SEBI Tightens Norms Governing Inter Scheme Transfer Of Securities Within Mutual Funds

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The Securities and Exchange Board of India has tightened the norms governing inter-scheme transfer of securities within a same mutual fund.

It has issued a circular prescribing additional safeguards for such transfers within schemes of open- or close-ended funds which may arise due to situations like meeting liquidity requirement arising from unanticipated redemption pressure or achieving prescribed sectoral or group rebalancing requirements. The circular will come into effect from Jan. 1, 2021.

Inter-scheme transfers came into the limelight after the winding up of credit risk schemes by Franklin Templeton, leading to increased redemption pressures on fund houses. Some investors pointed out concerns regarding such transfers within schemes of ICICI Prudential Mutual Fund earlier this year.

The additional safeguards, according to the market regulator, have been introduced to ensure the transfer of quoted instruments within a mutual fund are done in on-the-spot basis, at prevailing market prices and conform to the investment objective of the scheme to which the securities are transferred.

SEBI has prescribed the following additional safeguards:

- Purchases under inter-scheme transfers in close-ended schemes will be allowed only within three business days of allotment under a new fund offer. No transfers will be allowed from the fourth day.
- Transfers of securities will also be prohibited in case of negative news, rumours in the mainstream media or presence of an alert relating to deteriorating credit profile of the security issuer during the last four months.
- Open-ended schemes must resort to such transfers only after exhausting all other available liquidity generation options like market borrowings, using the scheme's cash or selling its securities in the market.
- Mutual funds can resort to inter-scheme transfers for rebalancing purposes only to the extent of rebalancing the breach of regulatory limits prescribed by SEBI.

Sumit Agrawal, founder of Regstreet Law Advisors, said the circular restricts the free inter-scheme transfer to a narrow compass in the wake of recent inspections and certain forensic audits. Strict timelines and scheme level liquidity risk management is a step ahead in enforcement, he said.

A negative news or rumor in the mainstream media has been given legal weight for decision making, and to add to the challenges of alpha fund managers, a subsequent downgrading of a security will lead to questioning the decision in hindsight, he said.

To ensure further accountability, the market regulator also stipulated that the fund manager of a scheme which buys securities under an inter-scheme transfer must provide rationale for such a move if there is a security downgrade within four months from the buy transaction.