Market Intelligence
& Analytics

CRISIL
An S&P Global Company

The big shift in financialisation

Savings in India are increasingly being channelled beyond simple fixed deposits to risk assets via professional managers

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Research

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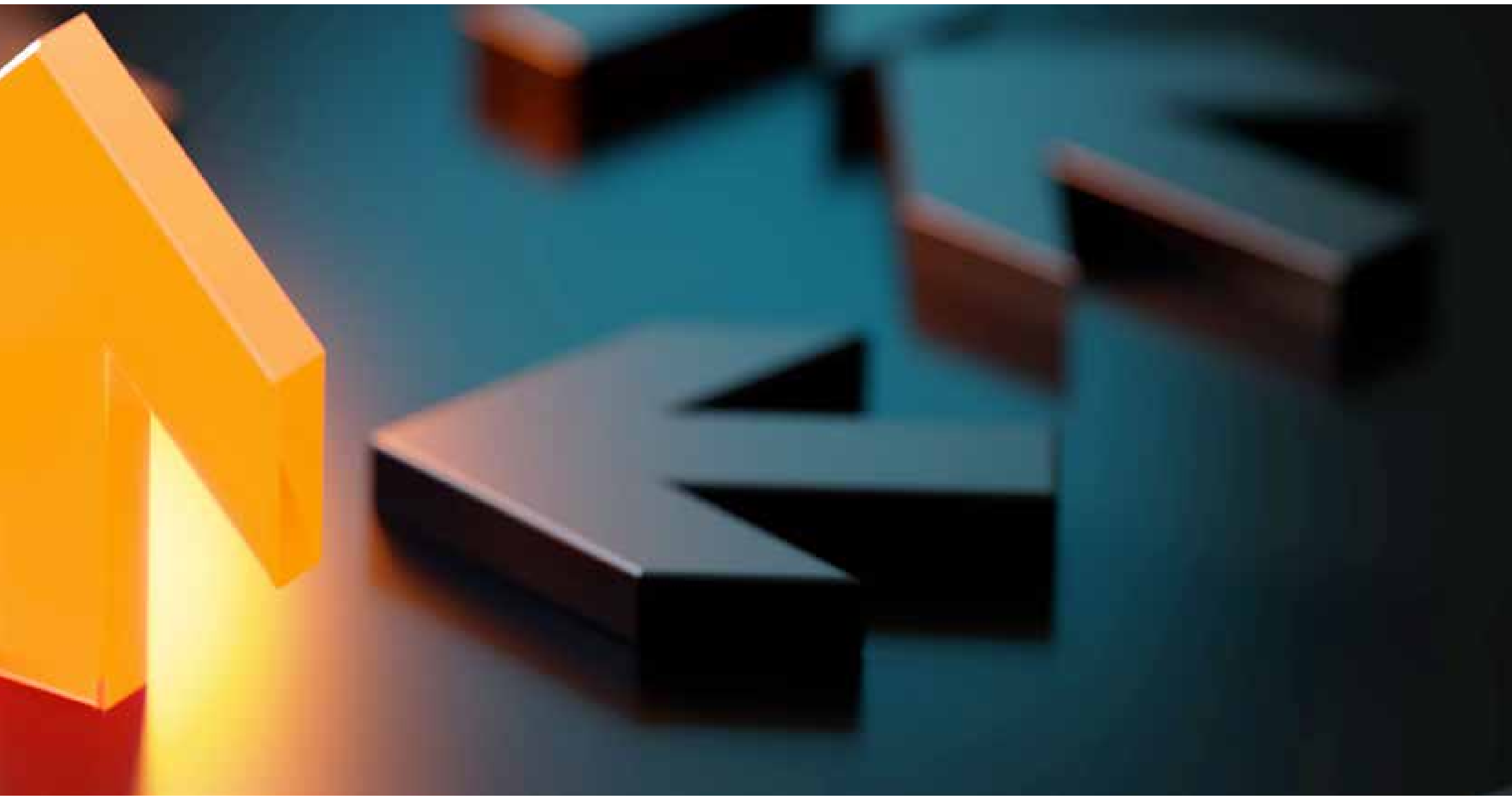

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Executive summary

Imagine 57% of India's gross domestic product.

Or the vastness of Rs 135 lakh crore[1] of *financial assets*.

That's where India's investment solutions — or managed investments — industry[2] surged to last fiscal.

Just five fiscals back, the industry's assets totted up to ~41% of GDP.

What gives?

In two words, increasing financialisation — of household savings.

Financialisation describes a move away from investments in traditional, 'physical' asset classes such as real estate and gold towards financial assets.

And we are only getting started.

Household savings comprised over two-thirds of India's total gross savings in recent years, except for the pandemic 'outlier' year (fiscal 2021) when this proportion shot up to 78.5%, touching Rs 43.9 lakh crore. Directed efforts at financial inclusion, digitalisation, a longer-term trend of rising middle-class disposable incomes, and government incentives on these instruments, have better channelled these savings to the industry. With rising inflation, households too, are seeking higher returns beyond fixed deposits.

Beyond households, investment opportunities in newer asset classes and the need for portfolio diversification are some of the factors driving institutional savings into the industry.

Though mutual funds (MFs) are always in the public eye, it is life insurance that comprises the biggest chunk of the total managed investments industry, with over Rs 52 lakh crore of assets under management[3] (AUM) as of last fiscal, amounting to ~39% of total industry assets.

MFs, with over Rs 38 lakh crore in AUM, or 28.4% of industry assets, come next.

Though these still represent only ~10%[4] of households' gross financial savings, they have gained from a big shift out of bank deposits.

Benchmarked vis-à-vis global peers such as the US, the Indian MF industry holds enormous potential as a vehicle of household/individual investments. Indeed, the number of MF folios and their spread have vastly and steadily expanded in recent years.

Then there are those that relied on the joint family system for their sunset years, but have now begun to plan differently for retirement due to rising living costs, increasing life spans, and nuclearisation of families. This has fuelled investment in pension schemes.

The National Pension System (NPS) launched by the government over a decade ago is open

1 Includes assets under management (AUM) of mutual funds, life insurance, National Pension System (NPS), provident funds (PF), portfolio management services (excluding PF and advisory assets) and commitments raised by alternative investment funds (AIFs), retirement fund assets as per CRISIL MI&A Research estimates
2 Includes life insurance, mutual funds, retirement funds (pension funds including NPS, and PF), AIFs and portfolio management services (PMS; excluding PF assets excluding PF and advisory assets)
3 Life Insurance Council
4 Outstanding position of financial assets and liabilities of households, Reserve Bank of India (RBI)

to all, and has seen strong participation on the back of incentives such as co-contribution and tax breaks. Assets under NPS rose to Rs 7.36 lakh crore as of fiscal 2022, clocking 33.7% compound annual growth rate (CAGR) over five years. Within this, the share of the private sector rose to 20% (from 12% in fiscal 2017).

Alongside, investments in the traditional social security cover for the organised segment, the provident fund (PF), has risen to more than Rs 25 lakh crore[5] at end-March 2022 from 12 lakh crore at end-March 2017. Increasing formalisation is bound to boost NPS and PF numbers further.

Over the past decade or so, there has also been a sharp rise in investor flows into big-ticket capital market instruments such as alternative investment funds (AIFs) and portfolio management services (PMS), which require minimum investment of Rs 1 crore and Rs 50 lakh, respectively. At the end of last fiscal, commitments for AIFs stood at Rs 6.4 lakh crore and AUM of PMS totalled Rs 4.4 lakh crore[6].

Overall, therefore, we find plenty of reasons to believe the products and services offered by the industry would see rapid uptake in the coming years.

But this would also depend on how the key drivers pan out and challenges are handled.

Way forward

At the macro level, the pace of technology and intermediation will continue to be crucial in driving product penetration.

At present, the industry presents an arbitrage for investors in terms of regulations and taxation benefits between segments. Having directionally similar taxation and regulations would send out a more coherent message, helping investors take better-informed decisions based on their risk-return profiles rather than spend their time grappling with various complexities.

Closing these gaps also calls for closer inter-regulatory engagement.

Finally, investor training, awareness, and development of a distributor segment needs to be commonly pursued across segments. In this, incentives to intermediaries to expand their network will be key to increasing both penetration and financial awareness in the hinterland.

Segment-wise, more feet on street for MFs, taking steps to extend the investment horizon, and encouraging product innovation will deepen retail engagement.

In the AIF segment, fund managers will have their task cut out in enhancing investor experience and attracting domestic flows with suitable product structuring in order to help the industry grow. However, since it is an evolving segment, building a strong foundation based on transparency, disclosure, and investor communication will be crucial.

Last but not least, a dedicated fund and campaign for a pension-side version of ‘Mutual Funds Sahi Hai’ could help bring the vast segment of informal workers under the fold of pension funds and NPS.

That said, financialisation of assets and its increasing flow into the managed investments industry has been backed by buoyant debt and equity markets fuelled by excessive liquidity.

Any prolonged disruption in the financial markets or liquidity conditions may have an impact on investor experience. Hence, handholding of the investor will become all the more important to cement growth.

5 CRISIL MI&A Research estimates
6 Excluding assets under advisory and PF

Factoids


Rs
315
lakh crore
Assets of the managed investments industry seen more than doubling by March 2027, to
~74%
of GDP by 2027
Rs
135
lakh crore
Total assets of the managed investments industry as of March 2022, or
~57%
of GDP
79%
Assets under managed investments as a proportion of fixed deposits as of March 2022

27%

The share of MF assets from B30* cities almost trebled in 2022 from 10% in 2017

17%

The share of SIPs (valued at Rs 6.5 lakh crore as of October 2022) in overall MF assets

~12 crore

The number of retirement accounts in India, as against working-age population of 94 crore

Alternatives strong

AIF commitments have logged a 50% compound annual growth rate in the past five years. Of the 881 AIFs registered with the Securities and Exchange Board of India (SEBI) as of March 2022, more than half were registered only in the last four years

Pension penchant picks up

Share of private sector employees in total NPS assets jumped to 20% as of March 2022, from 12% in March 2017, with state and central government employees continuing to dominate

Two-thirds

Of total life insurance assets were under life fund as of March 2022

Equity MFs soar, passives rise

Share of equity MFs seen surging to 72% by March 2027, from 58% as of March 2022. Passive funds as a percentage of equity assets seen rising to 24% from 18%

A lot for later

PF assets make up 80% of PMS assets

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The big picture is telling

The investment industry needs to be viewed holistically than on the silos it comprises. After all, it is more than a sum of its parts.

The big picture thus arrived at offers a more accurate view of its dimensions and importance when measured against some major parameters. Due to varying mix and inter-segmental shift in spoils, the starting point when comparing with macro parameters should be the aggregated AUM before drilling down to sub-segment level analytics.

