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DIVERSIFIED FINANCIALS

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Proposed TER overhaul implies steep profit hit for AMCs

- **SEBI moots all-inclusive TER with new AUM-based slabs to make mutual funds more transparent**
- **Regulator also targeting unnecessary churn by stripping away distributors' incentive to promote switch-outs from existing schemes to NFOs**
- **TER for listed players could shrink 13-34bps; expect FY25E net profit of HDFC AMC to be hardest hit while UTI AMC best placed**

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New slabs proposed: SEBI, in its recent consultation paper, proposes to set TER slabs at the AMC level, not at the scheme level. The revised slabs will be different for (i) equity and equity-based AUM and (ii) other-than-equity-based AUM, with the maximum fee that can be charged for an equity scheme being 2.55% for the first AUM slab (up to Rs 25bn). Per SEBI, the impact of the revised TER slabs on AMCs collectively would result in a ~5% reduction in expenses of equity, hybrid and solution-oriented schemes for investors.

Other key proposals: (i) The TER limit should be inclusive of all additional expenses such as brokerage, transaction expenses and GST. (ii) Additional commission to distributors may continue for inflows from B30 cities but with conditions in order to prevent unnecessary churn. (iii) TER could be made variable based on scheme performance. (iv) Exit load of open-ended schemes may be cut from 5% of NAV to 2%.

Safeguarding investors against misselling: Among the new proposals is one that entitles distributors to the lower of the commissions offered under the two schemes pertaining to any switch transaction. This is aimed at avoiding misselling by distributors due to the lure of higher commissions, given that the current rules permit a new scheme to charge higher TER than an existing one.

TER of listed players could shrink by 13-34bps: Assuming that the new rules are restricted to active equity schemes, our analysis shows that if all expenses are included in TER, then the negative impact could range from 13-34bps. Assuming 60% of expenses are passed along to distributors, then listed players with a large equity AUM corpus could see a sharp drop-off in FY25 net profit in the range of 6-15%, with HDFC AMC bearing the brunt. UTI AMC is the only exception with a 1% PAT upside.

Scenario analysis suggests some wiggle room: If our base-case brokerage and STT expense assumptions are halved (from 22bps to 11bps), then the decline in FY25 profitability would lessen to 2-11% (ex-UTI AMC). However, if expenses are halved but AMCs are able to only transfer 25% of these to distributors, then the hit on PAT would widen to a range of 5-23%, impacting all listed players.

Recommendation snapshot

Ticker	Price	Target	Rating
ABSLAMC IN	344	375	HOLD
HDFCAMC IN	1,787	1,946	HOLD
NAM IN	237	305	BUY
UTIAM IN	669	800	BUY

Price & Target in Rupees | Price as of 22 May 2023

Key TER proposals

SEBI has put out a consultation paper with a slew of proposals on the TER (total expense ratio) charged by AMCs to facilitate transparency and benefits of economies of scale to mutual fund investors. Key among these are:

- **TER slabs:** TER slabs are proposed to be at the AMC level and not at the scheme level. The revised slabs will be different for (i) equity and equity-based AUM, and (ii) other-than-equity-based AUM. For hybrid and solution-oriented schemes, the slab would be the weighted average of TER of equity & equity-related instruments and TER of other-than-equity & equity-related instruments. SEBI suggests that the maximum fee that can be charged for an equity scheme is 2.55% for the first AUM slab (up to Rs 25bn).

Fig 1 – New TER slabs for equity-based AUM

SN	AMC-level AUM	Equity & equity-oriented instruments (maximum TER for regular plan) (%)	Weighted average TER chargeable at the upper limit of AMC-level AUM (maximum TER for regular plan)* (%)
1	Up to Rs 25bn	2.55	2.55
2	On the next Rs 25bn	2.45	2.50
3	On the next Rs 50bn	2.30	2.40
4	On the next Rs 400bn (Up to Rs 500bn)	Reduction of 0.05% for every increase of Rs 50bn of equity & equity-related instruments.	2.14
5	On the next Rs 500bn (Up to Rs 1tn)	Reduction of 0.10% for every increase of Rs 100bn of equity & equity-related instruments.	1.87
6	On balance of the assets	1.30%	Depends on the AUM

Source: SEBI, BOBCAPS Research |*Rates given are for Regular Plans. TER of Direct Plans will be TER charged for Regular Plans minus distribution commission

Fig 2 – New TER slabs for other-than-equity-based AUM

SN	AMC level AUM	Max. TER for other-than-equity & equity-related instruments (%)	Weighted average TER chargeable at the upper limit of AMC-level AUM* (%)
1	Up to Rs 50bn	1.20	1.20
2	On the next Rs 250bn	1.10	1.12
3	On the next Rs 300bn	1.00	1.06
4	On balance of the assets	0.90	Depends on the AUM

Source: SEBI, BOBCAPS Research Note| *Rates given are for Regular Plans. TER of Direct Plans will be TER charged for Regular Plans minus distribution commission

