WTM/SM/IMD/IMD-I DOF2/13158/2021-22

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTIONS 11(1), 11(4) AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 IN THE MATTER OF CERTAIN FIXED MATURITY PLANS OF KOTAK MAHINDRA MUTUAL FUND

In respect of:

Noticee No.	Name of the Noticee	PAN
1	Kotak Mahindra Asset Management Company Limited	AAACZ1086G

Background in brief

1. Securities and Exchange Board of India (hereinafter referred to as "**SEBI**"), noticed that the investors of certain Fixed Maturity Plans (hereinafter referred to as '**FMP**'), launched by the Kotak Mahindra Mutual Fund (hereinafter referred to as '**KMMF**'/'***the Fund***'), were not paid their full proceeds based on the declared Net Asset Value (hereinafter referred to as '**NAV**') of the said schemes as on their respective maturity dates.

2. Upon noticing the same, SEBI sought certain information from Kotak Mahindra Asset Management Company Limited (hereinafter referred to as '**KMAMC**'/'***Noticee***') and on examination of the said information received from the *Noticee*, it was observed that KMMF had launched FMP series 127 and 183 as close ended debt schemes in November 2013 and December 2015 respectively, both of which have matured on April 8, 2019 and April 10, 2019, respectively. As per the Scheme Information Documents (hereinafter referred to as '**SIDs**') of the aforesaid schemes, the investment objective of the said schemes was to generate returns through investments in debt and money market

instruments with a view to significantly reduce the interest rate risk. As per the SIDs, the schemes were to invest in debt and money market securities, maturing on or before maturity of the said schemes.

3. In furtherance of the said investment objective, it was observed that the FMP series no. 127 and 183 of the *Fund* had invested in Zero Coupon Non-Convertible Debentures (hereinafter referred to as '**ZCNCDs**') of Konti Infrapower & Multiventures Pvt. Ltd. (hereinafter referred to as '***Konti***') and Edison Utility Works Pvt. Ltd. (hereinafter referred to as '***Edison***' and hereinafter collectively referred to as '***Issuers***'). The maturity dates of those ZCNCDs were April 08 & 10, 2019 i.e. before the maturity dates of the FMP Series no. 127 & 183 of the *Noticee*. It is noted that both the *Issuers* belonged to the 'Essel Group', which was the promoter of Zee Entertainment Enterprises Limited (hereinafter referred to as '**ZEEL**') and some other companies which are commonly known as 'Zee Group Companies'.

4. To secure the investment in the ZCNCDs of the *Issuers*, Cyquator Media Services Private Limited (hereinafter referred to as '**Cyquator**'), an entity of Essel Group and one of the promoters of ZEEL, had pledged shares of ZEEL with the *Noticee*. As per the submissions of the *Noticee*, the share cover for such investment was decided to be a minimum of 1.50 times of the exposure amount and it was mandated to be topped up in case of any drop in share cover falling below such mandated cover of 1.50 times of the investment exposure.

5. It is noted from the approval notes of the Investment Committee (hereinafter referred to as '**IC**') of the *Noticee* dated March 07, 2016 and May 18, 2016 that the above said investment was primarily made based on the presumption of receiving repayment thereof by way of refinance, without making any reference to the financials and business operations of the *Issuers*.

6. It is observed that the price of the scrip of ZEEL witnessed a sharp fall on January 25, 2019. Consequently, the share cover as a collateral also fell below the mandated 1.50 times; however, the promoters of ZEEL at that point expressed their inability to provide additional collateral cover to secure the afore noted

investment exposure of the *Noticee* when the margin call was triggered. Eventually, letters of intent dated February 07, 2019 were executed amongst the *Issuers*, pledgers of ZEEL shares and committee of lenders of which the *Noticee* was a part. The *Noticee*, upon failure of the said committee of lenders to reach any conclusion, entered into separate agreements on April 06, 2019 with each of the *Issuers* in terms of which it further extended the maturity period of the said ZCNCDs of the *Issuers* till September 30, 2019. The *Noticee* had also undertaken/guaranteed to the *Issuers* that it will not invoke the pledge over the shares of ZEEL kept as security against the investment made in those ZCNCDs, till the end of such extended maturity period. The same was reportedly intimated to the investors of the FMP series 127 & 183 on April 05, 2019. The *Noticee* has further asserted to have communicated to the Investors of the said two schemes informing them that it would withhold and defer the payment on certain units in the said FMPs in the interest of the Investors, beyond the maturity dates of those FMPs.

7. Upon observing that the aforesaid actions taken by the *Noticee* were *prima facie* in violation of certain provisions of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as '**SEBI Act, 1992**'), read with the SEBI (Mutual Funds) Regulations, 1996 (hereinafter referred to as '**MF Regulations, 1996**') as well as various circulars issued by SEBI in this regard from time to time, Show Cause Notices (**SCNs**) dated May 10, 2019 and June 12, 2019 were issued to the *Noticee* in response to which a written reply was filed by it *vide* letter dated August 29, 2019. Thereafter, in conformity with the principles of Natural Justice, an opportunity of personal hearing was granted to the *Noticee* which was successfully availed of by it on October 16, 2019. During the course of the said hearing, the *Noticee* was asked to submit as to whether the deferment of payment of proceeds to the investors on maturity of the FMPs was confined only to the above noted two FMP schemes or the same deferment was extended to some other schemes as well, due to the abovementioned event involving drastic fall in the market price the scrip of ZEEL. Subsequently, *vide* letter dated November 06, 2019, the *Noticee* made its post-hearing submissions which revealed that the *Noticee* had also subscribed to the ZCNCDs of the same *Issuers* from four other

schemes, namely, FMP series 187, 189, 193 and 194 and in respect of those four schemes also, the *Noticee* had permitted the *Issuers* to extend the maturity period of those ZCNCDs till September 30, 2019 in the same manner as it had done in respect of the investment made from the earlier noted two FMP series of 127 & 183.

8. Based on the revelations from the post hearing submissions as highlighted above, further information was sought by SEBI in detail from the *Noticee* with regards to FMP series 187, 189, 193 and 194 for making a detailed examination in respect of those four schemes. After observing similar violations in the conduct of the *Noticee* pertaining to those four schemes as was observed in case of earlier noted two FMP series of 127 & 183, another SCN dated August 13, 2020 was issued to the *Noticee* with respect to FMP series 187, 189, 193 and 194. It is observed that vide letter dated December 17, 2020, the *Noticee* submitted its response to the said SCN dated August 13, 2020 after which another opportunity of personal hearing was granted which was availed of by the *Noticee* on April 16, 2021. Subsequently, vide letter dated May 28, 2021, the *Noticee* has made its post hearing submissions as well, broadly on the same lines as made in the earlier post-hearing written submission dated November 06, 2019.

9. The allegations made against the *Noticee* in respect of its investment in FMP series 127, 183, 187, 189, 193 and 194 as communicated to the *Noticee* vide the SCNs dated May 10, 2019, June 12, 2019 and August 13, 2020 are summarised as follows:

   9.1. IC of the *Noticee*, in its meetings dated March 07, 2016 and May 18, 2016, granted approval for subscription to the ZCNCDs issued by the *Issuers* merely on the '*belief*' of repayment '*in all probability*' through refinance. No reference to the financials and business operations of the *Issuers* was made in such meetings of the IC of the *Noticee*.

   9.2. Therefore, it is alleged that the credit worthiness of the *Issuers* has never been considered while making the investment decision to invest in the ZCNCDs issued by the *Issuers*. Also, the IC of the *Noticee* has not examined any

documents/reports so as to assess the adequacy of the collateral (shares of ZEEL) offered by the *Issuers* so as to secure the safety of the investment.

9.3. In view of the aforesaid apparent omissions on the part of the *Noticee*, it is alleged that the *Noticee* has not rendered high standards of service, has not exercised basic minimum due diligence and has not taken proper care of its investors' money before taking an investment decision in the ZCNCDs of the *Issuers*. The above acts of the *Noticee* have allegedly violated the provisions of Regulations 10(a), 25(1), 25(16) and clauses 6 and 9 of the fifth schedule of MF Regulations, 1996.

9.4. The *Noticee* has also failed to furnish any research report or any other research inputs so as to demonstrate the factors based on which, the aforesaid investment decision was taken for the first time by the *Noticee* to invest in the ZCNCDs issued by the *Issuers*. Also, no records were maintained by the *Noticee* to substantiate its investment decision in such ZCNCDs of *Konti* and *Edison* which would have reflected the data, facts and expert opinion etc. that were considered by the *Noticee* before taking the above noted investment decision except for suggesting that the investment in the said ZCNCDs were secured through pledge of shares of ZEEL offered by Cyquator as collaterals and the external ratings provided by Credit Rating Agency, Brickwork ratings etc.

9.5. In the light of the aforesaid, it is alleged that the *Noticee* has failed to exercise even the minimum required due diligence and care before taking the above stated investment decision, and has not bothered to prepare or obtain any research reports about the issuance of those ZCNCDs by the *Issuers* or to analyse various factors that were crucial to be considered prior to taking such a significant investment decision and consequently, has violated the provisions of Regulation 25(2) of MF Regulations, 1996 read with SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000.

9.6. It is further alleged that various events that took place from January 25, 2019 till April 04, 2019 ultimately leading to serious adverse consequences on the investments of the investors of those FMP schemes managed by the *Noticee*

thereby adversely affecting their interests, were not communicated or disseminated to the said investors in a timely manner. The communications by the *Noticee* made from April 05 to 12, 2019 to the investors of the respective six FMP schemes were in fact made just before the maturity of the respective scheme(s) and not at the time or immediately after witnessing the event of sudden drastic fall in the market price of the shares of ZEEL on January 25, 2019. In view of the same, it is alleged that the *Noticee* has violated Regulations 10(a), 25(16) and clause 2 of the fifth schedule of MF Regulations, 1996.

9.7. It is observed that the FMP Series 127, 183, 187, 189, 193 and 194 were close ended debt schemes, all of which were going to mature during April-May, 2019. As per the SIDs of all these FMPs, the schemes were mandated to invest only in such securities which mature on or before the date of their respective dates of maturity of the said Schemes in accordance to SEBI Circular No. SEBI/IMD/CIR No.12/147132/08 dated December 11, 2008, whereas, as noted above, during the period January 25, 2019 to February 7, 2019, the *Noticee* had taken a decision to extend the maturity of the securities invested in by these schemes beyond the dates of maturity of the said schemes.

9.8. It is further noted from the replies of the *Noticee* dated April 22, 2019 and April 30, 2019 that KMMF had entered into multilateral agreements dated April 06, 2019 with the *Issuers*, Cyquator and Dr. Subhash Chandra in terms of which, KMMF extended the maturities of the ZCNCDs of the *Issuers* till September 30, 2019. In view of the above, it is alleged that the said extension of maturity of the debt securities is an investment decision *vis-a-vis* the aforesaid ZCNCDs of the *Issuers*, which was in violation of the provisions of Regulations 10(a), 25(1), 25(2), 25(16), clauses 6 and 9 of the fifth schedule of MF Regulations, 1996 read with Circular No. SEBI/IMD/CIR No.12/147132/08 dated December 11, 2008.

9.9. In response to SEBI queries, it is noticed from the email dated April 22, 2019 of the *Noticee* that the units of the six FMPs were not fully redeemed

and full payment was not made to the investors at the end of their respective maturity dates.

9.10. It is also noted that KMMF agreed with the *Issuers* for not redeeming the securities at the end of their original maturity period. Thus, it is alleged that the securities of the *Issuers* were rolled over beyond the maturity dates of FMPs in violation of the provisions of Regulations 10(a), 25(16), clause 9 of the Fifth schedule read with Regulations 33(4) and 39(1) of MF Regulations, 1996 by the *Noticee*.

9.11. It is also revealed from the examination that the investors have not been paid at full NAV within 10 working days on maturity of the FMPs and the complete payments were made to the investors only in September 2019. The above acts of not paying the investors within 10 working days from the date of maturity of the said schemes are alleged to be in violation of provisions of Regulations 10(a), 25(16), clause 9 of the Fifth Schedule read with Regulation 53(b) of the MF Regulations, 1996.

9.12. It is thus noticed that the pay-out for the portion of exposure in Essel Group entities in the said FMPs was made only during September, 2019. From the examination, it is noticed that the ZCNCDs of the *Issuers* were not downgraded to below investment grade during the period of January-September 2019 and the *Noticee* could not have segregated the securities in terms of SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018. The act(s) of *Noticee* of holding certain units of the said FMP schemes after their respective maturity dates amounted to creation of a segregated portfolio from the scheme portfolio without having the enabling provisions in the SIDs and without any trigger of the credit events as detailed out in the above noted circular on segregated portfolio. The said acts of the *Noticee* are alleged to have violated Regulations 10(a), 25(16), clause 9 of the fifth schedule of the MF Regulations, 1996 read with SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

9.13. It is further noticed that the *Noticee* had taken the investment decision of extending the maturity period of the aforesaid securities beyond the maturity dates of respective FMP schemes, as early as during the period January 25, 2019 to February 07, 2019. In the light of this, it is alleged that once the investment decision was taken and the residual maturity of the securities was found to be more than 60 days, the said securities should not have been valued on amortization basis but on the principles of fair valuation. However, the *Noticee* has valued those ZCNCDs of the *Issuers* on amortization basis during the preceding 60 days of from the original date of maturity of those securities.

9.14. In view of its aforesaid action(s), the *Noticee* is alleged to have violated provisions of Regulations 10(a), 25(16), 25(19), 47, clause 9 of the Fifth Schedule of the MF Regulations, 1996 read with Principles of Fair Valuation as mentioned in Eighth Schedule of the MF Regulations, 1996 and SEBI circulars SEBI/IMD/CIR No. 16/193388/2010 dated February 2, 2010 read with SEBI Cir/IMD/DF/6/2012 dated February 28, 2012.

10. In response to the said three SCNs dated May 10, 2019, June 12, 2019 and August 13, 2020, the *Noticee* has submitted its written responses by way of letters dated August 29, 2019, November 06, 2019, December 17, 2020 and May 28, 2021 wherein, the *Noticee* has broadly made the following contentions:

10.1. The *Noticee* has submitted that in early September 2019, part payment of investment proceeds was made to all unitholders of the respective schemes and the balance payment along with accrued interest was made on September 25, 2019.

10.2. The *Noticee* has sought copies of records and files inspected by it.

10.3. The *Noticee* has contended that Section 15D(b) and Section 15HB are mutually exclusive wherein Section 15HB is applicable in a case where no specific provision to impose penalty is available in case of contravention. However, Section 15D(b) is the relevant provision to deal with contravention by Mutual Funds and as such there is no scope to apply

Section 15HB in the present case.

10.4. The *Noticee* has also contended that the SCN does not give notice of all the specific directions that SEBI proposes to issue in exercise of its powers under Sections 11 and 11B of SEBI Act, 1992 to enable the *Noticee* to respond to the appropriateness of those proposed measures effectively.

10.5. The *Noticee* has also submitted that the SCN dated August 13, 2020 was unnecessary and was issued with an unexplained delay as the issues in this SCN have already been covered in the previous two SCNs.

10.6. It is the case of the *Noticee* that the IC, while taking the decision to invest in the debt securities, followed due procedure set out by them and informed the investors that the scheme would predominantly invest in 'A' rated securities. The *Noticee* has further submitted that the said investment was in due compliance of the procedure laid down by the board of the *Noticee*. As per the *Noticee,* the procedure as laid down to be followed by the IC while approving an investment is as below:

"Common functions of Equity and Debt Investment Committees:

To review

1. ***Internal investment restrictions and make modifications, if and when required.***
2. ***Performance and positions of the schemes with regard to the investment objectives of the Schemes;***
3. ***The portfolios of the Schemes on a regular basis to ensure compliance with all applicable regulations and scheme objectives;***
4. ***On a periodic basis the actual portfolios vis-à-vis the model portfolios or investment strategy determined for each scheme, and action plan for rebalancing the portfolios, if and when found necessary;***
5. ***The portfolio periodically to track illiquid assets and taking corrective action;***
6. ***Periodically Profit-and-loss at securities and portfolio levels;***
7. ***The investment procedures, manual, universe of securities in which the schemes may invest, limits of investment per security, if any etc.***
8. ***The list of brokers empanelled and effect changes, if and when required.***
9. ***To approve valuations on certain events and exceptions, and to review general valuation principles as it deems fit.***

Function specific to Debt Investment Committee:

To review

1. ***Counterparties and debt issuers with regard to credit risk;***
2. ***The ratings of all debt issuers the Schemes have invested in;***
3. ***Credit information on all counterparties and establishing counterparty lists and limits to***

avoid default on settlements;

4. ***To approve credit limits for investments by all the Schemes of the Fund, present or to be launched in future, in all kinds of debt and money market instruments, including any kind of derivative instrument, within the limits laid down by the Board"*** (*emphasis supplied*)

The *Noticee* has submitted that all the above procedures were followed by the IC in accordance with the scope approved by its Board of Directors.

10.7. The *Noticee* has further submitted that the investment in the ZCNCDs of the *Issuers*, which belonged to the Essel Group, was structured with a collateral in the form of pledge of listed shares of ZEEL which was a part of large cap Nifty 50 Companies. Therefore, the reliance was not on the cash flows of the *Issuers* but on collateral. At the same time, the track record of the Essel Group promoters was of timely payment, as far as repayment of loan against securities over decades was concerned. At the same time, the FPI holding of 47.63% as on December 2015 and 41.52%and 44.96% as on December 2018 and March 2019 respectively, in the scrip of ZEEL, was demonstrative of the confidence of investors in the said Company.

10.8. The *Noticee* has also submitted that till the date of full payment, the value of collateral for the ZCNCDs of *Konti* and *Edison* was far higher than the exposure to the said ZCNCDs.

10.9. The *Noticee* has further contended that the Essel Group had a long borrowing track at promoter level and as on February 28, 2016, the mutual fund Industry had debt exposure to the nine promoter entities of Essel Group to the extent of INR 3,697 crores (market value), out of which *Edison* had outstanding of INR 304 crores (market value) and *Konti* had outstanding of INR 174 crores (market value). The same increased to INR 605 crores (market value) for *Edison* and INR 355 crores (market value) for *Konti* as on March 31, 2016. Further, as per market intelligence, the promoters' borrowing of the Essel Group was in the range of INR 3,500-4,500 crores and as per shareholding pattern of ZEEL for the quarter ended December 2015, only 34.84% of the promoters' stake was pledged.

10.10. The *Noticee* has submitted that the main factor examined before making the said investment, was the underlying collateral i.e. equity shares of ZEEL

with minimum cover of 1.50 times the exposure to the ZCNCDs of the *Issuers*. In that context, the financials of Zee and Dish TV were also discussed in the IC. As there was no external research report on the *Issuers* available in the market, the 'Investment Notes' were based on *Noticee*'s own internal research. The Equity Investment team of the *Noticee* was actively tracking the scrip of ZEEL for a period of about 10 years before the aforementioned investment in debt securities of *Issuers*.

