of the regulations could be driven by developments in other countries. We have a strange habit of aping the West, however, without giving a thought as to how developed that market is and how grotesquely under penetrated we are.

Most Global markets do not have disclosure of commission amounts in account statements. The United States does not have the practice. **In our case there was no consultative process.**



OUR DETAILED REPOSENSE TO SEBI CIRULAR:

1. Disclosure should be for total cost and performance and not of any one element of cost:

Every investor investing any sum of money needs to know the returns that he is likely to make and the total costs he will incur in percentage terms. The returns an investor makes are in any case after costs.

Disclosure of costs is more relevant at the point that an investor is making his investment decision rather than post investments unless there is a significant change in costs.

The Regulator has already prescribed the maximum expense or costs (TER) that can be levied in any scheme in terms of the % of Assets under Management (AUM). This information is also disclosed in the Offer Documents and there is complete transparency relating to this information. All mutual funds are adhering to these guidelines prescribed by the Regulator and the expenses charged to investors are not exceeding the limits prescribed by SEBI.

It will be worth noting that in majority of the schemes, the total expense actually charged to the investors is below the maximum allowable TER prescribed by SEBI. We believe that of the total AUM of Rs. 13.50 lac crores, the industry is charging lower expenses than the maximum allowable TER on approximately Rs 8.00 lac crores (60% of the AUM).

Further the regulator has already taken a number of steps:

- 1) No entry loads to be charged on Direct Applications
- 2) Followed by complete ban on entry loads
- 3) Introduction of compulsory Direct Plans for all schemes by all AMCs with lower TER giving the investor's the option of not using distributors
- 4) Publishing total commission earned by large distributors
- 5) Disclosure of commission rates by distributors



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

6) Got AMFI to introduce caps on Commission payments just last year

It would be inappropriate and incorrect to focus only on one element of total cost. In effect, rather than protecting the investor the regulation might harm him as also harm the industry. The regulations will be imbuing a bias towards costs rather than performance.

It would also not be out of place to give a deep thought as to what actually protects the interest of the investor and whether only distributor commission disclosure protects the investor? Does the commission paid to the distributor only, determine whether the investment decision is good or bad?

Greater attention, if any has to be drawn to fund performance and for equity funds this needs to be measured over longer periods of 3 -5 years. Reviewing performance of equity funds over shorter periods will lead to wrong decisions by investors. The correct way of measuring performance and cost should be based on a percentage basis and not absolute amount. Providing absolute amounts is going to lead to a wrong assessment of service and performance.

2. Disclosure of the costs of the direct plan unfair to distributors after investor has taken a conscious decision to use the services of a distributor:

An investor uses the services of a distributor for many reasons. Prime amongst them is the reason that the investor is unable either to make an informed decision or is unable to execute the transaction and keep track of it till he remains invested.

The Regulator has also introduced Direct Plans with lower TER's thereby giving investors the option of NOT using the services of a distributor whilst making their investments. The Direct Plan is specified in the offer document and the fact sheets mention the NAVs of both the Regular and Direct Plans. Investors opting for Regular Plans have made a conscious choice of using the services of a distributor inspite of the higher TER.



An investor who has chosen to use the services of a distributor obviously sees benefits of doing so. Once an investor has chosen to invest in the regular plan then it is inappropriate to specifically also show him the costs of the direct plan in the garb of increased transparency. It amounts to promotion of the direct plan and probably appears to have been guided by an apprehension of mis-selling.

In the annexure attached hereto we have reproduced the section “Fallacies on Mis-selling” from our Comments on the Sumit Bose Committee Report that we have submitted to the Ministry of Finance. We repeat only the following over here:-

“The reality before the distributor is simple: the producer will pay provided there is a customer who buys. A customer will buy provided he trusts the distributor.

For a distributor, a satisfied customer not a satisfied producer is the key to sustainable business.”

