Mutual Funds – A Closed Chapter for Unlisted Debt Funds

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What is there in the Securities and Exchange Board of India (SEBI) Stricture?

SEBI, vide its circular dated 1st October 2019 ("Circular") has mandated and restricted all Mutual Funds to invest only through the listed and rated debt mutual funds and Securities channel, paving the way for enhanced credit risk management. This will result in higher and secured returns for the investors and fund managers.

The Circular further instructs that it will not stop the funds to invest in unlisted Non-Convertible Debentures (NCDs) on the condition of maintaining a simple and verified structure.

The Circular also grants leverage to invest in Securities under the government issuance and control and also in those for whom the credit rating is usually not ascribed.

A Critical Post-Mortem

The Circular is the stepping stone of a new era where the rights of the Fund Manager Companies of Debt Funds are severely curbed in so far as the investment in unlisted, unrated and credit enhanced securities are concerned. SEBI has actually attempted, with all sense and logic, to increase the security parameters and minimise the risk factors in investing funds in unlisted commercial papers. It is a proven methodology that the mandatory listing always forces and obligates the issuing companies of Debt Funds to furnish some additional declarations and trivia pertaining to their financial profile and thereby making things more transparent for the investors and the regulatory authorities.

Further, the Circular provides a fair restrictive measure to tightrope and prevent the unlisted commercial papers from being over-exposed and squeezed which has so far been the main source of a number of issues in the recent debt crisis. The Circular has made the domain a lot more rigorous and drastic for the Mutual Funds by absorbing the unexpected and increasing exposure to unrated debt funds, to a reasonable limit of just 5% of the net assets of a scheme compare to the present 25% irrelevant and harmful exposure allowed to such securities.

These guidelines by SEBI are expected to be beneficial in multiple ways as it will improve and bring back the confidence of the investors in debt funds, once lost in insecurity whirlwind. Moreover, it is helpful in diversifying scheme portfolios according to requirements and trends. Additionally, the guidelines facilitate regrouping the level of risk management.

One of the major revelations and key reforms of this Circular is that Debt Mutual Funds can only invest in listed securities including but not limited to listed commercial papers and prescribes certain limits for investment in sponsored group and sector exposure.

Though many Debt Mutual Funds have taken and recorded in their Books of Account investment in Commercial Papers on an unlisted footing prior to this Circular coming into effect, SEBI has now outlined a procedure for the same towards a workable resolution to the effect that such funds shall be allowed to be held till maturity.

The Circular also ignites controversies and debates as one major flaw still exists in the form of indulgence to unwanted exposure to non-sponsor groups at a pretty higher quantum and no real regulatory actions prescribed to limit its volume. Further, criticisms and contra feedback are being posted recurrently saying that these new measures will definitely fetch the best from all Asset Management Companies (AMC). And AMCs will be agile enough to remain glued to their objectives in determining the creditworthiness of the issuers and helping in decreasing the dependency level on different credit rating agencies. A few have given their statements unhesitatingly that this Circular is at a very precarious stage insofar as its applicability and enforceability are concerned. The wide-ranging norms under this Circular will be implemented within one month after the framework for listing all commercial papers and Debt Mutual Funds is structured and made functional or by 1st January 2020, whichever is later. A fund manager didn't even let that situation go where doubt had been cast as a common practice regarding the financial credibility of the issuers and this Circular will invariably add an extra layer in the disclosures of the issuers' financial data and profiles and will also enhance transparency tier and the Debt Funds will now get a real thrust and boost but that is more of an operational change rather than a change in strategy, provisions, and methodology as many Commercial Paper issuers were already issuing listed NCDs. Many schemes have an unambiguous write-up including provisions laid down in their scheme information documents for remedying various breaches and contraventions, therefore, no regulatory framework is required on the same.

How It Ends?

The sublime principle in Circular is armoured with multifaceted wings and weapons and the Circular has created a good notch from the regulatory aspect as it brings about some much expected and much-awaited tightening of the investment norms in Debt Funds market although some of the major bugs remain unattended and not fixed yet.

SEBI is surely working on it and shall put the Circular on a review table for a microscopic screening and scrutiny of the Circular where we all will have a flawless and all-pervading, purpose serving, object-oriented and centralised circular in force.

That day is nearby to welcome the Circular and stricture with grace!!!

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