Fixed Maturity Plans (FMPs) - Default

Why in news?

Kotak Mutual Fund and HDFC Mutual Fund recently wrote to their FMP investors that they have exposure to securities of troubled Essel Group companies.

What are fixed maturity plans?

- **Mutual Fund** (MF)/Asset Management Company (AMC) is an investment vehicle made up of a pool of moneys collected from public investors.
- The pooled money is used to buy other securities by professional money managers.
- This way, they give small or individual investors access to professionally managed portfolios of equities, bonds and other securities.
- **Fixed Maturity Plans** (FMPs) are fixed-tenure mutual fund schemes that invest in debt instruments.
- These include government securities, commercial papers (CPs), non-convertible debentures (NCDs) and certificates of deposits (CDs) among others.
- FMPs, thereby, generate interest income for investors.
- They are close-ended funds that mature after a predetermined time period.

What is the level of risk involved?

- Debt-oriented schemes are generally considered safe for investment.
- As, funds parked in government and private-sector debt instruments offer fixed returns.
- But it is risky if the fund house has invested in debt securities of a company that is not financially strong and facing liquidity pressure.
- In this case, the investments may suffer in the event of a default by that investee company.
- But investors in the affected FMPs have no legal grounds for complaint.
- This is because such defaults are part of the market risks they signed up for while investing in mutual funds.

What is the recent happening?

- Several FMPs that are due for maturity are not able to repay the entire amount.

- Those who invested in Kotak MF's FMP around Decemebr 2015 are supposed to get their capital along with interest income on April 10, 2019.
- But the fund house had high exposure (almost 27% of initial corpus) to ITNL and two Essel Group companies that are facing a liquidity crisis.
- Given the delay in recovery, Kotak is forced to hold back payments due to its investors in their fixed maturity plans (FMP).
- Other similar mutual funds include the HDFC Mutual Fund and Reliance Mutual Fund with exposure to Essel Group companies and IL&FS Group.
- Kotak said it has returned nearly 99% capital of its FMP investors and will return more with accrued interest after a successful strategic sale of the investee company (Zee) in September 2019.
- HDFC Mutual Fund has also informed investors of its plan to extend the tenure for one of its FMPs coming up for maturity by another year.

What is the larger implication?

- Banks are already facing a big NPA crisis on account of default by a number of corporate entities on their debt instruments.
- The present case is an indication of the problem of loan defaults reflecting in the fixed maturity plans.
- More and more corporate entities are increasingly facing debt woes.
- So the banks, NBFCs and mutual funds that have exposure to debt papers of such companies fall at risk.
- In turn, it puts both the interest income and capital investment of the MF investor at risk, raising alarm among investors.
- Debt-oriented mutual funds are mostly subscribed to by corporate investors and high net-worth individuals (HNIs), or those investing Rs 5 lakh and above.
- But the share of retail investors in such schemes has also grown over the last 4 years.
- So, retail investors too have exposure to such schemes and their money is at risk now.

What concerns does this highlight?

- The two Asset Management Companies (AMCs) were aware of the Essel group's troubles much earlier.
- But they have informed their investors of their inability to repay the proceeds only at the nth hour, just before the maturity date.
- Earlier intimation would have allowed investors to plan their finances better.
- Also, despite the many default events relating to debt funds in the last 5 years, AMCs are poor at communicating their impact to investors.
- Also, such concentrated exposures to the doubtful paper (troubled

companies), which are supposed to be conservatively managed, came to be held in FMPs.

What is to be done?

- SEBI has to evolve a material disclosure regime for mutual funds with standard communication formats similar to that for listed companies.
- It should thus strictly enforce security-specific limits in debt funds and bar inter-scheme transfers in close-end products.
- Mutual fund managers have to analyse if the extra returns they are chasing through varied deals are worth the risk.
- They should also be demanded greater accountability for their choices and mechanisms.

Source: Indian Express, Economic Times, BusinessLine

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