Chapter 5

Fund Distribution and Channel Management Practices
Investors in Mutual Funds

- Investors Eligible to Invest in Mutual funds
  - Individuals & Hindu undivided families (HUFs)
  - Companies & partnership firms
  - Trusts & charitable institutions
  - Banks & financial institutions
  - Non-banking finance companies (NBFCs)
  - Insurance companies, Provident funds, Mutual funds
  - Foreign institutional investors (FIIs), Non resident Indians (NRIs), Persons of Indian origin (PIOs)

- Resident individual investors are the largest segment
- HUFs can invest through Karta
- Overseas Corporate Bodies and foreign citizens (except PIOs) are not eligible
Retail and Institutional Investors

- The ‘Who Can Invest’ section of the offer document of a scheme specifies the categories of investors eligible to invest in a mutual fund scheme.

- The individual investor category includes retail investors, HNIs, minors and NRIs:
  - Retail investors may depend upon the distributor to provide the information and analysis.
  - HNIs may demand a better quality of service.
  - Minors can invest through a guardian.

- Institutional investors:
  - Approval of management committees and board of directors.
  - Board’s resolution and charter of the institution are required.
  - Authorised signatories invest on behalf of the institution.
Individual and Institutional Distribution Channels

- **Individual distributors are known as Independent Financial Advisors (IFAs)**
  - Establish personal long term contacts across investment products

- **Institutional distributors can be distribution houses, banks, or non-banking finance companies**
  - Employees and Sub-brokers
  - Wide branch network and large client base
  - Greater geographical reach
  - Standardised processes
  - AMC’s channel managers service the institutional distributors
  - Provide in-house research and product recommendations to investors
Newer Channels of Mutual Fund Distribution

- Online Mutual Fund Distribution
  - Online investments, view current holdings at latest NAV and conduct sale/re-purchase transactions
  - Investor creates an account
  - Account is password protected
  - Convenient and paper-less transactions
  - No cheque writing is required

- Distribution through Stock Exchanges
  - Stock exchange brokers to conduct mutual fund transactions through their trading platforms
  - Brokers must clear NISM MFD Certification, obtain ARN and empanel as distributor with AMC
  - NSE’s NEAT MFSS and BSE’s STAR Mutual Fund Platform
  - Open from 9am to 3 pm
  - Mutual funds can choose to tie up with any stock exchange
Appointment of Distributor

- Distribution agreements with AMCs on Empanelment
  - Terms and conditions of appointment

- Pre-requisites for being appointed as a distributor:
  - Individual distributors and employees of institutional distributors have to clear the NISM MFD certification examination
  - Need to obtain the ARN
  - Institutions in the distribution business also need to get registered with Amfi
  - Validity of certification examination is three years
  - Continuing professional education (CPE) training

- Empanelment form must be filled up while seeking empanelment
  - Personal details, names of key people handling sales and operations, business details

- AMC has the power to terminate agreement at any time, after due notice
Distributor Commissions

- No Sebi rules on the minimum or maximum rate of commission
- Distributors are not allowed to charge commissions on their own investment
- Initial Commission is paid up-front
  - Entry load has been banned since Aug 1, 2009
  - Investors have the power to decide the payment to advisors for their services
  - Distributors have to disclose the commissions they earn on comparable schemes when they recommend a scheme to the investor
- Trail commission is paid as long as the investor remains invested in the fund
  - Calculated on the current market value (units brought in by the distributor x current NAV of the units)
  - Amfi has banned trail commission for transferred assets
  - Money saved by AMC is to be used for investor education
Sales Practices

- Distributor actions must be in the interest of the unit holders.
- Distributors have to follow AMFI's code of ethics (ACE) as well as those prescribed by the concerned AMC, Amfi and Sebi.
- AMFI and fund houses have put in place a set of guidelines to be followed by the distributors. These include the following:
  - Distributor is accountable for the activities of the sub-brokers.
  - Distributors must have complete knowledge of the product on offer.
  - Distributors must know their clients' needs and profile.
  - The product chosen must meet the clients' requirements.
  - Distributors must encourage good investment habits such as long-term and regular investment.
  - Distributors must provide good and efficient after-sales service.
Summary

- Individuals, HUFs, Companies, Partnerships, Trusts, Mutual funds, insurance companies, banks, NRIs, FIIs, PIOs are eligible to invest in mutual funds.
- OCBs and foreign citizens are not eligible.
- Retail investors may be individuals, NRIs, minors, HNIs.
- Institutional investors require charter document, Board resolution and signatures by authorised signatories to invest in mutual funds.
- IFAs establish long term personal relationships with the investors.
- Institutional distributors provide benefit of large network of clients and branches, research and geographical research.
- Mutual funds are traded on stock exchange platforms through brokers between 9am and 3pm. NSE’s NEAT MFSS and BSE’s STAR Mutual Fund Platform.
- Distributors must clear NISM’s MFD certification exam (3 years validity), obtain ARN before getting empanelled.
- Initial commission is paid by investors while trail commission is paid by the AMC.
- Distributors must follow ACE, AGNI and guidelines prescribed by the AMC.