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Franklin Templeton Mutual Fund closes 6 Debt funds

Franklin Templeton Mutual Fund (FT) has closed six Debt Funds with total Assets Under Management of Rs 25,856 crore in India from April 23, 2020. The affected schemes are:

- Franklin India Low Duration Fund
- Franklin India Dynamic Accrual Fund
- Franklin India Credit Risk Fund
- Franklin India Short Term Income Plan
- Franklin India Ultra Short Bond Fund
- Franklin India Income Opportunities Fund

What was wrong with the schemes of Franklin Templeton Mutual Fund?

- **Liquidity Risk**
- **Stress in Financial sector due to lockdown**
- **Low Investment grade securities**

As the investments of FT's above schemes increased, the asset quality suffered. FT had exposure to financially stressed companies like Anil Ambani's Reliance group, Essel Group, DHFL to name a few. Amongst the many investment risks the fund undertook, it ignored an important aspect called '**Liquidity Risk**'.

Due to the Covid-19 pandemic, India's **financial sector is under intense strain** and grappling with crushing liquidity crisis. Due to uncertainty of returns, investors have been redeeming units from high credit risk funds such as FT.

Since the underlying securities were of **low investment grade**, the fund house was unable to find buyers in the secondary market. The fund house exhausted borrowing lines sought from banks as the redemption pressure kept on piling. Finally, after evaluating all possible options to raise cash, the fund house decided to wind up the credit schemes.

When can clients expect to get back their investments

Investors in these schemes will have to wait for Franklin Templeton to sell underlying securities at fair valuation to generate liquidity. The quantum of money to be returned to investors will depend on the ability of the fund house to generate cash between now and the maturity period of each of the schemes. Till such time, the NAV of the schemes will be published but investors will not be able to do any transactions.



Exposure of Naik Financials to FT's schemes

As a policy, Naik Financials does periodic review of all mutual fund schemes and had decided to stay away from credit schemes of all mutual fund companies, especially after the IL&FS fiasco in October 2018. We gave an exit call to redeem from credit schemes about a year ago and were successful in redeeming funds without any loss to investor's portfolio.

Risk assessment process followed by Naik Financials to identify Debt Schemes

Our parameters to identify mutual fund schemes in Debt category are as follows:

- **Investment Grade:** Our most important filter for recommending a debt scheme is the credit rating of underlying securities. Our preference is for schemes with 100% AAA rated securities. We do not recommend schemes which have exposure to below AA securities.
- **Average Duration of securities:** Debt funds can have duration ranging from overnight funds to up to 30 years of maturity. We restrict our advice to schemes with average maturity of up to 3 years.
- **Interaction with the Fund Manager and previous track record:** We try to get first-hand information from the fund manager before including the scheme in our recommendation list.
- **Fund Management Expense:** Underlying expense plays a key role while determining suitability of the scheme.
- **Performance of the Scheme:** Performance is not evaluated on standalone basis but it is culmination of all factors mentioned above. Such evaluation process helps in eliminating 'luck factor' and 'good performance' in short term. We give high evaluation scores for **long term** and **consistent performance**.

Our Verdict

In our professional career of over 20 years, in the Debt market, we have witnessed many events where credibility of the company or fund manager is tarnished because of oversight on important aspects of risk.

When it comes allocation to Debt schemes, our foremost priority is preservation of capital followed by the return potential. If the need comes to taking additional risk for that higher return, our preference is towards Equity Mutual Fund schemes and not Debt Mutual Fund schemes. After all, **the other name and principle of investing in Debt funds is "Fixed Income"** and our endeavour is to follow it.

We assure you of our risk management process and vow to continue to maintain the trust you have bestowed on us.