BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/SM/AE/2022-23/17536-17542]

UNDER SECTION 15-I OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995

In respect of:

Noticee No.	Noticee Name	PAN
1	Kotak Mahindra Trustee Company Limited	AAACK3434H
2	Mr. Nilesh Shah	AAJPS6768A
3	Ms. Lakshmi Iyer	AAGPI4510F
4	Mr. Deepak Agarwal	ACUPA5795J
5	Ms. Jolly Bhatt	AKDPB0624J
6	Mr. Abhishek Bisen	AFXPB5221Q
7	Mr. Gaurang Shah	AAFPS3900A

*(hereinafter collectively referred to as "**Noticees**")*

In the matter of Fixed Maturity Plans Series 127, 183, 187, 189, 193 & 194 of Kotak Mahindra Mutual Fund

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BACKGROUND

1. Kotak Mahindra Mutual Fund (hereinafter be referred to as, the "**Kotak MF**") is a mutual fund having a certificate of registration granted by SEBI, which offered certain Fixed Maturity Plans (hereinafter be referred to as, the "**FMP**") viz. FMP Series 127, Series

183, Series 187, Series 189, Series 193 and Series 194 inter alia. Kotak Mahindra Asset Management Company Limited (hereinafter be referred to as, the "**Kotak AMC**") is the asset management company of Kotak MF. Kotak Mahindra Trustee Company Limited (**Noticee 1**) is the trustee company which holds the property of Kotak MF in trust for the benefit of unit holders. Mr. Nilesh Shah (**Noticee 2**) is the Managing Director of the Kotak AMC; Ms. Lakshmi Iyer (**Noticee 3**) is the Chief Invesment Officer (Debt) & Head Products of the Kotak AMC; Mr. Deepak Agarwal (**Noticee 4**) is the Vice-President & Fund Manager of the Kotak AMC; Ms. Jolly Bhatt (**Noticee 5**) is the Compliance Officer of the Kotak AMC; Mr. Abhishek Bisen (**Noticee 6**) was the fund manager of the schemes viz. FMP Series 127 and 183; and Mr. Gaurang Shah, Director of Kotak AMC (**Noticee 7**) was one of the members of the investment committee that approved the investment decisions of the FMP Series 127, 183, 187, 189, 193 and 194 along with Noticee 2 & 3.

2. Based on examination of the irregularities in the aforesaid schemes of Kotak MF viz. FMP Series 127, 183, 187, 189, 193 and 194, SEBI initiated adjudication proceedings under Section 15D and Section 15HB of the Securities and Exchange Board of India Act, 1992 (hereinafter be referred to as, the "**SEBI Act**") for the violations of various provisions of SEBI (Mutual Funds) Regulations, 1996 (hereinafter be referred to as, the "**MF Regulations**") and various Circulars issued thereunder, alleged to have been committed by the Noticees.

APPOINTMENT OF ADJUDICATING OFFICER

3. Ms. Maninder Cheema was appointed as the Adjudicating Officer (**AO**) by SEBI, vide communique order dated May 17, 2019 to inquire into and adjudge under Section 15D and 15HB of the SEBI Act, the alleged violations of the provisions of MF Regulations and various circulars by Noticees 1 to 7 along with one Mr. Mayank Prakash, Fund Manager in Kotak AMC in the matter of FMP Series 127 and 183. An Adjudication Order dated July 09, 2020 was passed in respect of Mr. Mayank Prakash. Shri B J Dilip was appointed as AO by SEBI vide communication order dated August 28, 2020, to

inquire into and adjudge under Section 15D and 15HB of the SEBI Act, the alleged violations of the provisions of MF Regulations and various circulars by Noticees 1 to 5 and 7 in the matter of FMP Series 187, 189, 193 and 194. Pursuant to transfer of Shri B J Dilip, the undersigned was appointed as AO in the matter of FMP Series 187, 189, 193 and 194 vide communique order dated December 31, 2020. Thereafter, vide communique order dated December 15, 2021, the undersigned was also appointed as AO in the matter of FMP Series 127 and 183.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

4. With respect to the matter of FMP Series 127 and 183, a common Show Cause Notice dated May 31, 2019 (**SCN 1**) was issued by the erstwhile AO, Ms. Maninder Cheema to Noticees 1 to 7 under Rule 4(1) of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as '**Adjudication Rules'**) in the matter, to show cause as to why an inquiry should not be held against them under Rule 4 of the Adjudication Rules and penalty, if any, be not imposed upon them for the alleged violations of provisions of MF Regulations and various circulars, as specified therein.

5. With respect to the matter of FMP Series 187, 189, 193 and 194, a common Show Cause Notice dated October 12, 2020 (**SCN 2**) was issued by the erstwhile AO, Shri B J Dilip to Noticees 1 to 5 and 7, under Rule 4(1) of the Adjudication Rules in the matter, to show cause as to why an inquiry should not be held against them under Rule 4 of the Adjudication Rules and penalty, if any, be not imposed upon them for the alleged violations of provisions of MF Regulations and various circulars, as specified therein. A supplementary SCN dated May 06, 2022 was also issued to Noticees w.r.t SCN 1 and 2. The main allegations made against the Noticees vide the aforesaid show cause notices are summarized as follows –

    i. Kotak MF had launched FMP Series 127, 183, 187, 189, 193 and 194 as close-ended debt schemes which were to mature on various dates as detailed below –

Name of Scheme	Maturity Dates

FMP Series 127	April 08, 2019
FMP Series 183	April 10, 2019
FMP Series 187	April 15, 2019
FMP Series 189	April 22, 2019
FMP Series 193	May 02, 2019
FMP Series 194	May 15, 2019

ii. Investment objectives of all schemes were to generate returns through investments in debt and money market instruments with a view to reduce the interest rate risk.

iii. As per the Scheme Information Documents (**SIDs**), the schemes were to invest in debt and money market securities, maturing on or before maturity of the said schemes.

iv. All the six schemes had investments in debt securities i.e. Zero Coupon Non Convertible Debentures (hereinafter referred to as '**ZCNCDs**') of Konti Infrapower & Multiventures Pvt. Ltd. (hereinafter be referred to as, the "**Konti**"). FMP 127, 183 and 187 also invested in debt securities of Edisons Utility Works Pvt. Ltd. (hereinafter be referred to as, the "**Edisons**"). Both, Konti and Edisons belong to the Essel Group of Companies (hereinafter referred to as, the "**Issuers**"), and the investments by the schemes were backed by pledge of shares of Zee Entertainment Enterprises Limited (hereinafter be referred to as, the "**Zee**") by Cyquator Media Services Private Limited (hereinafter be referred to as, the "Cyquator"), a promoter of Zee, holding 22.80% of its total share capital. The shares of Zee are listed on the Bombay Stock Exchange (hereinafter be referred to as, the "**BSE**") and National Stock Exchange of India Limited (hereinafter be referred to as, the "**NSE**"). Other promoter and promoter group companies of Zee include Essel Corporate LLP (3.04% of its total share capital), Spirit Infrapower & Multiventures Private Limited and Essel Infraprojects Limited.

v. It is observed that Kotak AMC entered into an agreement with promoters and other promoter entities of Essel Group to extend the maturity of securities of various Essel Group entities to September 30, 2019. Consequently, investors of all the six schemes were not paid full amount on maturity based on the Net Asset Value (hereinafter be referred to as, the "***NAV***") of the aforesaid schemes. Therefore, examination was conducted by SEBI into all the aforesaid schemes.

Due Diligence while investing in Essel Group Companies

vi. The investment rationale for investment in debt securities of Konti and Edisons by the FMP 127 and 183 was stated in the e-mail dated April 22, 2019 sent by Kotak AMC, which *inter alia* mentions that the transaction was for funding the promoters of Essel group companies where the security was in form of pledge of equity shares of Zee by its promoter, Cyquator (holding 22.8% of the total share capital of Zee). The investment rationale for investment in debt securities of Konti and Edisons by the FMP 187, 189, 193 and 194 was stated in the e-mail dated December 10, 2019 sent by Kotak AMC, which *inter alia* mentions that the transaction was for funding the promoters of Essel group companies where the security was in form of pledge of equity shares of Zee by its promoter, Cyquator (holding 22.8% of the total share capital of Zee). This pledge was providing 1.50 times cover of the exposure amount, which was to be topped up in case of any drop in share cover below 1.50 times.

vii. On perusal of the notes of proceedings of the Investment Committee dated March 07, 2016 and May 18, 2016, it is observed that:

a. The investment plan was approved by Mr. Nilesh Shah, Managing Director of Kotak AMC, Ms. Lakshmi Iyer, Chief Invesment Officer (Debt) & Head Products of the Kotak AMC and Mr. Gaurang Shah (Noticee 2, 3 and 7 respectively).

