



भारतीय रिज़र्व बैंक  
RESERVE BANK OF INDIA

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July 5, 2011

The Chairmen & Managing Directors/  
Chief Executive Officers of  
All Scheduled Commercial Banks  
(excluding Regional Rural Banks)

Dear Sir,

**Investment by banks in liquid/short term debt schemes of mutual funds**

Please refer to paragraph 112 of the Monetary Policy Statement 2011-12 (extract enclosed) wherein it has been indicated that banks' investments in liquid schemes of mutual funds have grown manifold. The liquid schemes continue to rely heavily on institutional investors such as commercial banks whose redemption requirements are likely to be large and simultaneous; on the other hand, they are large lenders in the over-night markets such as collateralised borrowing and lending obligation (CBLO) and market repo, where banks are large borrowers. The various schemes of mutual funds also invest heavily in certificates of deposit (CDs) of banks. Such circular flow of funds between banks and mutual funds could lead to systemic risk in times of stress/liquidity crunch. Thus, banks could potentially face a large liquidity risk. It is, therefore, felt prudent to place certain limits on banks' investments in liquid/short term debt schemes of mutual funds.

2. Accordingly, it has been decided that the total investment by banks in liquid/short term debt schemes (by whatever name called) of mutual funds with weighted average maturity of portfolio of not more than 1 year, will be subject to a prudential cap of 10 per cent of their net worth as on March 31 of the previous

year. The weighted average maturity would be calculated as average of the remaining period of maturity of securities weighted by the sums invested.

3. With a view to ensuring a smooth transition, banks which are already having investments in these schemes of mutual funds in excess of the 10 per cent limit, are allowed to comply with this requirement at the earliest but not later than six months from the date of this circular.

Yours faithfully,

(A.K. Khound)  
Chief General Manager

Encl: As above

## **Investments in Debt Oriented Mutual Funds**

112. It has been observed that banks' investments in liquid schemes of debt oriented mutual funds (DoMFs) have grown manifold. The liquid schemes continue to rely heavily on institutional investors such as commercial banks whose redemption requirements are likely to be large and simultaneous. DoMFs, on the other hand, are large lenders in the over-night markets such as collateralised borrowing and lending obligation (CBLO) and market repo, where banks are large borrowers. DoMFs invest heavily in certificates of deposit (CDs) of banks. Such circular flow of funds between banks and DoMFs could lead to systemic risk in times of stress/liquidity crunch. Thus, banks could potentially face a large liquidity risk. It is, therefore, felt prudent to place certain limits on banks' investments in DoMFs. Accordingly, it is proposed:

- that the investment in liquid schemes of DoMFs by banks will be subject to a prudential cap of 10 per cent of their net worth as on March 31 of the previous year. However, with a view to ensuring a smooth transition, banks which are already having investments in DoMFs in excess of the 10 per cent limit, will be allowed to comply with this requirement in six months' time.