# REGULATION OF MUTUAL FUND FEES AND EXPENSES AND ITS IMPACT ON MUTUAL FUND INDUSTRY

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***Abstract***: *Mutual fund investments are made by pooling investments from various retail and institutional investors and investing in secondary market. In India, a mutual fund is established or registered as a trust which is run by the trustees and the idea of starting up a mutual fund is of the sponsors. Section 52 of the SEBI (Mutual Fund) Regulations, 1996 specifies the limits on fees and expenses that can be charged to a particular scheme by the Asset Management Company. As per the SEBI guidelines all expenses should be clearly identified and appropriated in the individual schemes. The objective of this paper is to see the importance of regulations on mutual fund industry. The paper tries to see the impact of regulation on mutual fund industry.*

***Keywords***: ***Mutual fund fees and expenses, regulatory changes, management fees, expense ratio.***

## 1. Introduction

A mutual fund is a type of investment in which the money is collected from different investors and the money collected is then invested into securities like bonds, shares, money market instruments, commodities etc. Money is pooled and invested in secondary market in a financial product. The idea behind a mutual fund is that individual investors generally lack the time, the inclination or the skills to manage their own investments.[1]

The modern mutual funds arrived in the 20$^{th}$ century, with the creation of Massachusetts Investors' Trust in the year 1924. The fund went public in the year 1928 and today the firm is known as Massachusetts Investors' Trust. In India, Mutual funds came into existence in the year 1963, when Reserve Bank of India and Government of India established the Unit trust of India by passing an act of Parliament called the UTI Act. The history of Indian Mutual Fund industry is divided into four different phases. The first phase was from year 1964 to 1987 when there was only one fund house (UTI) available for the investors to invest in capital market. In the year 1987 (second phase), other players also entered into the market, i.e. the public sector banks, Life insurance Corporation of India and General Insurance Corporation of India. The participation of banks and other non-UTI mutual funds led to growth in mutual fund industry and by the end of year 1993, the AUM of the mutual fund industry were Rs. 47,004 crores. The first regulation for mutual funds came into force in the year 1993 and this is the year which marked the entry of private sector into mutual fund industry. The third phase was from the year 1993 to 2003 where private sector funds started entering into the industry. The first private mutual fund was erstwhile Kothari Pioneer which is now merged with Franklin Templeton. The SEBI (mutual fund) regulations, 1993 were revised and

[1] Indian Mutual Funds Handbook, Sundar Sankaran (2013)

substituted by SEBI (Mutual Fund) Regulations, 1996. Since 1996, all the mutual fund houses are governed by these regulations. After the bifurcation of UTI into two different entities namely specified undertaking of UTI and UTI Mutual Fund in 2003, mutual fund industry has witnessed various mergers and acquisition and this has led to the fourth phase (since February 2003) of mutual funds' history in India. Since then the mutual fund industry has seen the phase of growth and consolidation with more and more fund houses entering into the industry offering varieties of scheme to invest in. The entry of new mutual funds led to formation of Association of Mutual Funds in India which is an association of all the mutual funds which are registered with SEBI. AMFI was incorporated on August 22, 1995.

Figure 1.1 Growth in AUM in India


Source: AMFI

Figure 1.1 shows the growth of AUM in Indian mutual fund industry. By the end of 1987, AUM were only Rs. 6700 crores. The second and third phases ended with AUM of Rs.

47,004 crores and Rs. 1, 21,805 crores respectively.by the end of March 2015, Indian mutual fund industry has grown tremendously with the growth in AUM to Rs. 10, 82,757 crores.[2]

At present, there are forty four mutual funds which are registered with SEBI and are members of AMFI. The list of these mutual funds with their date of incorporation is provided in Annexure A (List of AMCs in India) Indian Asset Management Companies are classified on the basis of their ownership. Before we understand this structure lets understand how a mutual fund can be set up in India. In India, a mutual fund is set up in the form of a Trust. Like the promoters of a company, the sponsors set up the trust. To manage the funds raised by the mutual funds and to provide the advisory services an Asset Management Company is incorporated. Custodian is the one who keeps the securities of various schemes under its custody and the custodians are also required to get themselves registered with SEBI. SEBI gives various powers to the trustees, who are responsible to monitor the performance of the AMC.

