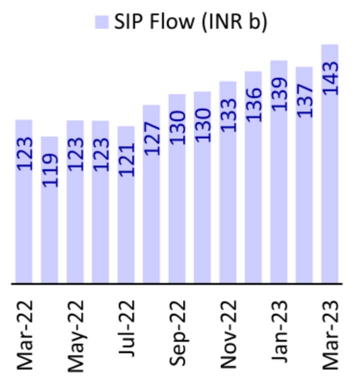
Sector Update | 10 May 2023

Mutual Funds

HNIs preferring FDs over debt MFs; Retail SIP traction strong

- **We interacted with a few large Mutual Fund distributors (having an AUM in excess of INR10b) and institutional sales representatives to examine customer behavior in the current environment.**
- **In recent times, the equity markets have displayed some resilience, although they have not yet surpassed their previous record highs . On the debt side, RBI surprised with a pause on its interest rate hike journey.**
- **Over the past couple of months, a few major developments have emerged: a) taxation on debt MFs, b) constant chatter on TER cuts by SEBI**
- **Our interactions with channel partners indicate: 1) the high-value segment continues to experience a decline in lump sum investments. 2) there has been a 5-10bp reduction in NFO commission payouts. 3) there has been a resurgence in SIP enrollments from rural areas and smaller cities, 4) after the change in tax regulations, there has been a shift towards FDs over debt MFs. 5) retail investors not showing significant interest in passive funds at present.**
- **We remain positive on CAMS and IIFLWAM in the AMC space, with a BUY rating on both stocks.**

Strong trends in SIP flows continue

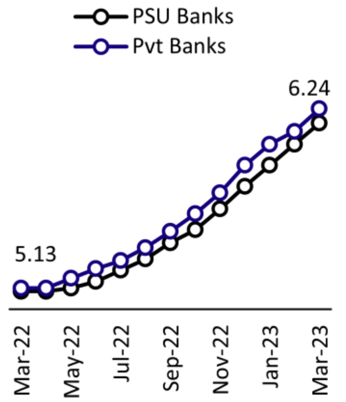


Source: MOFSL, AMFI

HNI flows into equity funds remains muted

- Equity flows: Redemptions have been steady and most distributors we spoke to were of the opinion that redemptions would increase once the broader indices cross certain thresholds. However, fresh lumpsum inflows have been difficult to come by. The trend is more pronounced in the high ticket segment. HNIs have been preferring PMS and AIFs as they find MF products commoditized.
- Urban vs Rural: Collection efficiencies in the smaller towns and cities have been trending higher for some distributors. SIP bounce rates have seen a significant decline from these geographies in the past few months.
- SIPs: The trend remains robust, particularly within the retail segment, where the average investment amount has been decreasing. This is encouraging for distributors as it indicates that new customers are joining at an accelerated rate. It has been somewhat difficult to maintain higher ticket SIPs among HNI customers as the returns on SIPs over the past three years have been minimal. As a result, the HNI segment has experienced lower renewal rates of SIPs.

Rise in average term deposit rates



Source: MOFSL, RBI

Debt flows remain muted post the tax change

- With the debt schemes now under the tax ambit, the relative attractiveness of Debt MFs v/s other fixed income products has reduced substantially.
- HNIs are favoring bank fixed deposits over mutual funds. Although HNIs comprehend the advantages of mutual funds over other financial products, past problems in this sector still concern them.
- One of the distributors cited that he has never lost a customer for poor returns in the equity segment, but has definitely lost customers because of weak returns in the debt segment.

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Retail customers still elusive to the passive space

- There is an increase in enquiries regarding Index funds. However, distributors are not marketing these products aggressively.
- The possibilities of generating alpha over the benchmark indices in case of a broad market rally continues to be the selling pitch of equity funds over index funds.
- Commission on these products can range between 25bp and 40bp v/s 90bp and 100bp for the equity schemes.
- The expansion of passive investment options in the retail market is expected to take considerably more time.

Short tenure SIPs for online distributors facing renewal challenges

- The online distributors have been in the ecosystem for a long period (7-8 years) now. However, unlike their impact on the broking industry, they have not yet been able to disrupt the MF distribution space.
- In fact, in the recent past, a few of the online distributors have seen a negative net SIP count.
- While offline distributors sell SIPs with a minimum tenure of 12 months, online players have been promoting SIPs of shorter durations such as 3-6 months, which has affected the renewal rates, as the returns for such short periods have been poor.

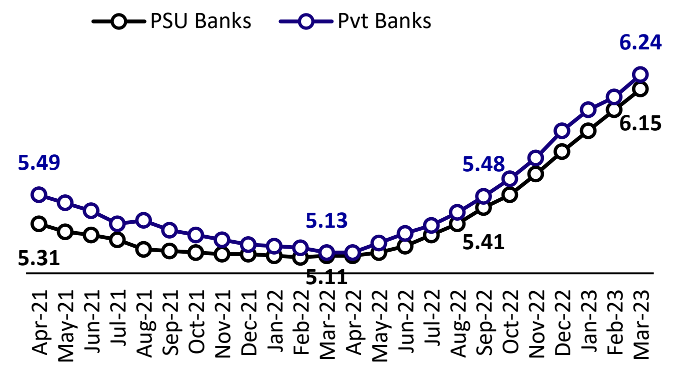
NFO commissions continue to normalize

- The commission on NFOs have normalized by 5-10bp over the past few months.
- There have been no significant alterations in commissions for existing mutual fund schemes.
- While the top 8-10 AMCs have not changed their commissions, smaller AMCs occasionally have doled out higher payouts.

