



## Credit quality of ICRA-rated MF schemes maintained amid slowdown in inflows

### Contacts

**Karthik Srinivasan**  
karthiks@icraindia.com  
+91-22-3047 0028

**Saket Kumar**  
sakets@icraindia.com  
+91-22-3047 0039

**Nikhil Paranjape**  
nikhil.paranjape@icraindia.com  
+91-22-3047 0026

ICRA has ratings outstanding on 89 Liquid/Debt Mutual Fund (MF) schemes across 24 Asset Management Companies (AMCs) as on date. An analysis of the credit quality across the ICRA-rated schemes reveals that over 90% of the schemes continue to qualify comfortably for the highest rating levels within their respective maturity categories, while the balance qualify for the next rating level. During 2010-11, the credit ratings of ICRA-rated schemes remained stable with NIL downgrades and two upgrades.

The Assets under Management (AUM) of ICRA-rated debt schemes accounted for nearly 32% of the industry debt AUM as on March 31, 2011<sup>1</sup> (around 46% as on March 31, 2010). The decline in market share of AUM of ICRA-rated liquid/debt schemes was on account of decline in the debt AUMs of two large fund houses, which outpaced the shrinkage in the overall AUM levels over the last few months. Large year-end redemptions driven by advance tax payment requirements, credit pick-up in the banking industry and year-end balance sheet management towards the close of fiscal 2010-11 by corporate and banks were the other prime contributors to the decline in the AUM towards the year-end.

As per AMFI data, majority of the investments (>70%) across various debt schemes were garnered from corporate and large institutions. However, with the increase in the Dividend Distribution Tax (DDT) for corporate investors to 30% from June 1, 2011 and the regulatory cap on banks' investment into debt mutual funds could possibly impact the overall Industry debt AUM levels. Nonetheless, the crucial factors such as higher returns, ease of transaction and liquidity may arrest the decline of inflows in the said schemes and thereby the overall industry AUM levels. ICRA believes that the fund houses will have to increase their focus on mobilising funds from the retail segment.

Overall, during 2010-11 the fund managers have preferred investments in relatively high credit quality liquid papers. ICRA expects the credit profile of its rated debt funds to remain stable.

Website

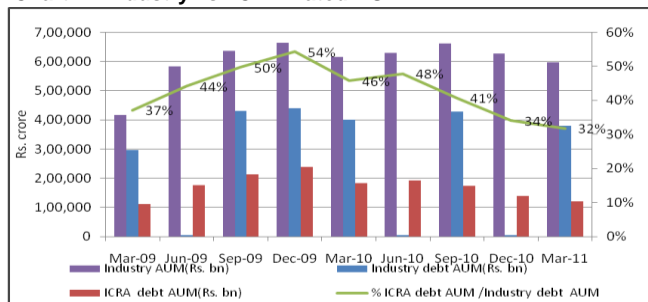
[www.icra.in](http://www.icra.in)

<sup>1</sup> Refers to end-of-period date throughout the note unless specified otherwise

## Industry AUM declines in 2010-11

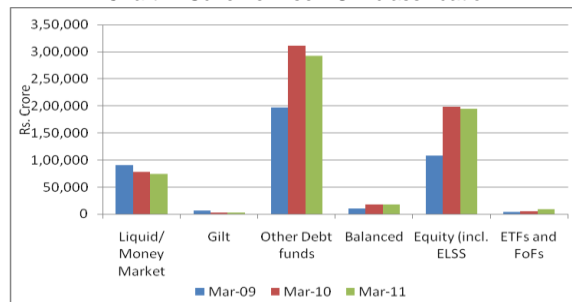
The AUM of the MF industry reported a decline of 3% year-on-year (Y-o-Y) in 2010-11 and stood at ~Rs.5.97 lakh crore as on year-end. Strong credit growth in the banking system and tight liquidity conditions led to greater outflows from the debt schemes as compared to the previous year when the banks had parked the surplus funds into MFs. In the equity schemes, volatility in the equity markets over the year led to higher redemption as investors became more cautious and favoured safer avenues for parking funds. Some of the investors used the opportunity of the stock market rally around September 2010 to book the profits on their investments.