10.11. As part of the transaction, the collateral was monitored on a daily basis by independent Debenture Trustee ("IDBI Trustee") which was issuing daily reports marking the same to the *Issuers* and all the investors. The collateral cover of 1.50 times the exposure to the ZCNCDs of the *Issuers* was maintained till January 25, 2019 with top-up done by *Issuers*/Pledger on various occasions as per underlying terms. In fact, there were 34 instances of top-up of collaterals by the *Issuers*/pledger during the period of March-June 2016 to January 24, 2019. During this period, there were eight instances of share release also as per terms of transaction while at all points of time prior to January 25, 2019, the share price of ZEEL were above the base price from the time of investment. The Investment Note also clearly mentions the number of days to liquidate the shares of ZEEL pledged with the *Noticee* in case such requirement arises.

10.12. The *Noticee* contended that the investment in NCDs of the *Issuers* structured in the form of pledge of shares, was compliant with and not violative of the provisions of the MF Regulations, 1996. In fact, the Mutual Fund Advisory Committee in its meeting dated July 02, 2019 discussed such instruments and one of the proposals for discussion included a minimum cover of 3 to 4 times the investment and listing of the same.

10.13. The *Noticee* has contended that the allegation of non-consideration of financials and business operations or the creditworthiness of *Issuers* is wrong as the Investment Notes clearly brought out various sources of cash flows for the companies including the IPO of Essel Infraprojects. It also addressed the increased valuation potential of Dish TV and Siti Cable.

10.14. The *Noticee* has also claimed that it had accessed and factored in the financials of *Issuers* before subscribing to their securities. Such financials of *Issuers* were part of Information Memorandum placed before its IC. Financials of *Konti* were received with e-mail dated March 3, 2016 i.e. prior to IC decision on March 7, 2016 and the financials of *Edison* were also reviewed by the *Noticee*.

10.15. The *Noticee* has fairly admitted to have not included the said financials in the approval note of IC as the structure of the transaction was considered as the primary factor by the IC and the same was based on the collateral of the shares of ZEEL.

10.16. The *Noticee* has contended that its presumption of repayment of NCDs through refinancing rather than internal cash flows is not wrong as globally as well as in India, majority of debt is repaid through refinancing, be it debts of Governments, Corporates, PSUs, etc.

10.17. The *Noticee* has denied making investments purely on the basis of security provided by the Cyquator, i.e. a promoter group company, through pledge of shares of ZEEL and submitted that various other factors were taken into account and all credit valuations required to be done, while acting diligently, were carried out by the IC.

10.18. The *Noticee* has submitted that the Investment Note for the said investment decisions mentions an initial cover of 1.6X and thereafter 1.5X the investment was to be maintained.

10.19. The *Noticee* has submitted that the investors to the six FMP schemes were informed that the said scheme would invest predominantly in 'A' rated securities. Thus, through the SIDs, the investors were well informed of the risk profile of the schemes. The rating of the ZCNCDs of the *Issuers* at the time of investment was A+(SO) by Brickwork.

10.20. The *Noticee* has stated that it has conducted itself with all requisite diligence in the investment process as no specific codification in directives/ guidelines on credit exposures was available until SEBI vide its circular no.

SEBI/HO/IMD/DE2/CIR/P/2019/104 dated October 1, 2019, laid down guidelines relating to investment in structured obligations and credit enhancement stipulating a minimum cover of four times considering the market value of such shares. Prior to the aforesaid circular was issued, the decisions of mutual funds can be said to be a matter of their best professional judgement, which cannot be quarrelled with.

10.21. The *Noticee* has submitted that there was no external research report available on the *Issuers*. Therefore, the research conducted was internal research. The investment by the referred schemes was in the NCDs of *Issuers*, which were structured in the form of pledge of shares. In this structure, the *Issuers* are generally not operating companies and hence the Investment Notes submitted to the IC concentrated on structure and collateral. In the process, main comfort was premised on the underlying collateral of equity shares of ZEEL with minimum cover of 1.50 times the exposure along with 'A' rating by an approved rating agency.

10.22. With respect to the allegation of delay in making disclosure of adverse information to the investors, the *Noticee* has submitted that the letter of intent dated February 7, 2019, issued by the *Issuers*, was an in-principle understanding between Committee of Lenders ('**COL**'), *Issuers* and pledgers. This was not a binding agreement in itself as it was contingent upon on determination by the COL. Thus, while there was an understanding, it fell apart within seven business days as the COL was not concluded by the *Issuers*. However, this in itself did not mean that *Issuers* had defaulted leading to any adverse impact on unitholders and the position of the *Noticee* remained unchanged.

10.23. The *Noticee* was in discussions continuously with the *Issuers* on providing requisite collateral cover in accordance with the guidance of its Board. During this period, the security cover was always in excess of the exposure to the ZCNCDs of the *Issuers*, albeit, lower than the committed security cover of 1.5 times the exposure to the said ZCNCDs. Considering the above, there was reasonable uncertainty to ascertain that there was any

adverse impact to investors.

10.24. Since no other options worked out, the *Noticee*, on the basis of various discussions during the period of January to April, 2019 entered into agreements with the *Issuers* on April 6, 2019. These agreements captured upside sharing by the *Issuers* based on the realized value from ZEEL's strategic sale. The *Noticee* has obtained a Personal Deed of Guarantee from Dr. Subhash Chandra Goyal for the said security. As soon as the structure of the abovementioned agreement was agreed upon, the *Noticee*, in order to maintain transparency, informed the investors of the same, i.e. on April 5, 2019.

10.25. In support of such contention, the *Noticee* has provided a copy of letter of CAMS dated January 13, 2020 confirming that status update of the Kotak FMPs was communicated to the investors of respective schemes through email and in case of investors where email addresses were not available in AMC/CAMS records, the communication was sent by sending physical letters. The *Noticee* has also submitted a copy of a vendor's bill dated May 11, 2019 raised against the *Noticee*.

10.26. In respect of allegation in respect of maturity date of NCDs of *Issuers* exceeding beyond the maturity date of the schemes, the *Noticee* insisted that the said FMP schemes matured on their respective maturity dates only and the realized value of investments in the scheme i.e. barring the portion of investments in ZCNCDs of the *Issuers* was paid off immediately. However, in order to pay the investors of respective schemes out of the funds to be realized from the ZCNCDs of the *Issuers*, the *Noticee* extended the time for repayment of the said ZCNCDs from respective maturity dates of the schemes *vide* the agreement dated April 6, 2019. However, after the maturity dates of the respective schemes, there has been no active fund management decision to invest beyond the maturity of the scheme. Further, with the benefit of hindsight, this decision of extension turned out to be far more favourable to the unitholders.

10.27. The *Noticee* has further attempted to justify the extension by stating that all

the investments made were well within the maturity dates of the schemes and the *Noticee* didn't make any fresh investment after maturity of the scheme and it has only given time to the *Issuers* to repay by way of extension of the due dates and the same cannot be construed as a fresh investment decision. It is merely a rescheduling of the date of the maturity wherein the due dates of the cash flows are realigned.

10.28. In respect of the allegation of failure to roll-on the FMP schemes and the non-payment of full NAV within 10 days, the *Noticee* has submitted that the investors were paid full NAV except for the funds to be realised from the repayment of ZCNCDs by the *Issuers*. The same was done within 10 days of maturity date of the respective FMP schemes. Additionally, the SEBI Circular dated June 20, 2002 envisaged a situation when the investments of the mutual funds may become default/illiquid and said funds may take time to realise the said amount. In such a circumstance, SEBI provided that if the said amounts are substantial and are realised they may be distributed to the investors. The *Noticee* also submitted that SEBI has now recognised the eventuality of a close ended scheme defaulting at the time of maturity and by way of Circular dated September 24, 2019, SEBI has evidently attempted to fill in existing gap in the regulatory framework.

10.29. In the context of allegation of part payment of the funds of the six FMP schemes, the *Noticee* submitted that it had acted with diligence protecting the interest of the investors by not selling the shares of ZEEL held as collateral since, there was steep correction in share price of ZEEL from January 25, 2019, hence, invoking of the pledge, enforcing the security and selling the Zee shares would have seen the risk of sub-optimal recovery of pending dues. This would have resulted in converting notional loss into an actual loss.

10.30. Additionally, Regulation 33(4) and Regulation 39(1) of MF Regulations, 1996 mandate that close ended scheme shall be wound up on maturity. But Regulation 41(2)(a) and Regulation 4l(2)(b) of the said Regulations do not

mandate the timeline for repayment of maturity proceeds, consequently, maturity proceeds can be paid on realization of investment value of the securities, in proportion to respective interest in the scheme on the maturity date. In accordance with the said provisions, the *Noticee* has redeemed the realized value of investments in the scheme i.e. barring the portion of investments in ZCNCDs of the *Issuers*. In early September 2019, a portion of investment in ZCNCDs of *Konti* and *Edison* was realized from the Essel promoters' stake sale to Invesco Oppenheimer Fund, which was paid to all unitholders on receipt of funds. On September 25, 2019, balance payment along with accrued interest was finally paid off to the unitholders of the respective schemes by invoking the pledge and selling the shares held as security cover.

10.31. As regards Regulation 53 of the MF Regulations, 1996, the same applies only in the event of redemption or repurchase. Redemption and/or repurchase as can be seen from the MF Regulations, 1996, apply to any open ended fund when an investor applies to the fund house to redeem or repurchase as per the applicable cut off timing at an applicable NAV. In a close ended scheme, an investor does not have to make any application within a cut off time for repurchase or redemption. The provisions of close ended fund, do not envision any time line for repayment nor does it envisage any action of repurchase/redemption by investors. The concept of cut off timing and applicable NAV accordingly does not exist. The *Noticee* is bound to realize the investments and make payment to investors proportionately after payments of approved costs. Thus, the provisions of Section 53(b) are not applicable to the said matter and the *Noticee* denies any violation on that count.

10.32. It is submitted that when the provisions of Regulation 10(a), Regulation 25(16) and Regulation 33(4), Regulation 39(1) and Clause 9 of Fifth Schedule of the MF Regulations, 1996 are read together in harmony, the interest of unitholders is paramount and as such the *Noticee* redeemed the realized value of investments in the scheme i.e. barring the portion of investments made in the ZCNCDs of the *Issuers* and was continuing to

make efforts to recover the full amount due from the *Issuers* so as to make full payment to the unitholders with possible upside in proportion to the units held by them.

10.33. In respect to the allegation of creation of segregated portfolio, the *Noticee* has strenuously argued that it has not created segregated portfolio in any of the said six FMP schemes. In this regard, the *Noticee* has submitted that SEBI Circular dated December 28, 2018 sets out specific preconditions for creation of segregated portfolio. As the pre-conditions to be fulfilled to form a "segregated portfolio" were not met out, the allegation of acting or creating any segregated portfolio in violation of Regulations 10(a), 25(16) and Clause 9 of Fifth Schedule of the MF Regulations, 1996 read with the SEBI Circular dated December 28, 2018 would not be sustainable.

10.34. In respect to the allegation of wrongly valuing securities on amortization basis rather than on fair valuation basis, the *Noticee* has submitted that due to the uncertainty, ZCNCDs of the *Issuers* were consistently valued as per established valuation policy till maturity date. Valuation of these securities from the date of investment till February 6, 2019 was done as per the valuation price received from third party valuation agencies on daily basis. From February 7, 2019 till the maturity date of respective scheme, the securities were valued on amortization basis. The *Noticee* extended the term of the security held only for purpose of realizing the pending dues. Till the time the *Noticee* received the revised term sheet, which was needed to receive price from independent third-party' valuation agency, the *Noticee* valued the securities on basis of a similar security' of same issuer, i.e. *Edison*. Once the term sheet was finalized and submitted to independent third-party valuation agency, the *Noticee* relied upon the said valuation.

10.35. In any case, the valuation method had no impact, whatsoever, on the valuation of the securities as the schemes were close ended and could only have been redeemed upon maturity.

11. Before proceeding to deal with the allegations against the *Noticee*, as recorded above, and consider the explanations offered and arguments advanced by the

Noticee on the said allegations, as have been highlighted above, I find it appropriate that for the purposes of easy reference, relevant provisions of the applicable Sections, Regulations, Guidelines, etc. as alleged in the SCN are reproduced hereunder:

The MF Regulations, 1996

Terms and conditions of registration

10. *The registration granted to a mutual fund under regulation 9, shall be subject to the following terms and conditions—*

(a) the trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations;

Asset management company and its obligations

25.(1) *The asset management company shall take all reasonable steps and exercise due diligence to ensure that the investment of funds pertaining to any scheme is not contrary to the provisions of these regulations and the trust deed.*

(2) *The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.*

(16) *The asset management company shall abide by the Code of Conduct as specified in the Fifth Schedule.*

(19) *The asset management company shall compute and carry out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and shall publish the same.*

Repurchase of close ended schemes

33.(4) *A close ended scheme shall be fully redeemed at the end of the maturity period.*

Provided that a close-ended scheme may be allowed to be rolled over if the purpose, period and other terms of the roll over and all other material details of the scheme including the likely composition of assets immediately before the roll over, the net assets and net asset value of the scheme, are disclosed to the unitholders and a copy of the same has been filed with the Board :

Provided further that such roll over will be permitted only in the case of those unitholders who express their consent in writing and the unitholders who do not opt for the roll over or have not given written consent shall be allowed to redeem their holdings in full at net asset value based price.

Winding up

39.(1) *A close- ended scheme shall be wound upon the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period under sub-regulation (4) of regulation 33.*

Valuation of investments

47. *Every mutual fund shall ensure that the asset management company computes and carries out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule, and publishes the same.*

Despatch of warrants and proceeds

53. *Every mutual fund and asset management company shall,*

(b) despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase;

FIFTH SCHEDULE

Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 [Regulations 18(22), 25(16), 68(h)]

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.*

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.*

Consideration and findings:

12. I have carefully considered the allegations against the Noticee, its written replies in response to the SCNs and oral submissions made in the course of two separate hearings and the materials available on record. Before dealing with the replies of the Noticee on merit on specific charges levelled against it in the three SCNs, I deem it necessary to first deal with the preliminary objections raised by the Noticee. To start with, the Noticee has challenged the authority and jurisdiction of SEBI in issuance of the Supplementary SCNs. It is contended that the Supplementary SCNs were issued without any further material found against the Noticee.

13. In support of its contention, the *Noticee* has relied upon the provisions of Section 28(7A) & 124 of the Customs Act, 1962, Section 23 of the Income Tax Act, 1869 and Section 17 of the Works of Defence Act, 1903, to contend that wherever required, the legislature has specifically empowered the respective authority to issue supplementary SCN, whereas the SEBI Act, 1992 does not provide any such power to SEBI to issue a supplementary notice.

14. In this respect, on perusal of the above referred provisions, I note that Section 28(7A) of the Customs Act, 1962 deals with 'recovery of duties not levied or not paid or short-levied or erroneously refunded'. Section 124 of the Customs Act, 1962 deals with 'issue of show cause notice before confiscation of goods etc.' Section 23 of the Income Tax Act, 1869 deals with power of collector to issue further notice in assessing any person, any source of income which has been overlooked. Similarly, Section 17 of the Works of Defence Act, 1903, provides the power to collector to issue supplementary notice where, any person entitled for compensation has not been given notice or not awarded compensation. Also, the specific provision for issuing the provision for a supplementary SCN under the Income Tax Act has to be understood in the light of the specific prohibition contained in Section 147 thereof on reopening of an assessment after expiry of four years from the end of the relevant assessment year. These provisions are in relation to taxations levied on various assesses and are intended to protect the interest of assesses and, therefore, have no relevance in respect of securities laws being administered, monitored and enforced by SEBI in the capacity of a Regulator of the securities market. Further, there is no such provision in securities laws restricting initiation or re-initiation of investigation into a matter involving violation of securities laws or for enforcement of securities laws whenever it comes to light. I also note that issuance of a show cause notice or supplementary show cause notice is an inbuilt requirement in any quasi-judicial proceedings as a part of Principles of Natural Justice and the same need not be required to be specifically provided for or mentioned in the legislation, rules, regulations or bye-laws etc. to entitle SEBI to issue a Supplementary SCN.

15. I note from the SCN dated May 10, 2019 that the *Noticee* was called upon to

show cause as to why suitable directions including the direction to claw back the management fee charged by it on FMP series 127 & 183 and to put operational constraints including not allowing launch of new FMPs for a specific period of time should not be issued against it and vide Supplementary SCN dated June 12, 2019, the *Noticee* was called upon to show cause as to why a penalty under the provisions of Sections 15D and 15HB not be imposed upon it for the violations of law, alleged in the SCN dated May 10, 2019. As noted above, during the course of personal hearing of the *Noticee* held on October 16, 2019, the *Noticee* was specifically asked to state as to whether the alleged acts were limited to FMP series 127 & 183 or the same acts were also followed and the payment on the ZCNCDs was similarly deferred in respect of any other schemes managed by the *Noticee* during the relevant period. In this respect, after the *Noticee* furnished the relevant details pertaining to similar FMP series, and based on the examination of the same, a separate SCN dated August 13, 2020 was issued wherein, the *Noticee* was again called upon to show cause as to why suitable directions including the direction to claw back the management fee charged by it on FMP series 187, 189, 193 & 194 and to put operational constraints including not allowing launch of new FMPs for a specific period of time should not be issued against it, as well as penalty be not imposed upon it under the provisions of Section 15D and 15HB of SEBI Act, 1992 for committing the violations of various provisions of law as alleged in the said SCN.

16. In the aforesaid context, I note that the SCN dated June 12, 2019 is in effect not a fresh SCN levelling any new and independent charge, but is a supplementary and in continuation to the SCN dated May 10, 2019 whereby the *Noticee* was asked to explain as to why penalty be not imposed on it for the violations already alleged in the earlier SCN of May 10, 2019. The said supplementary SCN was also issued in the light of the amendment made by the legislature in the SEBI Act, 1992 enabling thereby the Board of SEBI to impose monetary penalty while exercising its power under Section 11(4A) as well as under Section 11B(2) of the SEBI Act, 1992. Thus, through the aforesaid notice of June 12, 2019, in place of subjecting the *Noticee* to two separate proceedings, with respect to same set of facts and alleged violations, to be conducted by two different authorities (one by

the Whole Time Member and the other by a designated Adjudicating Officer), the *Noticee* was asked to file its additional response in the already initiated proceeding explaining its stand as to why penalty shall also be not also imposed on it, in case the alleged violations are established. Thus, in effect, instead of initiating two separate proceedings, the lawmakers have now empowered the Board, to adjudicate a matter and impose a penalty along with passing directions to the noticee(s) as may be deemed fit, under the provisions of Sections 11(1), 11(4), 11(4A) and 11B(1)& (2) of the SEBI Act, 1992 in one single proceedings. The said supplementary SCN was in fact issued for the benefit of the *Noticee* saving it from the requirement of defending its case before two different authorities on the same set of facts.

