



CIRCULAR

Cir. /IMD/DF/13/2010

October 5, 2010

All Portfolio Managers

Dear Sir/ Madam,

Sub: Portfolio Managers - Regulation of Fees and Charges

1. Portfolio Managers are registered and regulated under the SEBI (Portfolio Managers) Regulations 1993.
2. As per the aforesaid regulations, the *inter se* relationship between the portfolio manager and client, mutual rights, liabilities and obligations relating to management of funds or portfolio of securities are specified in the agreement signed between the portfolio manager and the client. The contents of the portfolio manager-client agreement are laid out in Regulation 14 to be read with Schedule IV of the SEBI (Portfolio Manager) Regulations 1993.
3. SEBI has been receiving complaints from clients relating to fees and charges being levied by portfolio managers. Upon scrutiny of the complaints, it has come to the notice of SEBI that the clauses relating to fees and charges in the portfolio manager-client agreement do not always clearly reflect the fees and charges payable by the client and the manner of computation of the same.
4. In order to bring about greater uniformity, clarity and transparency with regard to fees and charges, portfolio managers are advised to take the following measures in respect of all client agreements:

Fees and Charges

- a) Profit sharing / performance related fees are usually charged by portfolio managers upon exceeding a hurdle rate or benchmark as specified in the agreement. However there is no uniformity in practice on how the profit / performance of the portfolio computed. It is advised that, henceforth, profit / performance shall be computed on the basis of high water mark principle over the life of the investment, for charging of performance / profit sharing fee.

High Water Mark Principle: High Water Mark shall be the highest value that the portfolio/account has reached. Value of the portfolio for computation of high watermark shall be taken to be the value on the date when performance fees



are charged. For the purpose of charging performance fee, the frequency shall not be less than quarterly. The portfolio manager shall charge performance based fee only on increase in portfolio value in excess of the previously achieved high water mark.

Illustration: Consider that frequency of charging of performance fees is annual. A client's initial contribution is Rs.10,00,000, which then rises to Rs.12,00,000 in its first year; a performance fee/ profit sharing would be payable on the Rs.2,00,000 return. In the next year the portfolio value drops to Rs.11,00,000 hence no performance fee would be payable. If in the third year the Portfolio rises to Rs.13,00,000, a performance fee/profit sharing would be payable only on the Rs1,00,000 profit which is portfolio value in excess of the previously achieved high water mark of Rs.12,00,000, rather than on the full return during that year from Rs.11,00,000 to Rs.13,00,000.

- b) All fees and charges shall be levied on the actual amount of clients' assets under management.
- c) High Water Mark shall be applicable for discretionary and non-discretionary services and not for advisory services.
- d) In case of interim contributions/ withdrawals by clients, performance fees may be charged after appropriately adjusting the high water mark on proportionate basis.

Maximum Liability

- e) Regulation 14(1)(b)(xiii) of the SEBI (Portfolio Managers) Regulations, 1993 provides that the agreement between the portfolio manager and the client shall, *inter alia*, contain, in case of a discretionary portfolio manager, a condition that the liability of a client shall not exceed his investment with the portfolio manager.
- f) Portfolio managers shall strictly comply with the aforesaid Regulation.

Disclosure of fees and charges

- g) To ensure transparency and adequate disclosure regarding fees and charges, the client agreement shall contain a separate Annexure which shall list all fees and charges payable to the portfolio manager. The Annexure shall contain details of levy of all applicable charges on a sample portfolio of Rs.10 lacs over a period of one year. The fees and charges shall be shown for 3 scenarios viz. when the portfolio value increases by 20%, decreases by 20% or remains unchanged. An illustration of the same is enclosed as Annexure-1.



- h) All text and figures in the Annexure on fees and charges shall be at least in size 11 font.
- i) All existing clients may be sent a letter as an addendum to the agreement about the applicability of the new high-water mark principle and the resultant new fees/charge structure. This annexure has to be signed by the client and sent back to the portfolio manager.
- j) New clients shall be required to separately sign the annexure on fees and charges and add in their own handwriting that they have understood the fees/charge structure.

