

Understanding SEBI's PRC Matrix for Debt Mutual Funds

A comprehensive guide to assessing potential risk in debt mutual fund investments and making informed investment decisions



The Genesis of the PRC Matrix

December 2021 Mandate

SEBI made the Potential Risk Class (PRC) matrix mandatory for all fund houses, ensuring appropriate disclosure to promote investor safety and facilitate informed decision-making.

Unlike the traditional riskometer that considers only current risks and updates monthly, the PRC matrix provides a forward-looking perspective, defining the **highest level of risk** a mutual fund cannot breach.



What Exactly Is a PRC Matrix?

Definition

The PRC matrix defines the **extreme level of potential risk** a debt mutual fund can undertake, requiring fund houses to classify both new and existing schemes.

Purpose

It specifies the maximum degree of risk fund managers are willing to undertake through current and future investments, providing transparency to investors.

Implementation

Effective from 1st December 2021, all debt fund schemes must clearly disclose their PRC classification in their scheme documentation.

Understanding the Two Primary Risks

Credit Risk

Occurs when debt funds suffer defaults in principal or interest payments from bond issuers. Such defaults directly reduce the fund's NAV, impacting investor returns.

Interest Rate Risk

Arises from the inverse relationship between bond prices and interest rates. When rates increase, bond yields decline, reducing the scheme's NAV and overall value.



The PRC Matrix Categories

Interest Rate Risk



Class I

Lowest interest rate risk exposure



Class II

Moderate interest rate risk exposure



Class III

Highest interest rate risk exposure

Credit Risk



Class A

Lowest credit risk exposure



Class B

Moderate credit risk exposure



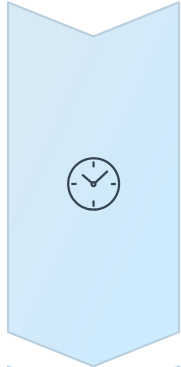
Class C

Highest credit risk exposure

- Remember: Debt fund risk is always assessed as a **combination** of both interest rate and credit risk. A scheme classified as A-I carries the lowest overall risk, whilst C-III carries the highest.

The Classification Criteria

How Debt Funds Are Categorised



Macaulay Duration (MD)

Determines interest rate risk by calculating the duration in years for investors to fully realise the price paid for bonds through interest and principal payments. Lower MD equals lower interest rate risk.

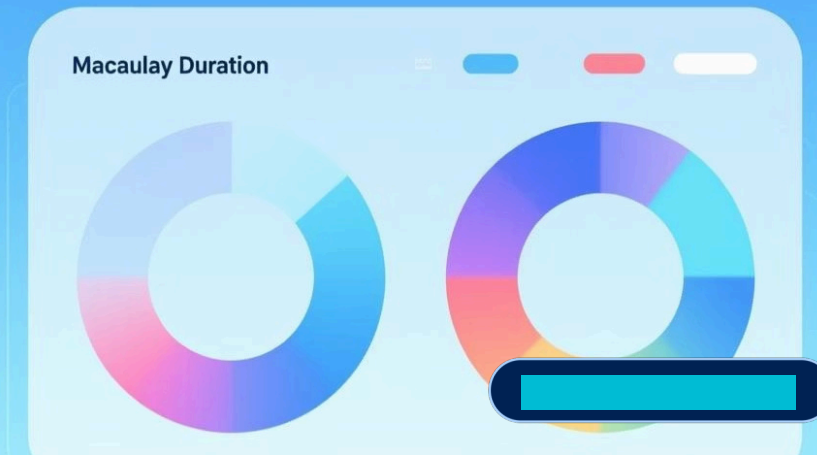
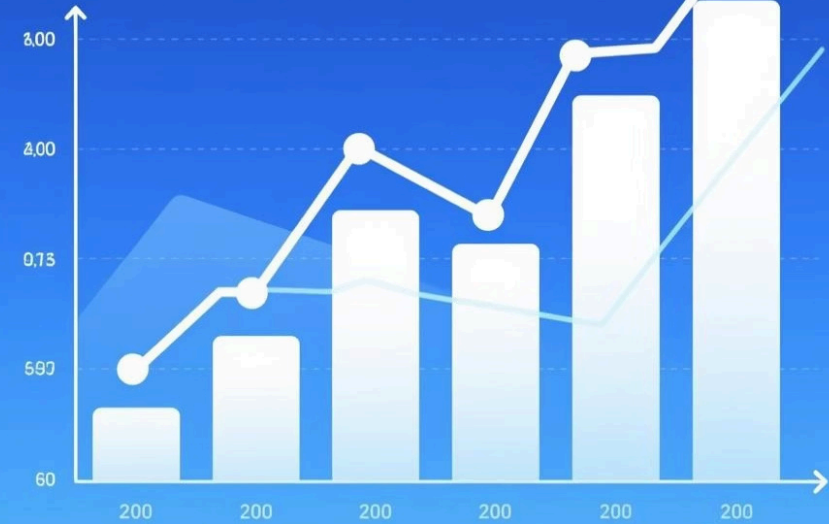