**Chart 1: Industry vs. ICRA Rated AUM**



Source: AMFI

**Chart 2: Scheme wise AUM classification**

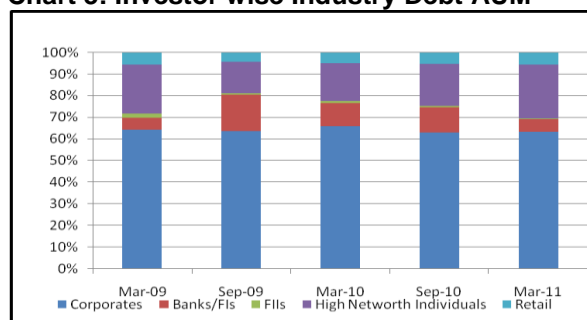


Source: SEBI

While the funds withdrawn by corporate entities at the year-end could still find their way back into liquid debt mutual funds, ICRA believes that the ratio of industry debt AUM to overall AUM could fall over the next six months in the wake of regulatory reforms (detailed later in this note).

The AUM of ICRA-rated debt schemes (89 liquid/debt MF schemes across 24 AMCs) accounted for nearly 32% of the industry debt AUM as on March 31, 2011 (around 46% as on March 31, 2010). The AUM of ICRA-rated liquid/debt schemes, which stood at Rs. 1.83 lakh crore as in March 2010, declined by nearly 34% to Rs. 1.21 lakh crore as in March 2011, on account of decline in the AUM of two large fund houses, which has outpaced the shrinkage in the overall AUM levels over the last few months. The financial year end requirements by banks and corporate led to a 13% decline in the AUM of ICRA rated schemes in March 2011 over February 2011.

**Chart 3: Investor wise Industry Debt AUM**



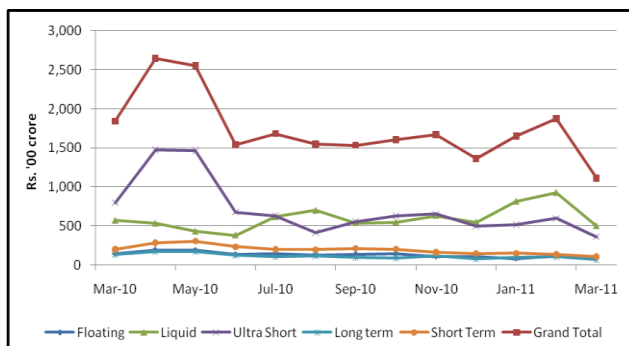
Source: AMFI

As per the chart 3 alongside, majority of the investments (>70%) across various debt schemes were garnered from corporate and large institutions. The impending increase in the DDT for corporate investors to 30% from June 1, 2011 coupled with the regulatory cap on banks' investment into debt mutual funds are likely to impact the overall Industry debt AUM levels.

## AUM of ultra short term schemes decrease sharply in H1FY11; stay fairly stable thereafter

In 2010-11, ultra short-term schemes witnessed considerable erosion in their asset base. Within ICRA-rated schemes, the AUM of ultra-short term schemes declined by around 55% from ~Rs. 80,000 crore as in March 2010 to ~Rs. 36,000 crore as in March 2011. This has resulted in the decline in the overall AUM levels of the ICRA rated debt schemes.

**Chart 4: Distribution of AUM of ICRA Rated Schemes by Scheme Type**



Source: ICRA Research

In line with the industry trend, the decline in AUM of ICRA rated ultra short term schemes in H1FY11 could be attributed to the new valuation norms which became effective August 1, 2010<sup>2</sup>. This resulted in investors withdrawing the funds from these schemes in the view of likely adverse impact on volatility of declared daily NAV and prompted investors to turn to liquid schemes. In the latter half of FY 2010-11, as the banks raised their deposit rates, some of the investors shifted their money into bank fixed deposits to

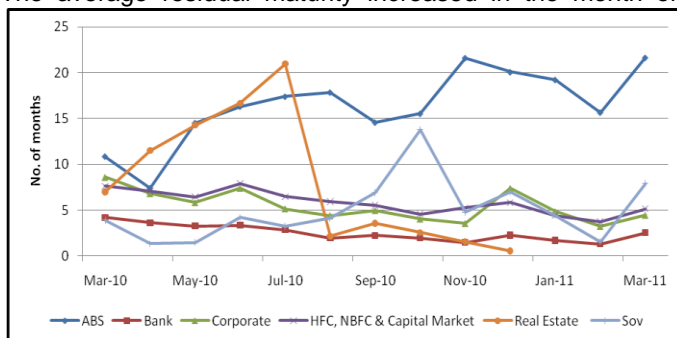
earn competitive returns; also FMPs became attractive in the rising interest rate scenario<sup>3</sup>.