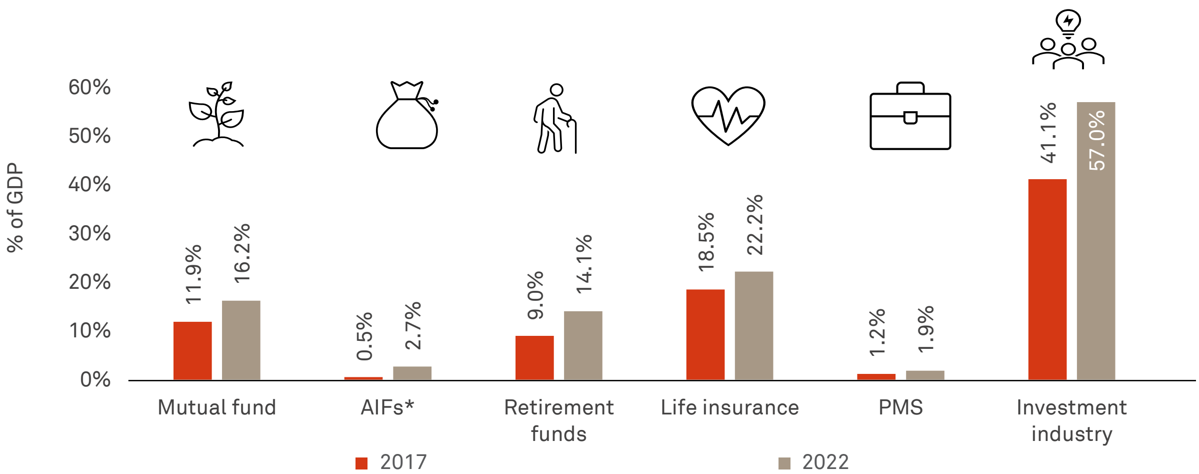
The ratio of AUM of any segment of the investment industry to the country's GDP is an important indicator of its growth.

For instance, assets of the world's largest mutual fund industry — the US — as a percentage of the country's GDP grew from 23% in 1991 to 68% in 2001, and ~150% in 2021.

In comparison, India's MF industry, at Rs 38.4 lakh crore, has just about crossed 16% of its GDP. Insurance has a slightly higher share, at over 22%.

That said, the various segments of the investment industry together comprise ~Rs 135 lakh crore in AUM, or ~57% of GDP (compared with ~41% five years ago), marking a steady rate of growth.

Size of investment industry in silos and aggregate as a % of GDP



*Value of AIFs refers to commitments raised
Source: Association of Mutual Funds in India (AMFI), NPS Trust, Insurance Regulatory and Development Authority of India (IRDAI), SEBI, Life Insurance Council, International Monetary Fund (IMF), CRISIL MI&A Research

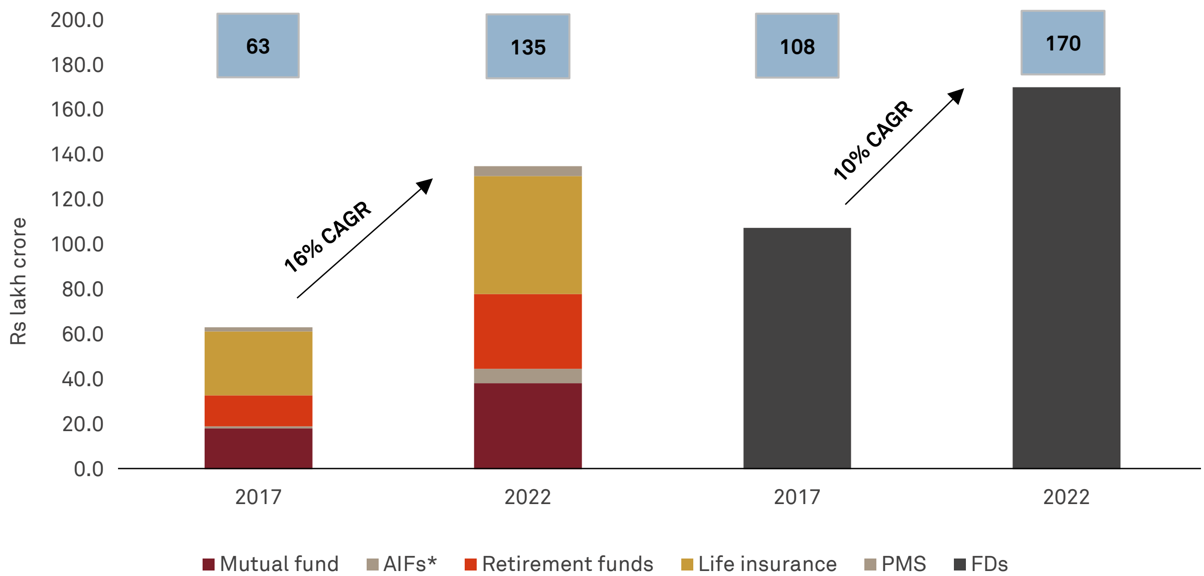
Closing in on traditional favourites — fixed deposits

Bank fixed deposits remain the most preferred financial instrument in the country, though their share has declined over the years, with investors moving towards capital market instruments.

In aggregate, the investment industry with Rs 135 lakh crore of assets has grown at a faster pace of 16% CAGR in the past five years compared with bank deposits, which grew at 10% CAGR.

This has meant the AUM of managed products is ~79% of the fixed-deposits market compared with 59%[7] five years ago. It is evident that domestic investors are increasingly looking at managed investment solutions as an alternative to park their money.

Managed investment solutions catching up with fixed deposits



*Value of AIFs refers to commitments raised
Source: AMFI, NPS Trust, IRDAI, SEBI, Life Insurance Council, RBI, CRISIL MI&A Research

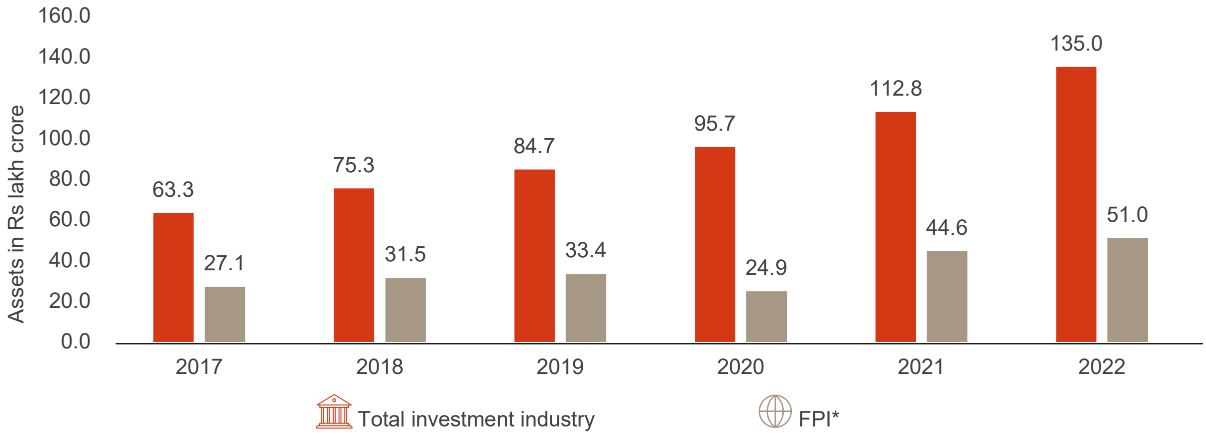
Domestic investors to the rescue

The capital market in India has traditionally been exposed to the whims of foreign portfolio investors (FPIs), leading to volatility and fluctuations in investor sentiment. In this context, the growing domestic investment industry has emerged as a strong bulwark against global factors.

In terms of assets under custody (AUC), the total holding of the domestic investment industry at Rs 135 lakh crore dwarfs the FPI holding of Rs 51 lakh crore[8] . The rise of a sticky domestic capital market, thus, protects the overall market from the hot flows of foreign investors.

7 RBI, CRISIL MI&A Research
8 NSDL category-wise AUC data for all clients

Assets of managed investments vs FPIs



*Assets under custody
Note: Data for retirement funds as per CRISIL MI&A Research estimates
Source: NSDL, AMFI, NPS Trust, IRDAI, Life Insurance Council, SEBI

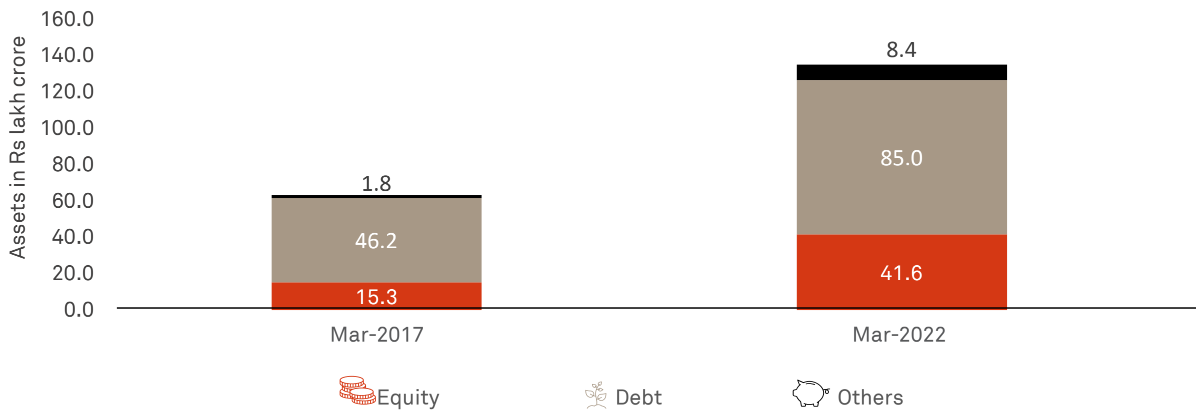
It is important to understand the larger context to these positive trends in the Indian investment solutions market. We examine these in the following section.

Equity and alternatives gain share

Indians have traditionally invested in fixed-income instruments, as seen in their penchant for bank fixed deposits, which accounted for 41% of the household savings pie as of March 2022.

This, however, is slowly and gradually changing with the adoption of capital market products by investors in the country. Within the investment landscape, the share of equity has increased from 24% in fiscal 2017 to 31% in fiscal 2022. We are also seeing higher adoption of alternatives as an asset class within the investor class with the risk appetite, viz. the high net-worth individuals (HNIs). The share of alternative products as represented by AIFs has grown from 1% to 5%[9] in the past five years.