Anticipated TER regulations to dent commission payouts

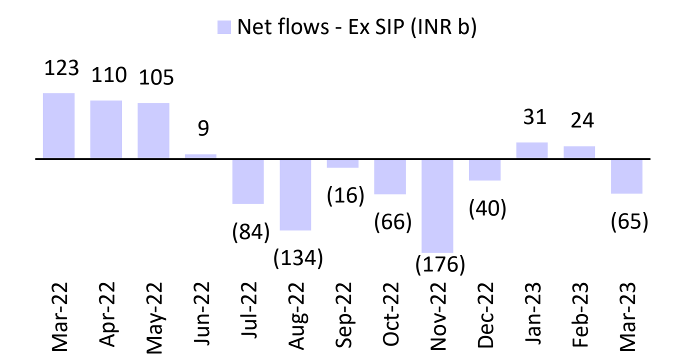
- As the regulator is expected to decrease the TER that AMCs can levy on schemes, distributors anticipate a reduction of around 10-20% in commission rates.
- However, any further cuts beyond the same would be self-damaging to the industry.
- Also, these cuts could drive consolidation among distributors (some of it already happening).
- Currently, a INR2,000 SIP generates ~INR70 commission in the first year for a distributor.

Exhibit 2: Weighted average term deposit rates have been rising in line with the rising repo rate



Source: MOFSL, RBI

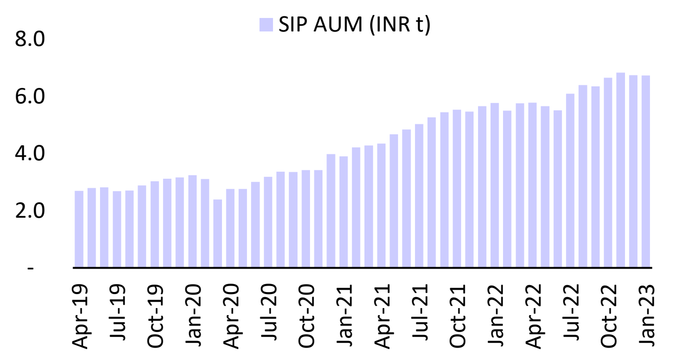
Exhibit 3: Excluding NFOs, lump sum flows have been negative for most part of FY23



Source: MOFSL, AMFI

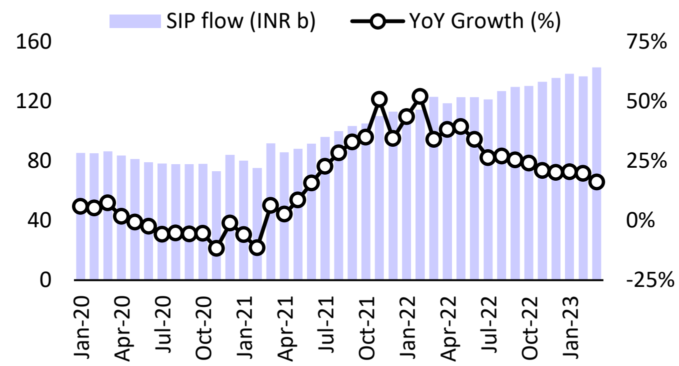
*Gross inflows in equity and hybrid, less SIP inflows and proceeds from equity and hybrid NFOs

