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Debt funds turn to safe havens as defaults sting

Since the IL&FS crisis, allocation to govt papers more than doubles, exposure to NBFCs drops

JOYDEEP GHOSH
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In the past 22 months, since the ₹99,000-crore default by Infrastructure Leasing and Financial Services (IL&FS), debt fund managers earning high returns for investors by taking credit risk have mellowed down substantially.

Latest numbers from the mutual fund industry show that they are investing much more in safe instruments like G-Secs, PSU debt, T-bills, and others. For example, industry's total allocation to G-Secs, PSU debt, and T-bills stood at 17.4 per cent in August 2018, and at the end of June 2020, it had more than doubled to 37.3 per cent. The data also reveals that during the same period, the debt fund industry's assets under management have barely grown less than 1 per cent from ₹14.75 trillion to 14.87 trillion.

Said Nilesh Shah, managing director, Kotak Mutual Fund: "The mutual fund industry's incremental investment shifted to higher-quality assets. While the credit quality of the portfolio has shifted towards sovereign and PSU risk, the yield has fallen correspondingly."

Since September 2018, the debt fund industry has come under tremendous pressure when companies started defaulting on a regular basis. It started with IL&FS when the parent company defaulted on a ₹1,000-crore short-term loan from Sidbi and has continued with companies like Dewan Housing Finance, Essel group, YES Bank, and others.

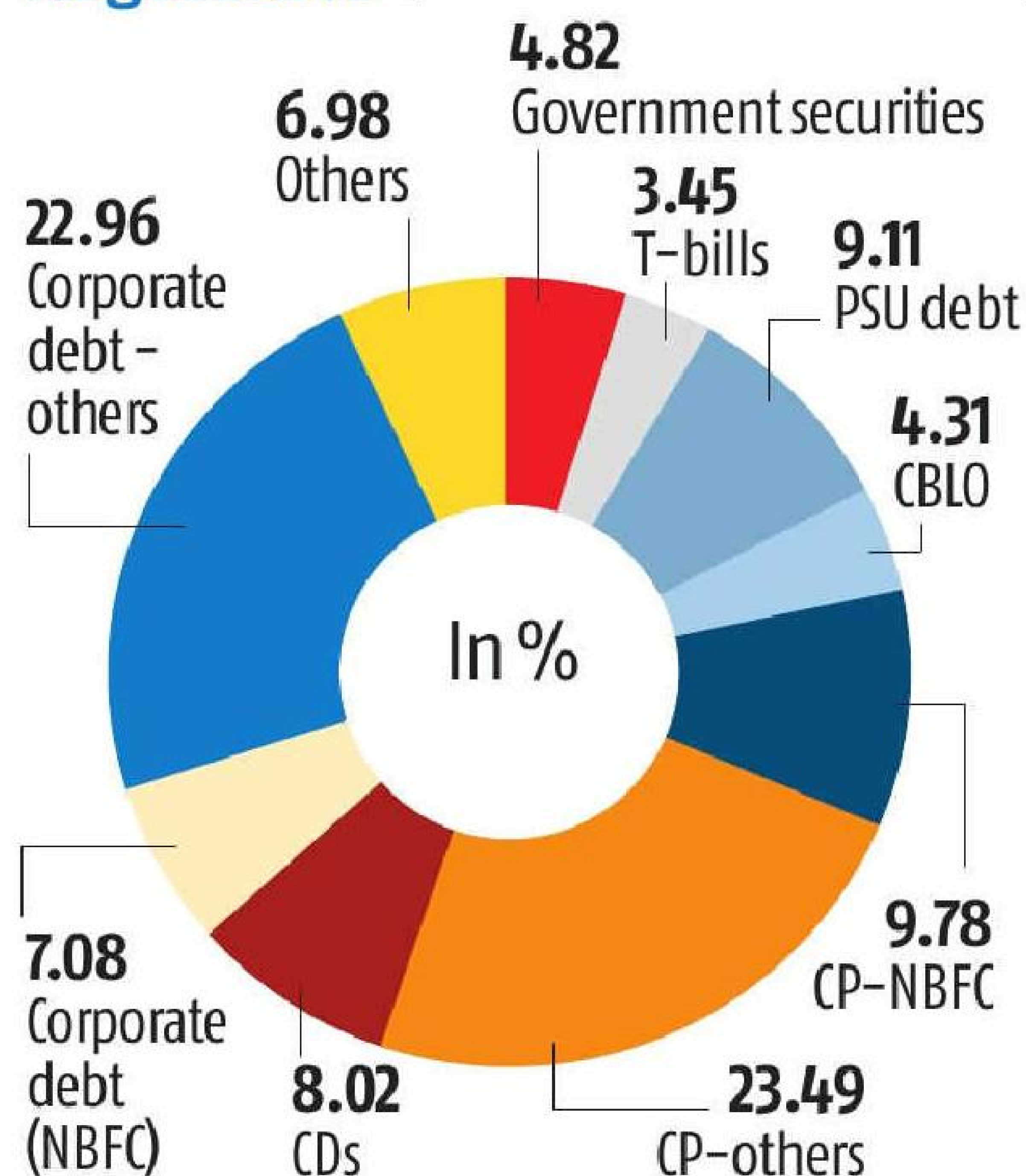
The rising number of defaults has queered the pitch for star debt fund managers, and as the numbers show, they have been forced to take defensive calls. That is, they have moved away from papers of non-banking financial companies (NBFCs), especially. Investments in commercial papers of NBFCs have come down almost one-third from 9.78 per cent to 3.65 per cent. Even allocation to corporate debt of NBFCs is down to 5.62 per cent from 7.08 per cent.