b. No reference was made to the financials and operations of the issuers in the investment plan. Investment decision was only based on analysis of collateral (Zee).

c. Initial security cover was of 1.6 times by pledge of shares Zee, which was to be maintained as 1.5 times thereafter. There is, however, no rationale as to how 1.6 times security cover is adequate collateral / coverage.

d. This transaction has been referred to as *Loan against Shares* where the collateral was in form of pledge over shares of Zee.

e. Investment Committee was of the view that repayment of its exposure was to be funded through a refinance. It took comfort from the reputation and track record of Essel Group in general and fundamentals, liquidity and performance of shares of Zee.

viii. Credit quality of a bond is primarily assessed by the repayment capacity of the issuer of the bond. Any collateral/ pledge is a secondary factor in this regard. The collateral/pledge by the issuer is an enabling clause and is only invoked in case of default on payment of maturity/interest. However, in the instant matter, Kotak AMC only mentions details about the collateral in the investment rationale. It is also observed that repayment capacity of the issuer was considered only based on its refinance capacity. Thus, it can be seen that that there is no mention of the credit quality of a bond of the issuers or the repayment capacity of the issuer of the bond in the investment rationale.

ix. It is therefore alleged that the investments are not based on Financials or the business operations of the issuer companies i.e. Konti and Edison. The investments are purely done based on the security provided by the Cyquator, a promoter group company, through pledge of shares of Zee Entertainment and the external rating of a Credit rating Agency (CRA).

x. Kotak AMC has also provided the annual reports of Edison for the FY ending 31st March 2015 and Konti for the FY ending 31st March 2013, 31st March 2014 and 31st March 2015. Further, Kotak AMC has provided the Private Placement Offer Letters (PPOL) of Konti dated March 11, 2016 & May 31, 2016 and of Edison dated March 21, 2016 & March 28, 2016. As per these annual reports and PPOLs, both Konti and Edison were loss making companies for all the three financial years (FY 2012-13 to FY 2014-15).

xi. Further, no research reports regarding Konti and Edison have been provided by Kotak AMC. Thus, it alleged that there is no specific research undertaken for investments in securities of Konti and Edison and investments are purely done based on the security provided by the promoter Cyquator through pledge of shares of Zee Entertainment Ltd.

xii. The investment in NCD of Konti and Edicson has been referred to as 'Funding of Zee Group Promoters against shares of Zee Entertainment Ltd.' by the investment committee. Even in the minutes of the meeting of Board of AMC and trustees, the said transactions have been referred to as Loan Against Shares (LAS).

xiii. Thus, it is alleged that even though the transactions happened through debt securities, the transactions are basically Loan against Shares (LAS) without considering the financials of the issuer company.

xiv. Clause 9 of the Schedule V of the MF Regulations mandates that "the trustees and the AMCs shall render high standards of service, exercise due diligence and ensure proper care". High standards of service require ensuring proper care at the time of investment by assessing the adequacy of the collateral and recording of the rationale as to how 1.6/1.5 times security cover is adequate coverage/collateral for repayment. High standards of service also require assessing of the credit quality of a bond of the issuers as well as repayment capacity of the issuer of the bond in the investment rationale.

xv. Therefore, it is alleged that by not taking investment decision(s) solely in the interest of unit holders, not rendering high standards of service, not exercising due diligence, not ensuring proper care at the time of investment by assessing the adequacy of the collateral, not recording of the rationale as to how 1.6/1.5 times security cover is adequate coverage/collateral, not assessing the credit quality of the underlying bond/ repayment capacity of the issuer in the investment rationale, Noticees have allegedly violated Regulation 10(a) of the MF Regulations, as well as Clauses (6) and (9) of the 'Code of Conduct' as specified in Fifth Schedule under Regulation 25(16) of MF Regulations.

xvi. On perusal of the Scheme Information Document of all the schemes, it is observed that the investment objectives of both the FMPs was to generate returns through investment in debt and money market instruments, maturing on or before the maturity date of the respective plans. Under various provisions of the MF Regulations (as provided in the paragraphs hereinabove), it is noted that the Noticees were responsible for exercising due diligence and professional judgment in running the affairs of the aforementioned plans to achieve their Investment Objectives.

xvii. Therefore, in view of the facts observed in paragraphs hereinabove, it is alleged that:

i. Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the transactions entered into and activities of Kotak AMC were in accordance with the provisions of the MF Regulations and the scheme document; failed to ensure that investments are in accordance with the investment objectives and that investment decision is taken solely in the interest of the unitholders; and failed to render high standards of service and exercise due diligence, thus violating Regulations 10 (a), 18(7),18(9) and 18(22) as well as Clauses 6 and 9 of the Code of Conduct in Fifth Schedule to MF Regulations. Further, provisions of SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 have also been allegedly violated.

ii. Noticee 2, being the Managing Director of Kotak AMC, failed to ensure that Kotak AMC complies with all provisions of MF Regulations, guidelines and circulars issued from time to time in relation thereto, that the investments made by the fund managers were in the interest of the unit holders, and that the investments were managed in keeping with the stated investment objectives in the interest of unitholders and with the high standards of service and due diligence required of Noticee 2, thus violating Regulation 25 (6A), 25(6B) and 25(16) of the MF Regulations read with Clause 6 and 9 of the Code of Conduct in Fifth Schedule of the

MF Regulations. Further, provisions of SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 have also been allegedly violated.

iii. Noticee 3, 4 & 6, who were fund managers and other signatories to the aforesaid investment proposals of the FMPs have failed to ensure that the funds of the FMPs were invested to achieve the objectives of the FMPs and in the interest of the unit holders with the high standards of service and due diligence required of them, thus violating Regulation 25(6B) and 25(16) of the MF Regulations and Clause 6 and 9 of the Code of Conduct in Fifth Schedule of the MF Regulations. Further, provisions of SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 have also been allegedly violated.

Due Diligence and care in all its investment decisions

xviii. On perusal of the Investment Rationale provided by the Kotak AMF, it is observed that Kotak AMF did not avail any external research report(s) available for investing in the ZCNCDs of issues such as Konti or Edisons.

xix. It is also noted that no records were maintained by the Kotak AMF in support for its decisions for investing in the ZCNCDs of the aforesaid issuers apart from two factors; firstly, ZCNCDs were secured through pledge of shares of Zee by Cyquator, and secondly, external rating provided by credit rating agency, Brickwork Ratings India Pvt. Ltd.

xx. SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 *inter alia* mandates that - "*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…While the AMC boards can prescribe broad parameters for investments, it is important that the basis for taking individual scripwise 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… The AMCs shall report the compliance of the above in their periodical reports to the trustees and the trustees shall report to SEBI in their half-yearly reports. Trustees may also check its compliance through* *the independent auditors or internal/statutory auditors or other systems developed by them*".

xxi. It is observed that securities of Edisons and Konti were privately placed and not listed. It is also observed that Kotak AMC had not given any material to indicate that it paid specific attention for its investments in Edisons and Konti. No detailed research report analysing various factors leading to an investment decision in securities issued by Konti and Edisons. Although financials of issue companies, *viz.* Edisons and Konti were provided to Kotak AMC along with the PPOLs, it is observed that there was no analysis of financials of issuer companies in the investment rationale. Financials of Edisons and Konti indicate that the issuer companies were loss making in the preceding three years of issue (2016), i.e. FY 2012-13, 2013-14 and 2014-15. Therefore, it is alleged that Kotak AMC did not take aforesaid facts into consideration before making investment in securities of the issuer companies. It is noted that the requirement of exercising due diligence and care includes requirement to pay specific attention and to have a detailed research report before an investment decision is made. However, it is alleged that Noticee 1-4, 6-7 did not exercise due diligence, skill and care.

xxii. In view of the facts mentioned hereinabove, it is alleged that:

i. Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the activities of and and transactions entered into by the Kotak AMC were in accordance with the MF Regulations and the Schemes, failed to exercise due diligence and care in decisions of investment in the securities of Edisons and Konti, and failed in taking investment decision based on detailed research reports and solely in the interest of unit holders, thus violating Regulation 10 (a), 18(7),18(9) and 18(22) read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000.

ii. Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with the provisions of the MF Regulations, guidelines and Circulars, that the investments made by the fund managers were in the interest of the unit holders, and that the basis for taking individual scrip-wise investment decisions were recorded or that detailed research reports for each investment decision for initial and subsequent investments were prepared, thus violating Regulation 25 (6A) read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000.

iii. Noticee 3, 4, 6 & 7, who were fund managers and other signatories to the aforesaid investment proposals of the FMPs, failed to ensure that the basis for taking individual scrip-wise investment decisions were recorded or that detailed research reports for each investment decision for initial and subsequent investments were prepared, and that the funds of the schemes were invested to achieve the objectives of the scheme and in the interest of the unit holders, thus violating Regulation 25(6B) of the MF Regulations read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000.

