BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OFINDIA

ADJUDICATION ORDER NO. PM/NR/2021-22/12225-12233

UNDER SECTION15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995

In respect of

Sl. No.	Name of the Notice	PAN
1	Franklin Templeton Trustee Services Pvt., Ltd.,	AAACT3916F
2	Sanjay Sapre	AALPS5825N
3	Santosh Kamat	AANPK4951D
4	Kunal Agarwal	ADYPA3090P
5	Sumit Gupta	AILPG1906E
6	Pallab Roy	AEBPR3653P
7	Sachin Padwal Desai	AFGPP2055M
8	Umesh Sharma	AMJPS8098R
9	Saurabh Gangrade	AIRPG6318C

(The aforesaid entities are hereinafter individually referred to by their respective names/Noticee nos. and collectively as "Noticees", unless the context specifies otherwise)

In the matter of Franklin Templeton Mutual Fund

BACKGROUND

1. Franklin Templeton Trustee Services Pvt., Ltd., ("Trustees") vide a Notice dated April 23, 2020, had inter alia informed the concerned unitholder(s) that it had decided to wind up the following schemes of Franklin Templeton Mutual Fund (FT-MF) pursuant to the provisions of Regulation 39(2)(a) of the SEBI (Mutual Funds) Regulations, 1996 ("Mutual Funds Regulations"), viz.,

    i. Franklin India Low Duration Fund ("FI–LDF");
    ii. Franklin India Ultra Short Fund/Ultra Short Bond Fund ("FI–UST");
    iii. Franklin India Short Term Income Fund/Plan ("FI–STIP");
    iv. Franklin India Credit Risk Fund ("FI–CRF");
    v. Franklin India Dynamic Accrual Fund ("FI–DAF");
    vi. Franklin India Income Opportunities Fund ("FI–IOF").

2. Based on certain media articles and complaints received by Securities and Exchange Board of India (SEBI), a Forensic Audit/Inspection ("Inspection") was initiated with regard to FT-MF in terms of Regulation 66 of the Mutual Funds Regulations to verify the compliance with provisions of the Securities laws such as Securities Contracts (Regulation) Act, 1956, SEBI Act, 1992 ("SEBI Act") and the Rules, Regulations including Mutual Funds Regulations, Bye–laws, Guidelines, Directions or Circulars issued there under.

3. Pursuant to the above, SEBI appointed M/s. Chokshi and Chokshi LLP, Chartered Accountants ("Auditor") to conduct a forensic audit/inspection of FT-MF, including of its in–house RTA activities, its Asset Management Company (AMC) and Board of Trustee/Trustee Company with respect to the debt schemes viz FI–LDF, FI–UST, FI–STIP, FI–CRF, FI–DAF and FI–IOF ("debt schemes inspected") amongst other schemes.

4. The findings of the Forensic Audit/Inspection Report were communicated to FT–MF vide SEBI letter no. SEBI/HO/IMD2/DF4/OW/12790/1/2020 dated August 5, 2020 advising FT–AMC and its Trustees to provide comments/explanations along with relevant supporting documents /records, if any, on the observations/findings contained therein. Thereafter, further supplementary observations to the Forensic Audit/Inspection Report, as received by SEBI from the Auditor, were forwarded to FT–MF vide SEBI e–mail dated August 24, 2020.

5. FT–AMC and Trustees submitted their response to the above-mentioned SEBI letter dated August 5, 2020, vide a common letter dated September 3, 2020.Pursuant to the above, SEBI had forwarded the letter dated September 3, 2020, to the Auditor for its comments in light of the said reply. The Auditor submitted its final comments to SEBI vide letter dated October 9, 2020.Upon consideration of the Forensic Audit/Inspection Report, FT–AMC and Trustees' response dated September 3, 2020 along with auditor's letter dated October 9, 2020, SEBI has initiated Adjudication proceedings against the following Noticees for violations of the provisions of corresponding Regulations and Circulars, which are alleged to have been committed by the Noticees, under Sections 15A(b), 15D(b), 15D(f) and 15HB of SEBI Act *(as applicable).*

Sl. No.	Name of the Entity	Violations observed
1.	Franklin Templeton Trustee Services Pvt. Ltd.,	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017
		SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017
		SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000
		Regulation 18 (7), 18 (8), 18 (9), 18 (22), 44 (3) and clause (2), (6), (8), (9) of the Code of Conduct as specified in the Fifth Schedule to the SEBI (Mutual Funds) Regulations, 1996
2.	Sanjay Sapre, CEO, FT-AMC	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017
		SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017
		SEBI Circular no. MFD/CIR/15/19133/2002 dated September 30, 2002
		Regulation 25 (6A) of SEBI (Mutual Funds) Regulations, 1996
3	Santosh Kamath, CIO	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017 SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017 Clause 9.1.1 of SEBI Circular no. SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019 Clause 1 of SEBI Circular no. SEBI/HO/IMD/DF4/CIR/P/2019/126 dated November 06, 2019 SEBI Circular no. CIR/IMD/DF/21/2012 dated September 13, 2012 SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000 Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996
4.	Kunal Agarwal, Fund Manager,	
5.	Sumit Gupta, Fund Manager	
6.	Pallab Roy, Fund Manager	
7.	Sachin Padwal Desai, Fund Manager	
8.	Umesh Sharma, Fund Manager	
9.	Saurabh Gangrade, Chief Compliance Officer	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017 SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017 Regulation 18(4)(d) of SEBI (Mutual Funds) Regulations, 1996.

6. The summary of findings of the forensic audit, for which Adjudication proceedings have been initiated against the Noticees, are furnished hereunder:

A. MULTIPLE SCHEMES RUN IN SIMILAR MANNER EVEN THOUGH INVESTMENT OBJECTS WERE DIFFERENT - (*Alleged violation by Noticees 1 to 9*)

There were similarities in investment strategy though the investment objectives were differing in the six wound up schemes. This was observed by way of common fund managers, high exposures in "AA and below" Corporate bonds in all the six schemes even though investment objectives as per the SIDs of these schemes are different. Further, as per the Portfolio holding data, most of the securities are rated AA or below at the time of investment. In addition, there was concentration of similar securities across schemes under audit where investments were made over 70% of the issue of such debt securities and most of the investments which were made in schemes were common at time of investment.

B. PRACTICES RELATED TO INTEREST RATE RESET PAPERS AND INCORRECT CALCULATION OF MACAULAY DURATION - (*Alleged violation by Noticees 3 to 8*)

The valuation and Macaulay duration of certain floating rate bonds with interest rate reset provisions were incorrectly calculated, since the interest rate reset date was taken as the reference date for calculation of valuation / Macaulay duration. The call/put and interest rate reset dates are inserted in the agreement and used for valuation of securities and calculation of Macaulay duration but are not exercised and/or exercisable. In 42 instances (for FI-UBF) and 17 instances (for FI-LDF), exit options were in fact not exercised where available in FI-UBF and FI-LDF

C. VALUATION PRACTICES - (*Alleged violation by Noticees 3 to 8*)

Failed to ensure that the changes in terms of investments are made available immediately for disclosure to valuation agencies and credit rating agencies and also for correct disclosure of portfolio to the investors.

D. MANAGING VARIOUS RISKS PERTAINING TO SECURITIES IN THE PORTFOLIO OF THE SCHEMES - (*Alleged violation by Noticees 1 to 8*)

Failed to carry out due diligence with respect to investments in illiquid securities and it was also observed that the pattern of investment transactions is akin to giving loan to issuers. No concrete steps were taken or guidance was provided in managing various risks viz., concentration, downgrades, early warning signal and liquidity issues, of the securities in the portfolio. Removal of investment risk monitoring from Business Risk Management Committee (BRMC) and lack of independence of risk management function was observed.

E. INVESTMENT RELATED DUE DILIGENCE - *(Alleged violation by Noticee 1)*

Failed to ensure that Investment Process Note (IPN) contains detailed objective criteria for investment and also failed to ensure appropriate policy to have pro-rata allotment of partial buyback to all the schemes.

APPOINTMENT OF ADJUDICATING OFFICER

7. The undersigned has been appointed as Adjudicating Officer vide Order dated November 11, 2020 under Section 19 read with Sub-section (1) of Section 15-I of the SEBI Act, 1992 and Rule 3 of the SEBI (Procedure for Holding Inquiry and imposing penalties) Rules, 1995 (*hereinafter referred to as "SEBI Adjudication Rules"*) to inquire into and adjudge the alleged violations committed by the Noticees as mentioned in pre-para 5 above, under Sections 15A(b), 15D(b), 15D(f) and 15HB of SEBI Act, 1992 *(as applicable)*.

SHOW CAUSE NOTICE, REPLY AND HEARING

8. A Show Cause Notice ref. no. EAD-8/PM/NJMR/20544/2020/1 dated November 27, 2020 (hereinafter referred to as "SCN") was served upon the Noticees mentioning the aforementioned allegations against the Noticees and requiring them to show cause within 14 days of receipt of the SCN, as to why an inquiry should not be held and penalty be not imposed against them under Sections 15A(b), 15D(b), 15D(f) and 15HB of SEBI Act, 1992 *(as applicable)* for the aforesaid alleged violation committed by them.

9. The Noticees vide email dated December 8, 2020 sought extension of eight weeks to furnish their reply in view of logistical challenges and disruptions resulting from the ongoing impact of the Covid-19 pandemic, besides professional commitments. Upon consideration of the requests made, the Noticees were given extension of time till January 15, 2021 to submit their reply, which was communicated vide email dated December 10, 2020. The Noticees vide email dated January 7, 2021 once again

sought extension of time till January 29, 2021 to furnish their reply, which was acceded to and a communication in this regard was sent to the Noticees vide email dated January 12, 2021.

10. The Noticees vide email dated January 29, 2021 submitted their reply. The reply of the Noticee 1 i.e., Franklin Templeton Trustee Services Pvt., Ltd., is summarized hereunder

(a) *At the outset, it is submitted that Franklin Templeton's commitment to the Indian market has been steadfast with a track record of over 25 years in India and a quarter of its global employee strength based here. FTMF has been registered with SEBI as a mutual fund since 1996 under the terms of the Mutual Funds Regulations. Apart from the said six Schemes, FTMF offers an additional 33 open ended schemes, 22 close ended schemes and 7 domestic fund of funds schemes in India with around 17 lakh investors and approximately INR 50,000 crores of AUM in fixed income, equity, hybrid, overseas, feeder and multi-asset categories.*

(b) *it is pertinent to highlight the role and responsibilities of the Trustee under the Mutual Fund Regulations, which are distinct and separate from the role and responsibilities of an asset management company. It is submitted that the allegations contained in the Notice are not sustainable, when viewed in the context of the role of the Trustee as contemplated under regulations.*

(c) *Further, day-to-day compliance by the mutual fund is the specific responsibility of specialised personnel engaged by the asset management company. For instance, under the terms of the Mutual Funds Regulations, fund managers are required to ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders and the compliance officer is required to monitor compliance with applicable laws and redress investors grievances.*

(d) *The Trustee is not directly involved in and does not directly control or participate in (i) investment strategy and individual investment decisions; (ii) ordinary course compliance activities; or (iii) operational aspects such as investment monitoring, specific due diligence or recording of investment decisions. For these matters, the Trustee has looked to ensure that the specialized portfolio management team is adequately qualified and is duly empowered to take investment decisions within the regulatory framework and in compliance with internal policies and processes, in conjunction with independent risk management and compliance functions.*

(e) *However, the Mutual Fund Regulations do not define or expand on the meaning of the term 'due diligence' or the standard thereof to be observed by* *the Trustee in discharge of its duties. Accordingly, reliance may be placed on relevant judicial precedent. Further, the Trustee place reliance on the Orders of the Hon'ble Supreme Court in the matter of Chander Kanta Bansal v. Rajinder Singh Anand and Hon'ble SAT Order in the matter of Almonds Global Securities Limited v. SEBI.*

(f) Allegations around portfolio liquidity do not appear to be supported by the facts – For instance, the Schemes were able to liquidate more than 50% of their AUM over a span of less than seven months, in worsening market conditions, in order to meet redemption demands. More than INR 27,000 crores of cash was realized between 1 October 2019 and 23 April 2020 from the portfolios of the Schemes. Of this, more than INR 17,000 crores (i.e., 63%) was from below-AAA rated securities.

(g) Similarly, allegations around portfolio quality do not appear to be supported by the facts - As of 15 January 2021, the NAV of five of the six Schemes is higher than their NAV on the date of the decision to wind up the Schemes and for one Scheme, it is marginally lower. The AUM of the six Schemes together was INR 25,648 crores on 23 April 2020 and it has increased to INR 26,343 crores as on 15 January 2021. Five of the six Schemes are cash positive and have accumulated distributable cash proceeds of more than INR 9,000 crores as on 15 January 2021 since the time of the winding up decision even without the ability to undertake active steps to monetize securities.

(h) The Trustee also regularly tracked periodic liquidity analysis undertaken by the risk management function as part of the Head-Risk Management's presentations to the board of the Trustee. Until the latter half of March 2020, such presentations did not highlight any critical or immediate liquidity concerns. Once the liquidity crisis in the Schemes came to the attention of the Trustee in the latter half of March 2020, the Trustee worked with the AMC towards ensuring that the same was being addressed, and carefully considered various options presented to the board of the Trustee including gating/suspension of redemptions, increase in borrowing limits etc. Even the decision to wind-up the Schemes was taken only to protect the interests of unitholders in these Schemes.

(i) Without prejudice to the foregoing, it is also submitted that the acts/conduct of the Trustee for the Schemes are also protected by the business judgment rule, which is a fundamental standard of judicial review in a number of developed common law jurisdictions with well-advanced corporate and securities laws. The business judgment rule requires courts to focus on the decision-making process instead of a substantive evaluation of the merits of a management decision, while also warning against hindsight bias.

11. A summary of the response filed by the Noticee-1 (Trustee) to the issue-wise allegations are as under:

A. MULTIPLE SCHEMES RUN IN SIMILAR MANNER EVEN THOUGH INVESTMENT OBJECTS WERE DIFFERENT

(i) Exposure in securities with rating as AA and below

(a) The Schemes were recategorized in terms of the Categorization Circular; FT-MF provided a "proposal" to SEBI on scheme recategorization and strictly complied with SEBI's comments on such proposal. FTMF had submitted a comprehensive proposal to SEBI with respect to the recategorization of its schemes for SEBI's review and comments. SEBI had made observations and sought clarifications from FTMF. This was followed by further correspondence with SEBI and in-person meetings with SEBI officials in January-February of 2018. Thereafter, on 4 June 2018, FTMF implemented the recategorization exercise, strictly in line with SEBI's observations. It has not been alleged that any such comments provided by SEBI on FTMF's proposal were not implemented. Therefore, FT had every reason to conclude that the Schemes were in compliance with the Categorization Circular.

(b) Scheme recategorization carried out by FT-MF pursuant to the Categorization Circular was a comprehensive (and by no means superficial) exercise which was undertaken by FT-MF in good faith. This is evident from the fact that in order to comply with the new scheme categories under the Categorization Circular:

- *FT-MF effected mergers of two of its existing schemes into a third scheme;*
- *FT-MF made changes to the fundamental attributes of 24 scheme;*
- *A total of 27,03,557 unitholders were provided with an exit option at the prevailing NAV and without any exit load and 94,782 unitholders exited, which entailed an out-flow of INR 3,412.87 crores in the aggregate.*

(c) No concerns regarding compliance with such circular have been raised as part of regular SEBI audits, including SEBI's inspection for FY 2018-19 (which in fact specifically addressed compliance with the Categorization Circular and made no noting of any violation) and an inspection / surveillance conducted in April 2019.

(d) An incorrect assumption has been made that the Categorization Circular prescribes 'exclusive' characteristics for each scheme category. This fails to consider the nature of fixed income products since a scheme is not composed of one feature alone. In fact, the categorization under the Categorization Circular is such that there is bound to be overlap amongst the various types of schemes on specific aspects such as interest rate risk, credit risk etc. In terms of the Categorization Circular, each debt scheme has been categorised on the basis of one specific parameter, e.g., duration, without any reference

to credit risk or credit risk without any reference to duration or in other cases maturity or type of instrument. For instance, the Categorization Circular broadly defines two types of schemes based on credit risk, viz., corporate bond funds (at least 80% exposure in AAA rated bonds) and credit risk funds (at least 65% exposure in AA and below rated bonds. Therefore, any mutual fund schemes whose categorization is defined with respect to duration as against credit risk may overlap with either one of the two credit-risk based types of schemes.

(e) It is not alleged that any of the Schemes has breached the specific characteristic prescribed for it. Instead, the allegation is premised on certain "similarities" among the Schemes. Every similarity or even multiple similarities are not automatically a breach of the Categorization Circular. The appropriate standard is that the schemes should not be 'duplications' of each other or be run with minor modifications. The Schemes are in fact distinct on multiple parameters and cannot be said to be "duplications", as is clear from the detailed response.

(f) Stipulations regarding credit rating are being read into schemes classified only on the basis of Macaulay duration, without any basis for the same under regulations. Under the scheme of SEBI regulations, investments must be made in 'investment grade' quality securities (i.e., BBB- and above). Beyond that, fund managers have flexibility to determine the credit rating composition of schemes. There are no caps prescribed for the exposure to certain categories of rating and the interpretation being taken of the Categorization Circular by the Notice amounts to indirectly reading in such caps. In fact, prior to issuance of the Categorization Circular, including credit-rating based distinctions in duration-based schemes was considered (as evidenced by deliberations of the MFAC sub-committee constituted by SEBI prior to issuance of the circular). However, the final circular issued has no such distinction indicating that this was never intended to be a point of distinction.

(g) The Notice does not allege that FTMF is the only mutual fund, which has exposure to a significant percentage of AA and below rated securities in duration-based schemes. However, without prejudice to the same, it is to be noted that there are in fact multiple duration-based schemes of other mutual funds, which carry significant exposure (and in many cases over 65%) exposure to AA and below rated securities over a consistent period of time. For instance, multiple schemes of other mutual funds in the medium duration category appear to have a significant exposure to AA and below securities. Illustratively only, it may be noted that – (i) Nippon India Strategic Fund has consistently had exposure of well in excess of 65% to AA and below rated securities for the period from June 2018 to March 2020; (ii) Kotak Medium Term Fund consistently had exposure in the region of or more than 65% for

the period from June 2018 to May 2019. The above instances are only illustrative and are without prejudice to the Noticee's contention that the Categorization Circulars do not, in any event, stipulate rating-based criterion for duration-based schemes. Such interpretation of the Categorization Circular will have unintended consequences for the market. For instance, if these Schemes instead had a larger proportion of higher-rated corporate bonds, then the Schemes would have been comparable to a 'corporate bond' scheme (which is required to have >80% of AAA rated bonds). In other words, if such an interpretation is sustained, it would become impracticable to run a duration-based scheme without falling foul of the Categorization Circular in one way or another.

(h) Investment strategy for a scheme is not premised on one feature; it is a function of multiple parameters including credit risk, maturity, duration, yield to maturity, liquidity risk, volatility, macroeconomic trends and sectoral concentration, which interact in a complex manner. Certain similarities amongst the Schemes (such as credit rating, portfolio overlap, 'investment pattern' and fund managers) have been emphasised. Other features where the Schemes demonstrate differences have not been considered. In fact, the differentiation amongst the Schemes is borne out in practice with respect to various other parameters, such as

(i) standard deviations in daily returns, which measures the volatility (i.e., the level of interest rate risk) of the portfolios,
(ii) average maturity, which measures the maturity profile of the portfolio based on the maturity of the underlying securities,
(iii) yield to maturity (YTM), which measures the expected rate of return for investors on the portfolio,
(iv) annualized returns, which measures historical annual returns earned by the Schemes, and
(v) relative exposures to large issuances amongst the Schemes

(i) Further, the fact that the six Schemes were differentiated is also clearly borne out in practice by the pattern of cash realised from the Schemes after winding up, the details of which are tabulated hereunder:

(in ₹ crores)

Scheme Name	***Gross AUM as on April 23, 2020***	***AUM as on April 23, 2020***	***Total amounts disbursed since winding up***	***Cash currently available to distribute***	***Total cash generated post winding-up as a % of the Gross AUM on April 23, 2020***
Franklin India Ultra Short Bond Fund	*10481.4*	*9630.2*	*7335.8*	*598.5*	*83.82%*

Franklin India Low Duration Fund	*2666.7*	*2356.1*	*2056.1*	*49.9*	*90.62%*
Franklin India Short Term Income Plan	*7385.7*	*5553.4*	*1569.9*	*450.2*	*52.16%*
Franklin India Income Opportunities Fund	*2396.5*	*1743.9*	*458.2*	*115.1*	*51.16%*
Franklin India Credit Risk Fund	*4191.6*	*3417.3*	*1745.8*	*115.3*	*62.88%*
Franklin India Dynamic Accrual Fund	*2638.6*	*2514.2*	*1406.2*	*104.5*	*61.97%*
Total	***29760.7***	***25215.3***	***14572.3***	***1433.8***	***69.06%***

(j) The above figures also demonstrate that the liquidity of the six Schemes was aligned with their respective Macaulay durations. Short duration funds such as Ultra Short Bond Fund and Low Duration Fund generated 83% and 89% of liquidity within a short span of time (without the ability to actively monetize the portfolio until the order of the Supreme Court in March 2021). FISTIP and FIIOF have 1 to 3 year and 3 to 4 years Macaulay durations respectively. The cash generated in these schemes are comparatively lower than the short duration funds. Therefore, as intended by the different scheme objectives, short duration funds were able to generate liquidity quicker relative to long duration Schemes.

(k) FTMF has consistently followed a differentiated yield-oriented strategy and adopted a distinct market positioning for the Schemes, relative to schemes in the same categories offered by other mutual funds. The risk profile of the Schemes has always been disclosed as 'moderate' (i.e., the highest risk profile, which could have been disclosed for debt schemes under SEBI's circular of 30 April 2015 and AMFI's Best Practices Guidelines Circular No. 57 dated 18 May 2015). Many schemes of other mutual funds falling within the same SEBI categories disclose a lower level of risk.

(l) Since the implementation of recategorization under the Categorization Circular, the fact-sheets for FTMF have consistently disclosed the Schemes as 'managed credit' funds (as against FTMF's other debt funds, which were positioned as 'high credit' funds).

(m) Even under the recently revised requirements pertaining to 'risk-o-meter', all scheme categories (including duration based-schemes) are required to separately compute and disclose liquidity risk, interest rate risk and credit risk, which demonstrates the regulatory intent that duration-based schemes were always contemplated to have varied credit risk in their portfolios.

(n) Under SEBI regulations, investments must be made in 'investment grade' quality securities (i.e., BBB- and above). Beyond that, fund managers have

the flexibility to determine the credit rating composition of schemes. The Categorization Circular does not provide stipulations with respect to credit-ratings for 'duration-based' funds. Hence, 'duration-based' Schemes may have similar exposures to AA and below rated securities.

(o) *The Schemes cannot be said to be 'duplications' or 'minor modifications' of each other, since they show differentiation in other features such as the Macaulay durations and various performance parameters*

(p) *The Notice conflates duration (which measures interest rate risk) with credit rating (which measures credit risk). Low duration investments do not necessarily have correspondingly low credit risk. An investor may be willing to take exposure to greater credit risk but at the same time reduce his exposure to changing market interest rates – such an investor would choose to invest in a low duration Scheme.*

(q) *The Government has advocated for policy measures to encourage investments in securities below AAA (e.g., budget speech of 2018-19 (Page 43 of Response) and SEBI consultation paper of 21 July 2018*

(ii) **Macaulay Duration based similarity across Schemes**

(a) *For two of these three Schemes (viz., FI-DAF and FI-CRF), there is no regulatory stipulation as to Macaulay duration and therefore, the Macaulay durations of these schemes may vary at different points in time. As a consequence, Macaulay durations for FI-DAF and FICRF may show significant similarities or variations relative to FI-STIP in the ordinary course.*

(iii) **Common investments by Schemes**

(a) *The Notice does not set forth the methodology employed to arrive at the above percentages of common securities.*

(b) *Regulations do not restrict multiple schemes of the same mutual fund from acquiring or holding (even simultaneously) the same security.*

(c) *Common holdings of particular securities within portfolios does not necessarily amount to similarities in the performance of the portfolios as a whole.*

(d) *This is also demonstrated by the relative performances of the Schemes in question (viz., FI-STIP, FI-DAF, FI-IOF and FI-CRF) over the relevant period (plus the first quarter of 2020-21), which show variations.*

(e) *Portfolio overlap may also be a by-product of other ordinary course practices such as laddering of portfolios (i.e., as the duration of an underlying security* *reduces, a longer duration scheme may sell it to a shorter duration scheme, which is consistent with the respective investment objectives and features of both schemes).*

(iv)Similarity in investment pattern

(a) *The Notice does not set forth the methodology employed to arrive at the percentage of securities in which the Schemes held more than 70% of the issuance.*

(b) *Regulations do not restrict schemes of a mutual fund from subscribing to a substantial part or even 100% of the exposure of a certain issuance. The recent SEBI circular dated 5 October 2020 regarding product labelling in mutual fund schemes (risk-o-meter) also acknowledges that mutual funds may subscribe to substantial portions (>90%) of single issuances.*

(c) *It is not uncommon for a single subscriber to take large positions in bond issuances. 99.2% of corporate debt issuances were undertaken through the private placement route in 2018-19 (in 2017-18, such proportion was 95.6%).*

(d) *From data on the website of the Bombay Stock Exchange, out of the 74 corporate bond issuances through private placement in December 2020, 39 issuances had only one investor There are a number of instances of other mutual funds subscribing to a significant portion of a single issuance.*

(v) Common Fund Managers

(a) *Regulations do not restrict having common fund managers across schemes. SEBI's circulars dated 22 August 2011 (Appendix 5) and 15 March 2017 (Appendix 6), in fact, recognise that the same fund manager may be managing multiple schemes.*

(b) *Details of the fund managers have been consistently disclosed including in the scheme information documents and the monthly fact-sheets published by the AMC. The above approach (on common fund managers across schemes) is consistent with the approach followed by other mutual funds as well.*

(c) *Fund managers have always taken decisions with respect to the Schemes independently, having separate regard to considerations affecting each Scheme.*

D. MANAGING VARIOUS RISKS PERTAINING TO SECURITIES IN THE PORTFOLIO OF THE SCHEMES

(i) High Exposure in Unlisted / Illiquid Debt Securities

(a) ***Consistent investment strategy followed historically; the Schemes did not face any liquidity issues, until the unprecedented COVID-19- induced market dislocation*** *– The Schemes have historically and consistently followed a certain investment strategy and pattern, involving investments to a greater extent in securities across the credit rating spectrum (including AA and A rated securities). This strategy has also extended to investments in unlisted securities or securities issued by lesser-known issuers with good credit. The strategy is in consonance with regulations and the objectives of and disclosures made for the Schemes. The Schemes have generated superior risk-adjusted returns for investors over a number of years while following this legitimate business strategy. The Schemes have effectively navigated all kinds of market cycles for their investors over this period without facing any liquidity issues (including extremely stressed market conditions such as the 2008 global financial crisis and the 2018 market dislocation induced by the IL&FS default). As such, in the absence of any violation of regulations or any concerns being raised in any audit reports, it would not have been appropriate (or desirable) for the Trustee to interfere with or second guess such strategy.*

(b) ***Schemes were able to generate substantial liquidity even from October 2019 onwards to meet heightened redemptions*** *– The allegation of liquidity issues during the audit period are not supported by the facts. Between 1 October 2019 and 23 April 2020, the Schemes were able to generate INR 27,000 crores of cash (i.e., more than 50% of their AUM) from their portfolio securities in worsening market conditions in order to meet heightened redemption demands. More than INR 17,000 crores (i.e., 63%) was from below-AAA rated securities. More than INR 6,900 crores was realized in this period from unlisted securities even though the marketability of such securities was substantially reduced after the changes to regulations introduced on 1 October 2019. Hence, this allegation ought to be considered in light of the fact that the Schemes were able to convert more than 50% of the AUM into cash in a span of less than seven months.*

(c) ***Impact of the COVID-19 pandemic and the resultant market dislocation on the Schemes*** *– The severe and sustained impact of COVID-19 on global and Indian bond markets is well documented. The severe market dislocation ultimately led to gating/closure/winding up of more than 75 funds across Europe and the US including funds run by Fidelity Investments and PIMCO. The Government of India, SEBI and RBI have also recognized the impact on the Indian debt market, with unprecedented measures such as moratorium on loans and suspension of the Insolvency and Bankruptcy Code being introduced. Detailed data on the impact of the pandemic on global and Indian bond markets and in particular, on the Schemes is set forth in our detailed response at Section V-D.2.ii (C) below.*

(d) *It is submitted that the FTMF has prudently managed the liquidity of the Schemes since their inception. However, while liquidity was not a concern for the Schemes over their years of operations in ordinary circumstances (and* *even in stressed market conditions), the severe and sustained liquidity crisis induced by the COVID-19 pandemic and the resultant market dislocation could not have been foreseen. It is submitted that even the most comprehensive risk management processes could not have anticipated the consequences of the COVID-19 pandemic.*

(e) ***Schemes were managed in good faith in reliance of the regulatory framework*** *– Historically, it was quite common even for marquee corporates with good credit ratings to issue unlisted debt securities on a private placement basis (e.g., Tata Sons (ICRA AAA), Tata Realty (ICRA AA), Bharati Telecom (CRISIL AA+)) and such securities were traded, similar to listed securities. An unfortunate ancillary effect of the regulations introduced on 1 October 2019 was the drying up of liquidity in the market for unlisted bonds. Significant percentage (around 30%) of the portfolios of the Schemes comprised unlisted bonds at the time. FTMF, as well as AMFI, made representations in this regard requesting for certain measures to ease such liquidity pressures, such as providing for a one-time listing window for existing unlisted securities and allowing 'grandfathered' securities to be traded amongst mutual funds, etc. After the Schemes had already been wound-up, such amendments were introduced, which goes to show the legitimacy of the concerns raised by FTMF in this regard.*

(f) ***Market realities have not been considered*** *– Market realities have not been considered insofar as the lack of depth and low liquidity in the secondary market for corporate bonds is a well-recognised industry-wide phenomenon. For instance, a research report of the RBI dated January 2019 notes that the corporate debt to GDP ratio in India stood at 17% in June 2017 relative to 123% in the US. Given that the secondary market for corporate bonds is not very large, the Noticee has, as a strategic matter, actively looked to rely more on other means of monetisation such as scheduled maturities, coupons and prepayments / buy-backs. This is a legitimate business strategy in consonance with regulations.*

(g) ***Exercise of subjective business judgment in good faith*** *– It is not alleged that any regulations relating to investments in unlisted securities, securities where the Schemes had a large percentage of the exposure or regulations with respect to credit ratings of securities have been violated. It is submitted that fund managers have flexibility to design investment strategies and take investment decisions for schemes in the exercise of their business judgment, so long as the same are in consonance with the regulatory framework, which is the case here.*

(h) It is submitted that the fund management team of the FTMF had formulated a differentiated investment strategy for the Schemes with a view to deliver superior risk-adjusted returns for investors, which was in consonance with the regulatory framework at all times, and which had successfully delivered superior outcomes for investors while navigating challenging market

conditions over the Schemes' long history. Therefore, so long as the regulatory requirements are complied with and the investment manager exercises due care and diligence, the investment strategy of the Schemes (e.g., with respect to the proportion of unlisted securities in the portfolio and credit rating composition of the portfolios), ought not to be questioned in hindsight.

(i) ***No regulatory violations with respect to exposure in unlisted, below AAA, substantial exposure etc.,*** *- It is not alleged that any regulations with respect to exposure to unlisted securities, securities where the Schemes had a large percentage of the exposure or securities with credit ratings below AAA have been violated.*

- *Until 1 October 2019, there were no regulations capping the exposure to unlisted securities. All investments in unlisted securities were made prior to 1 October 2019 and are accordingly 'grand-fathered' in terms of SEBI's circular dated 1 October 2019. No new investments in unlisted securities were made thereafter.*
- *The prevailing SEBI regulations did not restrict schemes of a mutual fund from subscribing to a substantial percentage or even 100% of the exposure of a certain issuance.*
- *With respect to credit ratings, SEBI regulations only prescribe that investments by debt schemes must be made in investment grade securities (BBB- and above). Within the category of investment grade securities, regulations do not mandate thresholds or specific caps on exposure to AAA or below AAA rated securities (except for 'credit risk funds' and 'corporate bond funds').*

(j) ***Correlation between listing status and liquidity*** *- A direct, material and causal linkage has not been established between listing status and liquidity of a security. Even most listed securities are issued to a limited number of investors on a private placement basis. As per data available on SEBI's website, out of the total issuances of listed corporate bonds in FY 18-19 and FY 19-20, 94% and 97.8% were issued through private placement respectively. Further, most secondary trades in corporate bonds take place through OTC / privately negotiated deals, irrespective of whether the bonds are listed, since listed corporate bonds are not on par with listed equity shares, which are held by lakhs of investors and therefore have a ready market on the stock exchange.*

(k) Even in practice, unlisted securities have contributed significantly towards the overall share of liquidity within the portfolios of the Schemes. For instance, in FY 2019-20, unlisted securities contributed to 42.7% of the overall liquidity generated by the Schemes (in fact, unlisted securities contributed greater liquidity to the portfolios than listed securities on a weighted basis).

(l) ***Correlation between credit rating and liquidity -*** *A credit rating other than AAA does not by itself imply that a bond is illiquid. Liquidity for corporate bonds is determined by a variety of other factors such as bond terms (maturity, duration, embedded options, etc.) and the structure of Indian secondary markets. Between 1 October 2019 and 23 April 2020, more than INR 17,000 crores of liquidity (i.e., 63% of the total amount) was derived from below AAA rated securities, which also generally corresponds to the proportion of below AAA rated securities within the portfolios.*

(m) Historically, liquidity requirements of the Schemes have been comfortably met through all types of market cycles. Liquidity of unlisted securities in the portfolio was impacted only after the change in regulations on 1 October 2019.

(n) ***Inter-scheme transfers –***

- *It is not alleged that any regulations with respect to ISTs have been breached. Even the audit report dated 5 August 2020 (on which the Notice is based) notes that the requirements have been met (i.e., there was commercial justification for such ISTs from the perspective of both the buying scheme as well as selling scheme and valuation requirements were also met).*
- *No instance of any loss being suffered by any Scheme on account of a particular IST or an IST not being in consonance with the objectives of either the buying or selling scheme has been identified, despite the forensic audit.*
- *Decisions with respect to undertaking ISTs are entirely within the purview of the fund management team (as set forth under the AMC's policy for ISTs) and are not required to be escalated to the Trustee in the ordinary course.*
- *All ISTs in each month are evaluated by the internal auditor and reported to the Trustee as part of their monthly reports. In addition, ISTs are reported to the Trustee under bi-monthly CTRs. None of such reports had identified any non-compliances in this context. In fact, no material exceptions or escalations were reported to the Trustee through any of the established governance mechanisms at the AMC. For the limited observations made through these channels, the Trustee received confirmation that the same had been duly implemented. Accordingly, the Trustee did not have any reasonable basis to question the ISTs involving the Schemes.*
- *In any case, without prejudice to the foregoing, the contribution of ISTs within the Schemes to liquidity was not substantial (~16% between April 2019 and March 2020), i.e., it is not established that the Schemes relied significantly on such ISTs for liquidity management.*

(o) ***Allegation that the investments amount to loans*** *– The import of the allegation is not clear. No specific investments which amount to loans, and the basis for the same have been identified. The Schemes have always invested in bonds in line with applicable regulatory provisions. No loans have been provided. Secondary sales have materially contributed to liquidity (which would not have been possible with loans). Customised provisions (rate resets, call/put options etc.) are present in most bond issuances as well (and are not restricted to loans). As stated above, there was no restriction on the Schemes investing in a substantial portion of a bond issuance. Further, in the absence of any indication (as part of periodic reports received from the AMC, ongoing SEBI audits and internal audits or reporting at board meetings by the fund management team) that one or more investments (or the overall investment strategy or investment pattern) amounted to provision of loans, the Trustee had no reason to question the same. Hence, liability ought not to be imposed on the Noticee in such circumstances.*

(ii) Risk Management

(a) At the outset, it is submitted that Trustee has always acted in good faith and exercised due diligence honestly in the discharge of its duties. Accordingly, the Trustee board has put in place a robust investment and risk management framework.

