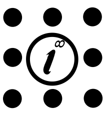
Infomerics Ratings

Infomerics Valuation And Rating Pvt. Ltd.

SEBI REGISTERED / RBI ACCREDITED / NSIC EMPANELLED
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INDUSTRY OUTLOOK

TLTRO 3.0 – RESERVE BANK TO BAIL OUT THE COPORATE BOND MARKET YET AGAIN?

25 April 2020

FRANKLIN TEMPLETON RINGS THE ALARM BELL

The announcement by Franklin Templeton Mutual Fund to suspend 6 debt schemes amounting Rs.25,900 crore with no clarity to the investors as to when they will be receiving the proceeds of their investment has sent shock waves to the investing public at large and to the mutual fund industry. The unusual selling by some of the mutual funds in the WDM segment of the exchanges as an immediate fall out resulted in the medium & short term yields to move up by about 30 bps. These were good enough signals to the market to gauge the liquidity challenges the MFs will face in the near term. Mutual Fund managers were seen conducting webinars & concalls to assuage its investors, distributors & other stakeholders to apprise the developments. Some of them were more than willing to share their current portfolios with the stakeholders to convince them that their holding of 'risky' assets was negligible.

It is just over a week since RBI successfully completed TLTRO 1.0 for Rs.1 lakh crore that generated huge interest from some of the leading scheduled commercial banks facilitating them to earn a decent arbitrage by investing in top class corporate bonds in the primary and secondary market. The operation by RBI has resulted in compression of the corporate bond yields by about 250 to 300 bps from where they were traded during the third week of March 2020, the three year segment witnessing the maximum demand & compression in yields. Many leading PSU & Corporate borrowers availed of this opportunity to raise resources, besides mutual funds getting the much wanted liquidity. However, the Franklin episode may reverse the positive atmosphere felt in the corporate bond market.

NBFCs IN LIQUIDITY CRUNCH?

Total fixed income corpus of the mutual funds as on 31st March 2020 was little over Rs.13 lakh crores of which 35% i.e. around Rs.4.50 lakhs will mature by 30th September 2020. In this, less than 5% of the debt is rated lower than AA-. About Rs.80,000 crore roughly about 18% is invested in the NCD/CPs of NBFCs and HFCs that did not receive the benevolence of RBI in its moratorium guidelines issued on 27th March 2020.

NBFCs and HFCs are the worst affected on account of the situation caused by COVID 19. Though HFCs are in a slightly better position due to their exposure to salaried class, those with larger exposure to LAP & developer loans will face severe liquidity crunch. NBFCs are affected worse since banks resist from giving them moratorium, securitization has no takers, near impossibility to receive repayments / effect recovery from low income group borrowers.

Top rated NBFCs may sail through the difficult times for a short while as they liquidity buffer or have been successful in raising funds under TLTRO 1.0, the second notch companies in this sector may find the going tough as perceived by a larger section of the market participants. It is relevant to note that TLTRO 2.0 that was intended to benefit the NBFC sector did not evoke the response expected from the SCBs, despite an extension of investment period and breather on priority sector lending.

TIME FOR TLTRO 3.0

The Franklin Templeton suspended MF debt schemes, even though constitute less than 1.50% of the total funds managed by the Indian mutual funds, can have a ripple effect on short term debt mutual schemes managed by others. Mutual Funds may face severe liquidity constraints temporarily that can send the corporate bond & commercial paper yields to unchartered territories. MFs can borrow up to 20% of their assets to meet redemption and dividend payouts for a period of 6 months. Earlier, in 2008 SEBI had allowed certain mutual funds to borrow up to 40% to help them meet heavy redemption pressures during the global financial turmoil after the collapse of Lehman Brothers . Many MFs had borrowed (net liabilities) in their debt schemes as at 31.3.2020 ranging from 3-17% of their scheme AUM[1].

During July 2013, RBI had opened a special three-day repo window that allowed banks to borrow a total of ₹ 25,000 crore at a rate of 10.25% for on lending to MFs amidst tight liquidity conditions.

The current situation is unprecedented. According to Ms.Gita Gopinath, Chief Economist IMF: "This is a crisis like no other, and there is substantial uncertainty about its impact on people's lives and livelihoods. A lot depends on the epidemiology of the virus, the effectiveness of containment measures, and the development of therapeutics and vaccines, all of which are hard to predict. In addition, many countries now face multiple crises—a health crisis, a financial crisis, and a collapse in commodity prices, which interact in complex ways. Policymakers are providing unprecedented support to households, firms, and financial markets, and, while this is crucial for a strong recovery, there is considerable uncertainty about what the economic landscape will look like when we emerge from this lockdown[2]".

To predict the length& depth of this pandemic at this stage is foolhardy. Mutual Funds may find the loan product from the banks an unviable proposition as they may not realize the underlying assets in time – within 6 months. Hence, a longer life line is needed similar to TLTRO 1.0 for a period of 3 years wherein the banks may either purchase corporate bonds from the mutual funds, to be held in HTM category or extend loans to them against the security of investible grade corporate bonds, with a mandatory provision to substitute the securities of equal value 1 month in advance, of their respective maturity. This will help the mutual funds to restructure their exposures to NBFCs/HFCs under default, within an extended period of 3 years, by which time our economy is expected to fire on all cylinders. Relief from SEBI in the form of relaxation of guidelines in valuation norms of such restructured assets will go a long way to avert situations for a larger number of MFs who have exposure to weak credit to suspend their debt schemes causing destruction of investor wealth & confidence in the industry.

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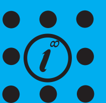

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