Maturity date of the security exceeded the maturity date of schemes

xxiii. FMP Series 127, 183, 187, 189, 193 and 194 were close-ended debt schemes of Kotak MF, which were to mature on April 08, 2019, April 10, 2019, April 15, 2019, April 22, 2019, May 2, 2019 and May 15, 2019 respectively.

xxiv. However, following multilateral agreements dated April 06, 2019 were executed:

i. Kotak MF (through KMAMCL - Lender) and Konti and Cyquator and Dr. Subhash Chandra (Personal Guarantor).

ii. Kotak MF (through Kotak AMC - Lender) and Edisons and Cyquator and Dr. Subhash Chandra (Personal Guarantor)

xxv. It is observed that as per the multilateral agreements, Kotak MF (through Kotak AMC), in consideration of Konti and Edison agreeing to make payment of the agreed upside to it from proceeds of Zee Stake Sale, has agreed to:

i. Extension of maturity date of NCDs from 8th April, 2019 to 30th September, 2019; and

ii. Enter into this agreement for capturing the terms and conditions which would govern the inter-se relationship amongst the parties.

xxvi. From the e-mails of the Kotak AMC dated April 22, 2019 and April 30, 2019 addressed to SEBI, it is noted that a multilateral agreements dated April 06, 2019 were entered into by and among Kotak MF, Edisons, Cyquator & Dr. Subhash Chandra and Kotak MF, Konti, Cyquator & Dr. Subhash Chandar as parties. By virtue of the agreements dated April 08, 2019, Kotak MF agreed to extend the maturity dated of FMP 127 and FMP 183 to September 30, 2019 from April 08, 2019 and April 10, 2019 respectively, which is an investment decision.

xxvii. As per SEBI Circular No. SEBI/IMD/ CIR No.12/147132/08 dated December 11, 2008, a close ended debt scheme shall invest only in such securities which mature on or before the date of the maturity of the scheme.

xxviii. There is no provision under MF Regulations which enables a FMP scheme to extend the maturity of securities in a scheme beyond the scheme maturity date.

xxix. The Scheme Information Documents (SIDs) of all the schemes states that the scheme shall invest only in such securities which mature on or before the date of the maturity of the Scheme in accordance to SEBI Circular No. SEBI/IMD/ CIR No.12/147132/08 dated December 11, 2008.

xxx. It is observed from the various multilateral agreements dated April 06, 2019 that the mutual fund has agreed for extension of maturity from 8th April, 2019 to 30th September, 2019, in consideration of the Knoti and Edison agreeing to make payment of the agreed upside to the mutual fund from proceeds of Zee Stake sale. Therefore, the extension of maturity of the debt security is an active decision and is considered as re-investment decision in those debt securities.

xxxi. Further, it observed that Konti and Edison have honoured all the top up requests as per stipulated terms and security cover was maintained during the period from 2016 till January 25, 2019. Thus, it is clear that from January 26, 2019 onwards neither the required top up was provided nor the security cover was maintained and the investments in those securities was completely relied on the collateral. Therefore, the AMC instead of invoking the pledge, agreed to extend the maturity of those securities beyond maturity of the scheme.

xxxii. In view of the aforesaid, it is alleged that the Kotak AMC's decision to extend date of maturity of all the schemes was not in accordance with the provisions of the MF Regulations and circulars issued thereunder, was not in the interest of the unit holders, was not taken after exercising due diligence and care, and was not meant to achieve the objectives of the 4 schemes.

xxxiii. In this regard, it is also noted that Regulation 18 (4) (d) states that – *"The trustees shall ensure before the launch of any scheme that the asset management company, has,— appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors grievances".*

xxxiv. In view of the facts mentioned hereinabove, it is alleged that:

i. Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the activities of and and transactions entered into by the Kotak AMC were in accordance with the MF Regulations and the Schemes, failed to exercise due diligence and care in decisions of investment in the securities of Edisons and Konti, and failed in investing in accordance with the investment objectives stated in the offer documents, thus violating Regulation 10 (a), 18(7),18(9) and 18(22), Clause 6 & 9 of the Schedule V of the MF Regulations read with SEBI Circular: SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

ii. Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with the provisions of the MF Regulations, guidelines and Circulars and that the investments made by the fund managers were in the interest of the unit holders, thus violating Regulation 25 (6A) read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

iii. Noticee 3-4, who were fund managers as well as Chief Investment Officer (Debt) and Vice President of Kotak AMC respectively failed to ensure that the funds of the schemes were invested to achieve the objectives of the scheme and in the interest of the unit holders, thus violating Regulation 25(6B) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

iv. Noticee 5, who was a compliance officer of the Kotak AMC, failed to monitor the compliance of the MF Regulations and various circulars issued thereunder, thereby, violating Regulation 18(4) (d) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

Partial redemption of FMPs at the end of their maturity periods and the FMPs not being wound up at the end of their maturities

xxxv. Vide letter dated April 11, 2019, SEBI sought response of Kotak AMC on certain queries which included whether the manner of winding up of FMPs 127 and 183 including delay in payment of the maturity proceeds were in compliance with MF Regulations and circulars issued thereunder. In its response by way of letter dated April 12, 2019, Kotak AMC informed SEBI that the realized value of investment in the scheme have been paid to the unit holders on maturity. It also informed that the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme on realization of the residual assets. It is also observed that Kotak

AMC entered into agreements dated April 06, 2019 with issuers for extending the maturity period of the securities. Similarly, it is also noted that vide letter dated April 12, 2019, Kotak AMC informed its investors it had to withhold certain part of units in certain FMPs that included FMP 127 and FMP 183 and that it is working to recover balance dues and the same will be distributed to the unitholders on realization.

xxxvi. Regarding FMPs 187, 189, 193 and 194, Kotak AMC by way of letter dated December 10, 2019, informed SEBI that the realized value of investment in the scheme (barring the portion of investments in NCDs of Essel group companies) have been paid to the unit holders on maturity. In early September 2019, part payment of the pending dues, was also paid to all unitholders of the respective schemes. On September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes.

xxxvii. Regulation 33(4) of the MF Regulations provides that a close ended scheme shall be fully redeemed at the end of 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 SEBI. Similarly, Regulation 39(1) of the MF Regulations provides that a close-ended scheme shall be wound up on the expiry of duration fixed in the scheme on the redemption of the units unless it is rolled over for a further period under Regulation 33(4) of the MF Regulations.

xxxviii. Regulation 53(b) of MF Regulations provides that every mutual fund and asset management company shall despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase.

xxxix. From the aforesaid, it is observed that units of the aforesaid 6 schemes were not fully redeemed at the end of their respective maturity periods and nor were they rolled over for a further period in terms of Regulation 33(4) of the MF Regulations. Therefore, it is alleged that all the 6 schemes were not wound up on expiry of duration fixed in FMPs by Kotak AMC which led to non-payment of full NAV within 10 working days on maturity of these 4 schemes.

xl. In view of the aforementioned facts, it is alleged that:

i. Noticee 1, being the trustee company of Kotak AMC, failed to ensure that: (i) All the 6 schemes were fully redeemed at the end of maturity period or were rolled over in accordance with the provisions of MF

Regulations; (ii) All the 6 schemes were wound up on the expiry of duration fixed in the schemes, and (iii) despatch of redemption or repurchase proceeds within 10 working days from the date of redemption. Further, Noticee 1 also failed to ensure that the activities of Kotak AMC were in compliance with the MF Regulations and Circulars issued thereunder and it also failed to render high standards of service, exercise due diligence and proper care in decisions of Kotak AMC. Therefore, Noticee 1 has violated Regulation 10(a), 18(7), 18(9) and 18(22), Clause 9 of the Fifth Schedule of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations.

ii. Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that: (i) All the 6 schemes were fully redeemed at the end of maturity period or were rolled over in accordance with the provisions of MF Regulations; (ii) All the 6 schemes were wound up on the expiry of duration fixed in the schemes, and (iii) despatch of redemption or repurchase proceeds within 10 working days from the date of redemption. Noticee 2 also failed to ensure Kotak AMC's compliance with provisions of MF Regulations. Therefore, Noticee 2 has violated Regulation 25 (6A) read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations.

iii. Noticee 3-4, who were fund managers as well as Chief Investment Officer (Debt) and Vice President of Kotak AMC respectively failed to ensure full redemption of all the 4 schemes, leading to Kotak AMC's failure in investment of the funds of the schemes in the interest of the unit holders. Therefore, Noticee 3-4 have violated Regulation 25(6B) of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations.

iv. Noticee 5, who was a compliance officer of the Kotak AMC, failed to monitor the compliance of the MF Regulations by Kotak AMC, thereby, violating Regulation 18(4)(d) of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations.

