



Digital loans against MFs are fast, but here's what you should know

Do not max out the LTV ratio, do not use it for long-term funding, and keep a watch on market volatility

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You may have heard of loans against mutual funds. Now, fintech platforms are stepping in to make them popular—offering quick, paperless access through fully digital channels—where you can get the loan amount in your bank account in minutes.

That said, loans against MFs carry risks. Because what you pledge as collateral is a volatile asset class—equity funds, particularly, can go through volatile phases during market turbulence. If you fail to maintain the required margin, you may be forced to part with your investments.

We look at how fintech platforms enable quick access to loans against mutual funds and why you should be cautious when availing them.

Quick access

So, if you have a fintech app that offers loan options such as a loan against mutual funds, all you will need to do is submit your PAN number on the platform's app. The app automatically fetches the borrower's fund holdings linked to that PAN. Based on the platform's loan-to-value (LTV) ratio and its list of eligible schemes, the credit limit is calculated. The borrower can then choose to either go with the same credit limit or set a lower limit.

Most platforms have a minimum loan amount, often in the range of ₹10,000-25,000, while the upper cap can run into a few crores depending on the borrower's portfolio size. The LTV ratio tells you how much you can borrow for each type of loan.

The borrower can also adjust the credit limit at the scheme level by selecting how many units of a particular scheme to pledge. The credit limit acts as an overdraft facility; you are charged interest on the amount you withdraw from this facility. Debt mutual funds offer a higher LTV ratio. You cannot sell the pledged mutual funds until you fully repay the loan.

The next step is to link your bank account. This account will receive the loan amount and be used to set up an auto-debit mandate for monthly interest payments. The mandate becomes active after loan disbursement.

After linking your account, you need to pledge your mutual fund units, which you can do by simply entering the OTP sent to your registered mobile number. Once the pledge is confirmed, a digital loan agreement pops up, which you can review and sign digitally to complete the application.

"As it is a fully digital process, the loan can be availed almost instantly," said Krishna Kanhaiya, chief executive officer of Mirae Asset Financial Services. Digital platforms take minutes to a few hours to disburse the loan into the borrower's bank

Quick access to loan against mutual funds

Digital mode



Note: If KYC is not already done, that will also be an additional step

Other details

Loan tenure:	12 months, 24 months or 36 months
Interest rate	9-15%; on amount drawn from credit limit
Processing fee:	₹999 or 0.5-1.5% of loan value (higher of two; with certain caps)
Principal payment:	Pay before loan tenure or renew; no foreclosure charge
Eligible mutual funds	Funds part of platform's approved list; no locked-in units

Platforms can charge renewal fees, equivalent to original processing fee



Loan-to-value ratio (LTV) linked to fund type

	Loan-to-value ratio	Credit limit
Equity mutual fund	50%	₹2 lakh
Debt mutual fund	80%	₹3.2 lakh



Risk of margin call

If mutual fund value falls; the borrower needs to restore the loan-to-value ratio

Example:

Equity mutual fund value:	₹4 lakh
Loan at 50% LTV:	₹2 lakh
Mutual fund value falls by 20%:	₹3.2 lakh
New LTV:	62%

How to avoid margin call

- ▶ Avoid maximizing the LTV
- ▶ Use debt funds where volatility is low

Borrowers need to either pledge more mutual fund units or pay the shortfall to bring back the LTV to 50%.

If not acted within 7 days, platform has the right to sell already pledged mutual fund units to restore the LTV.

VISHAL DHAWAN
founder of Plan Ahead Wealth Advisors

"Consider this option only in case of short-term funding needs. Loan against debt MF is preferred given the relatively low volatility."



account.

With certain caps, the loan processing fee is ₹999 or 0.5-1.5% of the loan amount. The loan tenure may be 12 months, 24 months or 36 months. At the end of the tenure, borrowers who wish to extend the facility must pay a renewal fee, usually equal to the original processing fee. The processing fee for a personal loan ranges from 1% to 3% of the loan amount.

