Franklin Templeton India Predicament: A Case Study

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Abstract: ***Investing in mutual funds is always encouraged and especially in debt funds but after Franklin Templeton imbroglio most investors including the unit holders are bit precarious related to the investment in mutual funds. Though the investors are aware about the fact that the "Mutual Funds are subject to market risks" and also the ill effects of pandemic Covid -19 which has also adversely affected the investments in Franklin Templeton six wound up schemes. This paper attempts to provide deep insight into the Franklin Templeton plight. The paper takes into account the reasons for the failure of the six debt schemes, various extinguishments made by the Asset Management Company to the unit holders of the six schemes being wound up and also the maturity dates by which the schemes are declared in their frequent declarations on their official website. Besides the predicament of Franklin Templeton's debt schemes, one cannot ignore the very fact that though debt funds are also subject to risks being the core element of mutual funds but still they prove to be safer than the other schemes of mutual fund i.e. equity schemes, hybrid schemes, etc. In addition, the paper also designates the cushion effect of having a portion of investment in debt schemes of mutual fund. The paper brings to light the reason of failure of Franklin Templeton, how the asset management company is making a successful attempt to return the blocked amount of the unit holders and finally the reasons why debt funds are still safe despite the failure of debt schemes of Franklin Templeton.***

Keywords: Mutual funds, Franklin Templeton, debt funds, debt schemes, COVID 19, extinguishments

1. Introduction

A famous proverb in financial world goes "High risk leads to high returns" and thus is the principle on which the mutual fund all over the world works. Mutual funds are the companies which pool the money of investors and invest them in shares, debentures, bonds and other instruments with a motive of gaining exuberant returns at the same time considering the very fact that losses may be inevitable at times. Gain and loss in financial market is wholly dependent on market performance i.e. the performance of the instruments wherein the money of investors are invested and also the macro factors or situations related to economy and one of the striking examples of this fact is the case of Franklin Templeton. Franklin Templeton was established in New York by Rupert H. Johnson, Sr. in 1947. It is operating in India since past twenty five years. The lucrative past of the AMC had perfectly won over the confidence of the various classes of investors but the intrusive effects of Covid 19 also impacted this asset management company in the worst of its ways. The debt schemes which are considered to be safer when it comes to investing in mutual funds collapsed in the case of Franklin Templeton. The schemes which collapsed were Franklin India Ultra Short Bond Fund (FIUBF), Franklin India Low Duration Fund (FILDF), Franklin India Short Term Income Plan (FISTP), Franklin India Income Opportunities Fund (FIIOF), Franklin India Credit Risk Fund (FICRF) and Franklin India Dynamic Accrual Fund (FIDA).

2. Literature Study

Extensive work has been done in the areas of mutual fund performance analysis of various funds and also prediction of performance but very few studies have been conducted in Indian debt market and especially on Franklin Templeton crisis. This proves to be the gap for study in this research paper.

3. Objectives of the Study

1) To study the portfolio statement and extinguishments made and to be made by six schemes of Franklin Templeton India under winding up.
2) To elucidate the reasons that debt schemes are still better than equity schemes of mutual fund.

4. Research Methodology

1) Sample Size: The sample comprises of data from May 31, 2021 to April 30, 2025 (Maturity Values) of six debt schemes being wound up by Franklin Templeton India.
2) Types of Data: The data comprises of secondary data only.
3) Source of Data: The secondary data has been selected from various sites like Franklin Templeton India website, Reports by FTI, CRISIL (Credit Ranking Information Services of India Limited), ValueResearch journal, reports of AMFI (Associations of Mutual Funds in India), Mutual Fund Sai Hai website, etc.
4) Tools for Analysis: Various charts, graphs, tables etc. has been used for pictorial representation of various information.

"Mutual funds give people the sense that they're investing with the big boys and that they're really not a disadvantage entering the stock market."