(b) As can be seen from the instances mentioned below, the Trustee regularly informed themselves and acted promptly as and when concerns came to their attention. In doing so, the Trustee relied upon inputs received not only from the risk management team, but also from various other reporting and audit mechanisms (including the fund management team, the CEO, the CIO-Fixed Income and third-party auditors) so as to get a complete picture of the issues.

(c) The Trustee deliberated on such inputs in a holistic manner and provided guidance to the relevant teams, where the same was considered necessary.

(d) The minutes demonstrate that Trustee considered and duly deliberated upon the items presented by the Head-Risk Management, and sought the investment team's views on such matters as well.

(e) Specifically, with respect to 'issuers under close monitoring and downgrade of securities' -

(i) Certain exposures were downgraded to below investment grade or were showing 'early warning signs' (EWS), which is an inherent risk attached to debt investments.

(ii) It is submitted that the fund management team provided detailed updates to the board regarding exposure to groups which were highlighted in the risk team's presentations as issuers under monitoring/ downgrade, EWS etc., including YES Capital, Essel Group, Reliance ADA Group, WGC Group and Vodafone Idea. Such updates included actions taken by the

fund management team for exposure reduction, risk management and mitigation and recovery, tracking of equity raises reflecting improving credit quality, large prepayments/ repayments, coupon resets, precautionary steps taken (reset of exposure norms) and continued engagement with issuers to ensure adequate collateral and recovery.

(iii) *While the Trustee board did not directly participate in individual investment / buy-sell decisions, it regularly considered developments with respect to issuers under close monitoring, issuers displaying early warning signals (EWS) / stressed sectors, upgrades and downgrades, significant exposures of the fixed income portfolio and updates on 'focus group exposure' etc.*

(a) At the 15 July 2019 meetings, the board noted near full recoveries in WGC and YES Capital.

(b) At the meetings of 25 October 2019, with respect to EWS issuers/ downgrades, the board noted the management's views regarding the fixed income portfolio's well-defined product structure. Certain funds followed more traditional investment strategies and focussed on AAA rated securities while other funds were following a differentiated yield-oriented strategy of investing across the credit rating spectrum (including below AAA rated securities). The board was also briefed on the fixed income team's process for monitoring exposures and taking necessary action in the interest of investors.

(c) At the 3 December 2019 meetings, the CIO-Fixed Income provided updates with respect to focus groups (Essel, Vodafone Idea, Reliance ADA Group) and explained the steps taken to deal with these issuers. With respect to Reliance ADA Group, there were specific discussions on the ongoing dialogue with Reliance ADA Group management.

(iv) The board at times made additional data requests or asked for the data to be presented in a different form to allow for more effective / informed analysis and review or asked that the risk management team and fund management team continue monitoring issues actively.

(a) At the 6 March 2020 meetings, the board asked the risk management team to present a further sub-categorisation of stressed exposures based on severity of risk.

(b) The CIO also provided a status update on bonds issued by stressed issuers at the meetings of 6 March 2020. The board, in the course of deliberations, advised the CIO to closely monitor the exposures and take necessary actions to recover investments. As part of corrective measures, the maximum exposure limits with respect to non-bluechip groups were reduced for one year – resulting in substantial reduction in both % limit and absolute limit in exposure to non-bluechip entities. The board also advised the CIO to work towards reducing passive breaches.

(v) With respect to upgrade-downgrade ratios, it is clarified that issuers facing material downgrades (for instance, downgrades below 'A') were highlighted to the board either by the fund management team or by the risk team. Exposure to such issuers and steps taken for managing these exposures were discussed at the board (as these would also form part of the focus/ stressed groups / EWS issuers). For instance, in his presentations in board meetings between 15 July 2019 and 6 March 2020, the CIO-Fixed Income presented the exposure status and steps taken with respect to WGC Group, Reliance ADA Group, Essel Group, Vodafone Idea etc. (as key focus groups).

(vi) With respect to certain other issuer downgrades highlighted by the risk team in their presentations (e.g., Edelweiss, Jindal Power, Piramal group etc.), the CIO also provided details of other material developments and risk mitigants (e.g., equity raises/ large prepayments/ repayments).

(vii) It is submitted that the issuers tracked as 'EWS' were labelled and tracked in this manner from a conservative perspective with a view to anticipate and proactively track any potential risks. In fact, out of a total of 64 EWS issuers tracked by the AMC's fund management and risk teams during the period April 2017 – August 2020.

(a) No downgrades occurred in 38 issuers, i.e., credit rating remained stable in 59% of EWS issuers. Such issuers, whose ratings remained stable, include 11 entities (amongst others, Aptus Housing, Bharti Airtel, DLF, Five Star, JM Financial, Shriram Transport and Vedanta), which were flagged by the risk team as EWS / stressed / issuers under monitoring at board meetings between July 2019 – March 2020. The credit ratings of two such issuers, i.e., Aptus Housing and Motilal Oswal Home, were in fact upgraded during this period.

(b) The issuers which faced material downgrades to below investment grade during this period were Vodafone Idea Limited and entities belonging to the following groups – Reliance ADA Group, Essel Group, Dewan Housing Group and YES Bank Group, all of which were presented to the board as EWS / 'issuers under close monitoring' by the risk team, and as 'focus groups' by the fund management team. These exposures were therefore regularly monitored and detailed updates were presented to the board. The board records also reflect notings of recovery efforts, risk mitigants and actual recoveries made from these issuers.

(viii) It may be noted that the reasons for each downgrade were recorded in downgrade notes prepared pursuant to the Credit Appraisal Policy approved by the board. Further, the Investment Committee had primary responsibility for assessing and addressing downgrade risks in the first instance; hence, the downgrade notes were presented before it. Thereafter, issuers facing material downgrades were also discussed by the board, as described above.

(ix) *As regards the alleged violation regarding liquidity concerns, it is submitted that the presentations cited in the Notice (i.e., made to the board in July 2019, October 2019, December 2019 and March 2020) included a specific slide providing a liquidity/coverage ratio analysis of FTMF's debt funds (including the Schemes), which depicted the liquidity position for the Schemes to be comfortable –*

> *"Normal market: Major funds have a good coverage ratio indicating comfort with respect to average redemptions across certain time periods.*
>
> *Stressed Scenario: A simple stress scenario takes in account those instances where redemption > VaR. This indicates that in a scenario where there could be heavy redemptions, the existing lines with banks shall suffice to meet the liquidity needs in short term."*

(x) *FTMF in fact as a matter of prudence has maintained committed credit lines for its schemes with a view to mitigate any potential liquidity risks. However, before March 2020, no occasion or liquidity constraints even arose that required the Schemes to avail its 'on-tap' borrowing facilities to any significant extent. As of 31 January 2020, the Schemes had NIL borrowings and even as of 29 February 2020, the borrowings were limited to small amounts in three Schemes (5.02% of AUM in FILDF, 2.10% of AUM in FISTIP and 0.33% of AUM in FICRF). This also demonstrates that the liquidity of the Schemes has been prudently managed. Significant borrowings were required to be raised only in March and April 2020 on account of the market impact of the unforeseen Covid-19 crisis.*

(xi) *In the light of the aforesaid facts, it is submitted that the board, when required and when its attention was drawn to certain facts, did play a proactive role and acted with such prudence as would be expected out of any reasonable board of trustee occupying the same position and placed with the same set of facts.*

(iii)Removal of monitoring of investment risk from Business Risk Management Committee (BRMC) and lack of Independence of risk management function:

(a) *It is alleged that the Board of the Trustee failed to take steps in response to the risks reported to the board by the risk management function in board meetings held on 15 July 2019, 25 October 2019, 3 December 2019 and 6 March 2020. In this regard, t is submitted that Trustee has always acted in good faith and exercised due diligence honestly in the discharge of its duties. Accordingly, the Trustee board has put in place a robust investment and risk management framework.*

(b) *It is submitted that the fund management team provided detailed updates to the board regarding exposure to groups which were highlighted in the risk team's presentations as issuers under monitoring/ downgrade, EWS etc., including YES Capital, Essel Group, Reliance ADA Group, WGC Group and*

Vodafone Idea. Such updates included actions taken by the fund management team for exposure reduction, risk management and mitigation and recovery, tracking of equity raises reflecting improving credit quality, large prepayments/ repayments, coupon resets, precautionary steps taken (reset of exposure norms) and continued engagement with issuers to ensure adequate collateral and recovery.

(c) *While the Trustee board did not directly participate in individual investment / buy-sell decisions, it regularly considered developments with respect to issuers under close monitoring, issuers displaying early warning signals (EWS) / stressed sectors, upgrades and downgrades, significant exposures of the fixed income portfolio and updates on 'focus group exposure' etc.,*

(d) *The board at times made additional data requests or asked for the data to be presented in a different form to allow for more effective / informed analysis and review or asked that the risk management team and fund management team continue monitoring issues actively.*

(e) *With respect to upgrade-downgrade ratios, it is clarified that issuers facing material downgrades (for instance, downgrades below 'A') were highlighted to the board either by the fund management team or by the risk team. Exposure to such issuers and steps taken for managing these exposures were discussed at the board (as these would also form part of the focus/ stressed groups / EWS issuers).*

(f) *With respect to certain other issuer downgrades highlighted by the risk team in their presentations (e.g., Edelweiss, Jindal Power, Piramal group etc.), the CIO also provided details of other material developments and risk mitigants (e.g., equity raises/ large prepayments/ repayments).*

(g) *It is submitted that the issuers tracked as 'EWS' were labelled and tracked in this manner from a conservative perspective with a view to anticipate and proactively track any potential risks. In fact, out of a total of 64 EWS issuers tracked by the AMC's fund management and risk teams during the period April 2017 – August 2020*

(h) *It is submitted that the presentations made to the board in July 2019, October 2019, December 2019 and March 2020 discussing concentration risks and liquidity issues did not convey critical or immediate concerns around the liquidity of the Schemes.*

(i) *FTMF in fact as a matter of prudence has maintained committed credit lines for its schemes with a view to mitigate any potential liquidity risks. However, before March 2020, no occasion or liquidity constraints even arose that required the Schemes to avail its 'on-tap' borrowing facilities to any significant* *extent. As of 31 January 2020, the Schemes had NIL borrowings and even as of 29 February 2020, the borrowings were limited to small amounts in three Schemes (5.02% of AUM in FILDF, 2.10% of AUM in FISTIP and 0.33% of AUM in FICRF). This also demonstrates that the liquidity of the Schemes has been prudently managed. Significant borrowings were required to be raised only in March and April 2020 on account of the market impact of the unforeseen Covid-19 crisis.*

(j) In the light of the aforesaid facts, it is submitted that the board, when required and when its attention was drawn to certain facts, did play a proactive role and acted with such prudence as would be expected out of any reasonable board of trustee occupying the same position and placed with the same set of facts.

E. INVESTMENT RELATED DUE DILIGENCE

(i) Deficient Investment Policy

(a) Circular alleged to be violated is advisory - The Notice refers to the SEBI's circular dated 27 July 2000 – it is clear from the language of the circular that the same is advisory and not mandatory.

(b) Requirements under regulations, i.e., setting forth broad parameters for investments apply to the AMC (and not the Trustee) - SEBI's circular dated 27 July 2000 states that the board of the AMC 'can' prescribe the 'broad parameters for investments. In other words, the circular does not apply to the Trustee and hence, the allegation against the Trustee is not clear. In any event, without prejudice to the foregoing, this is only an enabling provision, and what is contemplated to be prescribed is 'broad parameters for investments.

(c) Requirements under circular are complied with, in any event – In fact, it is acknowledged at the very beginning of paragraph 48 at page 58 of the Notice that "It is noted that the FT-AMC Board has prescribed broad parameters in the form of Investment Policy / Investment Process Note (IPN)".

(d) Basis for regulatory violation is not clear since regulations do not provide any specific format or mandate inclusion of any specific criteria in IPN – It is then stated in the Notice that "…However, it does not cover any objective criteria for compliance except the Issuer level limit and credit rating-based limit." It has not been identified as to what regulation has been breached on account of the same. There is no breach since the regulations neither prescribe a particular format for, nor require the inclusion of any specific 'objective criteria' in, the investment process note. The requirement under regulations is complied with, as stated above.

(e) Investment policy is not limited to IPN – It is reiterated that regulations do not provide the form or manner in which such 'broad parameters' are to be specified. The concept of a specific investment process note is not even specifically recognised under regulations. There is also no requirement that the investment policy must all be housed in one document, i.e., in this case, the IPN, which is only one out of a comprehensive range of policies and processes put in place by the Noticee (in conjunction with the board of the AMC) for investment decision-making, including a Credit Appraisal Policy, specific Investment Limits approved by the board, Valuation Policy, Charter for the Investment Committee (Debt) and Charter for the Credit Appraisal Committee. It is not clear to the Noticee as to why reference has been made only to the IPN.

(f) IPN is not intended to be an overly prescriptive document - Without prejudice to the foregoing, it is submitted that considering the purpose of the IPN, it is not overly prescriptive so that the portfolio management team, as the specialised team, has sufficient flexibility to take investment decisions in the best interests of unitholders. At the same time, the IPN prescribes broad parameters for investments to provide adequate guidance and direction to the relevant teams in taking investment decisions. This is in compliance with the regulatory standard.

(g) Basis of specific identified parameters for inclusion in IPN is not clear – No basis has been provided for why the identified parameters ('periodicity of review of IPN', 'maximum subscription in particular security issued by issuer', 'list of prohibited transactions', or 'haircut based on nature of collaterals') have been chosen as needing to be incorporated in the IPN, since as stated above, there is no such requirement under regulations. Even if some or all these points were addressed in the IPN, credit investments cover innumerable other considerations, and it may then be asserted that such other considerations have not been adequately covered in the IPN. It is submitted that requiring such prescriptive policies was never intended under the regulations, as is evidenced by the lack of such a prescriptive list under regulations.

(h) Even KPMG's review of the AMC's risk management framework in May 2019, which was undertaken pursuant to a SEBI mandate, did not identify any substantive deficiencies in the IPN.

(i) In any event, as demonstrated in our detailed submissions below, each of the parameters identified are addressed in FTMF's investment protocols as a whole (including the credit appraisal policy, internal investment limits, valuation policy and charters for the investment committee (debt) and credit appraisal committee), which should be considered holistically.

(ii) Inconsistency in exercising buyback option, leading to preferential treatment given to investors of one scheme over the other

(a) Decisions on buy-backs / prepayment offers are not escalated to the Trustee – Decisions with respect to individual investments/ buy-backs / pre-payment offers from issuers are entirely within the purview of the fund management team of the AMC and are not required to be escalated to the Trustee in the ordinary course.

(b) No breach of regulations

- *No breach of any regulation has been identified. It is stated that – "As per the generally accepted practice with regard to buyback of securities, the buyback amount is exercised on pro-rata basis across all the Schemes".*
- *No basis is provided to substantiate that this is a 'generally accepted practice' or as to why such 'practice' ought to have the force of law.*
- *In fact, the prevailing regulations did not impose restrictions on the manner of apportioning buy-back offers between different schemes holding the same security (i.e., there was no specific requirement that the apportionment must be on a pro-rata basis).*
- *Further, this is also made clear by the fact that such regulation (i.e., that trades (including buybacks) should ordinarily be allocated pro-rata amongst schemes) was only recently introduced by way of a circular dated 17 September 2020.*
- *Moreover, even the new regulation permits disproportionate allocations of trades (including buybacks) with certain internal approvals. In other words, even under the new regulations, SEBI has recognized that it may not be appropriate in all cases to apportion buy-backs proportionately.*

(c) Practice followed was consistent with requirement to take independent decisions for each scheme –

- *In any event, consistent with the scheme of the Mutual Funds Regulations, decisions with respect to participation in buyback offers were taken independently for each Scheme, considering the liquidity position, investment strategy and other factors applicable to such Scheme.*
- *It is also submitted that during the time period in question, FTMF did have a Fixed Income Allocation of Investment Opportunities Policy, which dealt with allocation of primary and secondary trades to various schemes (which would include buybacks). Such policy, in recognition of the above factors (i.e., that there can be no 'one-size-fits-all' approach for allocating investment opportunities to the Schemes) did*

not mandate a pro rata allocation of trades in all circumstances. This approach was fully consistent with the prevailing regulations.

- *Further, with respect to each of the instances identified, the Trustee had no reason to believe that the CIO did not give due consideration to the objectives, features, interests and circumstances specifically relevant to each of the Schemes in question and determined, in exercise of his business judgement, the participation of each Scheme in the buybacks.*

12. The reply submitted by the Noticee 2 i.e., Sanjay Sapre, CEO, FT-AMC is summarized hereunder:

(a) It is submitted that the allegations in the Notice ought to be set aside on the basis that they fail to consider the specific role and responsibilities of the CEO as contemplated under the Mutual Fund Regulations and the well-settled legal principles relating to applicable standards of diligence and the exercise of business judgment in the discharge of such professional responsibilities. No case for a breach on the part of the Noticee is made out, when the allegations as stated are tested against these standards (without prejudice to any of the other submissions).

(b) The standard of care that the CEO would be expected to meet in the discharge of his responsibilities under Regulation 25(6A), is that of reasonableness and general prudence, having regard to the prevailing facts and circumstances.

(c) While Regulation 25(6A) delineates the general responsibilities of the CEO, the Mutual Fund Regulations do not specify the standard of care and diligence, which apply to a CEO in the discharge of such professional functions. Accordingly, guidance may be drawn from relevant judicial precedents. In this regard, reliance is placed on the decision of the Hon'ble Supreme Court of India in Jacob Mathew v. State of Punjab and Ors , wherein the court examined the standard of care applicable to a professional in the discharge of his duties. Further, the Noticee place reliance on the judgments of the U.S. Court of Appeals in James Ellis & Anr. V. Fidelity Management Trust Company and the Orders referred by the Hon'ble SAT in the matter of Price Waterhouse & Co & Ors v. SEBI viz., Bolam vs Friern Hospital Management Committee [1957] 1 WLR 582 and Eckersley & Others vs. Binnie & Others, the Court of Appeal (Civ Div).

(d) It is submitted that any judicial or quasi-judicial inquiry should apply the business judgment rule as the appropriate standard to judge decisions taken by the CEO of a mutual fund. Imposition of liability with the advantage of hindsight for good faith decisions will hamper exercise of subjective business judgment and produce suboptimal results for investors.

(e) The Noticee has ensured that qualified and experienced personnel are engaged in investment management and risk monitoring for the schemes of FTMF, including the Schemes.

(f) The investment team, comprising of specialised portfolio managers, takes investment decisions for the schemes of FTMF. Consistent with the role of the CEO as contemplated under regulations, the Noticee does not directly take investment decisions including buy/sell decisions with respect to individual securities; he relies on the significant expertise and experience of the portfolio management team, while exercising oversight over their functions with a view to ensure regulatory compliance and effective risk management.

(g) In doing so, the Noticee also taps into the expertise of the investment risk management team and leverages the comprehensive governance, oversight and risk mitigation framework implemented at the AMC including various specialised committees.

(h) The Noticee is involved in and exercises oversight over the process of identification, assessment and mitigation of all business and operational risks relating to the business of FTMF.

(i) The Noticee has ensured that a separate investment risk management function is in place for tracking and monitoring investment risks. The investment risk management function is a specialised function, requiring significant technical expertise and experience. Therefore, the Noticee has ensured that appropriately skilled personnel are part of such function and are able to discharge their role with due autonomy (including by leveraging Franklin Templeton's global resources), while at the same time exercising ultimate oversight over such function.

(j) The Noticee considers and reviews monthly reports on investment risks prepared by the Head-Risk Management and provides his comments and raises appropriate questions as necessary with respect to the same. It is also pertinent to note that FTMF has been managing a wide array of schemes across fixed income, equity, hybrid, overseas, feeder and multi-asset categories (39 open ended schemes including the six Schemes, 22 close ended schemes and 7 domestic fund-of-funds (FOF) schemes). In this regard, the Noticee exercises oversight over the entirety of FTMF's operations but necessarily relies on the specialised expertise brought to bear by the fund managers responsible for each individual scheme.

(k) The Noticee also proactively engages with industry bodies such as AMFI (including as a member of the board of AMFI and Chair of the AMFI operations and compliance committee) and where necessary, with the regulator, on implementation of new regulations or amendments to existing regulations and keeps himself updated on regulatory changes and updates. As a member of MFAC since January 2018, the Noticee has been actively contributing to

regulatory initiatives in a variety of areas including valuation, TER rationalisation, Pool Account usage, risk-o-meter etc.

(l) The Noticee also oversees the implementation of such regulatory changes at FTMF including those affecting the risk management function. In addition to presenting his updates and findings to the Noticee (in his capacity as CEO), the Head - Risk Management has the opportunity to present his independent views directly to the boards of directors of both the AMC (of which the Noticee is also a member) and the trustee of FTMF, viz., Franklin Templeton Trustee Services Private Limited (Trustee) at each board meeting.

(m) The Noticee, as the CEO, oversees all board reporting and reviews and approves all presentations made to the boards of the AMC and the Trustee, including presentations made by the Head – Risk Management as well as the Chief Investment Officers (CIOs).

(n) The Noticee is also actively involved in the process of monitoring and mitigation of all other types of business and operational risks. The Noticee chairs the Business Risk Management Committee (BRMC), which monitors all business-related risks impacting FTMF, other than (a) investment risks; and (b) technology risks, both of which are handled by specialised functions/committees owing to their technical and specialised nature, viz., the investment risk management function and the Information Technology Committee respectively.

(o) The Noticee regularly presents reports on business and operations risks ('Risk Management Update') to the boards of the AMC and the Trustee.

(p) A number of business verticals (including HR, Products/Sales, Fund Accounting, etc.) present their reports on the risks affecting their respective verticals at the BRMC. As chairman of the BRMC, the Noticee reviews the agenda and attached presentations / reports in advance of each meeting and gives his views on the same. The Noticee assesses and regularly reports the 'top risks' identified through the BRMC to the boards of the AMC and the Trustee.

(q) The Noticee also chairs the Information Technology Committee of the AMC, which also counts amongst its members an external technical expert. The Noticee regularly updates the board of the AMC on matters considered by the Information Technology Committee and on technology risks impacting the business, including appropriate mitigants with respect to the same.

13. Further, the Noticee 2 has made submissions with regard to the audit findings mentioned in Para 11 (A) and (D) above, which are identical to the submissions made by the Noticee 1 i.e., Trustee and hence, the same are not reproduced here for the sake of brevity.

14. The replies furnished by the Noticees 3 (Santosh Kamat, Chief Investment Officer), Noticee 4 (Kunal Agarwal), Noticee 5 (Sumit Gupta), Noticee 6 (Pallab Roy), Noticee 7 (Sachin Padwal Desai) and Noticee 8 (Umesh Sharma), who are Fund Managers, are summarized hereunder:

(a) *While Regulation 25(6B) of Mutual Fund Regulations delineates the general responsibilities of a fund manager, the Mutual Fund Regulations do not specifically lay down the standard of care, which would apply to a fund manager in discharge of his/her functions. In fact, the Mutual Fund Regulations were recently amended only with effect from 29 October 2020 to, inter-alia, provide a 'code of conduct' for the fund managers and dealers (in Part - B of the Fifth Schedule) laying down the specific responsibilities to be carried out by fund managers.*

(b) *Since, no specific guidance regarding the fund manager's duty of care is available in the regulations prevailing at the time of the alleged violations, reference must be made to available judicial precedents. In particular, reliance is placed on Jacob Mathew v. State of Punjab and Ors., wherein the Supreme Court of India had occasion to examine the standard of care which would apply to a professional, in discharge of his duties.*

(c) *Further, the Noticee place reliance on the judgments of the U.S. Court of Appeals in James Ellis & Anr. V. Fidelity Management Trust Company and the Orders referred by the Hon'ble SAT in the matter of Price Waterhouse & Co & Ors v. SEBI viz., Bolam vs Friern Hospital Management Committee [1957] 1 WLR 582 and Eckersley & Others vs. Binnie & Others, the Court of Appeal (Civ Div).*

(d) *In the absence of any guidance under the Mutual Fund Regulations, and in view of the specific judicial precedents discussed above, it is evident that the standard of care that a fund manager (as a professional) is expected to meet in the discharge of his/her responsibilities under Regulation 25(6B), is that of reasonableness and general prudence, having regard to the prevailing facts and circumstances. The yardstick to measure such standard would be a person of ordinary competence engaged in the same profession (and not a person of highest competence). Courts have also categorically warned against hindsight bias and held that the conduct of the professional ought not to be judged by the eventual outcome or performance in any given case. 8. It is respectfully submitted that in view of the above, so long as the fund manager meets the above standard of care in the discharge of his/her professional responsibilities, he/she would not be personally liable under Regulation 25(6B).*

(e) *In this context, it is submitted that the Noticee has performed his obligations in good faith and with reasonable prudence and diligence and has adequately* *met the above stated standard. In this regard, the Noticee has ensured that all investments by the Schemes were made in the best interest of the unitholders, in line with the objectives of the scheme and in consonance with regulations.*

(f) It is also pertinent that a differentiated investment strategy (involving investments in securities across the credit rating spectrum, as against primarily AAA-rated securities) had been formulated, with a view to achieve superior risk-adjusted returns for investors. Such strategy has been consistently followed for the Schemes and has delivered superior returns for investors for over a decade, even in times of wide-spread market stress. The Noticee has ensured that such strategy is in consonance with regulations and in the best interest of the unitholders.

(g) It is also submitted that business decisions taken by the Noticee for the Schemes are protected by the business judgment rule. The business judgment rule requires courts to focus on the decision-making process instead of a substantive evaluation of the merits of a management decision, while also warning against hindsight bias. In the absence of any malafide or some other corrupt ulterior motive, the Noticee may not be liable for errors of judgment (even assuming, but not conceding, that such errors took place), whether those mistakes are classified as mistakes of fact or mistakes of law.

(h) The Noticee, in its role, is required to take rational risk-integrated business decisions. It is submitted that any judicial or quasi-judicial inquiry should apply the business judgment rule as the appropriate standard to judge investment decisions made by the Noticee as the investment manager of FTMF. Holding the Noticee liable for regular and good faith investment decisions with the advantage of hindsight, will hamper and discourage business / investment decision making, and thereby, adversely impact the interests of investors.

(i) It is submitted that fund managers have flexibility to determine investment strategies and make investment decisions, subject to compliance with the overall regulatory framework and after making adequate disclosures to investors. Investment decisions made by fund managers are necessarily subjective, which require an exercise of business judgment and often an assessment of competing considerations. It is submitted that the exercise of such business judgment in the interests of investors ought not to be made the basis for adverse and punitive directions and that such a precedent will disincentivise fund managers from taking risk-weighted calls in the interest of investors.

(j) As such, it is emphasised that the appropriate yardstick would be to assess whether or not the Noticee acted reasonably and in good faith, given the prevailing circumstances, and the Noticee in any event ought not to be judged by the wisdom of hindsight.

(k) *It is submitted that even regular inspections conducted by SEBI (including the SEBI inspection for FY 2018-19, which specifically addressed compliance with the Categorization Circular) and the audit conducted in FY 19-20 by an external consultant (KPMG) pursuant to a SEBI mandate did not identify any material concerns with the scheme categorisation and the investment decisions. In fact, no such concerns have been raised in any manner until the turn of events arising from the impact of the Covid-19 pandemic.*

(l) *It is also noteworthy that regulations do not impose restrictions on having common fund managers across schemes. It is submitted that, SEBI's circulars dated 22 August 2011 and 15 March 2017, in fact, recognise the fact that the same fund manager may be managing multiple schemes. Such circulars provide that advertisement of performance data of a scheme must include performance of all other schemes managed by the concerned fund manager.*

15. A summary of the responses to the issue-wise allegations concerning the Noticees 3 to 8 – Fund Managers

B. PRACTICES RELATED TO INTEREST RATE RESET PAPERS AND CALCULATION OF MACAULAY DURATION

(i) Macaulay Duration computed appropriately

(a) *It is worth pointing out at the outset, that SEBI regulations do not define or provide the manner of computation of 'Macaulay duration'. In the absence of such regulation, it is standard practice to define Macaulay duration and describe its manner of computation in the Scheme Information Document (SID) for the relevant scheme. For this purpose, mutual funds rely on the accepted industry meaning of the term (see below).*

(b) *As such, the Notice ought to be set aside, inasmuch as no regulatory breach in relation to the manner of computation of Macaulay duration is made out (or even specifically alleged). Since there is no violation of SEBI regulations in relation to the manner of computation of Macaulay duration, the question of breach of the Categorization Circular also does not arise.*

(c) *Similarly, with respect to valuation, SEBI has cited its circular dated 18 September 2000 (Valuation Circular). In this context, while the Valuation Circular does deal with valuation of securities containing call options and/or put options, it does not deal with securities with interest rate resets coupled with call or put options (which are fundamentally different from securities with only call and/or put options, in terms of implications on interest rate risk of the security, as explained below). As such, the Valuation Circular, by its terms, does not even apply to interest rate reset papers, and the question of violation of such circular does not arise.*

(d) As submitted above, the appropriate standard for 'due diligence' in the present case would be reasonable care and prudence and doing "everything reasonable, not everything possible".

(e) In the context of computation of Macaulay duration and valuation, in the absence of specific regulatory requirements, the relevant yardstick to assess compliance by the Noticee would be whether, in the course of such computation, a reasonable basis rooted in industry practice was adopted and a process for such computation was followed, such that it met the requisite standard of care and due diligence.

(f) As set out below, the manner of computation of Macaulay duration is well-reasoned and backed by appropriate precedent. In addition, a robust process has been followed for computing the Macaulay duration of securities within the Schemes' portfolio in line with standard industry practice, wherein computations were obtained from two AMFI appointed independent valuation agencies (CRISIL and ICRA), in line with regulatory requirements.

(g) Specifically, the Macaulay duration for a scheme is calculated in the following manner:

i. The Macaulay duration of each individual security is independently calculated and shared by two independent valuation agencies i.e., CRISIL and ICRA, on a daily basis. The valuation agencies make this determination based upon an independent review of the investment memorandum of the securities in question. The same Macaulay duration is generally used by all fund houses, which hold the same security.

ii. For each security in the portfolio of a scheme, the Macaulay duration of the security is calculated as the average of the Macaulay duration provided by the two independent valuation agencies.

iii. Thereafter, the holding percentage of each security in the portfolio of the scheme is multiplied by the Macaulay duration of the respective securities.

iv. The summation of this result for all the securities in the portfolio of the scheme provides the Macaulay duration of the scheme, which is the weighted average of the Macaulay duration of the individual securities in the portfolio.

(h) Even with respect to valuation, in the absence of regulatory guidance, the Noticee has followed a well-reasoned approach in line with understood industry concepts. This approach is also consistent with the position advocated for by AMFI. In this context, reference is made to Annexure B1, which contains the minutes of an AMFI Valuation Committee meeting held on

15 June 2018, where the valuation of rate reset papers was discussed with CRISIL and the AMFI Valuation Committee's feedback was provided on the same to CRISIL.

(i) *As submitted above, it should be noted that regulations do not define Macaulay duration. The concept of 'duration' (including, specifically, Macaulay duration), as a financial / industry term, is meant to measure interest rate risk as it reflects the portfolio's price sensitivity to changes in market interest rates (i.e., it indicates the degree by which the value of the portfolio will change relative to a change in market interest rates).*

(j) *The degree by which a portfolio's price moves in response to a corresponding movement in market interest rates is a function of the following factors:*

   i. *Maturity: The price of bonds with longer maturity would have greater sensitivity to changes in market interest rate, since cashflows are locked in at the prevailing yield for a longer time period, while market interest rates can change in the intervening period.*

   ii. *Coupon rate: The coupon rate of the bond also determines the extent of impact that a movement in market interest rate will have on the price of the bond. All else being equal, prices of lower coupon-rate bonds are affected to a greater degree by movements in market interest rates (relative to higher-coupon bonds).*

   iii. *Repayment schedule: The greater the amount of periodic repayments (e.g., amortizing bonds), the lesser the sensitivity of the bond's price to intervening changes in market interest rates (since the amount of reinvestments of such periodic repayments will be at prevailing market yields).*

(k) *These factors together determine the 'interest rate risk' of the bond (i.e., the susceptibility of the bond's price to fluctuate in response to fluctuating market interest rates). The 'Macaulay duration' is a quantitative measure of such interest rate risk and is calculated by considering each of the above factors as inputs within its formula. The formula for computing Macaulay duration has a defined understanding within the financial sector (and has been disclosed in the scheme information documents for the Schemes).*

(ii) Interest rate reset clauses

(a) *The Notice cites seven issuers, where, according to the Notice, there were concerns in the interest reset clause, such that it affected FT's right to obtain an interest rate reset.*

i. Edelweiss Rural and Corporate Services Limited (ERCSL) and Edelweiss Commodities Services Limited (ECSL) (ISIN INE657N07381 and ISIN INE616U07036)
ii. AASAN Corporate Solutions Private Limited (ISIN INE081T08090 and ISIN INE81T07027)
iii. Piramal Realty Private Limited (ISIN INE680R07012)
iv. Indostar Capital Finance Limited (ISIN INE896L07660)
v. ECSL (ISIN INE657N07605 and ISIN INE657N07597)
vi. JM Financial Credit Solution Limited (ISIN INE651J07739)
vii. Motilal Oswal Housing Finance Limited (ISIN INE658R08149)

(b) Noticee's responses to these seven cases can be classified under three broad heads –

A. <u>Head A</u>

i. *Edelweiss Rural and Corporate Services Limited (ERCSL) (ISIN-INE657N07381); and*

ii. *Edelweiss Commodities Services Limited (ECSL) (ISIN INE616U07036)*

(i) According to the Notice, the relevant term sheet contains the following clause:

"Issuer through the Debenture Trustee has an <u>option</u> to propose revised interest rate to the investors via 'Interest rate reset notice' at least 60 calendar days prior to the interest rate reset date. If Issuer proposes revised interest rate, investors have option to accept or reject the proposed revised interest rate and shall communicate the decision of acceptance/rejection at least 45 business days prior to the interest reset date. NCDs held by these investors, to whom the proposed interest rate/ coupon rate is not acceptable, shall be mandatorily redeemed on the interest rate reset date."

(ii) However, the above provision, as extracted at paragraph 20(i)(c) of the Notice, is not found in the relevant term sheets.

(iii) On the contrary, the relevant provision appearing in the term sheet reads as under:

"revised interest rate / coupon rate <u>will</u> be mutually decided between the Issuer and the Debenture Trustee…" and for this purpose "..the Issuer <u>will</u> communicate via 'Interest Reset Notice', the Proposed revised Interest rate/Coupon rate to Debenture Trustee"..

(iv) *Further, the clause confers an exit option upon the bond-holder in the following terms:*

"NCDs held by those investors, to whom the proposed revised Interest rate/Coupon rate is not acceptable, <u>shall be mandatorily redeemed</u> on the Interest reset date".

(v) *Therefore, in these two cases, FTMF was justified in using the interest reset date for calculation of Macaulay duration.*

B. <u>Head B</u>

(a) Indostar Capital Finance Limited (ISIN INE896L07660); (Paragraph 20(iv) of the Notice)

(b) Edelweiss Commodities Services Limited (ISINs INE657N07605 and INE657N07597) (Paragraph 20(v) of the Notice); and

(c) JM Financial Credit Solution Limited (ISIN INE651J07739) (Paragraph 20(vi) of the Notice)

(i) In the above three cases, there is a rate reset clause, which however is subject to a cap on the spread.

(ii) The table below indicates that, whereas there may be a cap on the spread, the interest rate on the bond itself is subject to the fluctuations in the SBI MCLR rate, thus making the interest rate a floating rate. If that be so, the fact that there is a cap on the spread would not disentitle FTMF to use the reset date for calculating the Macaulay duration.