By disclosing only distributor commission amounts the Regulator wants to highlight the costs of using the services of a distributor. But it must be borne in mind that for most investors THE COST OF NOT USING THE SERVICES OF A DISTRIBUTOR would be higher than the commission paid. This would be in the form of inferior returns from an uninformed and sub optimal choice of asset class or investment instrument.

Disclosure of TER of Direct Plan and Regular Plan is, therefore, also not a true comparison and can cause more unintended harm. The disclosure as mandated should be accompanied with a statutory warning about the nuances of investing and the risks of making an uninformed investment? The selective perception induced by only distributor commission disclosure would result in a biased and unbalanced view.



3. Inappropriate for Regulator to Push Direct Plans:

Disclosure on an ongoing basis of the difference between the direct plan v/s the regular plan to an investor who has already opted for the regular plan also does not seem to add any benefit to the investor -- other than creating a rift between investor and distributor and the promotion of passback to the investor, a practice which is prohibited by the regulator.

Disclosure of absolute amount of commission in the account statement and pointing out the difference of expense ratio of Direct and Regular Plans is a thinly disguised invitation for investors to abandon fund distributors and switch to direct plans.

Disclosing the TER of direct plan equivalents to an investor who has opted to invest in the regular plans is in no way a disclosure of what he owns - it is additional information on what he doesn't own. This is a clear cut case of a regulator nudging investors towards one product/channel in preference to another.

The regulator has introduced Direct Plans for Do it Yourself investors. It is inappropriate for the regulator to bless both - regular plans and direct plans and then put in a huge effort and bias to induce investors to choose one over another.

This issue of regulatory bias towards direct plans at the expense of regular plans also extends to the pricing formula for direct plans. The pricing of Direct Plans is arrived at by reducing the distribution expense in form of distributor commissions from the Regular Plan. The acquisition and servicing costs of direct clients ought to be captured separately and reflected in the pricing of direct plans. In the absence of this, regular plan investors are effectively subsidizing direct plan investors. This is clearly an anti-investor move and is strongly demonstrating regulatory bias for one set of products / one channel over others.



4. Unfair Treatment to Mutual Fund Industry – No level playing field:

SEBI regulations are also unfair in treatment of Mutual Funds relative to other investment products. Such disclosure is not required for other financial products.

The Sumit Bose Committee has come out with recommendations, which are under consideration of the government. Investment-Linked life insurance plans, bank deposits and mutual funds compete for the same investor funds. The current regulations widen the regulatory arbitrage thus the regulations clearly harms the development of the Mutual Fund industry vis a vis Life Insurance, Bank Deposits, Gold.

There is no level playing field. These regulations will be detrimental to the development of the mutual fund industry.

In no other industry, is any distributor required to statutorily disclose the commission amount. Nor is a shopkeeper / seller of goods required to disclose his margins while selling the goods.

Does any company ever disclose the breakup of Selling and Distribution and other costs to the customer? In fact, no company ever sells its products at prices lower than what its distributor does. It is only in the mutual fund industry where this practise is blessed.

Can an investor, howsoever informed he maybe purchase a stock on the bourses directly?

To enable the investor to have a proper choice a level playing field is essential.



5. Privacy of Information should not be violated:

The contract for managing money is between the investor and Fund/AMC. The cost of services charged by the Fund/AMC is known to the investor.

On the other hand, the distributor is an agent of the Asset Management Company/Fund. Why should the commission earned by a distributor from the Fund/ AMC be disclosed to each individual investor?

What increased transparency does it create?

The Privacy (Protection) Bill, 2013 (“Bill”) focuses on the protection of personal and sensitive personal data of persons and provides that “no person shall collect, store, process, disclose or otherwise handle any personal data of another person except in accordance with the provisions of this Act and any rules made thereunder. Sensitive personal data includes the data subject’s financial and credit information. This disclosure will amount to violation of privacy of information and needs to be withdrawn.

