AMFI

Association of Mutual Funds in India

701 - Tower 2B, One Indiabulls Centre, 841, Senapati Bapat Marg, Mumbai - 400 013
Tel. +91 22 43346700 Fax: +91 2 43346712 www.amfiindia.com

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To,
All AMFI Members

Dear Members,

AMFI Best Practices Guidelines Circular No.93 / 2021-22
Prudential norms for Liquidity Risk Management for Open-ended Debt Schemes

Please refer to SEBI circulars SEBI/H0/IMD/DF3/CIR/P/2020/229 dated November 6, 2020 and SEBI/HO/IMD/IMD-II DOF3/P/CIR/2021/583 dated June 25, 2021 regarding Prudential Norms for Liquidity Risk Management of Open Ended Debt Schemes.

As mentioned in para 3 of SEBI circular no. SEBI/H0/IMD/DF3/ CIR/P/2020/229 dated November 6, 2020, an expert committee was set up by AMFI to deliberate on norms regarding holding of liquid assets in open ended debt schemes.

Vide SEBI circular SEBI/H0/IMD/IMD-11 DOF3/P/CIR/ 20211583 dated June 25, 2021, AMFI was advised to prescribe a suitable framework based on the recommendations of the aforesaid committee, in consultation with SEBI, for liquidity risk management for open ended debt schemes (except Overnight Fund, Gilt Fund and Gilt Fund with 10-year constant duration) within a period of one month from the date of issuance of the circular. *The circular also stipulates that the said framework shall be adopted by all AMCs.*

The committee’s recommendations, arrived at after extensive deliberations, was duly endorsed by AMFI and submitted to SEBI for consideration. The final framework based on the recommendations of the aforesaid committee, finalised in consultation with SEBI is appended hereto *for being mandatorily be adopted by all AMCs,* except for the ‘Best practices’ indicated at the end of Annexure 1 hereto, which may be adopted by AMCs at their option.

1. All open-ended debt schemes (except Overnight Fund, Gilt Fund and Gilt Fund with 10-year constant duration) shall follow the requirements indicated as ‘Mandatory’ under the liquidity risk management framework stipulated at Annexure 1.

2. Further, AMCs are also advised to ensure that:
   a. all open-ended debt schemes (OEDS) (except Overnight Fund, Liquid Funds, Gilt Fund and Gilt Fund with 10-year constant duration) shall continue to hold at least 10% of their net assets in liquid assets in terms of SEBI circular no. SEBI/HO/IMD/DF3/CIR/P/2020/229 dated November 6, 2020 or as prescribed at Annexure 1, whichever is higher; and

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b. Liquid Funds shall comply with requirement of maintaining liquid assets at 20% as per para 1 of SEBI circular SEBI/HO/IMD/DF2/CIR/P/2019/101 dated September 20, 2019 or as prescribed at Annexure 1 below, whichever is higher.

c. Further, in continuation with para 3(b) of SEBI circular SEBI/HO/IMD/IMD-ll DOF3/P/CIR/2021/583 dated June 25, 2021, It is clarified that Mutual Funds shall ensure that for asset allocation limits (applicable for Banking and PSU Bond Fund, Floater Fund, Credit Risk Fund and Corporate Bond Funds scheme categories in terms of SEBI circular on 'Categorization and Rationalization of Mutual Fund Schemes'), the base shall be considered as net assets excluding the extent of minimum stipulated eligible assets i.e. higher of 10% of net assets or LR-CRaR (Liquidity ratio based on 30-day Conditional Redemption at Risk).

3. The confirmation on compliance of this circular shall be reported to SEBI in the Compliance Test Report (CTR).

Members are requested to confirm having noted the contents of this circular for due compliance and also to place this circular before their Trustees for information at the next meeting of the Trustees.