-Ron Chernow

Investing in mutual funds and primarily in debt funds is always seen as playing safe, not ignoring the very fact that "Mutual funds are subject to market risks". Proving this again is the famous Franklin Templeton imbroglio. Franklin Templeton is an American based company with a long history of 25 years. On 23rd April 2020, Franklin Templeton declared to close down six of its debt schemes. The six schemes shut down by Franklin Templeton were debt funds namely Franklin India Ultra Short Bond Fund (FIUBF), Franklin India Low Duration Fund (FILDF), Franklin India Short Term Income Plan(FISTP), Franklin India Income Opportunities Fund (FIIOF), Franklin India Credit Risk Fund (FICRF) and Franklin India Dynamic Accrual Fund(FIDA) with a total AUM of Rs 25,856 crores approximately. The reason adduced was severe market dislocation and illiquidity in the financial market. After the schemes were shut down investors were not allowed to invest again and neither their money was allowed to be redeemed. It should be clear that Franklin Templeton has not been shut but only the debt schemes which went into crisis were. They are still other stable debt, equity and hybrid schemes working under the pen name of Franklin Templeton which are into operation. These six bonds had credit risk issue which is mainly because exposure to low rated bonds. A scheme of Mutual Fund may be wound up, after repaying the amount due to unit holders, on happening of any event which, in the opinion of trustees, requires the scheme to be wound up. According to SEBI regulations the scheme first should discharge its liabilities before returning money to the investors. Franklin Templeton has started receiving prepayments/repayments from some energy and renewable sector companies like Xander Finance and Renew Power Ltd among others. Much of the amount recovered has gone in extinguishing bank liabilities which arose to bear theredemption pressure arose during Covid pandemic. The schemes have returned Rs. 14,572 crores to unit holders which is 58% of AUM as on April 23, 2020.

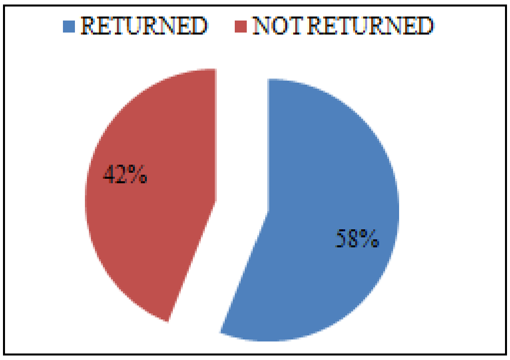

Figure 1: Percentage of AUM under six debt schemes as on April 31st, 2020

Portfolio statement of six schemes under winding up as on May 31, 2021

1) Franklin India Ultra Short Bond Fund

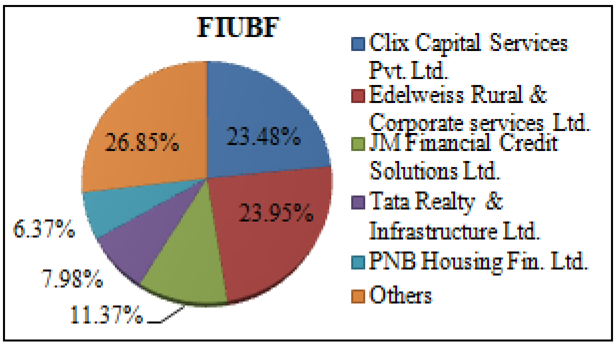

Figure 1.1: Group wise portfolio statement of Franklin India Ultra Short Bond Fund

The portfolio of Franklin India Ultra Short Bond Fund as on May 31, 2021 largely consists of investments in Clix Capital Services Pvt.Ltd. and Edelweiss Rural & Corporate Services Ltd. The investments in Clix Capital Services Pvt.Ltd. who had maturity by 6th May 2021 and 6th July 2021 of Rs. 20,000 lacswere received as full value on maturity and full value as pre-payment. Edelweiss Rural & Corporate Services Ltd. paid its obligations in the year 2020.Franklin Templeton India received its amount worth Rs.11, 030.04 crores fromJM Financial Credit Solutions from sale of security which had maturity date of 23rdJuly, 2024.Tata Realty & Infrastructure Ltd. Franklin Templeton India realized its receipt from Tata Realty & Infrastructure Ltd. on 4th June, 2021 which was its maturity date. PNB Housing Finance Ltd. paid full amount for all its instruments by 7th May, 2021 on maturity of Rs. 67,511.04 lacs inclusively. Considering all other instruments constituting 26.85% of total investments are expected to be matured by 23rd July, 2024.

