Backstop Entity

Why in news?

The Chairman of Securities Exchange Board of India (SEBI) suggested for a backdrop entity.

What are the suggestions?

- Referring to Franklin Templeton freezing investor payouts by shuttering six open-end schemes, the SEBI's Chairman mooted three possible measures to prevent a repeat.
- He suggested a **backstop entity** that would buy out illiquid corporate bonds from debt funds during stress, with support from industry players.
- He proposed an **advisory committee** to come up with mechanisms for stress-testing and swing pricing of debt funds.
- **Interim rules** will be framed requiring all debt funds to park a minimum proportion of their assets in liquid instruments.

Is there any pushback?

- All this has attracted pushback from debt fund managers.
- They complain that creating a backstop facility will pose practical difficulties and that holding liquid instruments would dilute returns.
- But such complaints divert focus from the structural anomaly in open-end debt schemes that promise anytime liquidity to their investors, while investing mostly in illiquid corporate bonds.

- This problem is bound to crop up time and again hurting investors, unless SEBI finds lasting fixes to it.

What did AMCs do?

- In recent years, domestic Asset Management Companies (AMCs) have amassed debt assets of ₹12.6 lakh crore.
- They have pocketed handsome fees, from selling 'high-yield' funds that dabble in illiquid corporate bonds.

What is the problem?

- The problem of bunched-up redemptions in such funds is of industry's own

making as it has actively wooed corporate treasuries and High Net worth Individuals (HNIs) to these funds.
- Now it is only fair that the industry foots the bill to ensure that these funds fulfil their promise of anytime liquidity, instead of knocking at regulators' doors every time there's a crisis.
- The RBI's latest MF liquidity window marks the third occasion on which it has had to bail out the industry after the crises of 2008 and 2013.
- This raises questions of moral hazard.

How should the appropriate size be arrived?

- The appropriate size for a backstop entity can amount to 20% of the ₹1.5 lakh crore assets managed by credit risk and corporate bond funds.
- Also, every AMC could contribute in proportion to the assets it manages.

What is next?

- If the industry feels that such a backstop is difficult to fund, it needs to curtail corporate debt funds managed in the open-end format.
- They should move to a more manageable close-end format.
- SEBI can allow debt funds to gate redemptions for limited periods.
- It can apply investor-level caps on fund holdings to prevent bunched-up outflows.
- Many of these issues would sort themselves out once India's corporate bond market attains a reasonable stage of development.
- For this, SEBI needs more active support from the Centre and RBI.

Source: Business Line