



July 26, 2010

CONSULTATIVE PAPER

Portfolio Managers – Proposal on Regulation of Fees and Charges

A. Background

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.

B. Proposal

4. In order to bring about greater uniformity, clarity and transparency with regard to fees and charges, it is proposed to advise portfolio managers 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 as specified in the agreement. It is proposed to be advised that, henceforth, profit sharing / performance related fees shall be charged on the basis of high water mark principle over the life of the investment.

High Water Mark Principle: The high water mark principle means that if the portfolio value goes down and then recovers, the manager does not earn fees till all losses have been made up. 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 dropped 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 charged on the actual amount of clients' funds under management.
- c) In the event of partial withdrawal of funds by investors, all fees and charges shall be proportionately charged based on the time after which withdrawal is made and the value of funds withdrawn, and the high watermark shall be accordingly adjusted.

Maximum Liability

- d) 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.
- e) Portfolio managers shall strictly comply with the aforesaid Regulation.

Disclosure of fees and charges

- f) 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 10%, decreases by 10% or remains unchanged. An illustration of the same is enclosed as Annexure-1

- g) All text and figures in the Annexure on fees and charges shall be in size 12 font.
- h) The client shall be required to separately sign the Annexure on fees and charges and add in his own handwriting that he has understood the charge structure.

Disputes

- i) 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.
 - j) 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. While these measures are proposed to be made applicable for all fresh client agreements with effect from the date of issue of proposed circular, for existing clients, it is proposed that revised client agreements incorporating these terms may be implemented by 01 October 2010.

C. Public Comments

6. Comments are invited from the public on the above proposal. The comments may be sent up to August 09, 2010 by e-mail at manisht@sebi.gov.in. A hard copy may also be sent at the address given below with the subject line indicating “Comments on proposed policy for Portfolio Managers –Regulation of Fees and Charges” so as to reach the SEBI office latest by August 09, 2010:

The Deputy General Manager
Division of Funds- 1
Investment Management Department
Securities and Exchange Board of India
SEBI Bhavan, Plot No: C – 4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai 400 051



Annexure -1

Illustration for Annexure on Fees and Charges

1. Charges on a sample portfolio of Rs. 10 lacs over a period of 1 year when the portfolio value increases by 10%:-

Nature of Fees	Amount in Rs.	Amount in Rs.	
Capital Contribution	Xx	xx	
Less: Upfront fees (If any)	Xx		
Less: Any other fees (please enumerate)	xx		
Amount Invested	xx		
Add: Profits on investment during the year @ 10% on amount invested	xx		
Gross Value of the portfolio at the end of the year			
Less: Brokerage/DP charges/any other similar charges	xx		
Less: Management Fees (if any)	xx		
Less: Performance fees (if any)	Xx		
Less: Any other fees (please enumerate)	xx		
Total charges during the year			xx
Net value of the portfolio at the end of the year			xx
% change over capital contributed		xx%	

2. Charges on a sample portfolio of Rs. 10 lacs over a period of 1 year when the portfolio value decreases by 10%:-

Nature of Fees	Amount in Rs.	Amount in Rs.	
Capital Contribution	Xx	xx	
Less: Upfront fees (If any)	Xx		
Less: Any other fees (please enumerate)	Xx		
Amount Invested	Xx		
Less: Losses on investment during the year @ 10% on amount invested	Xx		
Gross Value of the portfolio at the end of the year			
Less: Brokerage/DP charges/any other similar charges	Xx		
Less: Management Fees (if any)	Xx		
Less: Performance fees (if any)	Xx		
Less: Any other fees (please enumerate)	Xx		
Total charges during the year			xx
Net value of the portfolio at the end of the year			xx
% change over capital contributed		xx%	



3. Charges on a sample portfolio of Rs. 10 lacs over a period of 1 year when the portfolio value remains unchanged:-

Nature of Fees	Amount in Rs.	Amount in Rs.
Capital Contribution	Xx	xx
Less: Upfront fees (If any)	Xx	
Less: Any other fees (please enumerate)	Xx	
Amount Invested	Xx	
Add: Profits/Losses on investment during the year @ 0% on amount invested	Xx	
Gross Value of the portfolio at the end of the year		
Less: Brokerage/DP charges/any other similar charges	Xx	
Less: Management Fees (if any)	Xx	
Less: Performance fees (if any)	Xx	
Less: Any other fees (please enumerate)	Xx	
Total charges during the year		
Net value of the portfolio at the end of the year		
% change over capital contributed		

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