

Coping with Change

The recent changes in the financial services sector have left investors confused about their long-term strategies. The fourth MONEY TODAY Round Table on mutual funds asked six experts about ways to re-strategise. The panel included Vikramaaditya, Director and CEO, HSBC Asset Management (India); Vikaas M. Sachdeva, Country Head, Business Development, Bharti AXA Investment Managers; I.V. Subramaniam, Director and CIO, Quantum Advisors; Rajesh Krishnamoorthy, MD, iFAST Financial India; Yateesh Srivastava, CMO, Aegon Religare Life Insurance, and Kartik Jhaveri, Director, Transcend Consulting.

Q What are the changes likely to take place in the investment space and how will these impact investors?

KARTIK JHAVERI: The most significant change expected in the near future is the introduction of the Direct Taxes Code, and within it, the tweaking of the capital gains tax. While investors don't need to reconstruct their portfolios, they might have to do a bit of asset shifting. I have been hearing about the advice that is being shelled out to investors: 'If you have been holding stocks or mutual funds for several years, sell now to avoid paying a higher tax rate.' This is speculative and investors should not react to such news in a knee-jerk manner.

Q What do you think of the current focus on charges and commissions in mutual funds and insurance?

YATEESH SRIVASTAVA: There is no industry in the



world, be it candy, cards or financial products, that does not elicit distribution costs. Customers believe they are paying the MRP and don't realise that all costs, including distribution costs, are built into the product. In mutual funds, the concept of zero entry load is based on the premise that the customer will seek value and pay for advice. This may be true, but do we have enough trained financial advisers who can justify being paid for consultation? Also, practically everybody is willing to provide advice, so people don't feel the need to go to qualified advisers and pay them. What customers need to know is if they are getting value for money.

Will zero entry loads be good for customers? This has to be planned with a long-term perspective. Yes, there is malpractice, but this does not mean you malign the entire community of financial intermediaries. Are our financial planners better than the current set of agents or brokers, or whoever is selling stocks?

Q The finance minister has said that India should act as a role model for the world by doing away with loads for financial products. Do you think it will work? Has it been effective for mutual funds?

VIKRAMAADITYA: It has been nearly nine months since entry loads were abolished for mutual funds and it has taken all this while for distributors to find new business models and start talking to customers about their service proposition and fees. It has necessitated a change in mindsets, which is not very easy. The mandate that the regulators are looking at globally is greater transparency in all financial products, and embedded loads do not lead to transparency.

In the short term, it has led to some pain in the industry because it has been very difficult for people to adapt. You cannot change an organisation or its processes overnight. But the no-load policy is bound to create greater transparency in the long run. It is here to stay and everybody in the industry has to find a way to work with it.

Q One way to cut costs is to create an online platform for transactions. Do you think this will benefit investors?

RAJESH KRISHNAMOORTHY: An online platform does not mean you will not be able to get advice. In fact, the model should be designed in such a way that a customer does not have to fill forms repeatedly. He should fill the 'know your customer' form and all future interactions with the fund house should be through the electronic media. The adviser should be able to view the investor's portfolio and provide recommendations. If the investor accepts these, the transactions should take place. In this process, when you reduce logistics, you bring down costs. Also, the lesser the paper work, the fewer the logistics involved in a transaction and, hence, the more efficient the system.

Q What about the trail commission? If I am applying directly to a company and not availing of any advice, why should I pay?

I.V. SUBRAMANIAM: I do not agree that you need to pay a trail commission to retain customers. If the distributor has done his job of getting clients and if they are happy with the mutual fund and the service provided, there is no need to pay any more

(Standing, from left) Vikramaaditya, Yateesh Srivastava, Kartik Jhaveri and Vikaas Sachdeva; (Sitting, from left) Rajesh Krishnamoorthy and I.V. Subramaniam

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commissions. So, you can bring down the commission cost further.

Q Expense ratios of 2.25% or 2.5% could be justified if the industry were small. Now that it has grown and huge amounts are coming in, shouldn't the expense ratio come down?

VIKRAMAADITYA: The answer lies in market dynamics. Fund houses usually charge lower than the maximum expense ratio permitted by the regulator. Pricing is a function of the type of product and the amount the market can bear. It is also pertinent to note that the asset management industry is a business of scale. For a fund to be profitable, you need a certain critical mass because there is a fixed cost that you incur. So, there will be certain products that are bound to have high costs.

Q Do you think the consumer is aware of all the charges that he pays for his investments in mutual funds?

VIKAAS SACHDEVA: There are three types of customers. The first is the savvy client, while the second is the type who does not know much about financial products and puts his money in a fixed deposit. The third is the one who is sitting on the fence and wants to get in but does not know when to do so. The largest segment consists of the people who do not invest, while the smallest is populated by savvy guys. The latter, smart investors, will talk to 10 financial advisers and ultimately go to the one who gives them the most value. Also, they are willing to pay for guidance.