Issuer	***Initial Interest Rates***	***Cap on Spread***
Indostar Capital Finance Limited (ISIN INE896L07660)	*SBI (MCLR) + 2.25%*	*Additional 1% spread, over initial spread of 2.25%*
Edelweiss Commodities Services Limited (ISIN INE657N07605)	*SBI (MCLR) + 1.50%*	*Additional 1% spread, over initial spread of 1.50%*

Edelweiss Commodities Services Limited (ISIN INE657N07597)	*SBI (MCLR) + 1.50%*	*Additional 1% spread, over initial spread of 1.50%*
JM Financial Credit Solution Limited (ISIN INE651J07739)	*SBI (MCLR) + 1.60%*	*Additional 3% spread, over initial spread of 1.6%*

(iii) A further right to reset the spread over the benchmark was included to provide an additional layer of mitigation against change in interest rates. It was only this second level of reset which was subject to a floor / cap.

(iv) Therefore, FTMF was justified in using the interest reset dates for calculating Macaulay duration.

C. <u>Head C</u>

(a) AASAN Corporate Solutions Private Limited (ISIN INE081T08090 and ISIN INE81T07027) (Paragraph 20(ii) of the Notice);

(b) Piramal Realty Private Limited (ISIN INE680R07012) (Paragraph 20(iii) of the Notice); and

(c) Motilal Oswal Housing Finance Limited (ISIN INE658R08149) (Paragraph 20(vii) of the Notice)

(i) In the above three cases, the terms did not include an explicit exit option for the bond-holder or assurance of a rate reset.

(ii) However, there was in fact a commercial understanding with the issuer that the interest rate could be reset depending on fluctuations in the market interest rates.

(iii) In point of fact, in respect of each of these above three cases, the interest rate was reset from time to time in line with the commercial understanding, as will be found from Annexure 1 to this Note which is also found at Page 143 of the Response.

(iv) FTMF is accordingly justified in calculating Macaulay duration with reference to the interest rate reset date.

(c) Further, in addition to the seven issuers identified in the Notice, interest rate reset provisions appear in 26 other instances amongst bonds subscribed to be by the Schemes. Out of this, in 24 instances, FTMF had an unambiguous right to reset the interest rate as well as an accompanying put option on the interest rate reset date.

(d) In the remaining two instances (viz., Indostar Capital Finance Limited (ISIN INE896L07561) and Shriram Transport Finance Company Limited (ISIN INE721A070I4)), it is acknowledged that the interest reset process was at the instance of the issuer. However, even in these two cases, the interest rate was in any case pegged to a market benchmark (i.e., the SBI MCLR and Reuters-page JNCDFIX). Moreover, even with respect to these two cases, the following may be noted:

i. *In case of Shriram, the bonds were purchased in the secondary market in July 2019. While the next interest reset date was scheduled for March 2020, a part of the exposure was in any case sold in October 2019 and December 2019.*
Significantly, FTMF was able to exit the remainder of its exposure as part of the interest reset process in March 2020, clearly demonstrating that it was always the commercial intent that the bond-holder would have an exit option in conjunction with the interest rate reset.

ii. *In case of Indostar, there was a commercial understanding that the rate would be reset and the rate was, in fact, reset on a quarterly basis.*

(e) It is significant to note that the computations of Macaulay duration for each security in the portfolio were provided on a daily basis by two independent valuation agencies (CRISIL and ICRA). The valuation agencies provided such computation based on their own independent analysis of the transaction terms/documents. The same process is followed by all mutual funds.

(f) Lastly, Macaulay duration is different from maturity, and is meant to measure interest rate risk and not liquidity. This is consistent with disclosures made under the SIDs of the schemes and the characteristics of the duration-based schemes as defined under the Categorization Circular, neither of which make mention of the maturity of the underlying portfolio. Accordingly, the Macaulay duration of an ultra-short duration fund of 3-6 months, indicates a low interest rate risk but does not indicate the liquidity or maturity profile of the portfolio.

(iii) Non-exercise of options

(a) It has been alleged that in 42 instances (for FI-UBF) and 17 instances (for FI-LDF), exit options were in fact not exercised where available in FI-UBF and FI-LDF.

(b) Firstly, the Notice does not specify which regulation has been breached. Secondly, whether the put option / interest reset right will be exercised at an interest rate reset date will be a business decision by the investment manager taken in his best judgment at the relevant time. It has not been alleged that there was any lack of diligence in taking such a decision.

(c) With respect to each security identified in the Notice, certain factual clarifications are set forth under Annexure B6 of the Response which demonstrates that each decision was undertaken based on sound business considerations.

(d) Illustratively, in a large number of cases, the interest rate was increased to a rate higher than the market yield of the security at the time or an early exit was effectively secured (Paragraph 16 at Page 61-62 of Response).

For example, in case of FI-UBF –

(i) 10.8% RENEW (28SEP2022 P/C 27SEP2019) - the rate was reset to 12.65% on 27 September 2019, which was higher than the market yield rate of the security as on the same date (11.4%);
(ii) 9.60 AASAN SERIES II 13MAR2020 (P/C RATE REST EVERY QUARTER) - the rate was reset to 14.5% on 13 September 2019, which was higher than the market yield rate of the security as on the same date (10.35%); and
(iii) 11.50% CLIX CAPITAL SERIES A 06MAY2021 (P/C 06MAY2019 06NOV2019 06MAY2020 06NOV2020) - the rate was reset to 12.5% on 6 November 2019, which was higher than the market yield rate of the security as on the same date (11.5%).

In case of FI-LDF –

(i) 9.00% PEL 29MAY2020 (P/C 16DEC2018 16MAR2019 16JUN2019 16SEP2019 16DEC2019 16MAR2019) - the rate was reset to 10% on 16 March 2020, which was higher than the market yield rate of the security as on the same date (9.63%).

(e) In some cases, the interest rate was already above the market yield of the security at the time. In such cases, the interest rate reset option was not exercised since the investment was already generating superior returns. However, even in some of these cases, the reset option was exercised, and the rate was effectively reset to an even higher rate.

For example, in case of FI-UBF –

(i) 11.50% CLIX CAPITAL SERIES B 06JUL2021 (P/C 06MAY2019 06NOV2019 06MAY2020 06NOV2020 06MAY2021) – the already agreed rate (11.5%) and the reset rate (12.5%) on 6 December 2019 were both higher than the market yield rate of the security as on the same date (11.4%);

(ii) 11.50% CLIX CAPITAL SERIES D 12NOV2021 (P/C 12AUG2019 12FEB2020 12AUG2020 12FEB2021 12AUG2021) - the already agreed rate (11.5%) was higher than the market yield rate of the security as on 12 August 2019 (9.55%); and

(iii) STFC (INCD3M+SPREAD) 11MAR2021 P/C 11MAR2020 - the already agreed rate (9.22%) was higher than the market yield rate of the security as on 11 March 2020 (8.45%).

In case of FI-LDF –

(i) 11.96% RENEWSOLAR (01NOV2022 P/C 01NOV2019) – the already agreed rate (11.96%) and the reset rate (13.16%) (the interest rate reset option was exercised on 1 November 2019) were both higher than the market yield rate of the security as on 1 November 2019 (10.88%);

(ii) STFC (INCD3M+SPREAD) 11MAR2021 P/C 11MAR2020 - the already agreed rate (9.22%) was higher than the market yield rate of the security as on 11 March 2020 (8.45%); and

(iii) INDOSTAR CAPITAL SR XXXI (SBI MCLR+SPREAD) QTRLY P/C 2NOV2021 - the already agreed rate (9.85%) was higher than the market yield rate of the security as on 2 November 2019 (9.54%) and the reset rate of 13.1% (as on 2 February 2020) was higher than the market yield rate of the security as on 2 February 2020 (12%).

(f) In some cases, an increase in interest rate was negotiated in consideration for refraining from or deferring the exercise of the put option. This also benefitted the Schemes since the put option was effectively leveraged to secure an increase in the coupon.

For example, in case of FI-UBF –

(i) 9.60% RENEW QTRLY (26FEB2021 DCO 26AUG2018 CO 26FEB2019 P/C 26AUG2019) - the rate was increased to 12.75% on 26 August 2019, which was higher than the market yield rate of the security as on the same date (11.52%); and

(ii) 0% HEROSOLAR (21JUN2022 P/C 20DEC2019 20JUN2020 20DEC2020 20JUN2021 20DEC21 20JUN2022) - the rate was increased to 11.25% as on 20 December 2019, which was higher than the market yield rate of the security as on the same date (10.91%).

In case of FI-LDF –

(i) 9.60% RENEW QTRLY (26FEB2021 DCO 26AUG2018 CO 26FEB2019 P/C 26AUG2019) - the rate was increased to 12.75% on 26 August 2019, which was higher than the market yield rate of the security as on the same date (11.52%); and

(ii) 10% HEROWIND (08FEB2022 P/C 07FEB2020) - the rate was increased to 10.9% on 7 February 2020.

(g) It would be incorrect to state that the non-exercise of put options in the instances cited in the Notice compromised the liquidity position of the schemes in question (viz., FI-UBF and FI-LDF) including for the following reasons –

- *(i) The put option is a right available to the fund management team. There is no requirement that the same must be exercised in each case and the decision on whether or not to exercise the same takes into account various considerations with the immediate liquidity position of the relevant scheme being one such consideration.*
- *(ii) All relevant considerations were taken into account and there was clear commercial rationale which informed the decision each case.*
- *(iii) The Notice incorrectly assumes at paragraph 26 that the "debenture holder could not exit from the investments on the pre-decided call/put and interest reset dates even when there was requirement of funds".*
- *(iv) This is evident from the fact that FTMF was comfortably able to meet all redemption requests throughout the period in question. For reference, the net cash-flows of FI-UBF and FI-LDF for FY 19-20.*
- *(v) The Notice does not establish a correlation between non-exercise of these put options and any liquidity issues for these Schemes. These Schemes were able to meet all liquidity requirements until April 2020, and the liquidity crisis at that time was occasioned on account of the market dislocation caused by the COVID-19 pandemic and the associated lock-downs, which could not have been foreseen.*
- *(vi) The liquidity crisis faced by these Schemes in April 2020 was not attributable to any non-exercise of a put option. Mutual funds are expected to deploy funds in suitable investments in the interests of their investors. It is submitted that even if a put option had been exercised in say, November 2019 or December 2019, the Scheme would have only been expected to deploy the cash in another suitable investment in the ordinary course.*
- *(vii) Given this, where an existing investment carried a good yield and constituted sound credit, the fund managers at times chose to remain invested in the same (as against exercising the put option and then deploy the same cash in a new investment instead).*
- *(viii) The fund management team was proactive in securing sales and prepayments as necessary, at times even in the absence of contractual put options. For instance, in March and April 2020, the FT-AMF was able to sell or obtain prepayment from various issuers including Pipeline Infrastructure Private Limited, Vastu Housing, Aptus Housing, Bharti Airtel, SBFC, OPJ Trading etc.,*

C. VALUATION PRACTICES

(a) The allegations in the Notice under this head relate to two specific instances involving two issuers – OPJ Trading and Future Group, both of which are addressed below.

OPJ Trading

(b) On 16 October 2017, four Schemes invested in NCDs issued by OPJ Trading.

- *(i) Pursuant to a 25 October 2019 amendment to the DTD, a put option coming up on 16 October 2019 was deferred to 31 December 2019 in lieu of an increase in coupon from 14% to 16% and an increase in security cover from 2.7x to 3.75x.*
- *(ii) The put option was again deferred (first, to 31 January 2020, then to 28 February 2020 and finally, to 31 March 2020), in each case, in lieu of additional one-time fees.*
- *(iii) The relevant changes were communicated to valuation agencies on 23 March 2020.*
- *(iv) Exposure was prepaid in full on 7 April 2020.*

(c) At the outset, it is submitted that there was no default by OPJ Trading at any point. The put option in question was not linked to a default; instead, it was a commercially negotiated right which could be exercised on FTMF's option on certain agreed dates.

(d) Paragraph 35(a)(xx) at page 42 of the Notice states that – "This reflects that issuer was unable to pay and FT-AMC has neither disclosed the said information for valuation purposes nor has taken into account the stress of the issuer for the purpose of fair valuation of securities". This assumption is incorrect for the following reasons –

- *(i) The issuer had been servicing its payment obligations regularly and was in compliance with applicable financial covenants.*

- *(ii) In fact, the issuer discharged its payment obligations in full in April 2020 ahead of the scheduled maturity, as acknowledged in the Notice itself. The issuer made partial prepayment of INR 17.10 crores in March 2020 and paid the remaining amount of INR 171.09 crores in April 2020.*

- *(iii) It is submitted that non-exercise/deferral of put option does not automatically imply financial stress in the issuer (as alleged in paragraph 35(a)(xx) at page 42 of the Notice). This is particularly in view of the fact that the issuer offered to pay additional interest for that period / one-time fees and had provided legitimate commercial reasons for seeking a deferral of the put option, i.e., OPJ was expecting substantial cash flows from a sale of promoter-owned asset in some time, which it intended to use to retire FTMF's exposure.*

- *(iv) In paragraph 35(a)(xiii) at page 41, the Notice also refers to one occasion where the formal amendment to the debenture trust deed was executed 10 days after the option exercise date, and alleges that such delay indicates that the issuer was unable to pay on the relevant date and therefore the put option was subsequently deferred. This assumption is incorrect. It is clear from an email dated 10 October 2019 (i.e., prior to the option exercise date) that the deferral of the put option* *had already been agreed. The email recorded that formal document would follow thereupon.*

(v) The investment in OPJ was also secured by high quality collateral, i.e., a pledge over highly liquid listed securities (with original security cover being 2.7x, which was further increased to 3.75x in October 2019). In other words, FTMF was substantially insulated from any credit risk associated with the issuer's business. The investment was significantly over-collateralized. In this context, seeking higher coupon/one-time fee in lieu of deferral of put option was a legitimate commercial decision made in good faith in the interest of investors. The significance of such collateral was also noted by the credit rating agency, in the course of assigning / reviewing credit rating of OPJ NCDs.

(vi) The Noticee had no reason to believe that the issuer was under any financial stress, which called for an adjustment to the valuation. Hence, the question of breach of principles of fair valuation on account of failing to take into account the purported 'stress' ought not to arise.

(vii) Deferral of a put option is not included in the list of material events that may require review of credit rating (as set forth by SEBI in its circulars SEBI/ HO/ MIRSD/ MIRSD4/ CIR/ P/ 2017/ 71 dated 30 June 2017 and SEBI/ HO/ MIRSD/ DOS3/ CIR/ P/ 2018/ 140 dated 13 November 2018).

(viii) In view of the fact that the Noticee had no reason to believe that the issuer was facing any financial stress, the question of reporting to rating/valuation agencies did not arise.

(ix) There is also no requirement under SEBI regulations to intimate deferral of put options to rating/valuation agencies. The requirement to intimate credit rating agencies and valuation agencies is limited to cases of default and changes in terms of investment.

(x) Receipt of a one-time penalty does not constitute a "change in the terms of investment" such that it would need to be reported to credit rating agencies and valuation agencies. The Notice does not dispute the submission (made in FT's reply to the audit report) that, in any event, since such penalty was received immediately (and was accounted for as interest income), the valuation of the security would not have been impacted.

Future Group

(a) On 13 April 2020, Future Group requested for moratorium / deferment of interest / principal payment on account of COVID-19 lockdown and resultant impact on cashflows. On 18 April 2020, FTMF communicated its intent to grant such moratorium.

(b) The formal confirmation letter from the debenture trustee was obtained on 27 April 2020. On 28 April 2020, FTMF communicated the acceptance of moratorium proposal to the valuation agencies.

(c) In the past (vide an email dated 30 July 2019), the valuation agency had communicated to FTMF that changes to terms of investments cannot be processed and reflected in the valuation until formal documents reflecting the revised terms are shared.

(d) Valuation agency (CRISIL), in an email dated 25 September 2019, had also clarified, with respect to SEBI's circular dated 24 September 2019 that is relied on in the Notice, that reporting of changes to the terms of securities would need to be accompanied by formal documents.

(e) The principles of fair valuation do not provide any objective standard; instead, these are general principles meant to be utilised for undertaking valuation of securities in good faith. In fact, it is specifically stated that these are 'overarching principles. Therefore, the question of breach of principles of fair valuation ought not arise, so long as the AMC has acted diligently in good faith and taken into account relevant considerations.

(f) In the course of considering the implications of the moratorium, guidance was also drawn from the following factors –

(i) RBI's decision (applicable to banks and NBFCs) that rescheduling of payments on account of COVID-19 pandemic would not be considered as a default for reporting purposes (RBI Notification dated 27 March 2020 on 'COVID-19 – Regulatory Package' and Press Release dated 27 March 2020 on 'Statement on Developmental and Regulatory Policies').
(ii) SEBI's circular dated 30 March 2020, which recognized the impact of the COVID-19 pandemic and advised credit rating agencies that rescheduling of payments arising from the impact of the pandemic need not be recognized as a default

(g) The above approach was also consistent with a subsequent circular by SEBI dated 23 April 2020, which contained certain relaxations in valuation norms in view of the COVID-19 pandemic. It was expected at the time that such guidance would be provided shortly.

(h) In a separate matter, Future group had been given protection by the Bombay High Court in end-March 2020 from actions by a debenture trustee to sell off pledged shares of Future Retail.

(i) It was therefore the considered view of the fund management team in good faith after taking into account the relevant considerations and available information, that the proposed moratorium did not call for a write-down in valuation of the investment.

16. Further, the Noticees 3 to 8 made submissions with regard to the audit findings mentioned in Para 11 (A) and (D) above, which are identical to the submissions made by the Noticee 1 i.e., Trustee and hence, the same are not reproduced here for the sake of brevity.

17. The submissions made by the Noticee 9 i.e., Saurabh Gangrade, Chief Compliance Officer is summarized hereunder:

(a) *It is submitted that the allegations in the Notice ought to be set aside on the basis that they fail to consider the specific role and responsibilities of the CO as contemplated under the Mutual Fund Regulations and the well-settled legal principles relating to applicable standards of diligence and the exercise of business judgment in the discharge of such professional responsibilities. No case for a breach on the part of the Noticee is made out, when the allegations as stated are tested against these standards (without prejudice to any of the other submissions).*

(b) *The standard of care that the CO would be expected to meet in the discharge of his responsibilities under Regulation 18(4)(d), is that of reasonableness and general prudence, having regard to the prevailing facts and circumstances.*

(c) *While Regulation 18(4)(d delineates the general responsibilities of the CO, the Mutual Fund Regulations do not specify the standard of care and diligence, which apply to a CO in the discharge of such professional functions. Accordingly, guidance may be drawn from relevant judicial precedents. In this regard, reliance is placed on the decision of the Hon'ble Supreme Court of India in Jacob Mathew v. State of Punjab and Ors , wherein the court examined the standard of care applicable to a professional in the discharge of his duties. Further, the Noticee place reliance on the judgments of the U.S. Court of Appeals in James Ellis & Anr. V. Fidelity Management Trust Company and the Orders referred by the Hon'ble SAT in the matter of Price Waterhouse & Co & Ors v. SEBI viz., Bolam vs Friern Hospital Management Committee [1957] 1 WLR 582 and Eckersley & Others vs. Binnie & Others, the Court of Appeal (Civ Div).*

(d) *It is submitted that any judicial or quasi-judicial inquiry should apply the business judgment rule as the appropriate standard to judge decisions taken by the CO of a mutual fund. Imposition of liability with the advantage of hindsight for good faith decisions will hamper exercise of subjective business judgment and produce sub-optimal results for investors.*

(e) *In particular, it is submitted that the allegations are not sustainable when tested against the above-stated standards since*

i. Good faith conduct on the part of the Noticee ought not to be judged with the wisdom of hindsight.;
ii. The allegation is not premised on the breach of any specific regulation
iii. The allegations have also not been tested against the appropriate standard of due diligence applicable in the case

(f) Since the appointment of the Noticee as CO, FTMF, the AMC and Trustee have been inspected by SEBI appointed auditors for the period FY 2014-2016, FY 2016-17, FY 2017-18 and FY 2018-19. It is pertinent to note that none of the inspection reports identified material or significant breaches and to the extent there were any adverse observations in the inspection reports, these were due to inadvertent operational errors which were anomalous and immaterial. Such errors were duly and promptly corrected in all cases with the inputs and guidance of the Noticee, and processes and controls have been implemented to avoid recurrence of such issues. It may also be noted that during these audits, inspections or during regular interactions with SEBI officials, the Noticee has always maintained a high standard of professional conduct and fully cooperated with the auditors and representatives of SEBI.

(g) SEBI, through letters dated 9 July 2018 and 30 July 2019 (annexed at Annexure 2) to AMFI had advised mutual funds to take corrective actions on various observations arising out of SEBI inspections of mutual funds for the period FY 2014-16 and FY 2016-17 respectively. It may be noted that out of 25 and 23 observations noted by SEBI in the aforesaid letters (for the periods FY 2014-16 and FY 2016-17 respectively), only 2 and 3 observations respectively were applicable to FTMF. It may also be noted that for many other observations, FTMF already had in place better systems and processes to ensure compliance with SEBI guidelines.

(h) The Noticee has ensured that FTMF follows various practices in line with regulatory expectations. Following are some instances:

- *Quality of reporting and disclosures- Factsheet disclosures of FTMF have consistently been in line with best practice guidelines provided by AMFI;*
- *Half yearly reports- Half yearly reports from the Trustee to SEBI (prepared with the assistance of the CO) provides various disclosures beyond the mandated format of the report.*
- *Treatment of differential TER between direct and regular plans. Management fees charged in direct and regular plans have always been consistent. This practice was also noted as a best practice by the SEBI inspection team appointed for the period 2014-2016; and*

(i) In addition, FTMF, under the guidance of the Noticee, has implemented various best practices before the same had been mandated by SEBI. Few examples in this regard may be noted below:

- *Obtaining independent prices of securities from valuation agencies for the purpose of carrying out Inter-Scheme Transfers (ISTs) in debt securities; o Prohibiting inter scheme transfer of equity trades;*
- *Obtaining independent recommendations on voting from proxy voting agents; Implementation of Stewardship Code before the due date for implementation; and*
- *Change of internal auditors to ensure enhanced fund governance although the same was not required in the relevant SEBI circulars (SEBI had only advised rotation of statutory auditors and independent directors).*

(j) As submitted in detail below, the Noticee exercised active oversight over the preparation of FTMF's proposal in terms of the Categorization Circular (defined below). The Noticee also actively engaged with SEBI at the time with regard to such proposal. At no point during such process or thereafter (including under a SEBI audit which specifically considered compliance with the Categorization Circular) did the Noticee have any reason to believe that the recategorized schemes were not in compliance with the Categorization Circular in any respect.

18. Further, the Noticee 9 made submissions with regard to the audit findings mentioned in Para 11 (A) above, which are identical to the submissions made by the Noticee 1 i.e., Trustee and hence, the same are not reproduced here for the sake of brevity.

19. I note that all the Noticees filed an application for settlement of the proceedings under the provisions of SEBI (Settlement Proceedings Regulations), 2018, which was subsequently rejected by the Competent Authority.

20. Thereafter, in order to conduct an inquiry in the matter, in terms of Rule 4(3) of SEBI Adjudication Rules, the Noticees were given an opportunity of personal hearing on May 20, 2021, which was communicated vide notice dated May 11, 2021. However, in pursuance of the request made by the Noticees for short adjournment, the hearing was rescheduled to May 24 and May 25, 2021. In view of the difficulties by all concerned owing to Covid-19 pandemic, the hearing was conducted through videoconference on Webex platform. On the scheduled dates of hearing i.e., May 24 and May 25, 2021, the Authorized Representatives (ARs) of the Noticees (Mr. Janak Dwarkadas, Senior Advocate, Mr. Mustafa Doctor, Senior Advocate and Mr. Saurabh Gangrade, Chief Compliance Officer, FT-AMC) appeared before me through videoconference and reiterated the submissions made by the Noticees vide

email dated January 29, 2021. The ARs sought additional time till May 31, 2021 to make fresh submissions, which was acceded to.

21. On behalf of all the 9 Noticees, the AR vide email dated made additional submissions. I note from the submissions made by the Noticees that most of the submissions were similar to the replies furnished vide email dated January 29, 2021, which are not repeated for the sake of brevity. The additional submissions made by the Noticees are summarized hereunder:

a) *As on 16 May 2021, the NAV of the six Schemes is higher than their NAV as on the date of the decision to wind-up the Schemes (i.e., 23 April 2020). Rs. 14,572 crores have been distributed to unitholders pursuant to the Orders of the Hon'ble Supreme Court approving the winding up of the Schemes. In other words, investors have benefitted from the performance of the Schemes over an extended period. Such performance was achieved while consistently following the same investment strategies. All requisite disclosures of risk and portfolios were duly made to investors.*

b) *The table below will show that the role and responsibilities of each of the fund managers were different, for instance, some of the fund managers were responsible only for certain schemes.*

Sl. No.	Noticee	Role and Responsibilities
1.	**Noticee 3** (Santosh Kamath)	Chief Investment Officer (CIO) - Fixed Income and fund manager for the six Schemes.
2.	**Noticee 4** (Kunal Agarwal)	Out of the six schemes, the Noticee has been involved in the management of four Schemes, namely, FISTIP, FILDF, FIIOF and FICRF.
3.	**Noticee 6** (Pallab Roy)	Out of the six schemes, the Noticee has been a co-manager of FIUBF only. The Noticee is managing the following other schemes of FTMF - Franklin India Floating Rate Fund, Franklin India Liquid Fund, Franklin India Savings Fund and Franklin India Overnight Fund.
4.	**Noticee 7** (Sachin Padwal Desai)	Out of the six Schemes, the Noticee is a co-manager of FIDAF. In addition, he was also a co-manager for FIUBF until 25 October 2018. The Noticee is managing the following other schemes of FTMF - Franklin India Government Securities Fund, Franklin India Corporate Debt Fund, Franklin India Banking

Sl. No.	Noticee	Role and Responsibilities
		and PSU Debt Fund, Franklin India Equity Hybrid Fund (Debt Portion), Franklin India Pension Plan (Debt Portion), Franklin India Debt Hybrid Fund (Debt Portion), Franklin India Equity Savings Fund (Debt Portion) and Fixed Maturity Plans (100% AAA).
5.	**Noticee 8** (Umesh Sharma)	Out of the six schemes, the Noticee is a co-manager of FIDAF only. The Noticee has been managing the following other schemes of FTMF - Franklin India Government Securities Fund, Franklin India Banking & PSU debt Fund, Franklin India Floating Rate Fund, Franklin India Overnight Fund, Franklin India Corporate Debt Fund, Franklin India Liquid Fund, Franklin India Savings Fund, Franklin India Equity Savings Fund (Debt Portion), Franklin India Debt Hybrid Fund (Debt Portion), Franklin India Equity Hybrid Fund (Debt Portion), Franklin India Pension Fund (Debt Portion) and Franklin India Fixed Maturity Plans.
6.	**Noticee 5** (Sumit Gupta)	Out of the six schemes, the Noticee had been a co-manager of FICRF and FIIOF only until 1 August 2018. Post 1 August 2018, the Noticee ceased to be employed with the AMC. A number of allegations in the Notice relate to the time period after the cessation of the Noticee's employment with the AMC; therefore, the Noticee does not have any personal knowledge or involvement in such matters – details are as follows: (a) In Issue A (*multiple schemes run in similar manner*), certain data relied upon in the Notice to impute similarities between the Schemes, i.e., *'Three Schemes had similar Macaulay durations', 'Common investments across Schemes'* and *'Similar investment pattern'* pertains to the period after cessation of the Noticee's employment with the AMC. (b) In Issue B (*practices related to interest rate reset papers and calculation of Macaulay duration*): (a) Five out of seven securities cited in the Notice (i.e., other than Edelweiss Rural & Corporate Services Limited and Aasan Corporate Solutions Private Limited) relate to investments made by the Schemes after the cessation of the Noticee's employment with the AMC. (b) In relation to observations on *'non-exercise of exit option in certain cases'*, the period under review in the Notice (i.e., FY 2019-20) relates to the period after the cessation of the Noticee's employment with the AMC. (c) In Issue C (*valuation practices*), the two specific instances cited in the Notice (i.e., OPJ Trading and Future) relate to the time period after the cessation of the Noticee's employment with the AMC. (d) In Issue D.1 (*high exposure in unlisted / illiquid debt securities*): (a) The Schemes did not face any liquidity concerns while the Noticee was the fund manager. (b) All investments in unlisted securities made under management of the Noticee (i.e., prior to 1 August 2018) pre-date SEBI's circular on unlisted securities introduced on 1 October 2019.

c) *The Noticees have not made any gains or unfair advantage as a result of the alleged defaults. No such allegation is made in the Notice. The Noticees have* *acted in good faith at all times. As demonstrated above, the Schemes have been running transparently, with complete disclosures of investment strategy, risks and portfolios to investors and to SEBI. The Schemes have generated superior returns for investors for a number of years.*

CONSIDERATION OF ISSUES, FACTS OF THE CASE AND FINDINGS

22. After perusal of the material available on record, I have the following issues for consideration viz.,

I. Whether the Noticees have violated the relevant provisions of SEBI (Mutual Funds) Regulations and the Circulars dated July 27, 2000, September 18, 2000, September 30, 2002, September 13, 2012 October 6, 2017, December 4, 2017, September 24, 2019 and November 6, 2019?

II. Whether the Noticees are liable for monetary penalty under Sections 15A(b), 15D(b), 15D(f) and 15HB of the SEBI Act?

III. If so, what quantum of monetary penalty should be imposed on the Noticees?

ISSUE I: Whether the Noticees have violated the relevant provisions of SEBI (Mutual Fund) Regulations and the Circulars dated July 27, 2000, September 18, 2000, September 30, 2002, September 13, 2012 October 6, 2017, December 4, 2017, September 24, 2019 and November 6, 2019?

23. Before moving forward, it is pertinent to refer to the significant portions of the relevant provisions of the SEBI (Mutual Fund) Regulations and the Circulars, alleged to have been violated by the Noticees.

REGULATIONS/ CIRCULARS	REGULATION, ETC.	DETAILS
MUTUAL FUNDS REGULATIONS	**Regulation 18(4)(d), 18(7), 18(8), 18(9) and 18(22)**	***Rights and Obligations of the Trustees*** *18(4)(d) - The trustees shall ensure before the launch of any scheme that the asset management company, has appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors grievances;*

		18(7) - The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme; *18(8) - The trustees shall ensure that the asset management company has been managing the mutual fund schemes independently of other activities and have taken adequate steps to ensure that the interest of investors of one scheme are not being compromised with those of any other scheme or of other activities of the asset management company.* *18(9) - The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations;* *18(22) - The trustees shall abide by the Code of Conduct as specified in PART-A of the Fifth Schedule*
	Regulation 44(3)	***Investment, borrowing, restriction, etc.*** *(3) Save as otherwise expressly provided under these regulations, the mutual fund shall not advance any loans for any purpose.*
	Clauses (2), (6), (8) and (9) of the Code of Conduct as specified in the Fifth Schedule	***Code of Conduct*** *(2) Trustees and asset management companies must ensure the dissemination to all unitholders of adequate, accurate, explicit and timely information fairly presented in a simple language about the investment policies, investment objectives, financial position and general affairs of the scheme.* *(6) Trustees and asset management companies shall carry out the business and invest in accordance with the investment objectives stated in the offer documents and take investment decision solely in the interest of unitholders.* *(8) Trustees and the asset management company shall maintain high standards of integrity and fairness in all their dealings and in the conduct of their business.* *(9) Trustees and the asset management company shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.*
	Regulation 25 (6A)	*The Chief Executive Officer [whatever be the designation] of the asset management company shall ensure that the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund.*
	Regulation 25 (6B)	*The fund managers [whatever be the designation] shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.*
SEBI CIRCULAR NO. MFD/CIR/6/73/2000 DATED JULY 27, 2000		*Sub-regulation (2) of Regulation 25 of SEBI (Mutual Funds) Regulations, 1996 stipulates that the asset management company (AMC) shall exercise due*

	diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business. With a purpose to implement the regulation in an effective manner and to bring about transparency in investment decisions, the AMCs are hereby advised to maintain records in support of each investment decision which will indicate the data, facts and opinion leading to that decision. While the AMC boards can prescribe broad parameters for investments, it is important that the basis for taking individual scrip-wise investment decision in equity and debt securities should be recorded. While there should be a detailed research report analysing various factors for each investment decision taken for the first time, the reasons for subsequent purchase and sales in the same script should be recorded. The contents of the research reports may be decided by the asset management companies and the trustees. *AMC boards may develop a mechanism to verify that due diligence is being exercised while making investment decisions. They may pay specific attention in case of investment in unlisted and privately placed securities, unrated debt securities, NPAs, transactions where associates are involved and the instances where there is poor performance of the schemes.* *The AMCs shall report the compliance of the above in their periodical reports to the trustees and the trustees shall report to SEBI in their half-yearly reports. Trustees may also check its compliance through the independent auditors or internal/statutory auditors or other systems developed by them.*
SEBI CIRCULAR NO. MFD/CIR/8/92/2000 DATED SEPTEMBER 18, 2000	***Valuation of securities with Put/Call Options*** *The option embedded securities would be valued as follows:* *<u>Securities with call option</u>:* *The securities with call option shall be valued at the lower of the value as obtained by valuing the security to final maturity and valuing the security to call option.* *In case there are multiple call options, the lowest value obtained by valuing to the various call dates and valuing to the maturity date is to be taken as the value of the instrument.* *<u>Securities with Put option</u>:* *The securities with put option shall be valued at the higher of the value as obtained by valuing the security to final maturity and valuing the security to put option* *In case there are multiple put options, the highest value obtained by valuing to the various put dates and valuing to the maturity date is to be taken as the value of the instruments.* *<u>Securities with both Put and Call option on the same day</u>:* *The securities with both Put and Call option on the same day would be deemed to mature on the Put/Call Day and would be valued accordingly.*

SEBI CIRCULAR NO. MFD/CIR/15/19133/2002 DATED SEPTEMBER 30, 2002	*Risk Management Function (To be Mandated by SEBI)* *The Mutual Fund should have an independent risk management function consisting of one or more risk managers.* *…* *The function should be separate from fund management and should report to the Chief Executive Officer of the AMC. …*
SEBI CIRCULAR NO. SEBI/HO/IMD/DF3/CIR/P/2017/114 DATED OCTOBER 6, 2017	*It is desirable that different schemes launched by a Mutual Fund are clearly distinct in terms of asset allocation, investment strategy etc. Further, there is a need to bring in uniformity in the characteristics of similar type of schemes launched by different Mutual Funds. This would ensure that an investor of Mutual Funds is able to evaluate the different options available, before taking an informed decision to invest in a scheme. …* *Process to be followed for categorization and rationalization of schemes:* *a. Only one scheme per category would be permitted, except:* *i. Index Funds/ ETFs replicating/ tracking different indices;* *ii. Fund of Funds having different underlying schemes; and* *iii. Sectoral/ thematic funds investing in different sectors/ themes* *b. Mutual Funds would be required to analyze each of their existing schemes in light of the list of categories stated herein and submit their proposals to SEBI after obtaining due approvals from their Trustees as early as possible but not later than 2 months from the date of this circular.* *c. The aforesaid proposals of the Mutual Funds would also include the proposed course of action (viz., winding up, merger, fundamental attribute change etc.) in respect of the existing similar schemes as well as those that are not in alignment to the categories stated herein.* *d. Subsequent to the observations issued by SEBI on the proposals, Mutual Funds would have to carry out the necessary changes in all respects within a maximum period of 3 months from the date of such observation.* *e. Where there is a merger of schemes/change of fundamental attribute(s) of a scheme (as laid down under SEBI Circular No. IIMARP/MF/CIR/01/294/98 dated February 4, 1998), the AMCs would be required to comply with Regulation 18 (15A) of SEBI (Mutual Funds Regulation, 1996).* *f. Mutual Funds are advised to strictly adhere to the scheme characteristics stated herein as well as to the spirit of this circular. Mutual Funds must ensure that the schemes so devised should not result in duplication/minor modifications of other schemes offered by them. The decision of SEBI in this regard shall be binding on all the mutual funds.*
SEBI CIRCULAR NO. SEBI/HO/IMD/DF3/CIR/P/2017/126 DATED DECEMBER 4, 2017	*SEBI, vide circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017, has issued guidelines regarding categorization and rationalization of Mutual Fund Schemes. …*

	In respect of sr. nos. 3, 4, 6, 7, 8 and 9 of Section B of Annexure to the aforesaid circular, it is clarified that Macaulay duration shall be at portfolio level and accordingly, the column 'Type of Scheme (Uniform description of scheme)' of the respective scheme of the aforesaid sr. nos. is modified and shall be read as given below: *'An open ended XYZ scheme investing in instruments such that the Macaulay duration of the portfolio is between A to B years (please refer to page no.__) #.'* *#Please refer to the page number of the Offer Document on which the concept of Macaulay's Duration has been explained.*
CLAUSE 9.1.1 OF SEBI CIRCULAR NO. SEBI/HO/IMD/DF4/CIR/P/2019/102 DATED SEPTEMBER 24, 2019	*Any changes to the terms of investment, which may have an impact on valuation, shall be reported to the valuation agencies immediately.*
CLAUSE 1 OF SEBI CIRCULAR NO. SEBI/HO/IMD/DF4/CIR/P/2019/126 DATED NOVEMBER 6, 2019	*Please refer to Para 9 of SEBI Circular No. SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019 on conditions to be adhered to by Mutual Funds, while making any change to terms of an investment. In partial modification to the above circular, Para 9.1.1. shall read as follows:* *Any changes to the terms of investment, including extension in the maturity of a money market or debt security, shall be reported to valuation agencies and SEBI registered Credit Rating Agencies (CRAs) immediately, along-with reasons for such changes.*
SEBI CIRCULAR NO. CIR/IMD/DF/21/2012 DATED SEPTEMBER 13, 2012	*Mutual funds/AMCs shall disclose portfolio (along with ISIN) as on the last day of the month for all their schemes on their respective website on or before the tenth day of the succeeding month in a user-friendly and downloadable format.*

Brief background of Franklin Templeton Mutual Fund

24. Franklin Templeton Mutual Fund ("FT–MF") is a mutual fund having a Certificate of Registration granted by SEBI [Regn. No. – MF/026/96/8]. Franklin Templeton Asset Management Company Ltd ("FT–AMC") is the Asset Management Company of the FT–MF.