## 2. Objectives of the study

Mutual funds have different types of fees and expenses. Many regulatory changes have been made on these fees and expenses. There are some fees which are banned by the SEBI in India. These are entry load and initial issue expenses. The objective of the study is to see in detail what types of fees and expenses are prevalent in India and how they have an impact on the mutual fund industry. The broad objectives of the study are as follows:

1. To develop a conceptual framework of mutual fund fees and expenses.

2. To understand the regulations governing the mutual fund fees and expenses.

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[2] AMFI Website

3. To see the impact of regulatory changes on mutual fund industry.

## 3. Conceptual Framework of Mutual Fund fees and Expenses

The US Security Exchange Commission defines Mutual fund as a type of professionally managed collective investment scheme that pools money from many investors to purchase the securities.

According to Section 2(q) of SEBI Mutual Fund Regulations, 1996 a "Mutual fund" means a fund established in the form of a trust to raise monies through the sale of units to the public under one or more schemes for investing in securities including money market instruments, gold or gold related instruments and real estate assets. In India, a mutual fund is established or registered as a trust which is run by the trustees and the idea of starting up a mutual fund is of the sponsors. There is a three tier structure of mutual funds in India. The Sponsor approaches SEBI and gets the mutual fund registered as a Public Trust as per Indian Trust Act, 1882 and the members of the trust are known as the Trustees. The trustees hold the property of mutual fund in trust for the benefits of the unit holders. The Asset Management Company signs an investment management agreement with the trustees to purchase and sell the securities.

### 3.1. Regulation Of Mutual Fund Fees and Expenses in India

Section 52 of the SEBI (Mutual Fund) Regulations, 1996 specifies the limits on fees and expenses that can be charged to a particular scheme by the Asset Management Company. As per the SEBI guidelines all expenses should be clearly identified and appropriated in the individual schemes.

Different types of fees and expenses and their regulatory limits and guidelines.

1. Initial Issue Expenses

The expenses related to new fund offer are the initial expenses which include filing fees, printing and advertising expenses, marketing expenses and bank charges. These expenses were borne by the investors.

The charging of initial issue expenses to the scheme were abolished for open ended scheme from 22.5.2006 and subsequently it has been barred for all schemes from 16.4.2008. Before this abolition, the schemes were allowed to charge up to 6% of the resources mobilised in the New Fund Offer.

2. Brokerage and Transaction Cost

These costs are incurred to execute the trading; these are the cost of buying and selling of securities. SEBI has also specified limits on these costs so as to limit the ability of fund managers to frequently purchase and sell securities in the market. SEBI has put limit on the brokerage and transaction costs.[3] The guidelines suggest that brokerage and transaction cost incurred for the purpose of execution of trade may be capitalized to the extent of 12bps and 5bps for cash market transactions and derivatives transactions respectively. Any payment towards brokerage and transaction cost, over and above the said 12 bps and 5bps for cash market transactions and derivatives transactions respectively may be charged to the scheme within the maximum limit of Total Expense Ratio (TER) as prescribed under regulation 52[4]. Any expenditure in excess of the said prescribed limit (including brokerage and transaction cost, if any) shall be borne by the AMC or by the trustee or sponsors.

3. Entry Load

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[3] Circular No. CIR/IMD/DF/21/2012 dated September 13, 2012 & SEBI Circular No. CIR/IMD/DF/24/2012 dated November 19, 2012

[4] SEBI (Mutual Funds) (Second Amendment) Regulations, 2012, w.e.f. 01-10-2012,

Entry or front end load is the fee charged to the fund investor at the time of making the investment into mutual fund. The actual price paid by the investor is the NAV of the fund plus the amount of entry load. SEBI abolished the entry load in August 2009. Before the ban on entry load fund houses used the amount of entry load to pay for commission to the distributors and the amount of entry load was retained in a separate account from which fund's selling and distribution expenses were met. The entry loads were primarily paid to the agent as distribution fees. Prior to August 2009, mutual funds used to pay commission to the agents for their distribution activities and the rate could be as high as 2.5%.

