Chapter 6

Key Findings of the Study & Guidance from Findings

6.1 Financial Advisor regulation studies

Key lessons from the developed markets and suggestions for regulatory support for India Rollout of Financial Advisor norms:

The rollout of the FA regulations across developed geographies has been in a *phased* manner, including realistic timelines for adherence, a comprehensive participative decision making process through feedback capturing mechanism and the regulators update on his action. Whereas in case of India the pace of reforms has been speedy from 2009 as compared to other economies and it generated intense debates and media fury, there are now emerging impact analysis studies. But there is no commissioned study by the regulator in place yet. Thus, what has been the actual impact of the regulation on the Indian investor needs to be ascertained on an ongoing basis by the regulator through an *impact assessment study*.

Secondly, in developed economies investment is most often mandated through retirement plans and the product penetration is much deeper whereas in a transition economy like India, the agent community continues to play an important role in educating and driving sales of financial products. Both, researchers and industry bodies have suggested *different hybrid distribution models*.

Thirdly, while the regulation rollout in India, geared towards enabling a more transparent and customer friendly environment was much appreciated there is a clear need, to implement *effective tracking mechanisms for feedback received from various consumer forums, incentives and recognition for implementing it.*

Though disclosure will definitely help in providing the necessary information which is the foremost attempt of the regulation, it is not going to solve the problem of mis-selling.

Suggested process for a smoother and effective rollout of the Financial Advisor Regulations in India:

Advisor-Agent Hybrid: The two models maybe allowed to co-exist, with the intermediary given the option to use either of the models based on clear client documentation. This opens up a larger investor window for the intermediary. This will help the intermediary to approach charging each client relationship based on what the client is comfortable with. Clients could opt for either of the service, this may may lead to a wider adoption of the advisory model. Sebi data has previously revealed the low level of response for the advisory business model in India.

Process Flow: Concept papers / policy papers in US/UK/Singapore and Australia sought inputs in terms of regulator's responses to expert and participant suggestions and thus revealed a transparent mechanism. In India, this transparency to queries by experts and participants on regulation has to come into practice.

Regulation Impact Tracking: Investor Awareness and responses to Regulation to be tracked as a structured process and one of the replicable models is that in UK. The tracking mechanism needs to be an annual activity and it will help in understanding whether the final beneficiary (investor in this case) has actually gained from the regulation and it may provide a roadmap for future regulation.

6.2 Investor study findings:

H1: Awareness **of Reason for Legislation:** This shows dependence on the variable income only. There is a significant difference in the awareness of reason for ELR across income groups. Further testing within income slabs also revealed that income above INR 25 Lacs investors were highly aware about the regulation. Hence, all the stakeholders mainly the regulator may need to be more aggressive in their *investor awareness campaign* towards the other income group with all future regulations.

H2: **Understanding about the benefit of the ELR:** The investor understanding, shows dependence on variables Income and Occupation. Thus, an investor's awareness of the ELR will vary according to his Income and Occupation. Here the self-employed individuals showed most positive response and then other occupations. The salaried class and the *others* category could therefore be targeted for driving awareness and education regarding the reforms by the stakeholders.

H3: **Increase in MF allocation:** This variable is dependent only on variables gender, income and occupation.

There is a significant difference in the increase in MF allocation amongst the gender. According to Graham [2002], men are financially savvy than women. Hence, men could be more inclined to take cognizance of the positive change in regulation on ELR and increase their allocation to MF.

In the income category, higher income groups both greater than INR 25 Lacs and above INR 50 Lacs were more inclined to increase resources / allocations to mutual funds. The other income slabs (lower than INR 25 Lacs) may require focus campaigning by the AMCs, intermediaries and regulator to increase allocation to mutual funds. Also, allocation to real assets namely, gold and real estate has continued to be high and that may have contributed to this response.

In the occupation category, the salaried investor exhibited a cautious approach and hence would require a focused campaign from the AMC and regulator to drive an increase allocation towards mutual funds.

