

# Liquidity Risk Management

–How Debt Mutual Funds  
can help.

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# Agenda

- ❑ Liquidity Risk
- ❑ Mechanism to assess Liquidity Risk
- ❑ Mutual Fund Basics - History , Structure etc..
- ❑ Debt Mutual Fund –Types and how to choose the right fund
- ❑ Guidelines of investing in a Debt Mutual Fund
- ❑ Questions

# What is Liquidity Risk ?

**LIQUIDITY RISK** IS THE **RISK** THAT AN INDIVIDUAL OR BUSINESS MAY BE UNABLE TO MEET SHORT TERM FINANCIAL DEMANDS DUE TO THE INABILITY TO CONVERT A SECURITY OR HARD ASSET TO CASH, WHEN REQUIRED, WITHOUT A LOSS OF CAPITAL AND/OR INCOME IN THE PROCESS.

*LIQUIDITY RISK* GENERALLY ARISES WHEN A BUSINESS OR INDIVIDUAL WITH IMMEDIATE **CASH** NEEDS, HOLDS A VALUABLE **ASSET** THAT IT CAN NOT TRADE OR SELL AT ITS **ACTUAL VALUE** DUE TO A LACK OF BUYERS, OR DUE TO AN **INEFFICIENT MARKET** WHERE IT IS DIFFICULT TO BRING BUYERS AND SELLERS TOGETHER.

# Assessment of Liquidity Risk

## SOME TOOLS FOR ASSESSMENT OF LIQUIDITY RISK

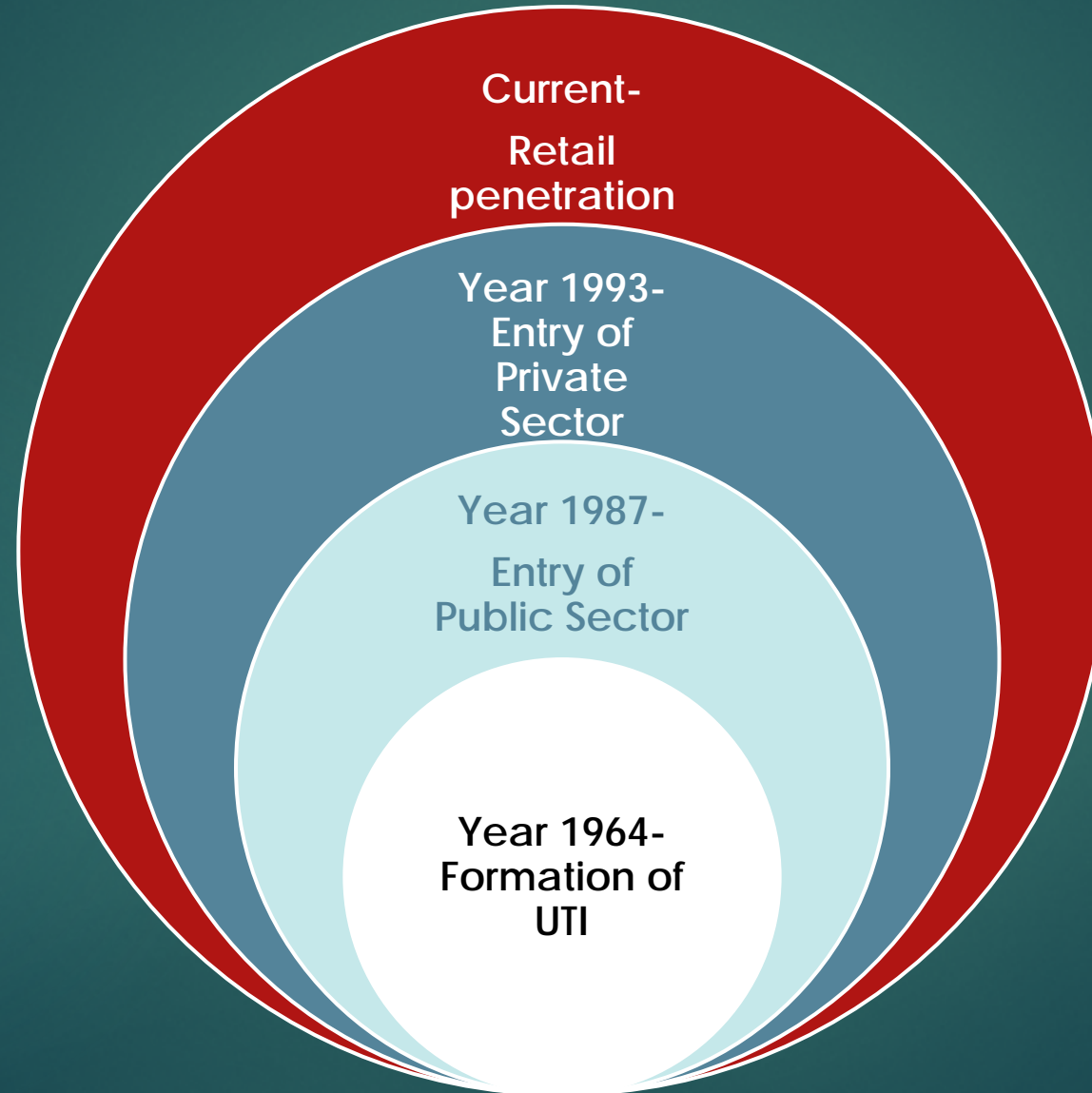
- ❑ A DETAILED PROJECTION OF FUTURE RECEIPTS AND PAYMENT OBLIGATIONS
- ❑ FUTURE NET CASH FLOWS ON GRANULAR LEVEL I.E DAY-BY-DAY / WEEK BY WEEK OR MONTH ON MONTH BASIS
- ❑ STRESS TEST
- ❑ SCENARIO ANALYSIS