6. Consultative Process not followed in India, as is the Global Experience:

Some of the regulations could be driven by developments in other countries. We have a strange habit of aping the West, however, without giving a thought as to how developed that market is and how grotesquely under penetrated we are.

Most Global markets do not have disclosure of commission amounts in account statements. The United States does not have the practice.

In our case there was no consultative process. Globally a very wide consultative process is followed. We give below the following example:



A) Approach followed by FSA in United Kingdom

In June 2007, a discussion paper was published by FSA setting out the thinking of the FSA based on the working of five groups of practitioners, consumer representatives and other stakeholders. The regulator held 100 public meetings to explain and discuss the proposed regulations.

In April 2008, an Interim Report was published by FSA, summarising the feedback on the discussion paper and setting out how the FSA had modified the thinking to reflect on that feedback. FSA held further discussions with stakeholders on the Interim Report.

In June 2010 FSA after considering the feedback received and drafted a consultative paper under the “Retail Distribution Implementation Programme”.

On 31st Dec 2012 final regulations were implemented only after making the public aware of such proposals and after holding meetings with the various stakeholders.

Even in a developed economy like the UK, the regulations were finally introduced after 5 years as they realised the far reaching impact of such a regulation. Detailed consultations held and the transition period equipped all the stakeholders better to deal with the changes sought to be implemented with these regulations.

It is essential that the regulator comes out with a discussion paper on the proposed regulations, invites feedback from all stake holders and then finalises the regulations and give adequate transition time to market participants to implement the same.

We urge that a similar process is followed before implementing the current circular.



7. Regulation will lead to promotion of unethical practices, corruption and rebating:

Regulations already prescribe the maximum amount that can be charged as expenses (TER). Disclosure of distributor commissions on an ongoing basis will lead to unethical practices of pass backs. Passback of commission is not allowed by the regulator. The regulation will lead to use of corrupt and illegal practices. Should regulations encourage unethical practices?

This will also result in depletion in government revenues. As an example let us assume that the total annual distributor commission paid at the industry level is Rs. 5000 crores. Even if it is assumed that the passback will be only 50% of the commission paid then a sum of Rs. 2500 crores will flow out of the system in form of passbacks. This will result in a direct loss of annual revenue of Rs. 800 crores to the government coffers. The regulation could even lead to unethical practices being followed within the distribution community, eventually leading to adoption of practices detrimental to the investors.

It is our humble submission that the current circular should not be implemented unless SEBI wants to legalise rebating.

8. Additional disclosures are being introduced on the presumption of mis-selling. However there is no evidence of the same:

Presumably the additional disclosures of distributor commission amount and the difference in TER of Regular and Direct plan is based on an assumption of mis-selling by distributors. Everyone casually talks of mis-selling. But where is the data? What is the proportion of mis-selling?

Regulatory decision cannot be taken solely on the perception. "In GOD we trust, rest bring the data" The famous quote has been attributed to W. Edwards Deming, a renowned American statistician, professor, author, lecturer and consultant and considered as the father of modern quality management. Mr. Narayan Murthy is famously known to be quoting it regularly. Is this really being



followed before arriving at regulatory decisions? Why not penalize few rogue elements instead of unsettling the entire industry? You don't cut your hand just for a small scratch on your finger. Thus it is essential that regulations are based on evidence.

Regulatory decision cannot be taken solely on perception. Why not penalize few rogue elements instead of unsettling the entire industry?

We annex hereto a note on some of the fallacies on mis-selling.

9. Regulations not in line with government vision:

The government has a vision to decimate the parallel economy, based on the black money or unaccounted money. It is a big menace to the Indian economy and its elimination will benefit the economy in more ways than one. The thrust of the government is to encourage self employment, enhancement of one's skill sets, opening of bank accounts, increase savings in the financial sector including retirement and pension funds etc.

However, at times unintentionally government agencies take certain policy decisions which are not in harmony of the vision of the government.