H4: Investor's **Intermediary selection and Fees:** The two variables are dependent on each other. Investor's selection of intermediary depends on the type of fees being charged. *Thus buyer's decision of intermediary has become sensitive to the fee structure rolled out by the intermediary.*

H5: **ELR implications and investor's choice of intermediary**: The two variables are dependent on each other. Investor's selection of intermediary depends on the impact of ELR. *Thus, investor's decision of selecting an intermediary depends on their understanding of how the ELR is going to impact them.*

Other significant Observation: In the interviewed investor sample, the definition of an Agent and an Advisor was not clear. The regulator needs to highlight this differentiation through *media and investor education forums.*

We may say that the ELR by bringing in transparency has clearly empowered the investor as seen from the investor's choice of intermediary and the analysis of his awareness and understanding. However, this awareness and understanding of the ELR is dependent on mainly income which clearly points towards a wealthy and also sophisticated customer. Hence, conscious effort needs to go in for investor education geared towards the unsophisticated Mutual Fund investor.

6.3 Distribution study:

Mutual fund distribution channel in India from 2009 has seen a broadening of regulation and compliance obligations across firms and product suites. There has been a large scale consolidation of products (schemes) by manufactures (due to regulator influence) and also a high level of interaction between manufacturing firms and distribution channels, and multi-tier distribution structures area also seen evolving. Newer alliances to consolidate on business focus are now emerging. For example L&T Finance an NBFC firm, has concentrated on the acquisition mode to expand its distribution reach for third party products. (DNA Network, 2012). The city of Pune has also seen the acquisition of a leading IFA – Finest Wealth Managers Pvt. Ltd. By a national distributor, India Infoline Finance Ltd – Wealth Management arm in 2010. Direct channel is emerging as a strong contender steadily. Manufacturing companies (AMCs) competing for distributors focus led to a squeezing of margins (CII-PWC, 2010). Banks are the emerging beneficiaries with access to large customer base and brand awareness.

Key Findings for the distribution channel are summarized hereunder:

H6: The impact of the ELR is only dependent on the Scope of Service that an intermediary offers. Thus, the impact is different for a Bank as against that on an IFA. *The scope of Services an intermediary provides determines how the regulation affects its Revenue Stream.*

H7: The Model- Advisory or Agent being adopted is independent of the Firm characteristic. There is no co-relation between any of the intermediary's firm characteristic and the Model being adopted post ELR.

H8: The intermediary *does not propose* to make any changes in his Business Strategy. He plans to continue enhanced focus on Mutual Fund Sales as an Asset Class and not diversify into other asset classes. *This is a very significant finding and a deviation from the market perception.*

Other important findings:

Knowledge and Behavioral Skills followed by Customer Service emerge as the two main Intermediary Training Needs. *The manufacturer's i.e. AMCs and the regulator may need to take cognizance of this for Mutual Fund growth.*

Trust emerges as the Key parameter for managing Client Relationships.

There is a dip seen in the allocation to Mutual Funds and Insurance and a rise in allocation to Deposits and Other Asset Classes post ELR.

A small percentage of intermediaries were identified as charging the client advisory fees while they had confirmed to be under Agent mode. The regulatory framework is required to be in place to identify and curtail this malpractice.

An evolved IFA model based on both quantitative and qualitative inputs is constructed in this study.

6.4 Guidance from this study:

Financial Advisor Regulations and Policy Implications:

The study reveals a need for consultative regulation rollout process with realistic time lines. The study clearly showed that the process of regulation is not participative. While there is a consultation paper at the time of introduction of regulation, when the final regulation was rolled out, there was no transparency on the regulator's response to the public suggestion. A more participative approach towards disclosure by the regulator is suggested regarding the stake holders feedback on the regulation and the action taken (accepted /declined) to be shared.

Since policy measures towards investor education are now in place, there is a need for tracking this process closely. As this research reveals, RIA emerges as a key towards a broad based review mechanism across sectors for assessing the impact of a regulation.

Investor Behavior:

This research study also points towards the regulation benefits accruing to a sophisticated investor. Hence, a need is seen for concentrated effort towards spreading investor *education* towards the unsophisticated Mutual Fund investor. Also, *marketing campaign* to be directed towards the lower income investors.

Intermediary:

This research study also identifies the twin pillars of knowledge and behavioral skills as key requirements of the intermediary to sustain his model. Both the manufacturer's i.e. AMCs and the regulator, need to take cognizance of this need to support the intermediary business in the long term.