2) Franklin India Low Duration Fund

The portfolio of Franklin India Low Duration Fund has a bigger proportion of investments in JM Financial comprising of 28% with the market value of Rs.18542.99 lacs and the amount was expected to be matured by 27th December, 2024. The full amount was received by Franklin Templeton India as pre-payment and on sale of the respective securities. Edelweiss Capital has a maturity of 30th June 2027 amounting 1,784.60 lacs (market value). Clix has the maturity of 27th June 2023 and maturity value of Rs. 6,186.12 lacs. Other instruments comprising 41% of total investments have maturity of 20th January 2025.

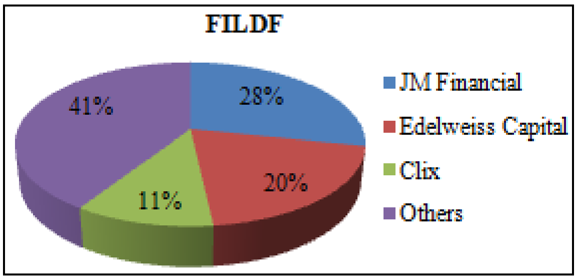

Figure 1.2: Group wise portfolio statement of Franklin India Low Duration Fund

3) Franklin India Short Term Income Plan

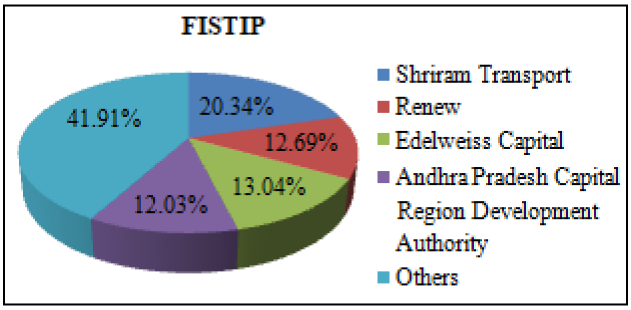

Figure 1.3: Group wise portfolio statement of Franklin India Short Term Income Plan

The scheme comprises 20.34% of investments in Shriram Transport of which Rs.892.35 lacs was received by sale of respective securities. Renew comprises of 12.69% of total investment in FISTIP of which Rs.13,904.20 was recovered as part payment, full value as pre-payment and on sale of respective securities , which were altogether had a maturity date of 31st March 2023. INR 2,500 was recovered from Edelweiss Capital on its maturity on 11th August 2020. Andhra Pradesh Capital Region Development Authority related investments have a maturity date of 16th August 2024.Other investments(including Call, Cash and Other Assets) in FranklinIndia Short Term Income Plan have maturity date upto 30th June 2027.

4) Franklin India Income Opportunities Fund

Franklin India Income Opportunities Fund had investments in Ajay Piramal comprising 18.87% with market value of INR 26,196.09 lacs and the scheme recovered INR 2,593.64 lacs on sale of security. Shriram Transport had INR 22,325.98(market value) lacs invested by Franklin India Income Opportunities Fund of which maturity date was by 21st June 2024 of which INR 124.46 lacs was recovered on sale of security. Hinduja investments had investments of market value of INR 13,826.83 lacs and INR 22.49 lacs with maturity date of 8th April 2022 were received on sale of security. DCB had investments of market value INR 13,826.83 lacs and of which INR 12,147.95 lacs has maturity on 12th January 2028.Other investments are expected to mature by 16th August 2028.

