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SIGNALLING SUPPORT: THE HINDU EDITORIAL ON RBI RELIEF FOR MUTUAL FUNDS

Relevant for: Indian Economy | Topic: Issues relating to Growth & Development - Banking, NPAs and RBI

The Reserve Bank of India's decision to open a special facility to ensure the availability of adequate liquidity for the mutual fund industry is a timely move in signalling to investors that the central bank is alert to the need to preserve financial stability in these challenging times. In assigning 50,000 crore exclusively for commercial banks to lend to mutual funds, the RBI made clear on Monday that it wants to tamp down on any build-up of liquidity strains at mutual fund houses in the wake of heightened volatility in the capital markets and increased redemption pressures as a fallout of the COVID-19 pandemic. The proximate trigger for the central bank's move was last week's announcement by Franklin Templeton Mutual Fund that it was winding up six debt funds — funds that collectively had assets under management (AUM) amounting to about 26,000 crore. The RBI has rightly recognised the urgent need to ward off any incipient contagion impact from the closure of these six funds. With the overall industry-wide AUM for debt funds at about 15-lakh crore, it was crucial for the banking regulator to reassure investors that liquidity need not be a concern while deciding on whether to retain or redeem their investments in these mutual funds. The Association of Mutual Funds in India (AMFI) had, separately, last week, sought to assure investors that a majority of debt fund schemes had "invested in superior credit quality securities" and had appropriate liquidity to back their normal operations.

While the facility is a straightforward 90-day repo-based lending window from which banks can avail credit to provide loans to mutual funds, there are concerns about the banking industry's willingness to expose itself to the credit risk involved in making these fresh loans. That the RBI was cognisant of this is evident in the way that the norms have been tailor-made to incentivise the banks to lend. From allowing banks to breach their 25% ceiling on held-to-maturity investments as a consequence of lending to mutual funds, to exempting the support extended from banks' overall capital market exposure limits, the central bank has sought to ease the flow of credit to the fund houses. Still, if the recent experience of getting lenders to support the non-banking financial companies through a targeted long-term repo operation backed by 50,000 crore is any pointer, clearly the banking industry — beset by bad loans — appears to have little appetite for adding any credit that it deems risky. Moreover, with the economy still in lockdown and the credit ratings of even relatively well-established companies facing a real and not-too-distant threat of downgrades, how willing banks would be to use this facility to lend to debt mutual funds remains to be seen. The Centre may need to be ready to step in with direct intervention if the RBI's gambit fails to ease the pressure on mutual funds.