Creation of Segregated Portfolio

xli. As brought out in the paragraphs hereinabove, it is observed that the Kotak AMC did not roll over any of the 6 schemes. At the same time, it is also observed that Kotak AMC did not pay full NAV to the investors of aforesaid FMPs. As stated earlier, the complete payout for FMPs 187, 189, 193 and 194 was done only on September 25, 2019 to the investors. A perusal of various documents including letters to investors by Kotak AMC, agreements entered into by it etc. reveal that pay-out for the portion of exposure in the group entities of Essel Group in the FMPs 127 and 183 has been deferred till September 30, 2019

xlii. Vide e-mails dated May 02, 2019 and December 10, 2019, Kotak AMC informed SEBI that FMPs 127, 183, 187, 189, 193 and 194 were close-ended schemes launched before the SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018 came into existence and therefore, they did not have provision for segregating portfolio as per the circular dated December 28, 2018.

xliii. It is also observed that Kotak AMC, in the communication to the investors had inter alia stated, "*We are working for optimal recovery from Konti & Edisons for the benefit of unitholders and are hopeful that such recovery will happen albeit with delay.*" It also stated that any realization from the said investments, will be shared proportionately with the unitholders subsequently.

xliv. This action by Kotak AMC reveals de-facto creation of segregated portfolio from the scheme portfolio without having enabling provisions in the Scheme Information Document and without trigger of credit events as detailed in the SEBI Circular dated December 28, 2018.

xlv. Therefore, it is alleged that Kotak AMC, by segregating portfolio in its schemes, viz. FMPs 127, 183, 187, 189, 193 and 194 did not comply with SEBI Circular dated December 28, 2018 and thereby, violated the same.

xlvi. In view of the aforesaid facts, it is alleged that:

i. Noticee 1, being the trustee of Kotak AMC, failed to exercise due diligence; and failed to ensure that Kotak AMC complied with Circular dated December 28, 2018 relating to creation of segregated portfolio in mutual fund schemes. Therefore, Noticee 1 violated Regulation 10(a), 18(7), 18(9), 18(22) and Clause 9 of the Fifth Schedule of MF Regulations read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

ii. Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with Circular dated December 28, 2018 relating to creation of segregated portfolio in mutual fund schemes, thus violating Regulation 25 (6A) read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

iii. Noticee 3-4, being the fund managers as well as Chief Investment Officer (Debt) and Vice President of Kotak AMC respectively failed to ensure that the Kotak AMC complied with Circular dated December 28, 2018 relating to creation of segregated portfolio in mutual fund schemes, thus violating Regulation 25 (6B) read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

iv. Noticee 5, being the compliance officer of Kotak AMC, failed to monitor the compliance of the MF Regulations and circular issued thereunder, thereby, violating Regulation 18(4) (d) of the MF Regulations read with SEBI Circular SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018.

Compliance with Principles of Valuation of Securities

xlvii. Regarding FMPs 187, 189, 193 and 194, the AMC in its e-mail dated December 10, 2019 regarding the valuation of the aforesaid securities stated that for the period from 07/02/19 to 07/04/19, the securities of Essel group were valued on the basis of amortization. From 08/04/19 to 11/04/19, the securities were valued on the basis of similar securities yield. On all other days, the securities were valued based on the price provided by valuation agencies. Further, the AMC received the valuation of securities on a daily basis from independent valuation agencies i.e. CRISIL & ICRA. These agencies have their independent model for calculation of valuation price of securities. Subsequent to the extension of the maturity date, based on the revised cash flow and maturity date the securities are valued basis the valuations provided by the third party valuation agencies i.e. CRISIL & ICRA with residual maturity greater than 30 days and based on amortization for securities with residual maturity upto 30 days. As stated earlier, in FMP 187, 189, 193 and 194 there are three securities of Essel Group entities (ISIN - INE097P07070, INE582R07044 and INE582R07051). The original maturity of all the above securities was April 08, 2019.

xlviii. Regarding FMPs 127 and 183, SEBI sought details regarding valuation of securities of issuers from two rating agencies, ICRA Management Consulting Services (IMCS) and CRISIL which were valuing securities of the issuer companies vide letter dated April 11, 2019. In their replies dated April 16, 2019 and April 18, 2019, IMCS and CRISIL provided SEBI with details of valuation of the securities backed by pledge of equity shares and those that have been restructured. It is observed from the replies of the aforementioned valuation agencies that FMP 127 had two securities of Essel Group companies (ISIN – INE582R07051 and INE097P07088) while FMP 183 had three securities of Esel Group companies (ISIN – INE582R07044, INE097P07070 and INE58207051), which were to mature on April 08, 2019.

xlix. As noted in preceding paragraphs, Kotak AMC had decided to extend the maturity period of securities beyond April 08, 2019.

l. As per SEBI Circular No SEBI/IMD/CIR No.16/ 193388/2010 dated February 2, 2010 as amended by Cir/IMD/DF/6/2012 dated February 28, 2012, securities can be valued on amortisation basis only in case of residual maturity of a security being less than 60 days.

li. From the facts mentioned hereinabove, it is observed that pursuant to the extension in maturity of all the 6 schemes, effective maturity date of securities of Edisons and Konti was no longer less than 60 days from February 07, 2019 when letters executed with issuer and pledgers of Zee group. SEBI Circular dated February 02, 2010 as amended by SEBI Circular dated February 28, 2012 require that all non-traded debt and money market securities, with residual maturity of up to 60 days may be valued on amortisation basis. However, from the reply of the Kotak AMC, it is observed that valuation of underlying securities of issuer companies was done on amortisation basis during the period February 07, 2019 to April 07, 2019 even when the residual maturity of securities was due in more than 60 days.

lii. Thus, from the above, it is observed that even after the decision of the Board of the AMC and Trustees to restructure the debt securities of Essel group entities, the AMC continued to consider the original maturity of the security as April 08, 2019 and valued the securities based on amortisation basis during the period 7th February, 2019 to 7th April, 2019.

liii. Regulation 25(19) of the MF Regulations require the asset management company of a mutual fund to compute and carry out valuation of investments made by its scheme(s) in accordance with the investment valuation norms specified in Eighth Schedule and to publish the same. Moreover, Regulation 47 of the MF Regulations requires every mutual fund to 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 the Eighth Schedule and to publish the same.

liv. Therefore, it is alleged that Kotak AMC has failed to comply with principle of fair valuation in terms of provisions of MF Regulations.

lv. In view of facts mentioned hereinabove, it is alleged that:

   i. Noticee 1, being the trustee of Kotak AMC, failed to exercise due diligence; and failed to ensure that Kotak AMC valued scheme investments fairly in compliance with applicable provisions of MF Regulations and SEBI Circulars dated February 02, 2010 as updated by SEBI Circular dated February 28, 2012. Therefore, Noticee 1 has violated Regulation 10(a), 18(9), 18(22), 47, Clause 9 of the Fifth Schedule read with Eighth Schedule of the MF Regulations and SEBI Circular No. SEBI/IMD/CIR NO. 16/193388/2010 dated February 2, 2010 and SEBI Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012.

ii. Noticee 2, being the Managing Director of Kotak AMC, failed to ensure that Kotak AMC complied with applicable provisions relating to fair valuation of scheme investments as provided under SEBI Circulars dated February 02, 2010 and February 28, 2012, thereby, violating Regulation 25 (6A), Regulation 25(19) and 47 of the MF Regulations read with Eighth Schedule of the MF Regulations and SEBI Circular No. SEBI/IMD/CIR NO. 16/193388/2010 dated February 2, 2010 as updated by Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012.

