Chapter 3

Literature Review

The objective of this literature review is to examine the business practices of mutual fund intermediaries and investors. To meet this objective academic literature in business was reviewed with focus on financial advisors, investors and regulation. Since this is an inter-disciplinary study relevant law journals and articles specifically related to investor law and government regulatory websites were also reviewed. This included trade journals, financial media including international and national news media.

As the practices in the financial sector are changing rapidly the focus was on the studies in the last ten years. Earlier studies are referenced in brief when relevant.

The aim of the Literature review was to identify the secondary research to address the research questions:

What is the best way ahead for financial advisor regulation in India?

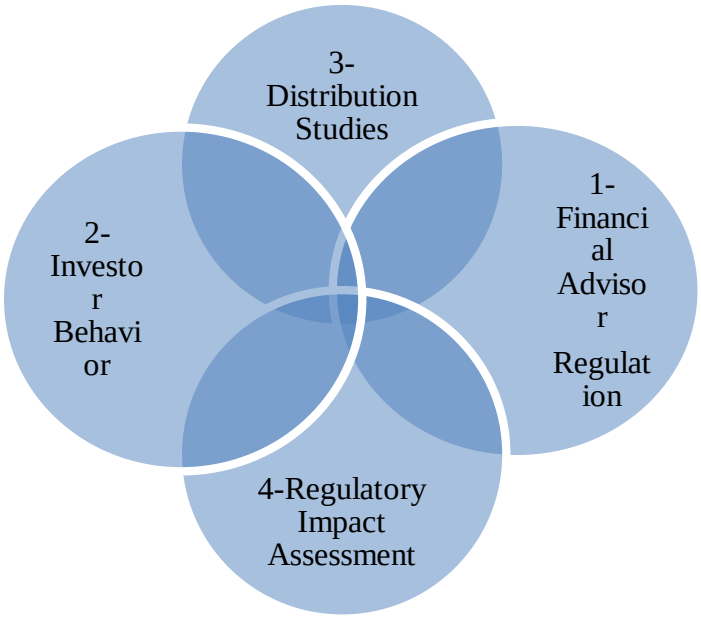
What is the impact of the ELR on the mutual investor?

What is the business model that has evolved in the distribution of mutual funds specifically amongst IFAs and Banks after the introduction of the ELR regulation?

The academic literature is strong in some areas and weak in other areas. A key relevant work on Financial Advisor regulation and distribution in India (Sahoo & Sane, 2011) constitutes a critical commentary, analysis and also proposes a regulatory model. This paper does not take into consideration trade body and business practitioner's view, which this research study attempts to capture. The literature review also reveals a large body of academic work on Financial Advisor regulation and related studies on UK, US and also European regulation.

3.1 Flow of Literature review: This literature review consists of 4 sections. First Section is related to Financial Advisor Regulation. Section two is related to Investor Behavioral studies, section three includes Distribution study, fourth Regulatory Impact Assessment studies.

Figure 1: Studies involved in this thesis



3.2 Financial Advisor Regulation

Introduction: This section will discuss key definitions, different types of regulations, what are the key theories of regulation imply and reasons for regulating Financial Services.

3.2.1 Definition of Regulation:

Regulation is a sustained and focused control exercised by a public agency over activities that are valuable to the community (Selznick, 1985). It is further described as a specific set of commands applied by a body established for that purpose, deliberate state influence designed to influence industrial or social behavior and also as all forms of social control or influence whereby all mechanisms affecting behavior are considered regulatory (Baldwin & Cave, 1999). Regulation is also defined as the assignment to a government agency of the responsibility of writing rules constraining certain kinds of economic decisions using a quasi-judicial administrative process to develop these rules (Noll, 1985). The green light theory of regulation, views regulation as having an enabling influence for outcomes that are desirable as against the red light theory which views it as having a restrictive influence on undesirable activities. (Harlow & Rawlings, 1997)

3.2.2 Definition of De-Regulation: This refers to the removal or reduction of regulation. The rationale behind it being that regulation is inhibitive and expensive. Deregulation has on occasions been introduced in order to address failures of regulation or to liberalise a sector or industry. India's mutual fund industry is an example of this.

3.2.2.1 Deregulation Movement – Theoretical Foundation: The University of Chicago is considered by many as the intellectual home of the Deregulation Movement. This Chicago School is founded on the belief in efficacy of free markets as a means for organizing or allocating resources (Friedman, 1974). Chicago school calls for less government intervention and fewer wealth distribution policies, along with promotion of more private enterprise so as to facilitate an efficient allocation of resources. This further led to the evolution of Rational Choice Theory, (Jacoby, 2000) which states that human beings are maximisers' of their satisfaction and will always pick options that maximize their satisfaction. Arguing against the Rational Choice Theory (Jolls, Sunstein, & Thaler, 1998) stated that individuals can and do make inferior decisions with regard to their welfare, decisions they *would not have* made if they had complete information, unlimited cognitive abilities and unlimited self-control.

Akinbami(2009) concludes that regulation will serve the interest of one party either the Consumers or Public in general or the other party i.e. Supplier/ manufacturer or a particular market or industry being regulated, and the government or regulator would face competing pressures from either side. The regulator will need to consciously or subconsciously take a call on whose side he wants to be or whom he wants the regulation to favor. The next section discusses reasons for financial regulation and is followed by Regulation studies in select geographies.

3.2.3 Reasons for Regulating the Financial Markets: The three most important reasons for regulating the financial markets (IOSCO, 2008) are:

- Consumer Protection,
- System Stability
- Maintenance of integrity of the Financial Markets.

3.2.4 Financial Regulation Studies:

Mayer (2001) says that most often consumer protection is the primary reason for regulating financial services and protecting investors (consumers) is viewed by many as the most important objective of regulation in Financial Services. The reason why these consumers need greater protection than other consumers is because of the amount of money that is at risk, and the high possibility of the principal – agent conflict of interest (Goodhart, 1998). The purpose of regulation is not to displace competitive pressures or market mechanisms, but to correct *market imperfection* and failures which produce suboptimum outcomes and distort consumer choices (Llewellyn, 1995). In this report, studies related specifically to mutual funds as financial product are further researched.

One of the *foremost reforms* initiated worldwide to address the concept of mis-selling of mutual funds was the Financial Services Act (FSA) of UK 1986. The Gower Review 1982 (Gower, 1982) had expressed concern about the then existing methods of regulation and in particular the lack of protection for the consumer against unfair selling practices and / or recommendation of inappropriate products. The FSA introduced the concept of polarization wherein any organization involved in the retailing of savings and investment products was required to adopt either tied or independent status. A tied agency would work as an agent of the provider of the product / single manufacturer and an independent intermediary was seen as an agent of the consumer with a duty to recommend to that customer the product which best meets their needs from the complete wide range of products available in the market. Here as per Sheldon (1990b) for a large number of organizations the cost of providing best advice was very high and for others like Banks who had their own associate companies as mutual fund and life insurance manufacturers to follow the principal best advice, meant products of these organizations had to be best in the markets. Hence excluding one bank, all others opted for a tied model. In 1988, the maximum, commission agreement was abolished and the tied agreement became extremely lucrative. Sheldon (1992) concluded that in 1992 itself the number of brokers offering independent financial advice (IFA) had fallen from 7300 in 1989 to around 6500. Limited strategic advantage was perceived by consumers in the independent advisor model, a fact that was corroborated by the National Mutual Life / MORI 1988 Study. Study by Sheldon (1990a) noted that public was not concerned about the tied or independent status of financial retailers provided that they were perceived as reputable organizations. In-depth interviews were conducted by Ennew (1992) with a representative sample, to examine consumer views of Independent financial advice (IFA). Her analysis suggested that to some extent the confusion

over the concept of IFA had been reduced. It also supported the Hypotheses that the status of the adviser was less important than his image and reputation and also that consumers perceived few benefits from IFA.