Asset allocation pattern of the managed investment industry, FY17 vs FY22



Note: Others include alternative asset classes such as AIFs, mutual fund units, gold and silver ETFs, and fund of funds (FoF) investing overseas
Source: AMFI, NPS Trust, IRDAI, SEBI, Life Insurance Council, CRISIL MI&A Research estimates

9 Value of AIFs refers to commitments raised

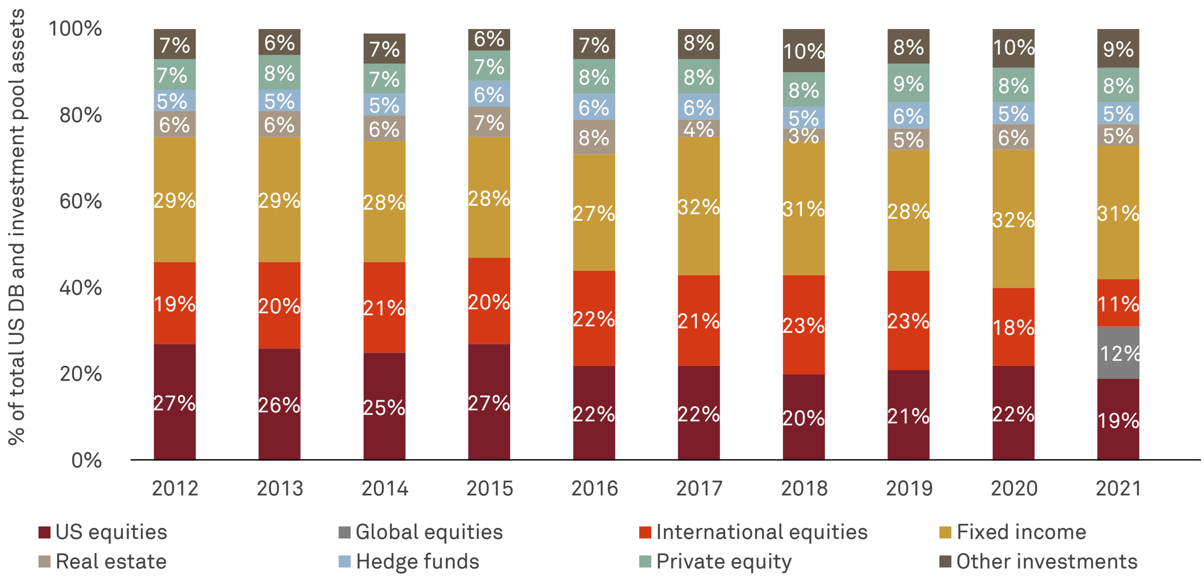
While the asset allocation pattern is turning aggressive, there is much that still needs to be done especially for a young demography like India. The country has one of the world's largest young population, with a median age of 28 years as of 2020. According to United Nations estimates, ~90% of Indians were still below the age of 60 by 2021, and 63% of them were between 15 and 59 years.

A large and young population translates into a large workforce and higher investment horizon, which when directed efficiently could emerge as a win-win for investors as well as the investment industry.

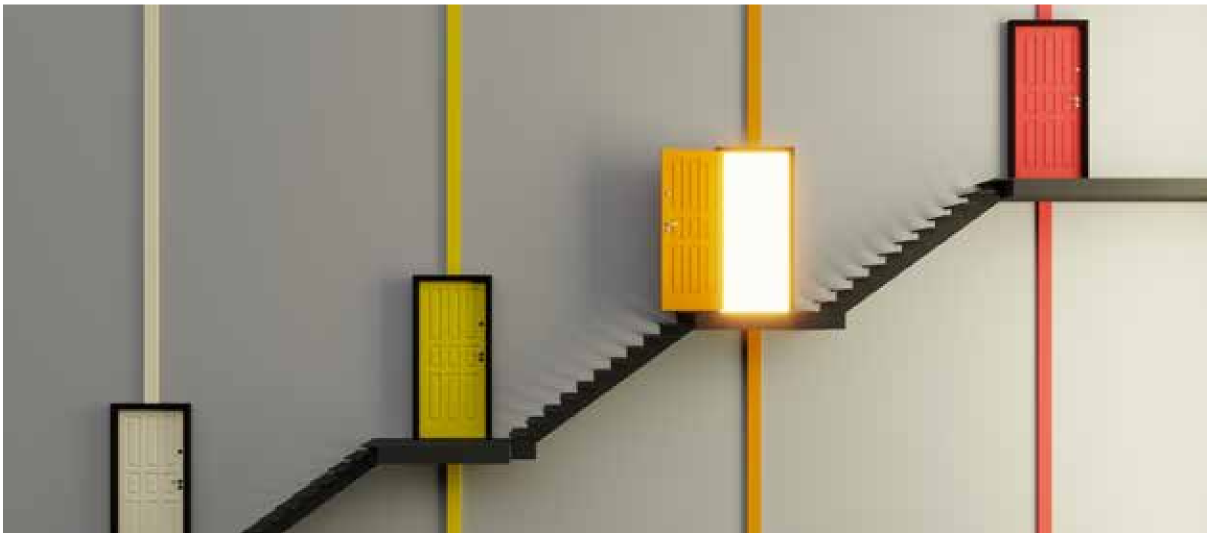
Equities, alternatives play a key role in global asset allocation

If we compare the asset allocation of India with the international investment landscape, we see that the global investment industry tends to have a greater role for equities and other alternatives. For instance, in the US, equities and alternatives (private equity, hedge funds and real estate) account for around 60% of the investment pool.

Asset allocation in America



Note: Other investments include multi-asset, infrastructure, commodities, money market, private debt and others; international equities include emerging markets
Source: Coalition Greenwich 2021 U.S. Institutional Investors Study



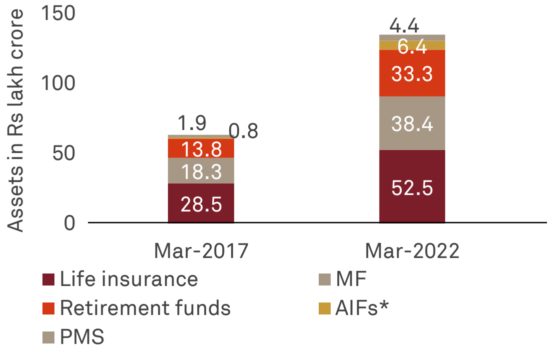
Potential 2.5x boost over assets gained in the past five fiscals

Assets of the managed investments industry in India have more than doubled in five years, from just ~Rs 63 lakh crore in March 2017 to ~Rs 135 lakh crore in March 2022.

By quantum, assets of MFs and insurers leapt Rs 20 lakh crore each. The next big gain in terms of assets was for retirement funds (NPS + PF).

However, if we look at the percentage change in assets, AIFs have seen the sharpest growth, at over 50% CAGR in the past five years, taking their commitment to more than Rs 6.4 lakh crore. Here, too, the next sharp growth has been in retirement funds, at 19% CAGR.

On a canter in the past five fiscals



*Value of AIF refers to commitments raised
Source: AMFI, NPS Trust, IRDAI, Life Insurance Council, SEBI, CRISIL MI&A Research estimates

While much has happened in the investment landscape over the past five years, the industry has not even touched the tip of the iceberg based on the potential and comparison seen with developed countries. CRISIL MI&A estimates the industry to grow to Rs 315 lakh crore in the next five years. And this growth will be led by a mix of macro and segment-specific factors.

The coming quantum leap

	CAGR 2017-2022	CAGR 2022-2027P	AUM 2022 (Rs lakh crore)	AUM 2027P (Rs lakh crore)	% of GDP 2022	% of GDP 2027P^
MF	16%	19%	38.4	93	16%	22%
AIFs*	50%	32%	6.4	26	3%	6%
PMS	19%	18%	4.4	10	2%	2%
Retirement funds	19%	20%	33.3	83	14%	20%
Life insurance	13%	14%	52.5	102	22%	24%

P: Projected; *Value of AIF refers to commitments raised
^Based on IMF GDP projections for calendar year 2026
Note: Retirement funds include NPS, APY, Employees' Provident Fund Organisation (EPFO) and other exempted trusts. PMS excludes advisory and PF assets
Source: CRISIL MI&A Research

The drivers at the macro level

Strong GDP growth

India was among the fastest-growing major economies in the world, with annual growth of around 6.7% between calendar years 2014 and 2019, before the pandemic derailed growth in 2020.

CRISIL MI&A Research expects India to regain its tag of one of the fastest-growing economies globally in the medium term. The IMF has also forecast that the country's GDP will grow at a faster pace compared with other economies.

India has increased its growth differential with the global economy — particularly advanced economies — since it started opening-up its economy by unleashing efficiency enhancing reforms in the nineties. There has been a significant notch up in its savings, investment, and GDP growth over the years.

Stepping up of the reforms process can, therefore, trigger a virtuous cycle of savings, investment, and growth. Strong GDP growth boosts household income and savings, which, in turn, shores up investments.

India does have challenges on the climate change and jobs fronts, but also enjoys certain structural strengths that will only cushion it against near-term global headwinds, but also provide it a platform for moving to a higher growth trajectory in the medium run.

For instance, the strong balance sheets of corporates not only cushion these against global headwinds, but also provide an opportunity to kick-start the private investment cycle in a broad-based manner once uncertainty subsides.

The Production-Linked Incentive scheme incentivises private investment and fast-forwards manufacturing investments.

Government focus on infrastructure investments creates multiplier effects for the economy.

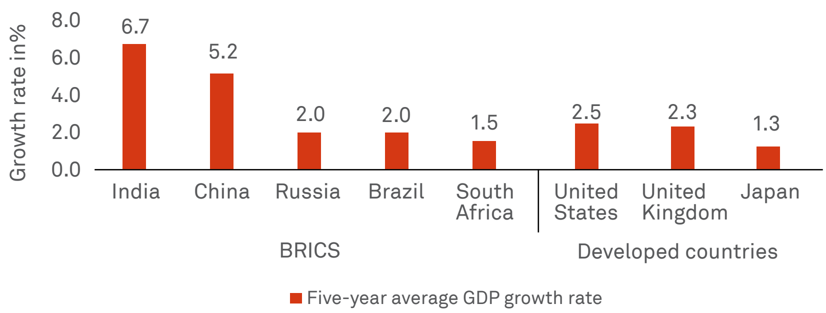
A well-capitalised banking sector, with low non-performing assets, allows the financial sector to lubricate the economic machinery.

And faster digitalisation provides citizens greater access to opportunities, cutting leakages via targeted delivery of services, and providing a platform for innovation.

Additionally, India can scale up the benefits from rewiring of global supply chains by improving its investment attractiveness.

All this spells a spurt in GDP growth, which gets built into market growth, supporting mark-to-market (MTM) growth and accelerating asset growth.

The fastest-growing major economies (GDP growth, % on-year)



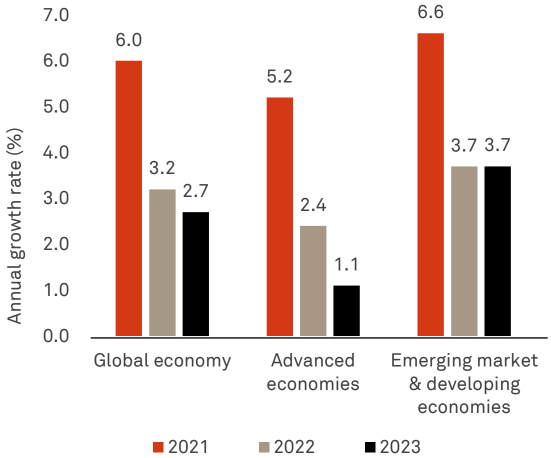
Note: All forecasts refer to IMF forecasts from calendar years 2022-2026; GDP growth is based on constant prices
Source: IMF (World Economic Outlook – July 2022 update)

Downside risks to the outlook

Investor experience is going to be an important aspect that will have a bearing on penetration in coming years. That is because investors who came in recent years have not experienced a prolonged market downturn such as the one seen during the 2008-09 financial crisis, or the European slowdown before that.

