SEBI lowers the expense ratio making mutual funds investing cheaper

On 18 September 2018, SEBI brought about major modifications in the current framework of expense ratio in the mutual funds domain. Previously, the maximum expense ratio that an equity fund and debt fund could charge was 2.50% and 2.25% respectively. It was felt that investors were losing out on returns they earned throughout the investment horizon. To ensure that investors got maximum out of investments, SEBI reduced the upper limit of expense ratio for all open-ended equity-oriented funds. It has specified expense ratio slabs based on asset under management (AUM) of the fund house. The expense ratio is capped at 1.05% for equity funds with AUM greater than Rs 50,000 crore. Fund houses operating with lower AUM are permitted to levy a slightly higher expense ratio as per the slab.

In addition to this, the expense ratio of index funds and exchange traded funds (ETFs) has been capped at 1%. In a nutshell, based on the AUM, the range of expense ratio has been lowered from 1.75%-2.5% to 1.05%-2.25%. The basic premise here has been to pass on the benefit of economies of scale to the mutual fund investor. Hence, as the asset size of the fund house grows, it is expected to lower its expense ratio proportionately.

Apart from that, SEBI has changed the manner in which mutual fund distributors will be compensated. Earlier, the industry followed the practice of upfront commission plus trailing commission. Upfront commission was paid to the distributor at the time of investment which was followed by trail commission for the entire duration for which an investor remained invested in the fund. The upfront commission, actually, reduced the amount going in for the actual investment. Now, SEBI has scrapped the system of upfront commission. After passing the regulation, the fund houses would follow only the full trail commissions method to remunerate the distributors. Ultimately, all these efforts go into making the whole structure more transparent and profitable for the retail investors.