25. Brief about Franklin Templeton Mutual fund as at April 23, 2020:

   i) **Sponsor:** Franklin Templeton International Inc. (USA)

   ii) **Trustee:** Franklin Templeton Trustee Services (India) Private Limited

iii) Asset Management Company: Franklin Templeton Asset Management (India) Private Limited

iv) Shareholding pattern of Franklin Templeton Asset Management (India) Private Limited as on 30th September 2019

Name of Shareholder	% of Shareholding
Franklin Templeton Holdings Limited, Mauritius	100%

v) Group companies & Associate Companies of Franklin Templeton Asset Management (India) Private Limited

Sl. No.	Name of Company	Nature of Relationship
1	Franklin Resource Inc., USA	Ultimate Holding Company
2	Franklin Templeton Holding Limited, Mauritius	Holding Company
3	ITI Capital Markets Limited, India	Subsidiary Company
4	Franklin Templeton Trustee Services (India) Private Limited	Fellow Subsidiary
5	Franklin Advisers, Inc., USA	
6	Franklin Templeton Companies, LLC USA	
7	Franklin Templeton Asset Management Limited, Singapore	
8	Equitas Small Finance Bank Limited	Associate
9	M F Utilities India Pvt. Ltd.	
10	Association of Mutual Funds in India	
11	Mywish Marketplaces Pvt. Ltd.	
12	Pangea Econetassets Private Limited	
13	Sonata Software Limited	
14	Indasia Fund Advisors Private Limited	
15	Godrej and Boyce Manufacturing Company Limited	
16	Kansai Nerolac Paints Limited	
17	Franklin Templeton Alternative Investments (India) Pvt. Ltd.	
18	Franklin Templeton International Services (India) Pvt. Ltd.	
19	Franklin Templeton Services (India) Pvt Ltd	
20	Franklin Templeton Investments (ME) Limited	
21	Franklin Templeton France S A	
22	Bajaj Auto Limited	
23	Universal Trustees Private Limited	
24	Helios Greentech Private Limited	
25	Ambit Private Limited	
26	Kancor Ingredients Limited	
27	KSB Limited	
28	Pfizer Limited	
29	BASF India Limited	
30	Bajaj Holdings & Investment Limited	

(Source: Financials of the FTAMC as at 30/09/2019 and Group Companies documents of AMC as at 30/06/2020)

vi) Details of Trustees

Name of Director	PAN of Director	Director Since	Designation
Ms. Sandra Martyres	AAUPM6410A	September 8, 2019	Independent Director
Mr. Arvind Sonde	AAFPS4609C	July 15, 2019	Independent Director
Mr. Sanjaya Johri	AABPJ5819R	October 16, 2019	Independent Director
Mr. Alok Sethi	AAXPS7658D	March 11, 2017	Director
Mrs. Shilpa Shetty	AMBPS3650B	June 23, 2017	Director

vii) Details of Directors of the Asset Management Company

Name of Director	PAN of Director	Director Since	Designation
Mr. V S Radhakrishnan	AFEPR0484G	May 01, 2018	Independent Director
Mr. Pradip Shah	AAEPS0592F	May 19, 2019	Independent Director
Ms. Tabassum Inamdar	AAAPI4635D	December 01, 2019	Independent Director
Mr. Sanjay Sapre	AALPS5825N	August 31, 2016	Whole Time Director
Mr. Vivek Kudva	AENPK7096K	March 11, 2017	Director
Mr. Jayaram Subramaniam Iyer	AAAPI2333L	September 12, 2014	Director

viii) List of Key Managerial Persons: -

Name	PAN	Designation
Mr. Sanjay Sapre	AALPS5825N	President AMC
Mr. Santosh Kamath	AANPK4951D	CIO & MD- LAM India
Mr Sachin Padwal Desai	AFGPP2055M	VP / Portfolio Manager- LAM India Fixed Income
Mr. Umesh Sharma	AMJPS8098R	VP / Portfolio Manager- LAM India Fixed Income
Ms. Pallab Roy	AEBPR3653P	AVP /Portfolio Manager- LAM India Fixed Income
Mr. Kunal Agrawal	ADYPA3090P	VP / Portfolio Manager- LAM India Fixed Income
Mr. Paul Parampreet	AMOPP0522E	Client Portfolio Manager- FT Multi-Asset Solutions
Mr. Sumit Gupta	AILPG1906E	Portfolio Manager- LAM India
Mr. Peshotan Dastoor	AADPD4774B	National Sales Director
Mr. Saurabh Gangrade	AIRPG6318C	VP & Head - India Compliance
Ms. Rini K Krishnan	AJNPK2731L	AVP & Head, Investor Services
Mr. Ajay Narayan	ACAPN1695A	Director & Head - FTS India AMC
Mr. Sameer Seksaria	AKSPS0071K	Director & Head - India TA
Mr. Deepak Balachandran	AJTPB7531K	VP & Head of Risk Management
Mr. Arun Gupta	AELPG9351F	VP-Head of credit
Mr. Nischal Shah	AZFPS7927Q	VP & Senior Research Analyst- Fixed Income

26. Vide a Notice dated April 23, 2020, Franklin Templeton Trustee Services Pvt., Ltd., had inter alia informed the concerned unitholder(s) that it had decided to wind up the following schemes of FT–MF pursuant to the provisions of Regulation 39(2)(a) of the SEBI (Mutual Funds) Regulations, 1996, viz.:

i. Franklin India Ultra Short Fund/Ultra Short Bond Fund;
ii. Franklin India Low Duration Fund;
iii. Franklin India Short Term Income Fund/Plan;

iv. Franklin India Income Opportunities Fund;
v. Franklin India Dynamic Accrual Fund;
vi. Franklin India Credit Risk Fund.

27. Scheme-wise Assets under Management (AUM) (including segregated portfolio), Folio Count and Borrowing as on April 23, 2020 is as under:

Name of Scheme	AUM (₹ in crores)	Folio count	Borrowing (₹ in Crores)
Franklin India Credit Risk Fund	3,416.57	34,892	665.06
Franklin India Dynamic Accrual Fund	2,514.03	23,312	98.09
Franklin India Income Opportunities Fund	1,743.58	17,809	241.96
Franklin India Low Duration Fund	2,356.06	51,571	277.73
Franklin India Short Term Income Plan	5,554.21	57,652	1027.48
Franklin India Ultra Short Bond Fund	9,630.80	1,66,117	802.2

Total AUM of FTMF (including segregated portfolio): ₹88,351.79 crore
Total Folio Count of FTMF: 37,50,141

28. Top 10 Holdings of the Fixed Income schemes as on April 23, 2020 are as under:

Name of the Scheme	Name of the Security	Value of the Security (₹)	% of total portfolio
Franklin India Dynamic Accrual Fund	Shriram Transport Finance Co Ltd	2,63,97,58,000	10.25%
	Piramal Capital & Housing Finance Ltd	1,93,04,87,856	7.49%
	Uttar Pradesh Power Corporation Ltd	1,79,33,09,046	6.96%
	Edelweiss Rural & Corporate Services Ltd	1,68,69,81,650	6.55%
	Vedanta Ltd	1,17,30,64,750	4.55%
	India Shelter Finance Corporation Ltd	1,13,19,96,714	4.39%
	Rivaaz Trade Ventures Pvt Ltd	1,09,42,34,382	4.25%
	Hero Solar Energy Pvt Ltd	99,23,33,000	3.85%
	S. D. Corporation Pvt Ltd	99,23,95,700	3.85%
	JM Financial Asset Reconstruction Co Ltd	98,87,78,000	3.84%
Franklin India Low Duration Fund	JM Financial Asset Reconstruction Co Ltd	2,96,82,99,640	11.43%
	Renew Power Ltd	2,17,00,00,000	8.36%
	Ess Kay Fincorp Ltd	1,99,12,38,000	7.67%
	Small Business Fincredit India Pvt Ltd	1,74,14,70,500	6.71%
	Uttar Pradesh Power Corporation Ltd	1,55,44,62,121	5.99%
	Renew Solar Power Pvt Ltd	1,53,28,74,938	5.90%
	Sterlite Power Grid Ventures Ltd	1,45,99,15,100	5.62%
	Shriram Transport Finance Co Ltd	1,34.54,82,610	5.18%
	Edelweiss Rural & Corporate Services Ltd	1,19,48,93,400	4.60%
	Talwandi Sabo Power Ltd	97,42,28,000	3.75%
Franklin India Ultra Short Bond Fund	PNB Housing Finance Ltd	8,54,88,79,920	8.29%
	Piramal Enterprises Ltd	8,35,78,67,700	8.10%
	Indostar Capital Finance Ltd	8,29,95,46,300	8.05%

Name of the Scheme	Name of the Security	Value of the Security (₹)	% of total portfolio
	Clix Capital Services Pvt Ltd	8,26,75,74,400	8.01%
	Vedanta Ltd	7,92,55,24,900	7.68%
	Edelweiss Rural & Corporate Services Ltd	7,44,04,82,490	7.21%
	JM Financial Credit Solutions Ltd	5,40,02,75,400	5.23%
	Nuvoco Vistas Corporation Ltd	3,78,16,23,750	3.67%
	Renew Power Ltd	3,75,49,61,700	3.64%
	Uttar Pradesh Power Corporation Ltd	3,68,13,08,638	3.57%
Franklin Short Term Income Plan	Shriram Transport Finance Co Ltd	8,12,56,80,624	11.22%
	Edelweiss Rural & Corporate Services Ltd	6,30,70,72,370	8.71%
	Uttar Pradesh Power Corporation Ltd	5,43,44,79,910	7.51%
	Andhra Pradesh Capital Region Development Authority	4,80,20,88,471	6.63%
	Piramal Capital & Housing Finance Ltd	3,71,69,22,034	5.13%
	Rivaaz Trade Ventures Pvt Ltd	3,65,30,98,964	5.05%
	Renew Power Ltd	3,62,84,54,140	5.01%
	Rishanth Wholesale Trading Pvt Ltd	3,54,39,60,000	4.89%
	S. D. Corporation Pvt Ltd	3,07,86,69,600	4.25%
	Five-Star Business Finance Ltd	2,83,77,89,430	3.92%
Franklin India Income Opportunities Fund	Piramal Capital & Housing Finance Ltd	2,56,66,82,113	10.96%
	Shriram Transport Finance Co Ltd	2,03,82,58,990	8.67%
	Coastal Gujarat Power Ltd	1,80,51,35,270	7.71%
	Uttar Pradesh Power Corporation Ltd	1,77,22,04,155	7.56%
	Rivaaz Trade Ventures Pvt Ltd	1,34,96,30,800	5.76%
	Hinduja Leyland Finance Ltd	1,28,09,66,450	5.47%
	DCB Bank Ltd	1,19,04,37,930	5.08%
	Andhra Pradesh Capital Region Development Authority	1,14,99,25,400	4.91%
	S. D. Corporation Pvt Ltd	99,14,39,000	4.23%
	Sadbhav Infrastructure Project Ltd	86,25,99,009	3.68%
Franklin India Credit Risk Fund	Shriram Transport Finance Co Ltd	4,70,34,95,160	11.48%
	Piramal Enterprises Ltd	3,45,39,65,200	8.43%
	Uttar Pradesh Power Corporation Ltd	3,34,18,88,278	8.16%
	Andhra Pradesh Capital Region Development Authority	3,09,73,35,564	7.56%
	Five-Star Business Finance Ltd	2,41,38,03,140	5.89%
	Rishanth Wholesale Trading Pvt Ltd	2,32,88,88,000	5.68%
	Hinduja Leyland Finance Ltd	2,04,97,21,720	5.00%
	S. D. Corporation Pvt Ltd	1,78,70,03,950	4.36%
	Piramal Capital & Housing Finance Ltd	1,72,16,87,555	4.20%
	Aadarshini Real Estate Developers Pvt Ltd	1,50,69,37,500	3.68%

29. The nature and objective of the six wound up schemes as mentioned in the SIDs are as below:

i) **Franklin India Low Duration Fund (FI-LDF/FTLDF):** An Open-ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months. The objective of the Scheme is to earn regular income for investors through investment primarily in debt securities

ii) **Franklin India Short-Term Income Plan (FI-STIP/FTSTIP):** An open-ended short-term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 1 year to 3 years. The objective of the Scheme is to provide investors stable returns by investing in fixed income securities

iii) **Franklin India Income Opportunities Fund (FI-IOF/FTIOF):** An open-ended medium-term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 years to 4 years. The Fund seeks to provide regular income and capital appreciation by investing in fixed income securities across the yield curve.

iv) **Franklin India Credit Risk Fund (FI-CRF/FTCRF/FICBOF):** An Open-ended debt scheme primarily investing in AA and below rated corporate bonds (excluding AA+ rated corporate bonds). The Fund seeks to provide regular income and capital appreciation through a focus on corporate securities.

v) **Franklin India Dynamic Accrual Fund (FI-DAF/FTDAF):** An open-ended dynamic debt scheme investing across duration. The primary investment objective of the Scheme is to generate a steady stream of income through investment in fixed income securities.

vi) **Franklin India Ultra Short Fund / Ultra Short Bond Fund (FI-UST/FIUBF/FTUBF):** An Open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months. To provide a combination of regular income and high liquidity by investing primarily in a mix of short-term debt and money market instruments.

30. A brief summary of the violations alleged in the SCN against the Noticees are furnished hereunder.

Sl. No.	Nature of violations	Name of the Noticees
A	**Multiple schemes run in similar manner** (i) Exposure in securities with rating as AA and below;	i) Franklin Templeton Trustee Services Pvt., Ltd., ii) Sanjay Sapre – CEO; iii) Santosh Kamath - CIO iv) Kunal Agarwal v) Sumit Gupta

	(ii) Macaulay duration-based similarity across schemes; (iii) Common investments between schemes; (iv) Similarity in investment pattern; (v) Common fund managers between schemes	vi) Pallab Roy vii) Sachin Padwal Desai viii) Umesh Sharma – Fund Managers; ix) Saurabh Gangrade – Chief Compliance Officer - **Noticees 1 to 9**
B	**Practices related to interest rate rest papers and calculation of Macaulay Duration** (i) Lack of due diligence at the time of investing in interest reset papers; (ii) Incorrect calculation of Macaulay Duration (iii) Non-exercise of exit opportunity in F-UBF and FI-LDF schemes;	i) Santosh Kamath - CIO ii) Kunal Agarwal iii) Sumit Gupta iv) Pallab Roy v) Sachin Padwal Desai vi) Umesh Sharma – Fund Managers; - **Noticees 3 to 8**
C	**Valuation practices** (i) Changes in terms of investments are not made available immediately to Valuation Agencies, CRAS and for correct disclosure of portfolio to investors.	i) Santosh Kamath - CIO ii) Kunal Agarwal iii) Sumit Gupta iv) Pallab Roy v) Sachin Padwal Desai vi) Umesh Sharma – Fund Managers; - **Noticees 3 to 8**
D	**Managing various risks pertaining to securities in the portfolio of the schemes** (i) High exposures in unlisted / illiquid debt securities; (ii) Risk management a) Removal of monitoring of investment risk from Business Risk Management Committee (BRMC) and lack of Independence of risk management function: b) Risk Management Presentations by Head-Risk Management of FT-AMC:	i) Franklin Templeton Trustee Services Pvt., Ltd., ii) Sanjay Sapre – CEO; iii) Santosh Kamath - CIO iv) Kunal Agarwal v) Sumit Gupta vi) Pallab Roy vii) Sachin Padwal Desai viii) Umesh Sharma – Fund Managers; - **Noticees 1 to 8**

E	**Investment related due diligence** (i) Deficient Investment Policy (ii) Inconsistency in exercising buyback option of subscribed Issuers by few of the debt schemes inspected leading to preferential treatment given to unit holders of one scheme over the other	i) Franklin Templeton Trustee Services Pvt., Ltd., - **Noticee 1**

A. MULTIPLE SCHEMES RUN IN SIMILAR MANNER

– Alleged violation by Noticees 1 to 9

(i) Exposure in securities with rating as AA and below

31. As per the Scheme Information Document (SID), Credit Risk Fund is a bond fund focusing on corporate bonds rated AA and below (excluding AA+ rated corporate bonds) and Corporate Bond Fund is an open-ended debt scheme predominantly investing in AA+ and above rated corporate bonds. In terms of the SEBI Circulars on categorization and rationalization of mutual fund schemes, viz. SEBI/HO/IMD/DF3/CIR/P/ 2017/114 dated October 6, 2017 read with SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 4, 2017 *("SEBI Categorization Circulars")*, the scheme characteristics for a Credit Risk Fund would involve minimum investment in corporate bonds: 65% of net assets only in AA and below rated instruments. The comparative analysis of Credit Risk Fund vis-à-vis other five schemes under audit with respect to holding in corporate bonds rated AA and below are as under:

(% of AUM)

Scheme	31-Mar-19	29-Jun-19	30-Sep-19	31-Dec-19	31-Mar-20
FTCRF	82.90%	76.14%	75.96%	85.94%	97.99%
FTDAF	81.30%	77.27%	75.31%	86.09%	88.60%
FTIPF	73.34%	71.56%	78.67%	83.58%	96.82%
FTLDF	71.42%	70.94%	73.40%	84.04%	105.51% #
FTSTIP	81.51%	74.72%	76.52%	79.84%	101.42% #
FTUBF	76.06%	69.46%	69.91%	72.68%	93.49%

 # Due to borrowings, percentage has exceeded 100%.

32. From the above-mentioned Table, it is observed that each of the debt schemes inspected had taken exposures of more than 65% of their net asset to securities

rated AA and below consistently for a long time, which is the exclusive scheme characteristic prescribed for a Credit Risk Fund such as FI–CRF.

33. From the investment portfolio of each of the aforementioned debt schemes, it is also noted that most of the securities forming part of their portfolio were either rated below or equal to AA even at the time of investment. Further, fresh investments in AA and below rated securities continued even after March 31, 2019, despite the respective debt schemes inspected having a high percentage of AA and below securities in the non–Credit Risk Funds.

34. With respect to the rating composition of the portfolio in the foregoing paragraphs, the Noticees submitted that the SEBI Categorization Circulars do not specify the credit rating requirement for securities held in duration-based schemes and the duration-based schemes are distinct based on the Macaulay duration. Accordingly, the Noticees submitted that a mutual fund scheme can also purchase any of securities which has credit rating of investment grade in duration-based schemes.

35. The introductory para of SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017 regarding Categorization and Rationalization of Mutual Fund Schemes reads "*It is desirable that different schemes launched by a Mutual Fund are <u>clearly distinct in terms of asset allocation, investment strategy etc</u>. Further, there is a need to bring in uniformity in the characteristics of similar type of schemes launched by different Mutual Funds. This would ensure that an investor of Mutual Funds is able to evaluate the different options available, before taking an informed decision to invest in a scheme*."

36. Further, Para (III) (f) of the aforementioned circular reads "*Mutual Funds are advised to strictly adhere to the scheme characteristics stated herein <u>as well as to the spirit of this circular</u>. Mutual Funds must ensure that the schemes so devised <u>should not result in duplication/minor modifications of other schemes</u> offered by them. The decision of SEBI in this regard shall be binding on all the mutual funds*."

37. It may be noted that in order to flag-off the inherent credit risk involved in the scheme exclusively to the investors of the Mutual Funds to evaluate different option available and to take an informed decision before investing in a scheme, Credit Risk Fund

was named accordingly and categorized exclusively. Further, in order to stop mis-selling the Credit Risk Fund as funds giving higher return, SEBI vide Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017 regarding Categorization and Rationalization of Mutual Fund Schemes has also clearly depicted that words/ phrases that highlight/ emphasize only the return aspect of the scheme shall not be used in the name of the scheme (*for instance Credit Opportunities Fund, High Yield Fund, Credit Advantage etc.)*. This was done as exclusive high yield nature of the credit risk funds were being highlighted prior to categorization not the credit risk of the portfolio.

38. I note that SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017 has defined the characteristic of Credit Risk Fund as a debt scheme with a minimum 65% of the total assets invested in below highest rated corporate bonds. Further, vide SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 4, 2017 it was clarified that Credit risk fund has to invest minimum 65% of net assets in AA and below rated instruments (excluding AA+ rated instruments).

39. Further, as per the aforesaid Circulars, mutual funds must strictly adhere to the scheme characteristics stated therein as well as to the spirit of the Circulars and further, they must ensure that the schemes so devised should not result in duplication/minor modifications of other schemes offered by them. Further, all credit risk schemes will have some interest rate risk, similarly all duration-based schemes will have some credit risk in the securities forming part of its portfolio. Therefore, the scheme specifically created for investments in securities with high credit risk i.e., Credit Risk Fund, should have higher exposure to credit risk securities while other schemes such as duration-based schemes, etc., should not have similar exposure to credit risk securities, which would otherwise defeat the purpose of the SEBI Categorization Circulars i.e., single scheme per scheme category.

40. As per the Categorization Circulars (October 4, 2017 Circular), SEBI had advised mutual funds that words/phrases that highlight/emphasize only the return aspect of the scheme like credit opportunities fund, high yield fund, credit advantage, etc. shall not be used in the name of a Credit Risk Fund. With respect to the categorization of debt schemes as per the SEBI Categorization Circulars, the nomenclature of a Credit Risk Fund was made for ensuring that such scheme is differentiated from

other types of debt schemes specifically with respect to the high risk involved in the scheme and further, for facilitating an investor to take an informed decision before investing in any scheme including various debt schemes. The Noticees in their reply had admitted to consistently following a differentiated yield–oriented strategy in the debt schemes inspected and further, had adopted a distinct market positioning for the aforesaid debt schemes vis–a–vis schemes offered by other mutual funds in similar categories and even including other schemes offered by FT–MF itself, which follow more traditional investment strategies. Admittedly, as part of the aforementioned overall strategy, the debt schemes inspected were invested to a greater extent in investment grade securities rated below AAA which offered higher yields as compared to AAA rated securities. Further, from the e–mail exchanged between FT–AMC and its Director, Mr. Vivek Kudva, FT–AMC had continuously referred to the debt schemes inspected as '*managed credit funds*'. In view of the same, it is noted that the debt schemes inspected including FI–CRF were nothing but high yield funds that were run and sold as duration-based schemes by FT–AMC.

41. From the minutes of FT–AMC's Board Meeting dated October 25, 2019, it is observed that when the concerns with regard to downgrade of securities were presented to the Board by the Head–Risk Management of FT-AMC, the management of FT–AMC had informed its Board that exposure to credits presented in the risk report was only in respect of the funds that follow a strategy of investing in high yield securities and therefore, were exposed to high credit risk. Further, it is noted that all debt schemes inspected had exposure to the securities presented in risk report/presentation.

42. The main submission of Noticees in respect of this observation is that SEBI circular on categorisation doesn't specify credit rating requirement for securities held in duration-based schemes. Hence, as per the Noticees' submission, the AMC is free to buy any security above investment grade in all duration-based schemes. In this context, it may be noted that debt securities are primarily exposed to credit/default risk, interest rate risk, liquidity risk etc. These risks are not exclusive but are inter connected and inherent risk present in all the debt securities. SEBI Circular of categorization of debt schemes was primarily based on different risk faced by debt schemes and to ensure that schemes does not result in duplication/ minor

modification of other schemes. So, for example, unique characteristic of Ultra Short Duration (UST) fund was to ensure that Macaulay Duration of the scheme is in the range of 3-6 months, while for Credit Risk Fund (CRF), as per the unique characteristic, schemes were supposed to invest at least 65% in AA and below rated securities. It is pertinent to note that there is no mention of rating in UST while there is no mention of duration in CRF. However, all Credit risk schemes will have some duration/ interest rate risk and vice-versa duration-based schemes will have credit risk in its securities. But that does not mean that Duration based schemes can take credit risk which is equivalent to or more than the specified credit risk which is borne by the Credit Risk scheme, since it will defeat the purpose of single scheme per category in terms of SEBI Circular. Further, from the point of view of investor, unitholders invest in Duration schemes based on the duration risk and assuming that he is not exposed to credit risk equivalent to credit risk funds, so that he receives his investment back within his desired duration. Whereas, if the duration-based funds are run akin to credit risk fund, the unitholders are exposed to credit risk and it would defeat their investment rationale. In view of the above, I find no merit in the submissions put forth by the Noticees.

43. The Noticees also submitted that they have consistently followed a differentiated yield-oriented strategy in these six schemes and adopted a distinct market positioning for these Schemes, relative to schemes in the same categories offered by other mutual funds and even some of FT's own schemes, which follow more traditional investment strategies. As part of this overall strategy, the Schemes have invested to a greater extent in investment grade securities rated below AAA that offer higher yields as compared to AAA rated securities. Thus, from the various submission of the Noticees, it can be reasonably concluded that all the six schemes including FICRF are high yield funds *(i.e., name of credit risk funds being used prior to categorization & rationalization of MF schemes)*.

44. I note that all the debt schemes inspected had exposure of more than 65% of net asset of the schemes to securities rated AA and below, which is the exclusive scheme characteristic prescribed for a Credit Risk Fund like FI–CRF, consistently for a long time. It is also noted that fresh investments in AA & below rated securities were carried out after March, 2019 even though the schemes were having more than

65% of the net assets invested in AA & below rated securities. Thus, the exposure in AA & below rated securities were being taken actively. By following general high yield strategy, FT–MF failed to clearly distinguish the investment strategy of all the debt schemes inspected, as per the requirement of the SEBI Categorization Circulars. Further, FT–MF had not disclosed the said strategy of primarily investing in AA and A rated security i.e., high yield securities, to the investors of the respective debt schemes inspected except FI–CRF and instead had sold the debt schemes inspected (excluding FI–CRF) as duration-based schemes.

45. The Noticees have also argued that the legislative intent of the Regulation while formulating the Categorization Circulars is to allow unlimited elbow room for corporate bond papers in the investment grade in respect of duration–based schemes. The Noticees have cited the deliberations in the Mutual Fund Advisory Committee (Sub–Committee) which had proposed credit rating–based distinctions in duration–based schemes. The Noticees have completely misread and misinterpreted the legislative intent here. It is a fact that credit–rating based further categorization of duration–based schemes was brought up for discussion in the Sub– Committee of MFAC, but SEBI was not in favour of such a proposal as the common investor has a very limited understanding of credit risk. Being very conscious of such lack of awareness on the part of the common investor, SEBI wanted only one scheme which could have a pre– dominance of credit risk and it was aptly named as “Credit Risk Fund”.

(ii) <u>Macaulay duration-based similarity across schemes</u>

46. I note that FT-MF was running Short Term Plan, Credit Risk Plan, Dynamic Bond & Income Opportunity schemes as different even though the weightage of AA & below rated securities and Macaulay duration was similar, which is evident from the table given below.

Month	Particular	FIIOF	FICRF	FISTIP	FIDAF
Jun-19	AA & below (% to AUM)	71.56%	76.14%	74.72%	77.27%
Jun-19	Macaulay Duration	3.32	2.47	2.36	2.27
Sep-19	AA & below (% to AUM)	78.67%	75.96%	76.52%	75.31%
Sep-19	Macaulay Duration	3.33	2.61	2.31	2.27

Dec-19	AA & below (% to AUM)	83.58%	85.94%	79.84%	86.09%
Dec-19	Macaulay Duration	2.92	2.04	1.97	1.90
Mar-20	AA & below (% to AUM)	96.82%	97.99%	101.42%	88.60%
Mar-20	Macaulay Duration	3.22	2.22	2.15	1.91

47. Further, Macaulay Duration of the wound-up schemes for the period FY 2019-20 as submitted by the FT-MF is as below:

Macaulay Duration (in years) for FY 19-20						
Month | Scheme	FIUBF	FILDF	FISTIP	FIIOF	FIDAF	FICRF
31 March 2020	0.54	1.20	2.15	3.22	1.91	2.22
28 February 2020	0.51	0.99	1.93	3.14	1.88	2.02
31 January 2020	0.52	0.99	1.93	2.95	1.93	2.03
31 December 2019	0.50	1.03	1.97	2.92	1.90	2.04
29 November 2019	0.54	1.05	2.01	3.05	1.99	2.16
31 October 2019	0.49	0.99	2.20	3.31	2.29	2.43
30 September 2019	0.49	1.03	2.31	3.33	2.27	2.61
30 August 2019	0.51	0.96	2.26	3.31	2.21	2.38
31 July 2019	0.55	0.95	2.28	3.33	2.19	2.40
28 June 209	0.49	0.91	2.36	3.32	2.27	2.47
31 May 2019	0.5	0.95	2.37	3.51	2.28	2.50
30 April 2019	0.49	0.99	2.35	3.55	2.24	2.50

48. From the above two tables, it is observed that the Macaulay Duration of both FISTIP and FICRF are almost same and are moving in the similar fashion throughout the financial year FY 2019-20. Moreover, both have exposures above 65% of the net assets to AA & below rated securities, so essentially there is no distinction between the two and FISTIP is replicating FICRF.

49. Further, from the data of above two tables it can be seen that FIUBF, FILDF, FIIOF are also type of credit risk fund (with the feature of investing more than 65% of the net assets in AA & below rated securities) with some variation in Macaulay Duration.

50. Moreover, as submitted by the Noticees *(with the assumption of no credit rating requirement for non-credit risk funds)*, FIDAF has complete flexibility with respect to both Macaulay duration and credit rating and FICRF, on the other hand, had complete flexibility on Macaulay duration but not so with credit rating of the underlying securities *(since at least 65% of its portfolio must be invested in AA and below rated securities)*. Since Dynamic Accrual Funds are supposed to vary their

duration requirement as per interest rate scenario of the time and not take credit risk equivalent to credit risk funds. Therefore, I note that Dynamic Accrual Funds will have similar duration as that of any one of the duration-based schemes at some point of time. But Dynamic Accrual Funds can't have similar duration with other schemes on continuous basis over a longer period of time. Further, an investor taking exposure in Dynamic Accrual Funds wants to give discretion to MFs to vary duration as per the interest rate scenario but doesn't suspect that MF will take credit risk equivalent to credit risk funds. Thus, as per the logic cited by the Noticees for distinguishing the schemes, if the dynamic fund invests over 65% of the net assets in AA & below rated securities, then it is nothing but a credit risk fund. It may be noted that FIDAF & FICRF both have more than 65% of net assets invested in AA & below rated securities throughout the financial year FY 2019-20 and both can invest in securities of any duration as contended by the Noticees *(as dynamic fund can invest in securities across duration & there is no duration requirement for credit risk fund)*. Thus, I find that there is no clear distinction between FIDAF & FICRF, since both are duplicate of each other.

(iii) Common investments between schemes

51. The comparative analysis of common securities in portfolio and Macaulay Duration (MD) of FISTIP, FIDAF & FIIOF with FICRF is as under

% of Common security to AUM & Macaulay Duration								
Scheme	Jun-19		Sep-19		Dec-19		Mar-20	
	% of common security	MD	% of common security	MD	% of common security	MD	% of common security	MD
FICRF	70.92%	2.47	74.41%	2.61	62.02%	2.04	66.10%	2.22
FISTIP	**65.94%**	**2.36**	**67.81%**	**2.31**	**63.75%**	**1.97**	**72.60%**	**2.15**

Table 2:	**% of Common security to AUM & Macaulay Duration**							
Scheme	Jun-19		Sep-19		Dec-19		Mar-20	
	% of common security	MD	% of common security	MD	% of common security	MD	% of common security	MD
FICRF	65.80%	2.47	65.53%	2.61	64.52%	2.04	69.05%	2.22
FIDAF	**65.86%**	**2.27**	**68.56%**	**2.27**	**68.91%**	**1.90**	**66.66%**	**1.91**

Table 3:	% of Common security to AUM & Macaulay Duration							
Scheme	Jun-19		Sep-19		Dec-19		Mar-20	
	% of common security	MD	% of common security	MD	% of common security	MD	% of common security	MD
FICRF	48.01%	2.47	52.45%	2.61	44.81%	2.04	50.29%	2.22
FIIOF	**59.64%**	**3.32**	**63.96%**	**3.33**	**58.81%**	**2.92**	**67.46%**	**3.22**

52. From the above table, it is observed that over 65% of the portfolio (AUM) of FISTIP is matching with over 65% of the portfolio of FICRF. Similarly, over 65% of the portfolio (AUM) of FIDAF is matching with over 65% of the portfolio of FICRF. Further, in case of FIIOF, almost 60% portfolio of FIIOF is matching with almost 50% of the portfolio of FICRF.

53. Further the investment strategy of having common securities was analysed and pursuant to which it is observed that in respect of FISTIP, FIDAF, FIIOF, common securities in FICRF and in the portfolio of at least three out of five non-credit risk funds are tabulated hereunder:

Scheme Name/Month	29-Jun-19	30-Sep-19	31-Dec-19	31-Mar-20
FIDAF	46.44%	47.55%	39.37%	38.30%
FIIOF	43.82%	45.69%	38.46%	43.15%
FISTIP	49.93%	50.09%	46.71%	53.65%

54. From the above table it can be seen that over 40% of the portfolio (AUM) of each of the above mentioned three schemes is constituted by the securities which are in the portfolio of FICRF & at least two out of rest four non-credit FT schemes and the same pattern has continued for very long period.

55. In addition to the above observation, it is observed that 38% of the total AUM of the six schemes is constituted by the securities which are available in at least four out of six wound up schemes. Though there are no regulatory guidelines stopping/denying MFs to have same security in multiple schemes, it may be noted that during the period FY 2017-20 investments worth ₹34,264.07 crores were done in at least four (which includes FICRF) out of the six wound up schemes simultaneously all at time during the deal. Thus, it is observed that the non–credit risk debt schemes inspected were taking similar risk as being taken by the Credit

Risk Fund by investing in the same securities which were subscribed by the FI–CRF, which is further admitted by the Noticees that FT-MF was following yield-oriented strategy in all its debt schemes inspected.

56. The Noticees have further argued that the recent Circular issued by SEBI in October 2020 on "product labelling in mutual funds: Risk–o–meter" buttresses its position that a duration–based scheme can freely invest in credit risk papers as credit risk is also sought to be measured for the duration–based scheme by the new Risk–o–meter. While the contentions raised by the Noticees are correct that the aforementioned Circular is a further refinement of the SEBI Circular dated October 6, 2017, in terms of risk measurement, the legislative intent of SEBI has remained the same in that while there is no prohibition on investing in AA and below rated corporate bonds in the debt schemes inspected, the predominance of such papers (being above 65%) can only be the unique scheme characteristic of "Credit Risk Fund".