With best regards,

B. M. Kini
Dy. Chief Executive

AMFI

Annexure 1

Framework for liquidity risk management for debt schemes of Mutual Funds

1. **The key elements of liquidity risk management framework are as under:**

Mandatory

a. Liquidity ratios to address investor behaviour based on the size of their investments
b. Back-testing of liquidity ratios
c. Additional Parameters to be monitored by AMCs (for the OEDS including Liquid Funds)

Best Practices

d. Providing liquidity for other known variables

MANDATORY

a. **Liquidity ratios to address investor behaviour based on the size of their investments**

I. Liquidity ratios: Eligible Assets / Scheme's Potential Outflows (Liability)

Two type of liquid assets shall be maintained by OEDS including Liquid Funds,

- one based on the Redemption at Risk (RaR) concept (to represent the likely outflows at a given confidence interval) and
- the other based on the concept of Conditional Redemption at Risk (CRaR)) (to represent the behaviour of the tail at the given confidence interval).

The liquid assets maintained by OEDS including Liquid Fund based on the concept of RaR shall be subset of the liquid assets maintained by OEDS including liquid fund based on the concept of CRaR.

The process for computation of the liquid assets to be maintained is explained below:

i. *Liquidity Ratio based on 30-day RaR (LR-RaR)*

- **Eligible Assets for LR-RaR:** Eligible Assets for LR-RaR include Cash, Government Securities, T-bills and Repo on Government Securities and should be more than or equal to Weighted average AUM outflow at 95 percentile RaR level computed as under.

Potential Outflows:

- The Weighted Average AUM Outflow will be computed by multiplying the AUMs under each of the four categories of investors (viz. investors falling in following four categories i.e. (a) less than or equal to ₹ 1 crore, (b) beyond ₹ 1 crore and upto ₹ 5 crore, (c) beyond ₹ 5 crore and upto ₹ 100 crore, and (d) beyond ₹100 crore, on the basis of PAN of primary investor) with the a factor representing the potential outflow from the respective categories at 95 percentile confidence level. The factors for the respective categories across the various types of funds are as tabulated below:

Table 1				
Scheme type	**Quantum of investment by single investor (PAN level) (₹ cr) as per investor category**			
	0 - 1	**>1 – 5**	**>5 – 100**	**>100**
Low duration fund	5%	9%	15%	23%
Short duration fund	5%	8%	11%	14%
Medium to Long Duration fund	8%	10%	12%	21%
Credit risk fund	5%	8%	9%	40%
Liquid Fund	5%	10%	14%	29%

ii. *Liquidity ratio based on 30-day Conditional Redemption at Risk (LR-CRaR)*

- **Eligible Assets for LR-CRaR** (computed below) should be equal to or more than Weighted average AUM outflow at 95 percentile Conditional redemption at Risk (CRaR) level.

  Eligible assets qualifying for liquidity under LR-CRaR include the following*:*

Table 2	
Asset category	**Weightage**
Eligible Assets for LR-RAR (Cash, Government Securities, T-bills and Repo on Government Securities)	100%
Listed AAA rated debt securities without bespoke structures/structured obligations, credit enhancements or embedded options or any other structure / feature which increase the liquidity risk of the instrument**	As per the regulatory haircut for repo transactions as prescribed by RBI from time to time.
For Liquid Fund scheme category, 100% securities held by the scheme which have credit rating of A1+, residual maturity of less than or equal to 30 days and no adverse news or rumours in the mainstream media about the said security**	100%

***With regard to adverse news or rumors in the mainstream media, AMCs are expected to conduct due diligence at the time of investment and keep a regular vigil on an ongoing basis for their investments. In case of adverse news or rumours within past 90 days from the date of consideration, the instruments shall be removed from the above asset category.*

Note: The aspect of eligibility of securities with credit rating of Al + subject to its issuer having lowest long term rating of AAA only, in the above asset category shall be reviewed by AMFI in December 2022.

Potential Outflows:

- The Weighted Average AUM Outflow will be computed by multiplying the AUMs under the four categories of investors with the respective factors for those categories at 95 percent confidence level.

