RBI’s Liquidity Offer for Mutual Funds

Why in news?

The RBI recently announced a special liquidity window of Rs 50, 000 crore to bail out mutual funds hit by the crisis in the debt fund segment.

Click here to know more on the recent Franklin Templeton Mutual Fund event.

How does the liquidity window work?

- Under the special liquidity facility for mutual funds (SLF-MF), the RBI will conduct repo operations of 90 days tenor at the fixed repo rate.
- The SLF-MF is on-tap (on demand, anytime) and open-ended.
- Banks can submit their bids to avail the funding till May 11, 2020 or up to utilization of the allocated amount, whichever is earlier.
- Funds availed under the SLF-MF will be used by banks exclusively for meeting the liquidity requirements of MFs.

What are the features of the offer?

- The RBI says exposures under this facility will not be reckoned under the *Large Exposure Framework* (LEF).
- It thus gives greater comfort for banks to borrow under this window.
- The face value of securities acquired under the SLF-MF and kept in the *HTM category* will not be counted for *adjusted non-food bank credit* (ANBC) for determining priority sector targets or sub-targets.
- The support extended to MFs under the SLF-MF will be exempted from banks’ capital market exposure limits.

What will banks do with this money?

- Banks can extend loans to mutual funds.
- They can undertake the outright purchase of and/or repos.
- This can be offered against the collateral of investment grade corporate bonds, commercial papers (CPs), debentures and certificates of Deposit (CDs) held by MFs.

Why is the offer now?

- There is heightened volatility in capital markets in reaction to Covid-19 pandemic.
- This has imposed liquidity strains on mutual funds.
- The stress is however confined to the high-risk debt funds segment.
- The debt segment has witnessed outflows of Rs 1.94 lakh crore in the month of March 2020.
- The credit risk fund category, notably, has assets of over Rs 55,000 crore.
- The condition has intensified more in the wake of redemption pressures related to closure of six debt schemes of Franklin Templeton.
- The RBI's liquidity offer is thus expected to bring some degree of comfort in the debt market, given such huge redemption pressure.

Source: Indian Express

Quick Facts

Large Exposure Framework (LEF)

- The large exposures framework sets prudent limits to large exposures.
- A large exposure is defined as the sum of all exposures of a bank to a single counterparty that is equal to or above 10% of its Tier 1 capital.

HTM category

- The investment portfolio of banks is classified under three categories:
    1. Held to Maturity (HTM)
    2. Available for Sale (AFS)
    3. Held for Trading (HFT)
- Banks normally hold securities acquired by them with the intention to hold them up to maturity under HTM category.
- Only debt securities are permitted to be held under HTM with a few exceptions, e.g., equity held in subsidiaries.
- Holding securities under HTM provides cushion for banks from valuation changes.
- However, holding in HTM book is subjected to a ceiling.

Adjusted non-food bank credit

- This includes non-food bank credit and total non-statutory liquidity ratio (SLR) investments of banks in commercial papers, shares and bonds/debentures.