4. Transaction Charges

After the abolition of entry load, it was felt that the agents and distributors do not have any incentive to indulge in the distribution and marketing of mutual fund schemes and this could result in reduction in the asset under management of the fund houses and can adversely affect the mutual fund industry. The distributors had been demanding introduction of the entry load again. They have been complaining that their business has taken a beating since then. Therefore in August 2011, SEBI allowed AMCs to collect the entry load but limited the fee to a very nominal account. For a first time investor investing more than Rs. 10000 the fee is Rs. 150 and nil if the investment is less than Rs.10, 000 and for an existing investor the amount is reduced by Rs.50. For the investors investing in systematic investment plans a transaction charge of Rs. 100 will be payable in four equal instalment starting with the second payment of SIP (in case the investment is more than Rs. 10,000). SEBI requires proper reporting of fees in Mutual Fund Statements.

5. Exit load

The back end load is applied when the investment is sold. The amount received by investors at the time of exiting from the investment is net of exit load. The repurchase price is NAV minus exit load. To discourage investors from withdrawing funds within a short period almost all fund houses charge an exit load of 1 to 3% based on the time within which an application is filed for redemption. As per the SEBI guidelines, while charging the load, the scheme cannot differentiate between unit holders on the basis of amount of subscription. Exit load cannot be charged on bonus units & units allotted on re investment of dividend. According to section 51A of SEBI (Mutual Fund) Regulations, 1996, the exit load charged, if any, after the commencement of the SEBI (Mutual Funds) (Second Amendment) Regulations, 2012, shall be credited to the scheme.

5A. Contingent Deferred Sales Charge (CDSC)

This charge is levied on the unit holders if they exit from a scheme within 4 years of entry. This charge decreases with increase in time period of holding the units. As per the SEBI guidelines a scheme has to be a no load scheme to charge CDSC. The Asset Management Company is entitled to levy a CDSC not exceeding 4% of the redemption proceeds during the first 4 years after the purchase, 3% in 3$^{rd}$ year and 1% in 4$^{th}$ year.

Exit load is different from the CDSC. Exit load is fees paid at the time of redeeming the investment. As per SEBI guidelines, exit load cannot exceed 7% and entry load and exit load put together cannot exceed 7% of the sale price.

As per the SEBI circular on June 30,2009 all loads including the Contingent Deferred Sales Charge for the scheme are maintained in a separate account and this amount can be used by the AMC to pay commissions to the distributors and to take care of other marketing & selling expenses. It is on the AMCs to decide whether they want to credit any surplus in this account to the scheme.

6. Service Tax

SEBI has put restriction on charging service tax via its Circular No. MFD/CIR/04/430/2002 dated June 19, 2002, SEBI Circular No. CIR/IMD/DF/21/2012 dated September 13, 2012.

As per SEBI guidelines AMC(s) can charge service tax, as per applicable taxation laws, to the scheme(s) within the limits prescribed under regulations. Mutual funds/AMCs may charge service tax on investment and advisory fees to the scheme in addition to the maximum limit of Total Expense Ratio (TER) as prescribed in Regulation 52. Service tax on other than investment and advisory fees, if any, shall be borne by the scheme within the maximum limit of TER as per Regulation 52. Service tax on exit load, if any, shall be paid out of the exit load proceeds and exit load net of service tax, if any, shall be credited to the scheme. Service tax on brokerage and transaction cost paid for execution of trade, if any, shall be within the limit prescribed under regulation 52 of the Regulations.

