

# CRISIL Ratings' criteria for intra-day borrowings by mutual funds

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## Criteria contacts

### **Somasekhar Vemuri**

Senior Director and Head  
Rating Criteria, Regulatory Affairs and Operations  
somasekhar.vemuri@crisil.com

### **Chaitali Nehulkar**

Associate Director  
Rating Criteria and Product Development  
chaitali.nehulkar@crisil.com

### **Ramesh Karunakaran**

Director  
Rating Criteria and Product Development  
ramesh.karunakaran@crisil.com

### **Vanshika Agarwal**

Analyst  
Rating Criteria and Product Development  
vanshika.agarwal@crisil.com

In case of any feedback or queries, you may write to us at [criteria.feedback@crisil.com](mailto:criteria.feedback@crisil.com)

## Executive summary

Mutual funds meet redemption requirements in debt schemes typically using inflows into the scheme, maturing investments in collateralised borrowing and lending obligations (CBLOs) or repos, or from sale of securities. However, proceeds from these sources are usually realised with a lag during the day, leading to temporary intra-day mismatches in cash flow. The mismatches may be more pronounced in the case of liquid and ultra-short-term funds, where the churn rates are higher. Mutual funds, therefore, avail of intra-day bank loan facilities to bridge such temporary shortfalls in liquidity.

Banks offer intra-day facilities to asset management companies (AMCs) against a predefined pool of the AMCs' debt schemes. The facilities are usually secured with specific assets in the schemes as collateral; the assets may include government securities (G-Secs) or treasury bills (T-bills), banks' certificates of deposits (CDs), commercial paper (CPs) and highly rated corporate bonds. Banks typically do not charge any interest on the facilities as the borrowing and repayment happen on the same day. CRISIL Ratings rates intra-day facilities on its short-term rating scale, based primarily on an assessment of the AMCs' operational policies, track record in liquidity management under normal and stressed scenarios, and the quality of schemes' assets.

## Scope

This article explains CRISIL Rating's methodology in rating intra-day facilities<sup>1</sup> that banks offer AMCs to meet redemptions in debt schemes.

The credit quality of the schemes' assets is a critical input factored into the rating analysis. However, this article does not explain CRISIL Rating's methodology in assessing the credit quality of debt schemes, for which the details are outlined in the article, 'CRISIL's bond fund credit quality ratings criteria,' available on [www.crisil.com](http://www.crisil.com).

## Rating scale

Intra-day facilities are rated on CRISIL Ratings' short-term credit rating scale—from 'CRISIL A1+' to 'CRISIL D.'

Banks offer intra-day facilities to AMCs after creating a charge on specific assets or pool of assets in their debt schemes. Nevertheless, the ratings are not assigned on CRISIL Ratings' structured obligations (SO) scale. That is because, payments to investors are made not from cash flows of underlying assets as in the case of securitisation transactions, but from fresh inflows into the schemes, maturing CBLO and repo investments, and sale of securities.

For more details on CRISIL Ratings' rating scales, refer to the article, 'Revision of Rating Symbols and Definitions,' available on [www.crisil.com](http://www.crisil.com).

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<sup>1</sup> This article is being republished following a periodic review of criteria. For accessing the previous version of the article, please refer to: [https://www.crisil.com/content/dam/crisil/criteria\\_methodology/funds/archive/criteria-for-rating-intraday-borrowings-by-mutual-funds-sep2019.pdf](https://www.crisil.com/content/dam/crisil/criteria_methodology/funds/archive/criteria-for-rating-intraday-borrowings-by-mutual-funds-sep2019.pdf)

## Methodology

The rating analysis focuses primarily on the AMC's ability to manage potential redemption pressures in debt schemes against which the intra-day facility has been offered. The rating is driven largely by the AMC's operational policy, its track record in managing liquidity in the schemes, and the quality of the schemes' underlying assets. Among other factors taken into account are whether the custodian and lender bank are the same, the adequacy of margins maintained by the AMC, and the financial flexibility it derives from the support of sponsors.

### A. Operational policy

AMCs with sound risk management policies will manage their liquidity requirements prudently. CRISIL Ratings, therefore, considers the following factors as part of the rating analysis:

**The size of the AMC's debt schemes:** Risk management policies are weighed with the size of assets under management (AUM) as context: CRISIL Ratings categorises debt schemes as large, mid-sized or small, depending on the AUM. When the AUM is large, the risk management policies need to be robust in managing the higher redemption requirements in such funds, given that investors' liquidity requirements may pose a high demand on large AMCs.

**Investor concentration risks:** CRISIL Ratings analyses the share of the top five investors—who are neither promoters nor sponsors—in the debt schemes to gauge the potential redemption pressures the schemes may be subject to. Higher investor concentration may result in sudden redemption pressures and spikes in liquidity requirement. Investor concentration is typically high for liquid and ultra-short-term funds targeted at institutional investors. Funds that strive to reduce investor concentration are, therefore, deemed to have better risk management practices.