Adequate disclosures to investors of FMP 127, 183, 187, 189, 193 and 194

lvi. Asset management company as well as trustee companies are required to render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment, at all times. Such high standards of service require timely dissemination of material information relating to the schemes.

lvii. It is observed that the Board of Directors of the Kotak AMC, along with other lenders had deliberated the issue of fall in share price of Zee in their meeting with the promoter of Essel Group on January 26, 2019. Consequent to their meeting with the promoters of Essel Group, the Board of Kotak AMC and Trustees agreed to execute the option to restructure the debt securities in the interest of unitholders on January 28, 2019. The Trustee Board also advised to take personal guarantee from the promoters of Zee for payments against their investments. Letters of intent were executed amongst issuers Kotak AMC, pledgers of Zee shares and committee of lenders on February 07, 2019. Thus, it is observed that the problem relating to Essel Group was known to both the AMC and Trustees since January 25, 2019.

lviii. The details of communication to investors of FMP 187, 189, 193 and 194 is as follows:

Name of Scheme	*Maturity date of Scheme*	*Date of communication to the investor*	*No. of investors communicated*	*Total number of investors as on the date of*

				maturity of the scheme
Kotak FMP Series 187	15/04/2019	*05/04/2019*	*1710 – Regular plan* *13 – Direct Plan*	*2134*
Kotak FMP Series 189	17/04/2019	*10/04/2019*	*330 – Regular Plan* *25- Direct plan*	*519*
Kotak FMP Series 193	02/05/2019	*09/04/2019*	*1069- Regular Plan* *24- Direct Plan*	*1345*
Kotak FMP Series 194	15/05/2019	*05/04/2019*	*1092 – Regular plan* *32- Direct Plan*	*1373*

lix. It can be seen that it was only on April 05, 2019 that Kotak AMC communicated to the investors of FMPs for the first time regarding the steep fall in the price of Zee and subsequent deliberations thereof. On April 12, 2019, it was communicated to the investors regarding the decision to provide additional time till September 30, 2019 to Promoters of Essel Group to complete the strategic sale process and that they had to withhold certain part of units in the FMPs for now which Kotak AMC believed to be in the interest of the unitholders.

lx. It is alleged that the information of Essel promoters not providing additional cover when the margin call triggered, the decision of AMC and trustees to extend the maturity of the securities, and the subsequent letters executed on February 7, 2019 all being information having adverse bearing on the investments of investors was not communicated to the investors when the events took place. Thus, sending the communication to the investors on April 5, 2019 just before the maturity of the scheme allegedly does not achieve the intended purpose of disclosure to the investors. Further, the Kotak AMC has not provided adequate proof that communications were sent to all investors.

lxi. Thus, it is alleged that the aforesaid events, which had an adverse bearing on the investments of the investors and thereby affecting their interests, were not communicated to the investors / disseminated to the investors in a timely manner, thereby leading to violation of Regulation 25(16) of the MF Regulations read with Clauses (2), (6) and (9) of the Code of Conduct specified in the Fifth Schedule of the MF Regulations and Regulation 10(a) of the MF Regulations by Kotak AMC.

lxii. Regulation 60 of the MF Regulations provides that the trustee company is bound to make disclosures to unitholders about any information that may have an adverse bearing on their investments.

lxiii. In view of the facts mentioned hereinabove, it is alleged that:

i. Noticee 1, being a trustee of Kotak AMC, failed to disclose scheme related information, particularly regarding the adverse situation related to Essel Group companies, to its unitholders accurately and in a timely manner, despite being aware of the same since January 26, 2019. Thus, Noticee 1 has violated Regulation 10(a), 18(22), and 60 of the MF Regulations as well as Clause 2 of the Code of Conduct in Fifth Schedule of the MF Regulations.

ii. Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with applicable provisions of the MF Regulations on disclosure of scheme related information to unitholders. Thus, Noticee 2 violated Regulation 25(6A) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations.

iii. Noticee 5, being the Compliance Officer of the Kotak AMC, failed to monitor the compliance with applicable provisions of MF Regulations with respect to disclosure of scheme-related information to unitholders. Thus, Noticee 5 violated Regulation 18(4)(d) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations.

<u>Inspection of Documents</u>

6. Vide letters dated June 14, 2019, in respect of SCN 1, Noticees, *inter alia,* requested for inspection of documents in the matter. Vide letter dated June 20, 2019, the said request was acceded to and Noticees were granted an opportunity of inspection of documents. The inspection of documents w.r.t SCN 1 was carried out by the authorized representative of the Noticees on July 03, 2019. Similarly, in respect of SCN 2, vide letter dated November 02, 2020, Noticees 1 to 5 and 7, *inter alia,* requested for inspection of documents in the matter. The inspection of documents w.r.t SCN 2 was carried out by the authorized representative of the aforesaid Noticees on November 09, 2020 wherein the documents inspected were provided in a CD. Pursuant to the personal hearing held on June 07, 2022, vide email dated June 08, 2022, the Noticees

requested to be provided the copy of the CD provided during inspection carried out on November 09, 2020. Accordingly, as per the Noticees' request, the copy of the CD was once again provided to the Noticees vide letter dated June 08, 2022. Subsequently, vide email dated June 15, 2022, the Noticees requested to be provided the copy of examination reports in relation to the SCNs and supplementary SCN issued in the matter and further Noticees requested to be provided certain other documents related to the documents provided in the aforementioned CD. The Noticees placed reliance upon the decision of the Hon'ble Supreme Court in *T. Takano v. SEBI*, Appeal Nos. 487-488 of 2022 in this regard. Vide emails dated June 16, 2022 and June 17, 2022 the examination reports and other documents sought by the Noticees were emailed to the Noticees.

<u>Replies</u>

7. Noticees have filed replies to SCN 1 and 2 and the Supplementary SCN as follows –

   a. Reply filed by Noticee 1 dated October 14, 2019 and additional submissions dated October 12, 2021 to SCN 1; Reply filed by Noticee 1 dated February 8, 2021 to SCN 2 and Reply filed by Noticee 1 dated June 7, 2022 to Supp SCN;
   b. Reply filed by Noticees 2-7 dated October 23, 2019 and additional submissions dated October 12, 2021 to SCN 1 and Reply filed by Noticees dated March 22, 2021 to SCN 2 and Reply filed by Noticees dated June 7, 2022 to Supp SCN;
   c. Written Submissions filed by Noticees on May 17, 2022 after the personal hearing before the AO on April 25, 2022; and
   d. Additional Written Submissions filed by Noticees vide letter dated June 14, 2022 with clarifications sought by the AO during the personal hearing.
   e. Vide email dated June 21, 2022, the Noticees submitted that they reiterate all the earlier submissions (as mentioned above) filed by them.

8. The main contentions made by Noticees are summarized as follows –

i. *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.*

ii. *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.*

iii. *As regards SCN 2, the issues at hand were already considered in proceedings pursuant to SCN 1. The same issues were covered in those proceedings and already detailed explanations have been given on those issues. Merely because further FMPs that had not matured by then have subsequently matured, the Noticees have been vexed yet again with these proceedings, which is unnecessary. There is no explanation as to why this belated notice is at all required.*

iv. *The investment objectives of the FMP schemes, as per their Scheme Information Documents ("**SIDs**"), are extracted below:*

*"The **investment objective** of the Scheme is **to generate returns through investments in debt and money market instruments** **with a view to significantly reduce the interest rate risk**. The **Scheme will invest in debt and money market securities, maturing on or before maturity of the scheme**.*

*There is **no assurance that the investment objective of the Scheme will be achieved**."*

v. *Noticee 1 is vested with a general power of superintendence over the Kotak AMC. Thus, the role of the Noticee 1 is supervisory and it is not suppose to engage in day to day management of the AMC. The action to be taken on recovery of dues from Essel Group of Companies on account of investment therein by schemes of the fund was discussed by management with the Board of AMC on January 28, 2019 and post approval of Board of AMC action was taken by management in the interest of unitholders of respective scheme. The decision of AMC Board was informed to Noticee 1 and decision of AMC Board was concurred by the Noticee*

1. Further, the MF Regulations also lay down parameters of specific diligence including, trustees shall obtain internal audit reports at regular intervals from independent auditors appointed by the trustees; trustees shall obtain compliance certificates at regular intervals from the AMC; trustees shall maintain records of the decisions of the trustees at their meetings and of the minutes of the meetings; etc. In a nutshell, it would therefore be seen that the Trustees are required to play a role of strategic direction rather than operational direction. Consequently, implications of day to day decision making cannot be visited upon the Trustees. After laying down the above parameters of diligence, the MF Regulations go on to state that the trustees shall not be held liable for acts done in good faith if they have exercised adequate due diligence honestly. Therefore, the only question that needs to be answered is whether the trustees exercised "<u>adequate due diligence</u>". In this regard, the decision of the Hon'ble Supreme Court in Chander Kanta Bansal v. Rajunder Singh Anand, (2008) 5 SCC 117 was relied upon. If in complying with its duties, the entity did everything that was reasonable to satisfy its legal obligations under the law, it will have acted with diligence. It is submitted that the Noticee was consistently careful and complied with all requirements of diligence under the MF Regulations. Therefore, as under Regulation 18(26) of the MF Regulations, if the Trustees have acted in good faith and have exercised adequate due diligence honestly, they cannot be held liable.

vi. *Noticee 1 has submitted that as Trustees, due process for functioning of the Investment Committee of the AMC, had been put in place. Once this is done, the Trustees cannot interfere with the actual decisions of such Committee.*

vii. *It is pertinent to note the procedure laid down by the Board of the AMC for the Investment Committee to approve the investment. The Minutes of Board Meeting dated January 17, 2014, lays down the following as scope of Investment Committee:*