7. Management Fees/ Investment and Advisory Fees

The management fee also known as the investment and advisory fees that the AMC charges to a mutual fund should be disclosed in the offer document. Regulation prescribes the following limits on the management fees. (Prior to SEBI (Mutual Funds) (Second Amendment) Regulations, 2012, effective from 01-10-2012)

- 1.25% on the first Rs. 100 crore of weekly average net assets outstanding in each accounting year.
- 1% on weekly average net assets exceeding Rs. 100 crore.
- In case of index funds, it should be 0.75% of weekly average net assets.

The base to calculate the management fees is net assets and not the unit capital[5]. Net assets can be more or less than the unit capital of the scheme depending on the performance and expenses charged to the scheme. Open ended schemes calculate the net assets on daily basis

[5] Unit capital of a scheme is equal to total outstanding units of a scheme multiplied by the face value of its units.

so management fees are also provided for on a daily basis. The management fees is accrued on daily basis or weekly basis but the actual payment of the fee can be quarterly, monthly or as agreed between the parties. Therefore, the amount is shown in the balance sheet as liability- “Management fees payable”. (Sankaran, 2012)

Following items cannot be included in the net assets to calculate the management fees.

- Investment by the AMC in the scheme;
- Investment by the scheme in other mutual fund schemes;
- Issue expenses not written off; and
- AMCs cannot charge management fees in the case of liquid and debt oriented schemes for parking of funds in short term deposits with banks.

Prior to SEBI (Mutual Funds) (Amendment) Regulations, 2010, w.e.f. 29-7-2010, AMCs were entitled to collect additional management fees not exceeding 1% of weekly average net assets outstanding in each financial year.[6]

Another provision on management fees deals with the expenses and management fees charged by mutual funds in the foreign countries. Management fees and other expenses charged by the Mutual Funds in foreign countries along with the management fee and recurring expenses charged to the domestic Mutual Fund scheme shall not exceed the total limits on expenses as prescribed under Regulation 52(6) of the Mutual Funds Regulations. Where the scheme is investing only a part of the net assets in overseas Mutual Funds, the same principle shall be applicable for that part of investment. Details of calculation for charging such expenses shall be reported to the Board of the AMC and the Trustees and shall also be disclosed in the Annual Report of the scheme[7].

[6] Omitted by the SEBI (Mutual Funds) (Amendment) Regulations, 2010, w.e.f. 29-7-2010
[7] SEBI MASTER CIRCULAR CIR / IMD / DF / 14 / 2013

8. Recurring expenses

Following recurring expenses can be charged to the fund as per SEBI guidelines.

(i) Marketing and selling expenses including agents' commission, if any

(ii) Brokerage and transaction cost (on distribution of units- not on purchase & sale of securities in the investment portfolio of scheme)

(iii) Registrar services for transfer of units sold or redeemed;

(iv) Fees and expenses of trustees;

(v) Audit fees;

(vi) Custodian fees;

(vii) Costs related to investor communication;

(viii) Costs of fund transfer from location to location;

(ix) Costs of providing account statements and dividend/redemption cheques and warrants;

(x) Insurance premium paid by the fund;

(xi) Winding up costs for terminating a fund or a scheme;

(xii) Costs of statutory advertisements

(xii-a) in case of a gold exchange traded fund scheme, recurring expenses incurred towards storage and handling of gold;

(xii-b) in case of a capital oriented scheme, rating fees;

(xii-c) in case of a real estate mutual fund scheme, insurance premia and costs of maintenance of the real estate assets (excluding costs of development of such assets) over and above the expenses specified in regulation 52[8] to the extent disclosed in the offer document.[9]

(xii-d) listing fees, in case of schemes listed on a recognized stock exchange; and

(xiii) Such other costs as may be approved by the Board.

