

SEBI is justified in asking mutual fund players to side pocket: Experts

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Has the Securities and Exchange Board of India got into a clash with the Reserve Bank of India by insisting on side pocketing of bad assets by mutual fund companies (MFs)?

Experts told BusinessLine that the market regulator has done the right thing by asking MFs to side pocket, simply separate bad assets from the good ones, and it is well within its ambit to formulate such norms.

A few MFs have indulged in off-market lending to promoters based on securities and other such instruments as underlying assets. Promoters were not able to pay back these MFs within the stipulated deadline and the fund houses had extended their tenure. SEBI has made it clear that it does not recognise or approve of private lending deals by MFs. SEBI had issued the side pocketing rule in December last year. This year, it further asserted that any extension of credit-terms to the promoters should be considered as 'default' and the MFs should follow norms applicable for default grade securities.

Accordingly, the MFs will have to take hair cuts, which could affect their net asset values and hence there is a heartburn in the industry.

A few MF players are now suggesting that SEBI, with its insistence on side pocketing and 'default' norms, could be in a clash with RBI, which regulates banks and has a policy on loan defaults. There is a certain inter creditor agreement (ICA), stipulated as per RBI norms, which the banks follow in dealing with default and resolution cases. MFs players are now mulling over ideas of joining this ICA. But SEBI insists that stressed asset should be segregated as per side pocketing norms before joining ICA.

"MFs are not allowed to indulge in lending like activity, which is what they did. It is illegal in letter and spirit and anti-investors interest. Therefore, when SEBI insists that certain assets where lending was done should be separated, the regulator is taking the right step. Why should investors of MFs suffer for mismanagement by funds, asset management companies and their trustees. SEBI direction that MFs side-pocket the stressed assets is logical. This direction of SEBI will go long way in improving governance and fixing of responsibilities," a leading regulatory expert, who is dealing in SEBI matters for over two decades, told Business Line.

Experts say that subjecting SEBI to take a liberal view on the matter would be like allowing MFs to get away with illegality. Even though the norms for side pocketing were announced

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by SEBI last year, none of the MFs have followed it so far despite holding bad assets worth several thousands of crore.