equaliFi ACADEMY

FII

CERTIFICATE IN
FIXED-INCOME INVESTING

# Session 8- Fixed Income Investing

# Key SEBI Rules

# Portfolio Concentration - SEBI Rules

| | |
|---|---|
| Single Issuer | 10% of NAV (12% with Trustee approval) of the Scheme |
| Single Sector | Existing: 25% of NAV<br>Exclusion: G-Secs, T-Bills, Bank CDs, CBLO, AAA PFI, AAA PSU, Bank Deposit<br>Circular dated 1 Oct 2019: 20% (applicable by ~~1 April~~ 30 June '20) |
| Additional to HFCs | Existing: 15% of NAV of the Scheme Circular dated 1 Oct '19: 10% Additional 5% for securitized retail / affordable<br>**Overall exposure in HFCs shall not exceed the sector exposure limit of 20%** |
| Group level | 20% of NAV (25% with Trustee approval) of the Scheme Exclusion: PSUs, PFIs, PSU Banks |
| Sponsor Group | 10% (15% with Trustee approval) of the Scheme<br>(this is as per Circular dated 1 October 2019) |

# No stopping redemptions

SEBI's statement:

As a philosophy, restriction on redemption should apply during excess redemption requests that could arise in overall market crisis situations rather than exceptional circumstances of entity specific situations.

Restriction may be imposed when there are circumstances leading to a systemic crisis or event that severely constricts market liquidity or the efficient functioning of markets such as:

Liquidity issues - when market at large becomes illiquid affecting almost all securities rather than any issuer specific security.
Market Failures, exchange closures
when exceptional circumstances are caused by *force majeure*

Restrictions on redemption may be imposed for a specified period of time not exceeding 10 working days in any 90 days period.

No redemption requests upto INR 2 lakh shall be subject to such restriction

# Explanation / Background

Though SEBI's 'language' does not specifically mention it, this was done in the wake of JP Morgan (Amtek Auto) and Franklin Templeton (JSPL) episodes.

The cases are covered in detail later, in brief:

In 2015, when Amtek Auto was downgraded, JP Morgan AMC bifurcated the 'bad asset' into another sub-fund with separate NAV and the regular or 'good assets' were retained in the 'main fund' with regular NAV.

Redemptions were stopped in the initial period, and post bifurcation, JP Morgan allowed redemptions only in the 'good fund' (main fund).
This phenomenon of shoving the 'bad asset' into another 'pocket' is known as side pocketing.

In 2016, when JSPL was downgraded, reportedly Franklin Templeton sought SEBI's permission for a similar action, but it was denied.

This led to doubts in the industry whether it is allowed or not, or whether it is a case by case approval.

This clarification issued in mid 2016 settles the doubt that it will not be allowed.