The IMF, in its latest economic outlook, has said that countries representing a third of world output could be in recession in 2023. It has warned of a disorderly repricing in markets, saying global financial stability risks have increased, raising the risks of contagion and spillovers of stress between markets.

Recessionary worries cast gloom



Source: IMF WEO, October 2022

Any prolonged downward pressure on the markets will impact investor sentiment and alter their experience and views on their investment trajectory.

Per-capita income surpasses inflection point

India's per-capita income crossed the $2,000 threshold in 2021, i.e., the inflection point when income crosses the subsistence expenditure level and moves on to spending and investments.

India's per-capita income expanded 7.6% last fiscal. The IMF estimates the country's per-capita income (at constant prices) would clock a 6% CAGR between fiscals 2022 and 2025, and nominal GDP per capita (at current prices) would log a 15% CAGR.

High per-capita income, prospects of strong economic growth, financialisation of household savings, emergence of technology, and access to capital market products provide a fillip to the investment climate in the country.

Rising middle-income population and demographic dividend

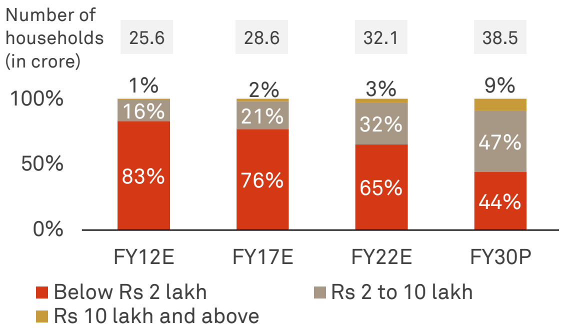
An estimated 83% of households in India had an annual income of less than Rs 2 lakh in fiscal 2012. That number reduced to 76% in fiscal 2017, and is expected to touch 65% this fiscal owing to the continuous increase in GDP and household incomes.

The proportion of middle-income India — defined as households with annual income between Rs 2 lakh and Rs 10 lakh — has been rising over the past decade. CRISIL MI&A Research estimates there were 4.1 crore households in India in this category in fiscal 2012. By fiscal 2030, these are projected to reach 18.1 crore.

That's around 1.5 times the number of households (12.4 crore) in the US as of 2021[10].

A large number of these households, which have entered the middle-income bracket in the past few years, are likely to be from the semi-urban and rural areas. The rise in incomes in these areas is also evident when one observes the trend in share of deposits coming into the banks. As of March 2021, districts outside the top 200 accounted for 30% of total deposits, up from 25% in March 2015

Household distribution by income



Note: E: estimated, P: projected. The boxes on top of each bar in the chart represent the total number of households in millions.
Source: NCAER, CRISIL MI&A Research

10 US census

Further, India has one of the world's largest young populations and is expected to retain this young demography in the near future. As per United Nations population projections, about 94 crore people, or 67% of India's population, currently belong to the working age group of 15-64 years. This cohort will increase by 10 crore over the next decade, despite declining birth rate.

Indeed, over the next decade, more than a fifth (22.5%) of the incremental global workforce will come from India.

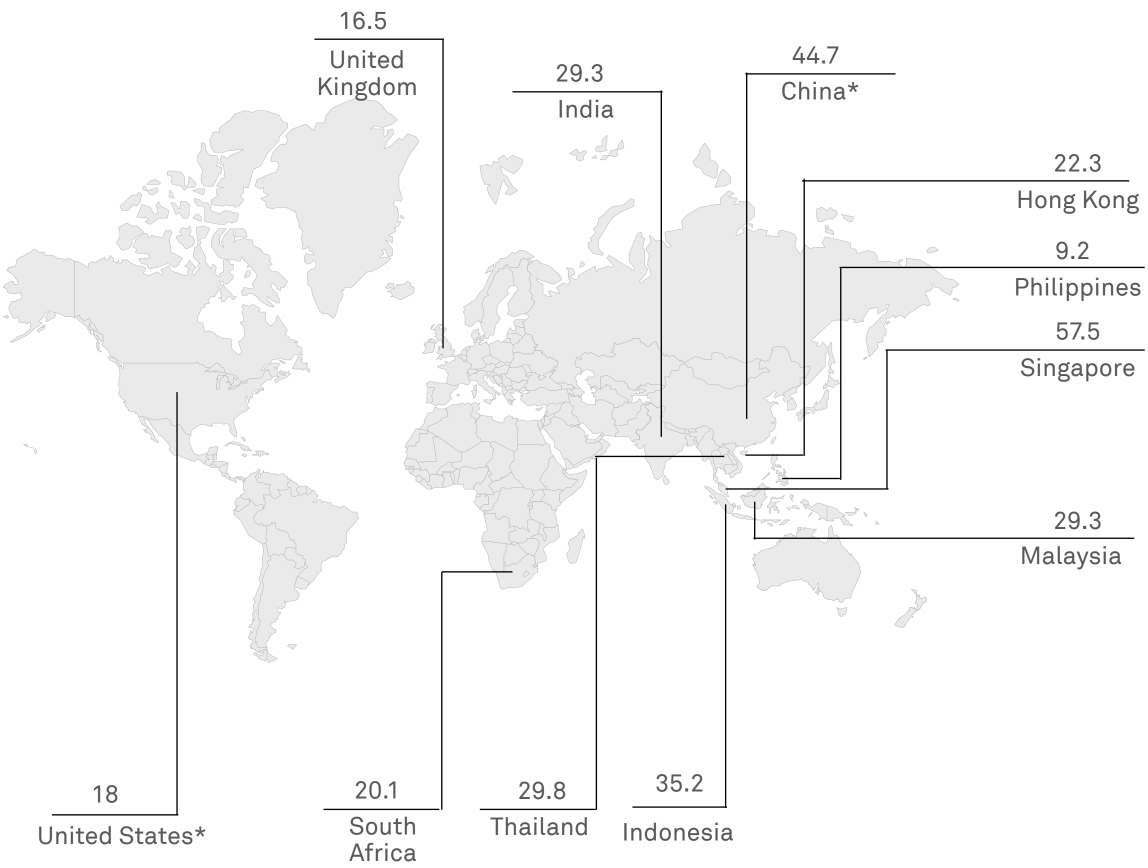
Growth of middle-income households and young demography, coupled with improvement in financial literacy, access to information, and awareness, is expected to bolster the managed investments industry.

The financialisation story

India's financial inclusion improved significantly over 2014-21 — the share of adult population with a bank account increased from 53% to 78% on the back of government measures and proliferation of supporting institutions.

This is improving the financialisation of savings rate of Indian households, which is one of the highest in the world. At end-2021, the domestic savings rate of 29.3% was higher than the global average of 26.9%.

India's savings rate is higher than the global average (%, 2021)

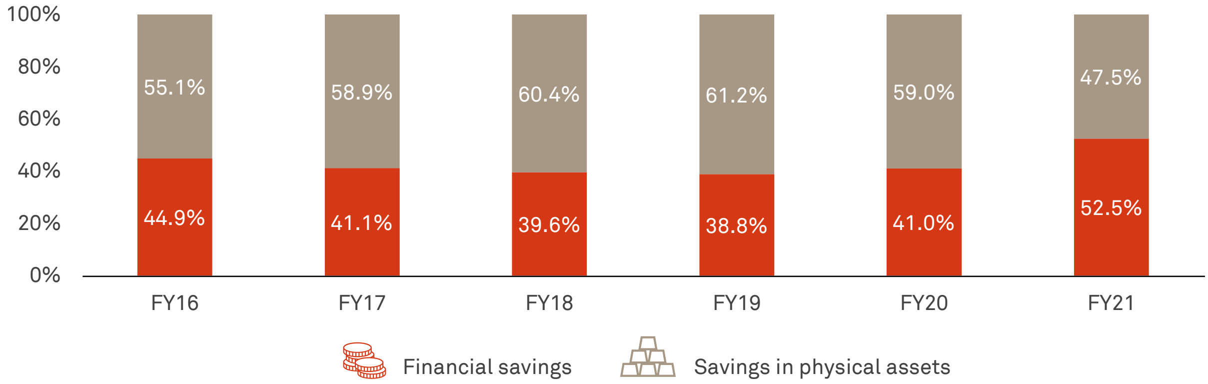


* Data for 2020
Source: World Bank, CRISIL MI&A Research

Indian households have traditionally held more physical assets such as real estate and valuables in the form of gold. That said, they are increasing investments in financial assets.

According to the RBI, the share of financial savings increased from 45% in fiscal 2016 to 52% in fiscal 2021, while that of physical savings fell from 55% to 48%.

Share of net financial savings increased from 45% in fiscal 2016 to 52% in fiscal 2021

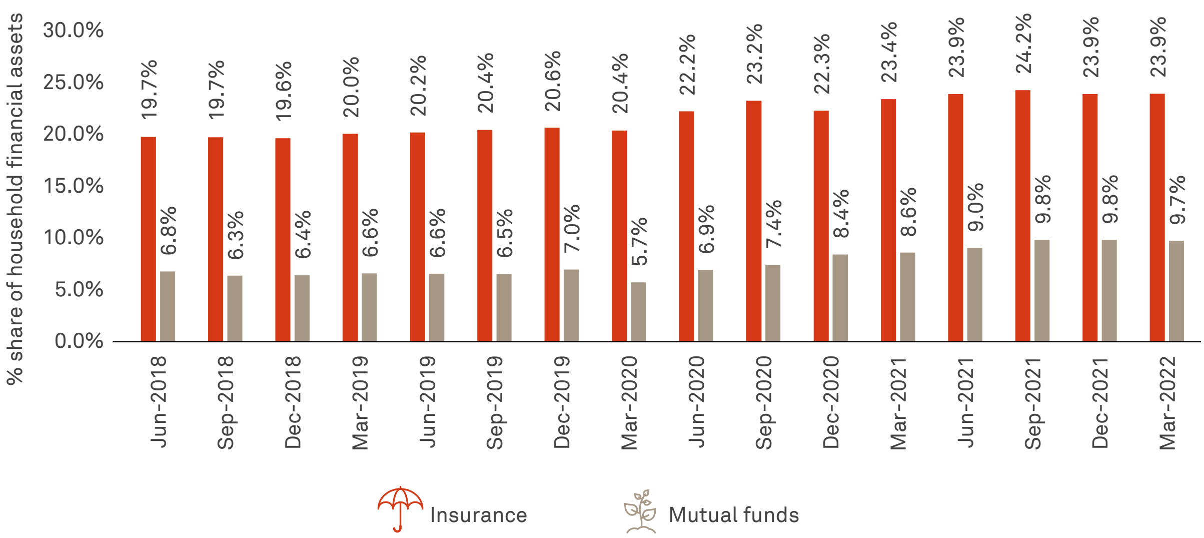


Note: Data is for financial year ended March
Source: RBI, CRISIL MI&A Research

Within financial savings, households are shifting to capital market instruments

The money getting financialised is increasingly being invested in capital market products such as MFs, whose share increased from ~7% in June 2018 to nearly 10% in March 2022, while the share of insurance funds has risen from ~20% to ~24% during the same period.