### Residual maturity remains low across major industries in 2010-11

The industry-wise analysis of ICRA rated schemes reveal that residual maturities continue to be low at less than six months across the major industries. Excluding the investments in ABS and Real estate, which together formed less than 0.5% of the AUM in 2010-11, the residual maturity of the ICRA rated schemes has reduced marginally as the interest rates remained firm during the year. In the Real estate sector, the exposure was only to two entities, of which exposure to one entity having long residual tenure was completely sold off in August-10, resulting in sharp reduction in the residual maturity. In ABS, the residual maturity remained high due to exposure to long tenure transactions originated by a few NBFCs, which are mainly into financing commercial vehicles. Nevertheless, such ABS transactions are largely rated at "LAAA" or equivalent, alleviating any concern on the credit quality.

**Chart 5: Residual Maturity of All ICRA Rated Schemes by Industry-wise**

The average residual maturity increased in the month of March-11 as the mutual funds pared down Government Securities (including CBLO transactions) to meet redemption pressure.



Source: ICRA Research

Given the increasing interest rate scenario over the past one year, fund managers have been increasingly opting for short-duration papers. The overall residual maturity across the ICRA-rated schemes stood at close to 3 months as on March-11, as against 5 months a year earlier.

### ICRA-rated MFs stay away from real estate investments; significant exposure to Financial Services Sector continues

According to data released by the Securities and Exchange Board of India (SEBI), as in March 2011, within debt mutual funds, investment in financial services sector was predominant, with bank certificates of deposit and fixed deposits standing at close to 67% (57% as in March 2010), while that in corporate debt (including financial services companies) was at 14% (15% in March 2010) and in commercial papers at 10% (13% in March 2010).

<sup>2</sup> These norms required fund houses to mark-to-market on a daily basis the securities with a residual maturity of over 91 days. These securities would be valued either at the weighted average price at which it is traded on the particular valuation day, and the non-traded or thinly traded securities would be valued using the benchmark yield/matrix of the spread over risk free benchmark yield obtained from agency(ies) entrusted for the said purpose by AMFI.

<sup>3</sup> As per AMFI data, for entire FY11, over Rs. 100,000 crore was mobilised through closed ended FMPs, of which about one-fourth was raised in Mar 2011 alone.

ICRA-rated MFs too continued to have significant exposure to financial services sector, with Banks accounting for around 70% of the average AUM in 2010-11. Within Banks, PSU Banks form more than 80% of the portfolio. Among other sectors, ICRA-rated MFs have been averse to making fresh investments in the real estate sector and had NIL exposure to this sector in Q4FY11.

Broadly, the fund managers have preferred investments in high credit quality liquid papers. Within the ICRA rated schemes, there has been a lower propensity to invest in securities of companies with a long-term credit rating of “LA” or equivalent and below (the overall exposure to companies rated “LA” and lower was 4.1% as in March 2011, against 7.8% as in March 2010). Moreover, the fact that such exposures still account for only a small portion of the total AUM is a positive from the credit quality perspective of the ICRA-rated schemes (refer Annexure 2).

### **Credit quality of ICRA-rated MF schemes remains comfortable**

Of the 89 MF schemes rated by ICRA, 84 schemes continue to qualify comfortably for the highest rating levels of mfAAA (schemes with residual weighted average maturity longer than 12 months) and mfA1+ (schemes with residual average maturity less than 12 months). Of the four schemes not in the highest rating category, two had not been rated in the highest category because of the underlying investment portfolio; while the remaining two schemes scored low on account of the short track record of the fund houses concerned. There were NIL downgrades in FY11. The schemes that were downgraded in the past suffered because of their underlying investments that were downgraded and also because of their fund managers’ inability to trade them in the secondary markets in light of the challenging operating environment in FY09. Going forward, with no incremental investments being made in instruments of weak credit quality issuers, ICRA expects the credit profile of its rated debt funds to remain stable.