# Mutual Funds -Basics

- ❑ A mutual fund is a trust that pools the savings of a number of investors who share a common financial goal.
- ❑ Funds thus pooled is then invested by the fund manager in different types of securities. These could range from shares to debentures to money market instruments, depending upon the scheme's stated objective.
- ❑ It gives the market returns BUT not assured returns.
- ❑ In the long term market returns have the potential to perform better than other assured return products.
- ❑ Mutual Fund is the most cost efficient distributors of financial products

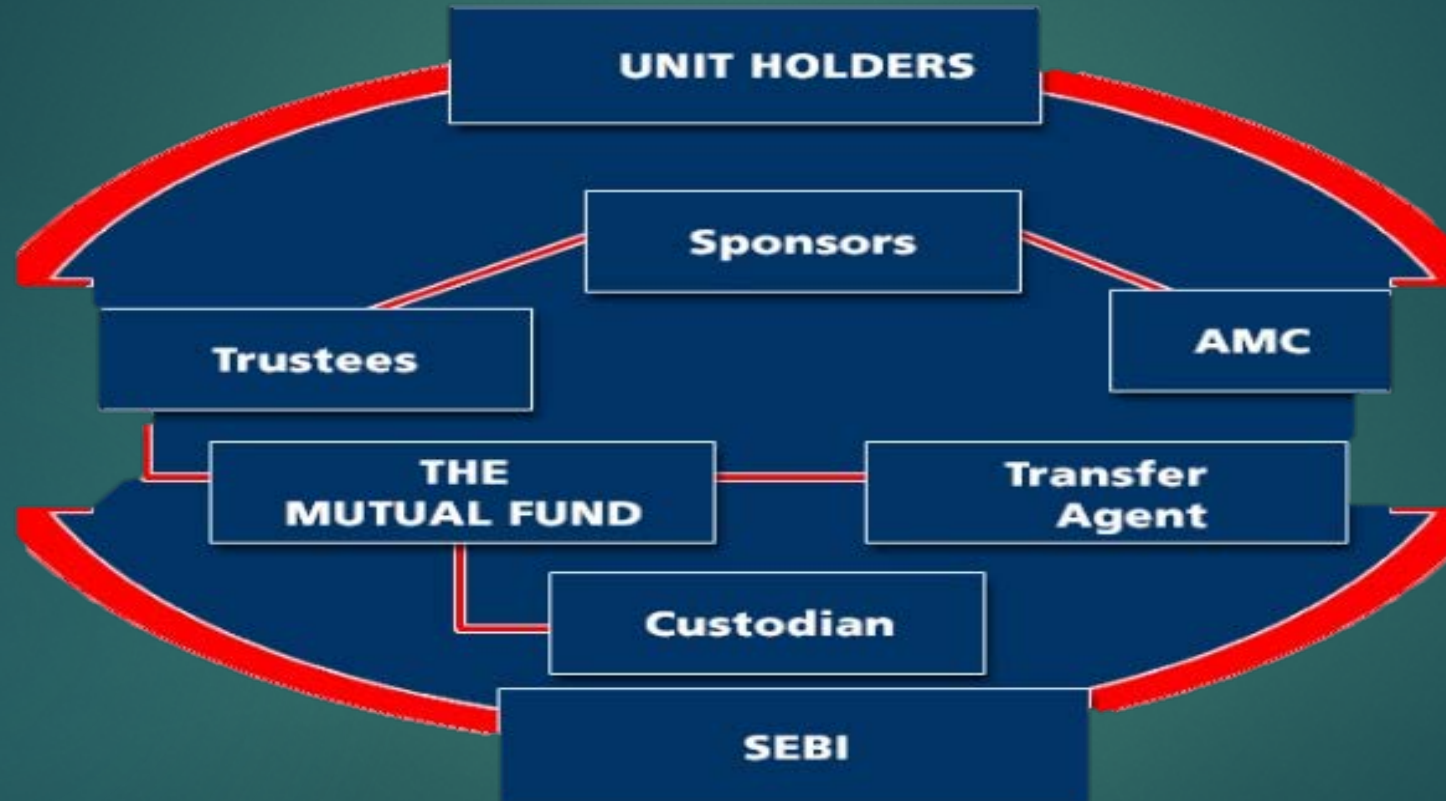
# Brief History Of Mutual Funds In India