Credit Risk Value (CRV)

Assesses credit risk using SEBI-assigned values to different debt securities. Higher CRV indicates lower potential credit risk, creating an inverse relationship.



Macaulay Duration Calculation



Macaulay Duration Classification



Class I

MD of up to 1 year

Potential interest rate risk is the lowest, suitable for conservative investors seeking stability



Class II

MD of up to 3 years

Potential interest rate risk is moderate, balancing risk and potential returns



Class III

Any other MD

Potential interest rate risk is the highest, suitable for long-term investors

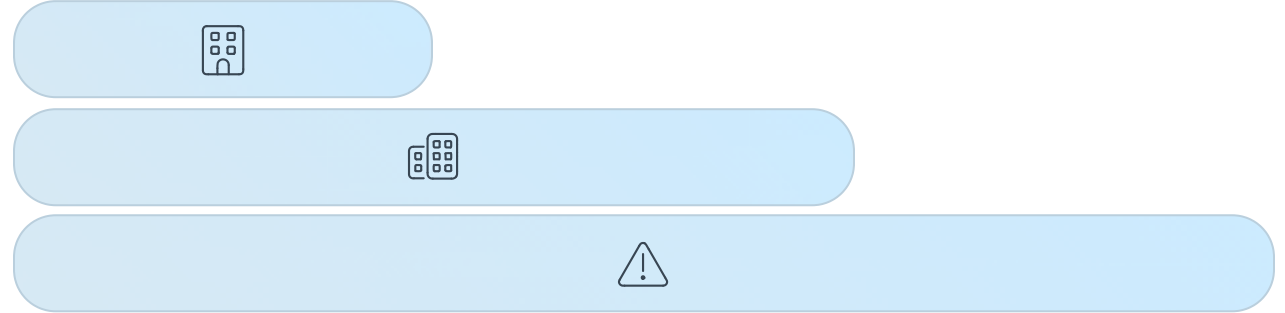
For schemes with multiple securities, the weighted average MD of all holdings determines the scheme's classification.

Credit Risk Value Classification

Understanding CRV

SEBI assigns specific Credit Risk Values to different debt securities, establishing a clear hierarchy of safety:

- **Government securities:** CRV of 13
- **AAA-rated securities:** CRV of 12
- **Unrated securities:** CRV of 2



Class A

CRV \geq 12: Lowest potential credit risk



Class B

CRV 10-11: Moderate potential credit risk



Class C

CRV $<$ 10: Highest potential credit risk

The Complete PRC Matrix Framework

Interest Rate Risk ↓ / Credit Risk →	Class A (CRV ≥ 12)	Class B (CRV 10-12)	Class C (CRV < 10)
Class I (MD ≤ 1 year)	A-I IRR: Lowest CRR: Lowest	B-I IRR: Lowest CRR: Moderate	C-I IRR: Lowest CRR: Highest
Class II (MD ≤ 3 years)	A-II IRR: Moderate CRR: Lowest	B-II IRR: Moderate CRR: Moderate	C-II IRR: Moderate CRR: Highest
Class III (Any other MD)	A-III IRR: Highest CRR: Lowest	B-III IRR: Highest CRR: Moderate	C-III IRR: Highest CRR: Highest

IRR = Interest Rate Risk | CRR = Credit Risk



Key Takeaways for Investors



Hedge Protection

Debt schemes are added to portfolios to hedge overall risk, as they're less risky than equity investments. Prudent investors need clarity on maximum potential risk.



Risk Transparency

The PRC matrix enables investors to clearly identify the upper limit of risk exposure, eliminating uncertainty about future risk levels in debt fund investments.



Informed Decisions

With the PRC matrix, investors can now distinguish between debt funds bearing different degrees of risk and make well-informed investment decisions aligned with their risk appetite.