The market opportunities and competitive pressure resulting from deregulation of financial services has been studied extensively by academicians and professional commentators in developed economies namely UK, US (Ennew & Devlin, 1993). In UK this has led to breakdown in traditional institutional division and expansion into new markets and products (Edgett & Thwaites, 1990). A natural corollary of the pattern of expansion has been a significant increase in the level of competition in financial market place (Ennew, Wright, & Watkins, 1990).

Inderst and Ottaviani (2012b) constructed a model that analyzed different consumers, and suggested that the role of consumer protection policy emerges when consumers are credulous or take the advice as unbiased and at face value.

Campbell, Howell, and Brigette (2011) discussed in their paper the active policy debate on the optimal way ahead to pursue consumer financial protection due to the 2008 financial crisis. Post this crisis, amongst the numerous policy options that emerged with regard to consumer credit as researched by Ko and Lee (2011) were Consumer *Empowerment through* financial literacy and disclosure regulation, the other is Direct *Intervention* into how financial products are sold and an *innovative approach* termed as *Delegation* proposed by them, under which credit management was delegated to third parties with aligned incentives. Relevant literature regarding consumer empowerment and direct intervention are discussed in the next sections.

3.2.4.1 Literature on Consumer Empowerment through financial literacy: There is a growing literature which evaluates financial literacy training programs with mixed results. Hastings, Brigitte, and Will (2012) conducted a detailed literature review across countries on financial literacy, financial education and economic outcomes. Their research results yielded that a well-designed well executed program is expected to yield a positive result. However what constitutes a well-designed financial education program remains unanswered and the researcher explicitly states a need for deeper study on the same. Drexler, Fischer, and Schoar (2011) examined the importance of financial education through two different programs. Their result suggested that how the financial education is structured would matter in whether it has a meaningful impact or not. Other researchers Cole and Shastry (2010) and Hastings and

Mitchell (2011) have presented an evaluation of financial literacy programs in a variety of contexts with mixed results. Though the impact of financial education program is not negative, its exact impact can be a subject of deeper research as per the review (Hastings, Brigitte, & Will, 2012). The next section discusses the direct intervention approach.

3.2.4.2Direct Intervention Approach*:* Under direct intervention approach is the banning of commissions being paid to financial product intermediaries and this has seen a significant number of reforms in UK, Singapore, Australia and India. In the US, the issue of banning commission is still being deliberated.

Literature regarding this ban specifically related to UK, Singapore and Australia and US are discussed below.

From 1st January 2013, the UK Financial Services Authority proposed to implement a ban on commission paid to independent financial advisors by financial product providers and this signals the death of the salesman who benefitted from trail commissions (Collinson, 2012). Australia has implemented a similar ban in July 2013 (Autralian Government, 2013). In Singapore, after prolonged deliberations on whether to ban commissions to advisors, adopted that they would continue with the commission structure but with enhanced disclosure of distribution costs for specific products (Monetary Authority of Singapore, 2013).

There has been a long standing debate in the United States on whether mutual funds should be allowed to charge a separate class of operating expenses, known as 12b-1 fees, specifically for the purpose of paying distribution expenses such as broker commissions. A pioneering study was undertaken in US on how expense ratios differed in a cross-sectional sample of mutual funds (Ferris & Chance, 1987). They found that large funds charged lower expenses suggesting that there were substantial economies of scale. Furthermore, their findings demonstrated the existence of *a 12b-1 plan* increased expenses indicating that the plan was a dead-weight cost to investors. The primary beneficiary of the 12b-1 fees is the fund advisor (Walsh, 2005).

On the subject of ELR, Indian academic studies are limited (Anagol, Marisetty, Sane, & Venugopal, 2013;Venkatesh Kumar & Ashwini Kumar, 2011).

Anagol *et al.*(2013) analyzed the mutual fund data for 2 variables namely Assets under Management (AUM) and Net Fund Flows for the period April 2006 – June 2012 using the ACE MF database. They identified the impact of the ELR policy change by comparing funds

charging high distribution fees prior to the ELR reform to those charging low distribution fees. Their analysis showed that trends in asset growth – AUM across these groups prior to the reform were similar, and they argue that a comparison of their asset growth after the reform is indicative of the policy impact. Contrary to industry claims that banning distribution fees would dramatically reduce investment in mutual funds, they found no *evidence* that the post-reform asset growth was lower for funds charging higher distribution fees prior to the reform. They primarily found that asset growth in funds with previously high distribution fees was higher after the policy change. Their results suggested that Indian mutual fund growth in the post-policy period *was lower for reasons independent* of this policy change, such as a general move away from mutual funds towards real assets such as gold and real estate following the 2008 financial crisis.

Statistical analysis of mutual fund schemes for the period December 2007 and March 2011 based on AMFI data, showed that ELR did not influence the Net New Money and other variables such as exit load, performance of the fund, prevailing interest rate, inflation rate, economic growth level, and demand-supply equations of securities traded in the capital market may be the factors that could influence the Net New Money (Venkatesh Kumar & Ashwini Kumar, 2011).

Other ELR related academic studies (Yadav, 2009; Saini, Anjum, & Saini, 2011) are restricted to basic awareness of the ELR. A large number of trade reports have analyzed the ELR regulation and estimated economic implications and Shah *et al.*(2010) is one most comprehensive and detailed report. Financial print media has also covered it extensively and the regulation received mixed coverage based on interpretation at the time of launch. It was largely considered in a positive light (ET Bureau, 2009; Saikat Das 2012). Amfi along with other independent trade bodies was against this regulation.

The ELR regulation was aimed at doing away with commission based selling by intermediaries and by making customers pay for advice bringing in transparency. A counter argument by broker bodies, financial product companies and analysts is that this ban reduces the incentive to sell mutual funds and a case to showcase is the exit of Fidelity AMC from India. Fidelity, one of US marquee AMC exit its India operations through a business sale to L&T AMC. Amongst the reasons cited was the plunging bottom-line in the two previous years (with the implementation of the ELR) along with its inability to garner the critical mass of Rs 10,000

Crore a breakeven point for an AMC (Basu & Govindraj, 2012). A directional guidance suggested, instead of banning commissions, is investor education and thrust on reaching out to the cities outside the top 5, where there is limited awareness of the mutual fund asset class (Sriram, 2012). The Top5 cities contribute to over 65% of the AUM as per AMFI, showing very low presence of Tier 2 and 3 cities.

Other three significant investment advisor regulations in India in recent times, besides ELR and introduction of advisor guidelines have been the *flexibility in usage of Total Expense Ratio (TER),* mandatory *2 basis points (bps) of* AUM allocation *to investor education* and the *color coding disclosure scheme* to be compulsorily part of all mutual fund investor document and communication. In the section below these regulations are briefly discussed.