This means, apart from the exceptions mentioned,

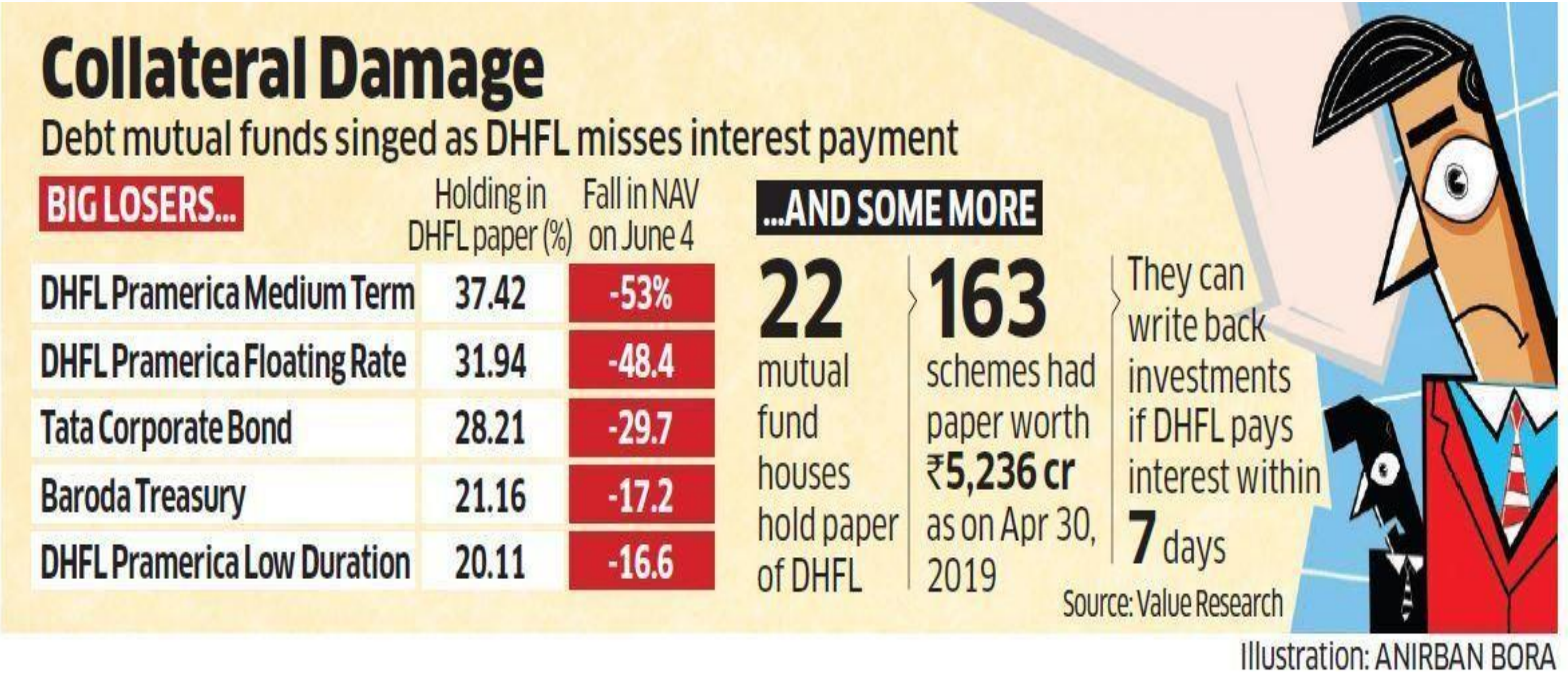
- AMCs will have to do their own risk management

- It will make them more alert

However, unwittingly, in a way, it puts the risk on the investors because if an asset goes bad (i.e. downgraded), there will be redemptions in the fund

The fund will have to sell the ‘good assets’, leading to the percentage of the ‘bad asset’ going up to that extent.

# Unintended fallout of not stopping redemptions



## Collateral Damage

Debt mutual funds singed as DHFL misses interest payment

**BIG LOSERS...**

| | Holding in DHFL paper (%) | Fall in NAV on June 4 |
|---|---|---|
| DHFL Pramerica Medium Term | 37.42 | -53% |
| DHFL Pramerica Floating Rate | 31.94 | -48.4 |
| Tata Corporate Bond | 28.21 | -29.7 |
| Baroda Treasury | 21.16 | -17.2 |
| DHFL Pramerica Low Duration | 20.11 | -16.6 |

**...AND SOME MORE**

**22** mutual fund houses hold paper of DHFL

**163** schemes had paper worth **₹5,236 cr** as on Apr 30, 2019

They can write back investments if DHFL pays interest within **7** days

Source: Value Research

Illustration: ANIRBAN BORA

# DHFL Pramerica Medium Term Fund (DPMTF)

**(An open ended medium term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years)**

**Quarterly (Jan-Mar 2019) Average AUM (₹ in Cr)**: 58.15
**Monthly Average AUM (₹ in Cr)**: 23.55
**AUM as on 31/05/2019 (₹ in Cr)**: 17.67

**Quarterly (Oct-Dec 2018) Average AUM (₹ in Cr)**: 255.77
**Monthly Average AUM (₹ in Cr)**: 105.60
**AUM as on 31/12/2018 (₹ in Cr)**: 68.18