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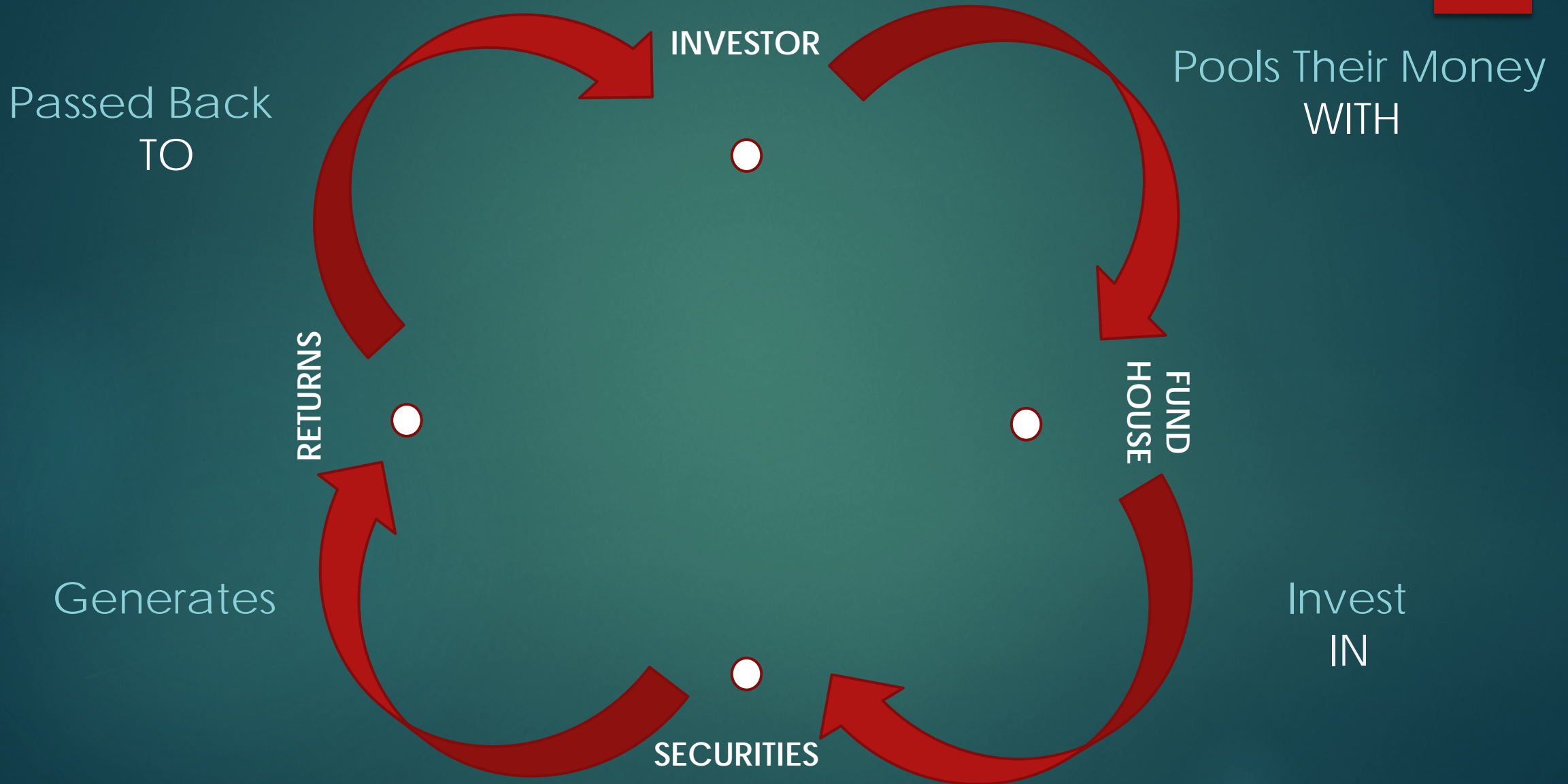


