WTM/GM/IMD/06/2021-22

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Sections 11(1), 11(4), 11(4A) and 11B of the Securities and Exchange Board of India Act, 1992 read with Regulation 11 of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003, in the matter of inspection of Six debt schemes of Franklin Templeton Mutual Fund

In respect of:

NOTICEE	PAN
VIVEK KUDVA, FLAT NO. 202, 2ND FLOOR, VISHNU VILLA, 7B, WORLI SEA FACE, WORLI MUMBAI- 400030	AENPK7096K.
ROOPA KUDVA, FLAT NO. 202, 2ND FLOOR, VISHNU VILLA, 7B, WORLI SEA FACE, WORLI MUMBAI- 400030	AETPK7710A.
VASANTHI KUDVA, B-BLOCK, FLAT GG, PALM TREE PLACE, 23 PALMGROVE ROAD, AUSTIN TOWN, BANGALORE 560047, KARNATAKA	AGEPK4376M.

The issue that arises for consideration in the present matter is whether the redemption of units in some schemes of a mutual fund by a director of the Asset Management Company of the Mutual Fund, and his immediate family, at a time when the said schemes were facing significant redemption pressure (the schemes were later wound up) and the director was allegedly in possession of material non-public information relating to the same, would fall within the scope of 'fraudulent' or 'unfair trade practice' as defined under the SEBI(Prohibition of Fraudulent and Unfair Trade Practices)Regulations, 2003.

BACKGROUND

1. Franklin Templeton Mutual Fund ("FT–MF") is a mutual fund registered with SEBI. Franklin Templeton Asset Management Company Ltd. ("FT–AMC") is the Asset Management Company and Franklin Templeton Trustee Services Pvt. Ltd. ("Trustees") acts as the Trustee of FT–MF.

2. The Trustees vide notice dated April 23, 2020, informed the unit holders of certain schemes of FT-MF that it was winding up the schemes in conformity with the provisions of Regulation 39(2)(a) of the SEBI (Mutual Fund) Regulations, 1996 ("Mutual Fund Regulations"). The schemes that were to be wound up ("Impugned Debt Schemes") were,-

   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").

3. Subsequent to the decision to wind up the schemes, Securities and Exchange Board of India ("SEBI/Board") ordered a Forensic Audit/Inspection ("Inspection") in terms of Regulation 66 of the Mutual Fund Regulations and appointed Chokshi and Chokshi LLP, Chartered Accountants ("Auditor") to conduct a forensic audit/inspection of FT–MF, FT-AMC and Trustees, particularly in respect to the Impugned Debt Schemes.

4. The data regarding the purchases and redemptions of units in the schemes by the key personnel of FT–AMC during the period April 1, 2019 to April 23, 2020 was also examined by the Auditor and it was observed that Noticee no. 1 - Vivek Kudva (Director of FT–AMC), Noticee no. 2 - Roopa Kudva (Wife of Vivek Kudva) and Noticee no. 3 - Vasanthi Kudva (Mother of Vivek Kudva) (collectively referred to as "Noticees") had redeemed units in the Impugned Debt Schemes during the period. The summary of the transactions by the Noticees in the Impugned Debt Schemes during the months of March 2020 and April 2020 is given below:

TABLE I

SR. NO.	NAME	REDEMPTION DATE	SCHEME NAME	VALUE (IN *Rs.*)
1.	Vivek Kudva	20.03.2020	FI–IOF	92,31,080
		3.04.2020	FI–STIP	10,70,06,622

2.	Roopa Kudva	23.03.2020	FI–STIP	1,00,00,000
		23.03.2020	FI–STIP	5,88,80,462
		23.03.2020	FI–STIP	1,00,00,000
		23.03.2020	FI–IOF	1,00,00,000
		24.03.2020	FI–IOF	9,33,96,222
3.	Vasanthi Kudva	20.03.2020	FI–STIP	64,51,027
		24.03.2020	FI–IOF	20,64,635
TOTAL				**30,70,30,048**

5. The findings of the Inspection along with the relevant Annexures were shared with FT–MF vide SEBI letter No. SEBI/HO/IMD2/DF4/OW/12790/1/2020 dated August 5, 2020, and FT–AMC and its Trustees were advised to provide comments on the observations made therein. FT–AMC and Trustees submitted their response vide a common letter dated September 3, 2020. Based on the report of the Auditors, and response filed by the AMC and the Trustees, the chronology of events for the period March 1, 2020 to April 23, 2020, was as shown below:

TABLE II

SR. NO.	DATE OF EVENT	NATURE OF EVENT/COMMUNICATION	REFERENCE DOCUMENT
1.	6.03.2020	Discussions in the FT–AMC and Trustee meeting where concentration and liquidity risks with respect to various securities in the portfolio of debt schemes was presented.	Minutes of FT–AMC and Trustee Board Meeting dated March 6, 2020.
2.	18.3.2020	Discussions between Vivek Kudva and Santosh Kamath with respect to redemptions which were happening in managed credit funds (viz the debt schemes inspected) and related markdown in such schemes. Vivek Kudva sought information on liquidity profile mentioning *".…….do send me the liquidity profile of the 6 managed credit funds ASAP, ideally by EOD today, if possible. We are losing between 500 - 1000 crores per day from the funds and I want to make sure we are well prepared for different scenarios…."*	E–mail dated March 18, 2020, from Vivek Kudva to Santosh Kamath, CIO-Fixed Income of FT–AMC.
3.	19.3.2020	Information of Annualized returns as on March 19, 2020, of certain Fixed Income and Liquid schemes which were negative. Lists of such funds	E–mail dated March 19, 2020, from Ajay Narayan, Director Fund Administration to

TABLE II			
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		included debt schemes inspected, viz. FI–UST, FI–STIP, FI–CRF and FI–DAF.	Sanjay Sapre, Vivek Kudva and others.
4.	19.3.2020	Request was made by FT–AMC to SEBI to increase the borrowing limits from 20% to 30% in the schemes FI–LDF and FI–STIP.	E–mail dated March 19, 2020, from Sanjay Sapre to officials of SEBI.
5.	21.3.2020	Request from Vivek Kudva seeking information related to returns of 6 fixed income schemes (these schemes were the debt schemes inspected) and borrowings of fund, percentage of such borrowing, AUM at end of day and other historical data in the debt schemes inspected. This information is non-public information.	E–mail dated March 21, 2020, from Vivek Kudva to Director Fund Administration of FT-AMC and to select functional heads of FT-AMC including Sanjay Sapre, CEO.
6.	23.3.2020	Reply to the information of 6 debt schemes inspected as sought by Vivek Kudva, was sent by Ajay Narayan at 11.36am. Such mail identified an attachment *"fixed income scheme information final"*, the details therein identified the 6 fixed income's scheme AUM as at March 20, 2020 (Monday), Borrowing limits % as on March 22, 2020 (Friday), and other such data. The data identified exhaustion of borrowing limit of 20% in FI–STIP (Based on internal calculation of Borrowing limits on previous day's AUM). This information is non-public information.	E–mail dated March 19, 2020 from Ajay Narayan, Director Fund Administration of FT-AMC to Vivek Kudva and select heads of FT-AMC including Sanjay Sapre, CEO.
7.	23.3.2020	Approval was accorded by SEBI vide its letter dated March 23, 2020, to increase the borrowing limit from 20% to 30% to meet redemptions in FI–LDF and FI–STIP.	SEBI approval Letter dated March 23, 2020 addressed to Sanjay Sapre, CEO
8.	3.4.2020	Discussion on concentration going up and the ability to sell the securities of debt schemes inspected happened wherein Sanjay Sapre, CEO mentioned to Vivek Kudva *"... Please see the attached fact sheet. Concentrations have gone up as anticipated, though in some*	E–mail dated April 3, 2020 from Sanjay Sapre, CEO to Vivek Kudva, e–mail subject *"franklin fact sheet_31032020_6 funds"*.