Any other expense which can be directly attributed to the scheme can be charged to the scheme with the prior approval of trustees and within the overall limit. Any other expenses shall be borne by the trustees, sponsors or the AMC. And the following expenses cannot be charged to a scheme;

- Penalties and fines for infraction of laws;
- Interest on delayed payment to the Unit holders;
- Legal, marketing, publication & other general expenses not attributable to any scheme;
- Expenses on investment management/ general management
- Expenses on general administration, corporate ads& infrastructure costs
- Depreciation on Fixed Assets & software development expenses

Total Expense Ratio (TER)

The total of all expenses charged to an investor are called Total Expense Ratio. TER is an annual charge on asset under management (AUM) and is calculated in percentage term. SEBI

[8] SEBI (mutual fund) Regulations, 1996, regulation 52 sets limit on fees and expenses on issue of scheme.
[9] Substituted by the SEBI (Mutual Funds) (Amendment) Regulations, 2009, w.e.f. 8-4-2009.

issues guidelines on calculations and limit on total expense ratio from time to time. As per SEBI guidelines, TER should decrease with the increase in Asset under Management. Total expense ratio is calculated by using following formula:

TER= {(Total expenses during an accounting period) * 100}/ Total net assets of the fund.

SEBI has prescribed limits on the expenses to be included in the calculation of total expense ratio. The following section discusses the regulatory limits on Expense Ratio of different types of schemes prescribed by Securities and Exchange Board of India.

Table 3.1: Limits on recurring expenses including the management fees but excluding the issue and redemption expenses in case of flow of funds

| | |
|---|---|
| UPTO 28.7.2010 | Shall not exceed 0.75% of daily or weekly Average net assets. |
| From 29.7.2010 to 30.9.2012 | Total expenses including Management fees shall be either of two:<br>Shall not exceed 0.75% of daily or weekly average net assets<br>It may consists of<br>Management fees not more than 0.75% of daily or weekly ANA<br>Other administrative expenses<br>Charges levied by underlying schemes,<br>Provided i, ii, and weighted average of Total Expense Ratio (TER) of underlying schemes should not exceed 2.5% of Daily or Weekly average net assets. |

| | |
|---|---|
| From 1.10.2012 onwards | Total expense of scheme including weighted average of charges levied by underlying scheme shall not exceed 2.5% of daily average net assets of scheme |

Table 3.2: Limits on recurring expenses including the management fees but excluding the issue and redemption expenses in case of Index Funds or Exchange Traded Funds.

| | |
|---|---|
| UPTO 28.7.2010 | In case of index fund scheme Total expenses cannot exceed 1.5% of Weekly average net assets (WANA) |
| From 29.7.2010 to 30.9.2012 | In case of index fund scheme or ETF, TE cannot exceed 1.5% of WANA |
| w.e.f. 01.10.2012 | In case of index fund scheme or ETF, TE should not be more than 1.5% of Daily net Assets |

Table 3.3: Limits on recurring expenses including the management fees but excluding the issue and redemption expenses in case of any other schemes

| | | |
|---|---|---|
| Prior to 29.7.2010 | Equity Schemes | Debt Schemes |

| | | |
|---|---|---|
| On first 100 crores of WANA | 2.5% | 2.25% |
| Next 300 crores of WANA | 2.25% | 2.0% |
| Next 300 crores of WANA | 2.0% | 1.75% |
| Balance of the assets | 1.75% | 1.5% |
| From to 29.7.2010 | Equity Schemes | Debt Schemes |
| On first 100 crores of DNA | 2.5% | 2.25% |
| Next 300 crores of DNA | 2.25% | 2.0% |
| Next 300 crores of DNA | 2.0% | 1.75% |
| Balance of the assets | 1.75% | 1.5% |

Recurring expenses' limits on Gold ETF schemes is same as Equity schemes' limit.

For balanced schemes limit would depend on whether the scheme is pre-dominantly invested in equity or debt.

According to SEBI Circular No. CIR/IMD/DF/21/2012 dated September 13, 2012 additional TER can be charged up to 30 basis points on daily net assets of the scheme as per Regulation 52, if the new inflows from beyond top 15 cities are at least

(a) 30% of gross new inflows in the scheme or

(b) 15% of the average assets under management (year to date) of the scheme, whichever is higher.