**Stated policy on liquidity management:** CRISIL Ratings evaluates the AMC's stated policy on meeting the liquidity requirements of debt schemes. It takes into account the cash holdings and investments in CBLOs and liquid securities vis-à-vis investor concentration, staggering of maturities, and effecting of inter-scheme transfers.

### B. Track record in liquidity management

CRISIL Ratings gauges the AMC's ability to manage liquidity in the future by taking into account the following:

**Trend of cash flows:** The inflow and outflow of funds are considered as a percentage of the schemes' AUMs. This indicates the possible mismatches between inflow and redemptions that have to be met from maturing investments and sale of securities.

**Managing business under normal and stressed scenarios:** CRISIL Ratings analyses the AMC's ability to manage scheme redemptions both in the normal course of business and during a liquidity crunch—whether sale of securities was adequate, or the AMC had to borrow overnight from banks to redeem debt schemes.

**Cash and cash equivalents maintained:** The quantum of cash and investments—in CBLOs or repos—maintained by the AMC is factored in, to gauge their adequacy in meeting scheme redemptions in the event of a shortfall in cash inflow.

## C. Quality of assets

CRISIL Ratings evaluates the underlying assets of the AMC's schemes for their liquidity and credit quality. The liquidity of the scheme depends on the AMC's ability to sell assets and generate funds in time to meet scheme redemptions, which will, in turn, depend on the credit quality of the individual securities. If the credit quality declines, the scheme may face redemption pressure, even shortfall in liquidity. Liquidating assets when credit quality is low may also pose challenges for the AMC. Liquidity and credit quality of underlying assets are, therefore, critical parameters in assessing the ability of the AMC to redeem its debt schemes on time.

**Liquidity:** The schemes' investments may be categorised as: highly liquid (G-Secs, T-bills), liquid (bank CDs, bonds of highly rated financial institutions), or semi-liquid/illiquid (CPs, corporate bonds). CRISIL Ratings applies appropriate haircuts to the assets based on the classification in its evaluation of the liquidity of the AMC's schemes.

**Credit quality:** The weighted average credit quality of the AMC's debt schemes is arrived at using CRISIL Ratings' credit quality rating (CQR) methodology. If one or more of the schemes have low credit quality, CRISIL Ratings will appropriately factor it in to the rating on the intra-day facilities.

## D. Other considerations

Other factors CRISIL Ratings considers in rating intra-day facilities include:

**Custodian and lender being the same:** Typically, intra-day facilities are offered by the custodian banks for the AMC's schemes. In case the AMC avails the facility from some other bank, the custodian creates a charge on the eligible collateral in the name of the lender and holds the assets for the benefit of the lender. The custodian and lender being the same bank is viewed more favourably in the rating analysis. In case the custodian and lender are different, CRISIL Ratings looks into the details of the contractual agreements between the two.

**Margins:** The AMC may not be contractually required to set aside margins for the facility being offered as there is no accrual of interest or other charges expected on intra-day facilities. Even so, AMCs typically maintain some margin for the benefit of the facility. The presence of such margins reflects favourably on the rating on the facility.

**Financial flexibility:** The financial flexibility the AMC derives from sponsor support is considered only in exceptional cases; that is because such support is rarely timely, given that borrowing and repayment happen the same day.

## Conclusion

Banks offer intra-day facilities to mutual funds to help them meet temporary mismatches in scheme redemptions. The facilities are offered against a predefined pool of the AMC's debt schemes, and are usually secured with specific assets in the schemes as collateral; the assets may include G-Secs or T-bills, CDs, CPs, and highly rated corporate bonds. The facilities are rated on CRISIL Ratings' short-term rating scale based on assessment of the AMC's ability to meet scheme redemptions. The rating is driven by the AMC's operational policy, its track record in liquidity management, and the credit quality of its underlying assets.

## About CRISIL Limited

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

It is India's foremost provider of ratings, data, research, analytics and solutions, with a strong track record of growth, culture of innovation and global footprint.

It has delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers.

It is majority owned by S&P Global Inc, a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

## About CRISIL Ratings

CRISIL Ratings is part of CRISIL Limited ("CRISIL"). We pioneered the concept of credit rating in India in 1987. CRISIL is registered in India as a credit rating agency with the Securities and Exchange Board of India ("SEBI"). With a tradition of independence, analytical rigour and innovation, CRISIL sets the standards in the credit rating business. We rate the entire range of debt instruments, such as, bank loans, certificates of deposit, commercial paper, non-convertible / convertible / partially convertible bonds and debentures, perpetual bonds, bank hybrid capital instruments, asset-backed and mortgage-backed securities, partial guarantees and other structured debt instruments. We have rated over 24,500 large and mid-scale corporates and financial institutions. CRISIL has also instituted several innovations in India in the rating business, including rating municipal bonds, partially guaranteed instruments and microfinance institutions. We also pioneered a globally unique rating service for Micro, Small and Medium Enterprises (MSMEs) and significantly extended the accessibility to rating services to a wider market. Over 1,10,000 MSMEs have been rated by us.

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