Flexibility in usage of Total Expense Ratio: At present, equity mutual funds can charge a maximum up to 2.5 per cent as expense ratio (expense ratio refers to a measure of costs debited by the asset management companies (AMCs) for operating a scheme). Mutual funds had to allocate a maximum of 1.25 per cent as fund management fee/charge, and 1.25 per cent as other expenses incurred by the AMC for marketing, distribution, operations and so on. Any expenses above 2.5 per cent are to be borne by the AMC. SEBI has now proposed *to remove the sub-limits on expenses*, giving AMCs the freedom to allocate the 2.5 per cent expense ratio the way they want to. *This fungibility will give fund houses full flexibility to use Total Expense Ratio (TER) the way they want.* But this may lead to a compromise on transparency and disclosures since detailed disclosures of costs incurred, other than management fee will not be given. According to the new proposal, AMCs are further allowed to charge additional TER up to 30 basis points, if 30 per cent of their net sales take place beyond the top 15* cities depending upon the extent of new inflows from locations beyond top 15 cities (claw back of additional TER if the investments are redeemed within a period of one year). This means that the total expense ratios for any money coming from other than the top 15 cities can be hiked to 2.8 per cent instead of 2.5 per cent for equity schemes, which will thus reduce investor's capital returns (Business Line, 2012).

Investor education: The key challenges identified at a national conference on investor education (IFIE, 2012) were 1) Achieving the behavioral change 2) Distinguishing between promotion and financial education 3) Leverage technology 4) Measure effectiveness.

A chronology of the *investor education* initiative in India is as follows:

2007: Sebi (Investor Protection and Education Fund) Regulation: Sebi Act 1992 mandated Sebi to take measures as maybe required to protect the investor interest. This fund - Investor Protection and Education Fund (IPEF) was created vide Sebi Order dated June 23, 2007.

2011: Appointment of a Committee to recommend best ways and means of utilizing the Investor Protection and Education Fund.

2012: Sebi circular on setting aside allocation for investor education and awareness initiative. A proposal for amendment of regulatory framework of Sebi tabled in 2012 mentioned that a certain amount of AMC fees should be set aside for investor education and subsequently vide circular no CIR/IMD/DF/21/20 dated 13th September, 2012, 2 basis points of AUM was the mandated amount. This circular stated that mutual funds shall annually set apart at least 2 bps on daily net assets within maximum limit of TER for investor education / awareness initiatives. This has received overall a positive feedback but strong counter feedback also from some analysts. Halan (2013) argued that instead of making sellers and manufacturers responsible, the regulator is making the consumer responsible through this regulation.

2013: Sebi Circular on Color Coding Scheme: A stringent disclosure practice was mandated in Mar 2013 with the requirement of labeling of mutual funds on the basis of parameters (Sebi, 2013). The details are encapsulated hereunder:

a. Nature of scheme such as to create wealth or provide regular income in an indicative time horizon (short/ medium/ long term).

b. A brief about the investment objective (in a single line sentence) followed by kind of product in which investor is investing (Equity/Debt).

c. Level of risk, depicted by color code boxes as under:

Blue – principal at low risk. (Debt)

Yellow – principal at medium risk. (Balance)

Brown – principal at high risk. (Equity)

The color codes shall also be described in text beside the color code box.

d. A disclaimer that investors should consult their financial advisers if they are not clear about the suitability of the product.

As per experts, though this labeling was considered a welcome move, they suggested a grade wise 10 point scheme as mutual fund schemes usually have a blend of equity and debt which needs to be a variation in risk and therefore returns. For example, a debt hybrid may have a higher risk then a regular debt product and should not be either blue or yellow (First Post, 2013). This labeling practice was also criticized when the Indian debt market gave negative returns in July'13. Debt funds had been color coded blue, stating principal at low risk and their negative return was a huge anomaly (Healthofmywealth, 2013). A detailed study of this can be undertaken as a separate research.

This section dealt with the investor education initiatives right beginning with setting up of a protection fund to the recently introduced color coding. The next section discusses the investor behavior.

3.3 Investor behavior studies:

3.3.1 Background: In the world of investments, the two main players are investors and the instruments that they invest in. Investor Behavior study attempted to study and understand the rationality of individual choices and then classify it according to various behaviors which are most exhibited and thereby guard us against making wrong choices based on our understanding of this irrational behavior.

The behavioral theory is drawn largely from the works of Kahneman and Tversky (1979) who worked on this research extensively. Their study showed that *the use of judgment heuristics (Rule of thumb),* resulted in *cognitive biases or weaknesses* (which were identified as 12) in individual decision making leading them to errors in decision making.

The study further classified heuristics as "availability heuristics", "adjustment heuristics" and "representative heuristic". "Availability heuristics" is the tendency of the people to judge different risk or an event based on their *past recollection* of previous examples of risks or events. "Adjustment heuristic / Anchoring" refers to the tendency of people to make a decision based on a given or assumed reference point. "Representative heuristics" refers to decision making based *not* on probability but on the *Likeness* to a previous outcome. Example is

"Gambler's Fallacy", where the player continues to push stake thinking that the next coin toss will come up the reverse way.

Cognitive biases simply stated is imperfection in the perception of reality. Three biases are explained in brief hereunder and these biases are **overconfidence**, **loss aversion** or status quo bias (Kahneman & Tversky, 1979) and mental **accounting**.

Overconfidence: Studies show that individuals tend to be overconfident in their predictions of their future or their personal ability (Weinstein, 1980; Taylor & Brown, 1988). Taylor and Brown (1988) further proposed, that a mentally healthy person is characterized *neither* by an accurate assessments of his or her personal qualities, nor realistic estimates of personal control, or a realistic outlook on the future *but by positive illusions*.

Loss Aversion: This refers to the reluctance to the individual's inability to realize losses. Investors tended to have a problem admitting to themselves that they had made a mistake and *avoided selling securities at a loss*, even though such sale had incentives. The theory was introduced by Kahneman and Tversky (1979) under the assumption that losses had a larger impact on preferences than that of the advantages of gains.

Mental accounting: The term *mental accounting* (Thales, 1985) describes a psychological phenomenon, the division of payoffs into separate accounts that are treated differently in spite of the fungibility of money.

The next section covers selective existing studies and surveys which cover investor studies in behavioral finance with reference to stocks and mutual funds.

3.3.2: International studies in Heuristics and Biases:

Benartzi and Thaler (2001) conducted a detailed study across employees of American University, on whether choice of investments into various options (Stocks / Bonds / others) in the US Retirement Saving Plan 401(K) was optimally done and good for the investors. They found that *investors mechanically* spread their money equally across funds (1/n rule) which is called as 1/*n heuristic*. Individual investors following the 1/n rule would divide their saving corpus equally across the options. This was naïve diversification and did not yield best results.

The mutual fund literature has documented two specific behavioral anomalies (Bailey, Kumar, & Ng, 2010). Firstly, individual investors bought funds with high fees. Gruber (1996) and

Barber, Odean, and Zheng (2005) documented that many individual investors held significant positions in high expense mutual funds. The finding of Elton, Gruber and Busse (2004) were again puzzling. They identified that substantial amounts had gone into index funds which charged high fees (over 2% per year) for passive holdings of broad indexes like the S&P500.

Second, individual investors chased returns. Studies by Sirri and Tufano (1998) and Sapp and Tiwari (2004) found that the fund flows tended to chase funds with high past returns. This in turn, may have been fostered by Morningstar's practice of rating funds based on past returns (Del Guercio & Tkac (2008)).

Numerous explanations had been offered for these two anomalies. Carlin (2009) explained that participation in high fee index funds using a model with search costs. Choi, Lisbon and Madrian (2009) interpreted their experiments on Wharton MBA students and participation in high fee funds as consistent with behavioral biases. Return-chasing has been ascribed to an agency problem that induces fund managers to alter the riskiness of the fund to maximize investment flows instead of risk-adjusted expected returns (Chevalier & Ellison, 1997). It may also reflect inferring managerial skill from past returns (Sirri & Tufano, 1998, Gruber 1996, Berk & Green 2004). However, with the exception of the experimental data used by Choi *et al*. (2009), these authors study aggregate fund flows rather than individual investor behavior.

