Sebi Examining Redemptions, Role of Board Members, Trustees at FT

Looks at issues flagged in forensic audit after Franklin Templeton wound up 6 schemes

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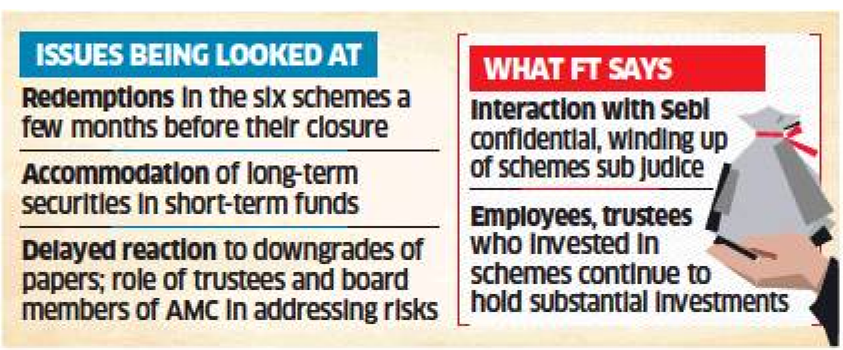
Mumbai:

Securities and Exchange Board of India (Sebi) is examining a raft of tricky issues that have cropped up in a forensic audit carried out after Franklin Templeton (FT) shut down six mutual fund schemes on April 23. These pertain to redemptions in the six schemes in the months before FT announced their winding up, accommodation of long-term securities in short-term funds, delayed reaction to downgrades of papers, and the role of the trustees and board members of the asset management company in addressing risks, among other things.

According to industry sources, the regulator has sought FT's response to redemptions, which ran into crores, since January 2020 by some of the senior persons. The six schemes, the audit points out, used the Macaulay duration framework to justify the investment in long-dated papers in short-term funds.



CHAIRMAN SUNIL MEHTA RULES OUT MERGER WITH SBI

Yes Bank Repays Full □50kcr to RBI

Yes Bank has fully repaid to RBI the □50,000 crore that it had borrowed under Special Liquidity Facility. Addressing the AGM, chairman Sunil Mehta ruled out a merger with largest shareholder SBI. ››5

Response to Ratings Downgrade

"Long bonds were purchased because these papers promised a higher return. However, the interest reset date on the securities, which for instance could be every six months, was considered as the deemed maturity date. Thus, less savvy investors would not be able to grasp the risk of a short-term fund holding long dated papers," said an industry official.

Based on the forensic findings, the regulator has also dwelt on FT's response to downgrade of credit ratings of securities in the six funds, and arriving at the fair value of the papers following a rating action. There was no proper guidance or direction, according to the report, from trustees and the asset management committee, even after some of the risks were flagged in a presentation. The audit also refers to similarity in the six schemes, and the practice of running multiple schemes with minor variations.

"Franklin Templeton has replied to Sebi on the findings of the forensic audit report. Sebi is examining the responses," said a source.

Responding to ET's email on the forensic findings and the communication from Sebi, a Franklin Templeton spokesperson said, "Our interactions with Sebi as our regulator are confidential and the issue of winding up is sub judice. Inspections and third-party audits fall within the purview of Sebi's oversight of mutual funds and we are cooperating fully with Sebi. The statements appearing in your email are not accurate, nor has Sebi come to any such findings at this time. Employees and trustees who made investments in the FTMF schemes continue to hold substantial investments in the affected schemes and they stand in the same position as our investors. We have already communicated the reasons for winding up (specifically the impact of the Covid-19 pandemic) and request our investors not to be swayed by unverified or speculative reports. Investments in these six schemes retain value according to their respective NAVs, which are published daily based on the valuation of reputed valuation agencies. We continue to follow due process, both in making investment decisions and with regard to the winding up of the funds."

The forensic report is being looked into by Sebi at a point when the Karnataka High Court is hearing various petitions challenging the closure of six creditoriented debt schemes. Four sets of investors had separately moved High Courts in Chennai, Gujarat, Delhi and the Supreme Court, challenging the AMC's decision to shut six schemes for redemptions citing redemption pressures and illiquidity. The petitioners have alleged mismanagement in these schemes and claimed the fund house cannot wind up schemes without unit holders consent. The Supreme Court has transferred the petitions before the various courts to Karnataka high court. Sebi counsel has argued before the court that the fund's trustees can decide to wind down schemes if they think it is in the best interest of unit holders. The counsel for Sebi has also told the court that it was not willing to make the forensic audit report public. However, the report can be submitted to the court in a sealed cover.

In the weeks after the closure, FT was criticised by analysts and media for running all the six schemes as 'credit risk funds' which have majority of investments in papers with lower credit rating -- though not a violation of regulations, it brought to the fore the sharp practice of the fund managers. This was because in laying down the rules to categorise debt mutual funds, Sebi had laid down the duration of the securities but had not specified the ratings for debt scheme papers. It was further reported that large portions of investments in the funds in question comprised bonds and securities issued by companies belonging to certain business groups. Besides the schemes had sizeable exposure to unlisted papers.