In case inflows from beyond top 15 cities is less than the higher of (a) or (b) above, additional TER on daily net assets of the scheme shall be charged as follows:

$$\frac{Daily\ net\ assets\ *\ 30\ basis\ points\ *\ New\ inflows\ from\ beyond\ top\ 15\ cities}{365\ or\ 366 * Higher\ of\ (a)\ or\ (b)}$$

The top 15 cities shall mean top 15 cities based on Association of Mutual Funds in India (AMFI) data on ‘AUM by Geography – Consolidated Data for Mutual Fund Industry’ as at the end of the previous financial year.

The additional TER on account of inflows from beyond top 15 cities so charged shall be clawed back in case the same is redeemed within a period of 1 year from the date of investment.

Mutual funds or Asset management companies are required to disclose the efforts they have undertaken to increase geographical penetration of mutual funds and detail of new Mutual funds opened especially in cities, which are not covered in top 15 cities in the half-yearly report of trustees. Expenses charged under this clause shall be utilized for distribution expenses incurred for bringing inflow from such cities. This can be better understood with an example. Assume the average AUM of an equity scheme is Rs 1,000 crore, of which Rs 100 crore is the additional inflows it gets. Of this Rs 100 crore, assume that your fund gets Rs 30 crore from beyond top 15 cities. Earlier, SEBI decided that if this single target (Rs 30 crore) is met, your scheme would be straightaway charged 30 bps extra. However, now this Rs 30 crore should also be at least 15% of your AUM. In this example, the Rs 30 crore "beyond top 15 cities" inflow falls short of the other criteria (15% of AUM or Rs 150 crore). If fund houses don't meet their target, they can charge additional TER, proportionately. The investors should be aware of the total expenses paid by them in a mutual fund investment. The Total Expense Ratio charged by the mutual funds is disclosed in the monthly fund factsheet of the scheme, if it is not there, the investors can find the ratio in Scheme Information Document (SID)

## 4. Review of Literature

The literature suggests that the regulations of a country also have an impact on the level of mutual fund fees and expenses **Khorana, Servaes and Tufano (2008).** Every country protects the rights of investor and the rules and regulations are also important for the efficient functioning of financial markets. Therefore the regulators put some limits on the level of mutual funds fees and expenses. These regulations are amended from time to time keeping in view the welfare of investors as well as the developments in the industry. In India, SEBI is the governing body and SEBI (Mutual Funds) Regulations contains the rules and regulations related to mutual fund industry. SEBI has also revised these regulations from time to time and amended and inserted new sections in these regulations.

**Anagol and Kim (2012)** have seen the impact of regulatory change on flow of mutual funds in a particular time period. The authors have divided the total time period of their study into regimes on the basis of change in regulation of open ended and closed ended funds. Under regime 1, open and closed ended funds, both were allowed to charge initial issue expenses (IIE) and entry loads (maximum limit was @ 6%). Under regime 2 closed-ended funds could charge only IIE and no entry loads and open ended funds charged entry Loads, no IIE. And in third regime initial issue expenses were banned and both types of funds were allowed to charge only entry loads. The authors studied these two law changes to see how these changes affected the decision making ability of Indian investors. The authors called initial issue expenses more shrouded because these expenses are amortised and gradually deducted from NAV. Therefore, the investors are less aware of these expenses whereas entry loads are deducted from initial investment and are less shrouded. Main analysis is in regime 2 (from April 2006 to Jan 2008) when closed ended funds were allowed to charge IIE in place of entry load. Regression equation (OLS) is made to provide evidence on MF starts and flows using number of funds started as dependent variable, return of SENSEX as control variable. The result shows that amount flowed into closed end funds in Regime 2 were significantly higher than the commensurate increase in funds flowed in open ended funds in the same period. The reason for such behaviour was that because closed ended funds in regime two were not charging any entry loads and investors were willing to pay initial issue expenses and not the entry load. They preferred closed ended funds over open ended funds. And when under regime 3 initial issue expenses were banned for both type of funds and closed ended funds had to compete with open ended funds, and initial issue expenses were disclosed as entry loads and closed ended funds were not considered good enough to warrant extra expenses by the investors and hence this resulted into demise of closed ended funds in regime 3. The authors have thus empirically tested the impact of regulatory changes on investment behaviour of mutual fund investors.