Bailey *et al. (*2010) analysed over thousands of US investor records to study behavioral biases. They found that "sophisticated" investors (better informed, higher income, older, and more experienced) investors made good use of mutual funds, holding a high proportion of fund for long periods, avoiding high expense funds, and experiencing relatively good performance. On the other hand, investors with strong behavioral biases or lack of attention to firm-specific or macro-economic news were less likely to hold mutual funds, or select mutual funds for the wrong reasons. When they did buy mutual funds, they traded them frequently, or tended to time their buys and sells badly, and preferred high expense funds and active funds rather than index funds. Bailey *et al.* (2010) also found that biased investors were more likely to chase fund performance, casting doubt on the idea that trend-chasing reflects rational fund selection decisions.

Barber and Odean (2013) using the same data as Bailey *et al.* (2010) traced the research on stock trading behavior of individual investors. Their research findings collaborated those of Bailey *et al*. (2008). They documented that individual investors (1) underperformed standard

benchmarks example low cost index fund, (2) sold winning investments while holding losing investments (the "disposition effect"), (3) were heavily influenced by limited attention and past return performance in their purchase decisions, (4) engaged in naïve reinforcement learning by repeating past behaviors that coincided with pleasure while avoiding past behaviors that generated pain, and (5) tended to hold undiversified stock portfolios. These behaviors they conclude deleteriously affect the financial wellbeing of individual investors.

Additionally, past decade of research in this field has produced a large body of evidence *suggesting that households may be bad at choosing portfolios on their own*. However, households did not make decisions in isolation. A large variety of influencing forces *namely* social interactions with friends and family, advertising and media, often influenced their choice. One particularly important source of inputs is the Financial Advisers.

Securities Exchange Commission (Sec), the US regulator, commissioned a survey with Rand Corporation to access Industry and Investor perspective on Investment Advisors and Broker Dealers. This report by Hung *et al.* (2008) covered retail households in US. They found that 73% of all individuals surveyed consulted a financial adviser before purchasing shares or mutual funds. Given this central role of advisers in the overall investment process Mullainathan et. al, (2012)had asked whether or not the market for financial advice serves to *de-bias* individual investors and thus correct potential mistakes they might make without these inputs.

In the section ahead, are included studies related to investor behavior specifically:

- Consumer awareness
- Selection of financial intermediary / Financial Service buying behavior

3.3.3. Consumer awareness studies: Investor naiveté or awareness has been covered by numerous researchers and enclosed are related studies.

Malmendier and Shantikumar (2007) empirically documented the form of consumer naiveté about incentives that the intermediary receives for facilitating the sale. Experiments with games of trust and cheap talk also suggested that many consumers are willing to heed advice more than they should, even when the payoffs and incentives are revealed to them (Cain, Loewenstein, & Moore, 2003). A survey results of over 6000 purchases of consumer finance in Europe by Chater et. al, (2010) showed that over fifty percent respondents thought that staff or financial advisors gave completely independent advice or information. A *limited number* of

investors were aware that the intermediary received a commission or a bonus fee for selling the investment. Of the respondents who purchased from a financial advisor or broker, only 5% confirmed paying an advisory fee.

A different type of customer naiveté was considered by other researchers (Gabaix & Laibson, 2006). Their study revealed that naïve myopic customer neglected the existence of high purchase add-ons and purchased low price basic product and engaged in substitution early. A suggestion given is that of more investigation into the perceptions of consumers, required to provide a more detailed insight into how consumers approach the complexity of financial services (Devlin, 2001).

Two countries that have an extremely strong Financial System namely UK and US are researched here to understand how these economies gauge investor perception primarily for the regulator. This is followed by India commissioned studies.

In the **United Kingdom (UK),** there have been press and commissioned studies by the regulator. Till 2012, Financial Services Authority (FSA) was the regulator and thereafter the regulation of the financial markets is with the Financial Conduct Authority (FCA).

Since **1999** the FSA and the Financial Services Consumer Panel had carried out various studies looking at unprompted recognition levels of the FSA as the financial regulator. These assessment surveys were administered through educational bodies or independent research agencies (Financial Services Authority, 2013). These survey questionnaire covered the following key aspects:

- Overall awareness of regulation by FSA
- Knowledge of Type of Financial Regulation
- Demographic Profile and its linking to awareness
- Awareness of Financial Products and Risk
- Aspects of Financial Regulation
- Confidence in regulation
- Awareness of Bankruptcy and Frauds
- Investor risk profile.

Other Disclosure / Studies: Every investment instrument, since 2001 in UK, had to include the term "*Regulated by FSA".* Firms were obliged to use this in a number of settings and these included financial promotions, regulatory material associated with the sale of investment

products and on financial advisers' business cards. By promoting this message FSA, was letting consumers know that they were given some regulatory protection.

As part of their review of **investment product disclosure** at the point of sale, the FSA considered making a number of significant changes to their current disclosure regime. In March 2005, they asked an independent market research agency to examine *the effect of these proposed disclosure changes on consumers' knowledge and behavior*. In particular, they tested proposed new disclosure documents.

In the **United States (US),** there too have been press studies and also commissioned studies by Securities Exchange Corporation (Sec) the financial market regulator, for understanding the investor's understanding of the differences among types of financial service providers and particularly between investment advisors and broker dealers and update of regulation. A select set of US centric studies are covered hereunder.
A survey of 1044 investors by *Opinion Research Group* in 2004, revealed low awareness about the differential in investor protection from services of a broker and advisor.

The 2005 Sec commissioned investor focus group study revealed that investors did not know the difference between various financial service providers like broker, financial advisor, financial consultant and planner (Siegal & Gale, LLC, 2005).

A 2006 survey of 1000 investors by *TD Ameritrade* found that even with the new disclosure rules from the 2005 rules, investors were generally unclear about the distinction between a broker and an investment advisor. There was a regulatory failure to clarify clearly to the investor the legal issues concerning financial advisors and brokers since the passage of the Investment Advisors Act and help the investor clearly distinguish between the two (Haslem J. , 2010)

Another detailed study sponsored by US-Sec, executed by RAND (Hung *et al.*,2008) across 654 investors and 4 focus groups in US revealed that investors were unaware about the Sec definition of Advisors and brokers and the basic difference between advisors and brokers or the difference in product / service provided by each of them. Investors however conveyed satisfaction over the management of their account by the respective financial intermediary.

In India, NCAER report constitutes the only extensive study commissioned by regulator Sebi. Presently, the 3rd NCAER report (2011) on Household Income and Savings has been tabled.

This study comprises of a detailed analysis of investment and saving habits, data on investor awareness levels about Sebi as a financial regulator and its role and risk attitude of over 38,000 Indian households. The investment and saving habits are cross mapped with demographic characteristics which include income to obtain the Indian investor profile.

While the NCAER survey covers basic awareness about financial regulator and role, there is a need for a contemporary and detailed study to understand investor understanding about Sebi's regulations. As seen from US and UK regulator commissioned annual studies, investor's awareness about regulation assists the regulator in gauging investors understanding of the regulation, and the impact and helps chart a future course of action. Entry Load Removal (ELR) Regulation implemented on 1st August 2009, is by far the most critical of all Sebi's regulations in the mutual fund regulation. A comprehensive empirical study of the ELR regulation is herewith undertaken in this research work to examine the gaps found in literature. This study examines the investor's *awareness and understanding* about the ELR. Here, we checked whether difference in Gender / Age / Education / Income / and Occupation lead to any differences in awareness or understanding about the ELR. This research also undertook a study *whether there is a change in allocation to Mutual Funds* by the investors based on Gender / Age / Education / Income / and Occupation. Hence, Hypotheses 1, 2, and 3 are based on the above.