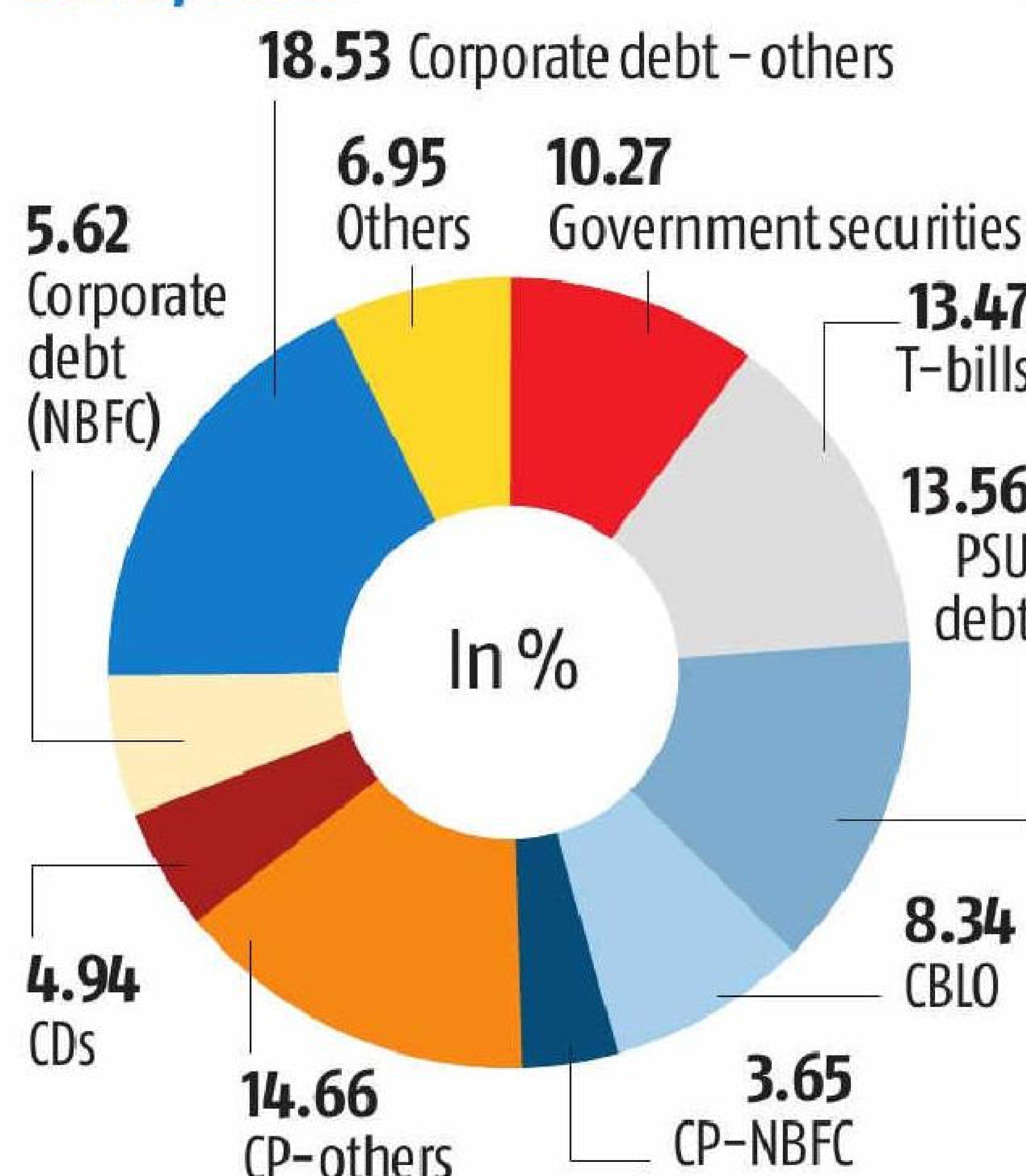
"Things have been bad for mid- and small-NBFCs. And things have worsened further as many NBFCs' customers sought moratorium whereas they were unable to raise funds aggressively. So fund houses have been more careful about lending to them," said a fund manager. The closure of Franklin Templeton's six schemes with total assets under management of ₹30,000 crore has hurt investor sentiment further. It impacted 310,000 investors, including 300,000 retail and high net-worth individuals. While some of the money has been received by investors after companies such as Vodafone Idea paid ₹2,850 crore in principal and interest to its bondholders, most of their investments are still stuck.

Players say things are unlikely to change for quite some time as fund managers do not have much risk appetite any more. And the Covid crisis has made them warier. "Before the crisis, investors were looking at some resolutions of debt problems. But those have been stalled now, making things very difficult," said another manager.

Another problem that fund managers point out is the absence of a strong bond market. In the US, credit-risk funds are doing rather well because of the bond market, but in India, this is still at a nascent stage. "Unless the bond market becomes deeper, fund managers will be very careful about taking credit-risk," said Shah.

CHANGE IN ALLOCATION SINCE IL&FS DEFAULT





Source: Industry

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