(iv)<u>Similarity in investment pattern</u>

57. The concentration of securities where FT-MF has subscribed above 70% of the debt issuance through the schemes under winding up and which are rated AA and below is given in the below table:

	PERCENTAGE OF AUM OF THE SCHEME				
SCHEME	31–MAR–19	29–JUN–19	30–SEP–19	31–DEC–19	31–MAR–20
FI–CRF	35.81%	39.02%	45.08%	51.27%	63.41%
FI–LDF	37.31%	43.96%	51.28%	62.63%	85.69%
FI–STIP	37.16%	41.68%	47.22%	50.61%	68.62%
FI–UBF	29.49%	26.93%	31.20%	40.81%	55.47%
FI–IOF	34.01%	36.28%	43.95%	46.65%	53.96%
FI–DAF	42.59%	46.38%	48.38%	53.13%	58.37%

58. From the table above, it is noted that over a period of time, all the debt schemes inspected were having similarity in investment pattern by subscribing to ISINs where FT–MF has subscribed significant portion (more than 70%) of the issue and the securities were rated AA and below. Such investment pattern across all the debt schemes inspected indicated that the schemes were being run in a similar manner. It may be noted that while there are no regulatory guidelines regarding the maximum subscription that a MF can subscribe in a debt issuance, however, such investment

pattern across six schemes indicated that the schemes were being run in a similar manner with minor modifications.

59. It was submitted by the Noticees that risk profile of the said six schemes have been disclosed as moderate risk (i.e., the highest risk profile for debt schemes) as per the Risk-o-meter and as well as the portfolio of the said schemes have been disclosed periodically. It is a fact that the disclosures have been made by FT-MF. However, regarding depicting the schemes as moderate risk in Risk-o-meter, it may be noted that Risk-o-meter depicts risk at consolidated level and investor may not be able to know how much risk he is taking on account of credit or interest parameters. Further, disclosing portfolio doesn't absolve FT-MF from the responsibility of not running schemes in a similar way by minor modification of the schemes.

60. Further, the Noticees stated that it was their conscious strategy to invest in high yield and high return securities in five non-Credit Risk schemes under winding up. However, it was noted that though FT-MF has disclosed the monthly portfolio and given risk o meter disclosures as submitted but no such disclosure regarding following of the said strategy was given in the SID of the said five schemes.

61. The Noticees in their reply raised an issue if certain schemes invest more than 80% in securities rated AA+ and above then whether the said schemes can be said to be replicating corporate bond fund. It may be noted that in corporate bond funds investor is assumed to be desirous of staying invested in highest rated papers while in credit risk funds he is willing to take more than usual level of credit risk. Further, in duration-based schemes investor is concentrating on getting back his investment in a particular time frame. Hence, in duration-based schemes he may not be worried of investment in highest rated papers as he will still receive his investment in a required time frame while exposure to excessive credit risk in duration-based schemes may also endanger his expectation to get investment back in particular time frame. Therefore, such comparisons of situations are unwarranted and can't be accepted.

62. The Categorization Circulars, while specifying unique scheme characteristics, do allow enough flexibility for the fund manager within the ambit of the risk parameters. The Noticees have contended that a narrow interpretation of the Categorization

framework would make it impracticable to run a duration scheme without falling foul of the regulatory requirements. To substantiate its argument, the Noticees have adverted to the hypothetical scenario where duration–based schemes being packed with AAA bonds would become similar to Corporate Bond Fund (*which require more than 80% of AUM to be invested in highest rated bonds)*, thus blurring the dividing line between Corporate Bond Fund and a duration–based scheme. To respond to this argument advanced by the Noticees, one has to look at the fundamental objective of financial regulation. Regulation seeks to protect the investor against excessive risk taking by market intermediaries by building a regulatory framework which sets reasonable limits on risk exposures. Any deviant behaviour by market entities will warrant regulatory action to curb undue risk taking. At the other extreme, if a market intermediary errs on the side of extreme risk aversion, it is expected that market forces will act to correct such tendencies rather than the regulator stepping in. Categorisation framework for mutual funds is more a principle–based regulation, which spells out the broad regulatory norms leaving enough room for mutual funds to operate, balancing risk with prudence. Clearly, the regulatory intent here is to carve out just one–scheme category for lower rated investment grade corporate bonds leaving the mutual funds enough elbow room to operate the other scheme categories setting prudent limits for AA and below rated bonds without replicating the "Credit Risk Fund" category. So, as pointed out by the Noticees, if a duration–based scheme was to be packed with AAA rated bonds (replicating the corporate bond fund category), it is more a venial breach of the Categorization framework and certainly not in the same league of breach committed by the Noticees. It is considered venial because under the investment strategy, the funds of the common investors are not exposed to a degree of risk beyond what is considered acceptable by the regulatory framework. To summarise, the regulatory intent of principle–based regulation is that the broad limits to risk–taking set by the regulator will be strictly followed by market entities fully being conscious of the regulatory intent. While some common securities between the schemes is perfectly in consonance with the Categorization Circular, five of the six debt schemes inspected exhibit striking similarities in terms of portfolio character and risk characteristics with Credit Risk Funds thereby undermining the regulatory objective of carving out a separate scheme category for low rated investment grade corporate bonds, which characterises the highest level of risk for common investors.

63. The Noticees in their reply have given some examples from the industry. It was noted that some of the examples cited with respect to similar practice by other Mutual Funds are of period prior to categorization circular. In certain other cases either the period of deviation is small or the deviation relates to schemes holding higher rated papers similar to corporate bond funds. Hence, in this regard the contentions raised by the Noticees are not accepted since citing other fund houses for alleged deviations doesn't justify the deviation of FT-MF. Further, from the facts cited by the Noticees it can't be concluded whether those observations in respect of other MFs were due to passive breach or as per the active strategy. It is also not clear whether such observations were at certain point of time or going on for longer period of time. However, in case of FT-MF, the observations cited above have been an active deviation and ongoing for a longer period under an erroneous strategy being consciously followed by the FT-MF.

(v) <u>Common fund managers between schemes</u>

64. It is observed that in 4 out of 6 the schemes under audit, Santosh Kamath and Kunal Agrawal are common fund managers. In the remaining 2 out of 6 schemes, Santosh Kamath is one of the fund managers. Also, Santosh Kamath is CIO - Fixed Income prior to 01-April-2017 till date and hence all fund managers for fixed income schemes were reporting to him. The details of the fund managers scheme-wise along with the duration is furnished hereunder:

Scheme	Fund Managers	Duration
FTSTIP	Santosh Kamath & Kunal Agarwal	01-Apr-17 - 23-April-20
FTLDF	Santosh Kamath & Kunal Agarwal	01-Apr-17 - 23-April-20
FTIOF	Santosh Kamath & Sumit Gupta	01-Apr-17 – 31-Jul-18
	Santosh Kamath	01-Aug-18 – 24-Oct-18
	Santosh Kamath & Kunal Agarwal	25-Oct-18 – 23-Apr-20
FTCRF	Santosh Kamath & Sumit Gupta	01-Apr-17 – 31-Jul-18
	Santosh Kamath	01-Aug-18 – 24-Oct-18
	Santosh Kamath & Kunal Agarwal	25-Oct-18 – 23-Apr-20
FIUSBF	Pallab Roy & Sachin Padwal Desai	01-Apr-17- 30-Sept-18
	Pallab Roy	01-Oct-18 – 24-Oct-18
	Pallab Roy & Santosh Kamath	25-Oct-18 – 23-Apr-20
FTDAF	Santosh Kamath, Umesh Sharma & Sachin Padwal- Desai	01-Apr-17 - 23-April-20

65. The Noticees have replied that having common fund managers is a norm in industry. It may be noted that having common fund manager is not any violation. However, the observation of common fund managers for the said schemes was given to depict that same fund managers were running six schemes with similar strategy as that of credit risk funds with similar portfolio of securities which amount to running similar schemes with minor modification. I agree with the Noticees that having common fund managers is itself not a violation of the Mutual Funds Regulations or the Categorization Circulars.

66. From the aforesaid findings, the similarity between the schemes is summarized as below:

i) **Similarity between FI–STIP and FI–CRF:**

- Similar investment strategy of investing in high-yield securities.
- Both have more than 65% exposure to AA and below rated securities.
- Macaulay duration of both the scheme is similar and also moving in similar manner.
- Around 65% of the portfolio of FI–STIP is matching with 65% of the FI–CRF portfolio.
- Similar investment pattern of subscribing to the Issuer securities where FT–AMC has subscribed significantly above 70% of the issue and which are rated AA and below.

ii) **Similarity between FI–DAF and FI–CRF:**

- Similar investment strategy of investing in high-yield securities.
- Both have more than 65% exposure to AA and below rated securities.
- Macaulay duration of both the scheme is similar.
- Around 65% of the portfolio of FI–DAF is matching with 65% of the FI–CRF portfolio.
- Similar investment pattern of subscribing to the Issuer securities where FT–AMC has subscribed significantly above 70% of the issue and which are rated AA and below.

iii) **Similarity between FI–IOF and FI–CRF:**

- Similar investment strategy of investing in high-yield securities.
- Both have more than 65% exposure to AA and below rated securities.
- Around 60% of the portfolio of FI–IOF is matching with 50% of the FI–CRF portfolio.
- Similar investment pattern of subscribing to the Issuer securities where FT–AMC has subscribed significantly above 70% of the issue and which are rated AA and below.

iv) **Similarity between FI–LDF and FI–CRF:**

- Similar investment strategy of investing in high-yield securities.
- Both have more than 65% exposure to AA and below rated securities.
- Similar investment pattern of subscribing to the Issuer securities where FT–AMC has subscribed significantly above 70% of the issue and which are rated AA and below.

v) **Similarity between FI–UBF and FI–CRF:**

- Similar investment strategy of investing in high-yield securities.
- Both have more than 65% exposure to AA and below rated securities.
- Similar investment pattern of subscribing to the Issuer securities where FT–AMC has subscribed significantly above 70% of the issue and which are rated AA and below.

67. From the aforementioned findings, it is noted that FT-MF was running all the six schemes under winding up in the similar fashion like a credit risk fund (which was exclusively categorized to flag-off the inherent credit risk involved in the scheme to the investors) with minor modification. By following a general yield-oriented strategy in all the six schemes, the FT-MF failed to clearly distinct the investment strategy of all the six schemes. This practice of FT-MF was against SEBI circular dated October 06, 2017 regarding Categorization and Rationalization of Mutual Fund Schemes, whereby Mutual Funds have been advised to ensure that the schemes so devised should not result in duplication/minor modifications of other schemes offered by them.

68. In respect of the reply furnished by the Trustees, it is noted that Trustees have admitted that AMC was following a strategy of high yield- high return over a long period of time and they didn’t find it appropriate to intervene in such strategy. Further, Trustees have also stated that no non-compliance with regard to SEBI categorization circular were brought to their notice by internal audit reports, various AMC reports etc., In this connection, I am of the view that Trustees being experts should have been able to infer from monthly portfolio disclosures, various information being given to them that the AMC is following high risk high yield strategy whereby all the six schemes were having investments in high percentage in AA & below rated papers for a long period of time. Further, admittedly they were aware of the strategy of the AMC. Thus, they failed to take steps to ensure that AMC follows SEBI categorization circular in this regard.

69. Further, it is noted that all the five schemes have substantial holding in corporate bonds rated AA and below, which indicates that these five schemes have been carrying the risk and liquidity profile similar to Credit Risk Fund. These indicate that the CIO and fund managers failed to ensure that the funds of the schemes are being invested to achieve the objectives of the scheme and in the interest of the unit holders. Further, it is noted that the CEO and the Compliance Officer too failed to take adequate steps to ensure that the FT-AMC follow the regulatory provisions.

70. Therefore, I conclude that multiple schemes were run by FT-MF in similar manner and the Noticees 1 to 9 had failed to ensure that the six wound up schemes were not run in a similar manner (similarities in investment strategy, credit rating, Macaulay Duration and Portfolio), even though the investment objectives were different. Accordingly, I hold that the Noticees 1 to 9 had violated the provisions of the following SEBI Regulations and Circulars.

Sl. No.	Name of the Noticees	Reference of Regulation/Circular violated
1	Mr. Santosh Kamath, CIO Fund Managers: Mr. Kunal Agarwal Mr. Sumit Gupta Mr. Pallab Roy Mr. Sachin Padwal Desai Mr. Umesh Sharma) **Noticees 3 to 8**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated Oct 06, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated Dec 04, 2017 Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996.
2	Chief Executive Officer (Mr. Sanjay Sapre) **Noticees 2**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated Oct 06, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated Dec 04, 2017 Regulation 25 (6A) of SEBI (Mutual Funds) Regulations, 1996.
3	Chief Compliance Officer (Mr. Saurabh Gangrade) **Noticee 9**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated Oct 06, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated Dec 04, 2017 Regulation 18 (4D) of SEBI (Mutual Funds) Regulations, 1996.
5	Franklin Templeton Trustee Services Private Limited **Noticee 1**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated Oct 06, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated Dec 04, 2017 Regulation 18(7), 18(9), 18(22) and clause (2), (6), (8), (9) of the Code of Conduct as specified in the Fifth Schedule to the SEBI (Mutual Funds) Regulations, 1996.

71. The Noticees contended that an inspection was conducted for FY 2018–19 by an external auditor appointed by SEBI and the Report was submitted on December 15, 2020. The aforesaid Report did not record any adverse findings with regard to the Categorization Circulars for any of the debt schemes inspected. I have perused the aforementioned Report. In this regard, I note that the inspection had commenced in February 2020 and could not be completed due to lockdown restrictions during the Covid–19 pandemic and the inability on the part of the Auditor to function off–site during the said pandemic. The Report was forwarded to the Trustee by the Auditor, before discussing the observations contained therein with SEBI. The aforementioned inspection for FY 2018–19 is not yet concluded as the Auditor is also conducting an analysis of the investments of the debt schemes of FT–MF and calculation of Macaulay duration of schemes. The Trustee is also aware of the ongoing inspection exercise. As opposed to the aforementioned inspection, the forensic audit on the basis of which the instant proceedings were initiated, was a special–purpose focused inspection pursuant to receipt of various complaints by SEBI. In these circumstances, I am compelled to leave the issue open at this stage without drawing any conclusion.

B. <u>PRACTICES RELATED TO INTEREST RATE RESET PAPERS AND CALCULATION OF MACAULAY DURATION</u>

– Alleged violation by Noticees 3 to 8

(i) Lack of Due diligence at the time of investing in interest rate reset papers

72. SEBI vide Circular no. MFD/CIR/8/92/2000 dated September 18, 2000 ("September 18, 2000 Circular") provided guidelines to value securities which require the security to be valued at all call dates, put dates and maturity date, as under:

a. For the securities having multiple call options, the circular requires that the lowest value obtained by valuing to the various call dates and valuing to the maturity date is to be taken as the value of the instrument.

b. For the securities with multiple put options, the highest value obtained by valuing to the various put dates and valuing to the maturity date is to be taken as the value of the instruments.

c. For the securities with both put and call option on the same day, would be deemed to mature on the Put/Call Day and would be valued accordingly.

73. It is noted that in case if the security is trading at premium, it will be rational decision for the Issuer to exercise call and exit from the agreement and enter into fresh agreement with lower coupon rate. Similarly, for put option if security is trading at discount before maturity period it would be rational decision on the part of investor to exercise put and enter into fresh agreement at higher coupon rate. Therefore, on securities with call and put option on the same date it is understood that the security will be in favour of either of the party and consequently one of the options will be exercised and the instrument will cease to exist and therefore put/call date can be considered as deemed maturity.

74. Accordingly, interest rate reset papers with explicit exit options to both Issuer and subscriber available on the interest rate reset date is akin to securities with both put and call option on the same day. Further, interest rate reset papers with explicit exit options to both Issuer and subscriber available on the interest rate reset date can be accepted as deemed to mature on the interest rate reset date and valued accordingly.

75. If there is no explicit exit option available to both the Issuer and subscriber on the interest rate reset date then the securities have to be valued considering call, put and maturity dates, whichever exist in the agreement, in line with the September 18, 2000 Circular. The Macaulay duration will then be calculated considering the said valuation date.

76. However, concerns with respect to interest rate reset clauses has been observed in certain securities of following Issuers (to which debt schemes inspected had subscribed) selected on random sample basis, details of which are given in subsequent paragraphs:

i. Edelweiss Rural & Corporate Services Limited (ERCSL) (formerly Edelweiss Agri Value Chain Limited) (with no floor no cap);
ii. AASAN Corporate Solutions Private Limited (a Piramal Group Company) (with no floor no cap);
iii. Piramal Realty Pvt. Ltd. (with no floor no cap);
iv. Indostar Capital Finance Limited (having floor and cap);
v. Edelweiss Commodities Services Limited (having floor and cap);
vi. JM Financial Credit Solution Limited (having floor and cap);

vii. Motilal Oswal Housing Finance Limited (having floor and cap).

Interest rate reset paper without floor-Cap but no explicit option to exit

77. Observations with respect to interest rate reset clauses are as under:

i) **Edelweiss Rural & Corporate Services Limited (ERCSL) (formerly Edelweiss Agri Value Chain Limited):**

a. I note that five of the *debt schemes inspected* (except FI–IOF), FT-MF had invested in the Non–Convertible Debentures ("**NCDs**") (ISINs - INE657N07381 and INE616U07036) issued by Edelweiss Rural & Corporate Services Limited (ERCSL) on private placement basis on June 30, 2017.

b. The actual maturity of these securities is June 30, 2027 and securities have interest rate reset clause with no floor and no cap and no call/put option. As per the interest rate reset clause Issuer has an option to propose interest rate reset at the end of 3rd year/5th year/7th year from the deemed date of allotment. Accordingly, first coupon interest rate reset date falls on June 30, 2020 and Issuer had to propose change in interest rate, if desired, by April 30, 2020.

c. With respect to interest rate reset, the term sheets states that "*Issuer through debenture trustee has an option to propose revised interest rate to the investors via 'Interest rate reset Notice' at least 60 calendar days prior to the interest rate reset date. If Issuer proposes revised interest rate the investors has option to accept or reject the proposed revised interest rate and shall communicate the decision of acceptance/rejection at least 45 business days prior to the interest rate reset date."* It is also mentioned in the term sheet that *"NCDs held by these investors, to whom the proposed revised interest rate/ coupon rate is not acceptable, shall be mandatorily redeemed on the interest rate reset date (Early Redemption)".*

d. FT–AMC has submitted in its reply that vide email dated April 07, 2020 to ERCSL that it was willing to exit on the next interest rate reset date (i.e., June 30, 2020) and appraised the Issuer in advance to plan for the prepayment. However, the Issuer vide communication dated April 30, 2020 apprised FT–AMC that under the terms of agreement the discretion of issuance of interest rate reset notice is solely at option of the Issuer and it has decided not to propose a revised rate.

e. From the above given facts, it is observed that in the instance wherein the Issuer does not propose interest rate reset the investor has no option to exit, since the term sheet talks about the exit clause when the proposed revised interest rate is not acceptable by the investor. It indicates that there is no exit opportunity for the FT-MF when there is no proposal of revision in interest rate, which will have a huge impact on the Valuation and in computation of Macaulay Duration since the reset date is taken as the deemed maturity date for all the practical purposes. Therefore, in the instant matter there is no explicit exit option to investor (FT–MF) on the interest rate reset dates and the redemptions before maturity date is not possible at the explicit option of the FT-MF. Accordingly, the said date cannot be taken as deemed maturity for the purpose of calculation of *Macaulay duration* and valuation of the security. In the instant case FT–MF has used this interest rate reset date as deemed maturity for the purpose of calculation of *Macaulay duration* and Valuation of the security and therefore wrongly calculated the *Macaulay duration* as well as the valuation of the security.

f. It is noted that in a situation where security yield goes up substantially and the issuer still doesn't propose a revised interest rate, there is no exit clause for the FT-MF since the term sheet talks about the exit clause when the proposed revised interest rate is not acceptable by the FT-MF. Therefore, as the reset date does not provide option to exit to FT-MF in the instance where reset rate is not proposed by the issuer, the reset date taken as deemed maturity, is incorrect. Further, as the deemed maturity date is used for the purpose of calculation of Macaulay Duration and

Valuation of the security, the Macaulay Duration as well as the valuation of the security is incorrect. In this regard, even the CRISIL valuation note, on which the Noticees have relied upon, states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

g. Moreover, the securities which have ultimate maturity of June 30, 2027 having no explicit exit option were subscribed by smaller duration funds like FIUBF & FILDF where the Macaulay Duration requirement is 3-6 months & 6-12 months respectively and the Macaulay Duration of the above-mentioned securities is calculated by taking the reset date as the deemed maturity, which is incorrect.

h. Further, it is also observed that vide email dated April 30, 2020 the issuer had specifically communicated that it has decided not to propose the revision or reset the interest/coupon rate. Accordingly, the deemed maturity date for the purpose of calculation of Macaulay duration and valuation had to be shifted immediately. However, AMC disclosed the information with regard to no reset proposal from the issuer on July 01, 2020, after two months, and reflected the same in valuation and calculation of maturity duration from the said date. This resulted into jump in the deemed maturity (next reset date) and impacted NAVs due to Mark to Market Margin (MTM) loss ₹111 Cr. This reflects that FT-MF has not only failed to value these securities correctly but also when the information was already available that the maturity is extended the same was not reflected in NAV during the period of May 01, 2020 to June 30, 2020 (schemes were closed) and NAV was declared artificially higher.

i. In view of the above, it is noted that Fund Managers (Noticees 3 to 8) have failed to value these securities correctly and artificially maintained higher valuation and NAV of these securities during the period of May 01, 2020 to June 30, 2020 when schemes were under winding up.

ii) **AASAN Corporate Solutions Private Limited (a Piramal Group Company):**

a. I note that five of the *debt schemes inspected* (except FI–UBF), FT-MF had invested in the NCDs (ISINs - INE081T08090) issued by AASAN Corporate Solutions Private Limited (having corporate guarantee of Piramal Management Services Private Limited) on private placement basis on December 14, 2016.

b. Further, FI–UBF has invested in the NCDs (ISIN- INE081T07027) issued by AASAN Corporate Solutions Private Limited (having corporate guarantee of Piramal Management Services Private Limited) on private placement basis on March 15, 2017.

c. The maturity of these securities was on December 13, 2019 and March 14, 2020 respectively. The coupon was 9.60% per annum payable quarterly and had interest rate reset every quarter without any floor and cap.

d. The term sheet of security with ISIN INE081T07027 contains the following interest rate reset clause: *"…With respect to those debenture holders to whom the revised coupon rate is not acceptable or the debenture holders who fail to communicate their decision within the timelines mention in clause (1) above ("Dissenting debenture holders"), <u>the company shall have the right but not the obligation to redeem the debentures held by the Dissenting Debenture Holders</u>, and pay to such dissenting debenture holders the principal amount of their debentures along with all the other amounts due, including accrued coupon on such debentures on the immediately succeeding coupon payment date…"*

e. It is noted that the above clause provides exit option to Issuer on each interest rate reset date. However, the investor had no explicit option available to exit on the interest rate reset date. From the said clauses, it is noted that the reset clause provides option to call the security to Issuer but investor does not have the put option. FT–MF has considered interest rate reset date as deemed maturity for the purpose of valuation as well as calculation of *Macaulay duration*. However, it is noted that September 18, 2000 Circular permits securities with call and put options on the same date to take the said date as deemed maturity date.

f. In this regard, I note from the CRISIL valuation note, which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

g. On March 15, 2017, the terms sheet of security with ISIN - INE081T08090, that was issued on December 14, 2016, was revised and the aforesaid interest rate reset clause was added in the term sheet of this security also.

h. Further, the Noticees submitted that in case of the instant Issuer, the commercial understanding was clear between the Issuer and FT–MF. However, it is noted that commercial understanding between the Issuer and subscriber cannot be a basis for arriving at deemed maturity which has direct impact on the valuation of the securities i.e., NAV of the scheme and the *Macaulay duration* of the portfolio. Further, the commercial understanding between the Issuer and subscriber cannot be enforceable in the court of law.

i. In view of above, the interest rate reset date should not have been considered as deemed maturity date for the purpose of Valuation and calculation of *Macaulay duration* as it does not provide explicit exit option to investor (FT–MF).

iii) **Piramal Realty Pvt. Ltd:**

a. I note that three schemes, viz. FI–UBF, FI–LDF and FI–STIP had invested in the NCDs (ISINs - INE680R07012) issued by Piramal Reality Pvt. Ltd. on March 15, 2017 on private placement basis.

b. The interest rate reset clause of the said security states: *"With respect to those debenture holders to whom the revised coupon rate is not acceptable or the debenture holders who fail to communicate their decision within the timelines mention in clause (1) above ("Dissenting debenture holders"), <u>the company shall have the right but not the obligation to redeem the debentures held by the Dissenting Debenture</u>*

Holders, and pay to such dissenting debenture holders the principal amount of their debentures along with all the other amounts due, including accrued coupon on such debentures on the immediately succeeding coupon payment date".

c. It is noted that the above clause provides exit option to Issuer on each interest rate reset date. However, the investor had no explicit option available to exit on the interest rate reset date. From the said clauses it is noted that the reset clause provides option to call the security to Issuer but investor does not have the put option. FT–MF has considered interest rate reset date as deemed maturity for the purpose of valuation as well as calculation of *Macaulay duration*. However, it is noted that September 18, 2000 Circular permits securities with call and put options on the same date to take the said date as deemed maturity date.

d. In this regard, I note from the CRISIL valuation note, which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date

e. The Noticees argued that the interest has been reset on the previous reset dates in both ways (increased & decreased), the securities got matured and amount has been received. However, the fact still remains that the FT-MF had no option to exit even when it disagrees with the revised interest rate.

f. In view of the above, it is observed that the Noticees failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Further, by considering interest rate reset date as deemed maturity for the purpose of valuation as well as calculation of *Macaulay duration* even when no explicit exit option is available to investor (FT–MF), the FT–MF was valuing the securities wrongly and the calculation of *Maculation duration* is also incorrect.

With floor-Cap but no explicit option to exit

iv) **Indostar Capital Finance Limited:**

a. FI–UBF had invested in the NCDs (ISINs–INE896L07660) issued by Indostar Capital Finance Limited on private placement basis on November 2, 2018.

b. As per the interest rate reset clause mentioned in the term sheet of the security, Issuer has to communicate the proposed revised spread to the debenture holders via written notice at least 30 business days prior to the reset date and debenture holders, to whom the proposed revised spread is acceptable shall communicate their written acceptance to the issuer at least 7 business days prior to the spread reset date. *In which case the debentures held by such dissenting Debenture Holders shall be mandatorily redeemed by the issuer (the "Early Redemption")".* The spread for initial three months has been agreed at 2.25% and thereafter spread has to be reset on quarterly intervals subject to floor of 2.25% and cap of 3.25%.

c. It is noted that the spread reset proposal date was May 2, 2020 available for the above-mentioned security issued by Indostar Capital Finance. Therefore, as per term sheet written notice at least 30 business days prior to the reset date falls on or before March 16, 2020 while seven days prior to reset date when the date of communication of acceptance or rejection by the debenture holder shall be on or before April 22, 2020. However, I note from the email dated April 21, 2020 sent by Mr. Kunal Agrawal (Fund Manager) to Mr. Santosh Kamath (Fund Manager and CIO) that FT–AMC has been discussing prepayment with Indostar for a long time but the Issuer did not consider any prepayment given the market condition and agreed to give cap rate on the NCDs to the subscriber. It clearly depicts that FT-AMC has been discussing prepayment with Indostar for a long time but the issuer is not allowing to consider any prepayment given the market condition and agreed to give cap rate on the NCDs to the issuer. It was noted that FT-AMC agreed to the increased rate and was not able to secure early redemption.

d. The Noticees have admitted in their reply that in the instance where FT–MF doesn't agree with the proposed interest rate*,* no right of prepayment was available to them even in terms of the commercial understanding with Issuer because the Issuer had already agreed to pay the cap rate*.*

e. It is noted from the above that FT–MF did not have explicit exit option. It is also noted that the Noticees admitted of no right of prepayment was being available to FT–MF even in terms of the commercial understanding and still FT–MF was taking the said date as deemed maturity for the purpose of valuation and for calculation of *Macaulay duration*.

f. The Noticees submitted that in several instances the interest rates were negotiated in past and revised rates were agreed on reset dates. However, the fact remains that if the rates offered are at cap/floor rate the investor/issuer does not have exit option. Accordingly, in these securities there is no explicit exit option.

g. I also note from the CRISIL valuation note which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

h. This security is similar to a security having only call option when the interest rate is at cap rate and put option when the interest rate is at floor rate. Therefore, valuation of these securities should have not been calculated considering the reset date as deemed maturity date.

i. Considering the said reset date as deemed maturity date results into incorrect valuation of the securities and Macaulay Duration as the deemed maturity date is used for the purpose of calculation of Macaulay Duration and Valuation of the security.

j. Further, I note that as in these securities the investor has no explicit option to exit on the pre-agreed dates, holding such long duration securities in shorter duration portfolio may result into illiquidity in the portfolio.

Therefore, I find that that Fund Managers should have paid special attention while investing in securities, through duration-based schemes, with such terms of investments.

k. Further, September 18, 2000 Circular permits securities with call and put options on the same date to take the said date as deemed maturity date. In the instant case the security is akin to a security having only call option when the interest rate is at cap rate and put option when the interest rate is at floor rate and also there is no explicit exit option to investors. Therefore, the interest rate reset date cannot be taken as deemed maturity for the purpose of valuation of these securities and also calculation of *Macaulay duration*.

l. In view of the above, it is noted that the Noticees failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Further, it is also noted that by considering the interest rate reset date as deemed maturity date FT–MF has valued the security and duration of the portfolio incorrectly.

v) **Edelweiss Commodities Services Limited (ECSL):**

a. Four schemes viz. FI–STIP, FI–IOF, FI–DAF and FI–CRF had invested in the NCDs (ISINs - INE657N07605) issued by Edelweiss Commodities Services Limited on private placement basis on December 21, 2018. Further, two schemes namely FI–LDF and FI–UBF had invested in the NCDs (ISIN- INE657N07597) issued by ECSL on private placement basis on November 28, 2018.

b. The interest rate reset clause of the term sheets of both the securities states that if the Issuer does not issue any spread interest rate reset notice for the applicable quarter, the existing spread shall be applicable for such quarter Further, it was also mentioned in the term sheets that "The Debenture holders, to whom the revised spread is not acceptable, shall communicate their written intimation to the issuer at least 7 calendar days prior to such spread reset date. Spread reset shall be subject to initial spread and spread cap. *Debenture holders will not have an option* *to seek mandatory prepayments as long as the issuer agrees to pay the revised spread which will always be between initial spread and spread recap (both inclusive).*

c. In this regard, it is noted that if the Issuer doesn't propose a revised spread rate, there is no exit to the debenture holder. Further, these securities have cap and floor rate fixed. Therefore, in the instant case if the Issuer proposes cap rate the investor has no option to exit and the Issuer had exclusive discretion to propose revision in rate. If the rate is agreed at floor rate and the Issuer does not propose revision in rate, as per the agreement the floor rate will continue till maturity.

d. It may be noted that these securities were valued and Macaulay Duration of the securities were calculated by taking the reset date as the deemed maturity date, though there was no explicit exit option available on reset date to the debenture holders as per the term sheets.

e. The Noticees submitted that in several instances the interest rates were negotiated in past and revised rates were agreed on reset dates. However, the fact remains that investor has exit option only when issuer proposes revised interest rate. Further, if the rates offered are at cap/floor rate the investor/issuer does not have exit option at all. Accordingly, in these securities there is no explicit exit option.

f. I also note from the CRISIL valuation note which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

g. Considering the said reset date as deemed maturity date results into incorrect valuation of the securities and Macaulay Duration as the deemed maturity date is used for the purpose of calculation of Macaulay Duration and Valuation of the security.

h. Further, I note that as in these securities the investor has no explicit option to exit on the pre-agreed dates, holding such long duration securities in shorter duration portfolio may result into illiquidity in the portfolio. Therefore, I find that that Fund Managers should have paid special attention while investing in securities, through duration-based schemes, with such terms of investments.

i. Further, September 18, 2000 Circular permits securities with call and put options on the same date to take the said date as deemed maturity date. In the instant case the security is akin to a security having only call option when the interest rate is at cap rate and put option when the interest rate is at floor rate and also there is no explicit exit option to investors. Therefore, the interest rate reset date cannot be taken as deemed maturity for the purpose of valuation of these securities and also calculation of *Macaulay duration*.

j. In view of the above, it is noted that the Noticees failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Further, it is also noted that by considering the interest rate reset date as deemed maturity date FT–MF has valued the security and duration of the portfolio incorrectly.

vi) **JM Financial Credit Solution Limited:**

a. Two schemes namely FI–UBF and FI–LDF has invested in the NCDs (ISIN- INE651J07739), issued by JM Financial Credit Solution Limited on private placement basis on July 23, 2019. It is noted that FT–AMC has subscribed 98.33% of the said security's debt issuance. The tenor of the security is 5 years (maturity July 24, 2024) with quarterly reset of spread.

b. The term sheets of the security included the clause: *"For the sake of complete clarity, if the Debenture holders are agreeable to continue at Benchmark+ Initial Spread, the Issuer has no option to repay/ prepay. Similarly, <u>if the Issuer is agreeable to continue at Benchmark + initial spread + 300 bps, the debenture holder will have no right to ask for repayment/prepayment</u>. If Debenture holders ask for a spread of more* *than initial spread (subject to a cap of spread cap), the Issuer may choose to repay/prepay the bonds in part or full".* Apparently, the above clause means there won't be any exit or prepayment to the debenture holders if the issuer agrees to pay the cap rate.

c. It is clear from the above clause that these securities have cap and floor rate fixed. Therefore, in the instant case, if Issuer agrees to cap rate the investor has no option to exit.

d. The Noticees submitted that in several instances the interest rates were negotiated in past and revised rates were agreed on reset dates. However, the fact remains that investor has exit option only when issuer proposes revised interest rate. Further, if the rates offered are at cap/floor rate the investor/issuer does not have exit option at all. Accordingly, in these securities there is no explicit exit option.

e. I also note from the CRISIL valuation note which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

f. Considering the said reset date as deemed maturity date results into incorrect valuation of the securities and Macaulay Duration as the deemed maturity date is used for the purpose of calculation of Macaulay Duration and Valuation of the security.

g. Further, I note that as in these securities the investor has no explicit option to exit on the pre-agreed dates, holding such long duration securities in shorter duration portfolio may result into illiquidity in the portfolio. Therefore, I find that that Fund Managers should have paid special attention while investing in securities, through duration-based schemes, with such terms of investments.

h. Further, September 18, 2000 Circular permits securities with call and put options on the same date to take the said date as deemed maturity date. In the instant case the security is akin to a security having only call option when the interest rate is at cap rate and put option when the interest rate is at floor rate and also there is no explicit exit option to investors. Therefore, the interest rate reset date cannot be taken as deemed maturity for the purpose of valuation of these securities and also calculation of *Macaulay duration*.

i. In view of the above, it is noted that the Noticees failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Further, it is also noted that by considering the interest rate reset date as deemed maturity date FT–MF has valued the security and duration of the portfolio incorrectly.

vii) **Motilal Oswal Housing Finance Limited:**

a. Three schemes namely FI–LDF, FI–DAF and FI–STIP had invested in the NCDs (ISIN- INE658R08149) issued by Motilal Oswal Housing Finance Limited (Erstwhile Aspire Home Finance Corporation Limited) on private placement basis on September 27, 2018. The FT–MF subscribed 100% of the above-mentioned securities. The maturity date is September 28, 2023 and having annual spread interest rate reset mechanism.

b. The terms of investment have mention of spread for one year from the date of issuance and for subsequent years spread is agreed to be mutually decided. However, the interest rate reset clause has not addressed the instance/situation wherein the Issuer and investor does not agree to the proposed spread. It is inferred that in case there is no agreement on the proposed spread the earlier spread has to continue and there is no exit to the debenture holders.

c. In view of the above, it is noted that in case there is no agreement on the proposed spread on the spread reset dates the on-going spread has to continue and there is no exit to the debenture holders.

d. It is also noted that the valuation and calculation of Macaulay duration of the security was done by taking the interest rate reset date as the deemed maturity date, though there was no explicit exit option available to the debenture holders on spread reset date.

e. The reply of the Noticees on this observation is generic in nature and refers only to commercial understanding between issuer and FT-AMC which may not stand in the court of law. Further, the fact remains that if the revised spread is not agreed, investor/issuer does not have exit option at all. Accordingly, in these securities there is no explicit exit option.

f. I also note from the CRISIL valuation note which states that in case of non-availability of explicit exit option, the valuation and Macaulay Duration has to be calculated based on actual maturity of the security and not based on the reset date.

g. Considering the said reset date as deemed maturity date results into incorrect valuation of the securities and Macaulay Duration as the deemed maturity date is used for the purpose of calculation of Macaulay Duration and Valuation of the security.

h. Further, I note that as in these securities the investor has no explicit option to exit on the pre-agreed dates, holding such long duration securities in shorter duration portfolio may result into illiquidity in the portfolio. Therefore, I find that that Fund Managers should have paid special attention while investing in securities, through duration-based schemes, with such terms of investments.

i. In view of the above, it is noted that the Noticees failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Further, it is also noted that by considering the interest rate reset date as deemed maturity date FT–MF has valued the security and duration of the portfolio incorrectly.