Investors guided by the distributors have invested in the markets when foreign investors were exiting during the period August 2015 to February 2016. This has given the markets great stability and has benefitted the investors. The circular and its focus on costs will send the wrong signal to the investors. The number of self employed skilled distributors will be forced to close shop resulting in loss of employment to a number of citizens.

The circular will lead to adoption of unethical practices, generation of black money, loss of revenue to the government, nudge investors to look at costs instead of returns, wean away investors from financial savings to unproductive investments, unemployment and many other unwarranted and unintended consequences and hence should not be implemented.



10. Circular will have Negative Impact on Retail investors and Growth of Industry:

Retail investors (and more importantly, potential new investors) are not going to magically dream up the knowhow required to become direct fund investors. If they do or are prompted to do so, then there will be dire unintended consequences. There's a huge (and crying need) for expanding mutual fund investments in India and the independent fund distributor is a crucial part of realising this potential.

The Sumit Bose committee appointed by the government on incentive structure of financial products observed that:

“One of the biggest challenges in the Indian context has been the weaning of the Household from real asset such as gold and real estate.”

The report also states that financial products are still sold than bought, and distributors play an important role (pg.25). It reiterates this by stating that agents play an important role in educating the customer about modern finance and financial products (pg.42). Given the importance of agents / distributors a rise in their numbers is vital.

However, the reality has been the reverse. At the current stage of Indian market, we have seen a dramatic fall in the number of agents. The number of MF distributors has, infact, declined from 92,500 in March 2010 to 40,000 in March 2014 (pg.20). Instead of being a worthwhile vocation, for them, it has turned out to be unviable.

Financial assets may be categorized into two sets of products: pull products and push products. Pull products have been long available, are well understood and widely distributed. Their incremental potential to rise to the challenge would therefore be limited. In contrast, push products, especially mutual funds and pension are nascent.



The report states that only 3.4% of the gross financial savings were invested with mutual funds (pg.20). These products, therefore, have the highest potential to achieve the above objective.

A further reduction is quite possible if additional disclosure requirement as proposed by SEBI's recent circular are implemented, leading a drastic fall in the reach of financial products to households across the country and continued low penetration of financial products. It must be recognized that financial viability of agents / distributors is vital for meeting the above challenge. Most retail investors need help, guidance and service for savings and investing. How can we reach out to and educate the masses without enabling distributors?

Clearly absence of a large distribution network will see households savings once again shift back to unproductive physical assets as most investors do not think beyond real estate and gold. As it is the retail penetration in financial assets is abysmally low and in the equity segment it is even worse. The government had initiated steps to reenergise the mutual fund industry because of the obvious benefits that it brings. It is oft stated that small investors should take an exposure to the stock markets only through the mutual fund route. However, with incremental regulations at regular intervals, especially the disclosure sought to be brought about by the recent circular, it is likely that many distributors would now find it unviable to carry on their profession due the consequences once the provisions of the circular are put in force.

The regulator desires that the distributors register themselves as RIA's and charge fees to the investors in lieu of the commissions they earn. We have all acknowledged time and again that in our society only a handful of investors would be willing to pay a fee to their advisor. The need of the moment is to educate the investor, expand the reach of the industry, create awareness amongst the investors before ushering in any far reaching regulations. Lets develop the industry and not kill it.



11. Inappropriate Disclosures, Impractical Calculations will lead to misleading conclusions:

The regulator often tends to justify the need for regulations by drawing comparisons with some of the developed economies of the world. The mutual fund industry in India is not as developed as some of the developed economies globally. In all the developed countries regulations are introduced after consultation with all stakeholders. Unfortunately in this largest democracy, regulations are sought to be thrust upon the stakeholders without any engagement with them.

It would have been appropriate for dissemination of information and objectives of the new regulations in the public domain, a healthy debate and discussion based on responses received a cost/benefit analysis of the proposed regulation, before deciding on additional disclosures. Consultations amongst industry stakeholders have not taken place nor has careful consideration been given to the disclosures proposed.