More household money flowing into the capital markets



Source: The RBI's outstanding position of financial assets and liabilities of households

CRISIL MI&A Research expects this share to increase over the next five years, driven by higher financial literacy, relative outperformance of capital market assets vs bank deposits in recent years, and the government's efforts to fight the shadow economy.

This is expected to boost financial investments in equities, MFs, pension schemes, insurance and alternative assets.

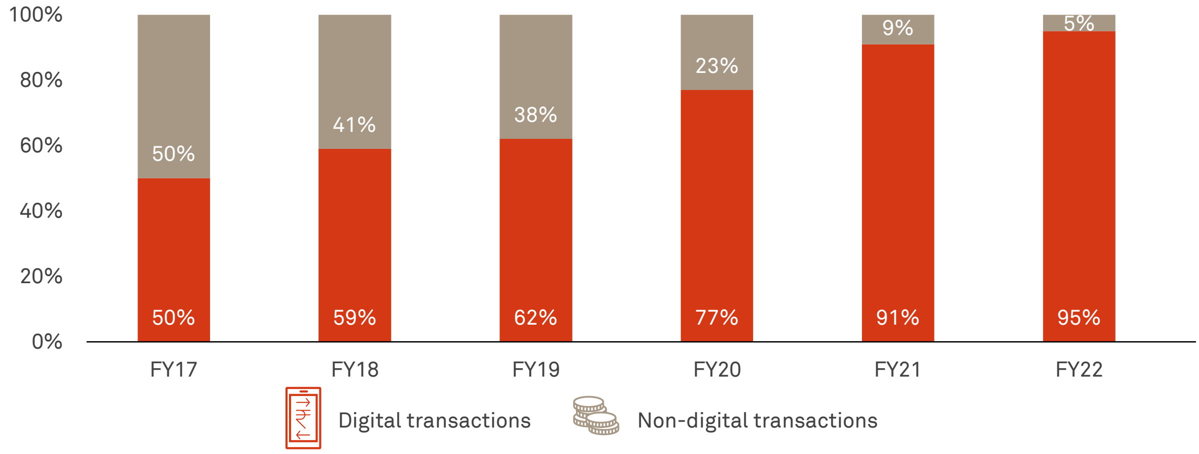
Bharat checks in

Technology and intermediation will be the key factors to penetrate the hinterland of the country.

Technology helps surmount challenges stemming from India's vast geography, which makes physical footprints in smaller locations commercially unviable. Given India's young demographic structure, technology acts as an enabler for the people and the country.

Demonetisation, when cash transactions fell and many new accounts were opened, led the shift in customer preference towards digital channels. Social distancing amid the Covid-19 pandemic gave further impetus to the shift.

Financial transactions by volume



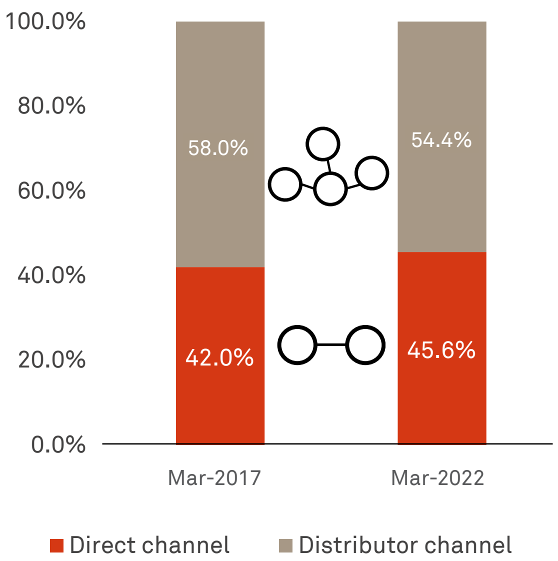
Note: Digital transactions include RTGS (excluding interbank clearing), ECS, NEFT, IMPS, NACH, cards and prepaid instruments; non-digital transactions include cheque/paper clearing and ATM transactions
Source: RBI, CRISIL MI&A Research

The investment industry is also moving towards digital channels of intermediation and investment, with a barrage of online options for investors across product segments. The pandemic-induced economic lockdown showcased the benefit of this technology, with money continuing to flow into the various industry segments.

The usage of technology is also resulting in a rising number of do-it-yourself (DIY) investors opting for this cheaper route of investment. Case in point, the AUM of direct plans of MFs grew to 46% in March 2022 from 42% at the end of March 2017.

That said, a large set of investors (existing and new) will continue to need support and guidance to funnel their money into the managed investments industry, to achieve their desired goals.

AUM growth via direct plans



Note: Based on monthly average AUM
Source: AMFI, CRISIL MI&A Research

Use of technology across the value chain, including planning, onboarding, transacting and settlement, and reporting will improve investor experience.

Feet on the street

A key spoke in the wheel for penetration of financial products in the country is the development of the distributor segment.

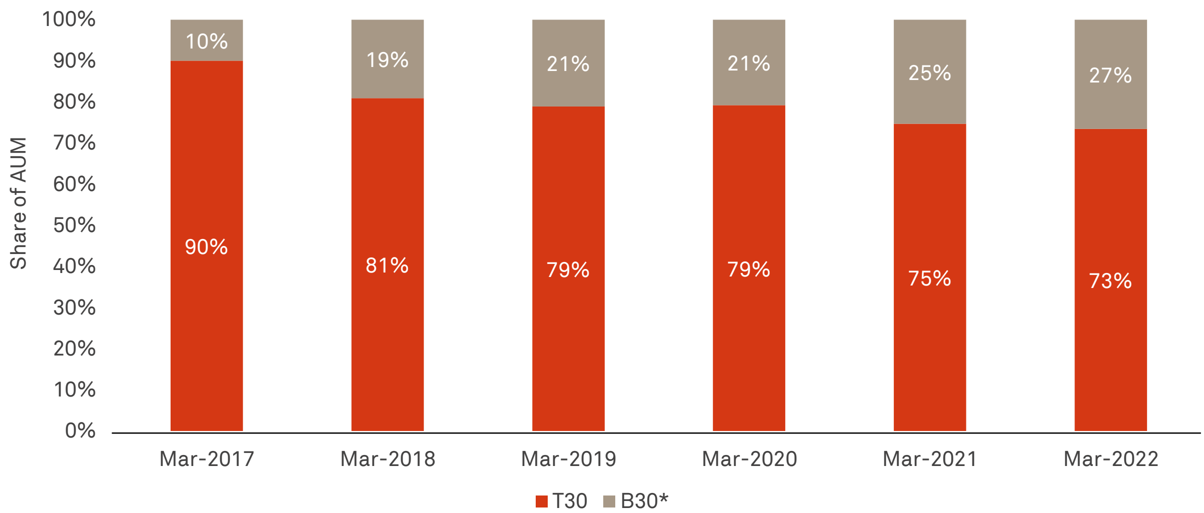
Intermediaries not only add subscribers/ investors, but also handhold them while spreading awareness and maintaining persistency. It is, therefore, important to have a developed intermediation system in place.

The insurance industry has taken a lead in this, also due to its vintage and the development of Life Insurance Corporation (LIC) of India. The segment has more than 24 lakh agents selling products across the country, while there are just about 1.25 lakh distributors in the mutual fund industry, and less than 100 point-of-presence (PoP) centres for NPS. Further, within active ARNs (AMFI registration number), around 1,500 agents received commissions of more than Rs 5 lakh in fiscal 2022 from selling MFs.

Lack of growth of distributors is also linked to insufficient incentivisation, which can lead to unviable business models. Further, the registered investment advisor (RIA) has also failed to take off due to inability to get a fee from investors — something that has also been seen globally.

It is, thus, important to sufficiently incentivise the intermediary to sell the product. For instance, the share of B-30 (beyond top 30) cities has grown to ~27% at end-March 2022 from ~10% five years ago, helped by higher incentivisation (30 bps) for inflows from retail investors of these centres.

MFs penetrating deeper into hinterland



Source: AMFI, CRISIL MI&A Research
*Including NRIs and overseas. Data based on monthly average AUM

Having a slab-based incentive structure and differential commission for different geographies to improve penetration can aid distribution for emerging segments such as NPS. The trail-based fee model followed by MFs ensures reduced churn and longer persistency of investment, which can be considered by other segments.

Sustaining the trend of incentivisation and efficient use of technology ensures a win-win situation for the industry and investors.

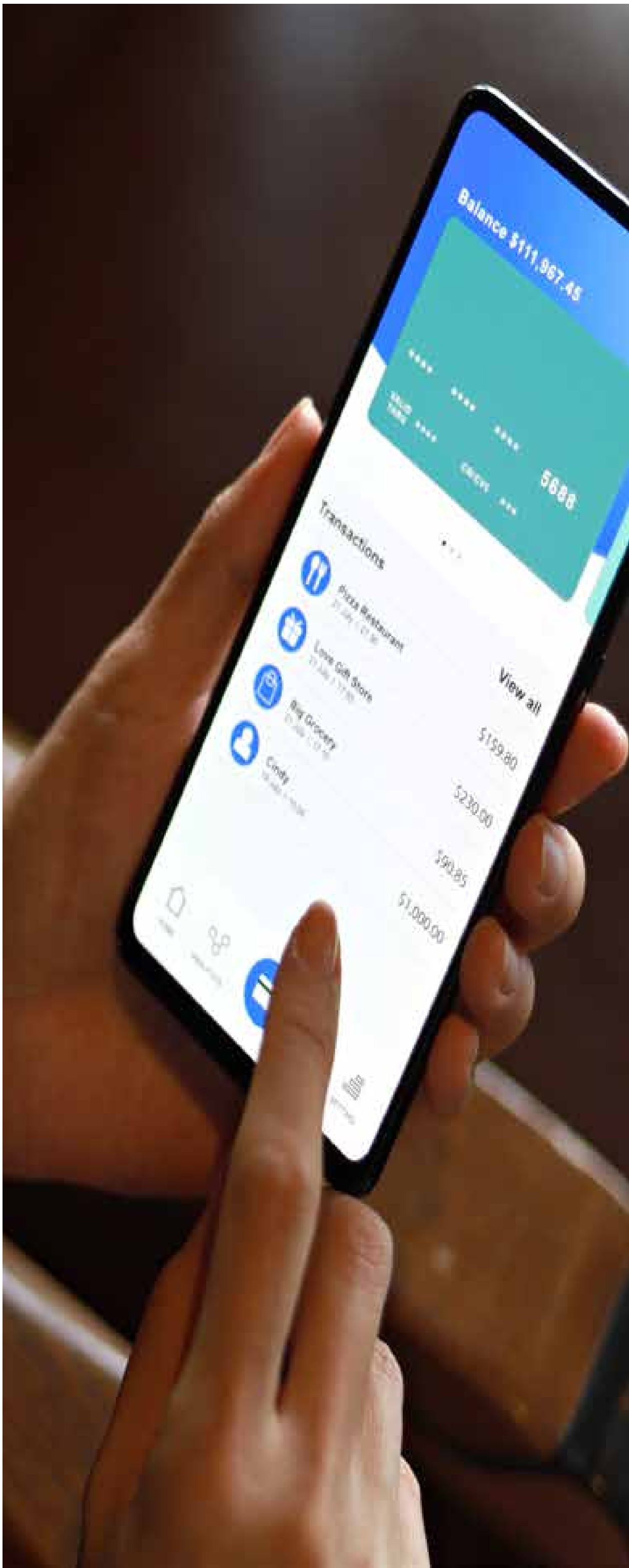
Additionally, usage of banking channels for targeting the retail audience, especially from the B-30 segment, partnerships with fintechs, e-commerce networks, small finance banks, self-help groups, and India Post will add feet on the street.