**Somashekar (2009)** has also tested the benefits of regulation in Indian Mutual Fund Market. The author has compared the performance of the funds governed by SEBI regulations with that of funds governed by weaker UTI Act regulations. The author examines whether the cost imposed by regulations are more than the benefits and concludes that SEBI governed funds have outperformed the UTI funds because SEBI funds have to follow stricter rules regarding disclosure requirements and corporate governance. The author points out that there is cost associated with compliance of regulations. For example disclosure of portfolio performance & expenditures may result to copycat funds free riding on the effort made by the main funds and thus this can deteriorate its performance. Various reforms have been made after the financial crisis of 2008. Some are related to financial literacy programs and some are on commission paid to brokers of different financial products **(Anagol, Marisetty, Sane and Venugopal, 2013).**

In 2013, the UK financial service authority has banned commission paid to IFA (Investment Fund Advisor) by financial product providers. USA's 12b-1 fee is also under debate which comes under operating expenses and used for selling and distribution expenses. It is believed that brokers' commissions influence them to sell more & more products to the investors which may not be as per the risk & return appetite of the investors. The authors have seen impact of ban on entry loads for all MFs in India in August, 2009. Asset growth of funds charging high distribution fees is compared with funds charging low fees. The growth in asset was same in both classes of funds prior to the reform that is why growth after reform can be checked to see the impact of this regulatory reform. In 2013, the UK financial service authority has banned commission paid to IFA by financial product providers. USA's 12b-1 fee is also under debate which comes under operating expenses and used for selling and distribution expenses.

## 5. Data Description and Research Methodology

The study is based on information collected from various primary and secondary sources. Research articles published in leading journals, newspapers and websites have been referred to in conducting this study. ACE MF database provided by Accord Fintech Pvt Ltd. and ICRA database on mutual funds have been used to collect data. The final sample consists of 132 equity schemes. The time period of the study is from 30$^{th}$ September 2008 to 30$^{th}$ September 2014.

Management fees are the fees charged by the fund houses for the management of mutual fund scheme. This is basically a price paid for the investment and advisory services taken by the investors from the fund managers. Six monthly data from March 2009 to March 2013 have been collected from ICRA mutual fund database to see the impact of regulatory changes on the mutual funds. The schemes were divided into six categories on the basis of their management fees.

**Table 5.1 Categories of schemes and their management fees**

| Category | Management fees (%) |
|---|---|
| I | 0-0.5 |
| II | 0.5-1 |
| III | 1-1.5 |
| IV | 1.5-2 |
| V | 2-2.5 |
| VI | more than 2.5 |

The table 5.1 shows classification of all the schemes on the basis of their management fees.

## 6. Empirical Results

Regulations of mutual funds play a very important role in the development of mutual fund industry. These regulations are amended from time to time to meet the demands of different stakeholders like investors, sponsors, AMCs, distributors etc. Amendments in the regulations have an impact on the functioning of overall industry. We have tried to see the impact of regulatory changes of mutual funds' management fees on the mutual fund industry. Before October 2012, there was a separate cap on management fees (maximum 1.5% in case of equity schemes) but this limit was removed by SEBI and now the AMCs are free to charge any amount of management fees within the limit of expense ratios. We have found that the amendment has impacted the mutual fund industry.

