Total Expense Ratio

- ✓ Annual fee **charged to mutual fund investors** to cover various expenses.
- ✓ Shows expenses of MF as a **percentage of total assets**.
- ✓ **Vary** depending on management styles, size and asset class.
- ✓ Lower expense ratio → Higher Returns
- ✓ TER to be **disclosed on a daily basis** of all schemes.

Expenses

Management Fee
To cover the costs of running the Asset Management Company.

Distribution Fee
Commission of MF distributors.

Other Expenses
Legal fees, auditor fees & other operational expenses.

$$\text{Total Expense Ratio} = \frac{Total\ Fund\ Costs}{Total\ Fund\ Assets}$$

Comparing Expense Ratio

- For **accurate evaluation** compare mutual funds within similar same asset class or similar investment strategy.
- Analyze in the **context** of overall fund performance. lower expense ratio can contribute to higher returns, it is also essential to **consider other factors** that influence an investment's performance.
- A higher expense ratio may be **justified** if it corresponds to **higher-quality management** or services provided by the investment manager.

Expense Ratio : SEBI TER Limits

Presently, **slab based TER** is applicable for various categories of scheme as follows -

Base TER limits for open ended schemes		
Daily net assets (AuM) in INR crore	Equity Oriented Schemes	Other than Equity Oriented Schemes
First 500	2.25%	2.0%
Next 250	2.00%	1.75%
Next 1250	1.75%	1.50%
Next 3000	1.60%	1.35%
Next 5000	1.50%	1.25%
Next 40,000	For every increase of Rs.5,000 crores of daily net assets, TER reduction of 0.05%	
Balance of assets	1.05%	0.80%

Base TER limits for the schemes	
Scheme	Max TER
Index Funds & ETF	1.0%
Fund of Fund	
Investment in Liquid fund, Index fund or ETF's	1.00%
Equity Oriented Schemes	2.25%
Other than equity oriented schemes	2.00%
Close Ended & Interval Scheme	
Equity oriented scheme	1.25%
Other than equity oriented schemes	1.00%

Source: Public Sources

Direct vs Regular

Post January 2013, all mutual funds are required to **classify the same fund scheme under two categories** viz. Direct Plans and Regular Plans.

Regular Plan

- Distributor will charge **commission** for services.
- Upfront/Trail commission **paid from fund** assets.
- Added cost of commission **increases expense ratio** resulting in lower NAV.

Direct Plan

- Commission is **eliminated** as no distributor involved.
- Reduce cost of commission means **lower expense ratio** resulting in higher NAV.

Popular Misconception

- Direct plans **do not eliminate all costs** rather they just save on the distribution expenses paid to intermediary.
- Both direct & regular plans are **subject to other costs** like management fee of fund manager, administrative fees redemption fee and other expenses like legal, accounting, custodial fees.

Direct vs Regular : Comparison

No.	Direct Plan	No.	Regular Plan
01	Buy the fund **directly from AMC**. No involvement of intermediary.	01	Buy **through a broker** who intermediates between investor & AMC.
02	No intermediary means no commission resulting in a **lower expense ratio**.	02	Commission has to be paid to third party resulting in a **higher expense ratio**.
03	Savings in commission are passed on to investors in the form of a **higher NAV**.	03	Higher expense ratio means a **lower NAV**.
04	**Simple** in nature. Investor is in full control.	04	Investor needs to **assess the option** of various third party.

Source: Public Sources

Regular Plan

1 Mutual Fund are procured through intermediaries like **brokers, financial advisors, or distributors**.

2 Fund house pays the intermediary a **commission or distribution fee**.

3 Intermediaries may also offer **added services**, including basic investment advice, portfolio evaluation, and transaction assistance.

4 Suitable for **investors new** to mutual funds or those lacking market knowledge and time for portfolio monitoring.

5 Regular plans contain 'Regular' or 'Reg' in scheme name.

Advantages

- **Streamlined Processing**: A well-qualified MFD can simplify the investment process, and handle all necessary paperwork, transactions, and any other online platform navigation-based actions. This can save investors valuable time and effort.
- Many MFDs take a **personalized approach** by tailoring investment recommendations based on investors' specific goals and risk tolerance.
- Most MFDs possess **in-depth knowledge**, be it about mutual fund products, related financial instruments, or even the broader financial markets.
- Investors can proceed with a confident assurance, considering the MFDs would operate in a **strict regulatory environment**.

Direct Plan

1 Mutual Fund are procured **directly either online or physically** by visiting registrar's or mutual fund company's office.

2 There is no involvement of third party eliminating any **commission or distribution fee**.

3 Making investment decisions **independently** means investors conduct own market research.

4 Ideal for investors who are **well-versed** in investment matters and don't require professional help.

5 Direct plans contain ‘Direct’ or ‘Dir’ in scheme name.

Direct mutual fund plans were introduced by the Securities and Exchange Board of India (SEBI) in **January 2013**. It made mandatory for all mutual fund houses to launch ‘Direct Plans’ for all schemes.