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		funds not as sharply as feared. Ability to sell down some of the top positions as we have been stating remains critical to the long term sustainability and saleability of the funds." Further the attachment which was part of the above mail had the fact sheets (as on 31.3.2020) of only the debt schemes inspected**.**	

SHOW CAUSE NOTICE

6. Upon consideration of the Auditor's observations on the transactions by the Noticees, chronology of events and FT–AMC / Trustees reply to the said observations, SEBI issued a Show Cause Notice (SCN) to the Noticees. The allegations made in the SCN is reproduced below,-

   a. Vivek Kudva in his capacity as a Director of FT–AMC, was privy to information such as concerns of redemption, concentration and liquidity risk pertaining to the stress in the Impugned Debt Schemes, most of which was not in public domain.

   b. In an e–mail dated March 18, 2020, Vivek Kudva had recognized and admitted that the stress in debt funds may need preparation for different scenarios and had requested FT–AMC to share the liquidity profile stating: *"Do send me the liquidity profile of the 6 managed credit funds ASAP, ideally by EOD today, if possible. We are losing between 500–1000 Crores per day from the funds and I want to make sure we are well prepared for different scenarios…"* Thereafter, on March 19, 2020, FT–AMC had shared the information on negative return of the schemes with Vivek Kudva, which included the debt schemes inspected. Subsequently, Noticee nos. 1 and 3 i.e. Vivek Kudva and Vasanthi Kudva, started redeeming their investments from debt schemes from March 20, 2020.

   c. Vide an e–mail dated March 21, 2020, Vivek Kudva had specifically sought details of the Impugned Debt Schemes. These details included latest borrowings of the schemes, % of borrowing at end of day, etc. The information sought was received by him in an e–

mail dated March 23, 2020, forwarded by FT–AMC. The information contained in the aforementioned e–mail had *inter alia* identified exhaustion of borrowing limit of 20% by the FI–STIP. At the same time, SEBI had approved increase in borrowings limits in the schemes, FI–LDF and FI–STIP, on March 23, 2020, beyond regulatory limits, pursuant to the request made by FT–AMC vide an e–mail dated March 19, 2020.

d. On March 23, 2020, Noticee no. 2 -Roopa Kudva- redeemed all her investments from FI–STIP and a portion of her investments from FI–IOF. Further, on March 24, 2020, Noticee nos. 2 and 3 i.e. Roopa Kudva and Vasanthi Kudva, redeemed all their remaining investments from FI–IOF.

e. Vivek Kudva was part of the Liquidity Review Committee, which was formed by FT–AMC for assessing the liquidity crunch in the corporate bond market arising from the Covid–19 pandemic and the resultant market dislocation. Further, as per the reply of FT–AMC, the said Liquidity Review Committee had received daily reports and held meetings/calls as necessary to monitor liquidity and discuss strengthening of the existing range of liquidity measures that the Schemes had implemented from March 27, 2020. The daily reports submitted to members of the Liquidity Review Committee consisted of information such as inflows (pre–payments, maturity & coupon payment, etc.), redemptions and borrowing related data as well as projected cash flows and breach of limits related to borrowings, etc. pertaining to the managed credit funds.

f. Vide an e–mail dated April 3, 2020, Sanjay Sapre, CEO, FT–AMC, had shared the fact sheets (as on 31.3.2020) of the six debt schemes inspected with Vivek Kudva. In the said e–mail, it was stated that: *"Concentrations have gone up as anticipated, though in some funds not as sharply as feared. Ability to sell down some of the top positions as we have been stating remains critical to the long term."* On that said date, Vivek Kudva was left with an investment of around Rs. 10.70 Crore in FI–STIP. The information shared with Vivek Kudva included the factsheet of FI–STIP along with the details of the rating and concentration of

securities. The said investment was redeemed by Vivek Kudva on the same date i.e. April 3, 2020. Post April 3, 2020, none of the Noticees had any investment in any of the debt schemes inspected.

g. From the pattern of transactions of the Noticees, it is observed that they had been holding units in two of the debt schemes inspected, viz. FI–IOF and FI–STIP, for a long time as no transaction was observed from April 1, 2019 till March 19, 2020 i.e. except the redemption of the entire holding of the Noticees on the dates mentioned in Table II at paragraph 9.

h. In its reply dated September 3, 2020, FT–AMC had stated that: "*Vivek and his wife are settlors of two private trusts and primary beneficiaries of each other's Trusts. Each trust has invested Rs. 5 Crores (total Rs. 10 Crores) in Franklin India Dynamic Asset Allocation Fund-of-Funds (FD–AAF), as recently as 26 February 2020 and FD–AAF invests in the Franklin India Short Term Income Plan, which is under winding up. Hence through the trusts, they continue to have significant exposure to the funds being wound up".* However, the investment of Franklin India Dynamic Asset Allocation Fund of Funds ("**FD–AAF**") scheme was open for redemption and were not part of the schemes under winding up. Further, the Noticees had redeemed all their direct investments in the debt schemes inspected. These redemptions from direct investments were during the period when Vivek Kudva was in possession of the non–public information and prior to the decision for winding up of the schemes, as taken by Trustees.

i. Further, FT–AMC had in its reply dated September 3, 2020, submitted that the Noticees had also redeemed their investments from other Franklin schemes during the aforesaid period and hence, it would be incorrect to isolate few transactions and attribute motive to the same. However, FT–AMC's reply is not acceptable as Vivek Kudva had specific non–public information while redeeming all his units from the debt schemes inspected.

Accordingly, redemptions with respect to debt schemes inspected cannot be compared with redemptions from other schemes.

j. In view of the above, Vivek Kudva, being director of FT–AMC, after recognizing and admitting the stress in debt funds, had continued to seek and receive information from FT–AMC, which was not available in the public domain and upon receipt of the said information, had along with the other Noticees started redeeming their investments from debt schemes inspected.

k. In view of the above, it was alleged that the act of redemption of units by the Noticee nos. 1, 2 and 3 in two of the Impugned Debt Schemes - FI–IOF and FI–STIP, while in possession of non–public information with respect to stress in the debt schemes inspected, amounted to an unfair trade practice in securities market and a fraud on the other unsuspecting unit holders of said debt schemes who were not privy to such confidential information and therefore, could not redeem their investments. As a result, the Noticees had avoided loss (which shall be calculated as Redemption amount + Interest earned on the redeemed amount) with respect to the redemptions of their investments in two of the debt schemes inspected, viz. FI–IOF and FI–STIP, prior to closure of the said schemes. Further, as a Director of FT–AMC, Vivek Kudva should have acted in a fiduciary capacity and should not have, directly or indirectly, sold or otherwise dealt in any units of the debt schemes in a fraudulent manner or indulge in any unfair trade practice in securities market, while dealing in units of the schemes which were under extreme stress and which were subsequently wound up by FT–MF. Accordingly, Noticee nos. 1, 2 and 3 are alleged to have violated Section 12A(e) of the SEBI Act and Regulations 3(a), 4(1) and 4(2)(q) of the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ("**PFUTP Regulations, 2003**").

REPLY AND PERSONAL HEARING

7. Subsequent to the issuance of the SCNs, an opportunity of personal hearing was granted to Noticees on March 15, 2021 and March 16, 2021, wherein they were represented by Mr. Darius Khambata, Senior Advocate and Mr. Mustafa Doctor, Senior Advocate. Noticees had also filed written submissions dated January 19, 2021. Noticee No.1 filed submissions on behalf of himself and Noticee No. 3, whereas Noticee No. 2 apart from adopting the reply filed by Noticee No.1 also submitted a separate reply. Noticees also made further written submissions which was received by SEBI on March 30, 2021, containing the summary of the arguments made on their behalf during the oral hearing. The summary of the submissions made on behalf of the Noticees is given below,-

Noticee No. 1 and Noticee No. 3

i. It was submitted that the Noticees have neither effected any fraud or unfair trade practice and therefore any remedial intervention by way of disgorgement or imposition of monetary penalty is not warranted. The Noticees have neither gained anything/averted any loss for the same to be disgorged.

ii. Units of mutual funds are specifically excluded from the applicability of the PIT Regulations; SEBI's approach cannot be that PFUTP Regulations will cover activities which are specifically excluded from the PIT Regulations.

iii. SEBI has consciously decided not to extend the provisions of PIT Regulations 2015 to units of mutual funds despite the High Level Committee setup by SEBI to review PIT Regulations 1992 recommending that the definition of securities under the new regulations should be adopted from the definition of the term under SCRA which includes units of mutual funds. In view of the same, while accessing and inquiring in to allegations of fraud and unfair trade practice under the SEBI Act and PFUTP Regulations, the standard applicable to assess a charge of insider trading under the

PIT Regulations ought not to be applied. To apply such a standard would result in an incorrect standard being applied.

iv. The allegations in the SCN are based on the redemptions being undertaken on the basis of inequality of information, which is a characteristic of trading that is prohibited under the PIT Regulations. It was submitted on behalf of the Noticees that they have not dealt with the units on the basis on non-public information and that they have dealt with the same based on information available to all investors.

v. It was submitted that the charge in the present case is framed under the provisions of Section 12A(e) of the SEBI Act which reads as under:

> ***"Prohibition of manipulative and deceptive devices, insider trading and substantial acquisition of securities or control***
>
> ***12A. No person shall directly or indirectly—***
>
> *(e) deal in securities while in possession of material or non-public information or communicate such material or non-public information to any other person, in a manner which is in contravention of the provisions of this Act or the rules or the regulations made thereunder;"*

vi. It was submitted that Section 12A(e) applies when (a) a person communicates non-public or material information to another person; or (b) deals in securities while in possession of non-public information, in contravention of the SEBI Act, or the rules or regulations framed thereunder. The SCN does not refer to any other provision either under the SEBI Act or under any rules or regulations that refers to dealing in securities while in possession of material or non-public information.