Exhibit 4: Healthy growth in SIP AUM…



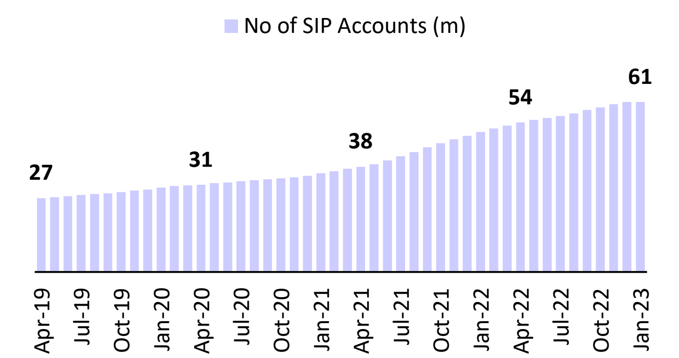
Source: MOFSL, AMFI

Exhibit 5: …with SIP monthly flows trending upward



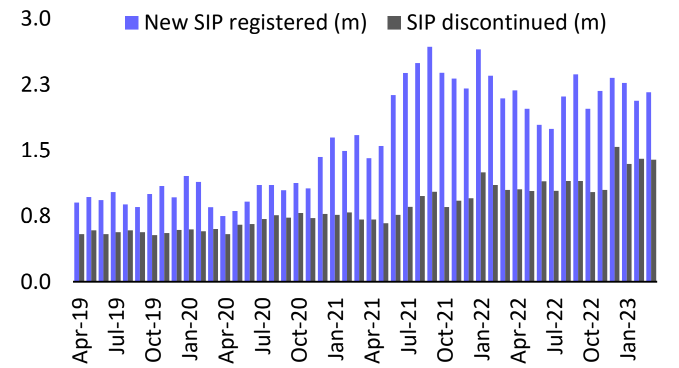
Source: MOFSL, AMFI

Exhibit 6: While there has been a sustained rise in the number of SIP accounts…



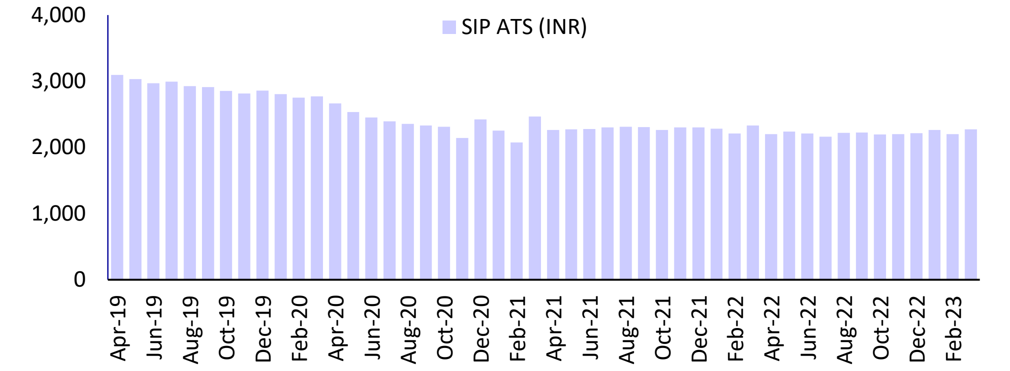
Source: MOFSL, AMFI

Exhibit 7: …incremental opening of SIP accounts slows down and SIP closures remain higher than that seen in FY22



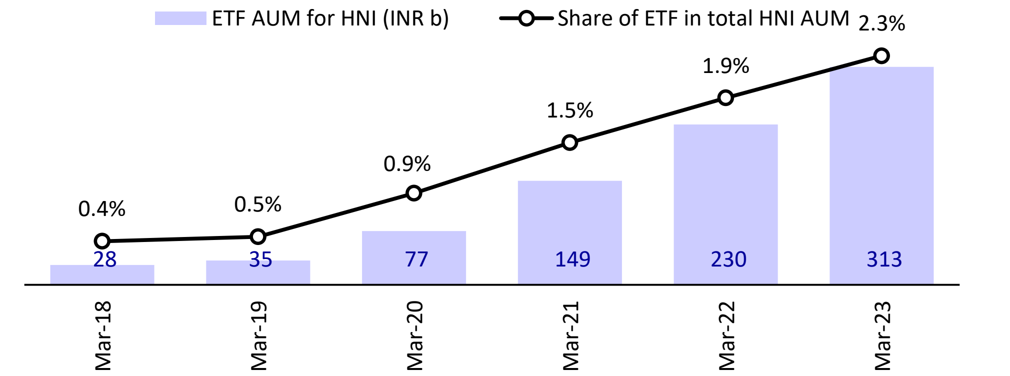
Source: MOFSL, AMFI

Exhibit 8: Decline in average SIP ticket size, led by lower ticket size of customers from FinTech platforms



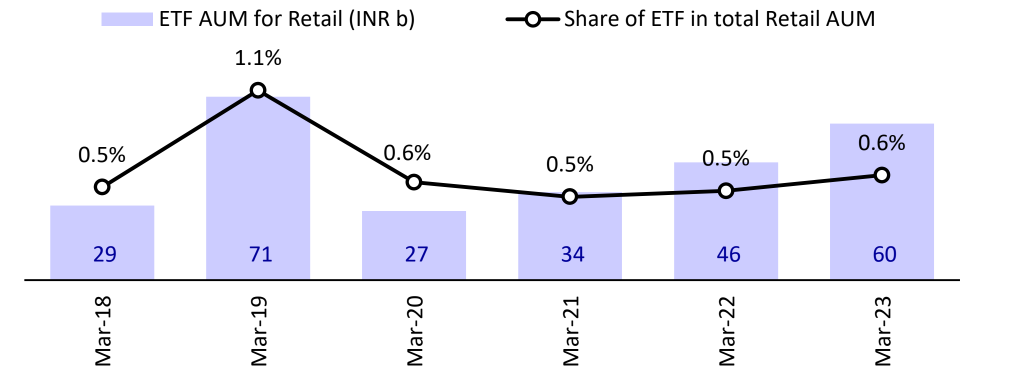
Source: MOFSL, AMFI

Exhibit 9: Increased HNI participation in Passive funds



Source: MOFSL, AMFI

Exhibit 10: Rising Retail participation in Passive funds, but still at a nascent stage



Source: MOFSL, AMFI

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