Ambiguity in MF rules on group debt investment

Mutual fund (MF) houses face some ambiguity in identifying group companies for investment in debt instruments, in line with the new rules in this regard.

In January, the Securities and Exchange Board of India (Sebi) had introduced group level limits for debt schemes and fixed the ceiling at 20 per cent of the net asset value (NAV), extendable to 25 per cent, after trustee approval.

The rules were meant to help funds mitigate credit risks and have a more diverse portfolio. They took effect from February 12. All government owned entities, including public sector banks, would be excluded from these limits.

The regulator had referred to a group as defined in Clause (ef) of Section 2 of the Monopolies and Restrictive Trade Practices Act, 1969. The MRTP Act defines this as any group of individuals or firms which exercises control or is in a position to exercise control on the company. “This is a very broad definition and can create confusion in identifying group companies,” said a fund official, on condition of anonymity.

Some say the Companies Act, 2013, would have been a better guide in defining a group company. The Act defines an associate or group company as one in which that other company has a significant influence. “Significant influence” means control of at least 20 per cent of total share capital or of business decisions under an agreement.

The inclusion of associates in the definition of group companies is another grey area, is one comment. Associates, as in the Sebi regulations, include companies with a common director. “Independent directors who sit on multiple boards might result in a situation where unrelated companies are clubbed for group exposure limits,” said R Sivakumar, head, fixed income, Axis MF.

There is also ambiguity surrounding exclusion of government owned public sector units from adhering to group limits. “ Life Insurance Corporation is a government owned entity. LIC Finance in turn owns a majority in LIC Housing Finance. Does this mean LIC Housing Finance is also a government- owned company and therefore is exempt from the group limits?” said the official quoted earlier.

IDENTITY CRISIS

- Mutual fund houses are at sea over identifying group companies for investment in debt instruments
- Early this year, Sebi had introduced group- level exposure limits for investment in debt instruments to help funds ease credit risks
- Funds can invest 20 per cent of net asset value in group firms, extendable to 25 per cent of NAV, after trustee approval
- Funds have to refer to MRTP Act to identify group companies but experts feel the Companies Act, 2013, would have been a better guide

- The inclusion of the word ‘ associates’ for identifying groups is another grey area.

(Business Standard)