No case has been made out against the Noticees under the PFUTP Regulations

vii. The burden of proof to be discharged to prove a charge of fraud under the PFUTP Regulations is higher than the one under the PIT Regulations.

viii. The charging provisions invoked under the PFUTP Regulations, i.e., Regulation 3(a), 4(1), 4(2)(q) have no applicability in the present case. It is a settled principle of law

that allegations in a show cause notice have to be interpreted very strictly, especially in cases of allegations of fraud, which can cause permanent damage to reputation and professional career of the person against whom they are made.

ix. The scope of inquiry for the purposes of the current proceedings must be as laid down under the PFUTP Regulations, which requires SEBI to demonstrate that the redemptions were undertaken in a fraudulent manner or constituted a manipulative or unfair trade practice. In terms of the PFUTP Regulations, to prove a charge of fraud, it is critical to establish inducement. In the facts of the present case, the Redemptions were not fraudulent as they did not and could not have induced anyone in the securities market or otherwise, to deal in the units of the Schemes. In terms of the SCN there has neither been any allegation against the Noticees nor has any evidence been adduced to indicate that the Noticees have induced any person to deal in the units of the Schemes.

x. In terms of the PFUTP Regulations, 'inducement' requires a positive act or omission on the part of the Noticees. Even assuming for the sake of argument that the Redemptions gave the Noticees an unfair advantage, the same cannot tantamount to 'fraud' as there was no inducement. Had it been the case that the Noticees had made any public comments on the Schemes and made any representation on the basis of which an investor would have bought units of the Schemes, then that may have amounted to 'inducement'. However, in the current case, the transaction of redemption does not even involve any counterparty, who may be said to have been 'induced' in any manner.

xi. Regulation 3(a) of the PFUTP Regulations prohibits a person from, directly or indirectly, buying, selling or dealing in securities in a fraudulent manner. The term 'fraud' has been defined under Regulation 2(1)(c) of the PFUTP Regulations, the extract of which has been set out below:

(c) "fraud" includes any act, expression, omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, and shall also include –

…

And 'fraudulent" shall be construed accordingly."

xii. For an act to be deemed as fraudulent, it has to satisfy the essential features mentioned in Regulation 2(1)(c) of the PFUTP Regulations. In this regard, the Noticees relied on the observations made by the L'd SEBI Whole Time Member in the matter of Nilesh Kapadia and Ors, which is reproduced below,-

"*In this regard, I note that regulation 2(1)(c) defines 'fraud" by providing an inclusive list of acts, expressions, omissions or concealments which shall be treated as fraudulent, by first identifying the features of 'fraud" and then by providing an inclusive list of identifiable conducts/acts/omissions, which amount to 'fraud". Thus, for a conduct to be 'fraudulent" it has to meet the essential features mentioned in regulation 2(1)(c) and does not have to necessarily fall in any of the 9 instances stipulated therein"*

xiii. Reliance was also placed on the observation of the Hon'ble Supreme Court, in matter of SEBI v Kanaiyalal Baldevbhai Patel & Ors[1]. It was submitted that the Hon'ble Court had in the matter had emphasized the factum of 'inducement' as critical for proving a charge of fraud. The relevant extract of the Supreme Court's decision relied by the Noticees is set out below:

"49. If Regulation 2(c) of the 2003 was to be dissected and analyzed it is clear that any act, expression, omission or concealment committed, whether in a deceitful manner or not, by any person while dealing in securities to induce another person to deal in securities would amount to a fraudulent act. The emphasis in the definition in Regulation 2(c) of the 2003 Regulations is not, therefore, of

[1] MANU/SC/1188/2017

whether the act, expression, omission or concealment has been committed in a deceitful manner but whether such act, expression, omission or concealment has/had the effect of inducing another person to deal in securities.

50. The definition of "fraud", which is an inclusive definition and, therefore, has to be understood to be broad and expansive, contemplates even an action or omission, as may be committed, even without any deceit if such act or omission has the effect of inducing another person to deal in securities. Certainly, the definition expands beyond what can be normally understood to be a fraudulent act' or a conduct amounting to fraud'. The emphasis is on the act of inducement and the scrutiny must, therefore, be on the meaning that must be attributed to the word "induce"".

xiv. It was submitted that from the definition of 'fraud' under the PFUTP Regulations and the above judicial pronouncements, it is clear that for an act to be deemed fraudulent under the PFUTP Regulations, it has to meet the essential features of the definition of 'fraud' as set out under the PFUTP Regulations, including that the act should have induced another person to deal in securities.

xv. It was further submitted on behalf of the Noticees that while the SCN makes a vague allegation of fraud, it does not specify the nature of the fraud that is alleged to have been committed with reference to Regulation 2(1)(c) of the PFUTP Regulations. Noticees submitted that it is well settled that particularly in the context of allegations of fraud, it is necessary to set out in detail with sufficient particulars the allegations that constitute the alleged fraud as also the legal provisions under which the charge is being made. In the absence of either one of the above, the charge of fraud is not sustainable.

xvi. It was further submitted that the Redemptions undertaken were not and could not have been an inducement to anyone to deal in the units of the Schemes. The Noticees decided sell to their units in the Schemes based on, inter alia, generally available public information and in the context of an extraordinary market situation due to the

unprecedented black swan event of Covid-19 pandemic. The Noticees did not encourage, advise or in any way induce any person to deal in such units nor has SEBI alleged or provided any evidence to support that any investor was so induced.

xvii. It was submitted that SEBI has not discharged the burden of providing any causation and impact in relation to the Redemptions. The actions of the Noticees were not to the detriment of the other unit holders in the Schemes and have not caused any other person to deal in the units of the Schemes in any manner whatsoever. Therefore, the allegation against the Noticees that they have committed fraud on the other unsuspecting unit holders is wholly unsubstantiated.

<u>Redemptions cannot be construed as an unfair trade practice</u>

xviii. It was submitted that in order to substantiate a charge under 4(2)(q), it is necessary to prove that a person has dealt in securities, while being in possession of non-public information regarding (a) a substantial impending transaction in those securities, (b) its underlying securities, or (c) its derivative.

xix. Noticees' contended that the discussion with regard to the winding up off the Schemes commenced only on April 16, 2020. The Redemptions were undertaken between March 20, 2020 and April 3, 2020. A charge under 4(2)(q) hinges on whether or not the Noticees had advance knowledge of a substantial impending transaction in the units of the Scheme. The SCN neither identifies the 'substantial impending transaction', if any, which formed the basis of the charge against the Noticees nor does it specify when the Noticees had allegedly become aware of this alleged impending transaction. Paragraph 11 of the SCN only alleges possession of information with respect to stress in the Schemes, which by any standards cannot be construed as a 'substantial impending transaction'.

Redemptions were undertaken based on publicly available information for bona fide reasons and based on prevailing market conditions

xx. Without prejudice to the above submissions, it was submitted that the Redemptions were undertaken in good faith and on the basis of publicly available information and that the Noticees did not act in a fraudulent or unfair manner.

xxi. From a reading of paragraphs 8 and 10 of the SCN, and communications between Vivek Kudva (Noticee I) and other personnel of FTMF, it has been alleged that Noticee 1 was in possession of non-public information with respect to stress in the Schemes, and that Noticee 1, along with his wife, Roopa Kudva (Noticee 2), undertook the Redemptions based on such non-public information. Further, merely because Noticee 1 may have possessed any non-public information, it has been erroneously assumed, without any supporting evidence, that he shared such information with his wife. The above actions of the Noticees have been alleged as `fraudulent' in terms of the Notice.

xxii. It was submitted that the fact that there was stress in the Schemes was publicly available information. As elaborated below, all relevant data points about the Schemes were disclosed to the unit holders through periodic disclosures in line with applicable law and investors had ample opportunity to redeem their investments prior to the announcement of the winding up of the Schemes, at net asset value ("NAV") higher than the NAVs at which the Redemptions were made by the Noticees. Thousands of investors had redeemed their investments during this period based on publicly available information. If this publicly available information was adequate for a lay investor without any specialized knowledge with regard to financial markets to take a decision to redeem his/ her units, it would be unfair to suggest that this information was not adequate for the Noticees to make the same decision.

xxiii. It was also submitted that even assuming that the Noticees had additional information which was not available in the public domain, the same did not motivate the decision to redeem their units in the Schemes as the information available in the public domain was in itself adequate for this purpose. It would lead to a highly invidious and unfair situation if the Noticees were prohibited from redeeming their units on the basis of generally available information only on account of the fact that they had additional non-public information, which was not material and which did not in any way contribute to the decision to redeem their units.

xxiv. The information which was available in the public domain that prompted their decision to redeem their units in the said Schemes included the onset of a once in a lifetime event, i.e., the Covid 19 pandemic which brought an abrupt and massive disruption to the global economy. It is a matter of general knowledge that, Indian government took stringent policy decisions in March 2020 including imposition of a country wide lockdown. Considerable public information was available which clearly demonstrated the difficult times that the economy and markets broadly were facing. The said information, led to the Noticees deciding to allocate a greater proportion of their investments to cash, which is a reasonable and widely adopted practice during times of heightened risk. The applicable regulatory framework did not prohibit the Noticees from undertaking the Redemptions.

xxv. It was also submitted that units of four other FTMF schemes held — (i) Franklin India Corporate Debt Fund — Plan A — Direct Growth (ii) Franklin India Equity Fund — Growth (iii) Franklin India Taxshield — Growth and (iv) Franklin India Focused Equity Fund — Growth — were also redeemed by the Noticees 1 (Vivek Kudva), 2 (Roopa Kudva) and 3 (Vasanthi Kudva) for an aggregate value of INR 18,68,95,287.88. Therefore, there was nothing peculiar to the Schemes in the decision to redeem.