78. In respect of all the above-mentioned securities it is observed that these deals were one to one negotiated deal where FT-MF had subscribed 100% or close to 100% of the issuance. However, being bespoke securities FT-MF had leverage to negotiate

various clause and insertion of following clauses terming as ‘reset clause’ has resulted into:

i. Exclusive discretion to issuer to propose reset of rates/spread as a result of which investor does not have exit option from the security at its discretion.

ii. In the scenarios where the yields have increased wildly due to market conditions or due to deterioration of the financial position of the issuer, the investor has no option but to continue with the agreement with cap rate.

iii. The terms of agreement include cap and floor rates which does not give exit option to either party and therefore the said reset dates cannot be treated as deemed maturity.

79. I note from the aforementioned seven securities that they are clear examples of contracts struck between the Issuer and the Investor (FT–MF) which are not equitable as the Issuer has a distinctive upper hand in some cases in deciding on whether to reset the interest rate or just allow the existing rate to continue. In such cases, since the interest rate reset is not automatic but at the discretion of the Issuer, the security loses the character of a floating rate bond. In some cases, the caps and floors set to the interest rate will interfere with the free movement of interest rate and hence, will not insulate the Investor from interest rate risk. Despite such fetters being placed on automatic resetting interest rates, the investor does not have the right to exit and find alternate better investment propositions. The Noticees have sought to explain away the unequal rights in contractual terms by citing the existence of a ‘commercial understanding’ between the Issuer and the Investor, which is not reduced to writing. The Noticees in their response have justified that FT-MF has commercial understanding with issuers beyond the mentioned clauses in the agreement. It is apparent that the FT-MF failed to record all such understandings in the agreement. I am of the view that commercial understanding not backed by a legal covenant will not be enforceable in a Court of Law. Further, I note that the commercial understanding cannot be a base for arriving at deemed maturity which has direct impact on the valuation of the securities i.e., NAV of the scheme and the Macaulay Duration of the portfolio. The actual duration of portfolio holding said securities would be higher if the duration was calculated taking into account the

maturity dates in terms of SEBI circular dated September 18, 2000, ignoring these artificial maturity dates.

80. The above practice of FT-MF is apparently to fit the higher yielding long terms securities as short-term securities to comply with the Macaulay Duration requirements of the portfolio even though it had the potential to create illiquidity for the short duration portfolio from where the investments were being made. I am of the view that no person engaged in the same business would take such investment decisions where debenture holders cannot exit in the extreme adverse situation and at the same time accommodate the otherwise long-term securities in short duration funds like FIUBF & FILDF where Macaulay Duration has to be in the range of 3-6 months & 6-12 months respectively.

81. It is noted that in the aforementioned securities FT-MF had subscribed to 100% or close to 100% of the issuance and the deal was on private placement basis. SEBI Circular dated July 27, 2000 specifically states that AMC Board needs to pay specific attention in case of investment in unlisted and privately placed security, unrated debt securities. Since, the investment strategy is delegated by AMC to the Fund Managers, it is the responsibility of the Fund Managers for implementation of the investment strategy of a fund and managing its portfolio of trading activities. In this instant case, it is noted that the Noticees 3 to 8 (Fund Managers) failed to pay specific attention to the clauses of the term sheets of these privately placed securities. In view of the same, I find the Noticee 3 to 8 failed to carry out proper due diligence at the time of entering an agreement and failed to ensure that the terms of investment are in favour of the unit holders of the scheme.

82. As regards the aforementioned seven securities, I note that the Noticees have admitted to certain imperfections in documentation in a few stray instances; however, the Noticees have contended that the same did not establish a systemic problem or breach of the Mutual Funds Regulations relating to due diligence, computation of Macaulay duration and valuation and classification of Schemes, especially when the commercial understanding was clear and was adhered to by all parties. In this context, it is noted that the observations of SEBI in respect of the above mentioned seven securities, had arisen on account of the outcome of an Audit conducted for only one year in respect of the debt schemes inspected. Such glaring

instances emanating even from a limited audit cannot be ignored especially when the Noticees itself have admitted to certain imperfections in the documentation. Further, the defence adopted by the Noticees that where documents do not provide an explicit exit option for the investor or assurance of a rate reset, the commercial understanding underlying the transactions was clear and was given effect to, i.e., the coupons were in fact periodically reset for these securities, cannot be accepted as such arrangements cannot be said to be enforceable in law unless exit options are clearly provided for in the term sheets/agreements.

83. In view of the above, I conclude that the fund management team (Noticees 3 to 8) failed to failed to pay specific attention to the clauses of the term sheets of these privately placed securities. Accordingly, I hold that the Noticees 3 to 8 have violated the provisions of SEBI Circular no. MFD/CIR/ 6 / 73 /2000 dated July 27, 2000 and Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996.

(ii) Calculation of Macaulay Duration

84. SEBI vide Circular no. MFD/CIR/8/92/2000 dated September 18, 2000 has issued guidelines to value securities. The circular requires the security to be valued at all call dates, put dates and maturity date. For the securities having multiple call options the circular requires that the lowest value obtained by valuing to the various call dates and valuing to the maturity date is to be taken as the value of the instrument. Similarly, in case there are multiple put options, the highest value obtained by valuing to the various put dates and valuing to the maturity date is to be taken as the value of the instruments. The securities with both Put and Call option on the same day would be deemed to mature on the Put/Call Day and would be valued accordingly. The rational for the same is that if security is trading at premium, it will be rational decision for the issuer to exercise call and exit from the agreement and enter into fresh agreement with lower coupon rate. Similarly, for put option if security is trading at discount before maturity period it would be rational decision on the part of investor to exercise put and enter into fresh agreement at higher coupon rate. Similarly, on securities with call and put option on the same date it is understood that the security will be in favour of either of the party and consequently one of the options will be exercised and the instrument will cease to exist and therefore that date can be considered as deemed maturity.

85. Conceptually reset papers with explicit exit options to both issuer and subscriber available on the reset date is similar to securities with both put & call option on the same day (reset date). Hence reset papers with explicit exit options to both issuer and subscriber available on the reset date can be accepted as deemed to mature on the reset date and valued accordingly.

86. However, if there is no explicit exit option available to both the issuer & subscriber on the reset, then reset date can't be considered as deemed maturity and the securities have to be valued considering call, put and maturity dates, whichever exist in the agreement, in line with the SEBI vide Circular no. MFD/CIR/8/92/2000 dated September 18, 2000 at the final maturity date.

87. It is noted from the audit observations that the reset dates, wherein there is cap and floor and wherein there is no explicit exit to any of the party, is taken as deemed maturity for the purpose of valuation and the said deemed maturity is used for calculation of the Macaulay Duration of the portfolio.

88. Any security having cap and floor rate is similar to a security having only call option when the interest rate is at cap rate and put option when the interest rate is at floor rate. Neither of the party has an option to exit if the cap/floor rates are offered. Therefore, for the purpose of valuation the said reset date cannot be considered as deemed maturity date. Considering the said reset date as deemed maturity date taken by FT-MF has resulted into incorrect Macaulay Duration of the portfolio.

89. Further, SEBI vide Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017 regarding Categorization and Rationalization of Mutual Fund Schemes read with SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 4, 2017 has mandated requirement of Macaulay Duration in certain debt schemes and the MFs are required to describe the concept of Macaulay Duration in the offer document of respective schemes. Against, this backdrop, I examine whether the Fund Managers (Noticees 3 to 8) have ensured calculation of Macaulay Duration correctly.

90. As per SID of Franklin India Low Duration Fund, an Open-ended low duration debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 6 months to 12 months. As per SID of Franklin India Ultra Short Bond Fund,

an Open ended ultra-short term debt scheme investing in instruments such that the Macaulay duration of the portfolio is between 3 months to 6 months.

91. The SID of the Franklin Templeton Ultra Bond Fund identified under page 12 as follows "*the Concept of Macaulay's Duration: The Macaulay duration is defined as the weighted average time to full recovery of principal and interest payments of a bond i.e***., the weighted average maturity of cash flows.** *The weight of each cash flow is determined by dividing the present value of the cash flow by the price of the bond. It is computed as follows:*

$$\textit{Macaulay Duration} = \frac{\sum_{t=1} (PV)\,(CFt) \times t}{\textit{Market Price of Bond}}$$

(PV)(CFt) = present value of cash flows of a bond at period t
t = time to each cash flow (in years)
n = number of periods to maturity

92. The portfolio concentration (as on December 31, 2019) in respect of ultimate maturity for FIUBF is tabulated as below.

Maturity profile of securities	% to total debt portfolio	Amount (Rs. in crore)
0 – 6 Months	19.42%	2876.98
6 – 12 Months	24.22%	3587.06
More than 1 year	56.36%	8349.07

93. It may be noted from the above that '% to total debt portfolio' under the 'more than 1-year category' is as high as 56.36%. It was observed that during the period FY 2019-20, in case of FIUBF and FILDF, there were 45 instances and 19 instances of securities respectively with put/call option or interest rate reset paper or both put/call & reset attached to it., out of which 3 in case of FIUBF & 2 in case of FILDF have been exercised. Moreover, some of the long-term securities (with 3 years maturity) were having frequent put / coupon reset options (quarterly/half yearly).

94. Further, it was noted that there was no rationale maintained for non-exercising the options and the credit reports do not contain evaluation of cash flow generation at each interest reset date by the issuer in respect of securities having frequent interest reset clause where issuer has obligation to repay in case of disagreement on rate.

Moreover, the minutes of the Boards of AMC and Trustees' meetings do not indicate any discussion pertaining to the non-exercise of put options, despite concentration level risks and potential liquidity risks being highlighted by the Head – Risk, repeatedly.

95. From the above-mentioned observations, it is evident that the FT-MF is using the put/call option, reset mechanism etc., to accommodate long term securities into ultrashort and low duration funds, which has repercussion on Macaulay duration as in these kinds of securities the reset date/ put-call date is considered as deemed maturity. Hence, Macaulay duration has been recalculated for FIUBF & FILDF by taking the ultimate maturity as the maturity date (the date on which principal/ face value is redeemed by the subscriber).

96. The Macaulay Duration (MD) is recalculated by just excluding interest rate reset date (of securities with floor and cap rates) as deemed maturity date; but treating all other interest rate reset dates as deemed maturity. The recalculated Macaulay duration of FI–UBF and FI–LDF is as follows.

***MACAULAY DURATION* OF FI–UBF**					
SCHEME	**31.03.19**	**30.06.19**	**30.09.19**	**31.12.19**	**31.03.20**
MD CONSIDERING ALL INTEREST RATE RESET DATE AS DEEMED MATURITY	0.47	0.49	0.49	0.50	0.54
MD NOT CONSIDERING INTEREST RATE RESET DATE WITH CAP AND FLOOR RATE AS DEEMED MATURITY	0.85	0.75	0.85	0.91	0.89

97. The Macaulay duration requirement of FI–UBF is 3 to 6 months. Excluding only the interest rate reset date with cap and floor rates as deemed maturity date, the Macaulay duration of the portfolio is much higher than the requirement of 3 to 6 months i.e., the actual duration of portfolio holding the said securities is higher when duration is calculated taking into account the maturity dates in terms of the September 18, 2000 Circular. From the above given table, it can be seen that the scheme has continuously calculated the Macaulay Duration incorrectly and breached the requirement of Macaulay Duration of the scheme. I note from the audit

observation the maturity profile of FIUBF as on December 31, 2019 states that very significant portion (56.36 %) of the debt portfolio has maturity over one year. It was also pointed out in the audit observation that for the period FY 2019-20, in case of FIUB, 27 instances had reset dates with cap and floor rate.

98. It is noted that other securities with interest rate reset clauses but without cap and floor rate are not even considered for this recalculation and still the scheme is in non–compliance with the requirement of Macaulay duration requirement for this scheme as per SEBI Categorisation circular.

***MACAULAY DURATION* OF FI–LDF**					
SCHEME	**31.03.19**	**30.06.19**	**30.09.19**	**31.12.19**	**31.03.20**
FI–LDF					
MD CONSIDERING ALL INTEREST RATE RESET DATE AS DEEMED MATURITY	0.96	0.91	1.03	1.03	1.20
MD NOT CONSIDERING INTEREST RATE RESET DATE WITH CAP AND FLOOR RATE AS DEEMED MATURITY	1.08	1.12	1.16	1.17	1.20

99. The Macaulay duration requirement of FI–LDF is 6 to 12 months. From the above given table, it can be seen that the scheme has continuously calculated the Macaulay Duration incorrectly and breached the requirement of Macaulay Duration of the scheme. Excluding only the interest rate reset date with cap and floor rates as deemed maturity date, the Macaulay duration of the portfolio is much higher than the requirement of 6 to 12 months i.e., the actual duration of portfolio holding the said securities is higher when duration is calculated taking into account the maturity dates in terms of September 18, 2000 Circular. It is observed that other securities with interest rate reset clauses but without cap and floor rate are not even considered for this recalculation and still the scheme is in non–compliance with the requirement of Macaulay duration requirement for this scheme as per SEBI Categorisation circular.

100. In respect of securities which have interest rate reset clauses with several restrictions as described above, it is reiterated that the Macaulay duration will be closer to the original maturity of the bond. Only an exhaustive audit of the portfolio

of the schemes (and not a sample audit as done by the forensic auditor) would reveal the extent of wrong calculation of Macaulay duration and the resultant misclassification of such papers in shorter duration schemes. However, even the sample analysed by the forensic auditor is a clear pointer to miscalculation of Macaulay duration and the resultant mis–categorization.

101. Further, SEBI Categorization circulars mandates requirement of Macaulay duration in certain debt schemes and Mutual Funds are required to describe the concept of Macaulay duration in the offer document of respective schemes. AMCs have the sole responsibility to ensure that the calculation of the Macaulay duration of the portfolio is in line with the regulatory requirements even in the instances where the activity is outsourced. However, it is to be noted that since these functions are delegated by AMC to the Fund Managers, it is the responsibility of the Fund Managers for implementation of the same. As noted from the above, the Noticees had incorrectly calculated Macaulay duration, taking interest rate reset dates as deemed maturity even though the covenants were not in consonance with normal floating rate bonds. Further, as an incorrect date was taken as deemed maturity date, the securities were valued incorrectly. Further, the actual Macaulay duration of duration–based schemes was much higher than what was projected by the FT-MF in the factsheet disclosed to investors. By way of taking interest rate reset date as deemed maturity date, I find that the Noticees had attempted to accommodate many long duration securities in shorter duration portfolios and had managed to run multiple schemes with similar strategy in contravention of the Categorization Circulars. Further, as in these securities the investor has no explicit option to exit on the pre-agreed dates, holding such long duration securities in shorter duration portfolio may result into illiquidity in the portfolio. Therefore, I find that that the Fund Managers should have paid special attention while investing in securities, through duration-based schemes, with such terms of investments. In view of the above, I find that the Noticees 3 to 8 have not complied with the provisions of SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 6, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 4, 2017 and Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996.

(iii)Non–exercise of exit opportunity in FI–UBF and FI–LDF

102. From the additional audit examination of the FI-UBF and FI-LDF schemes, it was noted that in FY 2019-20, there were total of 33 securities having interest rate reset mechanism or put-call options or both attached to it. From the deal dump data for the period 2017-20 with regard to the secondary market sell carried out by FTMF, it was observed that only 4 out of the 33 securities were sold in the secondary market in the period 2017-20 and in value term the secondary market sell of those 4 securities is abysmally low at 1% of the total secondary market sell carried out by FTMF in the period 2017-20.

103. Further, in respect of 36 and 15 instances available for FI–UBF and FI–LDF respectively during FY 2019-20 the market yield of the security (as on put/call notice date, interest rate reset notice date by considering notice day 30 days prior to the interest rate reset date) was more than the coupon yield at the time of such notice and the FT–MF was also facing liquidity issues October 2019 onwards. It is noted that in the said situation also Mutual Fund remain invested with higher negotiated coupon rate. It is noted that debenture holder could not exit from the investments on the pre-decided call/put and interest rate reset dates even when there was requirement of funds.

104. The Noticees 3 to 8 submitted that due to lack of liquidity in secondary market trades FT-MF heavily relies on scheduled maturities, coupons and pre-payments/buy-backs. In this regard, it is noted that during the FY 2019-20 there were total of 33 securities in the portfolio of FI–LDF and FI–UBF having interest rate reset clause and/or put-call options. There were 45 instances and 19 instances for FI–UBF and FI–LDF respectively during FY 2019-20 where the schemes had call/put and/or interest rate reset dates however in only 3 and 2 instances FI–UBF and FI–LDF respectively exercised the option. It is noted that the option of pre-payment is not exercised by FT–MF.

105. While the submissions of the Noticees is acceptable that there is no direct loss to the investor as FT-MF managed to get higher yield for investor but it is pertinent to note that this results into short duration schemes holding long duration high yield securities. In reference to the observation of non-exercising put option post downgrade of rating of the securities, the Noticees submitted that for different

issuers, they were able to get the partial pre-payment, get additional collateral, personal guarantee. These issues have been dealt in subsequent paragraphs on Valuation Practices.

106. It is also noted that majority of these securities were bespoke securities and their secondary market trades were virtually zero and securities having put and call options were rarely exercised. It clearly indicates that FT-MF was following a strategy to keep the securities till maturity.

107. The Noticees also admitted that FT-MF heavily relied on scheduled maturities coupons and pre-payments/buy-backs. In this regard the Noticees stated that "given that the secondary market for corporate bonds is not very large and that this is an industry wide phenomenon, FTMF has as a strategy actively looked to rely more heavily on other means of monetisation such as scheduled maturities, coupons and pre-payments/buy-backs. In other words, the schemes have historically relied on scheduled maturities, coupon payments and pre-payments/buy-backs along with secondary sales as sources for liquidity."

108. It may be noted that having strategy to hold securities till maturity by inserting call and put options on the same date and reset clauses FT-MF has artificially managed to reduce the Macaulay Duration of the portfolio. As a consequence, the scheme had substantial holdings of bespoke, lower rated and illiquid securities.

109. It is pertinent to point out here that the Noticees in their reply have vividly described the emerging liquidity stress in the portfolio since October 2019. In the Noticees' own words, it is as under: "However, signs of stress began to emerge in the portfolios of the Schemes commencing from the 24 October 2019 ruling of the Hon'ble Supreme Court of India in the AGR matter, which had serious financial repercussions for Vodafone Idea Limited (to which the Schemes had significant exposure), which ultimately culminated in the bonds being segregated from the main portfolio in January 2020. Such stress was aggravated and redemptions accelerated as a result of downgrades and defaults involving Essel Group bonds in December 2019, Yes Bank bonds in February 2020 and Reliance ADA Group bonds in March 2020. This was compounded by the fact that after 1 October 2019, the unlisted securities in the Schemes' portfolios were no longer marketable to most other market participants.

These pressures were then further exacerbated by the market dislocation arising from the COVID–19 pandemic.” Considering the numerous instances where the exit option was not exercised, it is noted that the same had resulted in situations where the Mutual Fund remained invested with higher negotiated coupon rate and debenture holders could not exit from the investments on the pre–decided call/put and interest rate reset dates even when there was requirement of funds. It is also relevant to note that the inspected debt schemes had exposure to total illiquid securities in the range of 73% to 85% for the month of May, 2019 and in the range of 85% to 94% for the month of January, 2020. These figures presented by the Head–Risk Management highlight the illiquid nature of the portfolio of the debt schemes inspected, long before the Covid–19 pandemic hit the financial markets. It is not clear why the Noticees did not exercise the exit option in the face of increasing liquidity stress. The Noticees did not produce any records or documentary evidence to justify the rationale of such decisions. I am therefore, not inclined to accept the contention of ‘business judgment’, as advanced on behalf of the Noticees.

110. In view of the above, I find that that the Fund Managers failed to exercise exit options in the schemes of FI-UBF and FI-LDF, when it was available. In view of the above, I find that the Noticees 3 to 8 have not complied with the provisions of SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated Oct 06, 2017, SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated Dec 04, 2017 and Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996.

C. VALUATION PRACTICES

– Alleged violation by Noticees 3 to 8

(i) Failed to ensure that the changes in terms of investments are made available immediately for disclosure to Valuation Agencies, Credit Rating Agencies and also for correct disclosure of portfolio to investors

111. The irregularities observed with respect to valuation of certain securities/Issuer detailed as under:

(a) OPJ Trading Ltd.

i. Four schemes, viz. FI–STIP, FI–DAF, FI–IOF and FI–CRF had invested in NCDs issued by OPJ Trading Ltd (ISIN – INE507R07033) on October 16, 2017 having maturity of 3 years with call and put option at the end of each year. The agreed coupon rate was 13.00% for first year, 13.50% for second years and 14.00% for third year. Post–Inter scheme transfers ("**IST**") three schemes of FT–MF namely FI–STIP, FI–DAF, FI–CRF together held 100% of OPJ Trading Ltd. Debentures comprising of ₹175 Crore.

ii. It was observed from an unsigned amended Debenture Trust Deed (DTD) in October 2019, that a new put option dated December 31, 2019 was inserted and there was revision in the rate of interest from 14% to 16% from October 16, 2019 (which was date of exercise of 2nd year put option). However, the changes in terms of securities were neither communicated to custodian nor to the valuation agency.

iii. Further, FT–AMC vide email dated December 12, 2019 had negotiations with Issuer and the following was agreed:

   a. The amount that remains outstanding as on December 31, 2019, a one-time compensation fees of 1% of the outstanding amount to be paid on or before December 31, 2019.

   b. An additional put option to be inserted for January 31, 2020 on which entire exposure has to be repaid.

iv. However, the debenture trust deed was amended in this regard on December 24, 2019 without mentioning that the entire exposure has to be repaid on January 31, 2020. It was observed that the put option was not exercised on January 31, 2020 and the outstanding amount was not received by FT–MF. The DTD was again revised on January 24, 2020 inserting new put option of February 28, 2020 and one-time fees for an amount equivalent to 0.75% of the outstanding amount on or prior to March 2020. The put option was again not exercised on February 28, 2020 and on the same day the debenture trust deed was amended and a new put option was inserted for March 31, 2020 and one-time charge of 0.75% of the total outstanding amount is agreed to be paid prior to February 29, 2020.

v. Issuer made payment on March 20, 2020 of ₹17.09 Crore and a query was raised by the custodian of FT-MF vide e-mail dated March 23, 2020 that the interest amount received from the Issuer is at an interest amount @ 16% instead of 14% from October 2019.

vi. Thereafter, the back office of FT–MF raised this issue with the fund manager vide e-mail dated March 23, 2020. In reply to the query, fund management team shared the unsigned amended DTD dated October 2019 (date not mentioned) with the back office stating that rate of interest is 16% from the start of third year of the bond. It is apparent that even the back-office team was unaware of the fact of change in interest rate

vii. In this regard, the back-office team raised query in email to custodian to check what interest rate is considered for the valuation. On the same day, custodian shared the revised rate of interest and debenture trust deed with valuation agencies for valuation of the security.

viii. It is noted that FT–MF has agreed that there was omission in communicating such changes in terms of investment to the back–office team within FT–MF and to valuation agencies.

ix. Further, the monthly disclosure of the portfolio by FT–MF on its website also reflected 14% as interest rate instead of the revised rate of 16% during the disclosure for the month of October 2019 to February 2020. The change in interest rate in disclosure was reflected only in March 2020 portfolio. In view of the above, it is noted that the disclosure of FT–MF with regard to monthly portfolio was incorrect during October 2019 to February 2020.

x. It was further observed that the put option was not exercised on March 31, 2020 also and the remaining amount of ₹171.09 Crore was received on April 07, 2020 and the transaction is mentioned as buy back of securities by Issuer.

xi. The Table below provides details of penalty/compensation/one-time charge received from Issuer for to defer the put option date and resultant payment which were deposited in the schemes:

Sr. No.	Particulars	Date of Receipt	Amount (₹ in Crore)
1	1% of outstanding amount agreed in DTD amended on December 24, 2019.	1.01.2020	1.80
2	0.75% of outstanding amount on agreed in DTD amended on January 24, 2020.	31.01.2020	1.37
3	0.75% of outstanding amount agreed in DTD amended on February 28, 2020.	02.03.2020	1.39

xii. The Noticees submitted in their reply that under the terms of the debentures issued by OPJ Trading Limited (OPJ), FT–MF was entitled to exercise its put option and demand prepayment on October 16, 2019. However, considering OPJ agreeing to: (a) an increased rate of interest on the debentures (increase from 14% to 16%); (b) increase in cover of the exclusive pledge and (c) OPJ granting FT–AMC a fresh put option (prepayment option) exercisable on 31 December 2019, FT–MF agreed to refrain from exercising its prepayment option exercisable on October 16, 2019.

xiii. In this regard, it is noted that option exercise date was October 16, 2019 and the amendment to the DTD was executed at New Delhi on October 25, 2019 i.e., 10 days after the option exercise date. Therefore, the decision of not exercising put option was not based on the revised agreed terms as the terms were agreed much after the put option exercise date and much after the last date for the notice period of exercise of put option. From the given fact it is noted that FT–MF wanted to exercise put option but the Issuer showed inability to pay on the put option exercise date and therefore FT–MF started negotiating the revised terms with Issuer and then the amendment to the debenture trust deed was executed at New Delhi on October 25, 2019 i.e., 10 days after the option exercise date. Thereafter, rather than reflecting the inability of issuer to make payment and default by the issuer in the valuation of security, FT-MF decided to hold on the information and started negotiating the revised terms with issuer.

xiv. Further, it is noted that as the change in terms of reference and interest rate was not communicated to the rating agencies as well as valuation agency and the same were not taken into account for valuation from October 16, 2019 to March 23, 2020.

xv. Further, FT–MF has informed that the impact of increase in interest from 14% to 16% was miniscule on NAV of the scheme and in terms of the SEBI Circular dated 24 September 2019, the aforementioned put options/ prepayment options, which were inserted subsequent to the issuance of the debentures, are to be disregarded for the purposes of valuation.

xvi. In this regard, it is noted that the valuation of security is not only affected by the coupon rate of the security but also yield of the security which is result of several factors taken into account while trading in market like sector specific risk, issuer level risk, probability of default of Issuer, liquidity of the security etc., I note that disclosure of the fact to the valuation agency and credit rating agencies adversely affects the valuation of securities and rating of the Issuer gets reviewed.

xvii. Further it is noted that for the said security, five times a put option was not exercised by FT–MF and for deferred exercise of put option one-time penalty was charged to the Issuer on the outstanding amount. It is noted that there are four instances wherein the Issuer has paid one-time penalty for deferment of payment and it could not honour its obligation on the pre-decided dates. This clearly indicated that at every instance of exercise of put option the issuer showed inability to pay the amount for which FT-MF charge penalty to the issuer and gave one more month time to issuer to repay the outstanding amount by inserting new put option.

xviii. It is noted that FT–MF was the only investor of the issue and the information with respect to inability of payment by Issuer and subsequent negotiations with Issuer were held by the fund manager and its team and was not disclosed to valuation agencies and credit rating agencies. This restricted flow of information due to which the financial stress of the Issuer and inability to pay was not reflected in the valuation as well as rating of the Issuer could not be reviewed.

xix. The important thing to note here is that the information with respect to non-payment by issuer on exercise of put option and subsequent negotiations with issuer after the default and changed terms of investment was held by the fund manager and its team and not disclosed to valuation agencies and credit rating agencies due to which the financial stress of the issuer and default could not get reflected in the valuation as well as rating of the issuer could not be reviewed. The FT-MF being the only investor of the issue, by not sharing the information, has led to higher rating for the issuer.

xx. From the submissions made by the Noticees it is noted that on one hand FT–MF submitted that Issuer's financial health was sound and on the other hand, it admits that FT–AMC's investment team was continuously seeking prepayment from OPJ by leveraging the put options under the terms of issue. This reflects that issuer was unable to pay and FT–MF has neither disclosed the said information for the valuation purpose nor has taken into account the stress of the Issuer for the purpose of fair valuation of securities.

xxi. Further, it is noted that the investors in mutual fund enter and exit the scheme based on daily NAVs and the ultimate responsibility of fair valuation of securities is of AMC. In the instant matter FT–MF had the information which would have adversely affected the valuation of the security but it failed to incorporate such information to reflect the fair value of the security. By artificially maintaining high NAV from October 16, 2019 to March 23, 2020, FT–MF adversely affected the investors who entered the scheme during the said period and benefited to the investors who exited from the scheme during the said period. Therefore, valuation of the security is in contravention of the Principle of Fair Valuation. Thus, FT–MF has not ensured fair treatment to all investors including existing investors as well as investors seeking to purchase or redeem units of mutual fund scheme at all points of time.

xxii. Further, with respect to valuation of security the Noticees argued that put options inserted on subsequent dates to the issuance of debentures are not to be considered for valuation in terms of SEBI circular dated September 24, 2019 and the approximate change to the NAV of the schemes that would have occurred due to increase in the rate of interest was miniscule, i.e., within the range of 0.007% to 0.01%.

xxiii. In this regard it is noted that valuation of security is not only affected by the coupon rate of the security but also yield of the security which is result of several factors taken into account while trading in market like sector specific risk, issuer level risk, probability of default of issuer, liquidity of the security etc. On disclosure of fact to the valuation agency and credit rating agencies, it would have impacted the valuation of securities of the issuer and rating of the issuer could have been reviewed and this would have also resulted into reflection of stress in market trades of the underlying security.

xxiv. However, the security value would have undergone change based on action of CRA and changed coupon rate. Also, though the Fund Management team was aware about the modification in interest rate, the same was not informed to the back-office team, the fair value based on their assessment. Therefore, the value at which security was valued during the period October 16, 2019 to March 23, 2020 was not be correct based on fair value principle. By not proactively disclosing such change in terms of investment to valuation and rating agencies, the fund managers have failed to act in the best interest of the investors. Hence, the Valuation of the security is in contravention of the Principle of Fair Valuation.

(b) Effect of Deferment of interest / principal payment on valuation of securities issued by Future Group

i. FT–MF held NCDs issued by companies forming part of Future Group. Value of such securities was totalling to ₹1025.74 Crore. On April 13, 2020, Future group requested for moratorium/deferment of interest/principal payment on securities issued to FT-FM citing the reason that due to COVID-19 lockdown their cash-flows are affected. Four of the six *debt schemes inspected* had investments in these securities of Future Group. On April 18, 2020, FT-FM agreed internally to grant moratorium to Future Group and the same was communicated to Issuer on April 18, 2020 but to valuation agencies on April 28, 2020**.**

ii. FT–MF was the sole debenture holder of the aforesaid Future Group NCDs. Therefore, the decision of FT–MF on the proposal of Future Group was final and debenture trustees had to be informed just for formal documentation.

iii. It is noted that FT–MF has not communicated the acceptance of moratorium/deferment of payment proposal of Future Group to the valuation agencies till April 28, 2020. As a result, the valuation of these securities has not reflected the financial stress of the Issuer. In terms of SEBI circular dated September 24, 2019, which was applicable, on April 18, 2020 when the FT–MF accepted the proposal of Future Group on deferment of payment by FT–MF, in case the interest/principal amount is not received or the maturity date is extended, the valuation agencies are required to treat the security as Default for the purpose of valuation.

iv. It is noted that in view of principles of fair valuation, it was the responsibility of FT–MF to take into account the impact of change in cash-flow on the valuation of the securities for the purpose of valuation from April 13, 2020 and the effect of change in realizable value of the security from April 18, 2020 when FT–MF concluded that there is a need to give moratorium as there is impact on the cash-flow of the company. Any impact on the cash flows of the company has definite impact on the valuation of the securities. It is also noted that there is no deliberation by valuation committee on valuation of Future Group securities at the time when FT–MF agreed internally to grant deferment of payments and also nothing regarding the request and acceptance of deferment of payments of Future Group was communicated to the unitholders. It is noted that valuation committee of FT–MF failed to record the reason for not recognizing the effect of moratorium on valuation of the securities. Further, at least on April 18, 2020 when after internal deliberation FT-MF concluded that there is a need to give moratorium as there is an impact on the cash-flow of the company they should have reflected this in the valuation of the securities. Even if FT-MF arrived at conclusion that there is no valuation impact of such vital information that needs to be recorded through minutes of valuation committee which was apparently not done, which makes it apparent that these submissions are mere distractions.

v. However, the impact of moratorium on valuation is considered on 28th April 2020 which is evident from the press release provided by FT–MF on its website on 29th April 2020. The valuation impact as per the press release is substantial & is mentioned in the table given below.

Scheme Name	Plan	NAV as on 27th April 2020	NAV as on 28th April 2020	% Movement
Franklin India Credit Risk Fund	Direct - Growth	19.4986	19.2037	-1.51%
Franklin India Dynamic Accrual Fund (FIDA)	Direct - Growth	70.3225	69.087	-1.76%
Franklin India Short Term Income Plan	Direct - Growth	4015.0258	3909.226	-2.64%
Franklin India Income Opportunities Fund	Direct - Growth	22.9258	22.0546	-3.80%

vi. It is evident that though the moratorium agreed on 18th April 2020, the impact on valuation is considered on April 28, 2020 post communication by Debenture Trustee. On April 18, 2020 it was decided by the FT–MF to give moratorium and considering the fact that they are the only investor in said securities the decision was apparently final. It is noted that FT-MF has not informed the decision of granting moratorium to valuation agencies immediately for the purpose of valuation. Further, they failed to follow the principle of fair valuation and valued the security by reflecting the effect of granting such moratorium. Hence, the security was not valued fairly considering moratorium impact during April 18, 2020 to April 27, 2020.

vii. It may be noted that the investors in mutual fund enter and exit the scheme on daily NAVs. Artificially maintaining high NAV from April 18, 2020 to April 27, 2020 (by not taking into account valuation impact of change in terms) which has adversely affected the investors who continued to hold the units and benefited the investors who exited from the scheme during the said period. Therefore, FT-MF failed to ensure fair treatment to all investors including existing investors as well as investors seeking to purchase or redeem units of mutual funds in all schemes at all point of time.

viii. Further, the Noticees stated that post communication of such moratorium on April 28, 2020 to valuation agencies, since one of the valuation agencies has taken a 25% haircut whereas the other valuation agency didn't take any haircut, in compliance with SEBI circular no. SEBI/HO/IMD/DF3/CIR/P/2020/70 on 23 April 2020, the FT-MF has taken the conservative price and the NAV was impacted subsequently. With regard to SEBI circular dated April 23, 2020, it may be noted that the said circular only gives discretion to the valuation agencies on treatment of default in case of delay in payments due to Covid19 lockdown impact and/ or in light of the moratorium permitted by RBI when it leads to temporary operational challenges in servicing debt. The circular nowhere prohibits to not reflect stress in the cash-flows in the valuation of the securities rather para 6 of the said circular explicitly makes it responsibility of the FT-MF to fairly value the securities. In this regard, it is to be noted that RBI has permitted granting of moratorium to banks and there is no such provision in respect of MFs, who are in fact governed by provisions of SEBI circular dated September 24, 2019 to treat any deferral of payments as default.

ix. It is to be noted that fair valuation of a security refers to the market realisable price of the said security on that day. On April 18, 2020 when the moratorium proposal was agreed, there is definitely impact of the same on the valuation of the securities as deferring the receivable has probable impact on yield of the securities or deferring the maturity which necessarily have consequences on valuation. Though the formal approval of debenture trustee was not received (the copy of which has to be shared with valuation agencies for any price impact), the FT-MF should have acknowledged the valuation impact in pursuant to the moratorium given to the future group NCDs and should have reflected the market realisable value of the NCDs considering the moratorium impact. Fair valuation at a time of huge redemption could have ensured fairness between the unitholders who redeemed and who were still there post such action. However, FT-MF has artificially maintained high NAV from April 13, 2020 onwards and definitely from April 18, 2020 onwards. This has adversely affected the investors who continued to hold the units and benefited the investors who exited from the scheme during the said period. Therefore, I find that the Fund Managers viz., Noticees 3 to 8 failed to ensure that the changes in terms of investments are made available immediately for disclosure to valuation agencies and credit rating agencies and also for correct disclosure of portfolio to the investors. Accordingly, I hold that the Noticees 3 to 8 had violated the provisions of Clause 9.1.1 of SEBI circular No. SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019 and Clause 1 of SEBI circular No. SEBI/HO/IMD/DF4/CIR/P/2019/126 dated November 06, 2019, SEBI Circular no. CIR/IMD/DF/21/2012 dated September 13, 2012 and Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996.

