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Reopening FT schemes will have a contagion risk: Sebi

This will lead to 100% redemption requests from Franklin's unitholders, it told HC

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Franklin Templeton's investors have urged the Karnataka high court to intervene so that the six debt schemes are reopened for transactions. The high court will begin hearing the arguments on 6 August. BLOOMBERG

Reopening for transactions the six debt schemes of Franklin Templeton that were wound down will have a contagion risk on the entire mutual fund industry, the Securities and Exchange Board of India (Sebi) said in its filing for the Franklin Templeton case in Karnataka high court. The court is hearing the four cases filed by investors who challenged the fund house's decision to wind down the six debt schemes without the consent of unit holders.

The investors have also urged the court to intervene so that the schemes are reopened for transactions, including redemptions and subscriptions.

The high court will begin hearing the arguments on 6 August.

Franklin Templeton had shut down its six debt schemes on 23 April, following severe illiquidity in underlying bonds and redemption pressures. Petitions filed in Gujarat high court on 3 June and 8 June had obtained a stay on the e-voting process, which would have started the liquidation and monetization of underlying bonds present in the portfolio.

The process of refund to Franklin's 300,000 investors can start only after liquidation, according to Sebi regulations.

The market regulator, which is a respondent in the case, said if the Gujarat high court stay is not vacated, the trustees will have to reopen the schemes for transactions and that would lead to all unitholders placing 100% redemption requests immediately. *Mint* has reviewed a copy of the affidavit.

"To meet the redemption request the mutual fund would have to distress sell securities at a very deep discount as the whole market now knows the distress," said Sebi in the affidavit. "Some of the bonds would be sold at a negligible price," it said.

"Distress selling of underlying bonds would establish a new, much lower price of these bonds in the market. This would bring down the NAV (net asset value) of all mutual fund schemes, which has these bonds."

The market regulator raised apprehensions that in such a scenario, investors will also put in redemption requests for schemes of other fund houses. These schemes would also need to resort to distress selling of other bonds in their portfolios, it said.

"This could create a widespread contagion effect across the entire mutual fund industry and harm the interest of investors at large," Sebi said.

In comparison, winding up of these six schemes will lead to preserving value for all unit holders and equitable exit to all investors, Sebi contended.

SEBI FEARS RIPPLE EFFECT IN MF SPACE

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