*"**Common functions of Equity and Debt Investment Committees:***
<u>To review</u>
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**]*

viii. *All the procedures were followed by the Investment Committee in accordance with the scope approved by the Board of the AMC as laid down in the minutes of Board meeting dated January 17, 2014.*

ix. *The investment philosophy of the AMC, is to assess the willingness and ability of borrowers to repay the obligations on a timely basis. The investment by the abovementioned schemes was in the NCD of Konti Infrapower & Multiventures Pvt. Ltd. and Edison Utility Works Pvt. Ltd. ("**Issuers**"), which belonged to the Essel Group (also known as the Zee Group), which was structured with a collateral in the form of pledge of shares. The track record of the Essel Group promotors, in loan against shares market over decades has been of timely payment. As of December 31, 2015, it has FPI holding of 47.63% and as of December 31, 2018 / March 31, 2019 it has FPI holding of 41.52% / 44.96%, which clearly demonstrates the confidence of investors in the Company. Additionally, the ability to repay was assessed based on adequacy of collateral.*

Till date, the collateral for the instrument is far higher than the value of the indebtedness.

x. *Other mutual funds also invested in this issuers other than Kotak Mutual Fund in March 2016.*

xi. *Approval notes also mentioned that as per market intelligence, the promoter borrowing was in the range of Rs. 3,500~4,500 crores. As on December 2015 – as per exchange filing, only 34.84% of the promoter's stake was pledged.*

xii. *The Issuers of the instruments subscribed to buy the FMPs was based on Investment Notes dated March 7, 2016 and May 18, 2016 ("**Investment Notes**") which were considered and approved by the Investment Committee. The entire process was focused on the structure of the instrument and the collateral since this would address all the relevant factors that needed to be considered.*

xiii. *All the relevant factors that have been taken into account by Investment Committee before making the investment in the said debentures are discussed in detail below:*

   a. *The main factor relied upon was the underlying collateral which is equity shares of Zee Entertainment Enterprises Ltd. ("**Zee**") with minimum cover of 1.50 times. Financials of Zee and Dish TV were provided in the Investment Note. There was no external research report on the Issuers which was available in the market place. Therefore, the Investment Notes were based on AMC's own internal research. Zee was a part of the Equity Investment Universe and hence was actively tracked at all points of time.*

   b. *The security, in the form of Zee shares, was provided by Cyquator Media Services Pvt. Ltd. (one of the main Promoter entities of Zee which owned more than 25% in Zee valued at more than Rs. 9,000-10,000 crore). Cyquator is pledger for the AMC's exposure and hence it was also obligor along with Issuers. Hence, this lending was based on the strong collateral provided by Cyquator.*

   c. *As this deal was structured against collateral in the form of listed shares of a large cap Nifty Company, the reliance was not on the cash flows of the Issuer but on collateral.*

   d. *As the part of transaction, the collateral / security cover is monitored on daily basis by independent Debenture Trustee ("**IDBI Trustee**"). The IDBI Trustee* *issued daily reports marking the Issuer and all the investors. As mentioned earlier, the collateral cover of 1.50 times was diligently maintained till January 25, 2019 with top-up done by Issuer / Pledger on various occasion as per underlying terms. Hence, the adequacy of collateral was properly assessed and monitored on daily basis. It should also be noted that the note also clearly talks of the number of days to liquidate the shares in order to encash our investments.*

e. *The adequacy of collateral was monitored on daily basis. There were various instances of collateral top-up which were honoured by the pledger / issuer within the prescribed timelines. Since the time of investments, i.e. March-June 2016 to January 24, 2019, there were 34 instances of top-up done with additional pledge to maintain the security cover as per terms of the transaction. During this period there were eight instances of share release also as per terms of transaction.*

f. *At the time of investment the level of pledge of promoter shares was only around 35%. While it increased subsequently, it was still below 60% till December, 2018. It will therefore be seen that not only was the debt owed by the Issuers well covered by the value of the underlying collateral but also it was found that more unencumbered potential collateral was available for future, which factor was also noticed and taken into account.*

xiv. *The investment in NCD of the Issuers, which was structured in the form of pledge of shares, was compliant with and not violative of the provisions of the MF Regulations and the Trust Deed. There is no such restriction on such investment under MF Regulations read with circulars issued thereunder from time to time and also under the provisions of Trust Deed. Such investments are commonly undertaken by Banks, NBFC's, FPI's and other regulated participants too. There is no express prohibition, in the MF Regulations, on such investments.*

xv. *In fact, investments by mutual funds in structured obligations of Issuers secured by collateral in the form of equity shares is a concept well known and considered in SEBI's regulatory framework. For example, the agenda for the meeting of the Mutual Fund Advisory Committee, held on July 2, 2019, squarely dealt with this subject. It does not even in future envision a ban on such investments. The* *proposal for discussion includes a minimum cover of 3 to 4 times and listing. It clearly implies that even SEBI recognizes that its permitted investments and it only envisions tightening of norms, if any, in future. In fact, one could argue that shares being liquid, are better securities than non-liquid collaterals like plant, machinery etc. SEBI vide its Circular dated October 1, 2019 has issued a directive that investment in debt instruments, having credit enhancements backed by equity shares, directly or indirectly, shall have a minimum cover of 4 times considering the market value of such shares. Additionally, that the AMCs may ensure that the investment in debt instruments having credit enhancements are sufficiently covered to address the market volatility and reduce the inefficiencies of invoking of the pledge or cover, whenever required, without impacting the interest of the investors. In case of fall in the value of the cover below the specified limit, AMCs should initiate necessary steps to ensure protection of the interest of the investors.*

xvi. *The SCN wrongly alleges that the creditworthiness of the promoters was not taken into account while making the investment decisions. The Investment Notes clearly brought out the various sources of cash flows for the companies viz. IPO of Essel Infraprojects. It also addressed the increased valuation potential of Dish TV and Siti Cable. It is submitted that an assessment of the creditworthiness of a borrower would entail an analysis of the ability of a borrower to repay on due dates, as such the Investment Notes set out in detail the various sources of funds for these companies and also the strong financial standing of the promoters.*

xvii. *It is alleged that the investments were to be repaid through refinancing rather than internal cash flows. Globally as well as in India, majority of debt is repaid through refinancing – Governments, State Governments, Corporates, PSUs, etc. all use the refinancing route to service their debt obligations. It is a common business practice and there is nothing unusual in lending or investing against the refinancing capacity of the borrower.*

xviii. *The SCN further alleges that the notice failed to provide any document/ report evidencing the adequacy of the collateral. It is submitted that the Investment Note clearly talks of an initial cover of 1.6X and 1.5X to be maintained thereafter. The Information Memorandum of Konti Infrapower & Multiventures Pvt. Ltd. dated March 11, 2016 has been shared with SEBI as a part of our responses vide e-*

mail on April 22, 2019. It clearly talks of a security cover of 1.6X and at all times to be not less than 1.5X on page 32. Thus, we wish to refute the allegation as we have indeed provided SEBI the said information.

xix. *It should also be noted that investment in securities on the basis of the pledge of shares as collateral is a market phenomenon. We have had such investments in the past too and all of them had performed well, without any issues.*

xx. *The AMC understands from market sources that there are various market participants which has lent to Essel Group under various structures. As on January, 2019, name of some of the lenders were Aditya Birla Finance, Aditya Birla Mutual Fund, Axis Finance, Baroda Mutual Fund etc.*

xxi. *From market sources its understood that KMF's investment in Essel Group promoter would be only around ~3%.*

xxii. *The intended portfolio allocation of the FMP series as per their respective SIDs was 95%-100% in NCDs having A or AA rating and 0%-5% in CPs having AAA/A1+ rating. The above disclosures clearly demonstrate that the investors were informed that the scheme would invest predominantly in securities with a "A" rating. Thus, through the SIDs, the investors were well informed of the risk profile of the fund. The rating at the time of investment was A+(SO) by Brickwork.*

xxiii. *As required, the Investment Committee reviews all the credits and structured obligations at its meetings. Additionally, various inspections conducted by SEBI in the past and audit reports have never raised any concerns on the investment process followed by the Noticees.*

xxiv. *The Noticee has conducted itself with all requisite diligence in the investment process. As regards any specific codification in directives/guidelines on credit exposures, until SEBI vide its circular no SEBI/HO/IMD/DF2/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, the decisions of mutual funds are a matter of their best professional judgement, which cannot be quarrelled with.*

xxv. *AMCs may ensure that the investment in debt instruments having credit enhancements are sufficiently covered to address the market volatility and reduce the inefficiencies of invoking of the pledge or cover, whenever required, without impacting the interest of the investors. In case of fall in the value of the* *cover below the specified limit, AMCs should initiate necessary steps to ensure protection of the interest of the investors Thus one can see that even now such investments are permitted albeit with a four times cover. Also on fall in the cover levels, the action to be taken is left to the best judgement of the AMC, in the interest of unit holders.*