**Quarterly (Jul-Sept 2018) Average AUM (₹ in Cr)**: 453.21
**Monthly Average AUM (₹ in Cr)**: 387.72
**AUM as on 28/09/2018 (₹ in Cr)**: 375.32

**Quarterly (Apr-June 2018) Average AUM (₹ in Cr)**: 538.05
**Monthly Average AUM (₹ in Cr)**: 498.31
**AUM as on 29/06/2018 (₹ in Cr)**: 488.58

**Quarterly (Jan-Mar 2018) Average AUM (₹ in Cr)**: 512.56
**Monthly Average AUM (₹ in Cr)**: 550.73
**AUM as on 28/03/2018 (₹ in Cr)**: 585.40

# Unintended fallout of not stopping redemptions

| Scheme Name | Redemption Trend (% fall in AUM) | | |
|---|---|---|---|
| | 1M | 3M | 6M |
| Franklin India Credit Risk Fund | -22% | -36% | -47% |
| Franklin India Dynamic Accrual Fund | -20% | -31% | -36% |
| Franklin India Income Opportunities Fund | -28% | -36% | -45% |
| Franklin India Low Duration Fund | -17% | -42% | -59% |
| Franklin India Short Term Income Plan | -23% | -45% | -56% |
| Franklin India Ultra Short Bond Fund | -19% | -41% | -53% |

*Source: MFI, FundsIndia Research. As on 22-Apr-20*

# Liquid Fund - recent SEBI Rules

**In continuation to the SEBI Board Meeting Press Release on June 27, 2019, SEBI has issued a circular dated Sept 20, 2019 on Risk management framework for liquid and overnight funds and norms governing investment in short term deposits, for mutual funds.**

**This note is an Impact Analysis of the provisions that have been elaborated by the recent SEBI Circular, as mentioned above.**

| Particulars | Provision | Effective Date | Debt Sub-Category Impacted | Nature of Impact on Schemes |
|---|---|---|---|---|
| **Liquid Assets** | Liquid funds shall hold at least 20% of its net assets in liquid assets. For this purpose, 'liquid assets' shall include Cash, Government Securities, T-bills and Repo on Government Securities. | April 1, 2020 | Liquid Schemes | Yield-to-Maturity (%) of the liquid fund portfolio will be marginally impacted as a certain percentage has to be mandatorily deployed in liquid assets. However, this may help liquid funds to become more true to label and manage liquidity in case of any unforeseen events. |
| **Investment Restrictions** | Liquid Funds and Overnight Funds shall not park funds pending deployment in short term deposits of scheduled commercial banks.<br><br>Liquid Funds and Overnight Funds shall not invest in debt securities having structured obligations (SO rating) and/ or credit enhancements (CE rating). However, debt securities with government guarantee shall be excluded from such restriction. | For fresh investment – Immediate Effect<br><br>For Existing investment – Grandfathering clause | Liquid and Overnight Schemes | This restriction will reduce investment options for the fund manager and may have an impact on creating enhanced returns. |

| | | | | |
|---|---|---|---|---|
| **Exit Load** | Graded exit load on investors who exit the Liquid Fund within 7 days of their investment.<br><br>Minimum exit load to be prescribed by AMFI in consultation with SEBI | 30th day from the date of this circular i.e. October 20, 2019 | Liquid Schemes | Investors who have been investing for duration between 1 to 7 days are most likely move their investments from liquid to overnight funds when an exit load becomes applicable. However, investors with investment duration of more than 7 days are likely to stay invested in liquid funds. |
| **Cut Off for NAV** | The cut-off timings for applicability of Net Asset Value (NAV) in respect of purchase of units in liquid and overnight funds shall be 1:30 p.m. instead of 2:00 p.m. | 30th day from the date of this circular i.e. October 20, 2019 | Liquid and Overnight Schemes | Investors who wish to avail the benefit of investing at the NAV of the previous day, will now have to invest in liquid and overnight schemes by 1:30pm instead of 2pm. |
| **Fees** | Asset Management Companies (AMCs) shall not be permitted to charge investment management and advisory fees for parking of funds in short term deposits of scheduled commercial banks. | 30th day from the date of this circular i.e. October 20, 2019 | Liquid and Overnight Schemes | Currently, we do not charge any fees to investors on deploying funds in short term deposits with scheduled commercial banks. Hence, there will be no impact on the investor with regards to this provision. |