# Structure of a Mutual Fund

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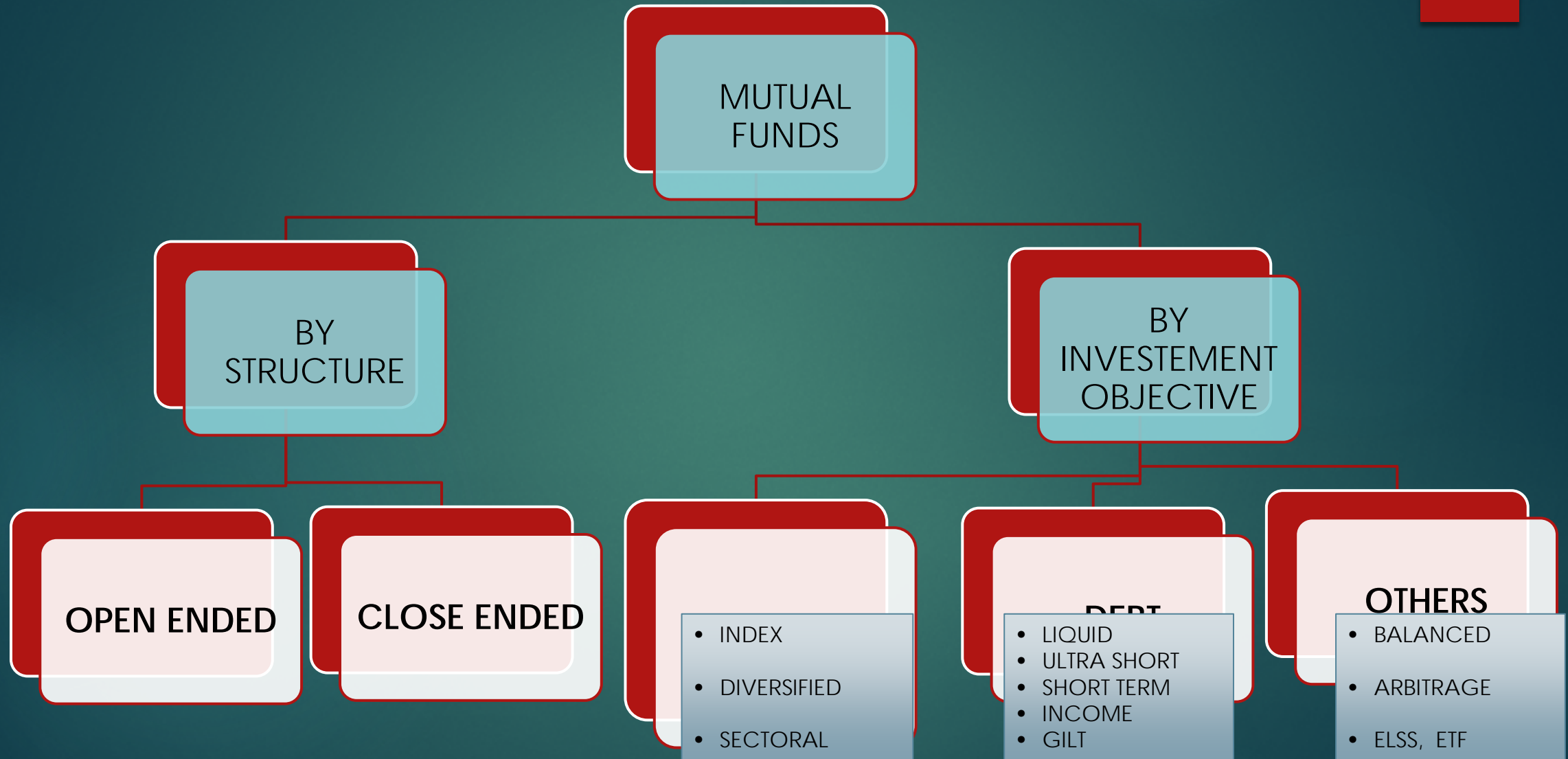


