

India Extends Special Liquidity Facility to Mutual Funds

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Original post [here](#).

On [April 27](#), the Reserve Bank of India (RBI) announced a ₹ 500 billion (\$6.6 billion) special liquidity facility for mutual funds (SLF-MF), in response to increased volatility in capital markets due to the COVID-19 pandemic. The SLF-MF operated for two weeks and closed on May 11.

The RBI reports that the program had [₹24.3 billion outstanding](#) as of May 11, of which ₹20 billion was allotted on April 27 and ₹4.3 billion was allotted on April 30. The Indian mutual fund industry has about \$300 billion in total assets under management, according to an industry association [website](#). [More than half](#) of those assets are in debt funds.

In the midst of increased client redemptions and drained liquidity in the debt market due to the COVID-19 crisis, [concerns around the potential contagion effects](#) were accelerated after Franklin Templeton's Indian arm halted withdrawals and shut six high-risk debt funds, trapping over \$3 billion of investor money.

To address this concern, the RBI established the SLF-MF. In a statement, the RBI [said](#) that market stress was “confined to the high-risk debt [mutual fund] segment at this stage; the larger industry remains liquid.” The SLF-MF is a 90-day repo operation at the fixed [repo rate of 4.4%](#). The SLF-MF was open from April 27 to May 11 to [liquidity adjustment facility](#) eligible banks. Borrowing banks must use these funds to meet liquidity needs of mutual funds by (i) extending loans, or (ii) 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 mutual funds..

Liquidity support provided by the funds obtained through the SLF-MF is eligible to be classified as held to maturity (HTM) in excess of 25% of the total investment permitted to be included in the HTM portfolio. It is also exempt from banks' capital market exposure limits.

Responding to the requests from banks, these regulatory benefits also became available to all banks providing liquidity support to mutual funds regardless of whether they used funds from the SLF-MF or from their own resources as of [April 30](#). A bank claiming the regulatory benefits was required to submit a weekly statement containing consolidated information on its support as long as the SLF-MF was open.

[Some commentators](#) view the SLF-MF as a step in the right direction, easing liquidity concerns and providing a psychological signal to mitigate investor panic. However, the measure is small relative to the asset management sector as a whole. According to the RBI's most recent [Financial Stability Report](#) (p.51), mutual funds are “the largest net providers of funds to the financial system.”

India faces a substantial [crisis of confidence](#), as its economy has been at a standstill since the nationwide lockdown implemented in early March. Even before COVID-19 concerns, rising corporate defaults, the collapse of lenders, and questionable lending practices in the mutual fund industry raised questions about the resilience of the financial system in India. On May 12,

India's Prime Minister Narendra Modi [announced](#) a \$260 billion economic rescue package, an amount equal to 10% of India's GDP, but currently [short on details](#).