Continuing with the literature survey on investor behavior the next section traces the literature with regards to the investor's selection of financial intermediary.

3.3.4 Selection of financial intermediary / financial service buying behavior:

Introduction: Mutual Funds in India are sold mainly through four main channels (Shah *et al.*(2010) namely Banks, IFA, Large distributors and Direct channel as discussed in the chapter II. This selection of intermediary is an important part of the investor behavior and mutual fund sales process and it consists of two main sections.

In the first section, the literature covering various factors influencing financial service buying behavior across studies is discussed, the gaps in literature are identified followed by a brief on the fourth Hypotheses. In the second part, other relevant investor studies are covered including a financial customer segmentation model.

3.3.4.1 Factors influencing financial service buying behavior: A large number of empirical studies related to the personal financial marketing mainly in the Banking arena have been conducted, helping identify important factors for financial services buying behavior. Leonard and Spencer (1991) traced the importance of *bank image* as a competitive strategy for increasing customer traffic flow, specifically considering student segment. A study covering US and UK found that there was a very *high expectation of service quality* and high perceptions of service received, yet gaps existed (Lewis, Orledge, & Mitchell, 1994). Other work Boyed *et al.*(1994) contrary to earlier research, identified that the consumer choice criteria for selecting financial institution was reputation *and cost*. *Ethnicity* should be considered as a construct having strong potential impact on consumption (Joy, Kim, & Laroche, 1991). Black *et al.* (2006) studied customer's choice of financial services channel. Their study revealed that *customer configuration, lifestyle factors, motivations and emotional responses* were the main influencers in the customer's choice of a channel. Other influencers were product, channel and Organisation factors such as *image and reputation*. *Location* i.e. convenience followed *by retail fees* was the criteria for selection of financial intermediary (Lee & Marlowe, 2003). These selection criteria differed on the basis of the consumer demographics. Morrison & Roberts (1998) highlighted the *significance of the product channel interactions* and the need to consider the degree of congruence when examining factors influencing choice of adoption of the channel.

An exploration of factors influencing choice of a Bank in Canada (Laroche, Rosenblatt, & Manning, 1986) determined that the importance of *location (convenience), speed of service, competence and friendliness* of Bank personnel as the key factors for consumers to associate with a financial intermediary. Identifying consumer loyalty as a useful construct in Retail Banking, Jain *et al.*(1987) found that non-loyal Bank customer were swayed by economic rationale whereas loyal Bank customers placed more emphasis on the human aspects of Banking. In evaluation of financial services, three studies have concentrated on retail banking and drew partially conflicting conclusions. In a value driven strategy, three factors price, speed and access were particularly important (Elliot, Shatto, & Singer, 1996). A counter view to that of Elliot *et al.* Was *that customer service* appeared more important than price (Reeves & Bednar, 1996). An earlier study by Khazeh and Decker (1992-93) had also found *service charge policy* to be the *most important factor* in explaining how customers chose banks. Extending this leads to the Hypothesis 4 and 5. The fourth Hypothesis tested if the *selection*

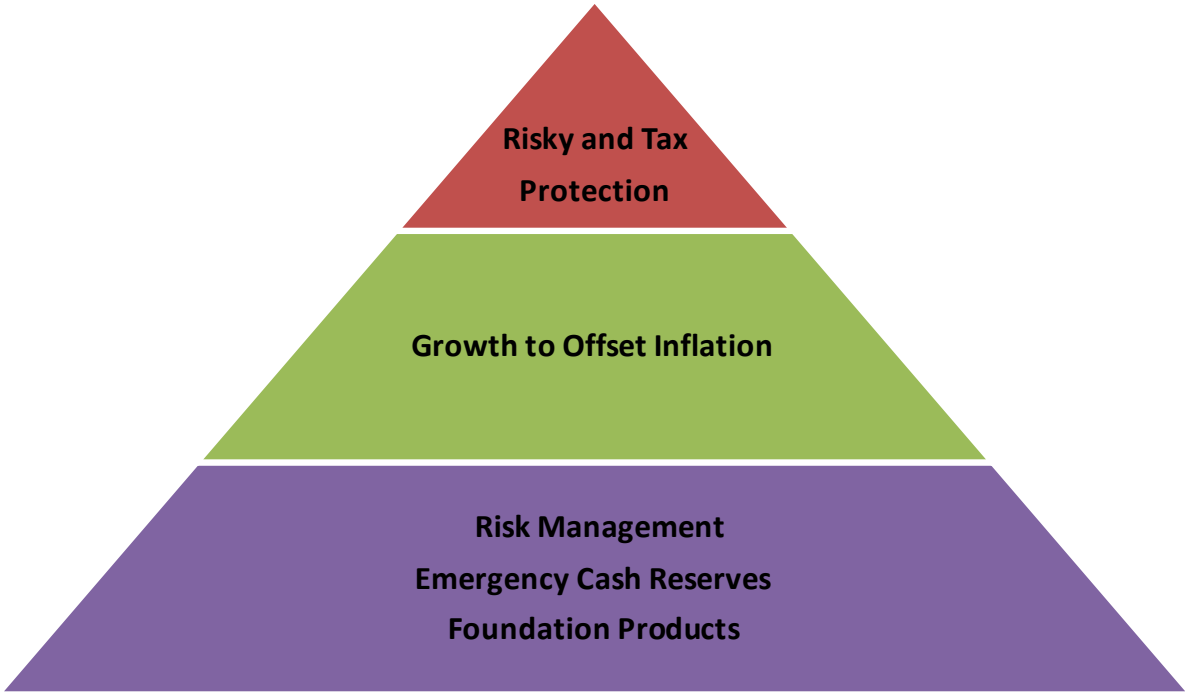
of type of Financial Intermediary (Bank or IFA or any other) by the investor depended on Type of fees or Charge by them. The fifth Hypotheses tested if the *selection of intermediary by the investor* depended on the his awareness about the ELR implications.

3.3.4.4 Other Related Investor Studies: Other related investor studies include that by Chan (1993) detailing the *financial sophistication in the youth market*. Younger population showed higher awareness of financial products and services. Burton (1996) identified that financial service providers had not yet accommodated the needs or *expectations of distinct ethnic groups*. Carlin (2009) considered consumers with varying degrees of sophistication and in his model sophisticated customers were able to observe individual product prices and non-sophisticated customers purchased randomly. Mckechnie (1992) undertook a comprehensive review of consumer buying behavior studies in financial markets. She concludes that there is a noticeable absence of any general conceptual framework that describes how consumers buy services in general, let alone financial services in particular and identifies a real need for marketing theories and concepts to be developed specifically for services. Overall as a consequence of the lack of intrinsic appeal and complexity of the range of financial services offered, it is argued that consumers do not actively recognize that they need to have a financial product, they remain essentially passive participants in the decision making process till the point of sale (Knights, Sturdy, & Morgan, 1994). The purchase process is influenced by the inseparability of production and consumption in financial services. Here, *frontline staff* plays an important 'boundary spanning role" in the production of service, as do the consumers themselves in their capacity as partial employees (Bowen &

Schneider, 1988). Therefore an important influence on the purchase process will be the *interaction between buyer and supplier*.