# How a Mutual Fund Works?



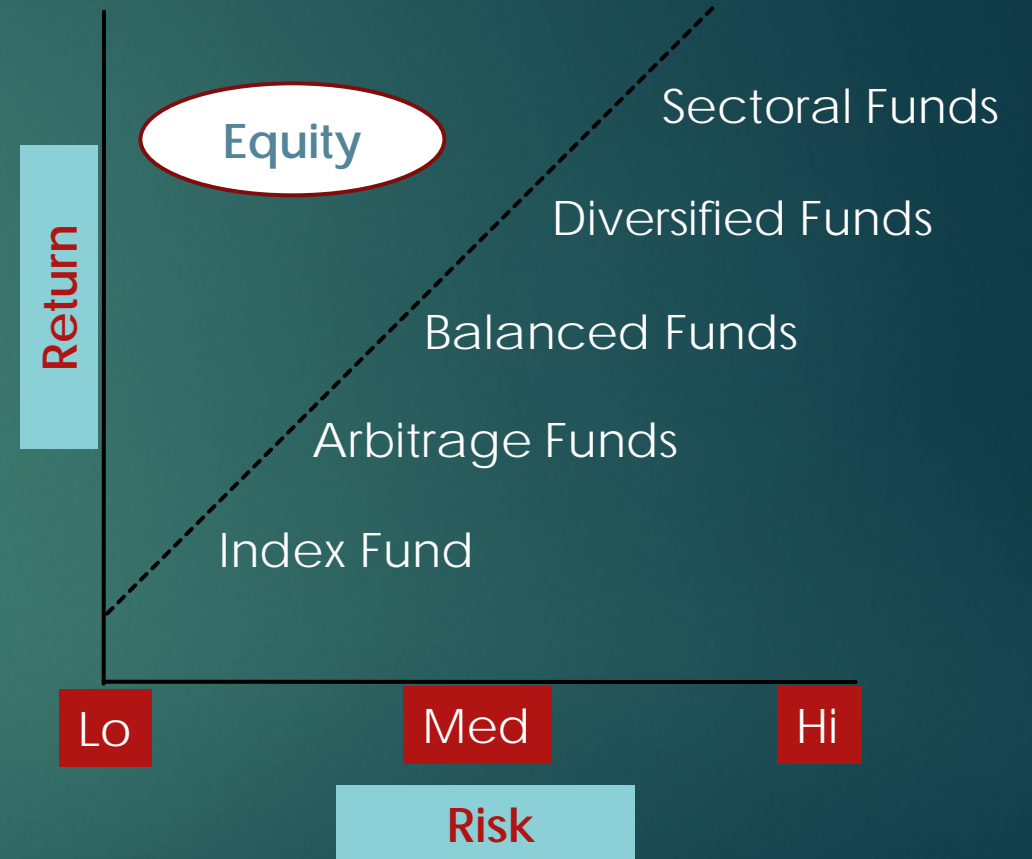
