Concerns of Related Party Deals in Stock Market

Why in news?

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The Securities Exchange Board of India's (SEBI) asked ICICI Prudential Mutual Fund to refund Rs.240 crore to investors in its schemes.

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What is the reason behind this decision?

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- SEBI's decision on ICCI Mutual Fund comes after the hidden governance issues for mutual fund (MF) investors.
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- The issue pertains to ICICI Pru MF's decision to invest Rs. 640 crore in the recent IPO of ICICI Securities.
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- In this regard the market regulator has reached a Private advisory and issued a notice to the asset manager ICICI MF to refund Rs.240 crore plus interest to investors in its schemes.
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- The regulator's contention is that the fund house has effectively engaged in an act of bailing out its sister firm when its IPO was in danger of failing.
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What are the issues with response from ICICI?

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- The fund house's defence is that it did not violate the prudential limits set out in SEBI's mutual fund regulations and that it made a bona fide investment, based on ICICI Securities' prospects.
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- But such defence is weak, for SEBI has found that ICICI Mutual Fund did not place its IPO bids at one go.

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- After investing Rs.400 crore on Day One of the book-built offer, it invested another Rs.240 crore on the last day.
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- If the fund managers were really convinced that the group firm was a great investment opportunity, there would be no need to break up the bids, or wait until the eleventh hour.
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What are the grey areas to SEBI's actions?

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- SEBI having decided to ask the fund house to make refunds, it has taken refuge in a private 'advisory' to ICICI MF instead of passing a public order to this effect.
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- This forces investors to rely on conjecture and hearsay on this issue, and sets no precedent for the future.
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- While there are obvious conflicts of interest to a MF investing in group entities, SEBI's MF regulations do not specifically forbid funds from taking group exposures.
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- While there are scheme-specific caps on stock, sector and group exposures to avoid concentration risks, MFs dealing with associates or group firms are required to make only half-yearly disclosures of such deals, post facto.
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- But investors seldom peruse the half-yearly accounts of their MFs and such disclosures come too late to make a difference.
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What measures are needs to address related party deal?

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- Private sector MFs now dominate the industry and the sponsors of leading MFs have their finger in many pies NBFCs, investment banking, brokerage and corporate lending.
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- Laxity on related-party deals can seriously compromise both governance and investor confidence in the vehicle.
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- To address this, SEBI can consider setting tight aggregate exposure limits for mutual funds looking to invest in group entities, with index names alone excluded from these curbs.
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- MFs must also be required to make immediate public disclosures of any investment in a group firm with a clear rationale.
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- SEBI must force the Trustees overseeing AMCs to take their fiduciary duties to investors more seriously, instead of mechanically rubber-stamping all of the asset managers' decisions.
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Source: Business Line

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