Advantages

- **Lower Expense Ratios** mean a smaller portion of investment goes toward fees, allowing more money to be invested in the market.
- Direct funds often provide **higher returns** than regular funds.
- Directly engaging with the fund house **mitigates the risk of being influenced** or misled by third-party intermediaries.

Direct vs Regular: Ideal in theory but not always feasible

The following example compares the direct and regular plans of the same mutual fund, which is typically ideal but not always true for different MF in same category. In reality, a higher expense ratio may be justified if it corresponds to higher-quality management resulting in higher returns.

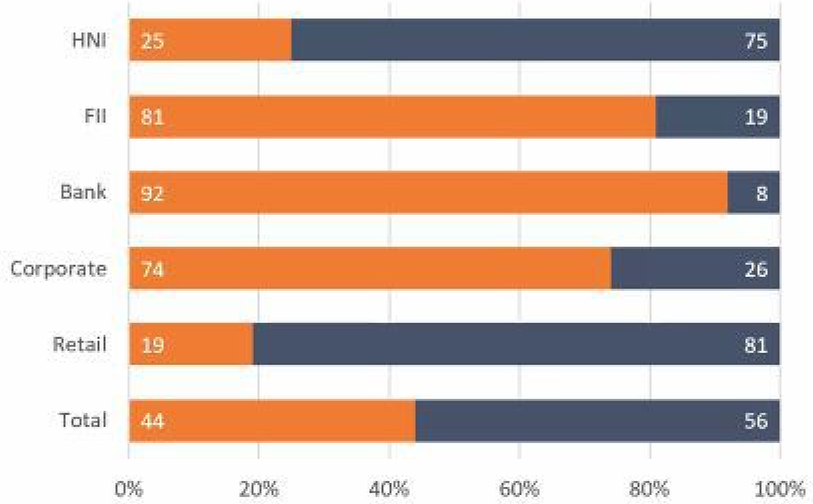
Particulars	Regular Plan	Direct Plan
Monthly SIP Amount	INR 25000	INR 25000
Investment Tenure	30 years	30 years
Annualized Return	12%	12%
Expense Ratio	2%	1%
Final Corpus at end of SIP Tenure	INR 5.17 crore	INR 6..46 crore
Outperformance by Direct plan	INR 1.29 crore (Around 20% more than regular plan)	

Source: Public Sources

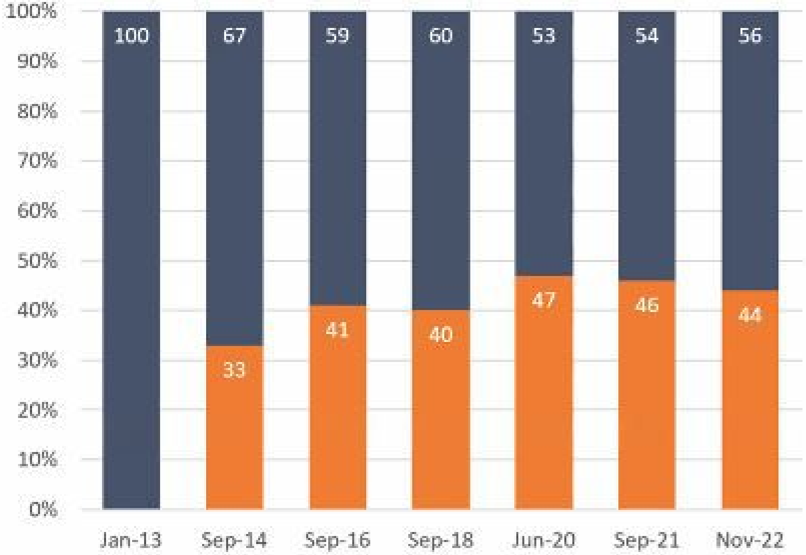
Direct vs Regular: Key Trends

Direct Plan   Regular Plan

Corporates, Banks and FII prefer direct route, while most retail and HNIs still rely on distributors