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CIRCULAR

SEBI/HO/IMD/DF4/CIR/P/2019/102 September 24, 2019

**All Mutual Funds/ Asset Management Companies (AMCs)/**
**Trustee Companies/ Boards of Trustees of Mutual Funds/**
**Association of Mutual Funds in India (AMFI)**

Sir / Madam,

**Sub: Valuation of money market and debt securities**

1.0 **Review of existing provisions on valuation of money market and debt securities:**

Further, with effect from April 01, 2020 onwards, amortization based valuation shall be dispensed with and irrespective of residual maturity, all money market and debt securities shall be valued in terms of paragraph 1.1.2.2 below.

All money market and debt securities including floating rate securities, with residual maturity of over 30 days shall be valued at average of security level prices obtained from valuation agencies.

In order to ensure uniformity in classification of securities as below investment grade or default and in the treatment of accrual of interest & future recovery (if any) with respect to such securities, the following has been decided:

A money market or debt security shall be classified as "below investment grade" if the long term rating of the security issued by a SEBI registered Credit Rating Agency (CRA) is below BBB- or if the short term rating of the security is below A3.

A money market or debt security shall be classified as "Default" if the interest and / or principal amount has not been received, on the day such amount was due or when such security has been downgraded to "Default" grade by a CRA. In this respect, Mutual Funds shall promptly inform to the valuation agencies and the CRAs, any instance of non-receipt of payment of interest and / or principal amount (part or full) in any security.

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**CIRCULAR**

**SEBI/HO/IMD/DF2/CIR/P/2019/104** **October 01, 2019**

**All Mutual Funds (MFs)/**
**Asset Management Companies (AMCs)/**
**Trustee Companies/ Board of Trustees of Mutual Funds/**
**Association of Mutual Funds in India (AMFI)**

Sir / Madam,

**Subject: Review of investment norms for mutual funds for investment in Debt and Money Market Instruments**

Mutual fund scheme shall not invest in unlisted debt instruments including commercial papers (CPs), other than (a) government securities, (b) other money market instruments and (c) derivative products such as Interest Rate Swaps (IRS), Interest Rate Futures (IRF), etc. which are used by mutual funds for hedging.

However, mutual fund schemes may invest in unlisted Non-Convertible Debentures (NCDs) not exceeding 10% of the debt portfolio of the scheme subject to the condition that such unlisted NCDs have a simple structure

## Restrictions on Investment in debt instruments having Structured Obligations / Credit Enhancements:

The investment of mutual fund schemes in the following instruments shall not exceed 10% of the debt portfolio of the schemes and the group exposure in such instruments shall not exceed 5% of the debt portfolio of the schemes:

Unsupported rating of debt instruments (i.e. without factoring-in credit enhancements) is below investment grade and

Supported rating of debt instruments (i.e. after factoring-in credit enhancement) is above investment grade.

Investment in debt instruments, having credit enhancements backed by equity shares directly or indirectly, shall have a minimum cover of 4 times considering the market value of such shares.

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# CIRCULAR

**SEBI/HO/IMD/DF3/CIR/P/2020/47** **March 23, 2020**

**Subject: Relaxation in compliance with requirements pertaining to Mutual Funds**

1. In light of the recent market events pursuant to COVID 19, a need has been felt for temporary relaxations with respect to compliance requirements for Mutual Funds. Accordingly, SEBI has decided to grant the following relaxations specified in SEBI (Mutual Funds) Regulations, 1996 and circulars issued thereunder:

**1.1.** All schemes (NFO) where observation letter was issued by SEBI and yet to be launched shall have a validity period of one year from the date of SEBI letter. All new schemes (NFO) where final observation letter will be issued shall have validity period of one year from the date of SEBI letter.