Ironing out tax differential

The investment industry also faces arbitrage in terms of regulations and taxation between segments. For instance, within retail, tax benefits are extended to all investments in insurance and pension products subject to the broad (Section 80C) and specific (Section 80 CCD) stipulations. However, MFs are bereft of tax benefit, except for the equity-linked savings scheme category. Similarly, tax diffrences exist for high-ticket mandates of AIFs and PMS.

At the time of vesting, too, there are variances between product segments and asset class categories.

Having directionally similar taxation and regulations enables passing on similar messages to investors, allowing them to make better-informed decisions based on their risk-return profiles instead of grappling with various complexities.



Segment-specific trends

Mutual funds

Insurance and retirement funds have benefitted from the regular investment feature built into their products. Investors of the MF industry have adopted a similar structure through systematic investment plans (SIPs).

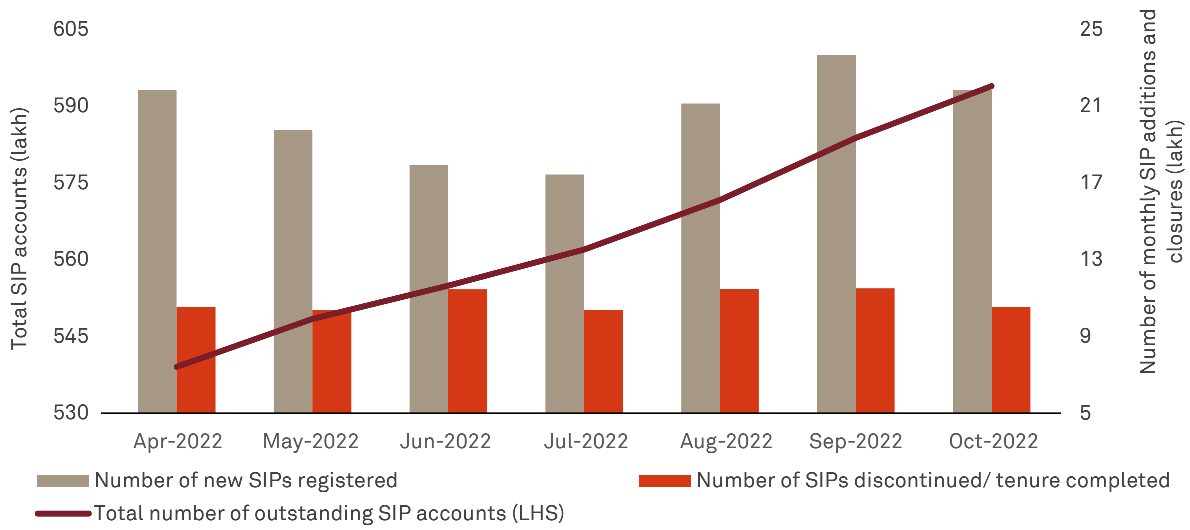
MFs gain as SIPs proliferate

A case in point is the proliferation of SIP accounts to ~6 crore as of October 2022, up 66 lakh accounts since the start of this fiscal.

The ratio of new SIP accounts opened to those closed also remains healthy, at about 2.4:1.

Assets under SIPs crossed Rs 6.5 lakh crore as of October 2022, taking their share to nearly 17% of the overall industry AUM. Further, this flow of money into MFs has been growing despite market volatility. SIP investments have increased from a mere Rs 3,000 crore as of April 2016 to over Rs 13,000 crore as of October 2022.

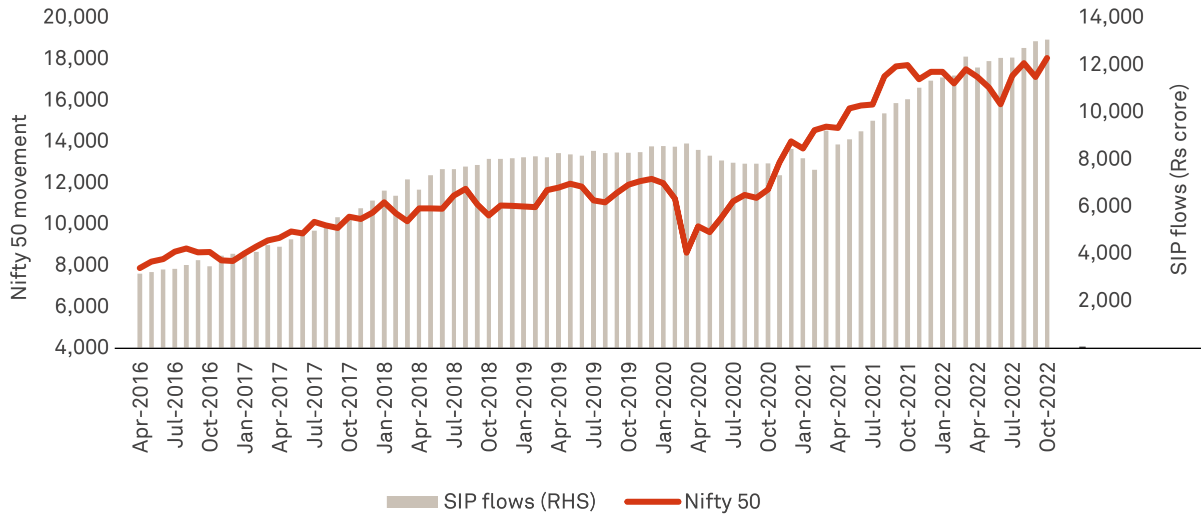
New investors opting for the SIP route vs discontinued accounts



Source: AMFI, CRISIL MI&A Research

Significantly, this growth continued unabated through the Covid-19-led crash of March 2020, the subsequent sideways movement, the global geopolitical situation, and the current spike in inflation.

SIP flows unaffected by market volatility



Source: AMFI, NSE, CRISIL MI&A Research

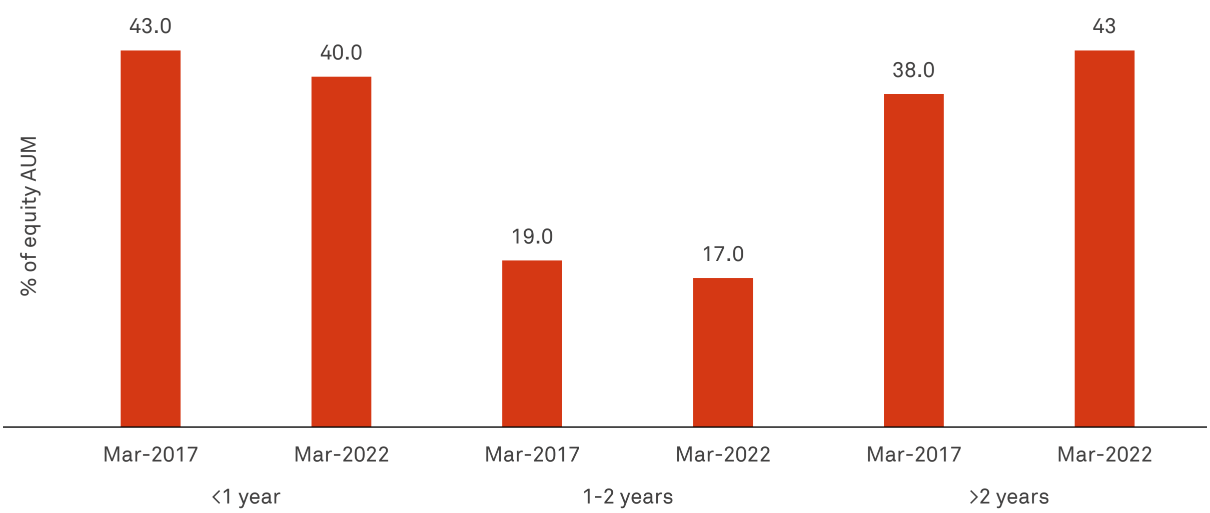
Using the sachet investment format to reduce the ticket size of investing in MFs would also aid penetration.

Expanding investment horizon to sustain growth

If we analyse individual investor investment in equity MFs by age, the maturity horizon among investors holding funds for more than two years has increased to 43% as of March 2022 from 38% five years ago. The number of investors in the less-than-one-year horizon bracket also remains high due to the large influx of fresh investments into MFs.

Going forward, extending the investment horizon further will play a critical role in providing a fillip to the industry. For this, concentrated efforts would have to be made towards investor education.

Equity MF investors showing more patience with investments



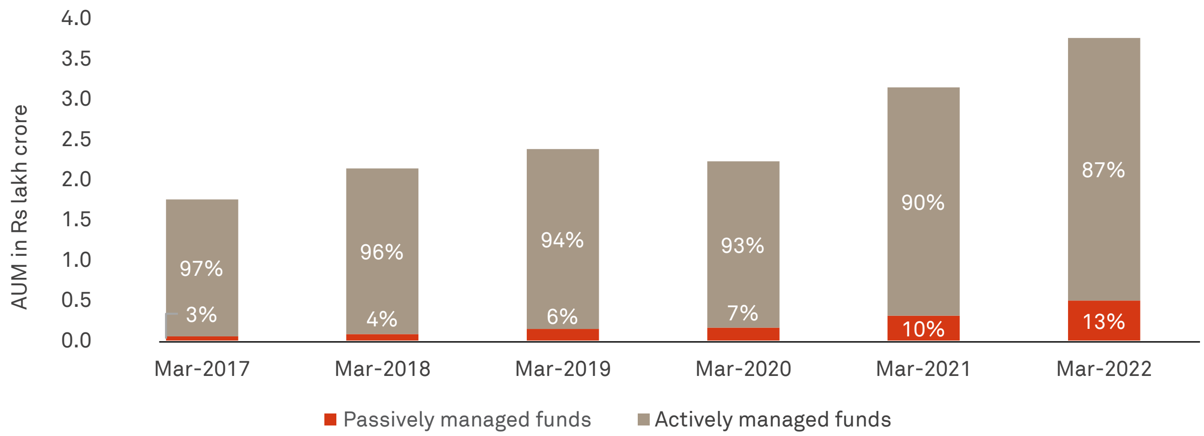
Source: AMFI, CRISIL MI&A Research

Institutions to bring long-term monies via passive investing

The share of passive funds[11] grew to ~13% in March 2022 from 3% in March 2017, led by investments from institutional investors such as PFs. While this trend of institutional investing will continue to grow in this segment, we expect individual investors to also gravitate towards this space given the declining alpha of actively managed funds.