The third type of customer, the one on the fence, is whom we call a 'do it yourself' customer. This segment is probably growing at the fastest rate and one that really needs a distributor because such investors can go wrong. Each time there is a structural change in the industry and the stock markets rally or fall, you will find people coming in at the fag end, burning their hands and then probably never coming back to the markets. So, these are the people who need

guidance, be it through an online distribution platform or an offline one.

We also need to concentrate on the segment that shies away from financial products. Why are they not investing? It's not as if this type of customer does not understand finance. After all, he balances his chequebook and manages credit cards. So, why is he reticent about buying a mutual fund or an insurance product? The primary reason is that such products are a little complicated. We need to empower such customers and to do this we need distributors. This type of investor needs basic information and the assurance that he is investing in a safe avenue. Also, we need simpler products. When was the last time that you saw product innovation? Over the past five years, there has hardly been any innovation.

Q How discerning are the investors? Is their investment decision influenced by the charges and costs incurred by them?

JHAVERI: Everyone is willing to pay for good recommendations. Customers approach us when they want advice and are willing to pay for it. The question is how much they are willing to pay and whether the payment model fits in with their expectations.

In a mass market, with a medium ticket size, distributors and advisers cannot charge more than the transaction cost. Whether it is a big customer, a high net worth individual or one who is investing only Rs 1,000 a month, everyone wants to know whether he is getting his money's worth while making the transaction. This is why an adviser has to take him beyond the plain vanilla suggestions and open a different world of services. For instance, if the client wants to buy a car, the adviser should not only explain how to take a loan but also its impact on his insurance expenses.

Q How can an investor ensure that he is getting the right advice and, more importantly, that it is impartial?

VIKRAMAADITYA: There are two fac-



The no-entry-load policy has necessitated a mindset change. It's here to stay and will promote transparency in the long run.



Vikramaaditya, Director and CEO,
HSBC Asset Management (India)

tors that can ensure the advice being given is impartial. One is transparency and the second is alignment of interest. If the goals of the investor and adviser are aligned, then the advice will be in the former's best interest. The challenge comes when the adviser's goals are at variance with those of the investor. One way to ensure greater alignment is to promote higher transparency. When an investor is aware that the adviser is not trying to earn a huge commission by pushing unsuitable products, it becomes a win-win situation.

SUBRAMANIAM: There will always be periods when you don't receive the best advice, but you have to allow the market to evolve. If you realise that the

Q Consumers are confused by the large number of insurance plans that look similar but are being marketed differently. Do we need product innovation or standardisation?

SRIVASTAVA: Standardisation sounds the death knell for any business and this includes insurance. If you are talking about the charges associated with insurance products, why should two absolutely similar plans have allocation charges ranging from 10% to 85%? This does not make any sense and because the customer does not know the difference between the two policies, he starts getting shafted. Also, the charge structure could be ridiculously different



advice you have received has been sound over the years, you will be ready to go back to the adviser and pay him for his services.

JHAVERI: Just as investors shop around before buying a car, they need to meet various advisers and know more about their work. For instance, an adviser's first step should be to determine the investor's goals and then identify the financial products that can help him achieve these. For some goals, the investor might need to be extremely aggressive, for others, he may want to be ultra-conservative. If the adviser starts a product demonstration within the first three to five minutes of a conversation, the investor should press the exit button.

SUBRAMANIAM: A customer needs to ask the adviser about the processes he follows, the basis for selecting a product, the experience he has, the number of years he has been in the market and, therefore, his long-term vision.

because it is being sold through a channel that might be milking a commission beyond any rational expectation.

SUBRAMANIAM: I don't believe you need a lot of innovations in financial products. Finance is fairly simple in terms of what you save and what you invest. Every time you launch an innovative product, there are complications in communicating it and consumers fail to understand the proposition clearly. Take derivative insurance, which was recently launched in the West. On the one hand, you could call mitigating risk a financial innovation. But if it is not managed properly, it can blow up. So, the products should be simple but the services should be innovative.

SACHDEVA: First we need to understand what is product innovation. In 2006-7, a lot of diversified equity funds were launched under various names. This was simply presenting old wine in a new bottle. However, there have been some real innovations involving

schemes and categories, such as dividend yield funds, liquid funds, income funds, etc. In 2008, we launched a daily systematic investment plan (SIP). This wasn't pitched against the monthly SIP. Instead, we tried to focus on expenses and savings. We told the customers that instead of spending Rs 300, they should invest it and it would reward them in the long run.

VIKRAMAADITYA: I think innovation must lead to simplicity rather than complication. If it's complicated, you are probably trying to disguise it. If we want to increase the penetration of financial products in India, we need to have simple products.

Q How critical are intermediaries when it comes to mutual funds? How can we incentivise a customer to come directly to a company?

SACHDEVA: A person does not invest because he is

weeded out. From the perspective of the asset management companies, it is not just the consumer they need to focus on, but also the distributor. They need to convince them that this is a viable, long-term proposition. They should also get new and fresh intermediaries and train them.