2. The effective date of implementation of certain policy initiatives have been extended as under:

| Sr. No. | Circular Name | Particulars | Due Date | Extended Date |
|---|---|---|---|---|
| 1. | Risk management framework for liquid and overnight funds and norms governing investment in short term deposits dated Sept. 20, 2019 | Liquid funds shall hold at least 20% of its net assets in liquid assets. | April 1, 2020 | May 1, 2020 |
| 2. | Review of investment norms for mutual funds for investment in Debt and Money Market Instruments dated October 1, 2019 | Existing open ended mutual fund schemes shall comply with the revised limits for sector exposure. | April 1, 2020 | May 1, 2020 |
| 3. | Review of investment norms for mutual funds for investment in Debt and Money Market Instruments dated October 1, 2019 | Maximum investment in unlisted NCDs as % of the debt portfolio of the scheme. | 15% - March 31, 2020 | 15% - April 30, 2020 |
| 4. | Valuation of money market and debt securities dated September 24, 2019 | Amortization based valuation shall be dispensed | April 1, 2020 | May 1, 2020 |

| Sr. No. | Circular Name | Particulars | Due Date | Extended Date |
| --- | --- | --- | --- | --- |
| | | with and irrespective of residual maturity, all money market and debt securities shall be valued in terms of paragraph 1.1.2.2 of the Circular | | |

**SEBI/HO/IMD/DF3/CIR/P/2020/76** **April 30, 2020**

| Sr. No. | Circular Name | Particulars | Extended Date |
|---|---|---|---|
| 1 | Risk management framework for liquid and overnight funds and norms governing investment in short term deposits dated September 20, 2019 | Liquid funds shall hold at least 20% of its net assets in liquid assets. | June 30, 2020 |
| 2 | Review of investment norms for mutual funds for investment in Debt and Money Market Instruments dated October 1, 2019 | Existing open ended mutual fund schemes shall comply with the revised limits for sector exposure. | June 30, 2020 |

| Sr. No. | Circular Name | Particulars | Extended Date |
|---|---|---|---|
| 3 | Valuation of money market and debt securities dated September 24, 2019 | Amortization based valuation shall be dispensed with and irrespective of residual maturity, all money market and debt securities shall be valued in terms of paragraph 1.1.2.2 of the Circular | June 30, 2020 |

# Quiz

As per SEBI's fund categorization norms, implemented from mid-2018, the number of debt fund categories are:

A. Ten
B. Fifteen
C. Twenty
D. Sixteen

As per SEBI rules, the maximum exposure to a single security i.e. securities issued by a single issuer, in a fund, is:

A. 5%
B. 10%
C. 15%
D. 20%

# Quiz

In a debt Mutual Fund Scheme, when there is a default or downgrade below investment grade:

A. The AMC can do side-pocketing, subject to approval from Trustees
B. AMC can do side-pocketing only if the SID allows it and Trustees approve
C. The AMC can amend the SID and do side-pocketing for a given default
D. Every side-pocketing requires SEBI approval

A Fixed Maturity Plan (FMP) has a given maturity date. It can be extended / rolled over:

A. To any extent as the AMC wants
B. It cannot be extended / rolled over
C. It can be extended, with investors' approval, and after informing SEBI
D. It can be extended only for the same period as the initial tenure

# Quiz

The mark-to-market of debt / money market instruments, as given by Crisil & Icra, is  for:

A. All instruments since 1 January 2020
B. All instruments since 30 June 2020
C. Instruments of maturity more than 1 year
D. Instruments of maturity more than 6 months

For previous day NAV, in Liquid Funds, the cut-off time for clear funds is:

A. 1 pm
B. 2 pm
C. 1 30 pm
D. 2 30 pm

# Thank You