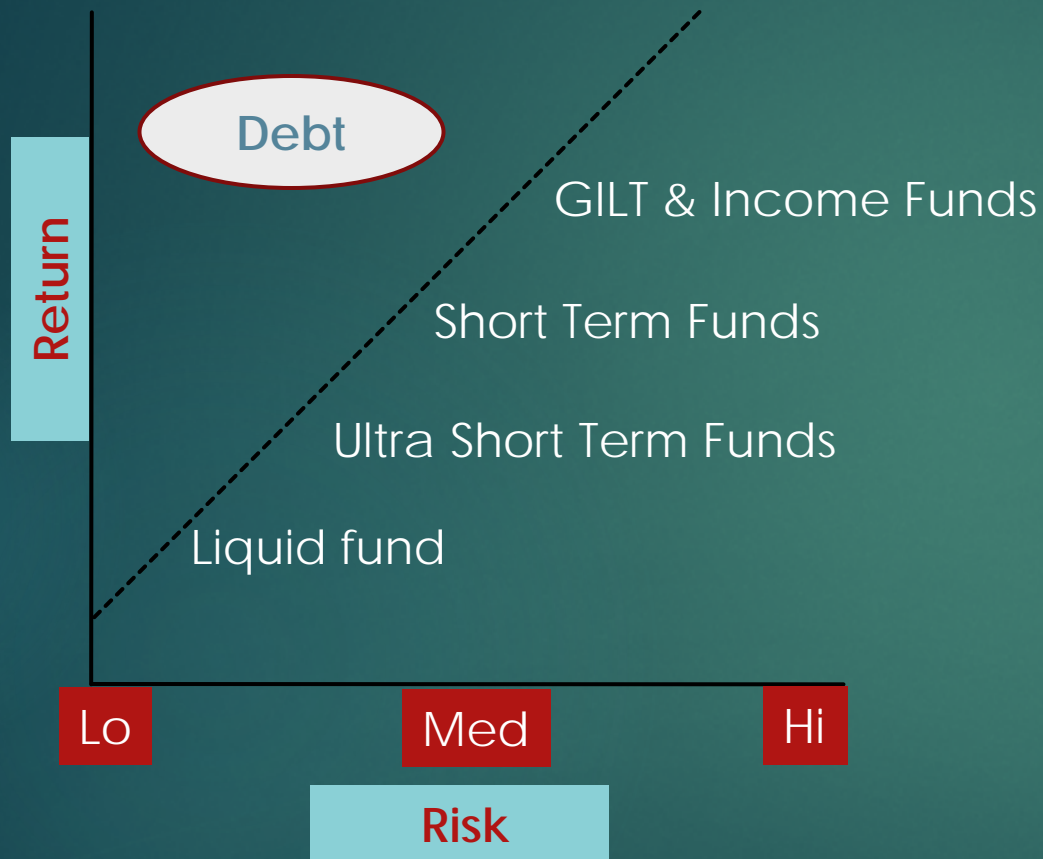