Last year, CRISIL had released a white paper on the declining alpha in the fund industry as an increasing number of funds had failed to beat market benchmarks in recent years. Our analysis showed that underperformance of active funds is a reality, though there is variation in terms of numbers. Further, the underperformance is more evident in large-cap MFs, even as mid- and small caps have gravitated towards lower outperformance. You can read the report here.

The rise of passive fund management

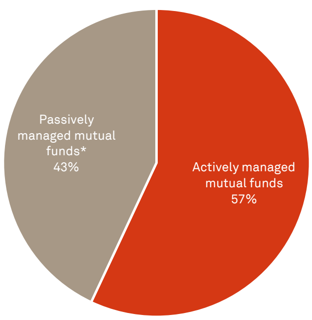


Source: AMFI, CRISIL MI&A Research

Further, the recent awareness and popularity of target maturity funds (TMFs)[12] in the debt space, and the corresponding regulatory focus are expected to benefit this segment.

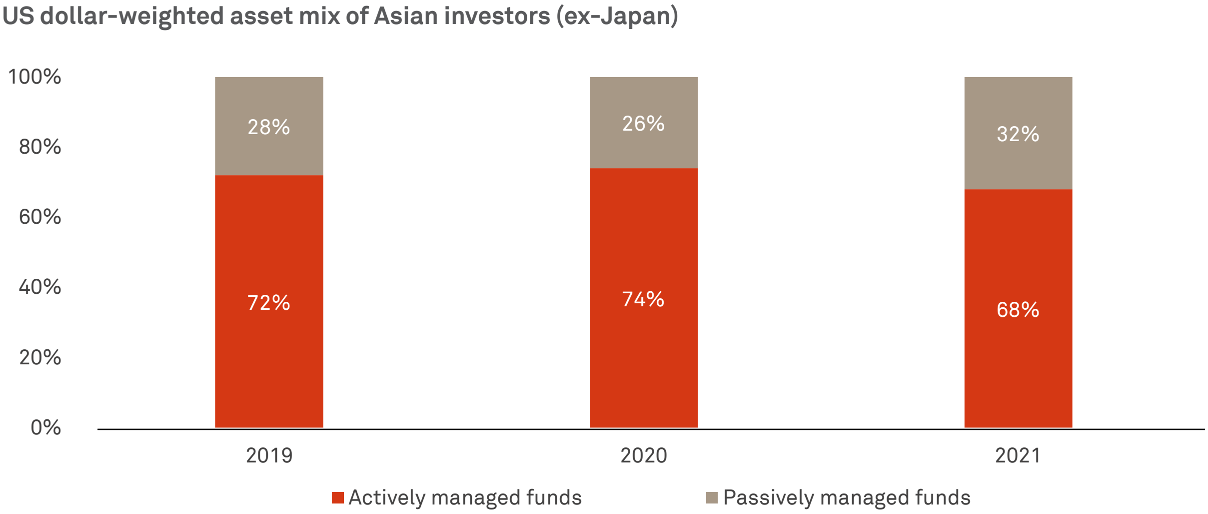
This rise in the share of passive funds in the Indian MF industry is in line with global peers. In the US, the share of passives was 43% in 2021 vs 19% in 2011, while in Asia ex-Japan, it was 32% in 2021.

As of 2021, 43% of US MF industry was passively managed



*Includes index MFs and index ETFs
Source: ICI Org, CRISIL MI&A Research

11 Includes ETFs and index funds
12 Target maturity funds are passive debt funds that track an underlying bond index

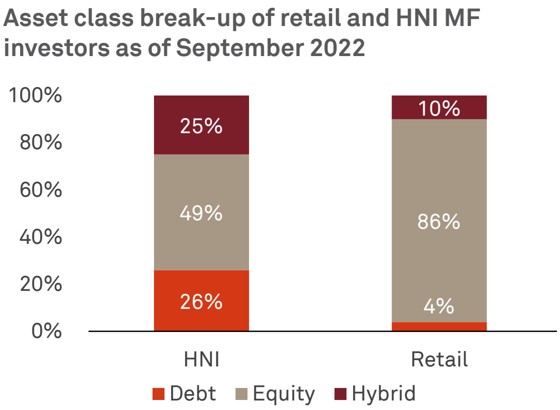


Source: Greenwich Associates, GII-Asia-21

The fixed-income dilemma

Individual investors, especially in the MF industry, have mostly preferred the equity side (86% of their investments) and shied away from the fixed-income segment due to lack of understanding and competition from traditional debt products. Therefore, it is important for the MF industry to educate investors about the opportunities on the fixed-income side.

Product innovation in terms of simple predictable return avenues — as seen in the success of TMFs recently — would also help bring in individual investors to the debt flank. Further, there is a big opportunity in the global play on yields.



Note: AMFI defines HNIs as individuals investing Rs 2 lakh and above
Equity includes growth/equity-oriented schemes, solution-oriented schemes, index funds, exchange traded funds (ETFs; other than gold), and FoFs investing overseas. Debt includes liquid/ money market/ floater funds, gilt funds with a 10-year constant horizon, remaining income/debt-oriented schemes, and gold ETFs.
Source: AMFI, CRISIL MI&A Research

Retirement funds

Formal sector driving retirement funds growth

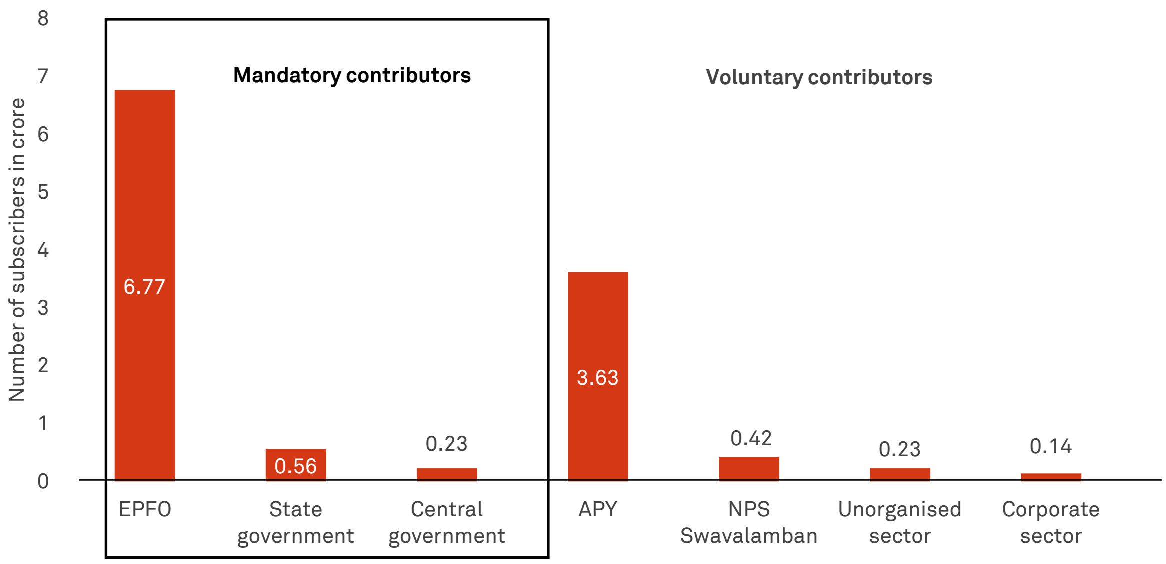
The formalisation of the economy will be an important growth driver of the retirement fund industry as it brings individuals within the mainstream segment of the financial landscape.

Subscribers from central government, state government and provident funds, which contribute mandatorily towards the retirement corpus, make up for 7.6 crore individuals.

Voluntary contribution schemes such as NPS (corporate and unorganised sector), Atal Pension Yojana (APY), and Swavalamban have 4.4 crore individual subscribers.

The total number of accounts from these schemes is around 12 crore, compared with a working-age population of 94 crore individuals in the country. Thus, there is a large untapped market for the retirement industry to grow in the voluntary contribution space, which, if covered, can emerge as a big growth catalyst.

Retirement fund industry subscribers



Source: EPFO, NPS Trust, CRISIL MI&A Research

APY can improve pension penetration in the country

APY, which leverages the power of the Jan Dhan-Aadhaar-Mobile (JAM) trinity, has picked up strongly since its launch, covering more than 3.5 crore subscribers and accounting for nearly 70% of NPS subscribers. The potent mix of a targeted pension payout working on the JAM trinity has been able to improve pension penetration in the country.

However, if we look at the overall working-age population, pension penetration remains abysmal, and APY has the potential to increase that substantially. For instance, there are 47.5 crore Jan Dhan accounts[13] , of which nearly 80% are operative with an average of around Rs 4,000 per account. Each subscriber is thus a potential APY candidate, building the pension coverage in the country from ground up, especially in the unorganised segment that is not covered by the regular social security structure.

13 https://pmjdy.gov.in/statewise-statistics

Viability, intermediation and awareness key to greater success

NPS has a low-cost structure that is beneficial for investors, but it creates a challenge for achieving higher penetration.

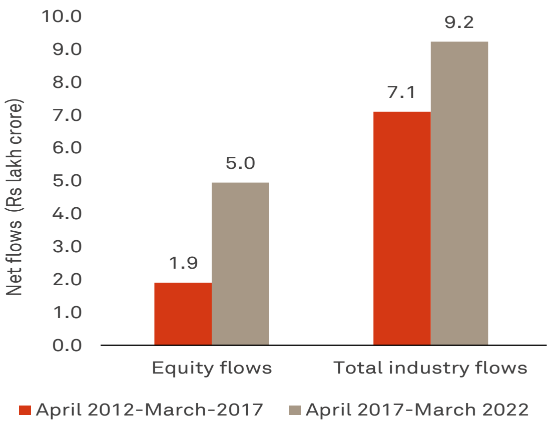
It is thus crucial that the business be made viable for both the asset manager and the intermediary so that it sustains over the long term and facilitates handholding services across the investment horizon of investors. Slab-based incentive structure and differential commission for different geographies can be adopted to improve penetration.

Further, investors lack awareness about NPS, especially in the informal sector. Hence, a focused investor awareness programme on the likes of the 'Mutual Funds Sahi Hai' campaign run by AMFI, backed by a dedicated fund for investor education, can bring a larger workforce under the pension fold.

Following the launch of the 'Mutual Funds Sahi Hai' campaign, the industry saw a total inflow of Rs 9.23 lakh crore between April 2017 and March 2022 — as much as 30% higher than the inflows seen in the previous five years. The impact on equity flows (invested mostly by individual investors) has been significantly higher, with the category seeing inflows of nearly Rs 5 lakh crore in five years since the campaign's launch — 2.5 times the inflows seen in the previous five years.