17. As far as the SCN dated August 13, 2020 is concerned, I find that same has been issued for different set of FMP schemes bearing different set of facts wherein similar violations as observed in the case of FMP series 127 & 183 were noticed during the course of personal hearing as well as from the examination of materials submitted post the hearing held on October 16, 2019 in the matter. It is relevant to note here that the violations, as were noticed by SEBI in respect of any single scheme constituted a single separate violation. In the present matter, as the violations were noticed at a later stage with respect to four more FMP series viz: 187, 189, 193 & 194, the said violations generated similar but a separate cause of action thereby warranting issuance of fresh consolidated SCN in respect of those four FMP series as noted above. I further find it relevant to record that in the course of first personal hearing, when specifically asked about other FMP series, the *Noticee* affirmatively indicated that it had also followed the same practice which it had followed in the case of FMP series 127 & 183, in respect of other FMP schemes as well. Under the circumstances, it was thought proper that all the SCNs issued to *Noticee* on the basis of identical facts including almost similar transactions during the same period involving identical nature of violation alleged in those SCNs ought to be put under a common trial, as the same would not only be fair to the *Noticee* but would also prevent pursuing separate proceedings arising out of separate SCNs from becoming mere mechanical or repetitive in nature. In view of the above, I find that the *Noticee*

has been afforded sufficient and fair opportunities to defend the charges made in the above mentioned SCNs and the proceedings initiated pursuant to issuance of those SCNs are not prejudicial to the interest of the *Noticee* in any manner whatsoever. Therefore, the aforesaid contentions raised by the *Noticee* on the supplementary SCN or issuance of different SCNs are not tenable either in fact or in law.

18. I note from the records before me that the *Noticee* had sought inspection of certain documents. In compliance with the Principles of Natural Justice, inspection of original documents was provided to the *Noticee.* In this regard, a reference to the observations made by the Hon'ble Supreme Court of India in the matter of *SEBI Vs. Monarch Networth Capital Limited* [(2016) 6 SCC 368], is relevant wherein, the Hon'ble Supreme Court, while dealing with the issue of principles of natural justice, has, *inter alia*, observed that: "…*In so far as the plea of violation of principles of natural justice, as raised on behalf of the respondent in C.A.No.282/2014 (Monarch Networth Capital Ltd.) is concerned, we do not think the same to be justified in any manner. The relevant extracts of the trade log which have been perused by us, in view of the clear picture disclosed with regard to the particulars of the offending transactions, must be held to be sufficient compliance of the requirement of furnishing adverse materials to the affected party.*"

19. Furthermore, the Hon'ble Securities Appellate Tribunal (**SAT**) in the matter of *Shruti Vora vs. SEBI* (Date of decision: February 12, 2020) have, *inter alia,* held that only the documents which have been relied upon need to be provided to noticee. It has also been held that in the absence of any law specifically imposing or casting duty to provide all the documents which are in the possession though have not been relied upon, it would not be justified on the part of the noticees to ask for those documents which are not having a role in attributing the allegation made on the noticees and therefore, denial of all such documents would not *ipso facto* result in breach of Principle of Nature Justice.

20. In this regard, the *Noticee* has submitted that it was not provided with the copies of the materials inspected by it in the instant proceedings. However, I note that

all the materials that have been relied upon while issuing the above stated three SCNs have been actually provided by the *Noticee* itself through various communications referred to in the respective SCNs. I find there is no material, (other than those communications referred to in the respective SCNs), which have been relied upon in the SCN but not provided to the *Noticee*. Further, it is not the case of the *Noticee* that it is not having the copies of the communications referred to in the SCNs and which have been exchanged by the *Noticee* itself with SEBI. Therefore, any copy of material that the *Noticee* demands is already in its possession by virtue of the fact that the said materials were provided by the *Noticee* itself. In view of the foregoing decision of the Hon'ble SAT, I am of the considered view that the Principles of Natural Justice have been adequately complied with in the present matter, as the all documents which have been relied upon in the SCN to allege and establish the charges against the *Noticee* have already been available with the *Noticee* and there is no document, that is being relied upon while passing the present order, which can be said to be not available with the *Noticee,* since the SCNs have been issued after examination of documents and information furnished by the *Noticee* itself. In view of the above, I find no merit in the contention of the *Noticee* as the *Noticee* has not been able to justify or substantiate as to what exact prejudice has been caused by not providing copies of which specific document hence, its claim of not receiving copies of documents remains a specious claim without any factual support.

21. I also note that, by citing *Gorkha Securities Services vs. Govt. of NCT of Delhi* as well as the Order dated February 03, 2016 of the Hon'ble SAT in the matter of *Royal Twinkle Star Club Private Limited*, the *Noticee* has contended that the SCN doesn't mention any specific nature of measure that SEBI proposes to take against it. In this regard, I note that vide SCN dated May 10, 2019, the *Noticee* has been called upon to show cause as to why appropriate directions under sections 11(1), 11(4) and 11B of the SEBI Act, 1992 including directions to claw back of the management fee charged on the FMP schemes No. 123 & 187 for a specified period as well as direction to put operational constraints including not allowing to launch new FMP plans for a fixed period of time should not be issued against it for the violations of the provisions of the MF Regulations, 1996 and certain

circulars issued by SEBI from time to time, as alleged in the SCN. Similarly, another SCN dated August 13, 2020 was issued to the *Noticee* in respect of similar violation asking it to show cause in case of similar violations in respect of FMP schemes No. 187, 189, 193 and 194. Therefore, it is factually incorrect to suggest that the SCNs do not indicate the likely measures that SEBI has proposed to take in the event the allegations made in the said SCNs are held established.

22. Without prejudice to the aforesaid, a bare perusal of the SEBI Act, 1992 shows a comprehensive list of possible directions outlined under Section 11(4) of the SEBI Act, 1992 which the competent authority under the SEBI Act, 1992 is empowered to issue and the aforesaid provision of law has been specifically referred to in the SCNs dated May 10, 2019 and August 13, 2020. Thus the SCNs make sufficient suggestions with regard to the directions likely to be issued, once the violations of provisions are established, and therefore, I see the contention of the *Noticee* is not valid. In this regard, I note that the SCNs contains detailed enumeration of the allegations, the basis of each of those allegations, the documents relied upon for making such allegations as well as the relevant provisions of the Securities Laws supporting those allegations. I reiterate that in the instant case the SCNs contain detailed charges made against the *Noticee* and the basis of each allegation duly supported by the documentary evidence supplied by the *Noticee* itself. Hence, the above noted contention raised by the *Noticee* in this regard does not have any iota of truth. Therefore, I do not find any merit in the submissions of the *Noticee* that SEBI has not mentioned the measures it proposes to take in the present matter. Additionally, I also find that reliance by the *Noticee* on *Gorkha Security* (Supra) is not appropriate as said case is factually distinguishable, where the observations have been made by the Hon'ble Supreme Court in the context of breach of a contract that was commercial in nature, whereas the instant proceedings have emanated out of exercises of powers vested in a Regulator of securities market, to take appropriate measure and pass appropriate directions for protecting the interest of investors as well as for the development of securities market.

23. In any case, I find that no prejudice whatsoever has been caused to the *Noticee*,

as it has been provided with sufficient opportunities to file its replies and also sufficient opportunities of personal hearing have been granted to the *Noticee*, which have been duly availed of by it, as mentioned in the pre-paragraphs of this order. Thus, it is grossly incorrect to contend that the *Noticee* in the present proceeding is unaware of directions that may be issued to it; hence, I find no merit in such contention for further deliberation.

24. In my view, the contention of the *Noticee* that there were other entities which also had invested in the ZCNCDs issued by the said *Issuers* and yet have not been proceeded against does not serve its purpose. It is common knowledge that in a quasi-judicial proceeding, the adjudicator gets confined to the four corners of the show cause notice that is placed before him for adjudication. In the instant case, it is not available on record if SEBI has proceeded against any other entity who had subscribed to the said ZCNCDs of either *Konti* or *Edison* or has decided that it is not necessary to proceed against any such entities. However, the absence of proceedings against other entities who had invested in the ZCNCDs of the *Issuers* cannot hamper or obstruct any proceedings against the *Noticee* as the case of the *Noticee* remains factually independent and based on its own merit, hence is unaffected by the investment activities of the other entities. In this respect, I note that in the matter of *Systematix Shares & Stocks India Limited v. SEBI (2012),* the Hon'ble SAT also had the occasion to deal with a similar argument of the appellant therein contending that the Board should have proceeded against all wrong doers and the action against the appellant and a few entities alone was discriminatory. In the said case, the Hon'ble SAT had held that *"We cannot subscribe to this view since the Board has set its own benchmark in selecting cases for action and, in any case, the appellant cannot plead himself innocent or his trades as lawful."*

In the instant case as well, the Board after examining and considering the acts and the role of the *Noticee* herein, have initiated proceedings against the *Noticee*. Be that as it may, the Board has set its criteria and exercised *intelligible differentia* while selecting cases for action more so for the instant proceedings, and the *Noticee* cannot plead innocence by basing its arguments on such extraneous reasons. The records before me do not indicate that like the *Noticee*, there were

also some other entities who have followed identically exact procedure while investing the money raised from their investors, in the ZCNCDs issued by the said *Issuers* so as to demonstrate that the *Noticee* was placed exactly similar and identical to other such market participants, who also did not make payment to their investors on maturity of the schemes and the maturity of such instruments (ZCNCDs) were extended in similar manner to avoid default on the part of the *Issuers* while deferring the payment (from the proceeds of those investments) to the investors following the same procedure as has been followed by the *Noticee* in the instant proceedings. It is also not the case of the *Noticee* that any such other similar market participants have been exonerated by SEBI from the charges on merit by way of any specific order passed by any authority, so as to advocate for itself, for a strong case for exonerations from the same set of charges. In any case, such other market participants are not parties (noticees) before me and therefore, it would not be appropriate to make any hypothetical observation in respect of any unknown market participants in the present proceedings. Considering the foregoing, I reject the afore-stated contention of the *Noticee in limine* and do not find it worthy of further consideration

25. Before moving ahead, I find it relevant at this point to discuss the structure of a mutual fund. A mutual fund has four components viz. the Sponsor, the Asset Management Company ('**AMC**'), the Trust and the Custodian. A mutual fund is set up when a Sponsor makes an application to SEBI under Regulation 3 of MF Regulations, 1996 and upon consideration of the same, a Certificate of Registration is granted by SEBI. The said Certificate of Registration is always subjected to terms and conditions as mentioned in Regulation 10 of the MF Regulations, 1996.

26. Such a mutual fund is required to be constituted in the form of a trust and the instrument of trust is required to be in the form of a Deed, duly registered under the provisions of the Indian Registration Act, 1908, executed by the Sponsor in favour of the trustees named in such an instrument. Such trust deed is required to contain all the clauses mentioned in Third Schedule of MF Regulations, 1996 and trustees to the said trust are appointed after prior approval of SEBI. Rights

and Obligations of such trustees have been elaborated in Regulation 18 of MF Regulations, 1996.

27. Subsequent to granting of the Certificate of Registration and creation of a mutual fund, the Sponsor or the trustee, if authorized by the trust deed, appoints an AMC, approved by SEBI under Regulation 21(2) of MF Regulations, 1996 by entering into investment management agreement with the AMC. The job of AMC is to manage the funds of the schemes launched by the mutual fund and to make the investment of funds of the schemes of the Mutual Fund. A detailed list of obligations of AMC is provided at Regulation 25 of MF Regulations, 1996. In furtherance of such duties and discharge of obligations bestowed upon it under the MF Regulations, 1996, the AMC is required to exercise due diligence and care in all its investment decisions.

28. Apart from the sponsors, the Trustees and AMC, there is a fourth player involved in the management of a Mutual Fund, which is the custodian appointed by the mutual fund to carry out the custodial services. The custodian is defined in clause (h) of Regulation 2 of MF Regulations, 1996 to be a person who has been granted a certificate of registration to carry on the business of custodian of securities under the provisions of the Securities and Exchange Board of India (Custodian of Securities) Regulations, 1996.

29. Thus, to summarize, a mutual fund is registered at the instance of the sponsor. The sponsor is required to execute a trust deed in favour of the Trustees. It can be a Board of Trustee or a Trustee company. The appointment of Trustees is to be made with the prior approval of SEBI. The Trustees have to appoint AMC by entering into an investment management agreement with them. Perusal of the Fourth schedule of the MF Regulations, 1996 which narrates the contents of the investment management agreement shows that it is the responsibility of AMC to float the Schemes for the Mutual Fund with the approval of the Trustee. It is the responsibility of AMC to manage the funds mobilized under various Schemes of the said mutual fund which shall be invested by AMC in accordance with the provisions of the Trust Deed and the MF Regulations, 1996. The AMC

is required to be diligent at all times and the activities of AMC are required to be conducted in accordance with the provisions of the MF Regulations, 1996.

30. A mutual fund can launch either an 'open-ended' scheme, 'close ended' scheme or an 'interval' scheme, which are defined at Regulation 2(1)(s) and 2(1)(f) of MF Regulations, 1996 respectively. In simple terms, an 'open ended' scheme is one where the investor can invest or redeem his money at any point of time. On the other hand, the period of investment and redemption is clearly defined in a 'close ended' scheme. In other terms, the close ended scheme has a fixed window of investment and a fixed maturity date on which the scheme matures upon which the units will be redeemed. A mutual fund can invest in securities (equity or debt), money market instruments, gold or gold related instruments, real estate assets and such other assets and instruments as may be specified by the Board.

31. Herein, I note that all the six FMP schemes of KMMF which are being dealt with in the present proceedings were 'close ended' schemes which had invested in the debt securities of various issuers including in those instruments (ZCNCDs) issued by *Konti* and *Edison*. The said schemes with serial number 127, 183, 187, 189, 193 and 194 were Fixed Maturity plans (FMPs) launched at different times but all of them were going to mature on different dates in the months of April and May 2019.

32. I find it relevant here to discuss the concept of ZCNCD for the purpose of the present order. In general, Non-Convertible Debentures (**NCDs**) are debt instruments purchased at the face value and have their coupon value i.e. interest rate disclosed in advance in the offer documents. At the end of the tenure of such NCDs, the issuers repay to the subscriber the face value of such NCDs along with the interest calculated on such face value. The interest payment upon such NCDs may be periodical or upon maturity, as decided by the issuer at the time of issuance of such NCDs. As opposed to that, a 'Zero Coupon Non-Convertible Debenture' (ZCNCD) is a unique type of debenture which is purchased at a discount to face value and at the maturity, the issuer pays the face value of such ZCNCD. There is no coupon rate defined in the such instrument

and no periodical interest payment is made in such instruments.

33. In this regard, I note that the *Noticee* had launched FMP Series no. 127 in 2013 which was rolled over in 2015. Rest of the FMPs viz. series no. 183, 187, 189, 193 and 194 were launched during 2015 and 2016. All the aforementioned FMP schemes launched by the *Noticee* had matured during April-May 2019 wherein the *Noticee* was required to repay the investors immediately thereafter. However, due to extension of maturity of ZCNCDs of the *Issuers*, the total AUMs of the six FMP schemes could not be realized by the *Noticee* and a part of the said amount was paid at a later stage in two instalments in the month of September 2019. The complete details of the schemes along with the payment schedule are as below:

Table 1: Details of FMP Schemes and the redemption to the investors

(amount in Crores)

FMP Series	Launch Date (L)/ Rollover Date (R)	AUM at the time of launch/ Rollover	Maturity Date	AUM at the time of Maturity	Amount paid on maturity	Amount paid on Sept 09, 2019	Amount paid on Sept 25, 2019
127	28/11/2013 (L) 30/11/2015 (R)	309.60	08/04/2019	451.18	371.20	44.93	40.60
183	23/12/2015 (L)	457.26	10/04/2019	561.97	455.47	59.80	54.03
187	24/02/2016 (L)	381.10	15/04/2019	496.82	394.09	57.74	52.16
189	18/02/2016 (L)	92.01	22/04/2019	123.02	110.82	6.85	6.19
193	29/04/2016 (L)	204.68	02/05/2019	248.07	221.52	14.86	13.43
194	11/05/2016 (L)	180.77	15/05/2019	211.17	187.24	13,38	12.08
Total		**1625.42**		**2092.23**	**1740.34**	**197.56**	**178.49**

I also find that, apart from various other securities, the *Noticee* had invested in ZCNCDs of the *Issuers* in the afore-discussed FMP schemes. The details of the investments made by the *Noticee* in ZCNCDs of the *Issuers* along with the schedule of maturity of such FMP series 127, 183, 187, 189, 193 and 194 are as following:

Table 2: Investment of FMPs in ZCNCDs of *Konti* and *Edison*

FMP Series	Maturity date of schemes	AUM at Maturity (in Crores)	Investment in	Investment date	Exposure as on the date of maturity (in Crores)	% of Exposure in AUM as on the date of maturity
127	08/04/2019	451.18	Konti ZCNCDs	01/06/2016	46.29	10.26
			Edison ZCNCDs (Series II)	28/03/2016	33.69	7.47
183	10/04/2019	561.87	Konti ZCNCDs	01/06/2016	44.7	7.96
			Konti ZCNCDs	11/3/2016	17.2	3.06
			Edison ZCNCDs (Series II)	21/03/2016	44.58	7.93
187	15/04/2019	496.97	Konti ZCNCDs	11/03/2016	51.48	10.36
			Edison ZCNCDs (Series I)	21/03/2016	51.33	10.33
189	17/04/2019	123.08	Konti ZCNCDs	11/03/2016	49.29	9.92
193	02/05/2019	248.28	Konti ZCNCDs	01/06/2016	26.56	10.7
194	15/05/2019	211.17	Konti ZCNCDs	01/06/2016	23.94	11.34

As noted above that the aforesaid investment in the ZCNCDs of the *Issuers* by the *Noticee* were secured against a collateral of shares of ZEEL, pledged by Cyquator with KMMF to the extent of mandated 1.50 times the liability of the *Issuers* at any point of time. All these ZCNCDs, mentioned in the table above, were going to mature on April 08 & 10, 2019. At the same time, the six FMP schemes floated by the *Noticee* were going to mature on different dates during April and May 2019, as mentioned in Tables 1 & 2 above.

34. It is observed that the price of the scrip of ZEEL witnessed a sharp fall by more than 26% on January 25, 2019, reducing the share cover (of ZEEL shares) as a collateral below the mandated 1.50 times of the exposure to the ZCNCDs of the *Issuers*. At this point, the promoters of ZEEL expressed their inability to pledge additional shares as collateral in favour of the *Noticee* so as to maintain the collateral cover at the pre-decided level of 1.50 times of the exposure to ZCNCDs of the *Issuers*. Eventually, letters of intent dated February 07, 2019 were exchanged amongst the *Issuers*, pledgers of ZEEL shares and committee of lenders of which the *Noticee* was also a part. However, the said arrangement failed to bear any constructive results and the *Noticee* subsequently entered into two

separate agreements dated April 06, 2019 with each of the *Issuers* of ZCNCDs through which the *Noticee* extended the maturity period of the aforementioned ZCNCDs upto September 30, 2019. The *Noticee* also guaranteed to the *Issuers* that it will not invoke the pledge on those shares of ZEEL till the end of the said extended maturity period of the aforementioned ZCNCDs *in lieu of* a personal guarantee given by Mr. Subhash Chandra, the promoter of Essel Group. The same was intimated to the investors of the FMP series 127, 183, 187, 189, 193 and 194 by way of separate scheme wise letters issued between April 05 and 12, 2019. Due to the extension of maturity period of the ZCNCDs of the *Issuers*, as agreed to by the *Noticee*, the entire investments made out of the aforementioned FMPs could not fully mature on or before the pre-notified maturity dates of those FMP schemes. As a result of this, the unitholders of these six FMP schemes were unable to redeem the full amounts of proceeds on their investments made in those schemes on the respective dates of maturity of those schemes.