### **Slowdown expected in MF inflows over the medium term owing to regulatory reforms...**

The following table summarises the impact to the regulatory reforms to the overall industry AUM levels:

**Table 1**

Regulatory Changes	Effective date	Expected impact
A. Cap on Banks' investments in liquid Mutual Funds	Six months timeline commencing April 1, 2011 for compliance	Moderate to High
B. Increase in DDT for corporate investors to 30%	June1, 2011	Moderate to High

(ICRA estimates)

#### **A. Banks not to park more than 10% of net worth in Debt Mutual Funds**

The RBI has now imposed a cap of 10% of the Banks’ net worth as of the previous year for investments in debt-oriented mutual fund schemes considering the systemic risk in times of stress.

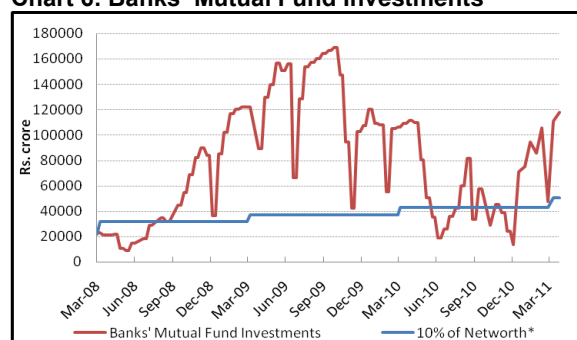
As shown in Chart 6 below, investments in mutual funds in the past two years have largely exceeded the proposed cap of 10% of net worth. Funds parked in mutual funds reached a peak of Rs. 1.69 lakh-crore in October 2009, and moderated upto June 2010 and remained within the 10% limit for a brief period upto August 2010. Notably, in Q4FY11, Banks continued to park upto Rs. 1 lakh-crore in debt mutual funds even as they remain heavy borrowers under the LAF facility of the RBI.

Going forward, the proposed cap would encourage Banks to park excess funds with the RBI at the Reverse Repo Rate or lend in the call money markets, which could reduce the volatility in the overnight inter-Bank market.

**Impact:**

The excess of Banks' investment over 10% of their net-worth stood at ~Rs. 68,000 crore as on April 22, 2011. Considering this entire excess investment exiting the system, the estimated decline in the industry debt AUM levels would be ~17% and estimated decline in overall AUM levels would be ~11% compared to March 31, 2011 levels.

**Chart 6: Banks' Mutual Fund Investments**



Source: RBI

**B. Increase in DDT to 30% for corporate investors  
With effect from June 1, 2011**

Apart from providing liquidity to corporate investors to park their surplus cash for the short term, debt funds also allow significant tax arbitrage in the form of lower Dividend Distribution Tax (DDT):

**Table 2<sup>4</sup>:**

Category	DDT Till 31.5.2011		DDT From 1.6.2011	
	Liquid/Money Market	Debt	Liquid/Money Market	Debt
Individual/HUF	25.0%	12.5%	25.0%	12.5%
Others	25.0%	20.0%	30.0%	30.0%

**Impact:**

The union budget 2011-12 proposal to hike dividend distribution tax would make investments in liquid funds for corporate investors (including banks) less attractive. The proposed DDT hike would nullify this tax arbitrage and possibly impact the future inflows into debt funds from corporate investors. Nonetheless, this impact would be offset in part on account of ease in transaction and liquidity offered by such funds and higher returns compared to short term bank deposits. With corporate investors (including banks) accounting for a significant portion of the industry debt AUM, any reduction in their investments will result in a sharp adverse impact on the overall industry AUMs. The following table depicts estimated decline in industry debt AUM levels at various levels of decline in corporate investments in debt mutual fund schemes from the level as on March 31, 2011.

**Table 3:**

<i>Decline in corporate investments in debt MFs by</i>	<b>10%</b>	<b>25%</b>	<b>50%</b>	<b>75%</b>	<b>100%</b>
Estimated decline in industry debt MF AUM levels	8%	17%	34%	51%	68%
Estimated decline in industry overall MF AUM levels	5%	11%	22%	33%	44%

(ICRA estimates)

**Overall Comments and Outlook**

While 2010-11 proved challenging with decline in the AUM levels on introduction of new valuation guidelines from August 2010 and a tight liquidity regime, ICRA expects the pressure to continue in 2011-12 on account of increase in the dividend distribution tax for corporate investments in liquid/debt funds and cap on banks' investments in select debt mutual funds. However on the credit quality front, ICRA expects the credit profile of its rated debt funds to remain stable, as we expect the fund managers largely maintain their risk-averse strategy given the need to maintain a liquid portfolio in a rising interest rate scenario.