Net flow sahi hai

Before and after the 'Mutual Funds Sahi Hai' campaign



Source: AMFI, CRISIL MI&A Research

Decumulation flexibility

The payout phase is as critical as the contribution/ accumulation phase in ensuring old-age security for the elderly.

Under the current NPS regulations, while 60% of the corpus can be withdrawn by an investor at retirement as lumpsum, without tax impact, the remaining 40% has to be used to purchase an annuity product.

Considering the low annuity rates offered, investors should be allowed better ways to liquidate — such as systematic withdrawal plans — to get flexibility on their cash flows.

Designing an effective payout system with some checks and balances will ensure an individual is able to meet basic needs during the retirement phase, as well as maintain a comfortable and healthy lifestyle and overall success of the system.

Life insurance

Insurance to maintain steady pace, led by rising awareness

The life insurance industry is expected to grow steadily on the back of increasing awareness among individuals, fuelled by the Covid-19 pandemic. The traditional bent of investors towards the product — on average 23%[14] of annual household savings have flown into insurance funds in the past three years — will also stoke growth.

Digitalisation at the core of industry transformation

Advanced technology has already become an integral part of the insurance industry. Nowadays, an individual can easily compare different life insurance quotes across various companies just by clicking a button. Managing coverage or checking the policy status can also be easily done via mobile apps or insurer websites. Such digital transformation offers insurers opportunities to redesign their business models to enhance customer satisfaction, reduce cost, and prevent errors.

The purported in-principal approval by the Insurance Regulatory and Development Authority (IRDAI) of Bima Sugam, a one-stop platform for all insurance needs — buying and selling, claim settlement, and agent and policy portability, across life and general insurance — is expected to improve efficiency and boost digitalisation in the industry.

Bancassurance[15] channel continues to grow at a robust pace

The life insurance industry, especially private insurers, has leveraged banking channels significantly to foster growth, in addition to traditional distribution channels.

Over time, this has led to an increase in the share of the bancassurance channel in new business premium — at ~32% in fiscal 2022 vs ~15% in fiscal 2012 — and a decline in the share of individual agents in distribution of individual life insurance products.

This has been driven by bank-promoted private life insurers and those who have empanelled large private or public sector banks with strong branch networks as their corporate agents. For private insurers, the share of bancassurance — at ~55% in fiscal 2022 on an individual basis — is much higher compared with the overall industry. This trend is expected to continue.

Trend in channel-wise share of individual new business premium of overall life industry

Channel-wise new business share	FY12	FY17	FY22
Individual agents	78.7%	68.8%	55.0%
Corporate agents – banks	15.0%	23.5%	32.0%
Corporate agents – others	2.7%	1.3%	1.9%
Brokers	1.8%	1.3%	1.9%
Direct business[16]	1.9%	5.0%	8.5%
Total	100.0%	100.0%	100.0%

Note: Total excludes referrals. Individual new business premiums in FY12, FY17 and FY22 were Rs Rs 0.65 lakh crore, 0.78 lakh crore, 1.25 lakh crore, respectively
Source: Public disclosures of LI players, CRISIL MI&A Research

14 RBI - Flow of Financial Assets and Liabilities of Households - Instrument-wise
15 “Corporate agents – banks” only
16 Includes online business through company website

Other factors that could benefit the industry

Increased awareness about retirement planning and focus of life insurance companies on improving the understanding of annuity products offered by the industry could attract investment in the space. Further, strong growth in group credit protect plans due to an expected robust rise in retail credit will support industry growth.

AIFs

Chase for returns propels the alternatives segment

Given the declining alpha of actively managed MFs and declining yields of fixed-income funds, investors in the affluent segment have shifted to alternative investment funds (AIFs). For instance, the aggregate performance of venture capital funds belonging to vintages 2016, 2017, 2018 and 2019 was better than that of S&P BSE Sensex as of September 2021. Similarly, debt AIFs across vintages, on average, delivered double-digit returns while outperforming the debt market index, i.e., CRISIL Composite Bond Fund Index.

AIFs will remain the fastest-growing segment of the investment landscape over the next few years as a rising number of the rich look at differentiated products and better returns for their investments.

Domestic capital flow increasing

Currently, AIFs are dominated by foreign investors. The shift in focus of intermediaries such as distributors and family offices from traditional products to AIFs will funnel domestic capital into the segment. In recent years, domestic institutional investors such as pension funds and insurance companies have been allowed in, which will be a major growth driver for the segment. The investor mix is expected to reverse in favour of domestic investors in coming years.

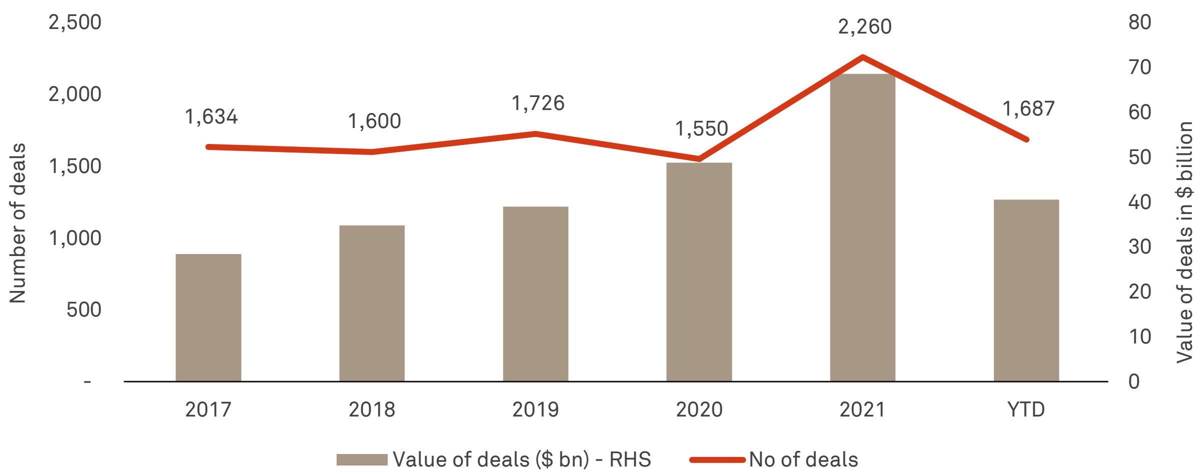
However, for this to happen, the conditions laid out by retirement funds for investment in AIFs need to be suitably modified to enable them to participate in this product. For instance, the requirement of AA or equivalent rating restricts the universe of eligible AIFs to debt funds. Similarly, investment conditions for category II funds also limits the eligible investment universe.

Supply surplus

Recent years have seen the growth of the start-up culture in India. Government data shows the total number of recognised start-ups in the country was more than 77,000 as of August 29, 2022.

The private equity industry has seen strong growth over the past decade, with investors rushing to invest in start-ups in India. There are a growing number of private market deals and initial public offerings as well. The total value of private market deals has grown to $232 billion over 2018-2022 YTD from $98 billion over 2013-2017.

Deals in private markets



Source: VCCEdge

All these factors provide fuel for the supply-side dynamics of the AIF industry, which invests large portions of its monies in start-ups. The dynamic nature of the underlying supply will also ensure there are enough exit options, boosting investor confidence.

Asset management practices

The AIF space is still evolving. While performance is a critical factor to be looked at; evaluating funds on the quality of investment and risk management processes, the overall governance architecture including oversight of the sponsor and the Board and experience, and talent of the investment team are equally important.

Given the nature of investments done by AIFs, it is important to have adequate risk controls and ensure those are implemented consistently over the life of the fund. Some of the best practices followed by established industry segments such as insurance and MFs can be adopted. This is critical from the perspective of instilling investor confidence in the long term and attracting institutional capital from retirement funds and insurance, and also foreign flows.

Regulatory and government focus

Over the past two years, the regulator has taken several important steps, such as standardisation of the private placement memorandum (PPM), PPM audits, and mandatory benchmarking of AIFs, with a view to improving transparency and helping investors make informed decisions. This has played an important role in reaffirming investor confidence in the industry. The regulator's continued focus on this will be one of the important enablers of industry growth.

In addition, simplification and standardisation of the taxation structure across categories will help improve investor participation in the industry.

The government remains committed to funding start-ups. In 2016, it launched a Rs 10,000 crore FoF for start-ups under the Startup India initiative. This will be an additional push for the industry.

Performance of AIFs to play a critical role in future growth

Distributions made by AIFs show the realised gains made by investors.

The table below represents the drawdowns and distributions across funds belonging to various sub-categories as of September 2021.

Sub-categories	Capital drawdown (Rs crore)	Distribution (Rs crore)	Ratio of distribution to capital drawdown
Venture capital fund	14,426	2,472	0.17
Equity funds – unlisted	33,733	3,239	0.10
Equity funds – listed + unlisted	44,706	10,621	0.24
Real estate funds	38,190	16,709	0.44
Debt funds	22,460	12,797	0.57
Other categories	49,353	15,977	0.32

Source: CRISIL MI&A Research

Barring debt and real estate funds, other categories of funds have lower distributions compared with drawdowns. This and the fact that 56% of the 881 AIFs registered with SEBI as of March 2022 were registered only in the last four years, show that most of the AIFs are yet to complete their life cycle and distribute a large portion of their portfolio.

In the coming few years, many AIFs will be moving towards the end of their life cycle. Hence, the ability of fund managers to make timely exits from their portfolio companies at favourable valuations will be a key factor that will decide the experience that an AIF investor will have. This, in turn, will determine their readiness for future investments in the segment.

PMS

Institutional portfolio management to drive PMS industry growth

PF money accounted for over 80%[17] of the PMS industry as of March 2022. It is expected to retain this share and drive growth of the segment over the next five years as the economy gets formalised and more people get employed in the organised segment.

Non-PF portion to benefit from need for customised products by HNIs

The non-PF portion of the segment is expected to benefit from the bespoke product requirement of the growing HNI population in the country. The ability of the industry to create tailormade products from the public market segment for the rich will continue to drive asset growth for the segment.

Formation of industry body APMI a positive

One of the significant positive developments for the PMS industry has been the establishment of the trade body, Association for Portfolio Managers in India (APMI). While the formation of the trade body itself will give voice to the industry's concerns and opinions, it should also focus on investor communication and raising awareness about PMS as a product.

Sharp focus needed to resolve operational challenges

The retail product segments of MFs, insurance and pension have adopted the digital route of on-boarding new investors quite successfully. Not so for PMS, as investors need to sign a physical copy of the power of attorney, which is yet to be digitalised.

The minimum investment amount required for PMS is Rs 50 lakh. While this amount is less than the minimum requirement for AIFs – Rs 1 crore – the PMS investors pay the whole amount in a single tranche, while AIF investors pay the same in different tranches as and when the capital is called. Allowing PMS investors to commit Rs 50 lakh but invest the same in smaller tranches will help attract more investors to the segment.

17 EPFO / PFs manage their assets through PMS

Notes

Notes

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