RBI announces 50,000 crore Special Liquidity Facility for Mutual Funds

Part of: GS-III- Economy-Capital markets (PT-MAINS-PERSONALITY TEST)

The Reserve Bank of India announced a Special Liquidity Facility for Mutual Funds (SLF-MF) of 50,000 crore rupees with a view to easing liquidity pressures on Mutual Funds. The RBI has stated that it remains vigilant and will take whatever steps are necessary to mitigate the economic impact of COVID-19 and preserve financial stability.

Imp points

1. The Apex bank has said that under the Special Liquidity Facility for Mutual Funds (SLF-MF), the RBI shall conduct repo operations of 90 days tenor at the fixed repo rate.
2. The SLF-MF is on-tap and open-ended and banks can submit their bids to avail funding on any day from Monday to Friday (excluding holidays).
3. The scheme is available from today till 11th of May or up to utilization of the allocated amount, whichever is earlier. The Reserve Bank will review the timeline and amount, depending upon market conditions.
4. Funds availed under this facility will be used by banks exclusively for meeting the liquidity requirements of MFs by extending loans, and undertaking outright purchase of and/or repos against the collateral of investment grade corporate bonds, commercial papers (CPs), debentures and certificates of Deposit (CDs) held by MFs, the central bank said.

Franklin Templeton

The move comes after Franklin Templeton Mutual Fund decided to wind up six debt funds that have combined assets under management of nearly ₹26,000 crore on account of illiquid, low rated instruments in their portfolio last week.

The fund house had said it decided to wind up the schemes to preserve the value at least at the current levels, as the value was getting eroded due to a combination of redemption pressures and mark-to-market losses due to lack of liquidity on account of the coronavirus impact on the markets.

“RBI move is very timely. This move will first improve the confidence; second, it can help in providing the necessary liquidity to mutual fund industry if anyone needs to avail it. With the yields dropping, one would assume banks may go down the credit curve and extend facilities,” said

“Heightened volatility in capital markets in reaction to COVID-19 has imposed liquidity strains on mutual funds (MFs), which have intensified in the wake of redemption pressures related to closure of some debt MFs and potential contagious effects therefrom. The stress is, however, confined to the high-risk debt MF segment at this stage; the larger industry remains liquid,” the central bank said.

“With excess liquidity of around ₹4.85 trillion as on April 24, 2020, banks, however, continue to remain largely risk averse. We expect the liquidity of the higher rated papers to improve on the back of this facility. Accordingly, active participation from the banks will be key to the success of
this scheme,"

About Mutual FUNDS and PAST news

1. The markets regulator Securities and Exchange Board of India (SEBI) has tightened norms on investments by mutual funds (MFs).

   - MF schemes can now invest only in listed debt or equity.
   - Valuation of securities in debt funds will now be on mark-to-market basis instead of the earlier practice of considering it on an amortisation basis.
   - Liquid funds can now invest a maximum of 20% of their assets in a single sector as against the current cap of 25%, and must keep aside at least a fifth of their assets in cash equivalents to meet sudden redemption pressures.

Mutual Fund: A mutual fund collects money from investors and invests the money, on their behalf, in securities (debt, equity or both). It charges a small fee for managing the money.

Liquid Funds: These are debt mutual funds that invest in securities up to a maturity of 91 days.

2. The redemption issues faced by fixed maturity plans (FMPs) of mutual funds due to their exposure towards Essel Group entities have only begun as there are nearly 80 FMP schemes with such exposure towards the corporate entity. The cumulative amount at stake is about ₹1,400 crore with more than 40 schemes maturing later this year. More importantly, about 14 schemes, with an exposure of nearly ₹475 crore (April 2019), will mature this month.

Background:

   - A mutual fund collects money from investors and invests the money on their behalf.
   - It charges a small fee for managing the money. Mutual funds are an ideal investment vehicle for regular investors who do not know much about investing.
   - Investors can choose a mutual fund scheme based on their financial goal and start investing to achieve the goal.

How to Invest in Mutual funds?

   - You can either invest directly with a mutual fund or hire the services of a mutual fund advisor. If you are investing directly, you will invest in the direct plan of a mutual fund scheme. If you are investing through an advisor or intermediary, you will invest in the regular plan of the scheme.
   - If you want to invest directly, you will have to visit the website of the mutual fund or its authorized branches with relevant documents.
   - The advantage of investing in a direct plan is that you save on the commission and the money invested would add sizeable returns over a long period.
   - The biggest drawback of this method is that you will have to complete the formalities, do the research, monitor your investment all by yourself. Types of Mutual Funds in India – The Securities and Exchange Board of India has categorised mutual fund in India under
four broad categories:
- Equity Mutual Funds
- Debt Mutual Funds
- Hybrid Mutual Funds
- Solution-oriented Mutual Funds

**Equity Mutual fund scheme:**

- These schemes invest directly in stocks. These schemes can give superior returns but can be risky in the short-term as their fortunes depend on how the stock market performs. Investors should look for a longer investment horizon of at least five to 10 years to invest in these schemes. There are 10 different types of equity schemes.

**Debt Mutual fund schemes:**

- These schemes invest in debt securities. Investors should opt for debt schemes to achieve their short-term goals that are below five years. These schemes are safer than equity schemes and provide modest returns. There are 16 sub-categories under the debt mutual fund category.

**Hybrid Mutual fund Schemes:**

- These schemes invest in a mix of equity and debt, and an investor must pick a scheme based on his risk appetite. Based on their allocation and investing style, hybrid schemes are categorised into six types.

**Solution-Oriented Schemes:**

- These schemes are devised for particular solutions or goals like retirement and child’s education. These schemes have a mandatory lock-in period of five years.

**Mutual Fund Charges:**

- The total expenses incurred by your mutual fund scheme are collectively called expense ratio. The expense ratio measures the per unit cost of managing a fund. The expense ratio is generally in between 1.5-2.5 per cent of the average weekly net assets of the schemes.

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**Securities and Exchange Board of India (SEBI)**

- It was established in 1992 in accordance with the provisions of the Securities and Exchange Board of India Act, 1992 (SEBI Act).
- The basic **functions** of SEBI
  1. To protect the investors interests in securities.
  2. To be a platform to promote, develop and regulate the securities market in India as well as the relating matters that are connected with it.
  3. To approve rules and laws pertaining to the stock exchanges.
  4. Examines books of accounts of financial mediators and recognized stock exchanges.
  5. To urge respective companies to list their shares in stock exchanges and manage the registration of distributors or brokers.

- **SEBI board has three main powers** – Quasi judicial, quasi legislative and quasi executive.
Mutual fund redemption

Mutual fund redemption is how the investors sell their fund units. However, if there is an exit load, then the investors necessarily pay it on redeeming their units. When investors redeem their units, they earn taxable capital gains. The taxability of capital gains depends on the type of fund and the period of holding. Here, investors should mandatorily consider all the expenses that they would incur on redeeming their units.

When to exit and redeem a fund

The right time to sell or redeem mutual funds depends on investors’ financial goals. One might be invested in a mutual fund for ten years to fifteen years to purchase a house or finance their child’s wedding. In some cases, it could also be a short-term goal, such as buying a car or an appliance. Once an investor gets close to realising his/her financial goal, then he/she should consider redeeming their fund units irrespective of the state of the market.