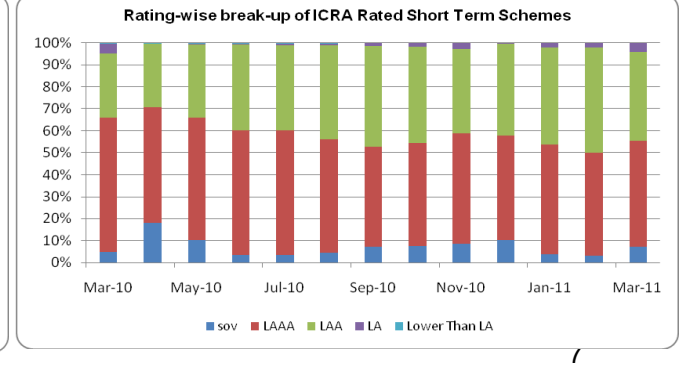
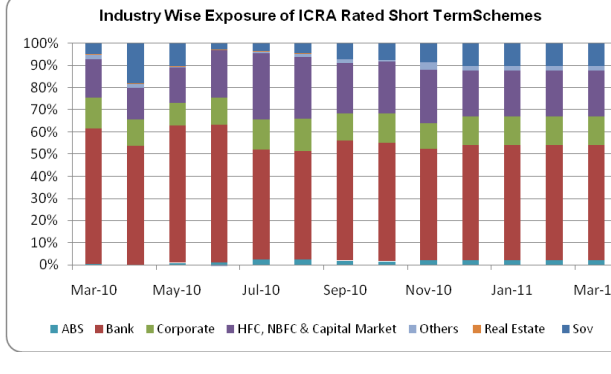
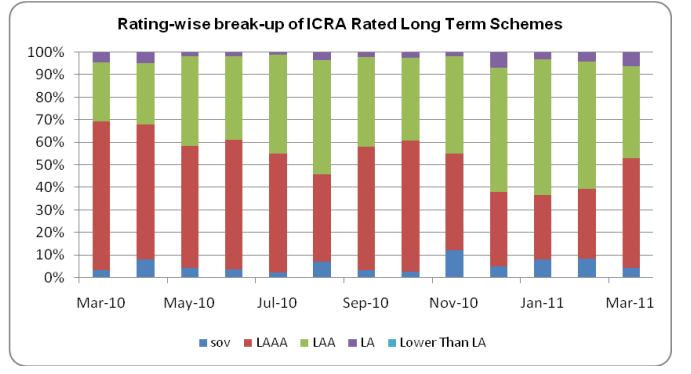
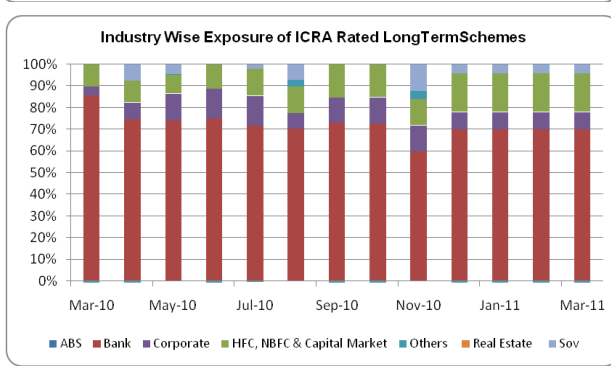
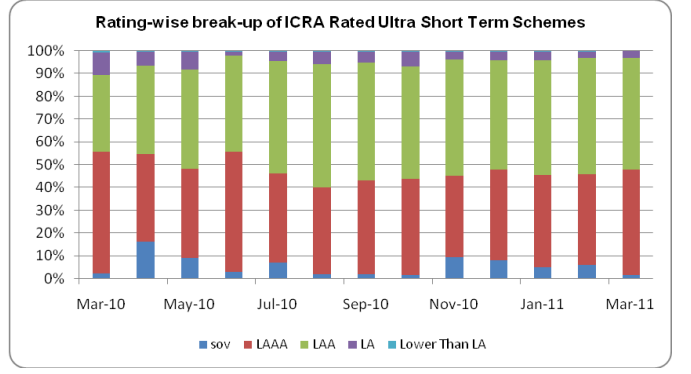