Disputes

- k) Regulation 14(1) read with clause 18 of Schedule IV of the SEBI (Portfolio Managers) Regulations, 1993 provides for settlement of grievances/disputes and provision for arbitration in the portfolio manager – client agreement.
 - l) In case of any dispute regarding fees and charges, the same shall be referred to arbitration for settlement as per the terms of the agreement, under the Arbitration and Conciliation Act, 1996.
5. These measures shall be applicable for all fresh client agreements with effect from November 1, 2010. For existing clients, the revised terms shall be implemented by January 1, 2011.
 6. This circular is issued in exercise of powers conferred under Section 11(1) of the Securities and Exchange Board of India Act, 1992 read with the provisions of Regulation 39 of the SEBI (Portfolio Managers) Regulations, 1993, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.
 7. This circular is available on SEBI website at www.sebi.gov.in under the category “Legal Framework” and under the drop down “Portfolio Managers”.

Yours faithfully,

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Annexure -1

Illustration for Annexure on Fees and Charges

This computation is for illustrative purpose only. Portfolio Managers may suitably modify this to reflect their fees and charges.

The assumptions for the illustration are as follows:

- Size of sample portfolio: Rs. 10 lacs over
- Period: 1 year
- Hurdle Rate: 10% of amount invested
- Brokerage/ DP charges/ transaction charges: Weighted Average of such charges (as a percentage of assets under management) levied in the past year/ in case of new portfolio managers indicative charges as a percentage of assets under management (e.g. 2%)
- Upfront fee (e.g. 2%)
- Management fee (e.g. 2%)
- Performance fee (e.g. 20% of profits over hurdle rate)
- The frequency of calculating all fees is annual.

Portfolio performance: Gain of 20%

Nature of Fees	Amount in Rs.	Amount in Rs.
Capital Contribution	10,00,000	11,76,000
Less: Upfront fees (If any)	20,000	
Less: Any other fees (please enumerate)	XX	
Assets under management	9,80,000	
Add: Profits on investment during the year @ 20% on assets under management	1,96,000	
Gross Value of the portfolio at the end of the year		
Less: Brokerage/DP charges/any other similar charges (e.g. 2% of Rs. 9,80,000)	19,600	
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000)	19,600	
Less: Performance fees (if any)(e.g. 20% of Rs.98,000 – working given below)	19,600	
Less: Any other fees (please enumerate)	XX	
Total charges during the year		58,800
Net value of the portfolio at the end of the year		11,17,200
% change over capital contributed		11.72%

Calculation of Performance Fees for above

Serial	Nature of Fees	Amount in Rs.
A	Profit for the year	1,96,000
B	Less: Minimum profit level (Hurdle Rate@10% on Rs.980000)	98,000
C	Amount on which Profit Sharing Fees to be calculated (B-A)	98,000
D	Performance Fees (@20% of C)	19,600



Portfolio performance: Loss of 20%

Nature of Fees	Amount in Rs.	Amount in Rs.	
Capital Contribution	10,00,000	7,84,000	
Less: Upfront fees (If any)	20,000		
Less: Any other fees (please enumerate)	XX		
Assets under management	9,80,000		
Less: Loss on investment during the year @ 20% on assets under management	1,96,000		
Gross Value of the portfolio at the end of the year			
Less: Brokerage/DP charges/any other similar charges (e.g. 2% of Rs. 9,80,000)	19,600		
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000)	19,600		
Less: Performance fees (if any)	XX		
Less: Any other fees (please enumerate)	XX		
Total charges during the year			39,200
Net value of the portfolio at the end of the year			7,44,800
% change over capital contributed			(25.52%)

Charges on Portfolio performance: No change

Nature of Fees	Amount in Rs.	Amount in Rs.	
Capital Contribution	10,00,000	9,80,000	
Less: Upfront fees (If any)	20,000		
Less: Any other fees (please enumerate)	XX		
Assets under management	9,80,000		
Add: Profits/Losses on investment during the year @ 0% on assets under management	0		
Gross Value of the portfolio at the end of the year			
Less: Brokerage/DP charges/any other similar charges (e.g. 2% of Rs. 9,80,000)	19,600		
Less: Management Fees (if any) (e.g. 2% of Rs. 9,80,000)	19,600		
Less: Performance fees (if any)	0		
Less: Any other fees (please enumerate)	XX		
Total charges during the year			39,200
Net value of the portfolio at the end of the year			9,40,800
% change over capital contributed			(5.92%)

Note: The frequency of charging various fees may be specified for every type of fees in the illustration.