The FMP fiasco

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It raises many troubling issues for the regulator to address

Even as the bad loan saga at Indian banks is winding down, the mutual fund industry seems to be flagging off a new chapter. Last week, investors in Fixed Maturity Plans (FMPs) from two of India's leading mutual fund houses received a rude shock after they were informed that the proceeds/returns they were expecting on their maturing schemes wouldn't be immediately forthcoming, thanks to their exposure to the troubled IL&FS and Essel groups. While Kotak Mutual Fund repaid the principal and offered to pay returns later subject to realisation of debt, HDFC Mutual Fund sought investor permission to extend its maturity date by a year, ostensibly to 'lock into' higher yields. In January, a clutch of domestic fund houses which had extended loans to the Essel group's promoters against pledged shares had agreed to a standstill on invoking those pledges and given the cash-strapped promoters time until September to meet their repayments. This may only be the beginning of troubles for FMP investors, as 56 schemes across six fund houses are said to hold Essel or IL&FS exposures.

Investors in the affected FMPs have no legal grounds for complaint given that such defaults are part of the market risks they signed up for while investing in mutual funds. But the FMP fiasco nevertheless raises troubling questions. First, there's the question of why, despite being aware of the Essel group's troubles as early as January, the two AMCs have informed their investors of their inability to repay the proceeds only at the nth hour. Earlier intimation would have allowed investors to plan their finances better. Other fund houses that have the same exposures in their ongoing FMPs have maintained radio silence even after this fiasco. Two, despite the many default events roiling debt funds in the last five years, AMCs remain poor at communicating their impact to investors. In this case, while Kotak has been upfront with its investors about the possible loss of returns, HDFC has made no mention of the default, while seeking investor consent for the rollover. It is time for SEBI to evolve a material disclosure regime for mutual funds with standard communication formats, akin to that for listed companies. Three, there's also the question of how such concentrated exposures to the doubtful paper came to be held in FMPs, which are supposed to be conservatively managed. To tackle this, SEBI needs to more strictly enforce security-specific limits in debt funds and bar inter-scheme transfers in close-end products.

Mutual fund managers on their part, have a lot of soul-searching to do on whether the extra returns they're chasing through promoter loan-against-share deals are worth the risk. The Essel and Ambani group episodes clearly show that the collateral in such deals fails bond-holders at the critical hour. It is also about time that fund trustees, tasked with the fiduciary duty of overseeing AMCs, demanded greater accountability from them instead of mutely rubber-stamping all their decisions.

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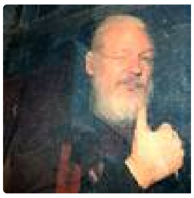

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