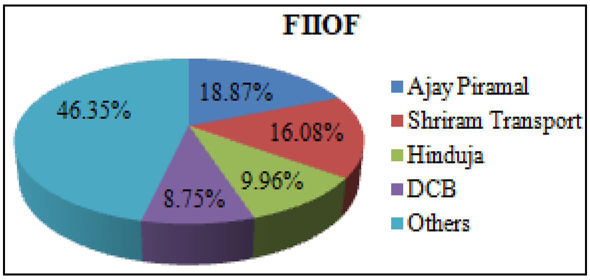

Figure 1.4: Group wise portfolio statement of Franklin India Income Opportunities Fund

5) Franklin India Credit Risk Fund

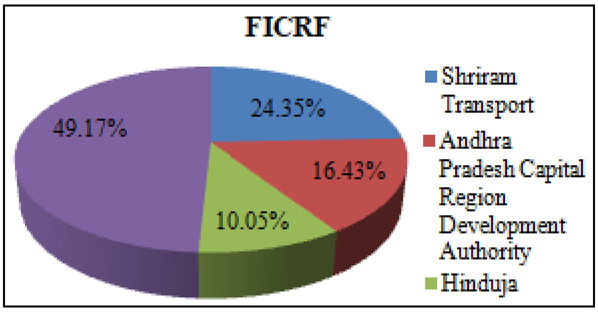

Figure 1.5: Group wise portfolio statement of Franklin India Credit Risk Fund

Franklin India Credit Risk Fund invested in Shriram Transport had market value of INR 50,764.92 lacs comprising 24.35% of total investments of which INR 218.69 lacs was recovered by Franklin Templeton India on sale of security which had maturity date of 26th April 2024 and in case of Andhra Pradesh Capital Region Development Authority investments stands at INR 34,249.84 lacs (market value) with maturity date of 16th August 2026. The scheme had invested INR 20,946.70 lacs in Hinduja Group of maturity date upto 29th September 2024 and recovered INR 954.13 lacs on sale of related security. Others (including cash, call and other assets) have maturity upto 12th January 2028.

6) Franklin India Dynamic Accrual Fund

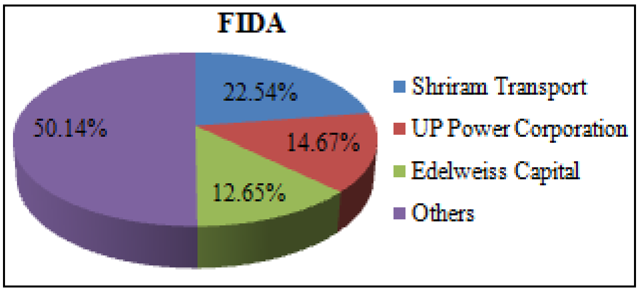

Figure 1.5: Group wise portfolio statement of Franklin India Dynamic Accrual Fund

Shriram Transport investments worth INR 28,292.13 lacs (market value) have maturity on 26th April 2024 and INR 300.44 lacs were recovered by the scheme by sale of related securities. Investments in UP Power Corporation with market value of INR 18,415.47 lacs have maturity on 20th October 2023. The scheme recovered INR 420.74 lacs as part payment and some portion on sale of related securities. Investments in Edelweiss Capital have market value as on 31st May 2021 of INR 15,878.25 and maturity date of some instruments as 29th November 2021 and 30th June 2027. Others (including call, cash and other assets) have maturity date upto 16th August 2027.

Reasons on winding up of schemes by AMC

The six debt schemes are being wound up in order to have safe, orderly and equitable exit to unit holders of six schemes. The credit climate in the economy was already extremely challenging and the Covid 19 gravely impacted it and resulted in rise in yields and thus liquidity reduced. The broad factors which can be listed because of which the board has no other option but to wind up the six debt schemes were:

- High redemption pressure
- Mark to market losses resulting in spike in yields
- Illiquidity in portfolios

All the above factors contributed to liquidity crunch and which the board considers to unlikely return to normalcy in near future. The winding of the schemes does not mean that the monies of unit holders are lost; the board clearly states that best and possible approach to liquidate the securities are being taken and monies realized are timely disbursed to the unit holders of respective schemes. With the ongoing pandemic lock downs and uncertainty, Investment Manager of the schemes did not find it prudent to increase borrowings in order to deal with immensely increasing redemption pressure.