- The percentage of outflows for four investor categories, based on 30-days 95 percent confidence level for the past 11 years' industry-wide data, are as follows:

Table 3				
Scheme type	**Quantum of investment by single investor (PAN level) (₹. cr) as per investor category**			
	0 – 1	>1 – 5	>5 – 100	>100
Low duration fund	8%	15%	23%	37%
Short duration fund	8%	12%	15%	19%
Medium to Long Duration fund	10%	12%	19%	56%
Credit risk fund	11%	17%	20%	69%
Liquid Fund	6%	16%	24%	43%

The above threshold percentages have been computed for five scheme categories in terms of SEBI circular on 'Categorization and Rationalization of Mutual Fund Schemes' and are extended by mapping the remaining eight scheme categories to one of the above 5 scheme categories as under:

Table 4	
Scheme categories for which percentages are computed*	**Mapped Schemes**
Liquid Fund	Liquid Fund
Low Duration Fund	• Money Market Fund • Ultra Short Duration Fund • Low Duration Fund
Short Duration fund	• Corporate Bond Fund • Banking and PSU Bond Fund • Floater Fund • Short Duration Fund
Medium to Long Duration Fund	• Medium Duration Fund • Dynamic Bond Fund • Long Duration Fund • Medium to Long Duration Fund
Credit Risk Fund	Credit Risk Fund

The above-mentioned percentages at Table 1 and Table 3, as prescribed by the Expert Committee appointed by SEBI, shall be applicable for one year from the effective date of the circular. Each AMC will use these tables to compute its liquidity requirements on a monthly rest (15^{th} of every month). The AMC should ensure that these required liquidity thresholds are maintained on a daily basis.

Subsequently, a committee under the aegis of AMFI shall calculate the aforesaid percentages on a rolling basis considering the past 10 years for the five categories of OEDS including Liquid Fund (aggregated at industry level) to arrive at the 30-day potential outflows at 95 percent confidence level.

Additionally, each AMC shall, on an annual basis going forward, collate the data applicable for the following one year in order to compute the outflow (as specified at table 1 and 3 above) for the scheme categories specified in Table 4 above.

Illustration

Consider a Short Duration fund, for which the LR-RaR and LR-CRaR shall be as under:

Table 5

Scheme type	**Quantum of investment by single investor (PAN level) (₹ cr) as per investor category**			
	0 - 1	>1 – 5	>5 – 100	>100
Short Duration fund (LR-RAR)	5%	8%	11%	14%
Short Duration fund (LR-CRaR)	8%	12%	15%	19%
Eligible Assets for LR-CRaR other than LR-RaR Eligible Assets (i.e. difference of Eligible Assets of LR-CRaR and LR-RaR)**	3%	4%	4%	5%

*** LR-RaR is a subset of LR-CRaR*

For the said Short Duration fund having AUM of ₹ 1,170 crores with investment as follows:

Table 6

Scheme type	**Quantum of investment by single investor (PAN level) (₹ cr)**				**Total (₹ cr)**
Investor category →	0 – 1	>1 – 5	>5 – 100	>100	
Short Duration fund	190	60	270	650	**1,170**

The percentage of eligible assets to be held by the said scheme is as under:

Table 7

Eligible assets	**Calculation of the assets**
LR-RaR	(190x5% + 60x8% + 270x11% +650x14%)/1170 = **11.54%**
LR-CRaR (including LR-RaR)	(190x8% + 60x12% + 270x15% +650x19%)/1170 = **15.93%**

Since LR-RaR figure is above 10%, the calculated value (i.e. 11.54%) is considered for eligible assets for LR-RaR. Further, the scheme shall hold at least 15.93% of eligible assets for LR-CRaR.

If a scheme is not holding 11.54% of assets under LR-RaR and 15.93% of assets under LR-CRaR (which includes LR-RaR), it shall ensure that the LR-RaR and LR-CRaR ratios are restored to 100% of the required level by ensuring that the net inflows (through net subscription/accruals/ maturity & sale proceeds) into the scheme are used for restoring the ratios before making any new purchases outside 'Eligible Assets' specified above.

b. **<u>Back-testing of liquidity ratios</u>**

Back-testing by AMCs shall involve capturing actual outflow data (in %) for each scheme on a rolling 30-day basis for each day and comparing the same with the predicted outflow using the above-mentioned methodology for that 30-day period. Thereafter, cases of breach of the back-test would be analysed (for instance, if the LR-RaR and LR-CRaR computed for a scheme on January 15, 2021 was 10% and 15% respectively, then, as a back-test, on February 15, 2021 the AMC can compute what has been the actual % movement in AUM from January 15, 2021 to February 15, 2021 and ascertain if the drop in AUM has exceeded the 10% or 15% threshold.