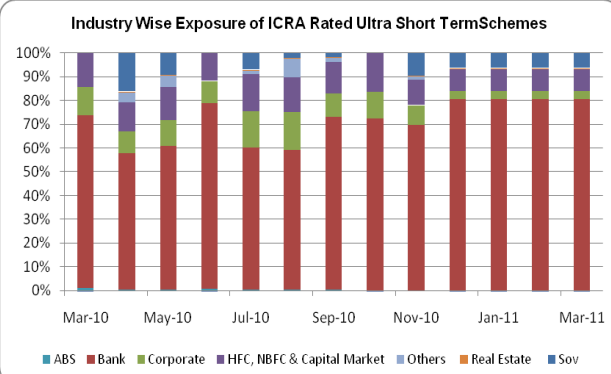
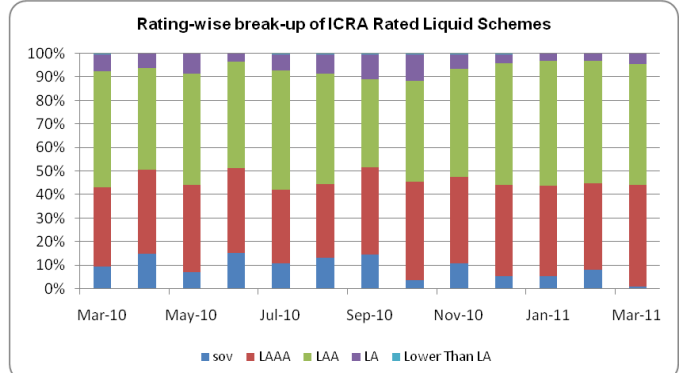
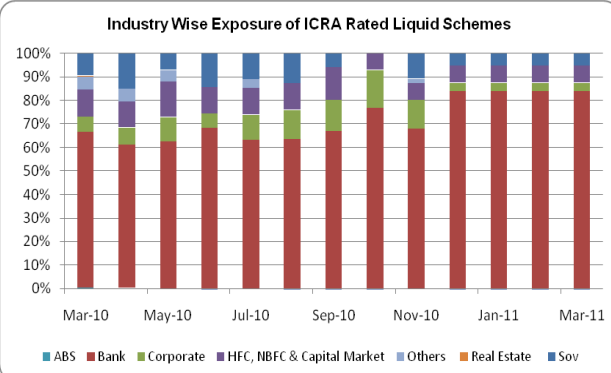
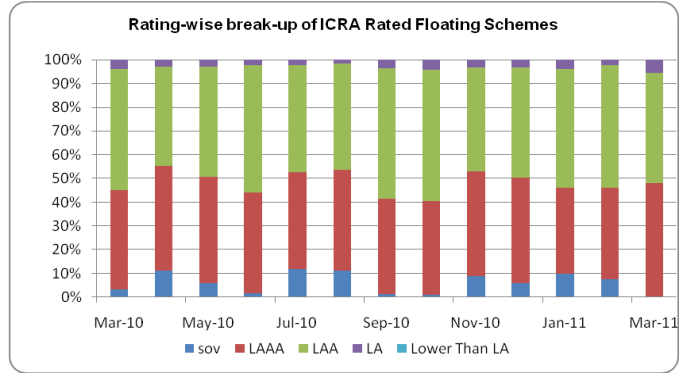
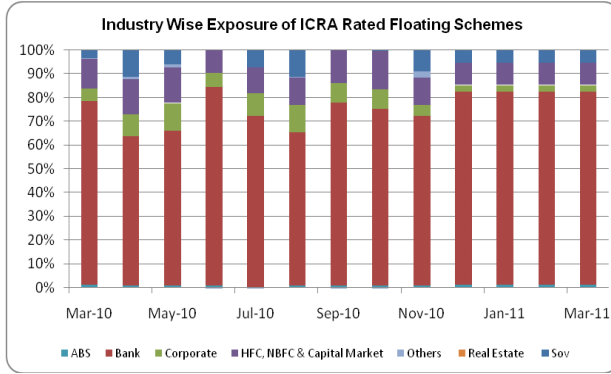
**May 2011**