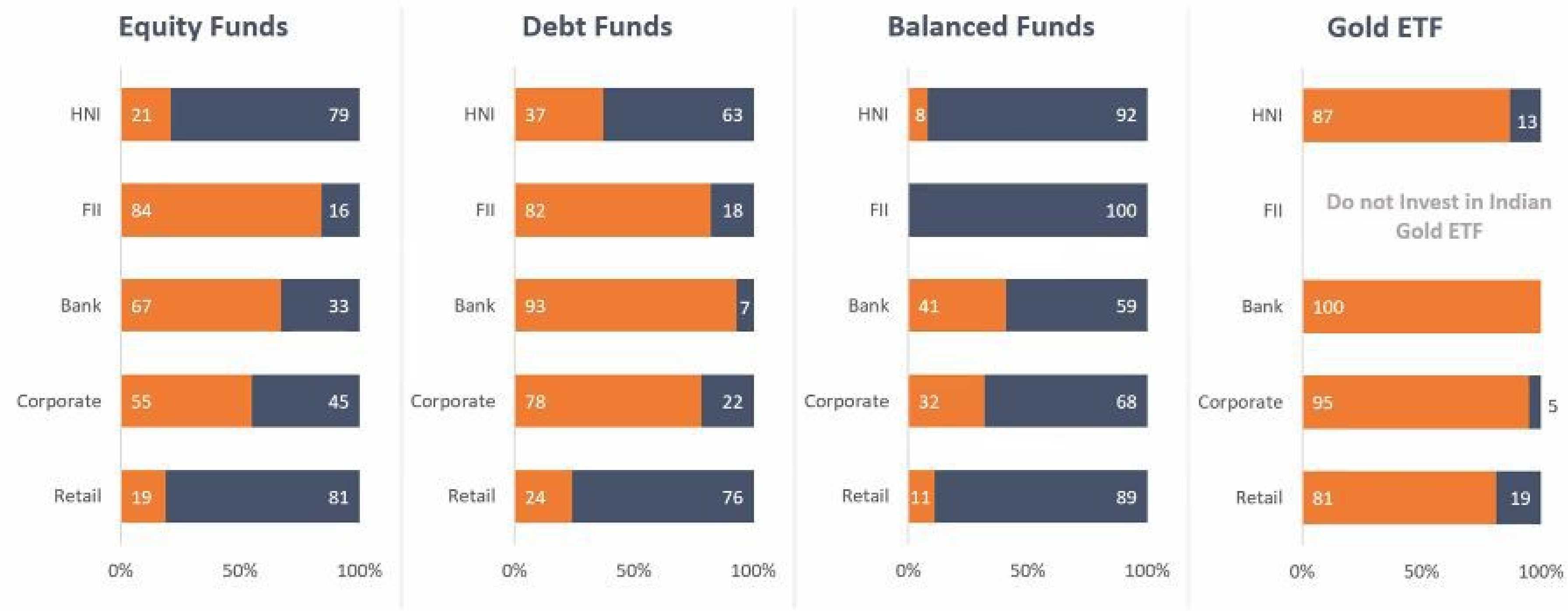
Growth of Direct AuM since 2013 SEBI circular



Source: AMFI data as of 2022

Direct vs Regular: Key Trends

Direct Plan | Regular Plan



Source: AMFI data as of 2022

Direct Plan : SEBI Consultation Paper 2024

SEBI in September 2024 released consultation paper on draft circular for "Disclosure of expenses, half yearly returns, yield and risk-o-meter of schemes of Mutual Funds". Public comments on these proposals are invited by October 18, 2024.

Current Scenario

Regulation 59 of SEBI (Mutual Funds) Regulations, 1996 requires half-yearly disclosure of unaudited financial results, which inter alia includes disclosure of total recurring expenses, returns during the half year and compounded annualized yield.

Currently, asset management companies (AMCs) only disclose information related to expenses, expense ratio, returns and yields for regular plans

Proposal →

Since direct plans have different expense ratios and returns, SEBI has proposed that such disclosures pertaining to both direct plan and regular plan shall be disclosed in a standard format.

Source: Public Sources

Direct Plan : Global Champions

Vanguard

- Founded in 1975 by John C. Bogle, Vanguard introduced the first index mutual fund.
- Pioneered the concept of no-commission direct investing.
- More than half (>50%) of Vanguard's USD 8 trillion assets are in direct plans or no-load funds.

Fidelity

- One of the largest asset managers in the U.S.
- Followed Vanguard's lead by introducing no-load mutual funds and low-cost index funds.
- Further disrupted the market by offering zero-fee index funds in 2018, drawing massive inflows from cost-conscious investors.

Hargreaves Lansdown

- Leading platform for investors to access direct mutual funds in United Kingdom.
- The company offers a wide range of no-load funds via its platform, which helped grow direct mutual fund investing in the UK.

BlackRock (Global)

- World's largest asset manager.
- Strong advocate of direct funds.
- Launched iShares ETFs, which are low-cost, passively managed funds with broad global market access.
- Today iShares command USD 3.3 trillion in assets under management.

Source: Public Sources

Regular Plan: Choosing a MF Distributor ?

- MF distributor must have passed the **NISM Series V-A certification test**, as mandated by SEBI. Successful completion of the NISM mutual fund distributor certification leads to issuing an **AMFI Registration Number (ARN)**, enabling registration as a mutual fund agent.
- Check the mutual fund distributor's **qualifications and experience**. An MFD should have adequate knowledge of investment and the personal finance domain. You can verify this information on the AMFI website and review the mutual fund distributor list.
- Considers MFDs who are **reputed** enough in their field, have a proven track record and may have received good reviews from their clients.
- Must have track record of maintaining an equal level of **transparency** regarding fees, commissions, information provided, etc.
- An MFD shall provide with a **comprehensive investment platform**. This may consist of an online desk that allows you to view your current holding, portfolio value, and different reports as well as transact with ease.
- Dive **into customer reviews and testimonials** to gauge client satisfaction levels. Pay attention to any red flags or recurring complaints that may signal potential issues.

Source: Public Sources