**Table 6.1: Frequency distribution of schemes on the basis of management fees**

| CATEGORY | I | | II | | III | | IV | | V | | VI | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| MANAGEMENT FEES | 0-0.5 | | 0.5-1 | | 1-1.5 | | 1.5-2 | | 2-2.5 | | more than 2.5 | | |
| | % | NO of Schemes | % | NO of Schemes | % | NO of Schemes | % | NO of Schemes | % | NO of Scheme | % | NO of Scheme | Total |
| Mar-09 | 11.95 | 35 | 18.43 | 54 | 69.62 | 204 | 0.00 | | 0.00 | | 0.00 | | 293 |
| Sep-09 | 4.65 | 14 | 23.92 | 72 | 70.76 | 213 | 0.66 | 2 | 0.00 | | 0.00 | | 301 |
| Mar-10 | 6.11 | 19 | 21.54 | 67 | 72.35 | 225 | 0.00 | | 0.00 | | 0.00 | | 311 |
| Sep-10 | 4.22 | 14 | 15.06 | 50 | 80.72 | 268 | 0.00 | | 0.00 | | 0.00 | | 332 |
| Mar-11 | 4.97 | 15 | 15.89 | 48 | 79.14 | 239 | 0.00 | | 0.00 | | 0.00 | | 302 |
| Sep-11 | 6.23 | 18 | 11.76 | 34 | 82.01 | 237 | 0.00 | | 0.00 | | 0.00 | | 289 |
| Mar-12 | 5.37 | 16 | 15.10 | 45 | 78.86 | 235 | 0.00 | 0 | 0.67 | 2 | 0.00 | | 298 |
| Sep-12 | 3.14 | 9 | 19.51 | 56 | 77.35 | 222 | 0.00 | | 0.00 | | 0.00 | | 287 |
| Mar-13 | 2.71 | 8 | 8.14 | 24 | 44.75 | 132 | 32.88 | 97 | 10.85 | 32 | 0.68 | 2 | 295 |

Table 6.1 shows that there is change in the pattern of fees charged by different schemes because of regulatory change which came in October 2012.

- Before October 2012, most of the schemes were in the category III i.e. they were charging the management fees in the range of 1% to 1.50%.
- The effect of the regulatory changes can be seen in the next six months that is in March 2013
- Till Sept. 2012, around 70% to 80% of the schemes were in category III but in the next six month the number of schemes in category III were only 45% and the AMCs started charging management fees in the maximum range of the total expense ratio i.e. up to 2.5%
- This shows that the major portion of total expense ratio of a scheme goes to management fees
- And regulatory changes do have an impact on the fees charging pattern of the AMCs.

## Conclusion

The purpose of this research was to examine the relevance of regulations of mutual fund fees and expenses. There is a long running debate that whether the mutual funds are charging higher fees in comparison of services rendered by them **(Adams et al, 2012)**. It is the duty of regulatory bodies to see that unnecessary fees are not charged by the AMCs. In USA, Supreme Court established that it is the fiduciary duty of the investment advisors to charge reasonable fees (Jones v Harris Associates). It was the first mutual fund case in which the court reaffirmed that mutual fund companies cannot charge disproportionately large fees. In India, SEBI regulates the mutual fund industry. SEBI Mutual Fund Regulations, 1996 provides all the guidelines related to mutual fund industry, it also limits the amount of fees and expenses charged by the AMCs. Although there is no standardised specification of role of distributor but SEBI regulation gives some rights to trustees and AMCs take actions against the intermediaries, such as the board of AMC can suspend or cancel the registration of intermediaries under certain circumstances[10]. The Board may initiate action for suspension or cancellation of registration of an intermediary holding a certificate of registration under section 12 of the Act who fails to exercise due diligence or to comply with the obligations under these regulations.[11]

Regulatory changes do have an impact on the mutual fund industry (Khorona et al, 2008) The regulations shape the future of any financial product. The objective of this study was also to see the impact of the regulations on mutual fund industry. We tried to find the immediate impact of regulatory change related to management fees on mutual fund industry practices. It was found that before the change in the regulation around 70% to 80% of the schemes were in category III (management fees between 1% to 1.5) but in the next six month the number of schemes in category III were only 45% and the AMCs started charging management fees in the maximum range of the total expense ratio i.e. up to 2.5%.

[10] Section 75 of SEBI (Mutual Funds) Regulations, 1996
[11] Section 18 of SEBI (Mutual Funds) Regulations, 1996

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