Directions for Disgorgement not justified in the facts of the present case

xxvi. It was submitted that the claim for disgorgement is *ex facie* unsustainable as the Noticees have neither made any wrongful gains nor averted losses, which are prerequisites for an order of disgorgement. It was stated that there were no gains relative to other investors in the Schemes.

xxvii. It was further submitted that the SCN contemplates disgorgement of the entire proceeds of the Redemptions (including interest earned on the redeemed amount) on the erroneous premise that other unit holders were not privy to the same information and could not redeem their investments. This premise, it was submitted, was fallacious for the following reasons:

a. It presumes that there was no window of opportunity for investors to exit the Schemes prior to the decision of their winding up being announced on April 23, 2020.

b. The redemptions by the Noticees took place between March 20, 2020 and April 3, 2020. There was more than adequate information in the public domain with regard to the Schemes in question for the investors to take a decision with regard to redemption. In line with the regulatory framework, information disclosures were routinely made on the website of FTMF and portfolio disclosures were also communicated to investors on a monthly basis, including in relation to liquidity profiles, percentage of borrowings and concentration. The format in which such information disclosures were made were as approved by SEBI. Therefore, it is incorrect that investors were unsuspecting or were unable to redeem their investments, as has been alleged in the Notice. Even between April 4, 2020 and April 23, 2020, the investors had adequate information to make a decision to redeem their units. During this time, NAV of the Schemes were, on many days, higher than the date on which the Redemptions were made by the Noticees.

c. The NAV of the Schemes on April 23, 2020, the date on which winding up of schemes by FTMF was announced, was also higher than the NAVs at which the redemptions were undertaken, whereas it is well established common ground that at the time of Redemptions, the winding up was not even being considered as a proposal.

d. For most days subsequent to the date of the redemptions undertaken by the Noticees, the NAV was higher than the NAV at which such redemptions were made. However, even on such few days when the NAV was lower than the NAVs at which the redemptions were made by the Noticees, the difference thereof was de-minimis, i.e., approx. 0.5% (half percent) of the NAVs at which the redemptions were made.

e. The presumption that other unit holders will not get any amounts after the date of winding up is also incorrect. The distribution of the winding up proceeds is underway and has not yet completed. As on date, NAVs of the Schemes are higher than the NAVs at which the redemptions were undertaken.

xxviii. The winding up of the Schemes does not mean that unit holders have lost their investments. In support of this contention, the following was submitted by the Noticees:

a. The Hon'ble Supreme Court, in its orders dated February 2, 2021 and February 12, 2021, has permitted distribution of the cash balances lying in the six debt schemes under winding up. In fact, as on date, INR 9,122 crores has been paid to the unit holders of the six schemes under winding up.

b. Moreover, an additional sum of INR 1,370 crores has accumulated and is available for distribution. In addition, as SBI Funds Management Private Limited begins to actively monetize the assets of the six debt schemes, it is expected that return of money to the investors will progressively increase.

c. The aggregate amount of monies received by investors will be known only at the end of the winding up process.

xxix. Without prejudice to the above and assuming that the disgorgement by the Noticees is to be calculated according to the return that the other investors will get on winding up, it is submitted that the correct course of action would be to await the distribution of proceeds of the Schemes in terms of winding up and not arrive at premature conclusions that any gains were made or losses were averted.

Conduct of the Noticees has at all relevant times been completely bonafide

xxx. It was stated in the reply that Vivek Kudva has over 34 years of experience in financial services (banking and investment management) and has a long-standing reputation in the financial markets. During this period, he has been associated with Franklin Templeton for over 14 years, and prior to that, has worked with HSBC for over 18 years. He has had an impeccable track record as a professional in the financial services space, and in his career spanning over more than three decades, there has been no occasion for SEBI or the RBI to express any concern with respect to his conduct in discharge of his professional responsibilities.

xxxi. It was further submitted that on the night of April 23, 2020, that is, immediately after the decision to wind up the Schemes was taken, the Noticees undertook to put themselves in the same position as investors who had remained invested in the Schemes. It was also undertaken that the proceeds of the Redemptions have been set aside and the Noticees will ultimately receive no more than the investors remaining in the Schemes.

No case is made out for imposition of monetary penalty

xxxii. It was submitted that while adjudicating penalty under Section 15HA of the SEBI Act, the Hon'ble WTM must consider the mitigating factors under Section 15J read with

Rule 5 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995. Further, the Hon'ble WTM is not bound to impose any penalty on the Noticees if the WTM deems it to be a fit case for no penalty.

xxxiii. Noticee further submitted that this was a fit case for exercising discretion and not imposing any penalty or passing any adverse order against the Noticees.

xxxiv. It was also submitted that Vivek Kudva's mother, Vasanthi Kudva (Noticee 3) has no connection with or involvement in the internal affairs of FTMF. The reply stated that she is an elderly woman and her investments are handled by Vivek Kudva in the normal course, including the act of Redemptions.

Noticee No. 2

i. Noticee 2 is not an employee of FT-AMC and has no connection with FTMF. The Notice does not contain any allegation that information in respect of FTMF was shared with Noticee 2.

ii. Noticee 2 heads Omidyar Network India Advisors, a social impact focused investment firm, and has been serving in that position for more than 5 years. Prior to that, Noticee 2 had a 23-year long stint with CRISIL, a global analytical company providing ratings, research, and risk and policy advisory services, out of which, she was MD and CEO for 8 years. Noticee 2 has an impeccable track record as a professional in financial services space.

iii. The allegations against Noticee 2 are entirely predicated and dependent on the allegations made against Noticee 1 (Vivek Kudva).

iv. It was submitted that Noticee 2 has reviewed the written submissions filed by Noticee No.1 and adopts all said arguments.

v. It was stated in the reply that the SCN does not even suggest that Noticee 1 shared any non-public information with Noticee 2 and merely proceeds on the presumption that the Noticee 2 was in possession of such information.

vi. It was submitted that the Redemptions were a reasonable logical and bona fide decision, and are also not barred in law. The Redemptions were essentially a fair decision to hold financial assets substantially in cash rather than in units of mutual funds during a period of uncertainty.

vii. It was also stated that Noticee 2 has no connection whatsoever with the affairs of FTMF and has never received any non-public information from Vivek Kudva, in relation to the Schemes or otherwise. Mere fact of spousal relationship cannot constitute evidence of any communication of information in order to establish a serious charge of fraud and market conduct.

Rationale for undertaking Redemptions

viii. Noticee 2 submitted that the decision to undertake the Redemptions was based on her own independent assessment following the onset of once in a lifetime event, i.e., the Covid 19 pandemic which brought abrupt and massive disruptions to the global economy and markets. It is a matter of general knowledge that the Indian government took stringent policy decisions in March 2020 including imposition of a country wide lockdown. Considerable public information was available and disclosures regarding certain specific events were made which clearly demonstrated the difficult times that the economy and markets broadly were facing.

ix. The said information on Covid-19, the economy and markets led to Noticee 2's decision to allocate a greater proportion of her investments to cash, which is a reasonable and widely adopted practice during times of heightened risk. The applicable regulatory framework did not prohibit Noticee 2 from undertaking the Redemptions.

x. It is further submitted that the Redemptions were (a) based on generally available, public information and in the context of an extraordinary market situation due to the unprecedented black-swan event of Covid-19 pandemic (b) undertaken in good faith, (c) pursuant to Noticee 2's independent assessment of the prevailing circumstances in March 2020. It is urged that the WTM examine the Redemptions in light of contemporaneous economic factors and market conditions, as they existed then.

xi. Further, the bona fides of Noticee 2 can be demonstrated by the fact that during the time of the Redemptions, she also redeemed her investments from other schemes of FTMF due to the above-mentioned reasons, and the Redemptions therefore cannot be looked at in isolation.

CONSIDERATION

8. The gravamen of the allegations made in the SCN is that Noticee No. 1, who was a director of the AMC of the mutual fund, along with his immediate family, while allegedly being privy to material non-public information, redeemed units in certain schemes of the mutual fund and thereby contravened the provisions of SEBI Act and the SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003.