3.3.4.3 : A unique Financial Consumer Segmentation study : An empirical study of financial service consumers found that the consumption and service acquisition occurs in an hierarchical order from higher liquidity, low risk to those high risk, low liquidity (Kamakura, Ramaswami, & Srivastava, 1991). This is explained in Figure below. Here Foundation products include Basic Saving accounts and related services. These exhibit high liquidity and low risk. Risk Management products includes Life Insurances, and Growth Products include Equity, and Risky and Tax Protection are Government Bonds. Government Bonds are high risk and low on liquidity.

Figure 2: Hierarchy of Products

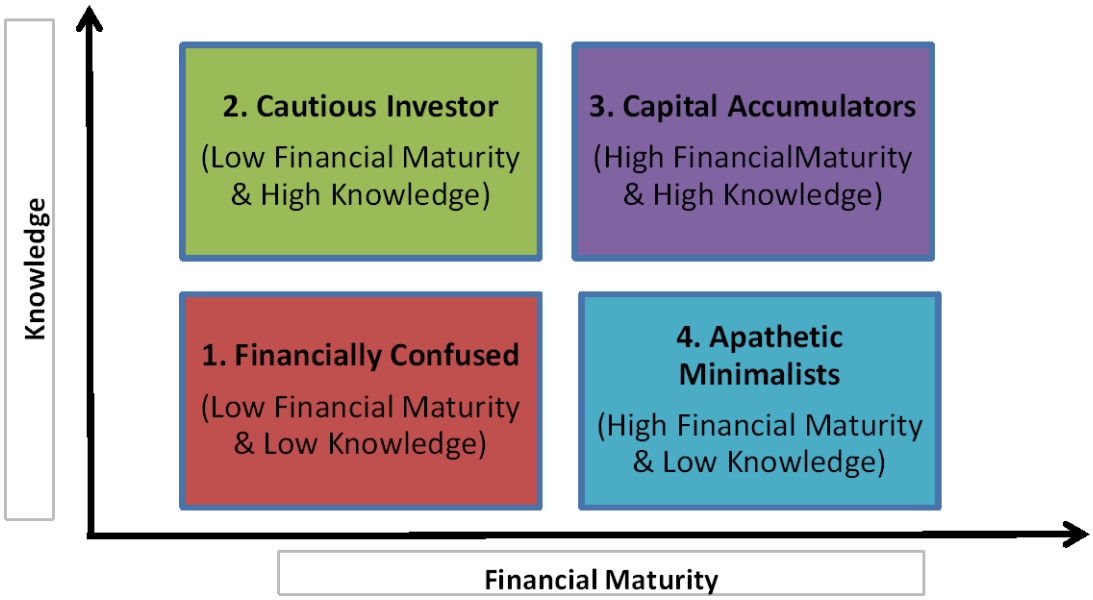


Source: Adapted from Kamakura *et al.* (1991)

Further, according to Kamakura *et al*. (1991) the investor *has* to have an ability to get involved with basic foundation products like saving and current accounts before more complex products are looked into.

Building on this consumption theory, *distinct consumer segments* were identified based on the financial maturity (derived from existing product holding) and perceived knowledge of financial services termed as financial maturity (Harrison, 1994). The four segments of investor identified were 1)*financially confused, 2)cautious investors, 3)capital accumulators and 4)apathetic minimalistic*. In the figure below illustrating this segmentation, X axis will be financial maturity and Y will be Knowledge.

Figure 3 :Customer Segmentation



Source : Adapted from Harrison (1994)

3.4 Distribution Studies in Financial Advisory:

The third segment in this literature review focuses on studies related to firstly on Entry Load and Mutual Fund Flows and secondly on Role of Financial Advisors and thirdly on distribution structures.

3.4.1: Entry Load and Mutual Fund Flows: Sales load is the charge which is borne by investors at the time of investment and is used for compensating the intermediary for motivating the sale. The earliest works on the Sales Load and Fund Flows in US for the period 1952 through 1958 found a positive relationship between sales loads and fund flows (Friend, Brown, Herman, & Vickers, 1962). An increase in sales load increased the inflow into the mutual fund. As per Sirri and Tufano(1998) who researched MF flows in US over two decades, consumers of equity fund inappropriately flocked to high performing funds and failed to flee lower performing funds at the same rate. The flow to mutual funds were fee sensitive but consumers response to fee was also asymmetric in that they responded differently to high and low fees, as well as increase and decrease in fees. Evidence was also provided that mutual fund flows are affected by factors related to their search costs, that consumers must bear.

Studies of US Mutual Fund flows by Barber, Odean, and Zheng(2005); Bergstresser and Beshears(2010); Bergstresser, Chalmers, and Tufano (2009); Zhao(2008); and Walsh (2005) found that funds that charged higher fees tend to grow faster. Bergstresser *et al*.(2009) also compared the risk adjusted returns of mutual funds sold through brokers and direct channel and found the returns lower incase of broker sold mutual funds.

According to Kristofferson *et al. (*2013) broker incentive played a significant role in the fund flows. Using unique data on commission levels, including the share of loads that brokers receive as commissions, they showed that funds with higher commission levels attract greater flows and have lower subsequent performance.

Analysis of a large German Bank's investor data by Hackethal *et al.*(2012) showed how it made large revenues through increased security transactions , when retail customers relied on the bank's advice. Other shorter period studies by (Ferris & Chance, 1987; Trzcinka & Zweig, 1990) showed no correlation between fees and fund flows implying that the relationship between Sales Load and Flows varies with time.

To summarise, the above studies showed the role of entry load and related incentive and its impact on flows into mutual funds.

Investors tend to be more sensitive to salient mutual fund expenses such as load fees than operational expenses, which are ongoing fees that were easily masked by the volatility of returns (Barber, Odean, & Zheng, 2005). Their further implied that investors are more likely to buy funds that attracted their attention through *exceptional performance*, *marketing or advertising* than funds with favorable fee structure. An analysis by Jain and Wu (2000) showed that advertising performance specifically lead to incremental flow, though this was not followed by superior performance.

In the next section the literature review relates to the role of Financial Advisors.

3.4.2 Role of Financial Advisers: Across the globe consumers rely on brokers and other financial advisers when making important decisions about purchasing any financial service like mortgage, life insurance among others. Three key surveys are discussed who support this. The 2003 survey conducted by European Commission Euro barometer 2003 documented that in European countries like Finland, Germany and Austria over 90% respondents expected to receive advice from financial institutions. In US, the 2007 survey conducted by ICI showed

that over 80% stated that they obtained financial advice from professional advisors. In India, as per IIMS (2007), 74% of mutual funds are sold through "Agents". In this literature section, Agent / Advisor are used in interchangeable format unless defined separately.

However there is a limited literature related to Financial Advisor Studies. Two of the noted early studies include Canner et.al(1997) and Bodie and Crane(1997). Canner *et al*. (1997) examined the general written advice given by investment advisers based on broad thumb rules. The analysis of seller's incentive to provide buyer with match specific information was done by number of researchers. Studies by (Johnson & Myatt, 2006;Bar-Isaac, Caruana, & Cunat, 2010;Ganuza & Penalva, 2010;Bluethgen, Gintschel, Muller, & Hackethal, 2008;Chalmers & Reuter, 2012; Hackethal et. al, 2011-2012; Kramer, 2012 and Bhattacharya, Hackethal, Kaesles, & Loos, 2012) all used Portfolio Outcome Data to *quantify the benefits of Financial Advice*. They found that investors who most needed the financial advice were least likely to obtain it. The investors who did obtain the advice (about 5%), however, hardly follow the advice, and so did not improve their portfolio efficiency much. Overall, their results implied that the *mere availability of unbiased financial advice is a necessary but not sufficient condition for benefiting retail investors*. Empirical evidence by Georgarakos and Inderst (2011) showed that trust in Professional Financial Advice has a statistically and economically significant effect on market participation for households having low financial capability.