Fig 3 – Reduction in expenses of equity, hybrid and solution-oriented schemes because of new slabs

Total expenses charged during FY22 (Rs bn)	Total expenses chargeable based on revised slabs* (Rs bn)	Impact at industry level (%)
308	294	4.6

Source: SEBI, BOBCAPS Research | *Total expenses chargeable includes expenses for direct plans plus regular plans

- **All-inclusive fee:** The TER limit should be inclusive of all additional expenses to encourage uniformity and transparency. Brokerage expenses (0.12% of trade value in the cash market and 0.05% in derivatives) and STT (securities transaction tax) should be a part of the TER limit to discourage high churn. In order to reduce the expenses towards these, AMCs should be allowed to obtain limited purpose membership with stock exchanges for executing trades in own MF schemes.

Fig 4 – AMC spends towards brokerage and transaction costs in FY22

Particulars	No. of mutual funds	Total spending towards brokerage and transaction cost (Rs bn)
Large AMCs	8	21
Medium AMCs	10	11
Small AMCs	24	3

Source: SEBI, BOBCAPS Research

- **GST:** TER may be inclusive of GST on investment and advisory fees.
- **Exit load fee:** The provision enabling charging of an additional expense of 5bps for schemes with an exit load may be discontinued.
- **B30 commission:** Additional commission to distributors may continue for B30 cities, but distributors may be paid only for investment/inflows from new individual investors (new PAN) from such cities at the industry level. Such additional commission may be fixed at 1% of the size of the first investment or SIP, subject to a maximum of Rs 2,000. This is to counter the practice of splitting investor application amounts to take advantage of current B30 incentives that are limited to investments under Rs 200,000.
- **Switch transactions:** The distributor shall be entitled to the lower of the commissions offered under the two schemes of any switch transaction. This is aimed at avoiding misselling by distributors for the lure of higher commissions, as current rules permit a new scheme to charge a higher TER than an existing scheme based on AUM slabs. SEBI observed that switch transactions in regular plans amounted to Rs 228bn (93% of total switch transactions), whereas no such churn pattern was observed in direct plans. NFOs garnered Rs 827bn over Apr'21-Sep'22, of which 27% was shifted from regular funds.

Fig 5 – NFO amounts gathered through switch transactions

Particulars	Active schemes	Passive schemes	Total
NFOs during 1-Apr-21 to 30-Sep-22	47	39	86
Amount garnered (Rs bn)	827	26	9
Amount garnered through switch (Regular Plan) (Rs bn)	224	4	2
Amount garnered through switch (Direct Plan) (Rs bn)	12	3	0.2
Percentage of amount garnered through switch by distributors (Regular Plan)	27.1	15.1	26.8

Source: SEBI, BOBCAPS Research

- **Women investors:** In order to encourage women investors, SEBI proposes an additional commission to distributors at 1% of the investment amount of the first application or SIP at the industry level, subject to a maximum of Rs 2,000 per woman investor.
- **Exit load:** The exit load of an open-ended scheme may be lowered from 5% of NAV to a maximum permissible limit of 2%.
- **Variable TER:** SEBI is exploring variable TER based on scheme performance and has suggested two approaches but said that new concepts can first be tested in a regulatory sandbox structure.

Fig 6 – Underperformance of regular plans is higher as compared to direct plans

Scheme Performance vis-à-vis Benchmark	Number of Schemes (Active Schemes)							
	1-Year return		3-Year return		5-Year return		10-Year return	
Data as on Feb'23	Direct	Regular	Direct	Regular	Direct	Regular	Direct	Regular
>1.25% underperformance to the benchmark	17.2	25.8	26.7	37.6	26.2	40.3	10.2	22.8
Up to 1.25% (equivalent to max. tracking difference permissible for debt ETFs/Index Funds) of underperformance to the benchmark	26.0	32.2	25.8	29.7	29.0	33.0	23.5	37.7
% of Schemes meeting the benchmark or outperforming	56.7	42.0	47.5	32.7	44.8	26.7	66.3	39.5

Source: SEBI, BOBCAPS Research

Material impact on profits

HDFC AMC could be hardest hit; UTI AMC best placed

We believe the proposed TER changes would be restricted to active equity schemes as non-equity schemes are already in the lower yield bracket. To analyse the potential impact on listed AMCs, we assume GST at the weighted average of equity schemes taken into consideration, brokerage at 12bps, STT at 10bps and exit load at 5bps. Of this, based on industry interactions, we assume distributors are paid 60% and the TER impact is in the same ratio. We foresee a financial impact from FY25 onwards given that SEBI has indicated a six-month implementation timeline from the date of regulation.

Our analysis below shows that HDFC AMC would be the worst impacted with an estimated 15% hit on FY25 net profit because of its large AUM corpus, whereas UTI AMC which has the least active equity assets of Rs 0.7tn would in fact be positively impacted by the new proposals (1% profit upside).