9. Section 11(2)(g) and section 11(2)(e) of the SEBI Act, entrusts the Board with the mandate to take measures for the 'prohibition of insider trading' and 'prohibition of fraudulent and unfair trade practices'. The terms 'insider trading', 'fraudulent' and 'unfair trade practice' are not defined under the SEBI Act. Using the power to make regulations under Section 30 of the Act, SEBI initially notified the SEBI(Prohibition of Insider Trading)Regulations, 1992 (PIT Regulations) and the SEBI(Prohibition of Fraudulent and Unfair Trade Practices)Regulations, 1995 (PFUTP Regulations 1995) wherein the terms 'insider' and 'fraudulent' were respectively defined. Thereafter, in

2002, Section 12 A was inserted in the SEBI Act, which has now become the main statutory source from which SEBI derives its powers to act against fraudulent and unfair trade practices and insider trading.

10. I note that the Noticees have contended in their reply that other than Section 12A(e) of the SEBI Act, the SCN does not refer to any other provision either under the SEBI Act or under any rules or regulations that refers to dealing in securities while in possession of material or non-public information. This contention of the Noticees gets answered as we trace the evolution of the legal framework encompassing trades done exploiting the asymmetric information advantage in the following paragraphs.

11. I note that SEBI has addressed the exploitation of informational advantages under both PIT and PFUTP Regulations. The PIT Regulations, when it was initially notified in 1992, covered within its ambit only 'corporate insiders' who were connected to the "issuer": whereas violations emanating from trading on the basis of asymmetric access to information by 'non-insiders' and intermediaries - like front running - was dealt with under PFUTP Regulations 1995. It can therefore be noted that Insider Trading Regulations, when they were notified in 1992, primarily sought to prohibit 'insiders' connected to the issuer of the security from trading on the basis of superior information obtained during the course of their employment or association with the issuer; whereas the PFUTP Regulations covered other forms of trading done by exploiting information asymmetries by any person, even though he may not be an 'insider' or connected to an 'insider'.

12. In this context, it is important to note that courts have also recognised that certain types of trades executed on the basis of superior information would fall within the definition of 'fraud' under the PFUTP Regulations 2003. The Hon'ble Supreme Court recently in the matter of Kanaiyalal (supra) has held that front running by non-intermediaries would come within the ambit of 'fraud' under regulation 3 and 4(1) thereof.

13. In this context, it is relevant to note that strictly stated, prior to the amendment[2] carried out in 2018 to PFUTP Regulations 2003, only intermediary front running was specifically proscribed under regulation 4(2)(q) of PFUTP Regulations 2003. This emphasises the fact that misuse of information which is not available in the public domain, even by a non-intermediary, has been construed to be prohibited under regulations 3 and 4(1) of the PFUTP Regulations 2003 by the Hon'ble Supreme Court. In short, trades exploiting information advantages would get covered under the general prohibitions contained in regulation 3 and 4(1) of PFUTP Regulation 2003, even if the activity is not specifically proscribed under regulation 4(2). It is also interesting to note that in this matter, the Hon'ble Supreme Court had observed that such practice of taking advantage of non-public information could also be considered as an 'unfair trade practice'. However, the Hon'ble Supreme Court in the matter of Kanaiyalal (supra) felt it was not necessary to delve further into the issue of 'unfair trade practice' as the facts therein made out a case of 'fraud'.

14. In view of the above, the issue that requires adjudication in the present matter would be whether the redemption of units by the Noticees made while in possession of material non-public information as alleged can be held to be a 'fraudulent' or 'unfair trade practice' as defined under the PFUTP Regulations. The PFUTP Regulations 2003 seek to prohibit 'fraudulent' and 'unfair trade practices' while dealing in securities. The definition of 'securities' under the PFUTP Regulations makes reference to section 2(h) of the Securities Contracts (Regulation) Act, 1956, which covers units of mutual funds within its ambit.

15. Thus, the laws dealing with information asymmetries (PIT Regulations and PFUTP Regulations) essentially seek to address the issues arising out of disparities in access to

[2] SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) (Amendment) Regulations, 2018

material information, that is otherwise not legally available to general investors, and to prevent those persons having access to such superior information from exploiting the informational advantage, in order to protect the integrity of the market and maintain investor confidence.

16. I will now proceed to look at the framework of the PFUTP Regulations 2003 and how the courts have interpreted the scope of various provisions of the said regulations, to the extent it is relevant for the instant case. I bifurcate the issues involved as,

    A. whether the Noticees can reasonably be expected to have access to material non-public information at the time of redemption of units; and

    B. whether redemption of units on the basis of non-public information, as alleged in the SCN, would satisfy the parameters of 'fraudulent' or 'unfair trade practice' as defined under PFUTP Regulations 2003.

Nature of the material non-public information accessed

17. To begin with the facts, I note from the replies filed on behalf of the Noticees that it is an admitted fact that the units were redeemed on behalf of Noticee No.3 by Noticee No.1. With respect to the redemptions by Noticee No. 2, it was submitted that the same was done on her own accord and there was no discussion related to the activities of the fund between Noticee No. 1 and Noticee No. 2.

18. As can be noted from Table 1, Noticee No. 1 made redemption from his own account on March 20, 2020 and April 03, 2020 and from the account of Noticee No.3 on March 20, 2020 and March 24, 2020. The redemptions were done by Noticee No. 2 on March 23, 2020 and March 24, 2020. From the chronology of events captured in Table II of this order, the replies of the Noticees and other information available on record, the material non-public information that was reasonably expected to be available to Noticee No. 1 is detailed in the following paragraphs.

19. On March 18, 2020, Noticee No. 1 had a discussion with the Chief Investment Officer-Fixed Income of FT-AMC regarding the redemptions that were happening in the Impugned Debt Schemes and related markdowns. In this regard, it is noted that even though the NAV of the schemes are published every day, the information regarding the redemptions and more critically the liquidity profile of the debt instruments held by the scheme is not public information.

20. Further, as per SEBI(Mutual Funds) Regulations, MFs are not allowed to borrow for investment purpose; they can only temporarily borrow to a limited extent of upto 20 percent of the net assets of the scheme to meet temporary liquidity requirements. Any additional borrowing requires prior approval from SEBI. During periods when schemes face extreme redemption pressures, to meet the redemption requirements, AMCs would typically liquidate the liquid assets in the portfolios first thereby increasing the exposure of the remaining investors to lesser liquid instruments.

21. Further, open-ended mutual funds permit investors to redeem their units at the prevailing NAV. However, following substantial outflows, funds may need to adjust their portfolios and conduct 'forced trades' of less liquid and illiquid securities at unfavourable prices to fund such redemptions, which could be detrimental to the interests of investors staying invested in the scheme. The MF Regulations provide that payments in respect of redemptions should be made within 10 days from the date of redemption. It can therefore be noted that when such schemes face extreme redemption pressures, the investors who are redeeming can exit at the prevailing NAV, but the actual process of liquidation of securities held by such schemes to facilitate payments for such investors could require the AMC to undertake certain 'forced trades' at unfavourable prices. The effects of such forced trades is borne by the unit holders who remain invested and they could be expected to witness significant erosion in the future NAV especially in cases where the securities held by the scheme are comparatively

illiquid and the redemption pressure is significant. It has also to be kept in mind, that the Impugned Debt Schemes had by this point almost exhausted the 20% borrowing limit permitted under the regulations, and if redemption pressures continued to persist, then it would have had to resort to liquidating instruments by resorting to distress sales or seek SEBI approval for enhancing the borrowing limit; the AMC ultimately ended up seeking an enhancement in the borrowing limits.

22. I note that in the present matter, most of the relatively liquid instruments held by the said schemes had already been liquidated by the time Noticees had started redeeming their investments in the Impugned Debt Schemes. It is noted from the disclosures made at the end of February 2020 that the schemes, FISTIP and FTIOF were holding 8.02% and 4.84% of the AUM, respectively, in AAA rated securities. However, from the disclosures made at the end of March 2020, it can be noted that the holding in AAA rated securities as a percentage of the AUM had dropped to 0.17% and 0.95%, respectively, in FISTIP and FTIOF. Further, as stated earlier, the information regarding market for the instruments the scheme continued to hold would not be available in the public domain. I note that this is true for most debt schemes investing in privately placed debt instruments but especially relevant in the context of the Impugned Debt Schemes as the instruments that these schemes were holding at this point were comparatively lower rated instruments, and many of them had complex bespoke structures, and the liquidity for such instruments under market conditions prevailing at that point in time would have been quite shallow.

23. The Noticees in their replies have contended that the instruments held by the scheme and their market price was publicly available information which was displayed at the end of every day on the website of the AMC. In this regard, I note that the price that can be realised from what can be characterised as a 'fire sale' of such lower rated instruments in the market conditions that were prevailing at that point in time cannot

be gauged by disclosures that were put out in the public domain by the AMC especially considering that a majority of the instruments that were held by these schemes were complex securities bearing idiosyncratic risks.