<sup>4</sup> Table 2 on DDT excludes surcharge, cess etc. for a simplistic representation

**Annexure 1: Scheme-wise Break-up of ICRA-rated Debt Schemes as on April 30, 2011**

Scheme	Type of Schemes						
	Liquid	Ultra Short	Short Term	Long Term	Floating	FMP	Total
Axis MF	1	1	1				3
Baroda Pioneer MF	1	1		1			3
Birla Sunlife MF	1				2		3
Canara Robeco MF	1	1	2	1	1		6
Daiwa Mutual Fund	1	1					2
DSP Blackrock MF		1		1			2
Edelweiss MF			1				1
Fidelity MF	1	1		1	1		4
HDFC MF	2	1	5		1		9
HSBC MF	1	1	1	1	2		6
ICICI Prudential MF						1	2
IDFC MF	1	2					3
Kotak Mahindra MF			2	2			4
LIC NOMURA MF(formerly LIC MF)	1	1					2
L&T MF	1		1	1	1		4
Mirae MF	1	1					2
Morgan Stanley MF			1	1			2
Peerless MF	1	1					2
Principal MF	1	1	1	1	2		6
Reliance MF	2	1	3		1		7
SBI MF	2	1					3
Tata MF	1	2	1	2	1		7
UTI MF	1	1			1		3
<b>Total</b>	<b>22</b>	<b>20</b>	<b>20</b>	<b>12</b>	<b>14</b>	<b>1</b>	<b>89</b>

## Annexure 2: Industry-Wise and Rating-Wise exposure of ICRA Rated Schemes



### Annexure 3: List of ICRA-rated MF Schemes with Credit Quality Ratings as on April 30, 2011

<b>Scheme</b>	<b>Rating</b>
Axis Liquid Fund	mfA1+
Axis Treasury Advantage Fund	mfA1+
Axis Short Term Fund	mfAAA
Baroda Pioneer PSU Bond Fund	mfAAA
Baroda Pioneer Liquid Fund	mfA1+
Baroda Pioneer Treasury Advantage Fund	mfA1+
Birla Sun Life Cash Plus	mfA1+
Birla Sun Life Floating Rate - Long-Term Plan	mfAAA
Birla Sun Life Floating Rate - Short-Term Plan	mfAAA
Canara Robeco Indigo Fund	mfA1+debt
Canara Robeco Liquid Fund	mfA1+
Canara Robeco Dynamic Bond Fund	MfAAA
Canara Robeco Short Term Fund	mfA1+
Canara Robeco Floating Rate Short Term Fund	mfA1+
Canara Robeco Treasury Advantage Fund	mfAAA
Daiwa Liquid Fund	mfA1+
Daiwa Treasury Advantage Fund	mfA1+
DSP Black Rock Strategic Bond Fund	mfAAA
DSP Black Rock Money Manager Fund	mfAAA
Edelweiss Short Term Bond Fund	mfA1+
Fidelity Cash Fund	mfA1+
Fidelity Ultra Short Term Debt Fund	mfA1+
Fidelity Flexi Bond Fund	mfAAA
Fidelity Short Term Income Fund	mfAAA
Templeton India Treasury Management Account	mfA1+
Templeton India Ultra Short Bond Fund	mfA1+
Templeton Floating Rate Income Fund	mfA1+
HDFC Cash Management Fund – Savings Plan	mfA1+
HDFC Floating Rate Income Fund - Short-Term Plan	mfA1+
HDFC Liquid Fund	mfA1+
HDFC Quarterly Interval Fund - Plan A	mfA1+
HDFC Quarterly Interval Fund - Plan B	mfA1+
HDFC Quarterly Interval Fund - Plan C	mfA1+
HDFC Cash Management Fund-savings Plus plan	mfAAA
HDFC High Interest Fund - Short Term Plan	mfAAA
HDFC Short Term Plan	mfAAA
HSBC Ultra Short Term Bond Fund (upgraded from mf A1 in FY11)	mfA1+
HSBC Cash Fund	mfA1+
HSBC Flexi Debt Fund	mfAAA
HSBC Floating Rate Fund – Long-Term Plan	mfAAA
HSBC Floating Rate Fund – Short-Term Plan	mfAAA
HSBC Income Fund- Short Term Plan	mfAAA
ICICI Prudential Fixed Maturity Plan – Series 49 – 3 year Plan A	mfAA
ICICI Prudential Blended Plan B	mfA1+
IDFC Cash Fund	mfA1+
IDFC Money Manager Treasury Fund	mfA1+
IDFC Money Manager Investment Fund	mfAAA
Kotak Bond Short Term Plan	mfAAA
Kotak Flexi Debt Scheme (upgraded from mf AA+ in FY11)	mfAAA
Kotak Floater Long Term Scheme	mfAAA
Kotak Multi Asset Allocation Fund	mfAAAdebt
LIC NOMURA MF Income Plus Fund (formerly LIC MF Income Plus Fund)	mfA1