One of the earlier studies analyzed how a seller must optimally charge for information when its quality is verifiable by consumers (Admati & Pfleiderer, 1986). An analysis of how incentives for information provision depended on competition among Banks was undertaken by Bolton, Freixas, and Shapiro (2007).

A number of studies by Inderst and Ottaviani have contributed significantly to the literature in this line. Inderst and Ottaviani (2009, 2012a) helped provide a theoretical framework that linked adviser compensation with the quality of advice. Their research focused on the multi-agency problem that a seller faces when hiring an agent to find as well as to advise customers. Inderst and Ottaviani (2010a) further analyzed the competition through commissions as well as through prices among multiple product providers in a common agency framework. In their analysis of how competing sellers (to be read as financial advisors) strategically set commissions, and considered alternative foundations for the suitability concern; for example, it could derive from losses in future business in a dynamic environment. Inderst and Ottaviani

(2012) also analyzed the compensation structure for advice, when buyers are naive about the advisor's incentives as they believe that the advisor is unbiased. Thus, buyers are subjected to a different behavioral biases in their two models discussed; and the two models addressed different questions.

ELR has impacted the incentivizing of the intermediary and a different charge model has emerged in India. There are no studies in this regard. An intelligent customer would select an intermediary who will be cost effective as per Inderst and Ottaviani (2012). Hence, here, we tested our Hypotheses 5, for basic understanding of the implications of Entry Load Removal (Awareness of Cost of advice) and judgment of selecting an intermediary who will be beneficial to him.

Stoughton, Wu, and Zechner (2011) carried out a detailed analysis on how intermediaries could be incentivized to target unsophisticated investors for selling investment products. As per their analysis, the kickbacks paid by portfolio managers to these intermediaries, enabled the fund manager to price discriminate across investors with more or less wealth. Advisors studies by Mullaithan et. al, (2012) also revealed that adviser's self-interest played an important role in providing advice to the customer and may not be in the best interest of the client.

3.4.3: Distribution structure and regulation in India:

Distribution of Financial Service refers to the availability of Financial Services through a process, in a specific place, time, and in a format that is appropriate and convenient to the customer (Chakrabarty & Ennew, 2007). The way in which the financial service is made available to the customer varies across countries as a consequence of different institutions and regulations. Though there are significant country specific differences, two trends which have emerged worldwide are Banc assurance (Selling of insurance through Bank) and multi-channeling. Amongst the various delivery channels used in financial services are the traditional brick and mortar and those driven through technology namely online web linked access. Ennew& Waite (2007) have explained distribution channels and also distinguished *direct and indirect channel*. **Direct channels** are defined as channels without intermediaries. The provider / manufacturer owns the channel. He acquires the customer and initiates a direct sales relationship with them. Examples of this are direct mail, direct sales force and the branch. The sale by the producer or Asset Management Company in this case is the Direct Channel.

Indirect channels, involve intermediaries /agent who do not own the channel but initiate the sales relationship with the customer. Indirect channel refers the use of intermediaries whether *institutional (tied)* or *independent*. Tied intermediaries sell the products of only one manufacturer and independent intermediary sell the products of multiple manufacturer. In India, for mutual fund sales, Banks, National Distributor and IFA all constitute the indirect channel. These intermediaries are mostly independent. For example, Citibank, Karvy Wealth (National Distributor), Wealth Managers (Regional Distributor) and Sapient Wealth (IFA) all sell mutual fund products of numerous Asset Management companies in India. This product sale through these entities is also termed as *third party sales*.

Technology has emerged as an important dimension in the distribution of financial service. Manufacturer websites allow customers to invest online, independent platforms are also being created by BSE / Amfi / Cams to provide a manufacturer neutral sales platform and these are now available to intermediaries at a nominal cost.

Chapter 2 in this report has covered a detailed discussion on the mutual fund distribution trends in India.

Avery small number of previous studies have investigated *attitudes* towards Government regulation or control of industry at a more general level. Barksdale *et al*. (1982) investigated attitudes towards Government regulation in six countries including England. This is a very dated study and the only other recent study is by Devlin (2014) investigated the attitude towards UK regulation. A literature review on regulatory impact assessment is therefore undertaken to understand the studies worldwide and specifically for India. For India, the research looked at financial regulation impact assessment study by the Indian regulator Sebi on the stakeholders. The next section is a review of these impact assessment studies.

3.5 Regulatory Impact Assessment (RIA):

Regulation can broadly be defined as any government measure or intervention that seeks to change the behavior of individual or group (Cabinet Office 2009). It is increasingly seen in a positive light as an instrument that facilitates private sector development and pro poor growth. Whether a regulation is effective can only be determined by examining benefits and cost associated with a particular regulation.

Regulatory Impact Assessment (RIA) is used to access the impact of new and also actual consequences of existing regulations, to assist those engaged in the planning, approving and implementation of regulatory improvement. It is not intended to replace competitive pressure or normal market mechanism, but to correct for market imperfections and failures that produce suboptimal outcomes and distort consumer choice.

Recent research into factors that enhance financial intermediation and financial sector stability and growth, highlight the important role of effective financial regulation. Both cross country analysis and case studies confirm that the strength of the prudential regulation policy and environment had a significant impact on the stability and performance of the financial sector (Brownbridge & Kirkpatrick, 2000).

RIA is not a technocratic tool that substitutes for or replaces other decision methods in the regulatory process, but it can play an important role in strengthening the quality of debate and understanding in the decision making process. The methods used by policymakers to reach decisions on regulation can be classified into five categories (OECD, 1997).

1. *Expert* – the decision is made by a trusted expert, perhaps an appointed regulator, who uses professional judgment to decide what should be done.

2. *Consensus* – the decision is reached by a group of stakeholders who reach a common position that balances their interest.

3. *Political* – the decision is reached by political representatives based on partisan issues of importance to the political process.

4. *Benchmarking* – the decision is based on reliance on an outside model, such as international regulation.

5. *Empirical* – the decision is based on fact-finding and analysis that defines the parameters of action according to established criteria.

RIA is part of the empirical approach to decision-making, and while it is not sufficient for designing sensible public regulatory policy, it can make an important contribution to improving quality of decision-making.

In particular, RIA meets the following criteria for good policy-making (OECD, 1997):

1. Improves understanding of benefits and costs of government action: RIA is an evidence-based approach to decision-making, and often draws on economic empirical evidence in assessing benefits and costs.

2. Integrates multiple policy objectives: RIA can be used as an integrating framework to identify and compare the linkages and impacts between economic, social and environmental regulatory changes.

3. Improves transparency and consultation: RIA is closely linked to processes of public consultation, which enhances the transparency of the RIA process, provides quality control for impact analysis, and improves the information provided to decision-makers.

4. Improves government accountability: RIA can improve the involvement and accountability of decision-makers by reporting on the information used in decision-making and demonstrating how the decision impacts on society.

Experience in OECD countries shows that, properly designed and applied, RIA can improve the effectiveness and efficiency of governments and can help address broader issues of competitiveness and economic performance in innovative and globalizing economies.