D. MANAGING VARIOUS RISKS PERTAINING TO SECURITIES IN THE PORTFOLIO OF THE SCHEMES

(i) High Exposure in Unlisted / Illiquid Debt Securities

– Alleged violation by Noticees 1 to 8

112. It is observed that all debt schemes inspected had several subscriptions wherein entire or major portions of issue size of a security issued by an Issuer was subscribed by these schemes. Further, it is observed that debt schemes inspected, also subscribed to unlisted securities. Following is the exposure of FT–MF schemes in such securities

EXPOSURE OF FT–AMC SCHEMES IN UNLISTED / ILLIQUID DEBT SECURITIES										
SCHEME NAME	70 % & ABOVE						OTHER UNLISTED		TOTAL	
	UNLISTED % TO 70% & ABOVE		LISTED % TO 70% & ABOVE		TOTAL % OF 70% & ABOVE TO PORTFOLIO		% TO PORTFOLIO		% TO PORTFOLIO	
	31.12.19	31.03.20	31.12.19	31.03.20	31.12.19	31.03.20	31.12.19	31.03.20	31.12.19	31.03.20
FI–CRF	29.28%	26.03%	70.72%	73.97%	60.55%	67.13%	8.95%	9.53%	69.50%	76.66%
FI–DAF	35.41%	33.53%	64.59%	66.47%	61.49%	68.12%	10.75%	9.69%	72.24%	77.81%
FI–IOF	48.44%	39.72%	51.56%	60.28%	55.26%	58.67%	8.43%	7.82%	63.69%	66.48%
FI–LDF	39.17%	36.94%	60.83%	63.06%	65.15%	76.82%	7.89%	4.77%	73.04%	81.59%
FI–STIP	38.43%	33.48%	61.57%	66.52%	59.44%	68.73%	10.91%	12.25%	70.34%	80.98%
FI–UBF	29.85%	31.41%	70.15%	68.59%	50.48%	55.58%	12.29%	7.71%	62.76%	63.29%

113. The total number of Securities where FT-MF had invested 70% or more of issue size involved in the above table is 142 having aggregating value of ₹24,250.90 Crores as on December 31, 2019. The total number of other unlisted securities involved in above table is 27 having aggregating value of ₹4,514.62 Crores as on December 31, 2019. During period 1 April 2017 to 31 March 2020, FTMF has done only 8 secondary trade aggregating value of ₹393.57 crores involving above securities. Further, from review of AMFI Debt Trade Dump for the period April 2019 to March 2020, it is observed that only two securities where FT-MF holding more than 70% were traded in secondary market on two days aggregating to Rs. 82.88 crores and two unlisted securities were traded aggregating to ₹174.37 crore. From the above given table, it is noted that the schemes had holding of such securities in the range of 63% - 73% as on December 31,2019 and 63% - 82% as on March 31, 2020.

114. It appears from the above data that most of these securities mentioned in above table were either traded very few times in secondary market or majority of them were never traded by mutual funds. Thus, these securities are thinly traded and hence, not easily saleable and illiquid in nature.

115. It is noted that the Noticees submitted in their reply that it is a credit rating of security which determines liquidity and not the listing status of the security. In this regard, even if the credit rating is considered as a factor for illiquidity it is noted from the table given below, that all debt schemes inspected have exposure of more than 65% of net asset of the schemes to securities rated AA and below consistently for a long time.

% of AUM					
Scheme	**31–Mar–19**	**29–Jun–19**	**30–Sep–19**	**31–Dec–19**	**31–Mar–20**
FI–CRF	**82.90%**	**76.14%**	**75.96%**	**85.94%**	**97.99%**
FI–DAF	**81.30%**	**77.27%**	**75.31%**	**86.09%**	**88.60%**
FI–IOF	**73.34%**	**71.56%**	**78.67%**	**83.58%**	**96.82%**
FI–LDF	**71.42%**	**70.94%**	**73.40%**	**84.04%**	**105.51% #**
FI–STIP	**81.51%**	**74.72%**	**76.52%**	**79.84%**	**101.42% #**
FI–UBF	**76.06%**	**69.46%**	**69.91%**	**72.68%**	**93.49%**

#*Due to borrowings, percentage has exceeded 100%.*

116. Further it is also noted that Head–Risk Management of FT–AMC, in his presentation to the Board of FT–AMC also highlighted increase in partial liquid (‘AA’ rated bonds) or potentially illiquid securities (‘A’ and below rated bonds) and its impact on one-week liquidity. From the said presentation, it is noted that debt schemes inspected

had exposure to total illiquid securities in the range of 73% to 85% for the month of May, 2019 and in the range of 85% to 94% for the month of January, 2020.

117. Risk management function as part of its presentations (May 2019, August 2019, September 2019 & January 2020) has highlighted liquidity/concentration risks where the entire fixed income issuance/ significant share of a fixed income issuance across the industry is held by Franklin Templeton schemes. As confirmed by management response, credit rating of security will be the base for determining the liquidity of corporate bond. Further management responses itself confirms that there is lack of depth in secondary bond market, especially for AA & below rated bonds.

118. Even though FT-MF was aware, that there is lack of depth in secondary bond market especially for AA rated & below, the investment in AA & below rated security was continued in FY 19-20 & which has resulted into significant increase in investment composition of AA & below rated securities (Refer table mentioned below). Further as evident from *risk management presentation (liquidity analysis), in case of FIUF scheme, one month coverage ratio was continuously below 1 from May 2019 till January 2020.

**Risk Management Presentation for the month of May 2019*

Fund Name	AA Rated Bonds & CP Lower than A1+ up to 1 month		Bonds Rated "A" & below		Total of Partially liquid & potentially illiquid		% of change of partially liquid & Potentially illiquid from May 2019 till January 2020	#1 Week Liquidity		% of change in one week liquidity from May 2019 till January 2020
	MAY'19	JAN'20	MAY'19	JAN'20	MAY'19	JAN'20		MAY'19	JAN'20	
	PARTIALLY LIQUID % to AUM		POTENTIALLY ILLIQUID % to AUM		Total of partially liquid & potentially illiquid % to AUM		Increase in % of illiquid Portfolio	1 Week Liquidity		Decrease in One week liquidity
FISTIP	37%	41%	45%	49%	82%	90%	**9.76%**	18%	10%	**-44.44%**
FICRF	36%	48%	49%	46%	85%	94%	**10.59%**	15%	6%	**-60.00%**
FIIOF	39%	49%	44%	41%	83%	90%	**8.43%**	17%	10%	**-41.18%**
FIUBF	38%	66%	35%	19%	73%	85%	**16.44%**	27%	15%	**-44.44%**
FILDF	28%	35%	47%	50%	75%	85%	**13.33%**	25%	15%	**-40.00%**
FIDA	33%	49%	51%	43%	84%	92%	**9.52%**	16%	8%	**-50.00%**

 # Percentage of one week liquidity consist of CBLO, Govt. Securities, CD, AAA rated bonds & CP having A1+ rating.

119. Management responses confirmed that schemes were not heavily reliant on secondary market sale to liquidate the portfolio. Out of the total liquidity generated in FY 19-20 & FY 18-19, amounting INR 50,061.99 crore & INR 76,618 crore respectively, only INR of 11,454.86 crore (22.88%) & 15,622 crore (20.39%) respectively was realized through secondary sale. Also, the investment strategy to investment in the issue size (70% & above) of a particular security, contributes investment of FT-MF & the secondary sale of these securities is approx.1.83% out of the total secondary sale of security during the period April 2017 till April 202 and out of the total secondary sale of security which constitute value of INR 11,454.86 crores only INR of 417.38 crore (3.64%) was of securities in which FT-MF subscription is 70% & above during the period April 2019 till March 2020. Further, it is noted that minimum 55% to portfolio was having exposure in security where the subscription is 70% & above in all six schemes.

120. In its reply, the Noticees had submitted that along with AMFI, it had made representations requesting for certain measures to ease such liquidity pressures, such as providing for a one-time listing window for existing unlisted securities and allowing 'grandfathered' securities to be traded amongst mutual funds, etc. After the Schemes had already been wound-up, such amendments were introduced, which showed the legitimacy of the concerns raised by the Noticee.

121. It is relevant, at this juncture, to throw some light into the facts that necessitated the reforms introduced in October 2019. In light of credit events since September 2018 (IL&FS default, etc.) that led to challenges in the corporate bond market, a need was felt to review the regulatory framework for Mutual Funds and take necessary steps to safeguard the interest of investors and maintain the orderliness and robustness of their investments. It was observed that unlisted debt securities, particularly bespoke securities in which only a single investor invested, suffered from both forms of opaqueness: opaqueness of structure and true nature of risk on the one hand and lack of ongoing disclosure in respect of financials of the issuer on the other. In order to address these issues and improve transparency and disclosure of investments in debt securities made by mutual funds with money entrusted to them by investors, SEBI had constituted various working groups. Working groups representing AMCs,

industry and academia were set up to review the risk management framework with respect to liquid schemes and to review the existing practices on valuation of money market and debt securities. Further, an internal working group was constituted to, inter-alia, review prudential norms for Mutual Funds for investment in various debt and money market instruments. The analysis along with recommendations of the working groups was placed in a meeting of Mutual Fund Advisory Committee ("MFAC") held in June 2019. MFAC had made several recommendations for prudential norms for Investment in Debt and Money Market instruments by Mutual Funds including investments only in listed NCDs and Commercial Papers ("CPs") in the interest of greater transparency and accountability. SEBI Board after deliberations in its meetings held in August 2019, and taking into account the recommendations of MFAC inter alia approved the following prudential norms for investment in listed debt securities:

> *"Mutual Fund schemes shall be mandated to invest only in listed non-convertible debentures (NCDs) and the same would be implemented in a phased manner. All fresh investments in Commercial Papers (CPs) shall be made only in listed CPs pursuant to issuance of guidelines by SEBI in this regard. However, the mutual funds to have flexibility to invest in unlisted NCDs up to a maximum of 10% of the debt portfolio of the scheme subject to such investments in unlisted NCDs having simple structures as may be specified from time to time, being rated, secured and with monthly coupon payments. This shall be implemented in a phased manner by June 2020."*

122. SEBI vide a Circular dated October 1, 2019, provided a timeline to comply with the investment limits for unlisted NCDs as 15% and 10% of the debt portfolio of the scheme as on March 31, 2020 and June 30, 2020 respectively (over a year from the date of recommendations by MFAC). In addition, it permitted mutual funds to grandfather the existing investments in unlisted debt instruments (as on the date of the circular) till maturity of such instruments, so as to not disrupt the market. These dates were subsequently extended to September 30, 2020 and December 31, 2020, respectively in view of Covid related disruptions. It is important to note that SEBI has permitted holding and trading in unlisted debt instruments but with simple structure. Debt securities which were not with simple structure were allowed to be grandfathered by mutual funds. It is important to note that these schemes of the FT-

MF had concentrations of high risk, unlisted, bespoke, structured debt securities with low credit ratings and where there was supposedly commercial understanding, as per the Noticees, which were not reflected in the term sheets. To tackle the issue of these kind of opaque deals in the market, SEBI had restricted trading of these securities and permitted holding of securities till their maturity. These schemes were having exit option from these securities by way of exercising put option and reset clauses. However, the FT-MF chose to remain invested in such illiquid securities.

123. It is noted that during the period of October 2019 to March 2020 there were 8 instances of put options in FI–UBF scheme which the FTMF had not exercised and the total market value of that securities as on the date of put option was around ₹900 Crore. Further, there were 15 instances of interest rate reset (excluding the call and put options) wherein the scheme had not exited even though the security had become illiquid and the amount involved is ₹4,708 Crore. Similarly, in the low duration scheme, during the period of October 2019 to March 2020 there were 4 instances of put option which were not exercised and the amount involved was ₹315 Crore. These instances of non-exercise of put option was part of the forensic audit/inspection observations also.

124. I am of the view that the FT-MF's decision to remain invested in such illiquid securities is a strong pointer to the (commercial) arrangement of lending money to the issuer for the pre–decided time or until the issuer repays. The resultant failure to manage liquidity exacerbated the redemption pressures due to Covid–19. This resulted into systemic risk which constrained the Regulator to permit the dispensation of grandfathering such securities. Prudence on the part of the FT-MF should have dictated capping of such investments at a much lower level given their bespoke structure and opaqueness. The changes in the regulatory framework would have had an impact on all Mutual Fund houses. As such, the changes introduced did not affect other Mutual Funds resulting in a winding up of their debt schemes. As rightly contended by the Noticees, the illiquidity of the secondary market for corporate bonds is well known and this very fact should have weighed in the minds of the Noticees to limit the investments in such securities to a bare minimum in the interests of maintaining liquidity. The Noticees have shifted the blame for all the ills

of portfolio illiquidity to the regulatory changes and Covid–related market pressures only to hide his total lack of prudence in managing the liquidity risk.

125. Further, the Noticees' submission that it had a differentiated investment strategy for the Schemes with a view to deliver superior risk–adjusted returns for investors, which was in consonance with the regulatory framework at all times, is not true. It is noted that the investment strategy for the schemes may be distinguishable when compared to the investment strategy of peer group or other MFs but internally all the schemes had similar investment strategies, which brought these schemes to the precipice in the face of mounting redemption pressures.

126. The source of liquidity during F.Y. 2019-20 is as under:

Source of liquidity during FY 19-20			
Particular	Source of liquidity	Amount (in Cr)	% to total
Other than Secondary sale	**IST**	**15,295.00**	**30.55%**
	Maturity	10,160.87	20.30%
	Prepayment/buyback/earlier redemption	9,219.82	18.42%
	Coupons	3,931.45	7.85%
	Total of other than secondary sale	**38,607.14**	**77.12%**
Through Secondary sale	**Secondary sale**	**11,454.86**	**22.88%**
Total Liquidity		**50,061.99**	**100.00%**

127. From the above table, it is observed that out of total secondary sale of ₹11,454.86 crores, only ₹417.38 crore (3.64%) trades belonged to securities where FT-MF held entire or major portion of issue size. This is also additional indication of illiquidity of underlying securities. The securities in which subscription is more than 70% are not saleable in secondary market. The liquidity is generated mainly from other than secondary sale as the portfolio contains the securities are either AA rate & below or 70% & above or both. Thus, it is seen that FT-MF could not sale the AA rated & below securities even though they had redemption pressure and resorted to borrowing to honour the redemption obligations.

128. It is noted that during 2019–20, the liquidity generated by the six schemes through various means is ₹50,062 Crore of which the liquidity generated through IST is approximately ₹15,295 Crore (30.55% – highest liquidity generated through IST, of the other means). Further, 46.57% of the liquidity generated is through the

maturities, interest payments and pre-payments which were to be received as per the scheduled dates. It can be seen that for meeting liquidity requirement for redemptions, the Noticee has largely relied on IST and then market sale, which constituted 22.88% of the total liquidity generated. Similarly, it is noted that during 2018–19, the liquidity generated by all the debt schemes inspected through various means is ₹76,618 Crore of which the liquidity generated through IST is approx. ₹31,739 Crore (41.42% which is the highest means of liquidity). Further, 31.19% of the liquidity generated is through the maturities, pre-payments/early redemptions/buy back which were to be received as per the scheduled dates and market sale which is 20.39% of the total liquidity generated. It is again quite clear that for meeting liquidity requirement for redemptions, the Noticee has largely relied on IST.

129. Further, from the below given table it is observed that ISTs were being used for managing liquidity. The Noticees in their reply also stated that it is well understood that inter–scheme transfers were being used to manage liquidity and such transactions were being used to manage liquidity and transactions were entered into on the basis of the judgement of the fund manager of the respective schemes.

SR. NO.	FINANCIAL YEAR	% OF TOTAL LIQUIDITY THROUGH IST
1	**2017-18**	**36.96**
2	**2018-19**	**41.42**
3	**2019-20**	**30.55**

130. The aforesaid practice of FT–MF is against the principle of fair treatment to all unit holders, specifically to the unit holders of transferor scheme. By using ISTs to cope up with the illiquidity arising out of underlying portfolio of schemes FT-MF failed to use IST in a fair manner. The Noticees have contended that it would be incorrect to conclude that the FT-MF had relied on ISTs to generate liquidity since the liquidity generated by the debt schemes inspected through ISTs from April 2019 to March 2020 (across all other schemes of FT–MF) was only 30.55% of the total liquidity generated by the schemes. In this context, it may be noted that the purpose of ISTs is to save cost if two schemes under the same mutual fund wish to buy and sell the same underlying securities given that such securities are matching with the objective of schemes. However, this would not mean that a scheme with cash surplus can buy any security for assisting the selling scheme to manage its liquidity issues.

Therefore, the practice of using ISTs for managing liquidity is against the principle of fair treatment to all unit holders. I find that by using ISTs to cope with illiquidity arising out of problems in the underlying portfolio of schemes, the Noticees have failed to use ISTs in a fair manner.

131. Debt schemes under inspection are open ended schemes where unit holders enter or exit at any point of time. Considering such a nature of the scheme, more importance should have been given to the liquidity of underlying security and such underlying security should have been easily sellable in the secondary market as and when required to generate liquidity. These schemes had huge investments in securities wherein major portions of issue size of a security was subscribed by FT–MF schemes and/or unlisted securities and/or AA and below rated securities. It is noted that FT–MF failed to prudently manage the liquidity of these schemes. it may be noted that even the risk management in their presentation had highlighted increase in partial liquid or potential illiquid securities and ultimately impact on one-week liquidity. It may also be noted from the same that the percentage of total illiquid security to the AUM in portfolios of six schemes were at least 73% and as high as 94%.

132. The Noticees submitted that Inter-schemes transfers are undertaken by Schemes in the ordinary course for a number of reasons such as portfolio rebalancing, duration rearrangement, issuer/group balancing, meeting redemption requirements, etc., However, I note the pattern of ISTs indicate that such high percentage of ISTs could not have been where one scheme genuinely wanted to buy a security and at the same time another scheme wanted to sell the same security. Rather, it is apparent that it was used as a tool to manage liquidity, which is also accepted by the Noticees. It may be noted that ISTs is not a tool to manage liquidity and hide illiquidity of underlying securities. The purpose of ISTs is to save cost if two schemes under the same mutual fund wish to buy and sell the same underlying securities given that such securities are matching with the objective of schemes. That does not mean that scheme with cash surplus buy any security to help selling scheme to manage their liquidity issues. This is against the principle of fair treatment to all investors.

133. The Noticees submitted that there are no regulatory guidelines/provision in respect of restricting 100% subscription of issue size. Further, the Noticees also submitted

that for monetization purpose it heavily relied on scheduled maturities, coupons and prepayments / buy-backs. In other words, the Schemes have historically relied on scheduled maturities, coupon payments and prepayments / buy-backs along with secondary sales as sources for liquidity. Trustees have submitted that the Schemes were not heavily reliant on secondary market trades to liquidate the portfolios of the Schemes and same is in line with the Schemes' strategy. It may be noted from the submission of Trustees that the securities were apparently being purchased with intention to hold till maturity.

134. It may be noted that in banking business, banks either on standalone or in consortium with other banks lend money and in turn expect return in form of interest payment and return of principal amount on closure of loan term. However, Mutual Funds especially in open ended schemes, are in business where, they invest in the securities of issuer and expect return in form of interest/coupon or capital appreciation/depreciation out of sale of securities in secondary market and not supposed to held such securities till maturity. Considering fundamental attribute of open-ended scheme, it may not be prudent for Mutual Funds to invest with assumption to hold such securities till maturity. Hence, the transaction pattern of FT-MF was similar to giving loans to issuers, which is prone to create illiquidity. However, the same was ignored by the FT-MF.

135. Further, it is noted from the investments of debt schemes inspected that they fully or almost fully subscribed to issues which were highly customized (i.e., call-put options, interest rate reset clauses, penalty for non-exercise of option and extension of maturity amongst others). The Noticees stated in their reply that it had commercial understandings with Issuers at the time of investments. However, it is noted that such commercial understandings are not reflected in the formal agreement.

136. From the above features and strategy of FT–MF followed in debt schemes inspected, it is concluded that investment of FT–MF in such securities is akin to loan to Issuer and not investment in securities. This investment pattern is prone to create illiquidity risk.

137. The Trustees in its reply submitted that *“The Trustee's board of directors consist of a majority of independent directors and the Trustee relies upon the independent risk*

management function, the investment team, the Investment Committee and other relevant governance mechanisms for risk management that have been established with the approval of the Trustee, for investment decisions, while providing general guidance and oversight. It is submitted that the Trustee has undertaken its obligations of oversight with diligence in this regard".

138. From the aforesaid findings, I note that Trustees failed to render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment in respect of taking steps to ensure that FT-AMC doesn't transact in a manner to create illiquidity for the schemes and to ensure that the pattern of investment transactions is not akin to giving loan to issuers.

139. Under Regulation 25(6A), Chief Executive Officer shall be responsible for the overall risk management function of the mutual fund. From the above, it is noted that CEO (Sanjay Sapre – Noticee 2) failed to address the risk of underlying illiquid portfolio. Further, it is noted that the Fund Managers i.e., Noticees 3 to 8 failed to ensure that the funds of the schemes are invested in the best interest of the unit holders.

140. In view of the above, I find that the Noticees 1 to 8 had violated the provisions of SEBI (Mutual Funds) Regulations as under:

Sr. No.	Particular	Reference of Regulation/circular violated
1	Mr. Santosh Kamath - CIO Fund Managers: Mr. Kunal Agarwal Mr. Sumit Gupta Mr. Pallab Roy Mr. Sachin Padwal Desai and Mr. Umesh Sharma) **Noticees 3 to 8**	Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996
2	Chief Executive Officer (Mr. Sanjay Sapre) **Noticee 2**	Regulation 25 (6A) of SEBI (Mutual Funds) Regulations, 1996
3	Franklin Templeton Trustee Services Private Limited **Noticee 1**	Regulation 18(7), 18(9), 18(22), 44(3) and clause (6), (8), (9) of the Code of Conduct as specified in the Fifth Schedule to the SEBI (Mutual Funds) Regulations, 1996)

(ii) Risk Management

(a) Removal of monitoring of investment risk from Business Risk Management Committee (BRMC) and lack of Independence of risk management function:

– Alleged violation by Noticee 2

141. In terms of the provisions of SEBI circular no. MFD/CIR/15/19133/2002 dated September 30, 2002 on Risk Management System, the Mutual Fund should have an independent risk management function consisting of one or more risk managers. This function will be responsible for identifying, evaluating or measuring all risks inherent in a mutual fund organisation, as well as establishing controls to mitigate such risks. The risks include:

- *<u>Fund Management:</u> volatility in performance, style drift and portfolio concentration, interest rate movements, liquidity issues, credit risk*
- *<u>Operations:</u> deal errors, settlement problems, NAV and fund pricing errors, inaccurate financial reporting, fraud, failure of mission critical systems and infrastructure, obsolete systems*
- *<u>Customer Service:</u> errors in deal processing, other investor services, fraud*
- *<u>Marketing and Distribution:</u> new product development, selling and distribution*
- *<u>Other Business Risks:</u> critical knowledge loss, skills shortage, non-compliance, third party risks.*

<u>The function should be separate from fund management and should report to the Chief Executive Officer of the AMC</u>. The function could be carried out in a number of ways:

- *As an additional function of an existing employee of the AMC, e.g. the Compliance Officer or Internal Auditor;*
- *Through a Risk Management Committee;*
- *Outsourced to an external agency; or*
- *As the Trustees of the mutual fund may deem fit.*

142. As mentioned in the Risk Policy, "BRMC has been chartered by senior management of the Asset Management Company in India to formalize risk management practices for business conducted by Franklin Templeton Asset Management (India) Pvt Ltd (FTAMC) which provides oversight of key risk practices for FTAMC in India. The ambit of the Business Risk Management Committee (BRMC) covered monitoring of all business-related risks including investment risks.

143. Based on the review of the Risk Management Function within FTMF, it has been observed that the review of risks was one of the functions of the BRMC. As per the

minutes of BRMC meeting held on March 6, 2019 the Head – Risk Management informed:

- *"…The inability to sell investments at the right time/price resulting inter-alia in difficulty in meeting redemptions without impacting the portfolio/ remaining investors"* & *"…Poor relative performance of the fund vis a-vis its peers".*
- *"…..that there was too much high yield, high risk assets and that we were overweight on NBFC/HFC relative to the industry.*

The President of FTAMC commented that *"reputational risk was valid but was there a portfolio risk? Investments should make its presentation next meeting to get clarity on these risks."*

144. It was observed that the next BRMC meeting took place after approx. 6 months on September 26, 2019. However, as per the minutes of the said meeting, no such presentation related to above mentioned risk was given ad the review of investment risk was excluded from the purview of BRMC, which was approved in the Board meeting of AMC and Trustees dated October 25, 2019.

145. As per the minutes of BRMC meeting dated September 26, 2019, discussion whether committee should be responsible of mitigation, took place. It was felt that broadly since Portfolio risks were being assessed in greater detail outside the committee, that the BRMC was not necessarily the appropriate forum.

146. From the above sequence of events, the following is summarized:

    a. It is noted that the President of BRMC (i.e., CEO of FT–AMC) in the meetings dated March 06, 2019, while discussing risk log and top risks, raised a query with regard to the portfolio risk. This was to be presented to BRMC in the next meeting.

    b. The next BRMC meeting was held on September 26, 2019, wherein the query raised by the president of BRMC with respect to portfolio risk was not addressed and it was decided to exclude monitoring of investment risk from the purview of BRMC to remove duplication of reporting of risk. The said exclusion of monitoring of investment risk was approved by the Boards of directors of the FT–AMC in their meeting dated October 25, 2019.

c. It was noted that BRMC itself decided not to review the investment risk in meeting dated September 26, 2019, though the same was part of the then BRMC Charter till the Board approved in October 25, 2019. BRMC of FT–AMC did not carry out its role as required by the existing Charter on the date of the BRMC meeting and deliberately postpone the discussion.

d. The aforesaid inaction regarding not making presentation on portfolio risk despite comments by the President of FTAMC in the BRMC meeting dated 06/03/2019 led to the said risk not being discussed in the subsequent meeting dated 26/09/2019, instead BRMC decided to exclude the review of investment risk from its purview, which was approved by the Boards of AMC and Trustees as per the minutes of their meeting dated 25/10/2019.

147. The Noticee in its reply submitted the following points, which needs worth consideration:

a) *There is no regulation, which is breached by virtue of the activity of monitoring of certain risks like portfolio risks being moved out from the ambit of the BRMC, so long as the risks are being adequately monitored through other means/mechanisms.*
b) *It is not alleged that the oversight subsequently exercised by the CEO (outside the ambit of the BRMC) as well as the board over the investment risk management function was inadequate.*
c) *Only 'dilution' of the BRMC has been alleged. Since there is no regulatory mandate that the investment risk management function be monitored necessarily through the BRMC, there is no question of any violation on account of 'dilution' of the BRMC's functions in this regard.*
d) *The conclusion by stating that the BRMC was where "the CEO could question and satisfy himself about the risk management activities and fulfil the responsibility assigned to him" is erroneous insofar as it assumes that the BRMC was the only means through which the CEO could so satisfy himself and fulfil its responsibilities.*

148. The requirement under the Mutual Funds Regulations is for risk management function to be 'independent' and 'separate from fund management'. I note that there have been structural changes in reporting by which the overall balance between risk management functions and investment management functions seems to have

shifted decisively in favour of the latter. However, upon a holistic consideration of the Noticee's submissions, I am inclined to accept that the internal changes in reporting does not point towards a breach of the Mutual Funds Regulations. It is observed that the CEO could still take charge of risk management activities without necessarily depending on BRMC.

(b) Risk Management Presentations by Head-Risk Management of FT-AMC: – *Alleged violation by Noticee 1*

149. The Head Risk Management of FT-AMC made presentations to the Board of FT–AMC and Trustees on the Risk Management for equity and fixed Income schemes from time to time. It is noted that following risks were highlighted to the Board of FT–AMC during the Board meetings held on July 15, 2019, October 25, 2019, December 3, 2019 and March 6, 2020:

1. <u>Concentration of securities</u>

   a. Head - Risk Management, in the FT–AMC Board meetings held on December 3, 2019 and March 6, 2020 presented a list of Issuers where Fixed Income schemes of FT–AMC held significant share of the industry. Details regarding the percentage of investment were also presented to the Board.

   b. It is noted that the following risk was informed to the Boards of FT–AMC by Head-Risk Management in the aforesaid meetings:

      - "*Issuers where FT holds the entire issuance/ significant share of the issuance across the industry indicates elevated concentration and liquidity risks."*

   c. Further, with respect to 100% of Industry holdings, Head-Risk Management presented the list of Issuers stating "*Issuers where risk recommends cautions are highlighted."*

   d. It is noted that no specific comments of FT–AMC board on this matter are recorded in the minutes of the meeting dated 3rd December 2019.

   e. In the meeting dated March 06, 2020, the FT–AMC Board noted following:

      - *"In some instances, fixed income schemes of Franklin Templeton appeared to be holding the entire issuance of certain debentures. However, this may not reflect the total* *borrowing of that Issuer. The Board advised that the comparison by Franklin Templeton vis a vis total debt of the Issuer be presented…*

- *While reviewing the total exposure to Issuers across Debt and Equity, the Board noted that there was no significant overlap. Board asked Management to continue to monitor consolidated exposure to an Issuer / group across Debt and Equity"*

f. It is noted that although the scheme names have not been mentioned in the said presentation slide, the list of securities in the slide were forming part of the *debt schemes inspected*.

g. On perusal of minutes of above-mentioned meetings, it is noted that the Board of Directors of FT–AMC did not give any direction in relation to addressing concentration risks as informed by the Head - Risk Management. Rather, FT–AMC board deferred the matter of concentration risks despite the matter was being highlighted again in meeting dated March 6, 2020, after being presented in the Board meeting dated December 3, 2019.

150. The Trustees submitted that, it is apparent from the risk management presentations as a whole that the presentations did not convey critical or immediate concerns around the liquidity of the Schemes at the board meetings of the Trustee and AMC commented upon by the auditor (i.e., for the period 15 July 2019 – 6 March 2020). In fact, each such presentation from the risk management function included a specific slide providing a liquidity/coverage ratio analysis of FTMF's debt funds (including the Schemes); such analysis did not raise any immediate or critical liquidity concerns. Thus, critical liquidity concerns threatening the ability of the Schemes to meet redemptions were not highlighted to the boards of the Trustee and the AMC at these meetings. As stated above, critical liquidity concerns, arising from the severe impact of the Covid-19 pandemic, became evident and were highlighted to the boards at the end of March 2020.

2. <u>Issuers under Close monitoring, Issuers displaying Early warning signals, stressed sector</u>

a. Head-Risk Management in the FT–AMC Board meetings held on July 15, 2019, October 25, 2019, December 3, 2019 and March

6, 2020, repeatedly presented concerns w.r.t. stressed sectors/Issuers being shortlisted in early warning signal (EWS).

b. The concerns raised repeatedly in the aforesaid presentation inter-alia pertained to issues such as Default of certain securities, NBFC/HFC Crisis and Downgrades of the securities held by schemes of FT–AMC.

c. The Issuers which were highlighted inter-alia included Essel / Zee, ADAG, Edelweiss Group.

d. Regarding the early warning signals observed in some securities, it is noted that, Mr. Santosh Kamath (CIO Fixed Income) clarified to the Board during the meeting dated 3rd December 2019 that investment management team have adequate investment rationale for having exposure to such securities. Mr. Kamath also advised the Board that the team is continuously monitoring the investee companies and appropriate actions are taken on an ongoing basis.

151. As per the findings of the auditor, risk management had presented to the Boards on July 15, 2019, October 25, 2019, December 3, 2019 and March 6, 2020 various issuers under close monitoring, displaying early warning signals and stressed sector.

152. It was noted from the submission of the Trustees that both the fund management team and the risk management team were also expected to track stressed exposures and material downgrades in the portfolio. Hence, the observations on the stressed and EWS issuers and downgrade of securities were part of the regular efforts to monitor, track and mitigate such risks.

153. The Trustees have further submitted that while the audit observations refer to the presentations made by the risk management team, they do not refer to the presentations made by the fund management team, which also dealt with the same set of stressed issuers at length and detailed various mitigation measures / steps towards improving credit profile or recovery etc.,

154. The Trustees have further submitted that the record demonstrates that the Board routinely deliberated and actively engaged on these matters. The audit observation states that the boards did not issue any direction on these issues. However, the

Board has submitted that it routinely asked both the fund management team and the risk management team to continue tracking these issuers, made additional data requests (*for instance, as recorded in the minutes of the meetings of the respective boards of the AMC and Trustee held on 6 March 2020, the boards asked the risk management team to present a further sub-categorisation of stressed exposures based on severity of risk*) and were provided updates on an ongoing basis on risk mitigation and recovery efforts. The board also emphasised to the fund management team that investment decisions need to be taken after conduct of thorough due diligence and in the interests of unitholders of these schemes. The fund management team confirmed to the boards that the investment processes were being complied with, there was adequate investment rationale for the exposure to stressed issuers and risks were being duly monitored.

155. It was further submitted by the Trustees that commencing from the IL&FS crisis in September 2018, there were various credit events and downgrades across the industry, including various instances of security downgrades and defaults, which affected multiple schemes of other mutual funds. Such downgrades did not impact the Schemes i.e., downgrades in this period were rising across the industry. The material downgrades in securities held by the Schemes were being regularly being tracked and the exposure to these issuers was also being discussed by the boards.

156. However, it has been noted that Auditor in its further comments had submitted that issues highlighted in presentation given by head risk management does not match exactly with the one which was given by fund management. Auditor has highlighted few issuers specifically which were not covered in the presentation given by fund management.

157. Hence, the argument that all the issuers were covered in the one given by fund management does not stand valid. It was further noted from the submission of auditor that Head risk management was not present in the meeting during which the presentation was done by CIO-fixed income. Auditor, has further submitted that the fund manager's presentation gave a macro view of economy but failed to address the risk concerns in the Board meetings. It is also pertinent to note that Risk Management is an independent function and hence it is more appropriate that risk

highlighted by the Head-Risk management ought to have been considered by the respective Boards.

3. Downgrade of securities

a. The Head–Risk Management in the FT–AMC Board meetings held on July 15, 2019, October 25, 2019, December 3, 2019 and March 6, 2020 presented total number of Upgrade and Downgrades of securities and relevant concerns to the Board.

b. The Head–Risk Management presented in the aforesaid meetings that "Upgrade downgrade *ratios is a concern and is worsening post the recent credit events.".* From the said presentations, it is noted that number of downgrades were increasing, despite which, no action was taken by FT–MF. Details of the downgrade/upgrade during the periods are as given below:

PERIOD	DOWNGRADE	UPGRADE
MARCH 2019– MAY 2019	**10**	**4**
JUNE 2019–AUGUST 2019	**16**	**2**
JULY 2019–SEPTEMBER 2019	**22**	**2**
OCTOBER 2019–JANUARY 2020	**21**	**4**

c. It is noted from the minutes of the Board meeting dated October 25, 2019 that on upgrades and downgrades management had apprised the Board that the investments in high yield securities were only by the funds which follow a strategy of investing in high yield securities. However, it is noted that no specific details, information etc., was sought by the Board to address the downgrade risk flagged by the Head-Risk Management.