LIC NOMURA MF Liquid Fund (formerly LIC MF Liquid Fund)	mfA1+
L&T Triple Ace Fund	mfAAA
L&T Floating Rate Fund	mfA1+
L&T Freedom Income – Short Term Fund	mfA1+
L&T Liquid Fund	mfA1+
Mirae Asset Liquid Fund	mfA1+
Mirae Asset Ultra Short Term Bond Fund	mfA1+
Morgan Stanley Active Bond Fund	mfAAA
Morgan Stanley Short-Term Bond Fund	mfAAA
Peerless Liquid Fund	mfA1
Peerless Ultra Short Term Fund	mfA1
Principal Ultra Short Term Fund	mfA1+
Principal Floating Rate Fund - Short Maturity Plan	mfA1+
Principal Floating Rate Fund - Flexible Maturity Plan	mfAAA
Principal Income Fund	mfAAA
Principal Cash Management Fund	mfA1+
Principal Income Fund - Short Term Plan	mfAAA
Reliance Liquid Fund – Treasury Plan	mfA1+
Reliance Floating Rate Fund	mfAAA
Reliance Liquidity Fund	mfA1+
Reliance Money Manager Fund	mfA1+
Reliance Short Term Fund	mfAAA
Reliance Medium Term Fund	mfAAA
Reliance Interval Fund-Monthly Plan Series 1	mfA1+
SBI Short Horizon Debt Fund - Ultra Short Term	mfA1+
SBI Magnum Insta cash Fund	mfA1+
SBI Magnum Premier Liquid Fund	mfA1+
Tata Floater Fund	mfAAA
Tata Floating Rate Short Term Fund	mfAAA
Tata Income Fund	mfAAA
Tata Liquid Fund	mfA1+
Tata Liquidity Management Fund	mfA1+
Tata Short Term Bond Fund	mfAAA
Tata Treasury Manager Fund	mfAAA
UTI Floating Rate – Short Term Plan	mfAAA
UTI Liquid Cash Plan	mfA1+
UTI Treasury Advantage Fund	mfAAA



**ICRA Limited**

*An Associate of Moody's Investors Service*

**CORPORATE OFFICE**

Building No. 8, 2<sup>nd</sup> Floor, Tower A; DLF Cyber City, Phase II; Gurgaon 122 002  
Tel.: +(91 124) 4545300; Fax: +(91 124) 4545350

**REGISTERED OFFICE**

Kailash Building, 11<sup>th</sup> Floor; 26, Kasturba Gandhi Marg; New Delhi 110 001  
Tel.: +(91 11) 2335 7940-50; Fax: +(91 11) 2335 7014

Email: [icrainfo@icraindia.com](mailto:icrainfo@icraindia.com), Website: [www.icra.in](http://www.icra.in)

---

Branches: **Mumbai:** Tel.: + (91 22) 24331046/53/62/74/86/87, Fax: + (91 22) 2433 1390 □ **Chennai:** Tel + (91 44) 2434 0043/9659/8080, 2433 0724/ 3293/3294, Fax + (91 44) 2434 3663 □ **Kolkata:** Tel + (91 33) 2287 0450, 2240 6617/8839, 2280 0008, Fax + (91 33) 247 0728 □ **Bangalore:** Tel + (91 80) 2559 7401/4049 Fax + (91 80) 2559 4065 □ **Ahmedabad:** Tel + (91 79) 2658 4924/5049/2008, Fax + (91 79) 2658 4924 □ **Hyderabad:** Tel +(91 40) 2373 5061/7251, Fax + (91 40) 2373 5152 □ **Pune:** Tel + (91 20) 2552 0194/95/96, Fax + (91 20) 2553 9231

---

© Copyright, 2011, ICRA Limited. All Rights Reserved.

Contents may be used freely with due acknowledgement to ICRA.

All information contained herein has been obtained by ICRA from sources believed by it to be accurate and reliable. Although reasonable care has been taken to ensure that the information herein is true, such information is provided "as is" without any warranty of any kind, and ICRA in particular, makes no representation or warranty, express or implied, as to the accuracy, timeliness or completeness of any such information. All information contained herein must be construed solely as statements of opinion, and ICRA shall not be liable for any losses incurred by users from any use of this publication or its contents.