Cost of borrowing

Each platform maintains its own internal list of funds eligible for loans. The LTV ratio depends on the type of fund. Typically, equity mutual funds allow you to borrow up to 50% of their value, while debt funds can fetch as much as 80%.

For example, if you hold equity mutual fund units worth ₹4 lakh, you can borrow up to ₹2 lakh against them. On the other hand, if you have debt mutual fund units worth ₹4 lakh, the loan eligibility could go up to ₹3.2 lakh.

The cost of borrowing is another

draw. While personal loans often carry interest rates of 9-24% per annum, loans against mutual funds are usually available at 9-15%, depending on the lender and fund type. Repayment is also more flexible—you typically need to service the monthly interest. You can partially prepay the principal by making a lump-sum credit to the overdraft facility, but before the loan tenure, you need to repay the entire principal or roll over the loan by renewing the tenure. Many platforms also allow prepayment without any foreclosure fees.

"Since the borrower provides collateral, the loan will likely get extended even if the borrower's credit score is low. However, if there has been a history of default on repaying loans, then the application might get rejected," pointed out Adhil Shetty, chief executive officer of Bankbazaar.

However, you need to be cautious.

Remember that markets can turn volatile, and falling value of your mutual fund units can lead to margin calls

If you borrow against equity mutual funds, you must pledge investments worth at least 50% of the loan amount as margin. The challenge arises during periods of high volatility, when the value of your pledged equity holdings can decline rapidly. In such cases, the lender may ask you to pledge more units, or allow it to sell part of your investments.

For instance, suppose you pledge ₹4 lakh worth of equity mutual funds to avail a loan of ₹2 lakh. If markets correct by 20%, the value of your pledged funds falls to ₹3.2 lakh. The lender needs to maintain at least 50% of the loan amount as margin, and the cushion has now shrunk to ₹1.6 lakh, creating a shortfall of ₹40,000. The lender can now ask you to pledge more units to restore the buffer or pay ₹40,000. If you cannot do either, the lender can sell part of your pledged investments to restore the margin.

Any restrictions?

You continue to enjoy dividends and capital appreciation from the mutual funds you pledge. The only restriction is that these units cannot

be sold or redeemed until the loan is cleared.

The borrower can keep adding to the same fund through lump sum investments or systematic investment plans. You cannot pledge locked-in units, such as those in equity-linked saving schemes, during their three-year lock-in period. Some platforms let you pledge the remaining free units, those that have completed the lock-in period, as collateral.

When should you opt for it

You may be borrowing at a cheaper rate, but the trade-off is the impact on your investments. If you need funding for the short term, a loan against a mutual fund is a better alternative than selling your mutual fund investments and losing on their long-term compounding potential. However, you can even lose your investments if you cannot restore your margin at volatile times.

"We advise clients when they have a short-term funding need to consider this type of loan, but we prefer they take the loan against debt mutual funds, where they can get a higher LTV, and the volatility of the collateral is on the lower side. This reduces frequent margin calls and pressure to pledge more units or repay to reduce the loan amount," said Vishal Dhawan, founder of Plan Ahead Wealth Advisors.

While planners may be okay for short-term funding needs, long-term funding through mutual funds is a strict no-no. "But if you need funding for a longer term, debt mutual funds are not ideal, as the interest rate is likely to be higher than the yield on such funds. In such scenarios, it may be better to redeem the debt fund rather than take a high-interest loan against it," said Surya Bhatia, financial adviser at Asset Managers.

If a borrower only has equity-oriented funds, it is wise not to maximize the LTV ratio. If you fail to bring the LTV back within limits in seven days, the platform has the right to sell your units to adjust the outstanding loan.

Use the option sparingly despite the limits, allowing you 80% LTV in a debt mutual fund and 50% in the case of an equity mutual fund. You shouldn't pledge more than 30-50% of your mutual fund investments for such loans, especially if you have linked these funds to your long-term goals.

Bottomline: While a loan against a mutual fund may seem like a quick and cheaper alternative, use the option wisely, or you might risk eroding the very wealth you are trying to protect.



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