# Types of Mutual Funds



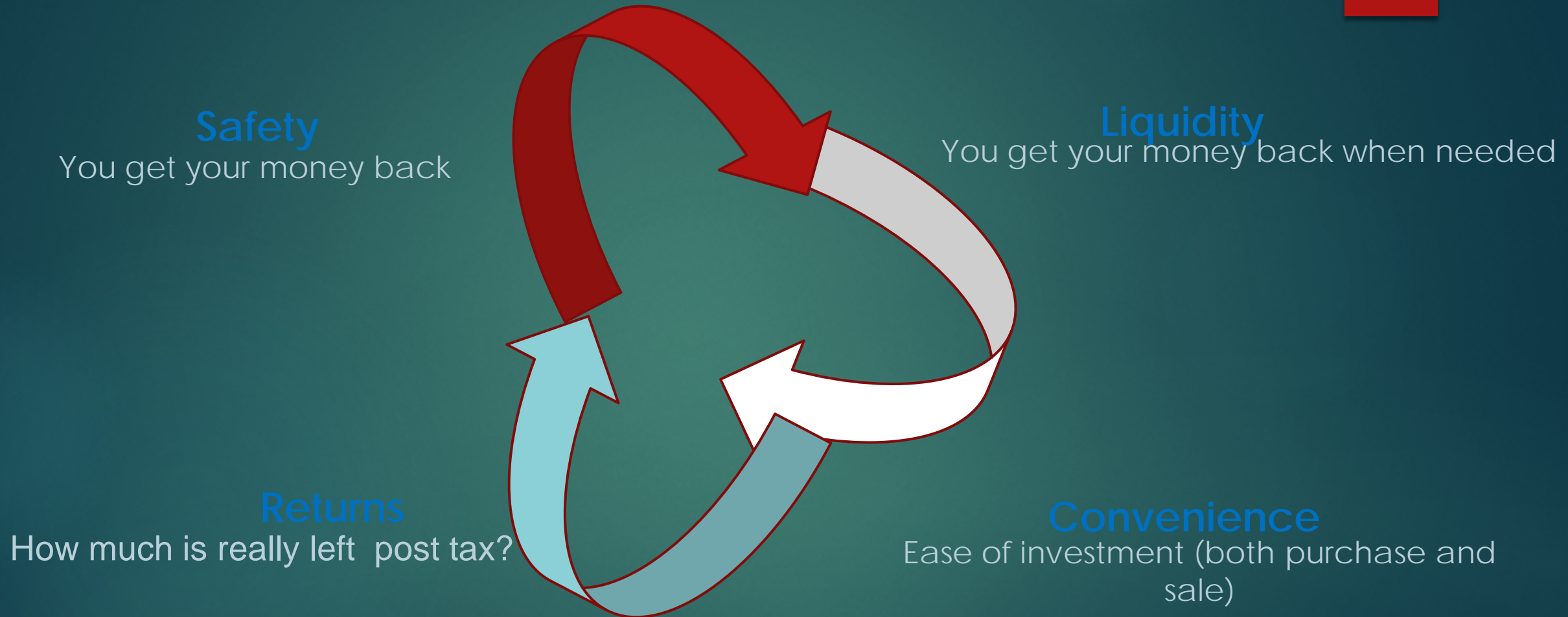
# Mutual Fund Products – Risk / Return

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# Key Investment Considerations

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# Advantages of Mutual Fund Investment

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- ❑ Professional Management
- ❑ Diversification
- ❑ Convenient Administration
- ❑ Return potential
- ❑ Low cost
- ❑ Liquidity
- ❑ Transparency
- ❑ Flexibility
- ❑ Choice of schemes
- ❑ Well regulated
- ❑ Tax benefits

# DEBT MUTUAL FUNDS

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A MUTUAL FUND THAT INVESTS IN 'FIXED INTEREST BEARING INSTRUMENTS OR DEBT INSTRUMENTS

DEBT MUTUAL FUNDS ARE FURTHER SEGREGATED BASED ON THEIR UNDERLYING INVESTMENTS

- ❑ **LIQUID AND ULTRA SHORT TERM** (INVESTS IN VERY SHORT TERM MATURITY PAPERS EG. TREASURY BILLS, CP, CD, CALL MONEY ETC.)
- ❑ **SHORT TERM AND INCOME** ( INVESTS IN LONGER MATURITY PAPERS EG. BONDS, NCD, G-SEC ETC.)
- ❑ **GILT FUND** ( INVESTS ONLY IN LONG TENOR G-SEC BONDS AND SECURITIES )
- ❑ **DYNAMIC BOND** ( FLEXIBILITY TO INVEST IN SHORT OR LONG TERM DEPENDING ON INTEREST RATE VIEW)
- ❑ **FLOATING RATE FUND** (INVESTS IN SECURITIES WITH FLOATING RATE COUPONS)
- ❑ **FIXED MATURITY PLANS** (INVESTS ONLY IN INSTRUMENTS WHOSE DURATION IS SIMILAR TO ITS OWN TERM )

# How to Choose the Right Fund

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## Step 1: Identify the investment goals

