# Franklin Templeton Debt Fund Crisis

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*Source: The Hindu*

**Manifest pedagogy:** High redemption pressures in light of covid-19 have put a strain of debt funds in India. The RBI announced special windows to cover for the liquidity crisis, but is it enough? We have to take into account both short term and long term consequences for the same.

**In news:** Franklin Templeton has announced the shutdown of six of its credit strategy oriented debt mutual fund schemes.

**Placing it in syllabus:** Mutual funds

**Static dimensions:**

- What are debt funds?
- Types of mutual fund schemes in India

**Current dimensions:**

- What is the crisis about?
- How safe is your money?

**Content:**

What are debt funds?

- A debt mutual fund invests a significant portion of one's money in fixed-income securities like government securities, debentures, corporate bonds and other money-market instruments.
- They lower the risk factor considerably for investors.

***Benefits of investing in debt funds:***

*Stable income*: Debt Funds have potential to offer capital appreciation over a period of time.

*Tax efficiency:* Debt funds are more tax-efficient than traditional investment options like fixed deposits (FDs) as tax is paid only in the year it is redeemed and not before that.

*High liquidity:* These funds are liquid and money can be withdrawn from the fund on any business day.

*Stability:* By investing in debt funds, one can adequately diversify a portfolio and bring down overall risk.

*Flexibility:* Debt mutual funds also offer the option of moving around money to different funds. This is possible through a Systematic Transfer Plan (STP). One can invest a lump sum amount in debt funds and systematically transfer a small portion of the fund into equity at regular intervals.

Types of mutual fund schemes in India:

**Based on structure:**

***Open-Ended Funds:*** These are funds in which units are open for purchase or redemption through the year. There are no limits on how much can be invested in the fund.

***Close-Ended Funds:*** These are funds in which units can be purchased only during the initial offer period. Units can be redeemed at a specified maturity date. Unlike open ended mutual funds, once the units or stocks are bought, they cannot be sold back to the mutual fund, instead they need to be sold through the stock market at the prevailing price of the shares.

***Interval Funds:*** These are funds that have the features of open-ended and closed-ended funds in that they are opened for repurchase of shares at different intervals during the fund tenure. The fund management company offers to repurchase units from existing unitholders during these intervals.

**Based on asset class:**

***Equity Funds:*** These are funds that invest in equity stocks/shares of companies. These are considered high-risk funds but also tend to provide high returns.

***Debt Funds:*** These are funds that invest in debt instruments e.g. company debentures, government bonds and other fixed income assets.

***Money Market Funds:*** These are funds that invest in liquid instruments e.g. T-Bills, CPs etc. They are considered safe investments for those looking to park surplus funds for immediate but moderate returns.

***Balanced or Hybrid Funds:*** These are funds that invest in a mix of asset classes. E.g. Franklin India Balanced Fund-DP, where 65% to 80% of the investment is made in equities and the remaining 20% to 35% is invested in the debt market.

**Based on investment objective:**

***Diversified funds:*** These refer broadly to pooled investments that build portfolios across several asset classes, regions, and/or industry sectors.

***Income funds:*** Under these schemes, money is invested primarily in fixed-income instruments e.g. bonds, debentures etc. with the purpose of providing capital protection and regular income to investors.

**Liquid funds:** Under these schemes, money is invested primarily in short-term or very short-term instruments e.g. T-Bills, CPs etc. with the purpose of providing liquidity. They are ideal for investors with short-term investment timelines.

***Tax-Saving Funds (ELSS):*** These are funds that invest primarily in equity shares. Investments made in these funds qualify for deductions under the Income Tax Act.

**What is the crisis about?**

Franklin Templeton has wound up **six of its debt schemes** – *Franklin India Ultra Short Bond Fund, Franklin India Short Term Income Fund, Franklin India Credit Risk Fund, Franklin India Low Duration zund, Franklin India Dynamic Accrual Fund and Franklin India Income Opportunities Fund.*

The combined size of these funds are Rs 25,856 crore as on April 22, 2020. The investors who got caught in the Franklin Templeton mess are those that had enrolled for **Systematic Transfer Plans (STPs).**

The investors who had planned to go to equity funds, via a short halt in Templeton's debt funds, are now stuck in these schemes badly. **Not only will their money not be invested in equity funds, their equity investing plans would also go for a toss.**

The COVID-19 pandemic resulted in foreign investors selling off equities and debt holdings massively in India as well as other emerging markets. As there were hardly any buyers and banks not willing to lend, they parked their surplus cash with the RBI.

The **illiquidity in the markets**, the **heightened exposure to lower-rated securities** made the matters worse. With no buyers for its securities and in the absence of market liquidity, Templeton wound up its schemes.

**How safe is your money?**

- Frequent downgrades in credit ratings have taken the net asset values of debt funds down.
- Though debt funds continue to remain good investments, debt fund investors should not expect anything more than

1.5 percent points over inflation.

- For investors in the higher tax brackets and who wish to invest for three years or more, debt funds continue to give good tax-adjusted returns.
- It would be a **safer option to invest in AAA-rated and sovereign instruments such as corporate bonds and banking & PSU bond funds.**
- Liquid and ultra short-term bond funds are still good for STPs if invested in one that holds only highly rated securities.
- Though the Franklin Templeton debt fund crisis does not impact bond schemes of other houses, it is necessary to keep an eye on the debt fund’s portfolio quality.

**Mould your thoughts:**

1. Define a debt fund. What is the Franklin Templeton Debt fund crisis all about?