Fig 7 – HDFC AMC could be the hardest hit owing to its large AUM base

Company (as of Mar'23)	Active equity AUM (Rs tn)	Base TER - Active equity (bps)	New slab excl. expenses (bps)	New slab incl. expenses (bps)	Difference (bps)	Blended yield impact (bps)	Impact on FY25E PAT (%)
HDFC AMC	2.6	146	152	112	(34)	(7)	(15.4)
Nippon AMC	1.2	159	178	138	(21)	(4)	(8.6)
ABSL AMC	1.0	162	189	149	(13)	(2)	(5.7)
UTI AMC	0.7	163	202	164	1	0	1.0

Source: BOBCAPS Research | Note: Expenses include GST, brokerage, STT and exit load.

Scenario analysis suggests wiggle room if distributors cooperate

A scenario analysis of the possible impact shows that AMCs could mitigate the fallout of the new proposals by lowering brokerage fees, though the benefits would be contingent on distributors sharing a bulk of the cost burden.

- **Scenario 1:** Players could lower brokerage and consequently STT. Assuming our initial expense estimate of 22bps (12bps brokerage and 10bps STT) is halved to 11bps and distributor expense share is unchanged at 60%, the negative impact on HDFC AMC's FY25 net profit would reduce to 11% from 15% earlier. ABSL and Nippon AMC would see net profit erosion of 2-3% vs. 6-9% earlier, while the upside for UTI AMC rises to 5%.

Fig 8 – Brokerage cut would cushion profit impact

Company (as of Mar'23)	Active equity AUM (Rs tn)	Base TER - Active equity (bps)	New slab excl. expenses (bps)	New slab incl. expenses (bps)	Difference (bps)	Blended yield impact (bps)	Impact on FY25E PAT (%)
HDFC AMC	2.6	146	152	123	(23)	(5)	(10.7)
Nippon AMC	1.2	159	178	149	(10)	(1)	(3.2)
ABSL AMC	1.0	162	189	160	(2)	(1)	(2.3)
UTI AMC	0.7	163	202	175	12	2	5.0

Source: BOBCAPS Research

- **Scenario 2:** Distributors may resist taking a big hit on earnings and may accept only 25% of the cost burden vs. 60% in our base case. Even assuming a halving of expense estimates, profitability for all AMCs irrespective of size will take the biggest hit in FY25 under this scenario – at 23% for HDFC AMC, 13-15% for ABSL and Nippon AMC, and 5% for UTI AMC.

Fig 9 – Lower pass-along of cost burden (25%) to distributors would hurt profits

Company (as of Mar'23)	Active equity AUM (Rs tn)	Base TER - Active equity (bps)	New slab excl. expenses (bps)	New slab incl. expenses (bps)	Difference (bps)	Blended yield impact (bps)	Impact on FY25E PAT (%)
HDFC AMC	2.6	146	152	123	(23)	(11)	(22.5)
Nippon AMC	1.2	159	178	149	(10)	(6)	(15.1)
ABSL AMC	1.0	162	189	160	(2)	(5)	(12.5)
UTI AMC	0.7	163	202	175	12	(2)	(5.0)

Source: BOBCAPS Research

Fig 10 – Comparison of AMC profitability

Year	Large AMCs		Medium AMCs		Small AMCs	
	Net PBT (Rs bn)	PBT Margin (PBT/ Total Revenue)	Net PBT (Rs bn)	PBT Margin (PBT/ Total Revenue)	Net PBT (Rs bn)	PBT Margin (PBT/ Total Revenue)
FY17	33	43.4	8.35	31.5	1.71	15.0
FY18	44	43.6	13	37.0	2.95	17.6
FY19	53	49.5	13	36.6	3.31	20.6
FY20	60	61.9	11	38.2	0.92	6.6
FY21	73	71.0	12	42.9	5.67	33.0
FY22	86	70.1	18	50.2	5.92	30.3

Source: SEBI, BOBCAPS Research | Note: Large MFs/AMCs- Mutual Funds having more than 5% share of industry AUM; Medium MFs/AMCs- Mutual Funds with 1% to 5% share of industry AUM; Small MFs/AMCs- Mutual Funds which had upto 1% share of industry AUM

Fig 11 – Glossary

Glossary of Abbreviations			
AMC	Asset Management Company	**NAV**	Net Asset Value
AUM	Assets Under Management	**NFO**	New Fund Offer
B30	Beyond the Top 30 cities	**SEBI**	Securities and Exchange Board of India
ELSS	Equity-linked Savings Scheme	**SIP**	Systematic Investment Plan
ETF	Exchange Traded Funds	**STP**	Systematic Transfer Plan
GST	Goods & Services Tax	**T30**	Top 30 cities
MF	Mutual Fund	**TER**	Total Expense Ratio
MFD	Mutual Fund Distributor		

Source: BOBCAPS Research

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