24. The Noticees have further contended that on many of the days between March 20, 2020 and April 23, 2020, NAV of the Schemes were higher than the NAV on the dates on which the redemptions were made by the Noticees. In this regard, I note that even though the Impugned Debt Schemes were witnessing heavy redemption pressure, by the time the Noticees had started redeeming units, the borrowing limits (including the enhanced limit pursuant to SEBI approval) had not been exhausted and therefore the schemes would have resorted to additional borrowing to meet redemption before embarking on a forced liquidation of assets. It is, however, pertinent to note that the cost of the additional borrowings as per the MF Regulations has to be met by the AMC and therefore even when approval for additional borrowing is obtained from SEBI, there would always be a point beyond which an MF would have to resort to forced liquidation of the assets. As long as the scheme is able to meet redemption demands out of borrowings, the impact on the NAV may be minimal. But once the forced sale of securities starts, the dent on NAV will be significant. Further, the chances of an AMC resorting to 'forced sales' would be higher when the redemption pressure is sustained over a period and is not a one off event. The adverse impact of forced sales on NAV was clearly on the cards, especially given the illiquid nature of the bonds in the portfolio, which was very much in the knowledge of Noticee No. 1. There is no doubt that the quality of information that Noticee No. 1 possessed at the time of undertaking redemptions was far superior to that of the general investor. Eventually, the AMC decided to wind up the Impugned Debt Schemes on April 23, 2020 and thereby avoided 'forced sale' of assets.

25. I note from the above that Noticee No. 1, being privy to the information regarding the redemption pressure, liquidity profile of the assets held by the scheme, and the borrowing limits getting exhausted, could reasonably be expected to have material non-public information relating to the Impugned Debt Schemes.

26. In view of the above, given the circumstances leading up to the redemption of units by Noticee No.1 on March 20, 2020, including the discussion with the CIO, as stated in paragraph 19 herein above, and the material non-public information that Noticee No.1 could reasonably be expected to be privy to at that point in time, I have no hesitation in holding that the redemption of units by Noticee No. 1 on March 20, 2020, was done while being in possession of material non-public information.

27. I also note that Noticee No.1 can reasonably be expected to be privy to additional material non-public information prior to the later redemptions on March 23, March 24 and April 03, 2020, which includes the following:

    a. Information forwarded to Noticee No.1 by Ajay Narayan, Director Fund Administration of FT-AMC, which included borrowing limits % as of March 22, 2020 in the Impugned Debt Schemes. This information regarding exhaustion of the borrowing limits would become publicly available only with month end disclosures.

    b. Discussion between Sanjay Sapre, CEO of FT-AMC and Noticee No.1 on April 03, 2020, regarding the concentration levels going up and the ability to sell down the instruments held by the Impugned Debt Schemes.

28. Having given a finding that the redemption made by the Noticee No. 1 on March 20, 2020, was while in possession of material non-public information, it automatically follows that the redemptions made on March 23, March 24 and April 03, 2020 by the Noticees were also while the Noticee No.1 was privy to material non-public

information, including the additional material information as provided in paragraph 27, as the said information had not become publicly available prior to the said redemptions.

29. The timing of the trades is also a crucial circumstantial evidence in this case. It can be noted that the trades by Noticee No. 2, who is the wife of Noticee No. 1, was undertaken on March 23, 2020 and March 24, 2020- i.e. the trades were done in close proximity to the dates when Noticee No.1 started redeeming his investments as well as that of Noticee No. 3. It is further seen that on March 24, 2020, both Noticee No.1, on behalf of Noticee No. 3, and Noticee No. 2 were redeeming units. It needs to be borne in mind that Noticee No. 2 is also an experienced finance professional in her own right. Given her experience, she was expected to be aware of the sensitivity of the transactions undertaken by Noticee No. 1, being a key functionary of the AMC with access to material non-public information and its implications.

30. In view of the same, given the facts and circumstances under which Noticee No. 2 had redeemed the units, it leads me to conclude that such redemptions were done on the basis of material non-public information Noticee No. 1 had in respect of the Impugned Debt Schemes.

31. Having held that the redemption of units by the Noticees was done while Noticee No.1 was reasonably expected to be privy to material non-pubic information pertaining to the Impugned Debt Schemes, I move on to address the issue of whether such redemption would attract the rigors of the provisions of the PFUTP Regulations 2003 alleged to have been violated by the Noticees in the SCN.

Whether the redemptions can be considered as fraudulent trades?

32. As can be noted from the title of the SEBI(Prohibition of Fraudulent and Unfair Market Practices)Regulations, 2003, the regulations seek to prohibit both 'fraudulent' and 'unfair trade practice' in the securities market. The term 'fraud' has been defined in

regulations while the term 'unfair trade practice' has been left undefined. Regulation 2(1)(c) defines 'fraud' as under,-

"(c)"fraud" includes any act, expression ,omission or concealment committed whether in a deceitful manner or not by a person or by any other person with his connivance or by his agent while dealing in securities in order to induce another person or his agent to deal in securities, whether or not there is any wrongful gain or avoidance of any loss, …"

33. I note that the Noticees in their reply, relying on the observations made by the Hon'ble Supreme Court in the matter of Kanaiyalal (supra), have submitted that the factum of inducement is critical for proving a charge of 'fraud'. They have also further contended that as the redemption of units by the Noticees could not have been an inducement for any other person to redeem units, the conduct of the Noticees does not satisfy the parameters of 'fraud' as defined by the Hon'ble Supreme Court. In view of the same, I consider it appropriate to refer to the observations made by the Hon'ble Supreme Court in this regard in the matter of Kanaiyalal,-

"50. The definition of 'fraud', which is an inclusive definition and, therefore, has to be understood to be broad and expansive, contemplates even an action or omission, as may be committed, even without any deceit if such act or omission has the effect of inducing another person to deal in securities. Certainly, the definition expands beyond what can be normally understood to be a 'fraudulent act' or a conduct amounting to 'fraud'. The emphasis is on the act of inducement and the scrutiny must, therefore, be on the meaning that must be attributed to the word "induce"."

34. It can be noted that Hon'ble Supreme Court has held that the critical factor while determining whether an act can be considered as 'fraudulent' is the presence of an element of inducement. In this regard, I note that details of individual redemptions made in open ended mutual fund schemes would not be available in the public domain; further, in such cases the fund would be the counter party to the redemption as opposed to trades executed over the stock exchange platform where another investor would be

the counter party. I also note that the SCN does not allege that the redemptions of units by Noticees had resulted in inducing or otherwise affecting the conduct of the other unit holders in the Impugned Debt Schemes.

35. I further note that it has been alleged that the conduct of the Noticees has been in violation of regulation 4(2)(q) of the PFUTP Regulations 2003. I, however, note that to sustain a charge under this provision, it would have to be shown that Noticee No. 1 had specific knowledge regarding certain impending redemptions and based on that information he redeemed ahead of others. The charge cannot be sustained on the basis that the Noticee No. 1, being privy to information regarding the pattern of redemptions till that point in time, could reasonably be expected to have information related to the redemptions continuing in the future too. I note that the SCN does not identify any instance of the Noticees having specific information regarding a 'substantial impending transaction' in the units of the Impugned Debt Schemes.

36. In view of the same, I find it difficult to hold that redemption of units by the Noticees satisfies the parameters of 'fraud' as defined under regulation 2(1)(c) read with regulation 3(a) of the PFUTP Regulations 2003. I also hold that the conduct of the Noticees does not satisfy the requirements for sustaining the charge under regulation 4(2)(q) of PFUTP Regulations 2003.

Whether the redemptions can be considered as an Unfair trade practice?

37. The term 'unfair trade practice' is not defined under the PFUTP Regulations 2003. However, the Hon'ble Supreme Court in the matter of Kanaiyalal(supra) had observed that the term is broader in scope than the term 'fraudulent' and includes the concept of 'deception' or 'fraud'. The Hon'ble Court has held that "*Broadly trade practice is unfair if the conduct undermines the ethical standards and good faith dealings between parties engaged in business transactions. It is to be noted that unfair trade practices are not subject to a single definition; rather it requires adjudication on case to case basis. Whether an act or practice is unfair is to be*

determined by all the facts and circumstances surrounding the transaction. In the context of this Regulation a trade practice may be unfair, if the conduct undermines the good faith dealings involved in the transaction. Moreover the concept of 'unfairness' appears to be broader than and includes the concept of 'deception' or 'fraud'."