35. It is in the light of the aforesaid facts, that various charges have been brought against the *Noticee* in the SCNs alleging that the acts of the *Noticee* pertaining to its investment in the ZCNCDs issued by the above named two *Issuers* out of the funds of its FMP series no. 127, 183, 187, 189, 193 and 194 and the subsequent extensions of maturity dates of those ZCNCDs of the *Issuers* beyond the maturity dates of the respective schemes with the active consent given by the *Noticee* itself, have led to the violation of various provisions of securities law. Accordingly, the SCNs have alleged that provisions of Regulation 10(a), 25(1), 25(2), 25(16), 25(19), 33(4), 39(1), 47, 53(b) and clauses 2, 6 and 9 of the Fifth schedule mentioned in MF Regulations, 1996 along with SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000, SEBI Circular No. SEBI/IMD/CIR No. 12/147132/08 dated December 11, 2008, SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018, SEBI Circular No. SEBI/IMD/CIR No. 16/193388/2010 dated February 02, 2010 and SEBI Circular No. SEBI/Cir/IMD/DF/6/2018 dated February 28, 2012 have been violated by the *Noticee*.

36. I have perused the SCNs and observe that the allegations levelled against the *Noticee* in the SCNs dated May 10, 2019 and June 12, 2019, issued with respect to FMP series No. 127 and 183, and the allegations made in SCN dated August 13, 2020, issued in respect to FMP series No. 187, 189, 193 and 194, are identical in contents and the submissions made by the *Noticee* in its replies dated August 29, 2019, November 06, 2019, December 17, 2020 and May 28, 2021 with respect to each of these FMP schemes have also been made on similar lines. Accordingly, I deem it appropriate to deal with the aforesaid SCNs by way of passing one common order.

37. The allegations with respect to the violations of MF Regulations, 1996 read with consequent circulars issued in this regard, can be categorised under the following headings:

37.1. Lack of due diligence and proper care leading to not rendering high standards of service.

37.2. Failure to consider research report and analyse various factors.

37.3. Non-disclosure of adverse information to the unit holders.

37.4. Extension of maturity date of NCDs beyond the maturity date of the scheme.

37.5. Partial redemption and FMPs not wound up at the end of maturity.

37.6. Creation of segregated portfolio.

37.7. Wrong method of valuation of securities.

I now deal with these allegations in the following paragraphs:

A. Lack of due diligence and proper care leading to not rendering high standards of service

38. The SCNs allege that the *Noticee*, while making a decision to invest in ZCNCDs of the *Issuers*, failed to exercise due diligence and proper care in examination of repayment capacity of the two *Issuers* as well as in the assessment of the adequacy of collateral/security cover. In the light of such a failure, the *Noticee* has allegedly failed to render high standards of service expected from an AMC while taking

such an investment decision.

39. It is relevant to mention here that an AMC is required under Regulation 25(1) of MF Regulations, 1996 to take all reasonable steps and exercise due diligence to ensure that the investment of funds out of any of its schemes is not contrary to the provisions of MF Regulations, 1996 and the trust deed. The AMC is also required under Regulation 25(2) of MF Regulations, 1996 to exercise due diligence and care in all its investment decisions as would be normally exercised by any other persons engaged in the same business of fund management. At the same time, in terms of clauses 6 and 9 of Code of Conduct prescribed under Fifth schedule of MF Regulations, 1996, the AMC is also required to render at all times, high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment solely in the interest of unit holders. In terms of Regulation 25(16) of MF Regulations, 1996, an AMC is mandated to comply with the clauses of Code of Conduct outlined as above.

40. I note from the approval notes dated March 07, 2016 and May 18, 2016 of the IC of the *Noticee* that the said note starts with the title subject matter as *"Funding of Zee Group promoters against shares of Zee Entertainment Ltd."* and in the tabular presentation of the key terms of the issue, the issuers are described as "*Promoter Entities*" and there is no mention about the names of such promoter entities or about the specific debt instruments (i.e. ZCNCDs) proposed to be issued by those promoter entities anywhere in the said note. Thus the internal approval note of the IC itself very strangely suggests that the IC of the *Noticee* was not aware about the issuer entity even on the date of approving the proposal to invest in the ZCNCDs of the *Issuers*. Consequently, given that the IC did not even bother to know the name of the issuers of debt securities, there arises no question of any reference to the financials and business operations of such issuers by the IC. Furthermore, in the said note, the IC has observed the following:

"*We believe that repayment of our exposures will, in all probability, be funded through a refinance. We take comfort from the reputation and track record of Essel Group in general and fundamentals, liquidity and performance of Zee shares*"

Thus, the investment note itself makes it very clear that throughout the entire due diligence exercise, the Issuer Companies, their financial status, antecedents etc. never existed in the horizon of the IC who had set out their only target of advancing loans out of the funds of their FMP series no. 127, 183, 187, 189, 193 and 194 to the Essel Group against shares of ZEEL, hence the IC was consciously oblivious about the identities of the *Issuers* or their debt instruments.

41. In this regard, the *Noticee* has stated that the financials of *Konti* and *Edison* were placed before the IC at the time of making investment decision. However, the financials were not included in the approval notes as the same were not the primary consideration in making investment decisions in the ZCNCDs of *Issuers* and such investment decisions were made on the strength of collateral, reputation and history of Essel Group in repayment and the capacity of Essel Group to refinance the loans taken against issuance of such instruments.

42. I find that the concept of due diligence has been elaborately discussed in various judicial decisions. The Hon'ble Supreme Court of India, while deciding the case of Chander Kanta Bansal Vs. Rajender Singh Anand [2008 (5) SCC 117], discussed the concept of due diligence in the following terms:

"……..*The words 'due diligence' have not been defined in the Code of Civil Procedure, 1908. 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 Phrases 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….*"

Similarly, the Hon'ble Securities Appellate Tribunal ('**SAT**'), in its order dated May 13, 2016 in the matter of *Almond Global Securities Ltd. vs. SEBI* has held that:

"*The diligentia that is expected of a Merchant Banker in a given case is such care as would be taken by a reasonable person. It would be the diligence or care a reasonable person would employ*

in a given situation. Degree of such care or diligence would, undoubtedly, differ from case to case and no straight-jacket formula can be prescribed by law. As already noted, the principle of due diligence is, by nature, incapable of being defined in precise terms and has, therefore, been left open or flexible to be determined in each case as per the existing facts and circumstances."

Thus, both the Hon'ble Supreme Court of India and the Hon'ble SAT have held that the standard of examination of due diligence, expected from an entity, cannot lead to roving and fishing enquiry but should be looked as due diligence expected from a reasonable person in the similar position. In fact, Regulation 25(2) explicitly enshrines this concept of due diligence wherein the phrase '*as would be exercised by other persons engaged in the same business*' has been inserted with this objective only.

43. In the light of the afore cited observations made by the Hon'ble Supreme Court of India and the Hon'ble SAT, it is necessary to examine if the investment decisions of the *Noticee* were taken after due diligence and care and if the *Noticee* was able to render high standards of service to its unitholders at all times.

44. An AMC is a professional entity meant to float schemes on behalf of the Mutual fund, professionally manage the funds so collected under the said scheme and invest those funds on behalf of unitholders of that particular scheme. For the said purpose, the AMC is required to enter into an Investment Management Agreement with the trustees of a Mutual Fund as prescribed under Regulation 18(1) of MF Regulations, 1996, the clauses of which are required to be adhered to, along with compliance with the provisions prescribed under the Fourth Schedule of MF Regulations, 1996. The *Noticee* was approved by SEBI as an AMC and was appointed as the AMC of KMMF specifically due to its professional capabilities to manage the funds collected under a particular scheme and to invest those funds as per the SID of that particular scheme. Therefore, the due diligence, care and standards of service, expected from the *Noticee* as a professional fund manager ought to be those professional standards which are significantly different and higher than the standards expected to be maintained by any common investor.

45. In this regard, I can observe that the *Noticee* in its various submissions before me has fairly admitted that, the said ZCNCDs of the two *Issuers* being structured products, it didn't give due consideration to the cash flow statement of the two *Issuers* and instead, made the investment in the said ZCNCDs mainly on the basis of reputation of Essel Group, the repayment history of the promoters of Essel Group and on the strength of collateral provided by Cyquator; while at the same time, expecting repayment by way of refinance. I can see from the material available on record that such a lackadaisical approach to due diligence adopted by the *Noticee* while investing in the ZCNCDs of the two *Issuers* is in fact the main bone of contention in the SCNs which allege lack of due diligence on the part of the *Noticee*. Such an allegation becomes more profound when the IC of the *Noticee*, while approving investment into those ZCNCDs, was seen to be not at all interested in even knowing the names of the issuers of such securities that the *Noticee* was intending to subscribe and the ZCNCDs of the *Issuers* were subscribed to merely on the basis of name, face value and reputation of the promoters of Essel Group.

46. There cannot be two opinions that a prudent investment by way of subscribing to debt instrument of an issuer demands that the subscriber of such debt securities should first assure itself that the said amount would be repaid by the issuer of such debt securities from its future cash flows. There is no dispute that the collaterals submitted by the issuer to the subscriber against such funds raised through those debt instruments act as a security for the subscriber to such debt instruments against any event of default in repayment of the money by the issuer. However, it is generally not in the interest of either of the parties to use collateral for repayment of such loans since, on the one side, the issuer loses the collateral, which is often sold in a hurry and under distress, thereby reducing the fair market realisable price which can be received by selling such collateral in normal market conditions thereby making the issuer to bear a notional loss on such sale; and on the other side, the subscriber also suffers additional expenses and other operational hassles and sometimes the subscriber also is not in a position to recover the full amount of outstanding dues defaulted by the issuer even after liquidating all the collateral in the market. Therefore, a prudent investment

practice demands that the subscriber, while subscribing to or investing in a structured product that eventually culminate in lending, must be assured by the issuer that the said debt shall be repaid on time using the future cash flow of such issuer and that the subscriber doesn't have to resort to a distress sale of the collateral. At the same time, the collateral cover should be so much that the subscriber to such debt instrument can assure itself to recover the whole amount of outstanding dues despite receiving a sub-optimal price in the event it has to resort to sale of such collateral under duress. Therefore, as a matter of prudent principle of investment in debt securities, the collaterals are accepted by the subscriber/investor after applying adequate haircuts to the present valuation of the collaterals of securities being offered by the issuer of such debt instruments.

47. I note that the *Noticee* has submitted before me the Annual Reports for the Financial Years 2012-13, 2013-14 and 2014-15 of *Konti* and for Financial Year 2014-15 of *Edison* which, the *Noticee* has maintained to be available with its IC at the time the investment decision was taken by the *Noticee*. Be that as it may, the following important items from the Annual Reports of *Konti* are noteworthy

Table 3: Financial Results of Konti

	2011-12	**2012-13**	**2013-14**	**2014-15**
Revenue	6,87,12,954	2,76,10,886	3,47,42,329	3,50,38,070
Profit after Tax	-1,03,22,387	-15,71,940	-85,40,468	-23,71,11,700
Long Term Liabilities	51,83,283	51,83,283	4,71,456	2,50,04,71,456
Short Term Liabilities (Loans & Advances)	5,97,92,36,166	8,49,37,36,166	15,11,47,86,166	3,36,61,00,000

Similarly, the following items are observed from the Annual Report of *Edison*:

Table 4: Financial Results of Edison

	2013-14	**2014-15**
Revenue	13,56,056	41,684
Profit after Tax	-30,90,67,725	-57,84,23,880
Long Term Liabilities (Borrowings)	9,05,66,05,000	9,55,01,05,000
Short Term Liabilities (Borrowings)	3,70,55,00,000	6,76,18,90,000

The above noted annual financial figures including the continuous losses incurred by *Konti* and *Edison* would nowhere suggest that these two *Issuer companies* had the capacity to repay the dues arising out of the ZCNCDs subscribed by the *Noticee* out of the funds of the aforesaid FMP schemes as already indicated in the Table 1 above in this order. Further, the loans outstanding in the balance sheets of these entities comprising the long-term and short-term liabilities aggregating to more than INR 586 Crores by *Konti* and more than INR 1600 Crores by *Edison* as at the end of Financial Year 2014-15, along with the continuous losses being incurred by both the *Issuers* were quite alarming enough for any lender/investor to avoid investing any funds into the debt securities of these companies as it was very much evident to the *Noticee*, even at the very initial stage of investment, that the repayment would never be made from the sources or future cash flows of the *Issuers*. However, as admitted by the *Noticee*, the same fact was available before the IC from the Annual Reports of the two *Issuers* but the IC did not take this critical factor into consideration.

48. Extending the aforesaid observations to the factual context of the present case, in my view, any prudent subscriber to such ZCNCDs of *Konti* and *Edison* would first conduct its own due-diligence to ascertain as to how the *Issuer companies* receiving the funds raised through the ZCNCDs would deploy those funds and find out if such deployment is likely to increase their profit and cash flow in the future allowing the *Issuers* to repay the said subscriptions with the returns thereon, in a hassle-free manner to the investors. However, I note from the submissions of the *Noticee* that the monies raised from the ZCNCDs were to be used by the *Issuers* for 'general corporate purposes'. Therefore, it is not the case of the *Noticee* that the *Issuers* invested in a project which went bad. It is also not the case of the *Noticee* that the promoters of ZEEL or the company ZEEL itself has committed any fraud or wilful default which was not detected by the *Noticee* despite its research and due diligence at the time of subscribing to those ZCNCDs. Therefore, in the present matter, no alleged offense of fraud on the part of the *Issuers* has been brought to my attention by the *Noticee* so as to defend their alleged lack of due diligence while investing in the ZCNCDs of the investee companies i.e. *Konti* and *Edison*.

49. I note from the post-hearing submissions of the *Noticee* that one of the reasons that triggered a drastic fall in the price of the scrip of ZEEL was sale of 65 lakh shares by certain lenders (IIFL, Edelweiss, JM and one more entity) whose margin call weren't honoured for about INR 200 Crores. It is again not the case of the *Noticee* that it was not aware of the extent of loans taken by either the *Issuers* or other entities of Essel Group against pledge of shares of ZEEL; *au contraire*, it appears from the submissions of the *Noticee* that it was constantly monitoring the debt situation of the Essel Group and also was keeping a track of the quantum of pledge of shares of ZEEL made by the promoters of the Essel Group from time to time. This fact leads to only one conclusion that the *Noticee*, despite its own submission of maintaining vigil over the *Issuers* and the promoters of the *Issuers*, has failed to exercise due diligence and care in respect of its investments in the ZCNCDs of the two *Issuers*. It is for the *Noticee* to answer as to why did it decide to invest in such entities which had absolutely no fundamentals or financial abilities to repay the investment and why the said investment was made in the ZCNCDs of the two *Issuers* solely against the security of collaterals (in the form of shares of ZEEL) only. The records before me do not suggest as to how the *Noticee* came to a satisfactory conclusion that the shares of ZEEL taken by it as security were sufficient in all circumstances to ensure the recovery of its investment amount. The *Noticee* has not brought any evidence on table to indicate to that it had ever factored into its due diligence, any worst case scenario to assure itself that in the event of any drastic untoward development (such as the sudden sale by other lenders causing drastic fall in market value of the collateral) pertaining to its investment or to the security so kept by it as collateral, any alternative back-up means has been assured by the *Issuers* to secure the investment so made by it.

50. The *Noticee* has also fairly stated that it had subscribed to the ZCNCDs of the *Issuers* knowing that the loan repayment would take place by way of refinance. Refinance is nothing but a loan created for the purpose of payment of earlier loan. In general, borrowers opt for refinance for various reasons *inter-alia* to change the tenure of loans (both for increasing and decreasing the tenure), reduction in interest rates, lower monthly payments or to consolidate their debts.

Refinance merely for the purpose of repayment of another loan has a very thin line of difference from evergreening of loans, a practice long back flagged by Reserve Bank of India as one of the reasons behind increasing Non-Performing Assets(NPAs) in the financial systems. In any case, from the financials and balance sheet of the *Issuers*, certain portions of which were reproduced above, it was clearly written on the walls that any prudent financial institution would avoid providing any loan to the *Issuers* or their promoters to refinance the redemption of the ZCNCDs of *Konti* and *Edison*, subscribed to by the *Noticee*. In fact, the events that ensued after the subscription made by the *Noticee* to the ZCNCDs of the *Issuers* rendered the possibility of any refinance by any other lender more difficult. This clearly shows that the *Noticee* was taking a huge risk with open eyes by making an unreasonable assumption that the *Issuers* will be able to honour the ZCNCDs on time and make repayment of the invested amount upon maturity of the ZCNCDs by way of refinance, when the balance sheets of the *Issuers* were in a really bad shape.

51. Further, the *Noticee* has contended that the subscription to the ZCNCDs of the *Issuers* was based on the strength of collateral of shares of ZEEL pledged by the *Noticee*. In support of its contention, the *Noticee* has submitted that ZEEL was part of its equity desk research for last 10 years and it was confident of the strength of the company based on the extensive research done by its equity desk during that period.

52. I understand that loan against security is not a new phenomenon and it may be a part of normal market practice wherein shares are used as collateral against loans. However, the present situation cannot be treated as an example of an ordinary loan transaction since advancing any kind of loan is prohibited in terms of the provisions of Regulation 44(3) of MF Regulations, 1996. In fact, even in common cases of Loan against Shares (LAS), the shares pledged as collateral are used as secondary security wherein primary security is always the financials and cash flows of the borrowing entity. However, in the present matter, by its own admission, the *Noticee* went ahead and made the subscription to those ZCNCDs of *Konti* and *Edison*, only on the strength of collateral of ZEEL shares completely

unmindful of the of precarious financials of those *Issuers*.

53. I find it relevant to mention here that the *Noticee* is an asset management company holding the funds of public (unit holders) in its fiduciary capacity and has a sacrosanct obligation to invest the said funds in a safe, highly secured and extremely diligent manner in compliance with the code of conduct prescribed under the relevant regulations, hence cannot afford to invest funds in a manner like LAS, which is specifically prohibited under the provisions of MF Regulations, 1996.

54. At the same time, accepting equity shares as collateral has another drawback viz. their ever fluctuating price due to various market as well as extraneous factors, some of which are not in the control of the company concerned viz. ZEEL in the present matter. Thus, many a times the market price of a scrip of a listed company is driven by factors beyond the control and financial strength of such company and is dictated by the interplay of various extraneous economic, political and even geo-political factors. Further, equity is generally a volatile class of security requiring extra care, vigil and due diligence while accepting the same as a collateral.