In case of a large number of back-test failures, the Trustee Board shall recommend a higher buffer to be applied to minimize the back-test failures in future. Accordingly, a back-test of the liquidity ratios should be presented to the Trustee Board on an annual basis by the AMC and the decision on liquidity buffers based on such review be taken during such review.

The schemes shall maintain the above two ratios at 100% of the requirement on a daily basis. However, to meet redemptions, AMCs may have to periodically dip into their liquid assets which may result in the liquidity ratio dropping below 100% on those days. To factor in such scenarios, the scheme shall ensure that the ratio is restored to 100% of the requirement by ensuring the net inflows (through net subscription/accruals/ maturity & sale proceeds) into the scheme are used for restoring the ratios before making new purchases outside 'Eligible Assets' specified above. In case the ratio remains below 100% for more than 15 consecutive days, then, this information shall be highlighted to Trustees till such time the said ratio is not restored to 100% of the requirement on weekly basis.

c. **Additional Parameters to be monitored by AMCs for aforementioned OEDS**

Certain additional parameters such as concentration of an investor group / distributor, exit load features, taxation dynamics, shall be monitored by the AMC at scheme level. Details of few such parameters are stipulated below:

i. Concentration by investor group:

For uniformity of definition of concentration of investor group across mutual funds, the definition of an investor group on the asset side and liability side shall be formulated by a neutral agency to be appointed by AMFI. To begin with, the monitoring of concentration of investor group shall be carried out by AMCs at scheme level only for group of investors with investments > Rs. 100 cr.

The AMCs should monitor investments of Top 1, 5 and 10 investor groups as % of total AUM of each scheme.

To ensure that tracking of this metric commences, an additional LR-RaR of 25 bps be maintained in case the AUM of any one or more of the top 1, 5 or 10 investor groups exceeds 25%, 50% and 70% respectively at scheme level. The AMCs should report the same to its Investment Committee on a quarterly basis. Based on which, the Investment Committee may decide holding of additional liquid assets in case high concentration is observed in any scheme, and report it to their Trustees annually.

ii. *Concentration by distributors:*
The AMCs shall monitor concentrations by Top 5, 10 and 20 distributors. An additional LR-RaR of 25 bps shall be maintained in case the AUM contributed by any one or more of the top 5, 10 or 20 distributors exceeds 30%, 50% and 70% respectively at scheme level. The AMCs shall report the same to its Investment Committee on a quarterly basis. Based on which, the Investment Committee may decide holding of additional liquid assets in case high concentration is observed in any scheme and report it to their respective Trustees annually.

iii. *Other parameters to be monitored*
A set of ratios shall be tracked for OEDS of AMCs:

- Eligible assets for LR-CRaR / Quantum of AUM outside exit load
- Eligible assets for LR-CRAR / Quantum of AUM beyond three years tax window (i.e. long term capital gains)

The above ratios shall be tracked by the schemes and reported to the Investment Committee on quarterly basis so that possible significant outflow is within the knowledge of the Investment Committee.

BEST PRACTICES

d. **Liquidity for other known variables**

The measures discussed above try to anticipate client behaviour by drawing on past data. However, in addition to the above, there are various known patterns of specific investors / investor types that a Fund Manager may be aware of based on redemption requests received in advance / interactions with the investors / having observed investment patterns of large investors. The Fund Managers should factor in various aspects (such as known redemption pattern around financial year end or subscription around start of financial year, pattern of specific investors/investor groups) while provisioning for liquid assets over and above the framework specified above.

2. The following shall be reviewed by a committee under the aegis of AMFI at the following intervals at the beginning of the respective financial year:

i. LR-RAR and LR-CRAR percentages specified at table 1 and table 3 above shall be reviewed annually based on past 10 years' industry data on rolling basis.

ii. Categorization of investors specified in table 1 and 3 above (i.e. (a) less than or equal to ₹1 crore, (b) beyond ₹1 crore and upto ₹5 crore, (c) beyond ₹5 crore and upto ₹100 crore, and (d) beyond ₹100 crore) shall be reviewed once in three years.

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