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Franklin Templeton Case: How to make mutual fund trustees more accountable

Key suggestions given by experts include having one board accountable for corporate governance, as well as oversight of the business

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The Securities and Exchange Board of India (SEBI) came down heavily on the trustees of Franklin Templeton Asset Management Company (AMC). The regulator held that they did not do enough to prevent the situation that eventually led to the winding-up of the six debt schemes.

Choksi and Choksi was appointed by SEBI to carry out a forensic audit of the six schemes of FT AMC.

The market regulator has not only pulled up trustees for their lack of action at critical points, but also levied a penalty of Rs 3 crore on Franklin Templeton Trustee Services.

The question is: Are mutual fund trustees doing enough?

Risks don't get enough attention

M Damodaran, former SEBI chief and former head of UTI Mutual Fund, says trustees of Indian mutual funds have usually not been quick or effective in dealing with issues where they suspect violations. "The trustees have to discharge a quasi-regulatory function. They are the first-level regulators in a mutual fund," Damodaran adds.

When it comes to monitoring risks in the schemes, he says trustees should run 'what if' scenarios or stress-tests to check if the portfolio of the scheme is robust enough to deal with difficult market conditions.

Trustees have the power to obtain internal audit reports at regular intervals to check whether their concerns are legitimate or not.

Amit Tandon, managing director of Institutional Investor Advisory Services (IIAS), says trustees are not able to go deeper into issues of risk management, as they handle several other reporting-related tasks.

However, from January 1, 2021, trustee companies are required to appoint an officer to provide administrative assistance.

But, is one support officer enough for trustees? Tandon says this can be linked to the size of the AMC. "In a large AMC, trustees may need more support, while a lesser number might be fine in a smaller AMC," he says.

Mutual fund trustees are required to have standing arrangements with independent firms for special-purpose audit or legal advice from January 1, 2021.

A trustee Moneycontrol spoke to says that so far it has not had full-time resources for independent investigation.

One board for trustee, AMC

A mutual fund is managed with a three-tier structure, with the sponsors, trustees and AMC.

The role of the trustees is to hold the funds on behalf of the unitholders and the AMC is given the job of managing the funds.

The trustees have their own board of directors and the AMC has its own.

Ananth Narayan, Professor of Finance at S.P. Jain Institute of Management and Research, says there should be one board accountable for corporate governance, as well as oversight of the business.

"This single body can oversee everything, including risk management and code of conduct. When there are two levels of governance, things can fall between the cracks," he says.

Experts say in the two-level structure, trustees may not have clarity on their roles and responsibilities.

"There can be confusion on the responsibilities of the board of trustees and AMC board," says Tandon.

But, can one body balance both interests of shareholders and unitholders, given their conflicting interests at times? For example, lowering of asset management fee may be favourable for unitholders, but no so for shareholders.

Professor Narayan says banks and non-bank financial companies have just one board looking after interests of shareholders and customers. "Just like the boards of banks and NBFCs can look after interests of shareholders and customers, a single board of an AMC should also be able to do so," he says.

Changing fee structure

The trustee is set up by the sponsor of the asset management company. The trustee company gets its revenue by way of trustee fees, which is a certain percentage of the total expense ratio (TER) charged to the mutual fund scheme. So, indirectly the trustee company gets its remuneration from the AMC.

Industry insiders say this arrangement can lead to conflict of interest and needs to change.

“What we need is an arrangement through which SEBI pools funds from AMCs, and then directly pays the fees to the trustee company,” says the AMC trustee cited earlier.

The person says the remuneration should also be increased for trustees so that they take their job more seriously. Currently, a director of the trustee board could earn Rs 3-4 lakh annually in sitting fees in a small AMC, and Rs 10-12 lakh a year in a large fund house, says the chief executive officer of an AMC, requesting anonymity.

Learn from others’ experiences

Damodaran says one way trustees can become better at their jobs is to have periodic meetings among themselves and exchange notes on issues that they are confronting or have dealt with in their mutual funds.

“Trustees can learn from each other’s experience on how they can deal with the fund management team when they see potential issues in running of the funds,” he says.

This can be a quick way for trustees to widen their understanding on different types of governance issues that could crop up in a fund house.

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