A consistent investment strategy was followed which included investing in active below AAA rated securities and it has been seen that they were able to go good through all market situations and providing returns and liquidity in the market. But the grave impact of Covid 19 affected the instruments rated below AAA and lead to the collapse of the six debt schemes. The instruments which are rated below AAA category are 13.55% Nufuture Digital (India) Ltd. of Future Group with BWR D rating as on 31st March2021, 13.00% Rivaaz Trade Ventures Pvt Ltd. of Future Group had a rating of BWR C as on 31st March 2021, 14.15% Future Ideas Co. Ltd. again of Future Group with BWR D rating as on 31st March 2021 etc. BWR (Brickwork Ratings) D signifies instruments are in default or expected to be in default soon and BWR C signifies instruments with very high risk of default regarding timely servicing of financial obligations.

Extinguishments made by Franklin Templeton India to unit holders of six schemes winding up

The figure 1.6 depict that as and when cash became positive for particular scheme then the extinguishment to the respective unit holders were made. It is clearly depicted that distribution was started to be made from February 12, 2021. On February 12, 2021, certain percentages of total AUM of five out of six schemes were extinguished. The scheme which did not have positive cash flow by February 12, 2021 was "Franklin India Income Opportunities Fund" and extinguishment for this particular scheme was not made by then. Disbursements were made in the three tranches based on NAV for all six debt schemes winding up. The following figures in the table 1.0 presents the disbursements made by Franklin Templeton India to unit holders of six debt schemes under winding up. The disbursements were made in three tranches. No outstanding borrowings in any of the six debt schemes under winding up were left with effect from March 30, 2021.

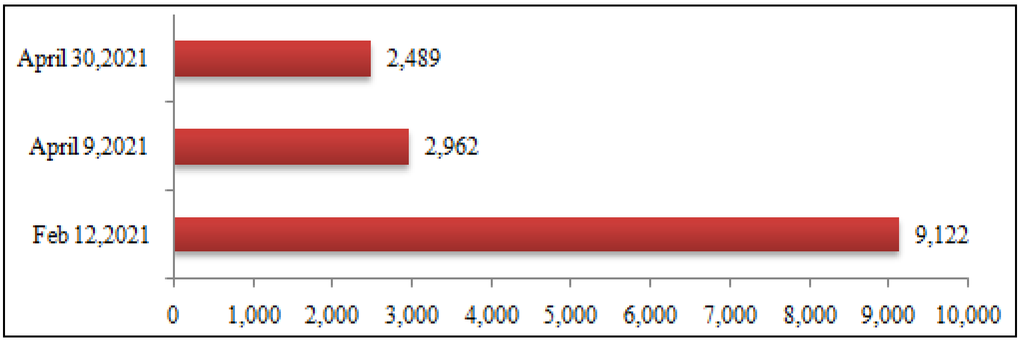

Figure 1.6: Extinguishment made to unit holders (in crores) based on NAV

Table 1: Summary of Disbursements (in INR crores)

Tranche	FIUBF	FILDF	FISTIP	FIIOF	FICRF	FIDA
1	5,075	1,625	469	-	926	1,025
2	1,489	141	710	121	320	181
3	772	290	391	337	500	200

Total Rs. 14,572 crores was disbursed by March 30, 2021. No outstanding borrowings are left in any of the schemes w.e.f March 30, 2021.According to SEBI regulations, each scheme will return monies to the unit holders after all obligations are settled. The maturity profile considering put and call option and put option dates of various schemes on cumulative basis from June 1, 2021 under winding up can be understood through Table 1.2 below:

Table 1.1: Maturity profiles considering call and put option and put option dates (in percentage)

Period upto	FIUBF	FILDF	FISTP	FIIOF	FICRF	FIDA
May 31,2021	77	81	44	39	60	61
April 30,2022	93	87	53	47	66	68
April 30,2023	93	94	66	55	72	77
April 30,2024	97	96	88	60	83	90
April 30, 2025	100	100	97	75	91	92
Beyond April 30,2025	-	-	100	100	100	100

The table above summarizes the percentage of amount receivable on maturity dates. The percentages calculatedabove have taken into account the market value of holdings and cash and cash equivalents as on May 31, 2021 plus the cash distributed. Cash and cash equivalents impliescash balance and investment in SBI Overnight Fund which is available to unit holders for the purpose of distribution.

