BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Date : 28.06.2021

Appeal No. 443 of 2021

Franklin Templeton Asset Management
(India) Private Limited …Appellant

Versus

Securities and Exchange Board of India …Respondent

Mr. Janak Dwarkadas, Senior Advocate and Mr. Mustafa Doctor, Senior Advocate with Ms. Ankita Singhania and Ms. Shruti Rajan, Advocates i/b. Ms. Shruti Rajan, Advocate for the Appellant.

Mr. Arvind P. Datar, Senior Advocate with Mr. Pratap Venugopal, Mr. Suraj Chaudhary and Mr. Atishay Jain, Advocates for the Respondent.

ORDER:

1. The present appeal has been filed against the order dated June 7, 2021 passed by the Whole Time Member ('WTM' for short) of the Securities and Exchange Board of India ('SEBI' for short) holding that the appellant has violated certain provisions of the SEBI (Mutual Funds) Regulations, 1996 ('Mutual Funds Regulations' for short) and circulars issued by SEBI in relation to the management of six debt schemes. By the impugned order, the appellant has been directed to refund investment management and advisory fees along with interest at

the rate of 12% per annum amounting to Rs. 512,50,92,534 within a period of 21 days. Further, the appellant has been prohibited from launching new debt schemes for a period of two years and has further imposed a penalty of Rs. 5 crore.

2. The facts leading to the filing of the present is, that the appellant decided to wind up six debt schemes with effect from April 23, 2020. This caused furore in the stock market and various complaints were made by the investors and many articles were also published, as a result of which, a forensic audit was ordered by SEBI in terms of Regulation 66 of the Mutual Fund Regulations to verify as to whether the appellant had complied with the provisions of the securities laws including the SEBI Act, Mutual Funds Regulations etc.

3. Based on the forensic report a show cause notice dated November 24, 2020 was issued under Section 11 and 11B of the SEBI Act alleging that the appellant was running a debt scheme which is akin to a credit risk fund scheme, whereas, the debt schemes were projected as duration based schemes instead of credit risk fund schemes. It was also alleged that the appellant had not disclosed its strategy of investing in high yield securities with credit ratings of AA and A to investors of the

respective debt schemes. It was further alleged that the appellant incorrectly calculated the Macaulay duration taking interest rate reset date as deemed maturity date even though there was no explicit exit to both the parties i.e. the issuer and the investor on the interest rate reset date. It was also alleged that the terms of investment were ambiguous as the appellant did not value the securities as per the principles of fair valuation. Other allegations were made including that the appellant did not exercise due diligence.

4. The WTM after considering the replies and the contentions raised by the appellant passed the impugned order issuing the aforesaid directions.

5. We have heard Shri Janak Dwarkadas and Shri Mustafa Doctor, the learned senior counsel along with Ms. Ankita Singhania and Ms. Shruti Rajan, the learned counsel for the appellant and Shri Arvind Datar, the learned counsel along with Shri Pratap Venugopal, Shri Suraj Chaudhary and Shri Atishay Jain, the learned counsel for the respondent.

6. It was contended that the findings in the impugned order relate to aspects such as scheme categorization, calculation of duration and valuation of portfolio securities, diligence and

monitoring of investments and portfolio risk management. It was contended that the impugned order was arbitrary and unreasonable as it took into consideration ex post facto event of winding up of the schemes. It was contented that it was necessary to protect the value for unit holders at the time when the Covid-19 pandemic had crept in and which is still continuing. It was also contended that the impugned order failed to consider that the decision to wind up the scheme was not an indicator of their portfolio quality in as much as the net asset value of the scheme is higher as on date then on the date of the winding up of the scheme i.e. April 23, 2020. It was also contended that the winding up of the scheme was eventually approved in February 2021 by the Supreme Court of India pursuant to which a sum of approximately Rs. 17, 778/- crore have already been distributed to the unit holders and additional cash of approximately Rs. 1,165/- crore was currently available with the scheme for further distribution. It was, thus, contended that the impugned order restraining the appellant from launching any debt scheme for two years was not only arbitrary but was putting a stop on the business activity of the appellant. It was also contended that the direction to refund investment management and advisory fees was wholly unwarranted and, in

any case, arbitrary as it directed the appellant to deposit within 21 days whereas the statutory period for filing the appeal is 45 days. It was, thus, contended that the respondent were not even giving enough time to the appellant to file an appeal which shows the arbitrariness on the part of the respondent.

7. On the other hand, the learned senior counsel for the respondent contended that the investigations were initiated pursuant to multiple complaints and multiple writ petitions being filed in various High Courts. Further, the closure of the debt scheme was on account of the poor performance of the scheme. It was also stated that the Karnataka High Court has observed in its orders that the management of the schemes was an issue which has to be considered in-depth. It was, thus, contended that considering violations committed by the appellant the impugned order does not suffer from any error nor any interim order is required to be passed at this stage.

8. We find that the appellant has been in this business for more than two decades and some of the schemes have been in existence for more than ten years. No complaints whatsoever have come on record to indicate the poor management of the schemes by the appellant. Further, upon a query raised by the

Tribunal, we have been informed that the appellant's were running 48 equity and debt schemes out of which 28 were debt schemes and as on date six schemes have been wound up by the appellant and therefore 21 debt schemes are still running.

9. In addition to the aforesaid, in response to another query raised by the Tribunal, we were informed that the direction to refund the investment management and advisory fees was the gross figure and did not take into consideration the expenses incurred by the appellant in managing the schemes.

10. In the light of the aforesaid, the contention raised by the parties will be considered at the stage of final hearing. We, therefore, direct the respondent to file a reply within four weeks from today. Rejoinder may be filed within three weeks thereafter. The matter would be listed for admission and for final disposal on August 30, 2021.

11. In view of the aforesaid, we are of the opinion that since 21 debt schemes are still being managed by the appellant and no complaint of these schemes have come to the fore the mere fact that the appellant have chosen to wind up six schemes does not mean that they should be debarred from launching any new debt schemes. Consequently, the direction in the impugned order

restraining the appellant from launching any new debt schemes for a period of two years shall remain stayed during the pendency of the appeal.

12. Insofar as the refund of investment management and advisory fees is concerned we find that the WTM has taken the gross amount as unlawful gains. In our view, *prima facie*, this appears to be incorrect, in as much as, at best, only profits could be directed to be refunded after deducting the necessary expenses actually incurred by the appellant in managing the schemes. This factor has not been taken into consideration. Consequently, the direction to deposit Rs. 512,50,92,534 appears to be excessive at this stage. Considering the direction to refund Rs. 512,50,92,534 and pay a penalty of Rs. 5 crore, we direct that the appellant shall deposit a sum of Rs. 250 crore in an escrow account within three weeks from today which shall be subject to the result of the appeal. The details of the escrow account will be supplied to SEBI within the same period. If the said amount is deposited within the aforesaid period the balance amount shall not be recovered during the pendency of the appeal.

13. Parties are directed to take instructions from the Registrar 48 hours before the date fixed in order to find out as to whether the matter would be taken up for hearing through video conference or through physical hearing.

14. The present matter was heard through video conference due to Covid-19 pandemic. At this stage it is not possible to sign a copy of this order nor a certified copy of this order could be issued by the registry. In these circumstances, this order will be digitally signed by the Private Secretary on behalf of the bench and all concerned parties are directed to act on the digitally signed copy of this order. Parties will act on production of a digitally signed copy sent by fax and/or email.

Justice Tarun Agarwala
Presiding Officer

Justice M.T. Joshi
Judicial Member

28.06.2021
msb

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