RIA by itself is not a sufficient basis for decisions; instead, RIA is best used as a guide to improve the quality of political and administrative decision-making, while also serving important political values of openness, public involvement and accountability. Most OECD countries now use some form of RIA. (OECD, 1997)

During the 1970s, US companies were faced with higher cost of compliance due to the evolving regulatory climate. The government promoted a cost-benefit analysis (CBA) to minimize regulatory burdens faced by the economy. The US was therefore the foremost in its adoption of the RIA. Till date the SEC, still conducts CBAs for its rule makings. The US enacted the Financial Regulatory Responsibility Act, 2011, to ensure that all financial regulators conduct comprehensive and transparent economic analysis ahead of adopting new rules.

Similarly, the Financial Services and Markets Act, 2000, was enacted in the UK, obliging the Financial Services Authority to undertake a CBA of any rules or regulations it proposes for the efficient governance of the financial markets.

3.5.1 Progression of RIA:

At the beginning of 2001, 20 of 28 OECD countries were applying regulatory impact assessment, although the extent of its use appeared to vary (Jacobs, 1997; Jacobs, 2002; Radaelli, 2002). By contrast there seems to have been little or no analysis of the potential for using RIA in developing countries or by organizations involved in the design and formulation of development policy (Lee N. , 2002; Stern, 2002; World Bank , 2003)

The use of RIA has been restricted, to a small number of middle-income developing countries, notably South Korea and Mexico (OECD, 1999; OECD, 2000). There has been some interest in the concept among APEC members (APEC-OECD, 2001) and in certain parts of Central and Eastern Europe, but there has been very little progress in adopting RIA in many of the countries in these regions (Lee N. , 2002).In Africa, the Middle East and much of Asia, RIA does not appear to be seriously considered within government or is perhaps known about at all, in spite of a recognized need to build regulatory capacity in developing countries (DFID, 2000; World Bank, 2001). There is a limited amount of empirical evidence on regulatory impact practices in *developing countries* (Jalilian, Kirkpatrick, & Parker, 2003; Djankov, F. Lopez-de-Silanes, & Scheifer, 2002) there is an absence of even rudimentary data on the positive and negative effects of particular regulatory measures (Guasch and Hahn, 1999).

3.5.2 RIA in developing economies:-

There is an absence of rudimentary data on RIA in developing countries (Guasch & Hahn, 1999).

Some developing countries have introduced RIA with the aim of improving regulation. The approaches adopted in Mexico and South Korea are detailed in (OECD, 1999; OECD, 2000) and were similar to those found in developed economies and were consistent with OECD principles.

On Mexico, the OECD report (1999, p.159) commented that: "The biggest problem for the Costs and Benefits Section of the RIA is that the quality of data is generally poor and thus a quantitative analysis of proposals is virtually impossible. Regulatory authorities are not asked to produce net benefit estimates for fear of creating additional incentives to distort already

inadequate data". It highlights the issue of RIA implementation. The report on RIA in South Korea notes that "the bulk of the RIA is still being conducted at a low level of sophistication (OECD, 2000, p.153).

To shed further light on the use of RIA in developing countries, a study of its use in the Philippines and Malaysia was undertaken in October 2002 using questionnaires distributed to government regulators (Kirkpatrick & Parker, 2003). The study revealed that in Malaysia the use of RIA was more extensive than in the Philippines. However, for both Malaysia and Philippines, there was uncertainty as to the extent to which benefits as well as costs are evaluated and apparently only sometimes are benefits and costs quantified. In Malaysia public consultation before the introduction of new regulations seemed well developed with all respondents agreeing that consultation occurred and this consultation usually included public meetings. Also, as in the Philippines, where RIAs are adopted, they are used at all stages in the regulatory process through to detailed proposals, but, again, the views of participants in the consultation exercise are usually not made public. There was disagreement amongst the respondents as to whether an explicit, published policy promoting government-wide regulatory reform or improvement existed, although most replied that published policies existed for promoting regulatory quality improvements in specific sectors. One important difference with the Philippines related to the existence of a dedicated body responsible for encouraging and monitoring regulatory improvements, with one-half of respondents confirming that such a body existed. The results for study in Malaysia and the Philippines were consistent with those for Mexico and South Korea. They confirmed that there is much to be done in terms of regulatory capacity building if RIA is to be operated systematically and effectively in developing countries.

Kilpatrick & Parker (2003) studied RIA focusing on the challenges that will be faced in introducing this concept more widely across developing economies has been undertaken. Their study results from a survey of a small number of middle-income countries suggested that a number of developing countries have some form of regulatory assessment, but that the methods adopted are partial in their application and are certainly not systematically applied across different government. The paper further suggests an implementation framework in terms of building an effective regulatory management system, improving the quality of new regulations and upgrading the quality of existing ones.

3.5.3 RIA in India

An exhaustive analysis by Parekh (2013) on RIA in India is the only notable study covering India. His study states that RIA has been carried out by Sebi, in a very limited scope, in a few situations. Sebi had initiated a process of introducing RIA in its board's decision-making for introducing new regulations around 2007, but has since then not been used routinely. In the Consultative Paper, issued on January 1, 2008 on amendments to SEBI (Prohibition of Insider Trading) Regulations, 1992, a limited RIA was conducted on each proposal that was put forward, in addition to asking for public comments on the same.

Additionally, in the SEBI Consultative Paper on (Issue and Listing of Debt Securities) Regulations, 2008, issued on January 3, 2008, SEBI issued a regulatory impact assessment on the limited success of primary corporate bond offerings. It stated that the proposed regulations would impose lower regulatory burdens on the issuing companies without compromising on the rights of investors. Notably, in SEBI's Board meeting on June 18, 2009, it was expressed that an RIA of the issue of shares with differential voting rights be carried out, in the backdrop of their impact on takeovers and corporate governance.

In the mutual funds regulation review, Parekh's study analyses Sebi's recent stance namely entry load banning, and later conceding to some demands of the mutual funds by allowing some charges to be reversed and it terms it as an *experiment in regulatory impact assessment*, some not so successful, some more successful.

Thus, there is a need for a study to understand the changes in the Indian mutual fund distribution space after the ELR regulation and the Advisor / Agent guidelines. This leads us to the following research questions:

- Is the impact (in terms of revenue) due to ELR regulation dependent on any specific intermediary firm characteristic?
- What is the Model (Agent / Advisor) being adopted by an intermediary dependent on?
- What is the strategy that the distributor adopted post the ELR?

This leads us to the 3 last hypotheses that are mentioned below:

H6: The Impact of the Entry Load Removal is independent of the Firm's Characteristics: Scope of Service, Ticket Size, Families being managed and Model (Advisory / Agent) being adopted.

H7: The Intermediary model (Advisory / Agent) being adopted is independent of the Firm characteristics: Scope of service, Vintage, Ticket Size, and Families being managed.

H8: The Intermediary does not propose to make any changes in his current business focus post the ELR regulation.

Summary:

This Literature review covered the following: financial advisor regulation, investor behavior, distributor study and regulatory impact assessment.

While investor studies covering US, UK and other financial market regulation existed, the review of investor behavior studies in Indian context yielded a clear gap in academic study covering behavior of Indian investor with regard to the Entry Load Removal and Advisor – Agent regulations. Research Hypotheses 1, 2,3,4,5 are related to this.

Distribution study related to regulatory impact, revealed that there was a lack of academic literature covering the post Entry Load regulation and Advisor Agent regulation for the mutual fund distribution channel in India. This study is an attempt to address this gap and Hypotheses 6, 7 and 8 involve assess the same.

In the next chapter, the first section covers the research methodology for both investor and distributor studies. In the second section investor behavior study is discussed.