It will be pertinent to note that the commission amount paid is a mix of upfront and trail commission. With the abolition of entry loads, the trail commission compensates the distributor for acquiring and bringing new customer/ households to invest in mutual funds. A distributor provides a no of services to fund house which are at a fund level and at a specific investor / scheme level. Hence allocating the commission amount at the investor / scheme level will give an incorrect picture of the expense incurred for that investor / scheme.

This is evident from the following:

- 1) Gross commission will have to be disclosed without recognizing that currently 15% of the revenue would straight away be appropriated by way of service tax. It also does not incorporate the cost of operations and overheads of the distributors thus giving a totally incorrect impression.
- 2) Expenses incurred by the AMC/Fund on travel and trips of a distributor has to be apportioned and disclosed at the folio level of each investor for each scheme



that a distributor is connected with. All distributors are not invited for the trips. The criteria for inviting a distributor is based on complex formulae with the combination of existing AUM, incremental net AUM, new business generated, number of SIPs and many more. This raises many questions. An illustration is given below.

- Will the AMCs now bifurcate the cost of such trips for each of the investment of each of the investor in their schemes based on their complex formula?
- Who will vouch for the accuracy of the information?
- Will the trustees give a declaration to all the distributors to vouch for the accuracy of the information?
- If the mutual fund invites a distributor and thinks it necessary for him to attend any of the seminars/ programmes and incurs costs to that effect, why is it considered as a form of commission paid to the distributor? The AMC/MF is doing so in the interest of its own business.
- Does the same then have to be treated as income in the hands of the distributor?
- And above all does that leave the investor any wiser?

3) It also talks of commission in the form of event sponsorships. Take the example of an investor meet of investors of a particular distributor which is sponsored by an AMC. This also raises many questions. An illustration is given below.

- How will the cost of such an event be bifurcated amongst the schemes/ investors of the distributor?
- Will it be bifurcated in the proportion of number of investors attending the meet or only those then investing in the scheme of the particular AMC?
- Or will it be on the basis of the new business generated out of such meet?
- Who will vouch for the accuracy of the information?



- Will the trustees give a declaration to all the distributors to vouch for the accuracy of the information?

Incorrect calculations at Investor/Scheme Level will lead to mis-leading conclusions.

12. Need to Focus on Financial Literacy and long term orientation:

The regulator should invest in improving financial literacy before any back-door attempt to push direct plans or switch to a fee-based model. Investment in Direct Plans should be allowed only for educated Investors as done in Singapore recently. By influencing investors' behaviour without first educating them to correctly interpret the added information they are about to get, SEBI will unintentionally send out the wrong signal and may be doing a disservice to the lay investor.

Disclosure of absolute amount of expenses every 6 months will create a short term orientation towards the distributor to what is essentially a long term relationship and investment.

To convince the investor to invest and stay invested for long periods of time over different market and economic conditions is itself a task.

The whole distribution committee has been educating the existing investors and new prospects and are whole heartedly committed to work with the regulator, government, AMFI to promote financial literacy and achieve financial inclusion.



13. The Regulations are Unfair:

- Is it fair that regulations concerning the mutual fund industry are being introduced without consultation and debate?
- The Regulator has prescribed the TER for various kinds of MF products. Is it not sufficient enough? The expenses cannot exceed the limits. Now it prescribes further disclosure of only distributor commissions in absolute terms. Is this a fair practice?
- Is it fair to push the investors including the uninformed investors to the direct mode of investing even though the investor has already made a choice?
- Does this act of luring an investor to go for direct plans without the aid of the incidental advice from distributors not amount to mis-selling and detrimental to the very investors whose interest is sought to be protected.
- Is it a message that the regulator does not want Distributors and is of the opinion that all Investors in India are mature enough to Invest in Mutual Funds on their own without any guidance and handholding through the ups and downs of the market?
- In the entire manufacturing universe including most of the insurance products there is no compulsion on manufacturers to sell products directly to the consumers or to have a price differential on products being directly sold to the consumers at an enforced cost determination. Even in the bourses an investor cannot opt for purchasing a stock without intermediation. Is it fair that only mutual fund industry is compelled to follow such regulations?