1. What are the investment objectives and needs?
2. How much risk is acceptable?
3. What are the cash flow requirements?

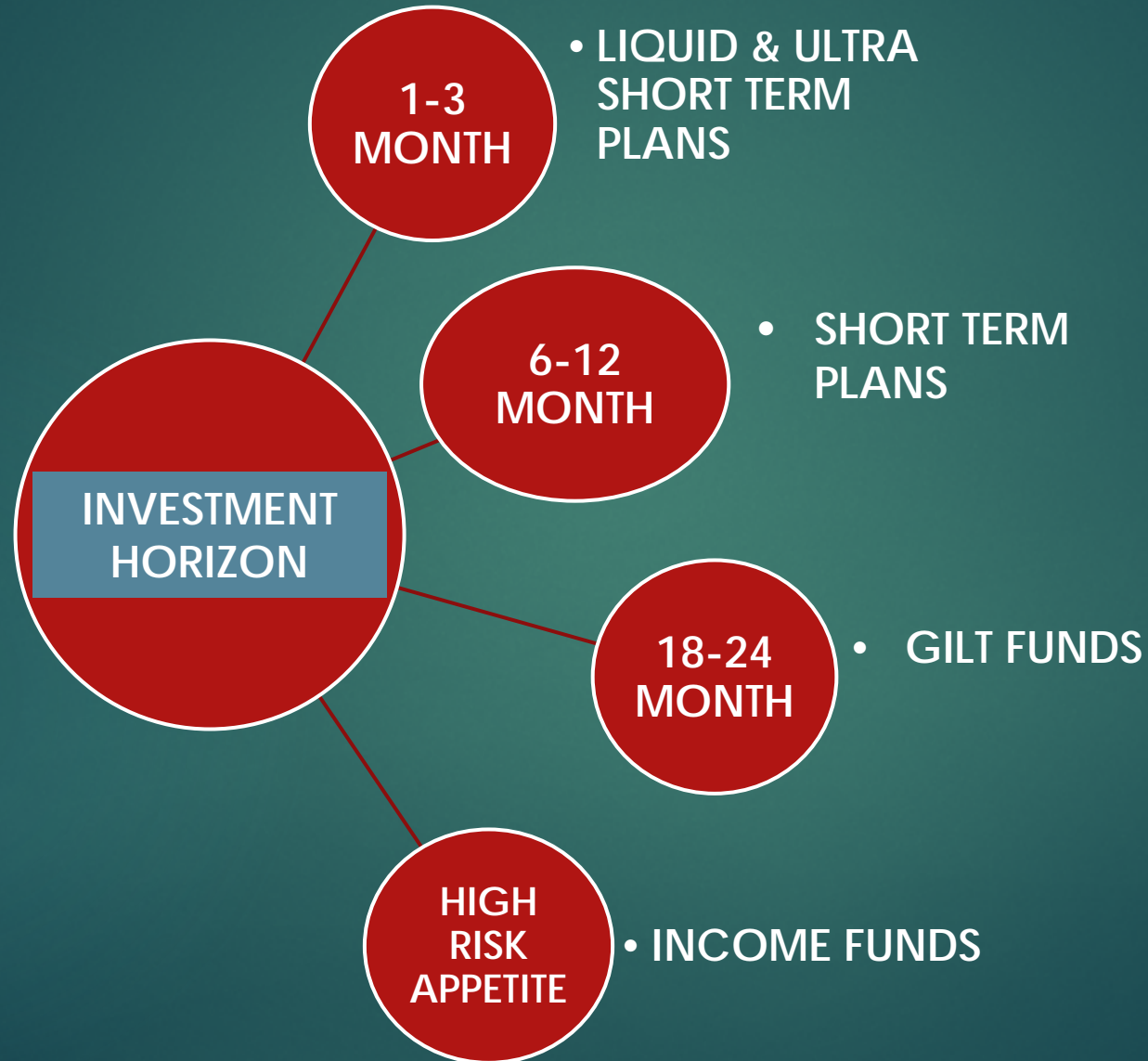
## Step 2: Choose the right mutual fund.

1. The track record of performance over the last few years in relation to the appropriate Benchmark and similar funds in the same category
2. How well the mutual fund is organized to provide efficient, prompt and personalized service.
3. Degree of transparency as reflected in frequency and quality of their communications.

## Step 3 : Select the ideal mix of schemes

1. Investing in just 1 scheme may not meet all investment needs.
2. Consider investing in a combination of schemes to achieve your specific goals.

# Choice of Debt Mutual Fund



# Net Asset Value (NAV)

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- ❑ NAV is the total asset value (net of expenses) per unit of the fund and is calculated by the Asset Management Company (AMC) at the end of every business day.
- ❑ Net asset value on a particular date reflects the realisable value that the investor will get for each unit that he is holding if the scheme is liquidated on that date.
- ❑ NAV per unit is computed once a day based on the closing market prices of the securities in the fund's portfolio.
- ❑ Mutual funds' buy and sell orders are processed based on the NAV.
- ❑ A low NAV does not mean it's a good buy !



# Guidelines for Debt Mutual Fund Investments

- CUT –OFFs
- Applicable NAVs
- Valuation Norms
- TAX Applicability

Link to the SEBI Master Circular for MFs : [http://www.sebi.gov.in/cms/sebi\\_data/attachdocs/1337083696184.pdf](http://www.sebi.gov.in/cms/sebi_data/attachdocs/1337083696184.pdf)

# Risks associated with Investment in MF

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Risk is an inherent aspect of every form of investment. For Mutual Fund investments, risks would include variability, or period-by-period fluctuations in total return.

**Market risk**

**Inflation risk:**

**Credit risk:**

**Interest rate risk:**

**Other risks associated are:**

**Investment risks**

**Liquidity risk**

**Changes in the government policy**

# QUESTIONS

THANK YOU