158. Similarly, auditor had observed that issues related to downgrade of securities were made in the presentation by Head Risk to the Board on July 15, 2019, October 25, 2019, December 3, 2019 and March 6, 2020. It was noted that the counts of number of issuer downgrades were increasing in each subsequent period. However, no specific comments were noted by the Board except on October 25, 2019.

159. The Trustees in their submission have stated that issuers facing material downgrades (for instance, downgrades below 'A') were being discussed at the boards considering that these were the same issuers, which were part of the focus groups / stressed groups / EWS issuers on which the investment team provided detailed updates. The steps being taken with respect to these issuers were presented to the boards.

160. The Trustees have further submitted that while the auditor has observed that the reasons for the downgrades were not recorded in the minutes, as stated above, the detailed updates around these issuers were presented to the boards (and the board records also reflect notings of recovery efforts, risk mitigants and actual recoveries made from these issuers). Accordingly, the boards regularly obtained an appraisal of developments with respect to issuers facing material downgrades from the management team and such issuers were discussed at the boards.

161. However, as per Trustee's submission, it may be noted the strategy adopted by these schemes involved these investing to a greater extent (relative to peers in the market) in below AAA rated securities of lesser-known issuers with good credit and attractive yields. Thus, from the above and the submission of the Trustees, it is evident that some stress in debt schemes started from IL&FS in 2018 and from October 2019 the issues compounded. Since the schemes were following a different strategy of primarily investing in AA and A rated security, the inherent risk was always on the higher side. The Trustee Board ought to have monitored the situation with a special focus because of the above strategy adopted.

162. It is also incorrect of the Trustee Board to state that they were not in a position to and neither did they consider it effective or prudent to second-guess investment decisions made by the portfolio management team, which was comprised of experienced professionals specializing in investment management. It may be noted that SEBI Mutual Funds Regulation does not restrict the Board from calling for any independent audit report.

4. <u>Liquidity issues</u>

a. The Head-Risk Management in the FT–AMC Board meetings held on July 15, 2019, October 25, 2019 and December 3, 2019 presented liquidity related issues in debt schemes.
b. In the said presentation, Bonds rated A and below were classified as "potentially Illiquid" and for these bonds it was stated that, "Liquidity might be difficult to achieve in certain fund flow environments/ market conditions."
c. From the above-mentioned presentations placed, the following is observed:
    - *For the month of May 2019, the debt schemes inspected had potentially illiquid securities as a percentage of scheme AUM ranging from 35% to 51%.*
    - *For the month of August 2019, the debt schemes inspected had potentially illiquid securities as a percentage of scheme AUM ranging from 35% to 53%.*
    - *For the month of September 2019, the debt schemes inspected had potentially illiquid securities* as a percentage of scheme AUM ranging from 32% to 49%.

163. It is also submitted by the Trustees that once the Board did become aware of liquidity concerns towards the end of March, they were proactive in addressing the situation. From the submissions, it was noted that a liquidity review group was formed in March end.

164. However, it is to be noted that auditor had raised observations pertaining to the Board meeting held on December 3, 2019 and March 6, 2020 wherein concentration risk was made in the presentation to the AMC Board and Trustee Board but no significant guidance/steps was made by the Board except the query raised in Board minutes dated March 6, 2020.

165. Similarly, auditor had observed that liquidity issues were made in the presentation by Head Risk management to its Board in July 15, 2019, October 25, 2019 and December 3, 2019. The presentation clearly highlighted the percentage of securities which were "potentially illiquid". However, the Board has failed to provide details of any concrete steps or guidance given especially considering the fact that in terms of their strategy they were investing in high yield/below AAA rated papers.

166. Though it may be true that the Trustee Board has taken several steps from end of March 2020 onwards, however from a holistic point of view from the various presentations made in the Board meetings from July 2019 in regards to the risk which has been highlighted by the Auditor in the inspection report, there does not indicate any action/direction/guidance provided by the Trustee Board.

167. Further, in terms of Mutual Fund Regulations 18(25)(B)(i), Trustees could also obtain internal audit reports at regular intervals from independent auditors appointed by the Trustees. In terms of SEBI Circular MFD/CIR/09/014/2000 dated January 5, 2000, "The mutual fund may decide to appoint independent auditors and/or may have separate full-fledged administrative set up for the Trustees."

168. Thus, from the above it is evident that the Trustees have the power to call for any report or appoint independent auditors. Head Risk management in its various presentations had already informed to the Boards with regards to the inherent risk present in the schemes (concentration/liquidity/early warning signal/downgrade of securities). Hence the Boards have failed to independently verify this from the independent auditors and take specific steps to address the concerns raised in presentation made by Head Risk Management.

169. As regards the contention that changes between the two versions of the presentation were limited to the form and the manner of presentation of certain information and there were no substantive changes, it is reiterated that the presentation incorporated certain concerns of Head-Risk Management with regard to Issuers like Yes Bank, DHFL and Vodafone and it can be seen in the hindsight that unfortunately these are the Issuers which have either defaulted on their payments or delayed their payments due to the financial stress.

170. Trustees have further contended that the record demonstrates that the Head–Risk Management had direct access to the Boards of the AMC and the Trustee. The Head–Risk Management presented reports at every board meeting. The boards considered the Head–Risk Management's views at every board meeting and duly deliberated upon the items presented by him. The Board sought the investment team's views on these matters as well. In this context, it is noted that of the said presentations which are presented to the board by Head–Risk Management, one

instance was observed wherein the presentation was changed and certain concerns raised by the risk management team were deleted, as required by the fund manager and its team. This instance indicates that there is no independence in reporting to the board. Further, contrary to the claim made by the Noticee that the board provided strategic direction and guidance to the management, it is observed that the same is however, not reflected in the minutes of the said meeting. As accepted by the Noticee, its strategy was to invest in high yield papers (investing in AA and A rated papers). These high yield papers have higher inherent credit and liquidity risk. These risks, which were inherent due to the investment strategy of AMC, were frequently highlighted to the Noticee's Board but the Board had not taken any corrective steps to address the issues pertaining to concentration, downgrades, early warning signal and illiquidity.

171. Further the detailed submission of the Trustees in regards to decision on the winding up, steps taken post winding up, resultant impact of Covid-19 pandemic on the Schemes is of no significance as the same is not under examination and is neither mentioned as a part of the audit observation/findings.

172. Further it was noted that in one of the minutes dated December 3, 2019 wherein it was sought by the Boards on what action was being taken, simply stating that decision to record investment rationale to the fund manager does not tantamount to the steps taken for the risk highlighted on liquidity/downgrade risk. Specific direction/guidance to address the risk was not clearly visible. I am of the view that the Board should have been guided by the overarching principles of prudence and safety rather than being led by the obsession of alpha generation of the fund management team as it should be constantly weighed against the responsibility of managing public funds.

173. The Trustees' response that the Board cannot be expected or required to take individual investment decision is not acceptable. The repeated flagging of concentration and illiquidity risk of the scheme portfolio dominated by lower rated securities by the Risk Management Team have been clearly muzzled by the fund management's argument of adopting a high yield strategy. In my view, the Board should have been guided by the overarching principles of prudence and safety rather than being led by the obsession of alpha generation of the fund management team

as it should be constantly weighed against the responsibility of managing public funds.

174. Thus, in view of the above concentration, downgrades, early warning signal and liquidity issues, that various risks as per the aforesaid comments were brought to the notice of Board of Trustee, which is evident from the discussion in various meetings mentioned above. However, the Board has failed to take any specific steps/guidance for the various risk highlighted above.

175. In view of the above, I hold that the Noticee 1 i.e., Franklin Templeton Trustee Services Pvt., Ltd., has violated the provisions of Reg 18 (7), 18 (9), 18 (22) and Clause (8), (9) of the Code of Conduct as specified in the Fifth Schedule of SEBI Mutual Fund Regulations.

E. <u>Investment Related Due Diligence</u>

– Alleged violation by Noticee 1

(i) Deficient Investment Policy Leading to Weak Due Diligence and Monitoring

176. Relevant extract of approved Investment Process Notes approved by the Board of AMC & Trustee Co., in their meeting held on March 2, 2017, July 27, 2018 & October 25, 2019.

The Investment process is intensely research oriented. It comprises of qualitative as well as quantitative measures. Macroeconomic call is taken on interest rate direction by doing detailed analysis of various influencing factors like Inflation, Money supply, Private sector borrowing, Government borrowing, Currency market movement, Central Bank policy, Local fiscal and monetary policy, Global interest rate scenario and Market sentiment. Interest rate direction call is supplemented by technical analysis of market and short-term influencing factors like trader position, auction/issuance of securities, release of economic numbers etc. Interest Rate direction call and anticipation of yield curve movement forms the basis of portfolio positioning in duration terms.

Credit research is done on a regular basis for corporates having investment grade rating. Credit research includes internal analysis of financial reports as well as rating rationale and other inputs from external agencies. Credit research is also used to minimize credit migration risk and for generating relative value trade ideas.

Investment team comprising of CIO and Portfolio Managers interacts on a daily basis to discuss market movement and analyse events and news. Trading strategy and asset allocations are firmed on the basis of these interactions.

177. Extract of scope of Investment Committee for the charter for investment committee – Debt approved by the Board by the Board of AMC & Trustee Co. in their meeting held on March 2, 2017, November 30, 2018 & March 6, 2020):

The Committee need to Monitor, Discuss and/ or review of the following:

- Portfolio holdings:
- Ensure compliance with regulations
- Monitor actual portfolio vis-à-vis the model portfolio, if any
- Monitor portfolio on a daily basis and periodically review it to track illiquid assets and take corrective action.
- Committee need to Monitor Risk Review/assessment process on monthly basis
- Committee need to review investment process note

178. From the above, it is noted that The Investment Process Note approved by the Boards of AMC & Trustee does not contain:

a) Any objective parameters for investment decisions and inclusion of the same in the research report.
b) The haircuts based on nature of collaterals viz. property, development rights, equity shares.
c) Any prohibition on transactions not permitted by Regulations like Loans.
d) Maximum subscription limit to any particular security (ISIN) of any issuer.
e) Periodicity of review

179. It may be noted that the observation is focused on the broad guidelines on investment in IPN that is supposed to provide all guidelines related to investment at one place. It should also define exceptional circumstances and steps to follow in those cases. However, it is noted that in respect of the following observations there is deficiency in the IPN as under:

a. Lack of basic objective criteria in IPN

The Trustees have submitted that SEBI has not defined any particular format of IPN. Further, KPMG (in its capacity as an independent consultant) has carried out review IPN and did not identify any deficiencies in the IPN. It is also submitted that apart from IPN there are various guidelines on investments. However, I note that the Trustee failed to reply on the lack of objective criteria for investments in securities.

b. Haircut based on nature of collaterals

The FT-MF failed to understand that ultimate responsibility to do fair valuations of collaterals is with it. Accordingly, what should be the haircut broadly based on the collateral i.e., liquid, non-liquid, fixed asset etc. Further, how frequently valuations of such collateral to be carried out by AMC to check whether such collaterals are sufficient or not. Such guidelines were not evident in the IPN.

c. List of prohibited transactions

Though the Trustee is of the view that at various place, such prohibitions specifically mentioned like SID, inbuilt software etc., they failed to submit that there is specific list of prohibited transactions as a part of IPN.

d. Maximum subscription in particular security of issuer

Though there are no regulations which restrict mutual fund schemes from subscribing to a substantial part of, or even 100% of, the exposure of a certain issuance, FT-MF should have documented guidelines on the same as a part of managing liquidity risk specially since they were deliberately following a strategy to subscribe entire or major portion of certain below highest-grade issuers through bespoke structure securities. However, I note that such guidelines are not evident in IPN.

e. Periodicity of review of IPN

Though the Trustees have submitted that they have reviewed IPN 3 times during inspection period, there is no specific durations evident from record, which define durations i.e., quarterly/half yearly/yearly etc. to review such important policy documents. However, no requirement regarding the same in SEBI guidelines and they have already done three times review. Accordingly, reply of the Trustee is accepted in this respect.

180. The Noticee contended that SEBI's circular dated July 27, 2000 is advisory and not mandatory. It is pertinent to note that the aforesaid circular was issued by SEBI under Regulation 77 of SEBI (Mutual Fund) Regulations, 1996, which empowers the Board (SEBI) to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management

companies and custodians. From the plain reading of the provisions of Regulation 77 of SEBI MF Regulations, it is clear that the Circular issued by SEBI is binding on all the concerned, which is a regulatory requirement. In view of the fact that the aforesaid circular was issued under the legal provisions of SEBI MF Regulations, I find the submissions of the Noticee that the circular is advisory and not mandatory, is devoid of any merit.

181. As per SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000, it is the responsibility of AMC Board to prescribe broad parameters for investments. In line with the circular, Auditor has carried out analysis of such broad parameters defined by AMC board in form of Investment Policy/Investment Process Note (IPN). It is pertinent to note the aforementioned circular requires the AMCs to report the compliance of the above in their periodical reports to the Trustees and the Trustees shall report to SEBI in their half-yearly reports. Trustees may also check its compliance through the independent auditors or internal/statutory auditors or other systems developed by them. Thus, it can be seen that the final responsibility has been cast upon the Trustees to ensure compliance of the aforementioned circular.

182. In view of the above, I find that the Noticee 1 i.e., Franklin Templeton Trustee Services Pvt., Ltd., had failed to ensure that IPN contains detail objective criteria for investments, which is in violation of the provisions of SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 and Regulation 18(7), 18(9), 18(22) and clause (8), (9) of the Code of Conduct as specified in the Fifth Schedule to the SEBI (Mutual Funds) Regulations, 1996.

(ii) Inconsistency in exercising buyback option of subscribed Issuers by few of the debt schemes inspected leading to preferential treatment given to unit holders of one scheme over the other

183. As per the generally accepted practice with regard to buyback of securities, the buyback amount is exercised on pro-rata basis across all the schemes. In the matter of 5 securities issued by 3 Issuers, a partial buyback of securities was offered on 20-Mar-2020 and 31-Mar-2020. The aggregate exposure of debt schemes inspected in these securities was of ₹769.88 Crore. The buyback option was exercised by 3 out of 6 debt schemes inspected, as per the details given below:

Issuer	Schemes holding securities	Aggregate exposure by schemes (₹in Crore)	Buyback option exercised by schemes		Remaining Holdings with the Schemes		% of Buyback Offered
			Name of schemes	Amount of buyback (₹in Crore)	Name of schemes	Amount (₹in Crore)	
Small Business Fincredit India Pvt Ltd	FI–LDF, FI–STIP & FI–UBF	366.83	FI–LDF	78.54	FI–STIP & FI–UBF FI–LDF(*)	118.94 169.35	21.41%
Sadbhav Infrastructure Project Ltd	FI–DAF, FI–STIP & FI–IOF	203.35	FI–DAF, FI–STIP	51.16	FI–IOF FI–DAF(*)	106.51 45.68	25.16%
Aptus Value Housing Finance India Ltd (TRANCHE I)	FI–STIP & FI–CRF	80.00	FI–STIP	25.00	FI–CRF	55.00	31.25%
Aptus Value Housing Finance India Ltd (TRANCHE II)	FI–STIP & FI–CRF	80.00	FI–STIP	55.00	FI–CRF FI–STIP(*)	20.00 5.00	68.75%
Aptus Value Housing Finance India Ltd (TRANCHE III)	FI–STIP & FI–IOF	39.7	FI–STIP	20.00	FI–IOF	19.70	50.38%
Total		**769.88**		**229.70**		**540.18**	
* Partially exercised buy back option							

184. From the above table, it is thus observed that following three schemes have not exercised buyback option:

a) FI–CRF;
b) FI–UST and
c) FI–IOF.

185. The schemes which have exercised buyback option have mentioned the reason for the above transaction as “*buyback*”. However, the schemes which have not exercised the offered buyback option have not documented the reason for not exercising the option.

186. The Noticee in its reply contended that: *“… the prevailing regulations did not impose restrictions on the manner of apportioning buy-back offers between different schemes holding the same security. Further, this is also made clear by the fact that such regulation (i.e., that buybacks should ordinarily be allocated pro-rata amongst*

schemes) was only recently introduced by way of a Circular dated September 17, 2020. Moreover, even the new regulation permits disproportionate allocations of buybacks with certain internal approvals. In other words, even under the new regulations, SEBI has recognized that it may not be appropriate in all cases to apportion buy-backs proportionately. In any event, consistent with the scheme of the Mutual Funds Regulations, decisions with respect to participation in buyback offers were taken independently for each Scheme, considering the liquidity position, investment strategy and other factors applicable to such Scheme. The Noticee does have a Fixed Income Allocation of Investment Opportunities Policy, which deals with allocation of primary and secondary trades to various schemes (which would include buybacks). Such policy, in recognition of the above factors (i.e., that there can be no 'one-size-fits-all' approach for allocating investment opportunities to the Schemes) does not mandate a pro rata allocation of trades in all circumstances. This approach was fully consistent with the prevailing regulations."

187. I note that generally each scheme at any point of time would have differing investment objectives and liquidity requirements. Further, the decision on whether or not to participate in a buy–back is an investment decision taken on the basis of an analysis of various considerations. I note that the Noticee had a Fixed Income Allocation of Investment Opportunities Policy, which did not mandate a pro–rata allotment of buy–back to all schemes. I note that the allegation of preferential treatment of unitholders of certain schemes over the other schemes has not been made out with specificities. In the circumstances stated above, I am not inclined to give any adverse finding in this respect.

Common contentions of the Noticees

188. The Noticees in their submissions stated that they had acted in good faith while discharging their respective duties and hence are not liable for any alleged infraction of the Mutual Fund Regulations. The Noticees in their defence relied upon certain case laws to justify their actions. In this connection, I am of the view that good faith has to be inferred from the facts of each case and cannot be a common nuance. In the case of Emperor v. Abdool Wadood Ahmed (1907) I L R 31 Bom 298 a Division Bench of the Bombay High Court observed that *"good faith requires not indeed logical infallibility, but due care and attention. But how far erroneous actions or*

statements are to be imputed to want of due care and caution must, in each case, be considered with reference to the general circumstances and the capacity and intelligence of the person whose conduct is in question".

189. In the instant case, it is to be noted that the Trustees of FT-MF are thorough professionals and the remaining Noticees are experts in their respective domains as CEO, CIO, CO and Fund Managers, yet they failed to avert certain lapses in the functioning of a Mutual Fund, as mentioned in the pre-paragraphs. The acts and deeds committed by them while discharging their duties are not in the interest of the unitholders in specific and the investors in general. It is expected from the Noticees to act in such a way so as to ensure that the Mutual Fund runs on the well-established regulatory practices without deviating from the standards set out in the statute. Therefore, I find no merit in the contentions raised by the Noticees in this regard.

190. Further, the Noticees contended that they had exercised utmost care and due diligence while discharging their respective duties and cited certain case laws in their defence. In this regard, I deem it appropriate to understand what due diligence means and the activities involved in discharging the same. The expression "Due Diligence" has been interpreted by Hon'ble Supreme Court of India, in the matter of Chander Kanta Bansal V. Rajinder Singh Anand (2008) 5 SCC 117. The relevant extract of the judgment reads as: *"……According to Oxford Dictionary (Edn. 2006), the word "diligence" means careful and persistent application or effort. "Diligent" means careful and steady in application to one's work and duties, showing care and effort. As per Black's law Dictionary (18th Edn), "Due Diligence" means the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation. According to Words and Pharses by Drain-Dyspnea (Permanent Edn. 13-A) "due diligence", in law, means doing everything reasonable, not everything possible. "Due Diligence" means reasonable diligence; it means such diligence as a prudent man would exercise in the conduct of his own affairs….."*

191. Normally, the degree of prudence in this regard is the diligence reasonably expected from, and ordinarily exercised by, a person who seeks to satisfy a legal requirement or to discharge an obligation. Bearing in mind these principles governing 'due

diligence', the Noticees 2 to 9 are expected exercise proper care and due diligence, while giving utmost consideration to the best interests of unitholders, which is not found to have been observed by the Noticees, as per the findings mentioned in the pre-paragraphs. In view of the reasons recorded hereinabove, I find that the Noticees 2 to 9 have not exercised proper due diligence while discharging their responsibilities at the relevant times.

192. Further, the Noticees contended that no concerns were raised in any audits by independent auditors or in SEBI inspections or any investor complaints in relation to the Schemes, over the long years of operation of the Schemes. I note that if the earlier inspections carried out by SEBI and the regulatory compliance by way of various reports to SEBI by the FT-MF, did not indicate any lapses, it does not preclude SEBI from taking any action, if it is found subsequently of any violation. Further, it is to be noted that the forensic audit on the basis of which the instant proceedings were initiated, was a special–purpose focused inspection pursuant to receipt of various complaints by SEBI. Therefore, I find that the argument put forth by the Noticees in this regard is devoid of any merit.

193. The Noticees in their submissions stated that investors have benefitted from the performance of the Schemes over an extended period i.e., from the date of the decision to wind-up the schemes till May 2021. It is to be distinctly noted that the post-facto resultant events pursuant to winding up of the schemes does not matter and during the time when the violations were observed, the Noticees were found to be not complying with the statutory provisions, which is notwithstanding the resultant factors. <u>Therefore, I find the arguments put forth by the Noticees in this regard does not help them in justifying their actions, which are found to be violative of the various provisions of SEBI Mutual Funds Regulations and the Circulars issued thereunder</u>.

194. The Noticees 2 to 9 contended that the allegations against them ought to be set aside on the basis of the well-settled legal principles relating to applicable standards of diligence and the exercise of business judgment in the discharge of such professional responsibilities.

195. I note that the business judgment rule is a judicial doctrine arising from courts' respect for corporate self-governance, as well as their dislike for second-guessing

the business decisions of corporate directors and officers. The business judgment rule has been described in Delaware case law as follows:

> *The rule "is a presumption that in making a business decision the directors of a corporation acted on an informed basis, in good faith and in the honest belief that the action taken was in the best interests of the company." Therefore, the judgment of a properly functioning board will not be second-guessed and "absent an abuse of discretion, that judgment will be respected by the courts." Because a board is presumed to have acted properly, "the burden is on the party challenging the decision to establish facts rebutting the presumption.*

196. I am of the view that the business judgment rule establishes a presumption that in making a business decision the directors of a corporation acts on an informed basis, in good faith and in the honest belief that the action taken will be in the best interests of the stakeholders. However, in the instant case, it is established in various findings narrated in pre-paragraphs, how the Noticees 2 to 9 had violated the regulatory requirements, which has hampered the interest of the stakeholders viz., unitholders.

197. In *Westmoreland County Employee Retirement System v. Parkinson,* 727 F.3d 719 (7th Cir.2013) the Federal 7th Circuit Court, USA stated that if a director breaches the fiduciary duty of loyalty, the business judgment rule affords no protection. The court went on to note that the fiduciary duty of loyalty was not limited to cases involving a financial or other cognizable fiduciary conflict of interest, but also encompassed cases where the fiduciary failed to act in good faith*." Where "directors fail to act in the face of a known duty to act, thereby demonstrating a conscious disregard for their responsibilities, they breach their duty of loyalty by failing to discharge that fiduciary obligation in good faith."* Or, put slightly differently, *"the intentional dereliction of duty or the conscious disregard for one's responsibilities [constitutes] bad faith conduct, which results in a breach of the duty of loyalty." Id*. (quoting *Stone v. Ritter*, 911 A.2d 362, 370 (Del.2006).).

198. In *In re Troll Communications, LLC,* 385 B.R. 110 (Bankr.D.Del.2008) the United States Bankruptcy Court, D. Delaware stated that the business judgment rule can be rebutted by showing that "the board of directors, in reaching its challenged decision, violated any one of its triad of fiduciary duties: due care, loyalty, or good faith." (citing to *Emerald Partners v. Berlin*, 787 A.2d 85, 91 (Del.2001).). The duty

of loyalty mandates that the best interest of the corporation and its shareholders takes precedence over any interest possessed by a director, officer or controlling shareholder and not shared by the stockholders generally. *Id*. *at 119* (citing to *Continuing Creditors Committee of Star Telecomm, Inc. v. Edgecomb*, 385 F.Supp.2d 449, 460 (D.Del.2004).).

199. In view of the above and from the relevant findings in pre-paragraphs, I find that the Noticees 2 to 9 did not act in the best interest of the unitholders and thereby caused to hamper the interest of the unitholders. Therefore, I find no merit in the arguments put forth by the Noticees 2 to 9 in this regard.

SUMMARY OF THE FINDINGS

A. There were similarities in investment strategy though the investment objectives were differing in the six wound up schemes. This was observed by way of high exposures in “AA and below” Corporate bonds in all the six schemes even though investment objectives as per the SIDs of these schemes are different. Further, as per the Portfolio holding data, most of the securities are rated AA or below at the time of investment. In addition, there was concentration of similar securities across schemes under audit where investments were made over 70% of the issue of such debt securities and most of the investments which were made in schemes were common at time of investment.

B. FT-MF had incorrectly calculated Macaulay duration, taking interest rate reset dates as deemed maturity. By way of taking interest rate reset date as deemed maturity date, FT-MF had attempted to accommodate many long duration securities in shorter duration portfolios and had managed to run multiple schemes with similar strategy. The bonds where put option was available was not exercised even though the rating of the securities were downgraded to BBB- which is the last threshold below which the security becomes non-investment grade.

C. There were discrepancies in respect of valuation of securities where terms of the issue have been changed frequently including postponement of put option, granting moratorium, change in coupon rate, etc., which resulted into declaration of incorrect NAV.

D. The Schemes had high exposure to (a) unlisted securities, (b) securities rated below AAA, and (c) securities where more than 70% of the issuance was subscribed to by the six Schemes. Investment risks were being regularly brought to the notice to the Trustee Board by the Head of Risk Management. These were in nature of concentration of securities, downgrades of securities, early warning signals in respect of issuers and liquidity issues in the fixed income schemes. Evidences available do not indicate actions / directions to establish that the Trustees had exercised high standards of service, exercised due diligence, ensure proper care and exercised independent professional judgment to address these risks.

E. Investment Process Note does not contain key aspects such objective parameters for investment decisions and inclusion of the same in the research report, haircuts based on nature of collaterals.

CONCLUSION

200. The serious lapses and violations clearly appear to be a fall out of the FT-MF's obsession to run high yield strategies without due regard from the concomitant risk dimensions. The FT-MF ought to have realised that the past track record in respect of high–risk strategies is no guarantee against future mishaps. For a fund house which has been in this industry in India for over two and a half decades, it is surprising that its systems to monitor and manage critical risks like liquidity, credit and concentration are less than robust. The effectiveness of these systems stand compromised in the process of the Noticee's single minded pursuit of reaping high yield. The Noticees have brought out the reasons of 'business judgment' to defend questionable decisions; however, it is seen that these decisions which involve deployment of public funds are barely documented. Similarly, the terms of investment covenants were apparently not in the interest of investors and the deficiencies in the agreements were sought to be corrected through a 'commercial understanding'. While it is easy to shift the blame for such mishaps onto black swan events, regulatory changes, etc. the Noticees needs to seriously introspect and put

in place robust risk control and due diligence mechanisms, given that the rest of the industry has been able to cope with the events and survive through the crisis period of the Covid 19 pandemic, without reaching the point of winding up. Accordingly, I find that the Noticees have violated the provisions of SEBI Circulars and SEBI (Mutual Funds) Regulations, as mentioned in pre-paragraphs.

ISSUE II: Whether the Noticees are liable for monetary penalty under Sections 15A(b), 15D(b), 15D(f) and 15HB of the SEBI Act?

201. According to SEBI MF Regulations "mutual fund means a fund established in the form of a trust to raise monies through the sale of units to the public or a section of the public under one or more schemes for investing in securities, including money market securities." A registered Mutual Fund is required to comply with the provisions of the Regulations. As per the Regulations, mutual fund is required to ensure proper conduct of the assessment management company with reference to the investment activities etc., It is the trustees who hold the property of the mutual funds in trust for the benefit of the unit holders. For the purpose of asset management, each mutual fund is required to appoint Asset Management Companies fulfilling the prescribed qualifications. It is imperative to note that every Mutual Fund registered with SEBI has to conduct its business in compliance with the terms and conditions subject to which registration has been granted and the provisions of the said Regulations and the Circulars issued from time to time. The Regulations have specifically provided for the duties and obligations of the Trustees and Asset management company. It is noted that the prime duty of the mutual fund is to carry on its business activities to benefit the unit holders. The trustees shall ensure that the asset management company does not act in any manner which is detrimental to the interest of the unit holders. Further, the professionals engaged by the FT-MF viz., CEO, CIO, CO and the Fund Managers are expected to carry out their respective roles in the interest of the unitholders by complying with all the prudential norms governing the functioning of the MF. However, in the instant case, since the charges against the Noticees have been conclusively established, the Noticees are liable for monetary penalty under Sections 15A(b), 15D(b), 15D(f) and 15HB of SEBI Act *(as applicable)*, the provisions of which are reproduced hereunder:

Section 15A(b) of SEBI Act

If any person, who is required under this Act or any rules or regulations made thereunder, — (a) to furnish any document, return or report to the Board, fails to furnish the same or who furnishes or files false, incorrect or incomplete information, return, report, books or other documents, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 15D(b) of SEBI Act

If any person, who is registered with the Board as a collective investment scheme, including mutual funds, for sponsoring or carrying on any investment scheme, fails to comply with the terms and conditions of certificate of registration, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 15D(f) of SEBI Act

If any person, registered as a collective investment scheme, including mutual funds, fails to invest money collected by such collective investment schemes in the manner or within the period specified in the regulations, he shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one lakh rupees for each day during which such failure continues subject to a maximum of one crore rupees.

Section 15HB of SEBI Act

Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

ISSUE-III: If so, what quantum of monetary penalty should be imposed on the Noticees?

202. While determining the quantum of monetary penalty under Sections 15A(b), 15D(b), 15D(f) and 15HB of SEBI Act, I have considered the factors stipulated in Section 15J of SEBI Act, which reads as under:

Section 15J SEBI Act - Factors to be taken into account by the Adjudicating Officer

While adjudging quantum of penalty under Section 15-I of SEBI Act, the Adjudicating Officer shall have due regard to the following factors, namely:

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
(b) the amount of loss caused to an investor or group of investors as a result of the default;
(c) the repetitive nature of the default.

203. The material made available on record has not quantified the amount of disproportionate gain or unfair advantage made by the Noticees and the loss suffered by the investors as a result of these Noticees' default. There is also no material made available on record to assess the amount of loss caused to investors or the amount of disproportionate gain or unfair advantage made by the Noticees as a result of default. The consequences resulting from violations committed by the Noticees are of serious of nature and are prejudicial to the interests of investors in the securities market. If violations of this nature and magnitude are not dealt with seriously with a firm hand then investors will lose faith in the Indian Securities Market.

204. It is noted that in the three-tier structure of Mutual Fund, the trustees hold the funds on behalf of investors on trust and the AMC is entrusted with the responsibility of managing fund. The guiding factor for the trustees is to look after the investor interest while AMCs operate to maximize the interest of their respective unit holders. The Trustees are guardian of funds of investors in order to protect the interest of all the investors they are expected to exercise fiduciary duties of trust and ensure fairness to all investors. In order to enable the AMC to carry out its objectives, the CEO, CIO, CO and the Fund Managers are expected to act diligently in the best interest of the unitholders by complying with the various regulatory provisions. It is pertinent to note that individuals who want to invest in the stock market but do not have expertise and time to do so, invest through a mutual fund so as to benefit from professional management, diversification of portfolio, liquidity, ease of investing and affordability. Thus, it is imperative for the Trustee and the persons at the helm of affairs viz., CEO, CIO, CO and the Fund Managers at all times, to act diligently and faithfully in the

best interest of the unitholders. Any non-compliance or deviation from the regulatory requirements, would derail the trust imposed by the unitholders in the Mutual Fund. Therefore, I feel appropriate to impose suitable penalty on the Noticees given the magnitude of the violations established against each of the Noticees, which is commensurate with the nature of violation and which acts as a deterrent factor for the Noticees and others in protecting the interest of the investors in securities market.

ORDER

205. Having considered all the facts and circumstances of the case, I, in exercise of the powers conferred upon me under Section 15I of the SEBI Act read with Rule 5 of the SEBI Adjudication Rules, hereby impose penalty of ₹15,00,00,000/- (Rupees Fifteen Crores) on the Noticees, as under, which is commensurate with the nature of violation by the Noticees:

Sl. No.,	Name of the Noticee	Violation of the provisions of	Penalty amount in ₹ and words
1	**Franklin Templeton Trustee Services Pvt., Ltd.,**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017 SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017 SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000 Regulation 18 (7), 18 (8), 18 (9), 18 (22), 44 (3) and clause (2), (6), (8), (9) of the Code of Conduct as specified in the Fifth Schedule to the SEBI (Mutual Funds) Regulations, 1996	**3,00,00,000/- (Rupees Three Crores only)**
2	**Sanjay Sapre**	SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017 SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017 Regulation 25 (6A) of SEBI (Mutual Funds) Regulations, 1996	**2,00,00,000/- (Rupees Two Crores only)**

<table>
<tr><td>3</td><td>Santosh Kamat</td><td rowspan="6">SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017
SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017
Clause 9.1.1 of SEBI Circular no. SEBI/HO/IMD/DF4/CIR/P/2019/102 dated September 24, 2019
Clause 1 of SEBI Circular no. SEBI/HO/IMD/DF4/CIR/P/2019/126 dated November 06, 2019
SEBI Circular no. CIR/IMD/DF/21/2012 dated September 13, 2012
SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000
Regulation 25 (6B) of SEBI (Mutual Funds) Regulations, 1996</td><td>2,00,00,000/-
(Rupees Two Crores only)</td></tr>
<tr><td>4</td><td>Kunal Agarwal</td><td>1,50,00,000/-
(Rupees One Crore fifty lakhs only)</td></tr>
<tr><td>5</td><td>Sumit Gupta</td><td>1,50,00,000/-
(Rupees One Crore fifty lakhs only)</td></tr>
<tr><td>6</td><td>Pallab Roy</td><td>1,50,00,000/-
(Rupees One Crore fifty lakhs only)</td></tr>
<tr><td>7</td><td>Sachin Padwal Desai</td><td>1,50,00,000/-
(Rupees One Crore fifty lakhs only)</td></tr>
<tr><td>8</td><td>Umesh Sharma</td><td>1,50,00,000/-
(Rupees One Crore fifty lakhs only)</td></tr>
<tr><td>9</td><td>Saurabh Gangrade</td><td>SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/114 dated October 06, 2017
SEBI Circular no. SEBI/HO/IMD/DF3/CIR/P/2017/126 dated December 04, 2017
Regulation 18(4)(d) of SEBI (Mutual Funds) Regulations, 1996.</td><td>50,00,000/-
(Rupees Fifty lakhs only)</td></tr>
</table>

206. The Noticees shall remit / pay the said amount of penalty within 45 days from the date of receipt of this Order, either by way of Demand Draft in favour of “SEBI - Penalties Remittable to Government of India”, payable at Mumbai, OR through online payment facility available on the SEBI website **www.sebi.gov.in** on the following path by clicking on the payment link.

ENFORCEMENT → Orders → Orders of AO → PAY NOW

207. The Noticees shall forward said Demand Draft or the details / confirmation of penalty so paid through e-payment to the Division Chief, Enforcement Department-I, DRA-IV, SEBI, in the format as given in table below

Case Name	
Name of Payee	
Date of payment	
Amount Paid	

Transaction No	
Bank Details in which payment is made	
Payment is made for	Penalty

208. In terms of Rule 6 of the SEBI Adjudication Rules, copies of this order are sent to the Noticees and also to SEBI.

Date: June 14, 2021
Place: Mumbai

PRASANTA MAHAPATRA
ADJUDICATING OFFICER