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TAKING CARE OF EXPENDITURE

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Capital Market & SEBI

What is expense ratio?

Expense ratio, as the name suggests, is that part of a mutual fund scheme that takes care of expenses related to managing the fund. It is used to meet the administrative, management and other operating expenses of the scheme. Fund houses have to pay salaries to fund managers, commissions to distributors and other marketing costs. As per Securities and Exchange Board of India (SEBI) regulations, all the expenses incurred while managing a particular scheme have to be borne out of the scheme only.

How much is the expense ratio?

As part of its measures to ensure that fund houses do not charge exorbitant amount or percentage as expense ratio, the capital markets regulator has capped expense ratio limit.

Last year, the board of the regulator capped the maximum total expense ratio or TER at 2.25% for open-ended equity schemes, some of which were earlier charging 2.75%.

Though the cut looked marginal in terms of overall cap, the benefits are believed to be significant as the regulator has also laid down various slabs based on the assets of the scheme with the TER going down as the assets rise.

For instance, if the assets under management (AUM) of a particular scheme is in excess of Rs. 50,000 crore then the TER has been capped at 1.05%. Earlier, any scheme with an AUM of more than Rs. 300 crore could charge 1.75%. So, for large schemes, the expense ratio was brought down by almost 70 basis points.

According to SEBI's own estimates, the reduction in TER would lead to investors saving around Rs. 1,300-1,500 crore in commissions.

Is the expense ratio standardised?

No. As a fund house has to put in more efforts and money to increase the overall penetration level of mutual funds to the far corners of the country, the regulator has allowed a higher TER for garnering flows from beyond the top cities of the country.

While lowering the cap for maximum TER, the SEBI allowed for an extra 30 basis points for retail flows from beyond the top 30 cities.

More importantly, it has been mandated that the additional expense will not be allowed for flows from corporates and institutions and will be limited only to retail flows.

Incidentally, all mutual fund houses, industry body Association of Mutual Funds in India (AMFI), along with SEBI have been putting in a lot of effort to channelise more household savings from far-flung towns into the stock markets through the mutual funds’ route.

For a scheme whose total assets exceed Rs. 50,000 crore, the total expense ratio is capped at 1.05%

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