- Is it fair that the distributor is made vulnerable by disclosure of his gross income?

14. Conclusion:

The mandate for SEBI regulations is to protect the interest of investors and to promote the development of securities market. From the above, it will clear that the circular on commission disclosure is more likely to be counter productive on all counts and must be withdrawn.



ANNEXURE:

NOTE ON FALLACIES OF MIS-SELLING:

Undoubtedly consumer protection in finance has taken centre stage post the 2008 global financial crisis. However the committee attributes the global financial crisis "was essentially a MIS-selling episode at a massive scale." We would like to humbly differ.

A number of causes have been identified for the global financial crisis. Dr Raghuram Rajan, currently Governor, Reserve Bank of India, in his book "Fault Lines" shows how the individual choices - made by bankers, government officials and ordinary homeowners - that collectively brought about the economic meltdown. In fact to quote from his book "One set of fault lines stems from domestic political stresses especially in United States. The second set of fault lines emanates from the trade imbalances between countries stemming from prior patterns of growth. The final set of fault lines develops when different types of financial systems come into contact to finance the trade imbalances....". He further states "We should resist the temptation to round up the most proximate suspects and pin blame on them". Clearly Dr Rajan dispels the common perception that the global financial crisis "was essentially a MIS-selling episode at a massive scale.". Even Credit rating agencies have been blamed for the role they played.

What is the Empirical Evidence in India ?

Out of over 1 lakh distributors(Source- <http://tinyurl.com/nmtnutl>)
Only 19 have been suspended and only 12 have been terminated
(as per AMFI data)

We believe the overwhelming majority of agents are focused on providing the appropriate product / solution for household and ensuring favourable outcomes. In India we believe there is a tendency to blame all ills related to the financial savings industry to the distributor/agent and to Mis-selling.



FOUNDATION OF INDEPENDENT FINANCIAL ADVISORS

We would like to point a number of common fallacies and false impressions on mis-selling.

“Agents are remunerated directly by the product provider and this could often lead them to represent the interest of the product provider.”

“This means that agents do not have to focus on serving the customer, but on meeting volume based targets.”

“The customer also does not pay the distributor directly; the distributor therefore has no incentive to service the customer. The distributor’s incentive is to maximize the income by selling the product that provides the highest commission regardless of whether it is in the interest of the customer.”

The above fallacies are apparent.

The reality before the distributor is simple: the producer will pay provided there is a customer who buys. A customer will buy provided he trusts the distributor.

For a distributor, a satisfied customer not a satisfied producer is the key to sustainable business.

The Sumit Bose Committee in its report states, “However, it (direct channel) seems to be more popular with corporate and institutional clients, than with retail investors who still seem to prefer to invest through distributors.” The continued reliance of the retail investor on the distributor is a mark of the level of trust and satisfaction that he has in the distributor.

The report, thus, presumes mis-selling and ignores the contrary evidence it itself contains.

Anecdotal “evidence” lacks scientific rigor and cannot be the basis for policy making. Regulations cannot be based on perceived mis-selling rather than actual mis-selling. The government/regulators need to study independently the extent



of mis-selling in India which could than form the basis of the need for making any changes.

Measures Already in Place :

The regulator has already put in a number of measures with a view to prevent mis-selling in MFs:

- a. Ban on entry loads.
- b. Introduction of the Direct Channel.
- c. Restriction of upfront commission to 1%.
- d. Clawback mechanism for upfront.
- e. Agent – advisor differentiation.

No “evidence” of mis-selling post the introduction of these steps has been presented by the regulator before coming out with additional disclosures. This raises the fundamental question whether any additional disclosures of commission and expense ratios are warranted today.