55. In this case, I find that the *Noticee* decided to take the shares of ZEEL as collateral against its subscription to the ZCNCDs of the two *Issuers* to the extent of 1.50 times the outstanding investment amount and these shares were taken as the only means to ensure repayment of its investment in those debentures issued by the *Issuers*. While the *Noticee* has contended that the value of the collateral cover was always more than the investment amount at any point of time till it received complete repayment, it has also accepted that the said collateral cover fell below the mandated 1.50 times cover on January 25, 2019 which was never replenished by the promoters of ZEEL by offering more shares to compensate the shortfall in the securities cover. The *Noticee* has also not offered any rationale for accepting shares of ZEEL valued at 1.50 times of the outstanding investment as a cover and has not provided any explanation as to whether, in any extreme scenario leading to drastic fall in the price of scrip of ZEEL (as happened on

January 25, 2019), the said cover was ever mapped by it to the recoverability of the outstand, ing investment, as a prudent risk-management measure and whether the collateral cover of 1.50 times the outstanding investment was found sufficient by it in such mapping. The details of such working and calculations accounting for the aforesaid extreme scenarios, if at all done by the *Noticee* have not been made available to me. In fact, I note from the note dated May 18, 2016 of the IC of the *Noticee*, that it had mentioned the eventuality of promoters running out of shares to pledge in the following terms:

"*There is no clarity on currant promoter 'share pledge-based borrowing numbers; based on rough calculations from pledge data and market intelligence, we estimate that it ranges from Rs. 3,500 cr to Rs. 4000 cr.* ***Given that the total unencumbered market value of promoter holding in India, in ZEE and Dish is ~Rs. 5000 cr and assuming LAS-based borrowing at Rs. 4000 cr, promoter runs out of shares if prices (in both Zee and Dish) fall by ~20%.***

We have Ignored promoter shareholding domiciled outside India. In case of distress, this stake can be pledged after obtaining authorization from an Indian Bank (as done in case of Cairn India by Vedanta Ltd.). The value of unencumbered foreign stake is Rs. 8000 cr.

Including the foreign promoter stake, promoter runs out of shares if prices (in both Zee and Dish) fall by ~35-40%."

This aforesaid remarks made by the IC show that not only the *Noticee* was not aware of 'share pledge-based borrowing numbers' of the promoters of Essel Group but also it was making such a huge investment decision purely on its own guesswork rather than asking for the actual figures from the promoters of Essel Group. Further, the *Noticee* had mapped two scenarios wherein the promoters would run out of shares to be pledged. However, at no point of time during the whole proceedings, the *Noticee* has indicated if such scenarios were taken into consideration while deciding on the ratio of collateral at 1.50 times the exposures to ZCNCDs of the *Issuers*.

56. Even if for a moment, presuming that the investment logic of the *Noticee* to invest in the ZCNCDs of the *Issuers* on the strength of the collaterals to the extent of 1.50 times the amount of exposure to be a prudent one, I find from

the facts that the said collateral cover actually turned out to be inadequate to recover the outstanding investment in the eventuality of a drastic fall in the price of ZEEL on January 25, 2019. The submission of the *Noticee* that the value of the collateral cover was always more than the liability of the *Issuers* towards it, doesn't sound convincing in light of the fact that, on the day of January 25, 2019, more collateral was actually required to cover the shortfall in collaterals due to sudden fall in the price of ZEEL, as the said existing collateral fell below the stipulated 1.50 times cover. By the submission of the *Noticee* itself, the sale of the shares of ZEEL held by it as collaterals would have led to sub-optimal returns to the unitholders as it would have taken around 18 days for the *Noticee* to completely offload such large number of the shares of ZEEL kept as collateral with it. During the said period, increased volume and public disclosure of such sale of shares would have spooked the market further which might have led to another drastic fall in the price of the shares of ZEEL as it happened on January 25, 2019 when, certain other lenders sold shares of ZEEL pledged with them by the promoters of ZEEL, as the promoters failed in honouring their margin calls. Thus effectively, by its own admission, the shares of ZEEL accepted by the *Noticee* as the only source of recovering its outstanding investment practically did not come to its rescue and it could not take a decision to sell those pledged shares of ZEEL in the fear of further erosion of value of those shares even though it was under statutory obligation to recover the unit-holders money invested by it in those ZCNCDs issued by two *Issuers* prior to expiry of the FMP schemes so as to make payouts to the unitholders.

57. The *Noticee* has contended that the practice of investment in structured obligation is a well-known concept in mutual funds industry and it is considered to be falling well within SEBI's regulatory framework. In support of its contention, the *Noticee* has referred to the minutes of meeting of Mutual Fund Advisory Committee (**MFAC**) dated July 02, 2019 wherein it was discussed to mandate the Mutual Fund Schemes to have collateral cover of at least three to four times of the outstanding investment.

58. I note that the aforesaid discussion in MFAC has led to SEBI issuing a circular

ref. SEBI/HO/IMD/DE2/CIR/P/2019/104 dated October 1, 2019 wherein investment in unlisted NCDs having structured obligation have been regulated by placing mandatory conditions on such investments. One of such conditions is that such structured investment has to be backed by equity shares to the extent of having a minimum cover of four times such investment. Thus, even if the said circular is to be applied to the present matter, it clearly indicates that the collateral cover of 1.50 times the outstanding amount of investment accepted by the *Noticee* was far below the said mandatory threshold of collateral cover in the form of equity cover as prescribed in the abovementioned circular. As observed earlier, the *Noticee* has offered no reasoning for accepting a collateral cover of only 1.50 times even knowing very well that the two *Issuer companies* of the Essel Group had no financial worth to repay the debt raised through those ZCNCDs. The reliance placed by the *Noticee* in the above noted SEBI circular to justify its acts is therefore misplaced on facts. Further, the *Noticee* should not forget that the circular referred to above was issued for compliance in addition to the primary requirements for compliances with high standards of due diligence and care as laid down in the MF Regulations, 1996 which demands that no AMC can afford to overlook its 'due diligence' and care before investing the unit-holders' money in any company or in any debt instrument. As already discussed above, the *Noticee* has grossly failed to take cognisance of the balance sheets of both the *Issuers* thereby failing to exercise basic due diligence prior to investing the funds of different FMP schemes in the ZCNCDs issued by these two *Issuers*. Further, the collateral cover of 1.50 times the outstanding investment accepted by the *Noticee* was glaringly far short of the threshold requirement of collateral equity cover as mandated in the abovementioned circular. While it is not the case of SEBI that the *Noticee* has violated the provisions of the abovementioned circular which was issued long after the investment made by the *Noticee* into the ZCNCDs of the *Issuers*; at the same time, the *Noticee* itself cannot take shelter under the said circular to justify its investments in a structured instrument, since the collateral cover accepted by it viz. 1.50 times the outstanding investment was far short of the prescribed threshold cover limit of four times the investment. If not anything, this circular at least shows the gaping insufficiency and negligence

in due diligence exercised by the *Noticee* before investing in the ZCNCDs issued by the *Issuers*. When seen from the point of view of minimum regulatory expectation of due diligence as expressed in the MF Regulations, 1996 as well as in the above mentioned circular issued by SEBI in the interest of the safety of unit-holders money, it becomes glaringly evident that the *Noticee* chose to hand over unit-holders' monies to the two *Issuers* to be utilized for their general corporate expenses merely on the face value of Essel Group, its reputation, and on the strength of shares of ZEEL which was of no use to it when the FMP series no. 127, 183, 187, 189, 193 and 194 maturated for payment to the unitholders and the *Noticee* could not redeem those ZCNCDs from the *Issuers*.

59. It is a known fact that the rationale followed by the investors while making investment in the equity segment and debt segment varies according to the variance in their investment objectives. While the prudent investment advisors advise the investors to invest in equity market, whether directly or through mutual funds, to grow their wealth, the commonly accepted objective behind investment in debt market has always been to 'safeguard the capital' with minimum assured return rather than 'growth of capital'. Therefore, keeping these objectives in perspective, any AMC investing in debt instruments as part of its schemes is expected to be conservative and extra careful in its investment decisions. It may be noted that there are several fund raising vehicles permitted under the SEBI Regulations. One such unique mode of raising of funds is through business 'Trusts'. Under the MF Regulations, 1996, entities are permitted to raise funds from investors through a 'Trust' vehicle. The business trust model casts an extra onerous duty to be more vigil while making investment from the funds raised from the common investors, as the funds so raised are held in fiduciary capacity on their behalf and not as an equity participation.

60. An investor, while investing in a mutual fund scheme, leaves his money in the hands of the AMC and the fund manager appointed by it, trusting them to act in the best interest of such investors *in lieu of* certain amount of management fees charged by them by way of an expense ratio as per the provisions of MF Regulations, 1996. While discharging their duties in managing the unit-holders

invested money, it is not only mandated by the clause 9 of Code of Conduct under the MF Regulations, 1996, but otherwise also has been a regulatory expectation that the duty of the AMC is to provide high standards of service at the time of taking investment decisions which are supposed to be in the best interest of unit-holders/investors. In this situation, any decision to make investment in the securities offered by unlisted companies has to be taken with extreme care, cautions, robust due diligence and with a conservative approach since these securities are inherently riskier assets due to the fact that the secondary markets for these securities are generally illiquid in nature and also detailed information as well as research reports regarding these entities are not easily available in the market. However, I note that the *Noticee* has comfortably invested in such unlisted securities of the two *Issuers* while being fully aware of the dismal profile of revenue and about the losses and debt outstanding of these *Issuers* and that too, with less collateral coverage of equity shares which again, in its own admission, proved to be very difficult to offload in the market to recover the outstanding investment for fear of drastic downfall in the price of the said securities. In these circumstances, the *Noticee* cannot be said to have provided high standard of service to its investors/unit-holders while conducting due diligence of the two *Issuers* prior to taking an investment decision to subscribe to their ZCNCDs.

61. It is not the case of any fraud having been committed by the *Issuers* on the *Noticee*, by way of account manipulation, siphoning off funds or by any other means. The *Noticee* has also not pleaded anything remotely suggesting the same. In this situation, it can safely be presumed that the information provided by the *Issuers* at the time of subscription was devoid of any falsehood. Therefore, despite knowing all the facts regarding the unfavourable financial conditions of these two *Issuers*, the decision of investment of the funds collected on behalf of its FMP series 127, 183, 187, 189, 193 and 194 by the *Noticee*, in the ZCNCDs of *Konti* and *Edison* cannot be said to be a reasonable decision taken by a prudent fund manager after due examination of the financials of these companies. In view of the aforesaid facts and discussions and the admitted position that the extremely poor financials or lack of repaying capacities of the two *Issuer companies*

viz. *Konti* and *Edison* never engaged the mind of the *Noticee* which was rather more comfortable in accepting the inadequate collateral cover of equity shares of ZEEL and was more influenced by the reputation of the Essel group, I hold that the *Noticee* has failed to exercise even the basic due diligence and care expected of an ordinary investor while examining the repayment capacity of the *Issuers* before deciding to invest in the ZCNCDs of *Konti* and *Edison*. The *Noticee* not only overlooked the primary source of repayment from the Issuers, but also failed to carefully assess the adequacy of collateral submitted by the pledger Cyquator against the subscription so made by the *Noticee* into the ZCNCDs of the two *Issuers*, out of the funds of the FMP series 127, 183, 187, 189, 193 and 194. The *Noticee* even did not bother to collect the actual figures of pledged shares of ZEEL from the promoters of Essel Group and based only on its guess work, it expected to get back the money invested by it by way of refinance without obtaining a detailed plan about such future refinance. The *Noticee* expected to obtain more collateral cover from the promoters' overseas ownership of shares of ZEEL without ascertaining how and within what time frame such shares can be received by them if such eventuality arose. The *Noticee* has evidently invested in the ZCNCDs on the basis of guesswork, expectations, theorising various possibilities, past track records and reputation of Essel Group rather than on the basis of any serious exercise of due diligence based on hard facts of financials of the *Issuers*, future cash flow, actual status of pledged shares and other financial parameters, as expected from a professional fund manager. By such acts and omissions on the part of it which put the unit-holders' funds to unwarranted risks, I am persuaded that the *Noticee* has violated the provisions of clauses 6 and 9 of Code of Conduct prescribed at Fifth Schedule read with Regulation 10(a), 25 (1), 25(2), 25(16) of the MF Regulations, 1996.

B. Failure to consider research report and analyse various factors

62. It is alleged in the SCNs that the *Noticee* has neither prepared adequate research reports nor has analysed various factors prior to taking its investment decision in the said ZCNCDs of the *Issuers* as expected to be exercised by an AMC engaged in business of investing money raised from investors. By its acts and omissions, the *Noticee* has allegedly violated the provisions of Regulation 25(2)

of MF Regulations, 1996 read with SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000.

63. As already noted earlier, an AMC is required to exercise due diligence and care in all its investment decisions as would be exercised by any other persons engaged in the same business. I have already observed that the investment in unlisted securities is inherently more risky than listed securities due to their illiquidity and lack of proper price discovery in the secondary market as also the absence of adequate information about such issuer companies in public domain so as to appreciate their business affairs or financial conditions on a regular basis. Keeping the aforesaid shortcomings and limitations in view, SEBI has prescribed certain safeguards in its circular no. MFD/CIR/6/73/2000 dated July 27, 2000, the relevant portion of which is being reproduced below:

"*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 scrip 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.****"* (emphasis supplied)

64. I have already held above that the *Noticee,* for the reasons recorded in details in the preceding paragraphs, has failed to exercise due diligence and proper care in examining the financials of *Konti and Edison* before subscribing to the ZCNCDs of these two *Issuers*. By its failure to do so, the *Noticee* has inter-alia acted in violation of the provisions of Regulation 25(2) of MF Regulations, 1996.

65. As may be observed, the above cited circular of SEBI not only requires an AMC to record the basis for taking investment decision scrip wise, but also requires the AMC to take into consideration a detailed research report analysing various factors for each investment decision to be taken for the first time. The relevant contents of the research reports have to be decided upon by the AMCs and the trustees.

66. The *Noticee* has contended that the *Issuers* being unlisted entities, there was no independent research report available in the market due to which, the investment notes were based on *Noticee*'s own internal research. Further, the investment was made on the sole basis of strength of the equity shares collateral viz. the shares of ZEEL. For this purpose, the financials of ZEEL and Dish TV were also discussed by the IC in the light of the fact that the Equity Investment team of the *Noticee* was actively tracking the scrip of ZEEL for a period of about last 10 years.

67. However, one can note that the Circular dated July 27, 2000 referred to above doesn't prescribe a requirement of 'independent research report' but a 'research report' implying thereby that there should be a proper research into the affairs and financials of the issuer entity before any investment decision is taken *qua* that issuer entity. Such a research may be conducted by internal means also; but the requirement of regulator is that the said research should be properly conducted and appropriately documented in a manner to demonstrate that all the essential as well as the relevant factors have been internally discussed by the AMC before the eventual investment decision was crystallised.

68. In this case, while the *Noticee* has contended that the investment notes were based on its own internal research, it has failed to produce any research report

regarding either *Konti* or *Edison* which the IC of the *Noticee* has supposedly perused and examined prior to taking a decision to invest in the ZCNCDs of the two *Issuers*. The *Noticee* has submitted certain documents showing its research on the scrip of ZEEL. However, it is pertinent to note here that the funds of FMP Series 127, 183, 187, 189, 193 and 194 were invested not in the securities of ZEEL or Dish TV but in the ZCNCDs of *Konti* and *Edison*. Therefore, the research on the scrip of ZEEL or Dish TV can at best be supportive and under no circumstances, can substitute the research reports required to be prepared on the *Issuer companies*. Therefore, evidently, the *Noticee* has failed to carry out proper research and prepare a research report, therein examining those necessary factors pertaining to the two *Issuer companies* which deserved to be considered for making an investment decision. Under the circumstances, I hold that the *Noticee* has failed to exercise due diligence and care while making its investment decisions to invest in the ZCNCDs of the two *Issuer companies* thereby violating the provisions of Regulation 25(2) of MF Regulations, 1996 read with SEBI Circular dated July 27, 2000.

C. Non-disclosure of adverse information to the unitholders:

69. It is alleged in the SCNs that certain events, which had an immediate adverse bearing on the investments of the investors in FMP series 127, 183, 187, 189, 193 and 194 thereby gravely affecting their commercial interests, were not communicated to the investors in a timely manner. The communication dated April 05, 2019 was made by the *Noticee* to the investors just before the dates of maturity of the respective scheme(s) and not at the actual time of occurrence of those events. Further, it is also alleged that the *Noticee* has not furnished adequate proof that the communications were sent to all investors. In the light of this, it is alleged that the aforesaid acts and omissions on the part of the *Noticee* were in violation of Regulations 10(a), 25(16) and clause 2 of Code of Conduct for AMCs prescribed at the Fifth Schedule of the MF Regulations, 1996.

70. Clause 2 of Code of Conduct for AMC as prescribed under the Fifth Schedule of MF Regulations, 1996 mandates an AMC to ensure the dissemination to all unit-holders, 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 such scheme which the investors are invested into.

71. In this regard, the *Noticee* has submitted that the event pertaining to the letter of intent dated February 7, 2019, issued by the *Issuers*, was an in-principle understanding between the Committee of Lenders ('**COL**'), *Issuers* and pledgers. This was not a binding agreement in itself as it was contingent upon the decision by the COL. Thus, while there was an understanding, it fell apart within seven business days as the COL was not able to arrive at an understanding to recover the funds of all the lenders.

72. Since no other options worked out, the *Noticee*, on the basis of various discussions held during the period of January to April, 2019 entered into separate agreements with each of the *Issuers* on April 6, 2019 and the same was duly informed to the unitholders of FMP series 127, 183, 187, 189, 193 and 194 by way of various modes of communication on the dates mentioned in the table below:

Table 5: Details of disclosure to unitholders

FMP Series Number	**Original date of maturity**	**Date of Informing the investors**
FMP Series no. 127	08.04.2019	05.04.2019
FMP Series no. 183	10.04.2019	12.04.2019
FMP Series no. 187	15.04.2019	05.04.2019
FMP Series no. 189	17.04.2019	10.04.2019
FMP Series no. 193	02.05.2019	09.04.2019
FMP Series no. 194	15.05.2019	05.04.2019

Subsequent developments were also informed to the unitholders through an email communication dated August 02, 2019. The unitholders of the respective schemes were also informed about the part payment of the pending dues on September 11, 2019 and balance payment along with accrued interest on September 25, 2019.

73. It can be observed from the chronology of events that the first major material event happened when there was a sudden fall in the price of the scrip of ZEEL on January 25, 2019 which brought down the collateral cover below the 1.50 times of the total outstanding investment amount which was agreed to between the *Noticee* and the *Issuers*. From the materials submitted by the *Noticee*, I note that IDBI Trusteeship Services Ltd., the debenture trustee to the ZCNCDs of the *Issuers*, vide its letter dated January 25, 2019 had informed the about the fall in collateral cover to *Konti* and advised it to pledge additional shares within two business days. The said time limit of two business days got over on January 28, 2019 (January 27 being a Sunday) but the *Issuers* showed their inability to pledge more shares so as to increase the cover to the mandated 1.50 times the outstanding investment.