38. The Hon'ble Supreme Court in this matter had gone on to observe that while *"regulation 3 prohibits a person from committing fraud while dealing in securities… Regulation 4 prohibits manipulative, fraudulent and unfair trade practices*". The Hon'ble Court observed that *"It is to be noted that the Regulation 4 (1) starts with the phrase 'without prejudice to the provisions of Regulation 3'. This phrase acquires significance as it portrays that the prohibitions covered under the Regulation 3 do not bar the prosecution Under Regulation 4 (1). Therefore Regulation 4 (1) has to be read to have its own ambit which adds to what is contained Under Regulation 3."*

39. It can therefore be noted that the Hon'ble Supreme Court has observed that the scope of the term 'unfair trade practise' is wider than that of the term 'fraud' and activities which do not satisfy the parameters of 'fraud' could independently be proceeded under Regulation 4(1) if it can be considered as an *'unfair trade practice'*. I note that the observations made by the Hon'ble Supreme Court in the matter of Kanaiyalal (supra) in relation to 'unfair trade practice' as contained under the PFUTP Regulations are very pertinent to the facts of the present case.

40. The primary purpose for having laws prohibiting trading on the basis of asymmetric access to information is to foster confidence in the securities markets. Prevalence of such trades erodes the confidence of the ordinary investors in the fairness and integrity of the securities markets. Further, such trading by directors of a company is also a breach of the fiduciary duty as the insider effectively converted corporate information for private profits to the detriment of the other investors. The Director of an AMC acts as a quasi-fiduciary in respect of the investors of the mutual funds managed by the AMC and is expected to serve in the interest of such investors. In respect of the conduct of a director

of an AMC facing extreme redemption pressure, an analogy can be drawn to the role expected to be played by the captain of a ship who has been informed about an imminent threat which could sink the ship. In such a situation, if the captain on realising that the available life boats would not be sufficient to accommodate all the men and women on board, decides to flee on the first available life boat, then such an action would not be considered to be in conformity with his duties as captain and the role he is expected to play given the circumstances.

41. I further note that Regulation 18(25)(B)(vi) and Regulation 18(27)(vi), respectively, requires the Trustees and the independent directors of the AMC/Trustee to put in place a 'code of ethics' which is designed to prevent fraudulent, deceptive or manipulative practices by insiders in connection with personal securities transactions. I further note that the AMC had formulated a Policy on Conflict of Interest in compliance with the SEBI circular No. CIR/CFD/CMD1/168/2019 dated December 24, 2019. Paragraph 5(g) of the Policy provides as under,-

"Approach for managing conflict of interest

…

f. Restrict the dealing in securities while in possession of material non-published information"

42. It is further noted that paragraph 6 of the Policy, which lists the obligations of the relevant persons, *inter alia*, requires employees and directors to "not [participate] in decision making in case person [is] having actual perceived or potential conflicts of interest in the transaction" and also requires them to "pro-actively report any actual perceived or potential conflicts of interest.". I note that Noticee No. 1 is a person having wide experience in the securities market and it is just, fair and reasonable to expect that his conduct would be in line with the quasi-fiduciary responsibility that a director of an AMC owed to the unit holders of the mutual fund.

43. The standard of conduct expected from a key decision-making official of an AMC should be exemplary and beyond reproach. Having made a sizeable investment in the Impugned Debt Schemes, Noticee No. 1 should have upfront declared his investments to the AMC and should have sought to recuse himself from any decisions related to the Impugned Debt Schemes. Further, he should have refrained himself from accessing any non-public information relating to the schemes, material or non-material. Far from recusing himself, the Noticee went about seeking non-public information like liquidity profile, redemptions, concentration etc. which are critical indicators of the failing health of the debt schemes under winding up. Hence, I am constrained to note that conduct of Noticee No. 1 in redeeming units in the Impugned Debt Schemes while in possession of material non-public information is not in line with the high ethical standards expected of a person vested with such quasi-fiduciary responsibilities. I further note that such conduct is also not in compliance with the 'code of ethics' and the 'Conflict of Interest Policy' of the AMC which clearly spelt out restrictions on dealing in securities while in possession of material non-public information. It is also noted that the Policy mandates pro-active reporting of any actual, perceived or potential conflicts of interest. I note that Noticee No. 1, in his reply, has contended that he reported the transactions to his controlling manager in the United States of America on April 23, 2020. I, however, note that this disclosure was made only after the lapse of a considerable period of time (20 days) after undertaking the redemptions, and that too only on April 23, 2020 after the decision to wind up the Impugned Debt Schemes was taken. This is certainly not in compliance with the proactive disclosure mandated under the Policy and clearly appears to be an afterthought on the part of the Noticee No.1 after the schemes were wound up on April 23, 2020.

44. It has been contended by the Noticees that the redemptions were based on their independent assessment of publicly available information related to the onset of a once

in a lifetime event -the Covid 19 pandemic - which brought abrupt and massive disruptions to the global economy and markets. The Noticees have also contended that thousands of investors had redeemed their investments during the same period based on publicly available information. I note that the Noticees have very strenuously tried to present an alternate legitimate cause for the redemptions that were undertaken; they have also argued that when scores of ordinary investors in the scheme were also redeeming their investments in the Impugned Debt Schemes during the same period, it would not be fair to label only their redemptions as 'fraudulent' or 'unfair'. I, however, find the above two contentions raised by the Noticees to be neither convincing nor acceptable. As stated earlier, laws dealing with asymmetric access to information seeks to prevent persons having access to superior material information, not legally available in the public domain, from exploiting such asymmetric informational advantages in order to protect the integrity of markets and maintain investor confidence. What the laws strive to achieve is to prevent people with such superior access to information from trading while in possession of such information. It would be possible for any person charged with trading on the basis of superior information to claim that the trades were based on alternate publicly available information and it would not be possible to ever conclusively prove the basis of any trade. In cases pertaining to trades done on the basis of non-public information, obtaining direct evidence is always difficult and a conclusion more often than not has to be reached based on the circumstances leading up to such trades and the material non-public information which the person executing such trades can reasonably be expected to be in possession, while undertaking the said trades. Having made investments in the Impugned Debt Schemes, Noticee No. 1 should not have participated in the discussions leading up to the winding up of the schemes. Having been part of such discussions, where critical material non-public information was shared with the Noticee,

it would not be open for him to contend that he has a right like every ordinary unit holder to redeem units as he pleases without any restrictions.

45. It is further noted that the Noticees have contended that they continued to have exposure to the Impugned Debt Schemes even after April 03, 2020, through their investment in a Fund of Fund which has exposure to the said schemes. I, however, do not find merit in this argument for the following reasons:

    a. The Noticees have vehemently argued that they have redeemed all their investments in debt and equity funds based on their view of the evolving macro-economic situation. I note that the same argument can be turned around and it can be questioned why their views on the macro-economic situation did not lead them to redeem their investment in the FoF which was also subject to similar potential head winds as the other investments that were redeemed.

    b. The investment in the FoF was made only in February 2020, and any redemption of units before the end of one year from the date of investment would have been subject to an exit load. I note that such exit load was not applicable on the units redeemed by the Noticees in the other Impugned Debt Schemes.

46. In view of the same, I hold that while the directors are not prohibited from trading in units of the schemes managed by the AMC, they should ensure that such trading conforms to ethical and moral standards and legal norms expected to be complied by a person entrusted with quasi-fiduciary responsibilities. Redemption of units by a director of the asset management company of a mutual fund while being privy to material non-public information cannot be considered as fair conduct. In view of the same, I hold that redemption of units by the Noticee No. 1 on his own behalf and on behalf of Noticee No. 3 while being privy to material non-public information is an 'unfair trade practice'

and is in contravention of regulation 4(1) of PFUTP 2003. I think it would be appropriate, at this juncture, to refer to the observations made by the Hon'ble Supreme Court in the matter of Kanaiyalal (supra), wherein it was noted that *"unfair trade practice, which though not a defined expression, has to be understood comprehensively to include any act beyond a fair conduct of business including the business in sale and purchase of securities."*

47. Further, as stated in paragraph 29, the facts and circumstances and timing of the redemptions made by Noticee No. 2 lead to a distinct likelihood that the said redemptions were also based on material non-public information passed on by Noticee No. 1. In view of the same, I hold that redemption of units in the Impugned Debt Schemes by Noticee No. 2 is also an 'unfair trade practice' and is in contravention of regulation 4(1) of PFUTP Regulations 2003.

48. It was brought to my notice during the course of the proceedings that Noticee No.3 expired on May 19, 2021. In view of the same, I do not propose to issue any directions in respect of the said Noticee and the proceedings against her stand abated. However, since Noticee No. 1 had done the transactions on behalf of Noticee No. 3, the directions of disgorgement will be applicable to the corpus standing in the name of Noticee No. 3 also.

DISGORGEMENT

49. I note that the SCN proposes to disgorge the loss avoided by the Noticees by indulging in transactions which I have held to be an 'unfair trade practice' in this order. I, however, note that, quantifying the exact loss avoided by the Noticees, may not be possible at this point as the pay-outs from the Impugned Debt Schemes are still continuing and the final amount that will be realised by the unit holders who had remained invested cannot be conclusively determined at this point.

