SEBI beefs up risk management norms, asks MFs to appoint dedicated officer

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The Securities and Exchange Board of India (Sebi) on Monday announced a new risk management framework (RMF) for the mutual fund (MF) industry. The framework prescribes procedures, risk management functions, roles and responsibilities to be followed by the management.

"There should be at least one CXO level officer identified to be responsible for the risk management of specific functions of the MFs. AMC should have a Chief Risk Officer (CRO), who would be responsible for the overall risk management of the mutual fund operation including the key risks," said Sebi in the circular.

The risk shall be divided into two broad categories: scheme-specific risks and AMC-specific risks. The scheme specific risks will be further divided into investment risk, credit risk, liquidity risk and governance risk. While for AMC regulators have suggested eight different categories like operational risk, outsourcing risk, talent risk among others.

The credit risk relevant to MFs is the issuer credit risk attributable to individual securities and the negative outlook on specific sectors or industries and its consequent impact on the credit exposures. To manage credit risk, the AMC must have a robust framework comprising an approved and documented Credit Risk Management policy.

"Formal procedure for AMCs to carry out their own credit assessment of assets and reduce reliance on credit rating agencies. For this purpose, all AMCs shall have an appropriate policy and system in place to conduct an in-house credit risk assessment or due diligence of debt and money market instruments or products at all points of time," said Sebi.

All securities run the risk of not being saleable in tight market conditions at or near their real values. Measuring and monitoring liquidity risk is an important aspect of risk management.

Liquidity Risk has to be modelled at the level of each scheme (except schemes that do not have continuous liquidity requirements like close ended and interval schemes) and should display alerts pertaining to asset liability mis-match on monthly basis and in line with any other relevant guidelines as specified by regulator in this regard from time to time.

"Stress testing should be mandatorily conducted for all schemes (excluding close ended and interval schemes) appropriately atleast on a monthly basis. The results of the stress testing may be placed before trustees in every quarter," added Sebi in its circular.

Regulator has also said that the AMCs shall also be responsible for the mis-selling done by the persons associated with selling of mutual funds including distributors.

With respect to talent risk, there should be proper succession planning for identified key positions. At no point of time the AMC is deprived of the services of any Key Managerial Person. AMCs may implement a remuneration policy that prevents excessive risk taking and also ensures retention of good talent.

The current risk management system shall be repealed from January 1, 2022, when the AMCs will need to comply with the new RMF.