xxvi. *Accordingly, Noticee 1 has denied the alleged violations.*

xxvii. *The AMC's Investment Committee has rightly acted within the parameters of the investment objectives in the relevant SIDs and has acted in the best interest of unitholders while continuing to render high standard of service, due diligence, care and professional judgment. Likewise, AMC's Investment Committee indeed analysed the proposal to invest in the relevant securities with a minimum cover of 1.50 times the exposure. At the time of making investment and till date of trigger all risks were appropriately analysed and the investment done within the scheme objectives. This demonstrates that there was independent professional judgement taken on investment proposal. Therefore, there is no question of the provisions of Clause 6 and Clause 9 of Fifth Schedule of the MF Regulations at all being attracted – more particularly being attracted by Noticee No. 2 who as the CEO of the AMC is obliged not to interfere with professional judgment and assessment on individual investment decision of the AMC. It is submitted that there is in fact no violation of Regulation 25(6A), Clause 6 of Fifth Schedule and Clause 9 of Fifth Schedule of the MF Regulations as alleged.*

xxviii. *Further, there is no question of the provisions of Clause 6 and Clause 9 of Fifth Schedule of the MF Regulations at all being attracted by the Noticees No. 3, 4, 6, and 7.*

xxix. *From the extracts of Regulation 18 of the MF Regulations, it is evident that the trustees, i.e. the Noticee 1, is vested with a general power of superintendence over the Kotak AMC. Thus, the role of the Noticee 1 is supervisory and it is not supposed to engage in day to day management of the AMC. The action to be taken on recovery of dues from Essel Group of Companies on account of investment therein by schemes of the fund was discussed by management with the Board of AMC on January 28, 2019 and post approval of Board of AMC action was taken by management in the interest of unitholders of respective scheme.*

The decision of AMC Board was informed to Noticee 1 and decision of AMC Board was concurred by the Noticee 1.

xxx. *Noticee No. 3 who as Chief Investment Officer (Debt) and Head Product of AMC, has been a part of the Investment Committee from April 28, 2010 till date. As such, at the relevant time, she was a part of the Investment Committee when it took the decision to invest in referred securities issued by Konti Infrapower & Multiventures Pvt. Ltd and Edison Utility Works Pvt. Ltd. It is submitted that she acted keeping in mind the objectives of the schemes and in the interest of the unitholders and all the processes that were required to be employed were followed. It is therefore submitted that there is in fact no violation, by Noticee No. 3, of Regulation 25(6B), Clause 6 of Fifth Schedule and Clause 9 of Fifth Schedule of the MF Regulations as alleged.*

xxxi. *In fact, the MF Regulations lay down parameters of general diligence including, the trustees shall be discerning in the appointment of the directors on the Board of the AMC; trustees shall review the desirability or continuance of the AMC if substantial irregularities are observed in any of the schemes and shall not allow the AMC to float new schemes; trustee shall ensure that the trust property is properly protected, held and administered by proper persons and by a proper number of such persons; trustees shall immediately report to SEBI of any special developments in the mutual fund; etc.*

xxxii. *Noticee No. 4 who as the Fund Manager and Vice President of AMC and Noticee No. 7 who as the Fund Manager of AMC had invested as per the decision taken by the Investment Committee to invest in referred securities issued by Konti Infrapower & Multiventures Pvt. Ltd. and Edison Utility Works Pvt. Ltd. It is submitted that they acted keeping in mind the objectives of the schemes and in the interest of the unitholders and all the processes that were required to be employed were followed by the Investment Committee. It is submitted that there is in fact no violation, by Noticee No. 4 and 7, of Regulation 25(6B), Clause 6 of Fifth Schedule and Clause 9 of Fifth Schedule of the MF Regulations as alleged.*

xxxiii. *Noticee No. 8 who as the Director of AMC has been a part of the Investment Committee from April 28, 2010 till date. As such, at the relevant time, he was a part of the Investment Committee when it took the decision to invest in referred securities issued by Konti Infrapower & Multiventures Pvt. Ltd. and Edison Utility*

Works Pvt. Ltd. It is submitted that he acted keeping in mind the objectives of the schemes and in the interest of the unitholders and all the processes that were required to be employed were followed. It is submitted that there is in fact no violation, by Noticee No. 8, of Regulation 25(6B), Clause 6 of Fifth Schedule and Clause 9 of Fifth Schedule of the MF Regulations as alleged.

B. Investments in debt securities allegedly without research report and analyzing various factors

xxxiv. *There was no external research report on the Issuers. Therefore, the research conducted was internal research. And as a consequence, the approach must be to assess and analyse whether what was done by the Noticees was inappropriate or found wanting in a manner warranting these proceedings, and not whether there was any investment without external research.*

xxxv. *It is reiterated that the investment by the referred schemes was in the NCD of Issuers, which was 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 Investment Committee concentrated on structure and collateral. Thus, main comfort was drawn from the underlying collateral which is equity shares of Zee with minimum cover of 1.50 times along with an "A" rating by an approved rating agency.*

xxxvi. *As, the reliance was primarily on underlying securities, i.e. Zee shares, the Investment Notes focussed on the same including:*

a. *details of market capitalisation, promoter holding, encumbrance on promoter holding, average daily turnover in shares etc.;*
b. *shareholding pattern of Zee with dividend track record;*
c. *share price movement of Zee for last four years; and*
d. *last three years of financials of Zee and Dish and latest interim results.*

xxxvii. *In light of the above, it is submitted that the allegations of the SCN that the Noticees failed to ensure that the AMC complied with the provisions of the MF Regulations as it neither provided detailed research report nor maintained any records in support of its investment decision, are wholly untenable and are denied.*

xxxviii. *From the perusal of the Regulation 25(2) of MF Regulations and SEBI circular dated July 27, 2000, it is clear after facing situations when there has been neither interest payment nor payment of principal amount by companies, it was found* *that transparency was essential in the decision-making process. As such, with the aim to implement Regulation 25(2) of the MF Regulations in an effective manner and to bring about transparency in investment decisions, the SEBI Circular date July 27, 2000 was issued. The said Circular requires the AMC to maintain record to support its decision to invest. As seen from above, the AMC has maintained records for every decision taken to invest in securities issued by the Issuers based on available data, facts and opinion related to Zee. Investment Committee had been diligent in taking conscious decision basis the requisite due diligence done with respect to Zee and recorded the relevant facets leading to the investment decision as required under the relevant provisions of law. It is pertinent to note that the collateral for the instrument is far higher than the value of the indebtedness. It is therefore submitted that the Noticees deny the allegation of violating of Regulation 25(2) of the MF Regulations and SEBI Circular dated July 27, 2000.*

xxxix. Accordingly, Noticees 1, 2, 3, 4, 6 and 7 have denied the alleged violations.

Maturity date of the NCDs of issuers exceeded the maturity date of schemes

xl. The schemes matured on their respective maturity dates and the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers is paid off. The AMC, expecting a recovery of the full amount due from Issuers and intending to pay the unitholders with possible upside in proportion of the units, held back proportionate units.

xli. In order to pay the investors of respective scheme on pending realization of funds invested in NCDs of the Issuers, the AMC extended the time for repayment of NCDs from April 8, 2019 to September 30, 2019, vide the agreement dated April 6, 2019. After the maturity date of respective scheme there has been no active fund management decision to invest beyond the maturity of the scheme.

xlii. To operationalize it, in terms of receiving appropriate valuation price of the security from the independent third party valuation agencies the tenure of these securities have been extended till September 30, 2019 with all other terms remaining the same.

xliii. *In early September 2019, part payment of the pending dues, was also paid to all unitholders of the respective schemes. On September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes. Therefore, with the benefit of hindsight also, this decision in fact turned out far more favourable to the unitholders.*

xliv. *It is therefore established that, the AMC is in compliance with the investment restrictions applicable to respective scheme i.e. all investments made at the time of the investments were well within the maturity date of the scheme. The AMC has not made any fresh investment in the security after maturity of the scheme and it has only given time to the issuer to the repay by way of extension of the due date. The said extension can in no manner be construed as a fresh investment decision as alleged. It is merely a rescheduling of the date of the maturity wherein the due dates of the cash flows are realigned. In fact, SEBI itself recognizes such a "reschedulement" of maturity and the same can be found in the Master Circular under the chapter on "9.7 Guidelines for Identification and Provisioning for Non Performing Assets (Debt Securities)".*

xlv. *It is reiterated that Noticee has complied with provisions of January 5, 2000 circular to be read in conjunction with investment restrictions stated under schedule VII of SEBI MF Regulations, 1996. At the time of investments all restrictions referred under Schedule VII were adhered to. As regards alleged extension of maturity of schemes, it is evident that scheme was not in existence after the scheduled maturity date of the respective scheme.*

xlvi. *Regulation 41(2)(a) of the MF Regulations, the trustee or the person authorised under sub-regulation (1) shall dispose of the assets of the scheme concerned in the best interest of the unitholders of that scheme. (b) The proceeds of sale realised under clause (a), shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken.*

xlvii. *The AMC has redeemed the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers. Efforts were being made to maximise the returns possible for the investors and the deferment was* *only with the aim of making full payment to the unitholders. In early September 2019, part payment of the pending dues, was also paid to all unitholders of the respective schemes. On September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes. Therefore, with the benefit of hindsight also, this decision in fact turned out far more favourable to the unitholders.*