KRISHNAMOORTHY: The manufacturers' job is to provide products to customers. The distributors' job is to figure out the products that suit the investors' financial framework. So, everybody has a role. But when the manufacturer cannot pay anything to the intermediary, it creates differentiation in the market. This is because if they cannot influence the intermediary with commissions, they can hold their ground only on the merit of the product.

SRIVASTAVA: In a way, distributors are also promoting financial literacy. When you interact with a distributor, you learn something.



convinced about the product, but because he is comfortable, and a distributor can help him feel this way. Also, we need to understand that the investor has a very fickle memory. He is being bombarded with information from various sources. For instance, an investor sees an ad proclaiming a return of 120% in a year. He goes to his financial adviser and asks why he cannot buy the product. Even if the planner tells him it isn't the right product for him considering his goals and asset allocation, temptation may get the better of the investor. So, he puts in his money, does not get the promised returns and, after some time, comes back to the adviser for counselling. This ratifies the perception that advisers are required. However, you cannot judge his performance over six months or a year. It will probably take 3-5 years before you get good results.

Another point to consider is the rate at which the people who are not serious about business are

SUBRAMANIAM: There is a big role that the distributors can play in reaching out to consumers. However, there are some questions that need to be answered: What should be the incentive structure for the middle man? Who should pay? How can you avoid its misuse? Currently, we are used to an opaque system of commissions, where the consumer does not realise what he is paying for.

There have been instances where distributors have approached us even though we have refused to pay commissions. They are convinced that if they sell a suitable product that profits the consumer, he will be willing to pay a fee for their services.

Q In the past year, there have been interventions by financial sector regulators. Will their role diminish as the market matures?

VIKRAMAADITYA: There is always a role for a regulator.

However, the way it carries out this role depends on the level of maturity that the industry has achieved. He will talk about either principle-based or rule-based regulation. Maybe more rules are needed at a certain point of time in the mutual fund industry, which is relatively young. If we don't take into account the UTI period, it's about 15 years old. As the players in the market—manufacturers, advisers and consumers—mature, one can move to a more principle-based regulation and allow the industry a certain level of freedom.

SRIVASTAVA: Yes, the industry needs regulation because this is a business where you are making money with other people's money. The regulators are also trying to bring in more transparency. They have begun to take various measures, such as the capping of charges on unit-linked products and disclosure of commissions. But regulation cannot be one-sided. You also need to have a dialogue. So a regulator should also be a quasi-industrial body.

Q Consumers have been confused by the tug of war between regulators, such as the one between Sebi and Irda regarding Ulips. Do we need a super regulator?

SRIVASTAVA: For a fair outcome, one definitely needs an overarching body for multiple financial products. Even the finance minister has mentioned that there is a need to set up the Financial Stability Development Council to have better inter-regulatory coordination in India. It does not mean that the existing regulators lose their control over the specific products they regulate.

Presently, consumers have a redressal mechanism for certain financial products. They can approach a banking ombudsman, go to a consumer court or file a complaint with Sebi. But what do they do when they have a problem with an intermediary? We do not have a regulation yet, though it is necessary.

Q Do you think the industry needs to do more in terms of handling consumer grievances? What are the most common complaints?

The industry needs regulation because this is a business where you are making money with other people's money.



Yateesh Srivastava, CEO,
Aegon Religare Life Insurance

SACHDEVA: There are regulatory mechanisms that address customer complaints on, say, transactions. But there is no forum to address advisory complaints perhaps because it is new and subjective.

JHAVERI: There are three areas—banking, investment and insurance. On the investment front, there aren't many problems, only minor transaction-related issues. In banking, there are many hassles. This is because firstly, there are a large number of products, such as credit cards, accounts, loans, etc. Secondly, if a consumer has a problem, he interacts with the call centre executive, who is not empowered to take any decision.

However, insurance generates the maximum number of consumer complaints. This is primarily related to advice and there is no way to regulate advice. A few years ago, when

Ulips were launched, it was considered an interesting concept. But now a lot of things have gone wrong. We have approached Irda regarding mis-selling, but nothing has happened. The redressal mechanism in banking is far more effective than in insurance.

SACHDEVA: Unchecked malpractice will eventually put you out of business. You only have to consider the lapse rate in the insurance sector to give credence to this statement. Anybody who has been in the industry long enough realises this. Currently, the penetration is only about 20%, so the room for growth is large. Insurers feel they can keep acquiring new customers year-on-year and forget about the past ones. At some point in time the market dynamics will create a balance.

Q What can the mutual fund industry do to get more people to invest in funds, instead of being goaded by regulators?

VIKRAMAADITYA: One option is to increase awareness about mutual funds and, more importantly, translate it into purchase by addressing the needs and goals of consumers. We will need about Rs 200-300 crore for a strong awareness campaign. To raise this sort of money, all the players will have to come together. Amfi and Sebi are taking concrete steps to enhance investor education. So, in the future, we should see more investors coming in.