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Franklin Templeton Mutual Fund cannot be allowed to make priority repayment to bank borrowings from cash flow received after closure of 6 debt schemes

***The following grievances and concerns of investors of Franklin Templeton Mutual Funds need to be addressed with utmost attention by Sebi and other relevant authorities**

The Franklin Templeton Mutual Fund is facing several serious litigations and strong proceedings recently, for illegally winding up six debt schemes in India wherein around Rs 28,000 crore of around 40,000 investors is stuck.

The media report that appeared in the 3rd July edition of The Economic Times, suggests that “the six debt schemes of Franklin Templeton Mutual Fund whose winding-up plan is stuck in legal uncertainty have received cash flows worth Rs 2,667 crore since April 24”.

Immediate concerns for investors of Franklin templeton

The cash flow which has been received against the investments in a wound up scheme post winding-up cannot be distributed either towards repayment of borrowing to a Bank or to a unit Holders due to following consideration;

- a. It is not known what the actual total value of the wound up portfolio is until a forensic audit is done and so any repayment to Banks with higher priority would impact the unit holders, since as of now they all are technically required to take a proportional loss.

However, there are other ethical and legal issues which will need to be decided before any loss can be attributed to the unit holders. The fear is that this loss can technically be any amount and the time for recovery can be anything.

- b. The forensic audit will show the true nature of losses suffered by Franklin Templeton Asset Management Company and whether there was any fraud, conflict of interest or poor investment decision, which will require Franklin Templeton Asset Management Company and Franklin Templeton Trustees to make good the loss. So until this is quantified and losses assured by Franklin Templeton Asset Management Company and Trustees, at this stage distribution cannot be done to anyone.
- c. The forensic investigation has to also show - Who are the lenders to Franklin Templeton Asset Management Company? What were the collaterals given to them? Who are the select redeemed unit holders who were given exit with higher borrowing? What is the mismanagement in investment of funds? So if any stakeholder takes a hit, then the lenders and early redemption unit holders too should pay back and take a hit or Franklin Templeton Asset Management Company should make good all such losses so that all can agree with an early redemption and distribution.
- d. Borrowing from the Bank is done by Franklin Templeton Asset Management Company and the unit holders are not responsible for such excessive borrowing. So no priority can be given to such lenders for mismanagement of funds by Franklin Templeton Asset Management Company. If there is a Franklin Templeton Asset Management Company guarantee involved in the loan transactions, then Franklin Templeton Asset Management Company should bail out the bank with its own internal resources.
- e. Since the entire Franklin Templeton default and forceful winding up matter is now before the Hon'ble Karnataka High Court, as per the decision of the Hon'ble Supreme Court, no decision can be taken until the matters before the Hon'ble Karnataka High Court are fully settled and the issues raised above are concluded.
- f. If Franklin Templeton wants to hurriedly settle the claim of the unit holders based on the money received by it as of now, due to genuine concern of Franklin Templeton Asset Management Company or Trustees for unit holders, then they can give an assurance to the Court that pending the final outcome, the present money can be distributed to the unit holders to reduce their concerns and in case there is any shortfall in total quantum of receivable against the total liability of Franklin Templeton Mutual

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fund, then the Franklin Templeton Asset Management Company and Franklin Templeton Trustees should agree to make good such losses and repay the unit holders their full dues.

- g. Post Forensic Audit, there would be additional concerns of breach of trust, fraud, conflict of interest, non-compliance of SEBI norms, Fit and Proper Assessment and, therefore, if Franklin Templeton Asset Management Company and Franklin Templeton Trustees are serious about starting to paying money to unit holders, then they should clearly state to the court that they may be permitted to start making payment and in case there is any shortfall later (within a finite period), they will make good the loss and clear full and final dues of all unit holders at their cost and risk. Further, Franklin Templeton and Trustees should also tell the Court that they will abide by the final order of the Court and SEBI on all other issues.

Key Issue Needs Immediate Attention

1. Franklin Templeton Mutual Fund is involved in illegal winding up of six schemes amounting to a default of total of Rs 28,000 crore. The matter is sub-judice and many concerns have come to light through media and some court cases, that Franklin Templeton Asset Management Company and Franklin Templeton Trustees have not managed the fund, borrowing, redemption and investment ethically which has induced this risk in the market. The whole closure episode post winding-up is being managed hurriedly so that the internal management of the fund should not be known to the public transparently and closure should happen gradually and without transparency to prevent public glare on illegalities.
2. The Hon'ble Gujarat High Court has ruled that "No winding-up process could be concluded without the consent of the unit-holders, as has been laid down in sub-regulation 15(c) of Regulation 18 of the Regulation. The Trustee shall have to obtain the prior consent of the unit-holders when a majority decide to windup or prematurely redeem the units. Thus, in view of the above provision of law, the interim injunction granted is confirmed till the forensic audit report comes in public domain".
3. While SEBI is expected to undertake the forensic audit and submit its forensic report to the Court and General Public, SEBI is still to appoint a Forensic Auditor. The present firm Chokshi and Chokshi has been asked to undertake a "special audit", the scope of which is not known to the public and this audit was initiated for compliance of SEBI's internal purpose in early May, 2020. The auditor was supposed to submit its report

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within one month but there is now news that the audit would be extended by another one month. It is not known when SEBI will convert this audit into a forensic audit or appoint another reputed firm as a forensic auditor to satisfy the order of Hon'ble Gujarat High Court.

4. According to the AMFI press release dated April 24, 2020, SEBI regulations allow mutual fund schemes to borrow up to 20% of their assets to meet liquidity needs for redemption / dividend pay-out. However, as of April 23, 2020 out of the 42 mutual funds only four mutual funds, including the affected mutual fund, had borrowings, aggregating to Rs. 4,427.68 crores.
5. According to the press reports, while SEBI regulations allow AMCs to borrow up to 20% of net assets of the scheme, Franklin Templeton had to seek special permission from SEBI to increase the limit to 40% for some of the schemes, as per Franklin Templeton spokesperson. According to press reports, the borrowings of Franklin Templeton for these six schemes is 2,500-3000 crore. This means Franklin Templeton has an exceptionally high borrowing which is nearly 56% to 67% of the industry –wide borrowing.
6. The date-wise exceptionally high borrowing of such order against the industry trend has to be seen from the perspective of what information was known to the Franklin Templeton Asset Management Company and Franklin Templeton Trustees, which made them borrow such large amounts of money and redeem unit holders with such money when they knew that the borrowing is not sustainable and against the interest of the portfolio and all other unit holders. SEBI allowed their borrowing beyond 20% and it is not known why SEBI was not alarmed at the high borrowing and whether SEBI knew the people for whom the industry-wide limit was being breached and what would be the impact of such select exit to general unit holders. This is despite the fact that SEBI knew of the concentration of investment in bad securities by Franklin Templeton Asset Management Company and so the risk of potential loss was known to SEBI and it still allowed Franklin Templeton Asset Management Company to borrow more money which the rest of the Mutual Fund Industry has not been indulging in.