74. Subsequently, the second important event unfolded when the Board of the *Noticee* and Trustees of KMMF deliberated on the matter and decided to go with the decision of majority of the lenders for restructuring the debt of the *Issuers* while taking personal guarantee from the promoters of ZEEL for payments against their respective investments. Acting on that, the *Noticee* met the *Issuers* and a Letter of Intent was executed amongst the *Issuers*, the pledgers of ZEEL shares and the Committee of Lenders, which the *Noticee* was a part of. As per the said letter of intent, the lenders agreed to reach an agreement within 7 days, which they failed to do.

75. Considering the materiality of the above stated developments, contrary to the claim of the *Noticee* of having informed the investors well in time, I am of the view that the implication of the abovementioned events were clearly adverse in nature from the perspective of the unitholders' interest, which even the *Noticee* has not denied. Therefore, in view of the mandate of clause 2 of the Code of Conduct prescribed under Fifth Schedule of MF Regulations, 1996, the aforesaid events/developments surrounding the fall in the collateral cover, letter of intent and subsequent failure of COL to come to an agreement etc. were required to be disclosed to the unitholders immediately after occurrences of these developments however, the *Noticee* has admittedly not done so till the time just

before the maturity of such FMP schemes.

76. The contention of the *Noticee* that nothing concrete had taken place for it to disclose to investors prior to its agreement dated April 06, 2019 with the *Issuers* and with Dr. Subhash Chandra, appears to be a feeble attempt on its part in order to justify the undue delay committed by it in making fair disclosures about various adverse developments that were taking place affecting the prospect of repayment out of those ZCNCDs issued by the *Issuers*. The *Noticee* became aware of the inability of the promoters of ZEEL to place additional shares as pledge as early as on January 28, 2019. The *Noticee* itself has submitted that the fall in market price of shares of ZEEL took place due to failure on the part of the promoters of ZEEL to honour a margin call of some other lenders which prompted those lenders to sell the shares of ZEEL on January 25, 2019. In this regard, I may note that pledging of additional shares of ZEEL was not the only method of increasing collateral cover to 1.50 times the outstanding investment. The *Noticee* was at liberty to enforce increasing collateral cover from the two *Issuer companies* through many other methods, for example, cash deposit, FD receipts, bank guarantee etc., could have been insisted upon the *Issuers* or the Guarantor so as to fulfil the mandated collateral cover. However, from the fact that the promoters of ZEEL failed to meet margin calls from other lenders, failed to provide more securities of ZEEL to the *Noticee* to honour their commitment of providing collateral cover of at least 1.50 times of the outstanding investment amount and also from the subsequent efforts made by the *Noticee* to negotiate with the *Issuers* or the promoters to provide further securities or any other marketable assets other than the shares of ZEEL so as to prevent the *Noticee* from suffering from any further adverse price fluctuations in the market, I am constrained to assume that the *Noticee* was very well aware of the acute financial difficulties that the *Issuers* as well as the promoters of ZEEL were going through at a time, when the ZCNCDs of the *Issuers* were maturing for redemption. In such a situation, the probability of default in payment of the ZCNCDs upon maturity by the *Issuers* and Essel group was extremely high, which could be eventually avoided by the *Noticee* only by allowing the defaulting *Issuers* to extend the maturities of those ZCNCDs beyond their original dates of

maturity. Despite being confronted with such a sure possible default situation, the *Noticee*, rather than informing the unitholders of the affected schemes about such an adverse situation in the interest of maintaining transparency at least immediately after the *Issuers* failed to recoup the collateral cover of 1.50 times, waited till last moment in an attempt to create a positive perception around its investments in such a precarious environment and decided to make disclosure to the unitholders only when an agreement was reached with the *Issuers*. Till then, the unitholders of the affected FMP series no. 127, 183, 187, 189, 193 and 194 were kept in the dark about the events, that were happening behind their back, adversely affecting their investment.

77. I find it pertinent to note here that the transparency in dissemination of information to the investors is reckoned as a crucial factor behind informed investment decisions in securities market and is considered as one of the pillars for protection of investors which SEBI has been promoting since the time of its establishment. With a view to achieving maximum investment protection, various regulations have been framed by SEBI and various circulars have been issued directing the listed companies as well as other entities falling under the purview of Securities Law to make maximum possible public disclosure at the earliest possible opportunity in the interest of their investors and other stakeholders.

78. In the context of the aforesaid regulatory objective, transparency in communication and dissemination of fair & true information at the earliest possible opportunity is equally important for the Mutual funds as they invest and manage the funds of the most vulnerable section of investors viz. retail investors. For the same reasons, the Mutual Funds are more closely regulated by SEBI as compared to the other sophisticated investment vehicles viz. Portfolio Management Services, Alternative Investment Funds etc. Transparency in communication on the face of adverse events/information becomes all the more important so as to make the investors know about the possible negative impact such adverse event/information would have on the investment made by the investors. In case of non-disclosure or delayed disclosure of any such adverse

information, as has happened in the present matter, not only the investors of the affected schemes but also other investors of the Mutual Fund would have to live through uncertain times since the sporadic information available on the public forums as was seen in this case, would mostly speak about the financial hardships of the affected companies viz. the *Issuers* and the promoters of the Essel group or about the listed company (ZEEL herein) but these information available in the media or other public forums would not clearly explain the actual impact of those information or news on a particular mutual fund schemes which only the asset management company can assess and inform to the unitholders as soon as such adverse information about the issuers or its promoters start circulating in public forums. Therefore, it is incumbent for an AMC to immediately come out with a formal communication explaining in detail the event(s), the schemes affected by it, its possible impact on each of the said schemes and the efforts being undertaken by such AMC to mitigate those possible adverse impact on the investors' money. However, I find that the *Noticee*, as against what is expected from a responsible AMC, has consciously delayed the disclosure of such adverse events that was triggered by the erosion of collateral cover and it had waited for long in the hope of finding a positive news to be informed thereby leaving its investors in dark about the aforesaid adverse events for a period of more than two months which was unjustified and uncalled for in the interest of its unitholders nor was it permissible in terms of MF Regulations, 1996 read with the Code of Conduct prescribed thereunder. In view of the aforesaid, I hold that the *Noticee* has failed to comply with the provisions of clause 2 of Code of Conduct for AMCs prescribed under Fifth Schedule read with Regulation 25(16) of MF Regulations, 1996 in letter and spirit.

79. It is also alleged in the SCNs that the *Noticee* has not furnished adequate proof of its claim of having sent the communication by it to the investors as it has failed to provide at least 10 sample copies of those letters/emails with adequate proof of dispatch to such investors as it was advised to provide, so as to substantiate its claim of having sent the communication to the investors/unitholders prior to as well as post the maturity of the six KMMF FMPs having series no. 127, 183, 187, 189, 193 and 194. However, I note that

the *Noticee* has submitted a letter dated January 13, 2020 from Computer Age Management Services Pvt. Ltd. (**CAMS**), the registrar to the aforesaid FMP schemes, wherein CAMS has stated that it had communicated the status update to the investors of the aforesaid FMP schemes by way of email or physical letter. I note that CAMS is a duly registered RTA with SEBI which is an entity completely independent of KMMF and it provides services to numerous mutual funds. Therefore, I find no reason to doubt the aforesaid confirmation made by CAMS in the absence of any complaint or any evidence against such a statement given by CAMS. Further, the *Noticee* has also submitted certain email logs in its post hearing submissions. Therefore, I find no reason to hold that it had not communicated the status update to investors through physical letters whose email IDs are not available with it when majority of investors have already been informed about the events via emails. In view of the above, based on the materials on record, I find that the charge of not communicating with the investors would not sustain hence, I drop the allegation of failure of the *Noticee* to provide proof of communication.

D. Extension of maturity date of NCDs beyond the maturity date of the scheme

80. It is alleged in the SCNs that the decision to allow the *Issuers* to extend the maturity of the ZCNCDs was taken by the *Noticee* during the period January 25, 2019 to February 7, 2019. In this respect, from the information furnished by the *Noticee*, it is observed that KMMF had entered into two separate multilateral agreements dated April 06, 2019, each agreement signed with one of the *Issuers*, Cyquator and Dr. Subhash Chandra wherein, KMMF voluntarily extended the maturities of ZCNCDs of the *Issuers* from April 08 & 10, 2019 to September 30, 2019. The said extension of maturity of the debt securities is alleged to be an active investment decision, which could have been taken only by the *Noticee*, the AMC which was managing the funds of FMP series 127, 183, 187, 189, 193 and 194. By extending the maturity of ZCNCDs of the *Issuers* beyond the maturity date of the FMP schemes, the *Noticee* is alleged to have violated the provisions of Regulations 10(a), 25(1), 25(2), 25(16), clauses 6 and 9 of the Fifth Schedule of MF Regulations, 1996 read with Circular No. SEBI/IMD/CIR No.

12/147132/08 dated December 11, 2008.

81. In this regard, it is to be noted that SEBI Circular dated December 11, 2008 *inter-alia* directs the following:

"*It has also been decided that a close ended debt scheme shall invest only in such securities which mature on or before the date of the maturity of the scheme.*"

The objective behind placing such a restriction on the investment in securities which would mature beyond the date of maturity of a closed-ended scheme is self-explanatory, as except for those cases where the scheme is allowed to be rolled over in terms of proviso to Regulation 33(4) of MF Regulations, 1996, a closed ended scheme is always required to be fully redeemed at the end of the maturity period. Even in the case of roll over of a closed-ended scheme, the AMC is required to take in writing, the consent of unitholders/investors agreeing for rolling over of the scheme and the unitholders who do not opt for the roll over or have not given written consent for the same, the regulation mandates that such unit holders must be allowed to redeem their holdings in full at the net asset value (NAV) based price. Therefore, under normal circumstances, a closed ended scheme is required to be wound up on a fixed maturity date when the AMC is required to fully redeem the said scheme to all its unitholders. Any investment made by a close-ended scheme in a debt instrument having maturity date beyond such redemption date of the scheme would mean that the AMC will not be able to fully redeem the scheme on its maturity date and the same would amount to violation of the said provision of MF Regulations, 1996.

82. The *Noticee* has submitted that it had not rolled over any of the six FMP schemes and yet, the *Noticee* has admittedly extended the maturity date of ZCNCDs of the *Issuers* by around 6 months; which was specifically prohibited by way of SEBI Circular dated December 11, 2008 as cited above.

83. In this regard, the *Noticee* has insisted that all investments made by it on behalf of the afore-mentioned FMP schemes were well within the maturity dates of the respective schemes at the time of such investments and the *Noticee* didn't make

any fresh investment after maturity dates of those schemes. According to the *Noticee*, it has only allowed more time to the *Issuers* to repay the outstanding investment by way of allowing the extension of the due dates of those ZCNCDs of the *Issuers* and this act of the *Noticee* cannot be construed as a fresh investment decision. The *Noticee* has contended that it has only allowed rescheduling of the date of the maturity of those NCDs wherein the due dates of the cash flows are realigned and the same is recognized by SEBI in chapter 9.7 of Master Circular on Mutual Funds. The *Noticee* has also contended that it had complied with the investment restrictions provided under SEBI Circular dated January 05, 2000 read with Seventh Schedule to the MF Regulations, 1996.

84. From the aforesaid contentions I find that the *Noticee* has mainly tried to derive support from SEBI Circular dated January 05, 2000 and Master Circular on Mutual Funds. However, a close scrutiny and perusal of both these circulars show that they do not help the case of the *Noticee*. I note that the Circular dated January 05, 2000 speaks about certain changes in MF Regulations, 1996 including the Seventh Schedule which deals with general investment restrictions placed on mutual funds. There is no allegation that the *Noticee* has violated any of the provisions of the said circular. However, SEBI Circular dated December 11, 2008 lays down a fresh set of restrictions on investment in close-ended schemes and it is not the case of the *Noticee* that there is any contradiction between the SEBI Circular dated January 5, 2000 and the circular dated December 11, 2008.

85. Further, the chapter 9.7 of Master Circular is titled as "*Guidelines for Identification and Provisioning for Non Performing Assets (Debt Securities)*". Evidently, the said chapter is applicable in case of Non-performing assets ('**NPA**') which are classified so by the AMC. One of the criteria of the same is that valuation of such securities is required to be treated as zero from the date of such classification. From the submissions made by the *Noticee*, clearly it is not the case of the *Noticee* that the investment in the said ZCNCDs of the *Issuers* were ever valued at zero or declared by it as NPA; hence, the said chapter in Master Circular is not applicable in the present case. The *Noticee*'s reference to and

reliance in the said chapter in Master Circular is grossly misplaced on facts and misleading in nature.

86. On the other hand, it is observed that the *Noticee* has unilaterally decided to extend the maturity period of the ZCNCDs of the *Issuers* due to which, the investors were not able to redeem their investments in the six FMP schemes on the dates of their maturity as per the terms of the said schemes. The *Noticee* has attempted to use provision of Regulation 41(2)(a) of MF Regulations, 1996 in support of its action stating that the said regulation allows it to dispose of the assets of the said FMP schemes in the best interest of the unitholders which eventually paid off, wherein the unitholders received whole amount that was due to be paid to them as on the extended date of maturity of the ZCNCDs, which included the interest on the amount as on the date fixed for the maturity of the said schemes. Having gone through the records and arguments advanced by and on behalf of the *Noticee,* I find the aforesaid arguments of the *Noticee* are neither convincing nor acceptable under the MF Regulations, 1996. What the *Noticee* did at the time of expiry of those FMP schemes was taking a risky wild bet on these ZCNCDs without evaluating or even knowing at that point of time, what will be the outcome of its decision to allow an extended period of expiry to the ZCNCDs of the *Issuers* which was taken without even providing any option to its investors/unit holders to give their consent or dissent to the proposed extension allowed by the *Noticee*. The above observation is further reinforced from the fact that the *Issuers* were ultimately not able to fully repay the outstanding dues to the *Noticee* despite getting an extended period of almost six months for redemption of the ZCNCDs as a result of which, a part of the dues had to be recovered by the *Noticee* by way of invocation of pledge of the shares of ZEEL on September 25, 2019. Since the six FMP schemes were close ended schemes, the investors were entitled to redeem their investment upon the maturity of such schemes, however, before the maturity of those schemes, the *Noticee* had already taken a decision to extend the maturity period of the ZCNCDs of the *Issuers*.

87. The *Noticee* has submitted that the investment made by it in the ZCNCDs of the

Issuers in the initial stage was only for a period less than the maturity dates of the said six FMP schemes which it was later on required to extend so as to recover the whole invested amount and the said decision proved to be a prudent decision in the hindsight. However, it is to be understood that the requirement to invest in securities having maturity date less than the maturity period of the close-ended scheme has been mandated for compliance for all times and not only for initial investment. Therefore, at no point of time, the *Noticee* was allowed to permit the maturity of the ZCNCDs of the *Issuers* to be extended beyond the dates of maturity of the schemes, unless the same was to be extended in terms of Regulations 33(4) of the MF Regulations, 1996. At the same time, it is noticed that the funds invested in the ZCNCDs of the *Issuers* were repaid to the *Noticee* by the promoters of Essel Group by selling their stake in ZEEL, which was initiated in September 2019 and continued at least till November 2019. This shows that the transactions got completed in the very last moment and the *Noticee*, in its own submissions, has stated that it received a part of the consideration of its investment in the ZCNCDs of *Konti* and *Edison* only on September 09, 2019 while rest of the investment could be recovered only by way of sale of pledged securities on September 25, 2019. It rather reveals in the hindsight that, looking at the large size of stake and the complexity involved in such transaction of sale of stake by the promoters in ZEEL for repaying the lenders/investors including the *Noticee*, had there been any difficulty or delay in the said deal, the unitholders would have faced a loss larger than the situation if the *Noticee* had invoked the pledge in April itself (when the FMP schemes matured). Thus, the *Noticee* took a riskier gamble with the unitholders money at the time when the FMP schemes were to mature and unilaterally extended the maturity dates of those ZCNCDs of *Konti* and *Edison*; a decision for which the unitholders of the said six FMP schemes had never subscribed to. The *Noticee* cannot bask in the glory of having returned the invested money with interest to its unitholders which in any case it was under a statutory as well as contractual obligation to do, and turn its back at the poor conduct it has displayed, staring from its slip-shod due diligence at the time of investing in those ZCNCDs of the *Issuers* who did not have any financial *locus standi* of their own, to taking an

unilateral call to flout the regulatory conditions governing close-ended schemes and allow the *Issuers* to extend the maturity dates of their ZCNCDs thereby postponing payment of dues to the unit-holders beyond the maturity dates of the schemes. In any case, the *Noticee* has itself submitted that it had paid rest of the consideration on September 25, 2019 by selling the shares of ZEEL pledged with it, hence, the rationale for not selling the pledged shares of ZEEL to pay off the unit holders at the time of maturity of the FMP schemes as contended by the *Noticee* does not survive any more.

88. Keeping the aforesaid deliberations and my observations in view, there is no doubt in my mind that the *Noticee* has failed to comply with the restriction imposed by SEBI Circular no. SEBI/IMD/CIR No. 12/147132/08 dated December 11, 2008 read with Regulations 10(a), 25(1), 25(2) and 25(16) of MF Regulations, 1996.

E. Partial redemption and FMPs not wound up at the end of maturity:

89. As observed earlier, it is alleged in the SCNs that the units of FMP series 127, 183, 187, 189, 193 and 194 were not fully redeemed and full payment was not made to the investors at the end of their respective maturity dates. It is also alleged that the FMPs were not wound up upon the maturity of such schemes. By such acts and omissions on the part of the *Noticee*, it is alleged that the *Noticee* has violated the provisions of Regulations 10(a), 25(16), clause 9 of the Fifth Schedule read with Regulations 39(1) and 53(b) of the MF Regulations, 1996.

90. As already discussed above, Regulation 33(4) of MF Regulations, 1996 allows a close ended mutual fund scheme to roll over, subject to a provision for such roll-over being already there in Scheme Information Document itself as well as redemption being allowed to dissenting unitholders. However, in the present matter, no such roll over has taken place in case of the six FMP schemes following the provisions of Regulation 33(4) of MF Regulations, 1996. In such circumstances, it is mandatory under Regulation 39(1) of MF Regulations, 1996 for such close-ended scheme to be wound up on the expiry of maturity period and unitholders be redeemed. Moreover, Regulation 53(b) of MF Regulations,

1996 requires an AMC to despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase.

91. However, it is observed in the present matter that, due to the unilateral act of extension of maturity of ZCNCDs of the *Issuers*, the *Noticee* was not having the whole AUM of the said six FMP schemes at its disposal for liquidation, as a portion of such AUM was stuck in the ZCNCDs of the *Issuers*. Due to that, only partial redemption of the units of the six FMP schemes was possible.