50. I note from the Fact Sheet published by the AMC in relation to the debt schemes under winding up that as on April 23, 2020 (the date of announcement of the winding up) STIP

had an AUM of Rs. 5658.22 crores and IOF had an AUM of Rs. 1854.61(excluding segregated portfolios). It is further noted from 'Maturity profile of schemes (cash flow projections) basis Portfolio holdings as on May 31, 2021' published by the AMC, that as on May 31, 2021, the Gross Value of the said two schemes, calculated as the sum of the AUM as on May 31, 2021 plus Cash distributed to the investors after April 23, 2020 was Rs. 5,869 crore (STIP) and Rs. 1,846 crore (IOF), and the cash distributed as percentage of the Gross Value was 27%(STIP) and 25%(IOF). It is therefore noted that even after a year from the date the decision to wind up the scheme was taken, the unit holders who had remained invested in the two schemes have received only 27% and 25% of their investments calculated as a percentage of the Gross Value of the schemes as on May 31, 2021. The Noticees by redeeming their units ahead of the other investors have enjoyed an unfair advantage by having access to their investments; whereas the unit holders who remained invested were left in the lurch as their investments were locked up for a considerable amount of time. In such a scenario, I find it appropriate to place the Noticees (with respect to their investments in the two schemes) in a similar position, to that of the unit holders who had remained invested.

51. The Noticees had cumulatively redeemed investments amounting to Rs. 11,46,91,937 in IOF and Rs.19,23,38,111 in STIP. As the Noticees would have only got 25% and 27% of the said redemptions as part of the winding up process, as on date of the order, if they had remained invested, I consider it necessary to direct as under:

A. the Noticees to transfer 75% (Rs. 8,60,18,952) and 73%(Rs. 14,04,06,821) of the amount received from the redemption of units in IOF and STIP, respectively, in an interest bearing Escrow Account marking a lien in favour of SEBI.

B. The amount (Rs. 8,60,18,952 + Rs. 14,04,06,821= Rs. 22,64,25,773) to be transferred to the escrow account as mentioned in paragraph 51(A), will be released in tranches to the Noticees in the same proportion as the cash distributed

to the unit holders (pursuant to the winding up process), taken as percentage of the AUM of the two schemes as on date of the decision to wind up the schemes i.e. April 23, 2020. Such proportionate releases from the Escrow Account will continue till the balance in the Escrow Account gets depleted to zero. If, on the other hand, on completion of the winding up process, any additional amounts remain in the Escrow Account, the same shall be transferred to the SEBI Investor Protection and Education Fund.

C. Noticees shall transfer the interest on the redeemed amount, calculated at the rate of 12% simple interest per annum from the date of redemption to the date of this order, to the SEBI Investor Protection and Education Fund.

MONETARY PENALTY

52. I find that violations committed by the Noticees, as found above, are serious in nature and calls for regulatory directions for debarment of the Noticees from the securities market and for disgorgement of wrongful gains made by Noticee no. 1, 2 and 3. I find that violations committed by Noticee no. 1, 2 and 3 also renders them liable for imposition of penalty under Section 15HA of the SEBI Act, 1992 which provides as under:

"Penalty for fraudulent and unfair trade practices.

15HA. If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher"

53. I note that while imposing penalty under Section 15HA of SEBI Act, 1992 the factors enumerated in Section 15J are to be taken into consideration. Section 15J of the SEBI Act, 1992 provides as under:

"Factors to be taken into account while adjudging quantum of penalty.

15J. While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or 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.

Explanation. —

For the removal of doubts, it is clarified that the power to adjudge the quantum of penalty under sections 15A to 15E, clauses (b) and (c) of section 15F, 15G, 15H and 15HA shall be and shall always be deemed to have been exercised under the provisions of this section."

54. As stated in paragraph 49 of this order, it is not possible to conclusively determine, at this point, the unfair advantage accrued to the Noticees pursuant to the redemption of the units in the Impugned Debt Schemes. It can, however, be noted that the Noticees had cumulatively redeemed units amounting to Rs. 30,70,30,048 while in possession of material non-public information: Noticee No. 1 had redeemed units worth Rs. 11,62,37,702 on his own behalf and units amounting to Rs. 85,15,662 on behalf of Noticee No. 3; whereas Noticee No. 2 redeemed units on her own account amounting to Rs. 18,22,76,684.

55. Further, as the redemptions of units by Noticee No. 1 on his own behalf and on behalf of Noticee No.3 and also the communication of the material non-public information to Noticee No. 2, was in breach of the quasi-fiduciary responsibilities, I am of the view that Noticee No. 1 is liable for a higher penalty as compared to Noticee No. 2. At the same time, I also note that the amount redeemed by Noticee No. 2 is about 1.5 times the combined amount redeemed by Noticees No. 1 and 3. The above factors have been kept in mind while issuing the following directions.

DIRECTIONS

56. In view of the aforesaid findings and having regard to the facts and circumstances of the case, I, in exercise of the powers conferred upon me under Section 19 read with Sections 11(1), 11(4), 11B(1) read with Regulation 5(3) of the SEBI (Investor Protection and Education Fund) Regulations, 2009 and Sections 11(4A), 11B(2) read with Section 15I of the SEBI Act and Rule 5 of the SEBI (Procedure For Holding Inquiry And Imposing Penalties) Rules, 1995, hereby direct as under:

i. Noticee No.1 and Noticee No. 2 shall be restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities, directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of one (1) year from the date of this order. During the period of restraint, Noticee No.1 and Noticee No. 2 shall not liquidate their existing holding of securities including the units of mutual funds;

ii. Noticee No.1 and Noticee No. 2 shall jointly and severally transfer the amounts mentioned at paragraph 51 in the manner provided therein within a period of forty-five (45) days, from the date of receipt of this order. In case of failure to do so, simple interest at the rate of 12% per annum shall be applicable from the expiry of the said 45 days till the date of actual transfer;

iii. Noticee No.1 shall be liable to pay a monetary penalty of Rs 4 crores for the redemptions undertaken on his own behalf and on behalf of Noticee No. 3, and Noticee No. 2 shall be liable to pay a monetary penalty of Rs 3 crores for the redemptions from her account, under Section 15HA of the SEBI Act, 1992;

iv. Noticee No.1 and Noticee No. 2 shall pay their respective penalties within a period of forty-five (45) days, from the date of receipt of this order. In case of

failure to do so, simple interest at the rate of 12% per annum shall be applicable from the expiry of the said 45 days till the date of actual payment.

57. Noticee No.1 and Noticee No. 2 shall comply with the directions at paragraph 51(C) by way of a demand draft in favour of "SEBI – Investor Protection and Education Fund", payable at Mumbai, or by e-payment to SEBI account as detailed below:

BANK	**BRANCH**	**RTGS CODE**	**BENEFICIARY NAME**	**BENEFICIARY ACCOUNT NO.**
BANK OF INDIA	BANDRA KURLA COMPLEX	BKID 0000122	SEBI – INVESTOR PROTECTION AND EDUCATION FUND	012210210000008

58. Noticee No.1 and Noticee No. 2 shall comply with the directions at paragraph 56(iii) by way of demand draft in favour of "SEBI–Penalties remittable to Government of India", payable at Mumbai, or by online payment through following path on the SEBI website: www.sebi.gov.in/ENFORCEMENT → Orders → Orders of Chairman / Members → Click on PAY NOW or at the link https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html. In case of any difficulties in payment of penalties, the Noticee may contact the support at portalhelp@sebi.gov.in.

59. The Noticees shall forward details of the demand draft or online payment made in compliance with the directions at paragraphs 56(ii) and 56(iii) (in the format as given in the table below) to the "The Division Chief, IMD – II/DoF-4, Securities and Exchange Board of India, SEBI Bhavan, Plot no. C-4A, 'G' Block, Bandra Kurla Complex, Bandra (E), Mumbai–400051". The Noticee shall provide the following details while forwarding the demand draft/payment information:

1. CASE NAME:	
2. NAME OF THE PAYEE:	

3. DATE OF PAYMENT:	
4. AMOUNT PAID:	
5. TRANSACTION NO:	
6. BANK DETAILS IN WHICH PAYMENT IS MADE:	
7. PAYMENT IS MADE FOR: (PENALTY/DISGORGEMENT)	

60. The Depositories shall not allow debits from the demat accounts (joint or otherwise) of Noticee No.1 and Noticee No. 2 except for the purposes of compliance with the directions at paragraph 56 of this Order. However, credits, if any, into the accounts of the aforementioned Noticees may be allowed.

61. This Order comes into force with immediate effect.

62. This Order shall be served on all the Noticees, Recognized Stock Exchanges, Depositories and Registrar and Share Transfer Agents and Banks to ensure necessary compliance.

Place: Mumbai
Date: June 07, 2021

G. MAHALINGAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA