The mutual fund industry in India: where to next?

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Where we came from

- 1963, India's first mutual fund, UTI was created by an act of Parliament, and was owned by GOI.
- 1993, economic liberalisation saw the entry of a lot more AMCs.
  Regulation by SEBI.
- 2001, UTI Act repealed. Mutual funds became one more part of the financial sector with relatively low public sector presence.

Regulatory controls on fund management

- 1998, CRB scam. SEBI regulation on the fund management resulted in extremely tight disclosure norms on funds under management.
- By 2001, after the changes to UTI, mutual funds became the most transparent fund management industry in India, and one of the most transparent by world standards.

Regulatory controls on costs of management

- From 2006 onwards, a lot of significant mutual fund regulation has focussed on costs of fund management.
- Mutual funds have a variety of expenses. There are one time expenses – initial issue expensies, investment and advisory (AMC) – and recurring expenses – marketing and sales, brokerages, depository, insurance, other service provider charges.
- SEBI controls include:
  - defining a set of expenses that cannot be passed on to the customer
  - limits on some others: initial issue, entry load, exit load, management fees.
- Circa 2006: 6% initial issue expense, 6% entry load, 2.5% expense ratio.
  Circa 2010: 0% initial issue expense, 0% entry load, 2.5% expense ratio, STT.

Recent controvertial regulatory changes

- The removal of entry loads on all schemes, and an explicit disclosure of payment of commissions to distributors.
- Tradeable on exchanges.
- Facilitating the process for an investor to change between distributors by eliminating the no objection certificate in December 2009.

Objectives

- Stated regulatory objective: improve retail participation.
- Cost control should lead to lower entry barriers.
- However, they are not the only determinant for participation.
  Case in point: Participation in the New Pension System (NPS) is very low.
- Then what needs to be done?

Towards attaining objectives

- Learning from NPS: Investor awareness is low. Improving investor awareness is expensive.
  - Part of the solution: ensure at least some plain vanilla products. Example: who provides govt. debt index funds?
  - In the hands of the industry.
- Investor access is low. Barriers: access to payment systems, high ticket sizes of products.
  - Part of the solution: UID access to payment systems.
- Increase provider competition while reducing product complexity.
- How is the rest of the world dealing with higher transparency of costs and distribution?

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