92. The *Noticee* has made a twofold submission in respect of the above allegation. Firstly, the *Noticee* contends that in terms of SEBI Circular dated January 05, 2000, "*All investment restrictions shall be applicable at the time of making investment.*" Accordingly, at the time of building the portfolio of respective schemes, the *Noticee* had invested in ZCNCDs of the *Issuers* maturing on or before the maturity dates of respective schemes. Secondly, SEBI Circular dated June 20, 2002 (partially modified by SEBI Circular dated September 24, 2019) envisages a situation when the investments of the mutual funds may become default/illiquid and such funds may take time to realise the said amount. In such a circumstance, SEBI has provided that if the said amounts are substantial and are realised subsequently within a period of two years from the date of maturity of scheme, they may be distributed to the investors upon realisation.

93. The first argument advanced by the *Noticee* has already been dealt with by me while discussing the previous issue wherein it has been held that the provisions of SEBI Circular dated December 11, 2008 are applicable during the whole term of a close ended scheme (and not only in the initial investment) and the decision to extend maturity of ZCNCDs of the *Issuers* was an active investment decision *suo motu* taken by the *Noticee* which was evidently taken in violation of the provisions of such circular.

94. Secondly, I note that SEBI Circular dated June 20, 2002 indeed deals with treatment and disposal of illiquid securities/NPAs at the time of maturity/ closure of the mutual fund scheme. The said provision clearly applies in case some of the securities either become NPA or due to their illiquidity, the AMC is

unable to dispose them off in the market. As mentioned earlier in this order, the *Noticee*, at no point of time, declared and valued those ZCNCDs of the *Issuers* as NPA. Further, the scenario of delay/failure in disposal of those securities (in the secondary market) due to their illiquidity doesn't apply in the present matter as the *Noticee* had subscribed to them and held them till maturity presuming that those ZCNCDs would be redeemed by the *Issuers* at the end of their respective maturities on April 08 & 10, 2019. Further, it is not the case of the *Noticee* that it had attempted to dispose off those ZCNCDs in the market but failed to do so. Therefore, in the facts & circumstances of the present matter, the provisions of SEBI Circular dated June 20, 2002 are not applicable.

95. The *Noticee* has further argued that the provision of Regulation 53(b) of MF Regulations, 1996 doesn't apply in the present matter as the provision of redemption and repurchase is applicable only in case of open-ended schemes. There is no requirement of redemption or repurchase in a close ended scheme like those in open-ended schemes wherein an investor is required to make request for redemption within the cut-off time. I am unable to accept this contention, as the provision of Regulation 53(b) is not qualified or has been made conditionally applicable to only one category or segment of Mutual Fund schemes to the exclusion of other types of schemes. In any scheme, be it close ended or open ended, the funds can be received back only by redemption or repurchase, be it upon request of unit holders or automatically upon maturity of the scheme. In fact, this contention of the *Noticee* falls flat on its face when one observes the key information memorandums of the six FMP schemes wherein the *Noticee* has clearly mentioned under the heading '*Despatch of Repurchase (Redemption) Request*' that '*The redemption proceeds shall be dispatched within 10 working days from the date of maturity of the Scheme.*' Such a proclamation made in the scheme documents of the above mentioned FMP schemes clearly shows the admission on the part of the *Noticee* of applicability of Regulation 53(b) of MF Regulations, 1996 on these six FMP schemes. Therefore, in terms of the principle of *estoppel*, the *Noticee* at this stage cannot deny applicability of the above mentioned provision of law to the said six FMP schemes.

96. Under the circumstances, the extant regulations require an AMC to wind up the close-ended scheme at the end of its maturity period, dispose off its assets as per the best interest of the unitholders, discharge the liabilities of the respective schemes, and then distribute the funds amongst the unitholders by redeeming their units within 10 days of such winding up. However, in the present matter, by extending the maturity of the ZCNCDs of the *Issuers* based on its own volition and discretion, the *Noticee* has failed to complete the said process laid down by law whereby the unitholders were not provided with the monies payable to them within 10 days of maturity of FMP series 127, 183, 187, 189, 193 and 194.

97. Therefore, in terms of the above discussions, the *Noticee* is found to have violated the provisions of Regulations 39(1) and 53(b) read with clause 9 of Code of Conduct for AMCs prescribed at Fifth Schedule further read with Regulations 10(a) and 25(16) of MF Regulations, 1996.

F. Creation of segregated portfolio

98. As observed from the aforesaid discussion, the *Noticee* has not paid the full NAV to the investors at the time of maturity of the FMP schemes in the months of April & May 2019 and the pay-out in respect of the portion of exposure in Essel Group entities (ZCNCDs of *Konti* and *Edison*) in the FMPs was made only during September, 2019 i.e. more than five months after the maturity dates of the respective FMP schemes. It is alleged that such act(s) of *Noticee* (of making final pay-outs to the investors much after the maturity dates of the schemes) amounts to creation of a segregated portfolio out of the original scheme portfolio without having any enabling provisions in the SID to do so and without trigger of the credit events as outlined in the SEBI Circular dated December 28, 2018 dealing with segregated portfolio, thereby violating the provisions of Regulations 10(a), 25 (16), clause 9 of the Fifth Schedule of the MF Regulations, 1996 read with SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

99. The *Noticee* has submitted in this regard that the SEBI Circular dated December 28, 2018 prescribes certain conditions upon fulfilment of which only a

segregated portfolio may be created by an AMC. However, certain prescribed conditions stipulated in the said circular as mentioned in the submission of the *Noticee* dated December 17, 2020 were not fulfilled. Therefore, the *Noticee* wasn't even allowed to create segregated portfolio. On the other hand, the *Noticee*, by virtue of SEBI circular dated June 20, 2002, was entitled to make delayed payment only in case of illiquid securities/NPA. Therefore, the actions of the *Noticee* did not amount to creation of segregated portfolio and amounted to mere delayed payment.

100. I have already held earlier in this order that contrary to the claim of *Noticee*, SEBI Circular dated June 20, 2002 cannot be made applicable or invoked in the present case as the *Noticee* didn't declare or valued the ZCNCDs of *Issuers* as NPA at any point of time which is an essential pre-condition for invoking the circular dated June 20, 2002; hence, the question of making delayed payment did not arise.

101. At this point, I find it relevant to discuss in brief, the concept of segregated portfolio as has been permitted by SEBI in the MF industry with effect from December, 2018. A segregated portfolio is created in response to a credit event to protect the interest of unitholders at the time of occurrence of such credit event. Segregated portfolio means a portfolio, comprising of issuers' money-market instruments affected by a credit event, that has been segregated in a mutual fund scheme from the rest of the portfolio of the said scheme, which is called 'main portfolio'. The role of segregated portfolio becomes more important in open ended scheme but there is no restriction on its implementation in a closed ended scheme also. In a Mutual Fund scheme, the happening of a credit event such as an issuer committing default in making payment on its debt instrument to the MF scheme, directly leads to a negative impact on the NAV of the said scheme. In the event of that, the risk averse investors can panic and attempt to leave the scheme, thus converting their notional loss into actual loss. Later on, in the aftermath of a resolution of such credit event leading to sudden rise in the NAV, the investors who have not redeemed their units or those who entered in such scheme subsequent to such credit event, get unduly benefitted from such resolution. To avoid such

circumstances, SEBI, vide Circular dated December 28, 2018, enabled a provision for creation of segregated portfolio in a mutual fund scheme for the first time. Broadly speaking, the segregated portfolio is created by the fund manager as soon as a credit event has happened and those assets/securities, which are affected by such credit event, are put in the segregated portfolio subsequent to which, the unitholders are not allowed to redeem their units from such segregated portfolio created out of the main portfolio of the Mutual Fund scheme and funds collected subsequently if any, from the disposal of assets of segregated portfolio will be transferred to the accounts of such initial unitholders in accordance with their units in the said segregated portfolio. By doing so, the benefit of resolution of such credit event goes into the account of original investors who were holding units of such mutual fund scheme at the time of happening of such a credit event.

102. SEBI Circular dated December 28, 2018 lays down a list of criteria/events based upon which creation of segregated portfolio is permitted and the procedure to be followed by the fund managers in this respect. Suffice to state here that for creation of a segregated portfolio, to begin with, the SID of a mutual fund scheme *inter-alia* should have a provision for segregation of portfolios and there must be a credit event upon which the AMC should acknowledge as a credit event warranting creation of a segregated portfolio and thereafter should obtain trustees' approval prior to creating such a portfolio.

103. The case of the *Noticee* is that, it did not indulge in segregation of portfolio. However, from the chain of events of the case as discussed earlier in this order, I note that while some of the securities, except for the ZCNCDs of the *Issuers*, were duly redeemed and payments were received thereon upon the maturity of the six FMP schemes, the pay-out of the units of the unit-holders corresponding to the ZCNCDs of the two *Issuers* of Essel group which could not be redeemed by the said two *Issuers*, was blocked and the said units were allowed to be redeemed only when payment was received from *Issuers* in the month of September 2019. This shows that for all practical purposes, the *Noticee* decided to divide the portfolios of the six FMP schemes into two parts, viz: one part

containing those securities which were duly redeemed by their issuers before the maturity of the said six FMP schemes and the other part carrying those ZCNCDs of *Konti* and *Edison* in respect of which, the *Noticee* decided to extend the maturity period beyond the expiry dates of the FMP schemes. In effect, the *Noticee* has created a segregated portfolio exclusively for those ZCNCDs issued by the two *Issuers* of Essel group without acknowledging a credit event and without following any of the procedure laid down in SEBI Circular dated December 28, 2018 referred to above. Therefore, I find that the said acts of the *Noticee* have violated the provisions of SEBI Circular No. SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018 read with the provisions of Regulations 10(a), 25 (16), clause 9 of the Fifth Schedule of the MF Regulations, 1996.

104. However, in all fairness, I am of the view that the creation of segregated portfolio in the said six FMP schemes had no impact on the investors of the said schemes, since being close ended schemes, there was no standalone impact of segregation of such portfolio on the investors. Therefore, I am inclined to treat the aforesaid violation as a technical violation, which may not be required to be proceeded further.

G. Wrong method of valuation of securities

105. The last allegation against the *Noticee* in the SCNs is that, despite extending the maturity date of the ZCNCDs of the *Issuers* from April 08 & 10, 2019 to September 30, 2019, the *Noticee* continued valuing the portfolios of FMP series 127, 183, 187, 189, 193 and 194 on amortisation basis rather than on fair value basis. By doing so, the *Noticee* has allegedly violated the provisions of Regulations 10(a), 25 (16), 25 (19), 47, clause 9 of the Fifth Schedule read with Principles of Fair Valuation as laid down in the Eighth Schedule of the MF Regulations, 1996 and in the SEBI circulars SEBI/IMD/CIR No. 16/193388/2010 dated February 2, 2010 read with SEBI Cir/IMD/DF/6/2012 dated February 28, 2012.

106. Regulations 25(19) and 47 of MF Regulations, 1996 require an AMC to compute

and carry out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in the Eighth Schedule of the said Regulations and also require to publish those valuation in the form of NAV for information of the investors. A perusal of the Eighth Schedule of MF Regulations, 1996 shows that the said schedule lays down certain principles to be followed by an AMC in order to ensure fair treatment to all investors including existing investors as well as to the investors seeking to purchase or redeem units of mutual funds in all schemes at all points of time. In fulfilment of the said objective, the first principle mentioned at clause (a) of Eighth Schedule states that the valuation of investments is required to be based on the principles of fair valuation i.e. valuation should reflect the realizable value of the securities/assets. This means that whatever method of valuation an AMC adopts, the same should reflect market potential of the securities that the mutual fund trust holds as investments under various schemes.

107. In furtherance of this principle, vide circular dated February 02, 2010, SEBI has prescribed certain valuation methods to be followed by the mutual funds. The mutual funds were granted liberty to value debt securities and money market instruments having maturity period more than 91 days either to be valued at the weighted average price at which they are traded on the particular valuation day or, if they were not traded on that particular valuation day, these securities are required to be valued on amortization basis. The purpose of such valuation was to ensure that the value of money market and debt securities held as investments in the portfolio of mutual fund schemes reflect the current market scenario. Vide circular dated February 28, 2012, the threshold maturity period of the securities for being valued at fair market valuation basis was reduced to 60 days i.e. securities having maturity date beyond 60 days are to be valued at fair market valuation basis and those having maturity date less than 60 days, had to be valued at amortization basis.

108. It is alleged in the SCNs that the decision by the *Noticee* regarding extending the maturity period of ZCNCDs of the *Issuers* was taken during the period between January 25, 2019 and February 07, 2019. Due to the said decision, the residual

maturity period of such securities *suo motu* got exceeded beyond 60 days thereby requiring those ZCNCDs of the *Issuers* to be valued on the principles of fair valuation in terms of the afore-mentioned circulars issued by SEBI. However, the *Noticee* has allegedly continued showing valuation of such securities on amortization basis due to which the said valuation was not reflecting real market value of those securities. The said act of the *Noticee* was allegedly in violation of principles enshrined in Eighth Schedule of MF Regulations, 1996 as well as the abovementioned circulars.

109. In this regard, the *Noticee* has contended that the valuation of the securities in question, i.e. ZCNCDs of the *Issuers* was done on fair valuation basis till February 06, 2019 and thereafter the same was done on amortization basis from February 07, 2019 till their respective maturity periods viz. April 08, 2019. In support of its contention, the *Noticee* has argued that there was uncertainty around those securities till an agreement was reached with the *Issuers*, Cyquator and Dr. Subhash Chandra. Subsequent to finalization of the term sheet and signing of agreements with the aforementioned parties (Cyquator and Dr. Subhash Chandra etc.), the said agreements were referred to third parties (valuing agencies) which provided valuation for those securities to the *Noticee*. However, after that, the valuing agencies once again started valuing securities of the *Issuers* on the basis of similarly placed securities in the market i.e. on a fair valuation basis.

110. The narratives and explanation offered aforesaid by the *Noticee* are far from being convincing. There cannot be two opinions that the market events that took place pertaining to the share price of ZEEL during January 25-28, 2019 were a matter of public knowledge wherein, due to a crash in the price of the scrip of ZEEL, the margin call was triggered from several lenders and investors to the ZEEL, and the promoters of ZEEL also showed their inability to the *Noticee* to pledge additional shares to restore the mandated collateral cover limit of 1.50 times the outstanding investment made by the *Noticee* in the ZCNCDs of the *issuers* on behalf of the said six FMP schemes. Surely this event would have affected the price-yield of ZCNCDs of the *Issuers* and the fact that the Essel Group was

unable to pledge additional security would have led to the belief in the market that there were higher chances of the Essel Group defaulting in the payment of these ZCNCDs. It is no one's guess that due to these developments, the value of these ZCNCDs of *Konti* and *Edison* would have gone down and corresponding yield of these ZCNCDs would have jumped on the higher side. Moreover, the subsequent development i.e. failure of the Committee of Lenders (COL) to obtain a concrete result out of the letter of intent signed by them on February 07, 2019 would have further aggravated the condition and the value of these ZCNCDs of the *Issuers* would have further fallen down on the face of the Essel Group's inability to replenish the collateral cover of those ZCNCDs issued by the *Issuer companies* purely on the strength of collateral of ZEEL shares. However, contrary to the aforesaid adverse market position and erosion of collateral cover of the ZCNCDs of *Konti* and *Edison* below 1.50 times the outstanding investment made by the *Noticee*, the valuation sheet supplied by the *Noticee* along with its replies depicts no adverse impact whatsoever, of the event dated January 25, 2019 and of the developments thereafter, on the valuation of those ZCNCDs in the books of the six schemes managed by the *Noticee*. This clearly shows that, irrespective of the method adopted by the *Noticee*, the valuation of ZCNCDs of the *Issuers* was certainly far away from adverse market reality prevailing at that point in time pertaining to those ZCNCDs throwing those six FMP schemes to huge amount of credit risks.

111. The *Noticee* has attempted to defend itself on three counts viz. firstly, it was taking valuation from a third party independent agency; secondly, there was uncertainty in respect of the ZCNCDs of the *Issuers* due to which, it continued valuing those securities as per the established valuation policy; and thirdly, the FMPs being close ended schemes, the valuation method has little to no impact on the investors as they can redeem their units only at the end of the respective maturity periods.

112. It has to be noted that the responsibility to undertake fair valuation of the assets/securities in such a manner that it reflects the market realizable values of those assets/securities is laid upon the AMC under Regulation 25(19) of MF

Regulations, 1996. Further, vide Regulation 47 of MF Regulations, 1996, the responsibility has been laid upon a Mutual Fund to ensure that the valuation of securities is done by the AMC as per the principles laid down in Eighth Schedule of MF Regulations, 1996. Therefore, while the work of valuation was delegated by the *Noticee* to an external third-party agency, the legal and statutory responsibility to conduct valuation as per the principles laid down in Eighth Schedule of MF Regulations, 1996 cannot be delegated to any third party. Therefore, in the event of failure of the third-party to do proper valuation to reflect the value of the securities closer to market realizable value thereof, the liability for such erroneous valuation will fall upon the *Noticee*. In the light of this, the delegation of valuation to a third-party agency cannot be taken as defence by the *Noticee* to justify the wrong valuation of the ZCNCDs of the *Issuers* as alleged in the SCN.

113. Secondly, it is a well-known fact that the securities market is a forward looking place where a security is not only valued on its present market linked rates but also is valued on its future market potential. Any uncertainty in predicting its future value leads to a further downgrade in the current valuation of such security. The *Noticee* itself has submitted that there was an uncertainty going on in the market regarding the ZCNCDs of the *Issuers*, which in my view would have certainly led to fall in price and rise of yield on these ZCNCDs. Further, the events that took place involving the shares of ZEEL and the Essel Group from January 25, 2019 onwards clearly suggest that there were strong possibilities of default on the part of the two *Issuer companies* to honour the redemption of the ZCNCDs on their maturities, an event which was prevented by the *Noticee* by extending maturity dates of these ZCNCDs. Therefore, irrespective of whatever method of valuation was adopted by the *Noticee*, the value of those ZCNCDs of the *Issuers* would have certainly witnessed a drastic fall which was necessarily required to be reflected in valuation of those ZCNCDs by the *Noticee*. However, a perusal of the valuation sheet submitted by the *Noticee* doesn't reveal any fall in the value of these securities and rather the values of those securities was shown to be rising incrementally either prior to or after the events of January 25-28, 2019 in a straight line as may be observed below:

Name of the Security	Valuation Date	Valuation price
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	15-Jan-19	134.6746
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	16-Jan-19	134.1557
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/20.19 (UL)	17-Jan-19	134.2827
0.00% EDISONS UTIl ITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	18-Jan-19	134.3304
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2.019 (UL)	19-Jan-19	134.3738
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	20-Jan-19	134.4172
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	21-Jan-19	134.4606
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	22-Jan-19	134.5068
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	23-Jan-19	134.5476
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	24-Jan-19	134.5951
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	25-Jan-19	134.4431
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	26-Jan-19	134.4892
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	27-Jan-19	134.5354
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	28-Jan-19	134.5616
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2013 (UL)	29-Jan-19	134.6241
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	30-Jan-19	134.6619
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/7.019 (UL)	31-Jan-19	134.7167
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 1.1.10) 08/04/2019 (UL)	01-Feb-19	134.2907
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	02-Feb-19	134.344
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	03-Feb-19	134.3973
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	04-Feb-19	134.4508
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	05-Feb-19	134.4922
0.00% EDISONS UT ILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	06-Feb-19	134.5459
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	07-Feb-19	134.600915
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	08-Feb-19	134.65593
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	09-Feb-19	134.710945
0.00% EDISON5 UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	10-Feb-19	134.76596
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	11-Feb-19	134.820975
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (IJL)	12-Feb-19	134.87599
0.00% EDISONS LJT111 rY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	13-Feb-19	134.931005
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	14-Feb-19	134.98602
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	15-Feb-19	135.041035
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	16-Feb-19	135.09605
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	17-Feb-19	135.151065
0.00% EDISONS UTILITY WORKS P LTD. (XIRR 11.10) 08/04/2019 (UL)	18-Feb-19	135.20608

Thus, from the above noted valuations made by the *Noticee*, it can be noticed that the subsequent events of failure of committee of lenders (COL), which the *Noticee* was a part of, constituted in terms of the letter of intent dated February 07, 2019, were not reflected or factored into the said valuation sheet furnished by the *Noticee*. It clearly establishes that the valuation done by the *Noticee* in respect of the ZCNCDs of the *Issuers* was far away from the market realizable value of these securities and the *Noticee* was disclosing artificially inflated

valuation of these securities so as to maintain an overstated NAV on a continuous basis and to avoid raising any kind of alarm amongst unitholders as well as to safeguard the *Fund* and its trustees from the questioning & complaints of the unit holders.

114. Finally, the *Noticee* has attempted to justify its actions by stating that the alleged wrong valuation would have no impact on the six FMP schemes as all of them were close-ended schemes; hence, there was no option available to the unitholders to redeem their units before the maturity of those schemes. However, it is to be noted that in terms of Regulation 32 of MF Regulations, 1996, every close ended scheme is required to be listed on a recognized stock exchange. Further, an examination of Key Information Memorandum of the six FMP schemes shows that the units of all these schemes were listed on Bombay Stock Exchange (**BSE**) where units of these schemes could be bought by any investors from any unit holders and also sold by any unitholders to any buyers at a price agreed by both the counterparties. However, due to the incorrect valuation as pointed out above, the NAV of these schemes was not showing the actual valuation of these schemes, thereby adversely affecting the interest of both the sellers and the buyers of the units of such schemes. In view of this, the submission of the *Noticee* that incorrect valuation would have made no impact on unitholders is grossly mistaken and cannot be accepted.

115. In view of the aforesaid discussions, I hold that the *Noticee* has blatantly failed to value the ZCNCDs of the *Issuers* closer to market realizable value of those securities against the regulatory mandate to do so. By its failure to do so, the *Noticee* has violated the provisions of Regulations 10(a), 25 (16), 25 (19), 47, clause 9 of the Fifth Schedule read with Principles of Fair Valuation as prescribed under the Eighth Schedule of the MF Regulations, 1996 and SEBI circulars SEBI/IMD/CIR No. 16/193388/2010 dated February 2, 2010 read with SEBI Cir/IMD/DF/6/2012 dated February 28, 2012.

116. The discussions in the preceding paragraphs succinctly bring out that the *Noticee* has not conducted itself in a responsible and diligent manner when it comes to

playing its fiduciary role of managing the money of its unit holders who had invested in its six close ended FMP schemes. The decision to invest in the ZCNCDs of *Konti* and *Edison* aggregating to a sum of INR 300 Crores was fraught with a careless and non-diligent attitude on the part of the *Noticee*. The *Noticee*, instead of carrying out a due diligence process in an objective and professional manner by examining the financials, the repayment capacity and other antecedents of the *Issuers* in granular details, has instead heavily relied upon the secondary factors such as the reputation and past history of Essel Group and entirely depended on the collateral cover which also eventually proved to be grossly inadequate to recover its outstanding investment. Such a poor professional judgment on the part of the *Noticee* lacked in even the elementary risk assessment prior to investing in the ZCNCDs of the two *Issuers* which barely had any tangible source of cash flows to meet their debt obligations at the time of maturity of the said ZCNCDs issued by them. While the reputation of the promoters of Essel Group was relevant in the process of due diligence so as to get a limited assurance against any possibility of fraud or misappropriation of the money raised by the *Issuers*, the repayment of the ZCNCDs could have been done only by having cash in hand with the *Issuers*, a critical component of their respective balance sheets which was conspicuously missing in the financial statements of *Konti* and *Edison*. The *Noticee* tried to insulate itself from the credit risk by accepting collateral in the form of pledged shares of ZEEL; however, when required, such collateral fell short of the stipulated collateral cover of 1.50 times its total outstanding investment. Admittedly, it also proved to be infeasible on the part of *Noticee* to dispose of those shares in the market in the fear of accentuating further fall in the price of the shares of ZEEL due to which the *Noticee* went on to extend the maturity of those ZCNCDs of the *Issuers* beyond the maturity dates of the FMP schemes, thereby postponing the redemption of the units corresponding to those ZCNCDs of the *Issuers* against the regulatory provisions governing the management of close-ended funds. Given the fact that the *Noticee* decided to accept equity shares as collateral cover against its investment in the debt securities of the *Issuers* which was vulnerable to extreme market volatilities, the *Noticee* was required to be more careful in deciding on the

nature and quantum of the collateral cover. Due to this basic flaw and negligence in due diligence exercise, the *Noticee* was left with inadequate cover when the promoters of Essel Group could neither honour the redemption of the ZCNCDs on their maturity nor could replenish the insufficiency of collateral cover and the *Noticee* had to search for outlandish ideas such as unilateral grant of extension of the maturities of the debt instruments issued by the *Issuers* without informing the unitholders prior to making such a decision (for which the unitholders of the said six FMP schemes had never subscribed to) at the cost of committing multiple flagrant violations of law, as discussed elaborately in the present order.

117. In the melee of the afore-discussed disorderly and irregular acts being indulged into by the *Noticee* in deviation from various regulatory provisions and the Code of Conduct prescribed thereunder, the *Noticee* has also resorted to another act of misconduct by promptly not disclosing information regarding the failure of the promoters to pledge additional shares when the collateral cover fell below the mandated 1.50 times the outstanding investment. Due to such delay on the part of the *Noticee*, the unitholders of FMP series 127, 183, 187, 189, 193 and 194 were left in the dark regarding adverse impact, if any, of such possible default on the part of the promoters of Essel Group on their invested schemes.

118. I am also not impressed by the submission of the *Noticee* that the decision for extension of maturity period of ZCNCDs of the *Issuers* had ultimately benefitted the unitholders of the six FMP schemes since the *Issuers* weren't able to ultimately repay whole amount to the *Noticee* despite the extension of maturity of those ZCNCDs by almost 6 months voluntarily allowed by the *Noticee* due to which, the *Noticee* went on to recover part of the funds by invocation of pledge of the shares of ZEEL and their subsequent sale in the market. Similarly, it cannot be lost sight of the fact that the *Issuers* could make a part payment of the redemption value of the ZCNCDs to the *Noticee* only because the promoters of Essel Group decided to make distress sale of their stake in ZEEL and also could find an investor for such a large chunk of shares in time. Had the promoters not been able to dispose of their shares of ZEEL, even the part repayment of those

ZCNCDs would not have been possible, thereby throwing the fate of those ZCNCDs to more uncertainties. The investors of the six FMP schemes ultimately might not have suffered any financial loss as claimed by the *Noticee*, however it cannot be denied that due to lack of due diligence, proper care and foresight as well as poor professional judgment on the part of the *Noticee*, the investors suffered mental agony as no communication was forthcoming from the side of the *Noticee* for around 2.5 months subsequent to the credit event pursuant to sudden fall in the share price of ZEEL, and when the *Noticee* unilaterally took the decision to allow extension of maturity of the ZCNCDs to the *Issuers* in which, the unitholders had no say. Moreover, no one including the *Noticee* could have been sure about receiving the repayment from their investments in the ZCNCDs from the *Issuers* or promoters of Essel Group at that point in time when the *Noticee suo motu* decided to extend the maturity of those ZCNCDs beyond the maturity dates of the FMP schemes, in gross disregard of an array of provisions of MF Regulations and Code of Conduct prescribed for the *Noticee* under the said regulations.

119. It is an accepted fact that mutual fund investments are subject to market risk. However, at the same time, such market risk is also presumed to be contained to a great extent by the due diligence, care and professional judgment of the AMCs which invest the funds of such mutual fund schemes in the securities market. The investors pay fees to the AMCs in terms of Total Expense Ratio with an expectation that the AMC, being a professional entity having expertise in investment in securities market, will render high standards of services that would benefit the investors in the long term. In view of the aforesaid, it becomes difficult to hold that the service provided by the *Noticee* while taking a decision to invest in the debt securities of *Konti* and *Edison* and later on by way of making delayed disclosure of a credit event to the investors, was a service of high standards. Instead, I am of the view that such acts and conduct displayed by the *Noticee* amount to extremely poor judgment and unprofessional conduct on the part of the *Noticee* and it has evidently faltered in providing even a minimum standard of service to its unitholders in the FMP series 127, 183, 187, 189, 193 and 194.

120. It is a well-known fact that mutual funds are portrayed as convenient investment vehicles specifically designed for retail investors who don't have the expertise to independently invest in the securities markets directly. For the said purpose, SEBI has attempted to regulate the mutual fund industry more closely than other investment mediums such as PMS and AIFs where the minimum threshold amount of investment has consciously been kept high leaving these products for investment by high net-worth entities. At the same time, certain areas have been left to the professional judgment of AMCs and fund managers for them to distinguish their products from others. However, it is expected that they will use their professional judgment while taking a call to invest in a particular security in the best interest of their investors. In fact, as a regulator, SEBI has been encouraging and promoting awareness amongst the retail investors for investment in securities markets through the mutual funds so that their funds are invested and managed in the hands of professionals who can render high standard of services to such teeming retail investors. In such a scenario, the events that have unfolded in this case as have been discussed aforesaid at length, have completely undermined the efforts of SEBI wherein, due to gross high handedness and poor due diligence on the part of the AMC, the interest of the investors has been affected negatively, be it financially or in any other way. As a regulator entrusted with the statutory mandate of investor protection, it is the duty of SEBI to at least curb and minimize such kind of events and conduct, as and when they come to notice, if it is not possible to completely eliminate such events and acts of negligence on the part of the Fund Managers like the *Noticee* in this case.

121. From the lapses in due diligence and the laid back approach adopted in risk assessment as displayed by the *Noticee* while taking investment decision *vis-à-vis* the ZCNCDs of the *Issuers* at the risk of violating relevant provisions of MF Regulations, it appears that the *Noticee* was rather willing to take an ambitious risk to generate high returns in its FMP schemes without any regard for the various underlying risks that were inherent in the said investment. The due diligence documents presented before me do not indicate that the *Noticee* has ever attempted to analyse various risk parameters, viz: credit risk, liquidity risk

and interest rate risk etc. while evaluating the proposal to invest in the ZCNCDs of certain insignificant and financially handicapped entities of Essel Group such as *Konti* and *Edison*. The *Noticee* ought to have realised that the 'high reward' is generally concomitant to 'high risk' which the retail investor is not capable to take in many situations especially in the case of a close ended debt scheme like the FMP schemes which are expected to be conservative in taking risks when it comes to investing the money of the unit holders in various debt instruments in the securities market. Therefore, the *Noticee* ought to have analysed and calculated the risks involved in the proposed investment in the said ZCNCDs of *Konti* and *Edison* first, by objectively evaluating the financials of these *Issuer companies* before looking forward to the reputation of the Essel Group and accordingly should have secured those risks so identified, first by being satisfied about the future cash flows of the *Issuer companies* and then by demanding adequate collateral cover from the *Issuers*, before deciding to invest in the said ZCNCDs of the *Issuers*. It should be noted that failure on the part of one mutual fund or one AMC or one Fund Manager to adhere to basic canons of due diligence thereby putting the interest of the unit holders at risk, as was done by the *Noticee*, can adversely affect the whole industry and its investors. One major instance of laxity in due diligence depicting a callous approach of one fund manager or AMC in handling investors' money can create a situation of panic and insecurity amongst the investors making them wary of investing in the securities market. The slipshod manner in which the *Noticee* was seen to have handled the hard-earned money of the unit holders by investing in the ZCNCDs of two almost incognito entities of Essel Group sans any worthwhile due diligence or risk assessment, can deter years of efforts being made by SEBI to promote participation by more and more investors in the securities market and can discourage the potential investors from investing even in the debt market which is otherwise perceived to be less risky and a safe market.

122. For a mutual fund house which has been in this industry in India for over two decades, the least that can be expected of the AMC of this Fund house is to have in place a robust system for research, risk assessment and due diligence; however, the insensitive manner in which the *Noticee* AMC is seen to have

actuated its system of risk evaluation and due diligence in dealing with the investment in the said ZCNCDs of the *Issuers*, it seems the effectiveness of its systems stood compromised in the process of the *Noticee*'s pursuit of reaping high yield out of those risky ZCNCDs which was clearly avoidable. The *Noticee* has brought out the reasons of 'business judgment' to defend its questionable decisions; however, it cannot be overlooked that those investment decisions which involve deployment of public funds require more and deeper scrutiny and cannot be left merely to the 'business judgment' of the AMC as was apparently done in the present case, whereby public money was exposed to unnecessary high risk. While it is easy to wash off the blame for such credit mishaps as happened in this case triggered by sudden price fall of ZEEL shares as an one off incident, the *Noticee* has to introspect and put in place robust risk control and due diligence mechanisms to increase confidence of retail investors in its products. At the same time, in all fairness, the investors deserve to be compensated for the fault & foul play of the *Noticee* which forced them to remain under a stressed situation with no mental peace in sight for a long period first, caused by poor due diligence and decision to invest in unviable as well as risky instruments and then on account of delay on the part of the *Noticee* to disclose the impact of various crucial material events that took place during January 25-April 05, 2019; while the investors were living in times of acute uncertainties about the fate of their investment in the six FMP schemes namely series no. 127, 183, 187, 189, 193 and 194.

123. The SCNs have also called upon the *Noticee* to show cause *inter alia* as to why penalty under Sections 15D(b)& 15HB of the SEBI Act read with SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 should not be imposed upon it. I note that the powers vested upon me under Section 11B(2) is without prejudice to the power to issue directions under Sections 11(1), 11(4) and 11B(1) of the SEBI Act. In this regard, I note that Sections 15D(b) and 15HB of the SEBI Act provide as under:

Penalty for certain defaults in case of mutual funds.

15D. *If any person, who is—*

(b) 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;

Penalty for contravention where no separate penalty has been provided.

15HB. *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.*

124. Keeping in view the foregoing factual exposition about various acts of indiscipline, utter neglect of due diligence, inordinate delay in communicating with the investors, violation of the statutory sanctity of the maturity dates of the FMP schemes, permitting extension of the maturity of the ZCNCDs of the *Issuers* in contravention of extant regulations etc., there remains no doubt in mind that the *Noticee* has acted in gross violation of provisions of the SEBI Act, 1992, MF Regulations, 1996 as well as various circulars issued by SEBI from time to time hence, the *Noticee* is *inter-alia* liable to be held guilty of failure to exercise due diligence, care and render high quality of service as well as for failure to disclose information having negative impact on the six FMP schemes to its investors on time.

125. Thus, keeping in view the deliberations as well as my observations as recorded in the foregoing paragraphs of this order with regard to the blatant and deliberate violation of various provisions of law, I hold that the SCNs have rightfully levelled various allegations against *Noticee* for committing those transgressions with open eyes unmindful of the regulatory & legal implications of such contraventions, thereby prejudicing the interest of the innocent investors and

unit holders of those six FMP schemes. Hence in all fitness of things, taking into account the abysmal standard of service rendered by the *Noticee* while handling the monies of the investors of those FMP schemes, it is a deserving case for holding the *Noticee* liable for issuance of appropriate directions for disgorgement of a part of the management fee that it had unjustifiably charged from the unitholders of the six FMP schemes. As a logical consequence to the aforesaid findings, I also hold that the *Noticee* is liable for imposition of appropriate penalty under Section 11B(2) read with Section 15D(b) and 15HB of SEBI Act, 1992.

126. It is necessary for me to take note of the mitigating factors in the light of Section 15J of SEBI Act, 1992 read with Rule 5 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995. In this regard, I note from the submissions of the *Noticee* that the investors have been fully repaid the amounts due to them, albeit with a delay but interest to the extent of delay has also been paid to the investors. Therefore, in monetary terms, the unitholders of six FMP schemes ultimately did not suffer any loss. While the same is a mitigating factor to be considered at the time of imposing penalties, I also cannot rule out the possibility of the opportunity cost attached with such delay in redemption, which cannot be calculated in the present matter.

Directions

127. Having carefully considered the materials available on record and the submissions advanced by the *Noticee*, I hold that the charges relating to violation of the provisions of the SEBI Act, 1992, MF Regulations, 1996 and various circulars issued by SEBI from time to time are found to have been established, and further, considering the factors enumerated under Section 15J of SEBI Act, 1992, I hold that it would be sufficient and proper that the instant proceedings be disposed of with issuance of certain directions to the *Noticee*. Accordingly, I, in exercise of the powers conferred upon me under Section 19 read with Sections 11(1), 11(4), 11B(1), 11B(2) and 11(4A) further read with Section 15G, 15HB and 15 J of the SEBI Act, , hereby issue following directions and impose following penalty:

127.1. The *Noticee* shall refund a part of the investment management and advisory fees collected from the unitholders of the six FMP schemes, equivalent to the percentage of exposure to the ZCNCDs of the *Issuers* in the respective schemes as on the date of maturity of the six FMP schemes, along with a simple interest at the rate of 15% per annum from the date of maturity of such schemes till the date of actual payment to the respective unitholders of the said schemes. The *Noticee* is also directed to submit a compliance report to The Division Chief, Investment Management Department-1, Division of Funds-2, Securities and Exchange Board of India, mentioning therein the details of such payments made to the unitholders of the six FMP schemes. The *Noticee* is directed to complete the exercise of payment of funds to the respective unitholders and submission of compliance report to the abovementioned authority within a period of 45 days from the date of this order.

127.2. Further, I impose a Monetary penalties of INR 50,00,000 (Rupees Fifty Lakhs only/-) on the *Noticee* under the provisions of Sections 15D(b) and 15 HB for the violations of the provisions of SEBI Act, 1992, MF Regulations, 1996 as well as various circulars discussed in the present order.

127.3. The *Noticee* is also restrained from launching any new FMP scheme for a period of six months from the date of this order.

128. The *Noticee* is directed to pay the penalty within 45 (forty-five) days from the date of service of this order by way of crossed demand draft drawn 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 linkhttps://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.

129. In case the *Noticee* decides to pay the penalty by way of Demand Draft, it is directed to send the demand draft towards the payment of penalty to "The Division Chief, Investment Management Department-1, Division of Funds-2, Securities and Exchange Board of India, SEBI Bhavan II, Plot no. C -7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai- 400051".

130. This Order shall come into force with immediate effect.

Sd/-

Date: August 27, 2021 **S. K. MOHANTY**

Place: Mumbai **WHOLE TIME MEMBER**