Debt funds better than equity funds?

Are debt funds better than equity funds? This used to be the question pre pandemic (Covid 19) period. Now, the question has become more precise to "Are debt funds better than equity funds?"The answer is still the same. It purely depends on the investor's risk profile. If an investor is risk averse then debt funds are a better option and if the investor is not reluctant in taking risk with his invested money then he may have bright future for his investments in equity market. Mutual Funds are still subject to market risks. Mutual funds invest in broadly two categories-Equity Funds and Debt Funds. Debt funds invest in fixed income securities as government securities and corporate bonds. In addition to capital appreciation the funds also fetch interest returns. Equity funds fetch good returns in long run but if an investor is short of time then debt funds are best for him. Risk appetite of investors is also one of the main factors which shall be considered while making a prudent investment decision. Risk appetite of financial sound young investors is far better than retired and senior citizens. A strong financial background induces an investor to take more risk. It is always said more planned risk leads to more return. If retired investors have good risk appetite then they may invest in equity funds, that will be provide them good cushion against inflation. But in a growing economy like India, most retired investors have small savings against bundle of responsibilities which make them reluctant in taking risky investments. For them debt funds may serve well than equity funds.

An investor before making an investment in funds must consider three broad conditions. These three conditions will aid the investor in choosing the best category of fund.

- Own risk profile
- Future financial goals
- Current market conditions

Moreover, debt funds have low expense ratio as compared to equity funds i.e. investing in debt funds will cost an investor much less than investing in equity funds. The very reason behind this is that it takes less effort to manage debt funds as compared to equity funds since equity funds invest in highly volatile equity market and it takes much efforts of the fund manager to manage the portfolio to get good returns from the portfolio. Timing of making or selling an investment in debt funds is also not that important as it is in case of making or selling an investment in equity fund because of volatility in stock market.Debt funds provide us options from investing in overnight funds i.e. investing for one day to many years with low to moderate risks. It is a good alternative to investing in fixed deposits and savings deposits. While equity funds are for long term only. They help in achieving long term financial goals. For the purpose of taxation, investing in debt funds is beneficial, because debt funds held for less than 36 months are taxable normally on the basis of income tax rate under which the investor is falling and if the investment is for more than 36 months than LTCG are taxed @20% after allowing for indexation benefits. While in case of equity funds, STCG are taxed @ 15% and LTCG upto 1 lacs is exempt from tax and taxed @ 10% thereafter.

5. Conclusion

It can be concluded now that mutual funds are still a good option for investors to be invested in. But before they put their investment in mutual funds, they must understand that though the investment is in the hands of professionals and knowledgeable persons but still the element of risk exists because all the investments are at the end invested in the highly volatile market and market movements affect the investments altogether. So is the case of "Franklin Templeton crisis". Then, the question arises if there's an element of risk then why should the investor opt for mutual funds? Now, the answer is again very simple, it's because if one wants exuberant returns on his investment and he is capable of taking risks then he should choose mutual funds according to his risk appetite. Now, a very rational investor knows that if he is short of knowledge regarding market ups and downs and more precisely the fundamentals and technicals of stock market they he should take the aid of professionals in any AMC he thinks is best suited for him by paying a nominal fees i.e. expense ratio. But one must still understand "Mutual funds are still subject to market risk". A professional in mutual fund can only select which securities or instruments are best to be selected in a portfolio so that they can fetch good returns to the investors but they are not in a position to make a security or instrument earn good returns. So, the case of Franklin Templeton should not discourage the investors from investing in mutual funds. Debt funds on the other hand are still safer when compared to equity funds because of very vital reasons likelow risk, low tax on gains as compared to equity funds etc. It can be truly said debt funds are better than equity funds only when the investor is risk averse in nature.

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