Name of Scheme	*Launch Date (L)/Roll over ® Date*	*Maturity Date*	*NFO /Rollover amount Rs. In Cr*	*Maturity Amount **Rs. In Cr*	*Amount Paid on maturity Rs. Cr*	*Amount paid on Sept 9, 2019 ***Rs in Cr*	*Amount paid on Sept 25, 2019**** Rs in Cr*	*Outstanding amount to be paid Rs. In cr*
Kotak FMP Series 127	*30/11/2015 (R)*	*08/04/2019*	*309.60 (Rollover)*	*451.18*	*371.20*	*44.93*	*40.60*	*-*
Kotak FMP Series 183	*23/12/2015 (L)*	*10/04/2019*	*457.26*	*561.97*	*455.47*	*59.80*	*54.03*	*-*

***includes market value of Zee group securities as on the maturity date*

**** Funds received & disbursed including income accrued till 08.09.19*

***** Funds received & disbursed including income accrued till 24.09.19*

Name of Scheme	*Launch Date/~~Rollover~~ Date*	*Maturity Date*	*NFO /~~Rollover~~ amount Rs. In Cr*	*Maturity Amount ** Rs. In Cr*	*Amount Paid on maturity Rs. In Cr*	*Amount paid *** on Sept 9, 2019 Rs in Cr*	*Amount paid on Sept 25, 2019**** Rs in Cr*	*Outstanding amount to be paid Rs. In cr*
Kotak FMP Series 187	*24/02/2016*	*15/04/2019*	*381.10*	*496.97*	*394.24*	*57.74*	*52.16*	*0.00*
Kotak FMP Series 189	*18/02/2016*	*17/04/2019*	*92.01*	*123.08*	*110.88*	*6.85*	*6.19*	*0.00*
Kotak FMP Series 193	*29/04/2016*	*02/05/2019*	*204.68*	*248.28*	*221.73*	*14.86*	*13.43*	*0.00*
Kotak FMP Series 194	*11/05/2016*	*15/05/2019*	*180.77*	*211.17*	*187.24*	*13.38*	*12.08*	*0.00*

***includes market value of Zee group securities as on the maturity date & not the maturity value of the securities.*

**** Funds received & disbursed including income accrued till 08.09.19*

***** Funds received & disbursed including income accrued till 24.09.19*

xlviii. *It is submitted that the SCN, after noting the facts of the case notes that the said decision to extend the maturity was in accordance with the MF Regulations and yet records that the same was not in the interest of the unitholders. This line of allegation is wholly unsustainable and is denied. In the alternate, in the event the SCN attempts to allege that the decision to extend was not in compliance with the MF Regulations, it is submitted that the said allegation is completely baseless.*

xlix. *In addition, the SEBI Circular dated June 20, 2002, partially modified vide SEBI Circular dated September 24, 2019, which has set out specific guidelines for the registered mutual funds, 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. It is pertinent to note 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.*

l. *When all the said provisions are read in harmony, the interest of the unitholder is paramount. As such, in early September 2019, part payment of the pending dues, was paid to all unitholders of the respective schemes and on September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes.*

li. *Accordingly, Noticees 1 to 5 have denied the alleged violations.*

D. Partial redemption of FMPs at the end of their maturity periods and the FMPs not being wound up at the end of their maturities

lii. *It is submitted that the SEBI Circular dated January 5, 2000 states that "All investment restrictions shall be applicable at the time of making investment." And SEBI Circular dated December 11, 2008 states 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.".*

liii. *In accordance with requirement of aforesaid SEBI Circulars, at the time of building the portfolio of respective scheme, the AMC invested in NCDs of the Issuers maturing on or before the maturity date of respective scheme.*

liv. *The schemes have matured on its respective maturity date and the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers is paid off. The AMC, expecting a recovery of the full amount due from the Issuers and intending to pay the unit holders with possible upside in proportion of the units, held back proportionate units.*

lv. *In order to pay the investors of respective scheme on pending realization of funds invested in NCDs of Zee Group of Companies, the AMC extended the time for repayment of NCDs from April 8, 2019 to September 30, 2019, vide the agreement dated April 6, 2019. After the maturity date of respective scheme there has been no active fund management decision to invest beyond the maturity of the scheme.*

lvi. *To operationalize it, in terms of receiving appropriate valuation price of the security from the independent third party valuation agencies the tenure of these securities have been extended till September 30, 2019 with all other terms remaining the same.*

lvii. *It is therefore established that in accordance with both the above referred Circulars, the AMC is in compliance with the investment restrictions applicable to respective scheme i.e. all investments made at the time of the investments were well within the maturity date of the scheme. The AMC has not made any fresh investment in the security after maturity of the scheme and it has only given time to the Issuers to the repay by way of extension of the due date. The said extension can in no manner be construed as a fresh investment decision as alleged. It is merely a rescheduling of the date of the maturity wherein the due dates of the cash flows are realigned. In fact, SEBI itself recognizes such a "reschedulement" of maturity and the same can be found in the Master Circular under the chapter on "9.7 Guidelines for Identification and Provisioning for Non Performing Assets (Debt Securities)".*

lviii. *Thus, it is clear that the AMC, initially invested only in securities which were maturing within the maturity of the schemes and an extension of time of repayment was not envisaged. However, due to change in circumstances and in the interest of the investors the time for repayment had to be extended and therefore the same cannot be construed as a fresh investment.*

lix. *Additionally, the AMC has not rolled over the FMPs and to the extent of realized value of investments of respective scheme is paid off to the investors. In early September 2019, part payment of the pending dues, was paid to all unitholders of the respective schemes and on September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes.*

lx. *In light of the above, it is submitted that the allegation of the SCN that the AMC partially redeemed the FMPs at the end of their maturity and did not roll them over for a further period and therefore the investors have not been paid at full NAV within 10 working days on maturity of the FMPs leading to violations of the provisions of MF Regulations are completely baseless. Therefore, the allegations of the SCN against the Noticees that they failed to ensure full redemption on maturity of the schemes and therefore failed to ensure compliance by the AMC of the MF Regulations are unfounded.*

lxi. *On reading the Regulation 33(4) of the MF Regulations, it is clear that a close ended scheme may be allowed to be rolled over if the all material details of the scheme "are disclosed to the unitholders and a copy of the same has been filed with the Board". As stated above, since no other options worked out, the AMC, on the basis of various discussions during the period of January to April, 2019 entered into an agreement with the issuer on April 6, 2019. This agreement captured upside sharing by the Issuers based on the realized value from Zee's strategic sale. The AMC has obtained a Personal Deed of Guarantee from Dr. Subash Chandra Goyal for the said security. This arrangement ensured that there would be no adverse impact to investors of the scheme. In fact, it provided for better terms to the unitholders with additional security of the personal guarantee of Dr. Subhash Chandra. As soon as the structure of the abovementioned agreement was agreed upon, the AMC, in order to maintain transparency, informed the investor of the same, i.e. on April 5, 2019 which thereafter was filed* *with SEBI as well. As such the Noticees deny the allegations of violating Regulation 33(4) and Regulation 39(1) of the MF Regulations.*

lxii. *Further, the Regulation 33(4) and Regulation 39(1) of the MF Regulations as referred to in the SCN must be read with Regulation 41(2)(a) and Regulation 41(2)(b) of the MF Regulations. It is submitted that the trustees or the persons authorised shall dispose of the assets of the scheme concerned in the best interest of the unitholders of that scheme and the proceeds of sale realised shall be first utilised towards discharge of such liabilities as are due and payable under the scheme and after making appropriate provision for meeting the expenses connected with such winding up, the balance shall be paid to the unitholders in proportion to their respective interest in the assets of the scheme as on the date when the decision for winding up was taken. In light of this requirement, the AMC has partially redeemed the amount receivable and extended the time of repayment so as to enable the repayment of balance amount, all in the interest of the unitholder.*

lxiii. *Additionally, Regulation 33(4) and Regulation 39(1) mandate that close ended scheme shall be wound up on maturity. But Regulation 41(2)(a) and Regulation 41(2)(b) 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 to the said provisions, the AMC has redeemed the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers. Efforts were being made to recover the full amount due from the Issuers and make full payment to the unitholders with possible upside in proportion of the units held by them.*

lxiv. *As regards Regulation 53 of the MF Regulations, the same applies only in the event of a redemption or a repurchase. A redemption or a repurchase, as can be seen from the MF Regulations, apply to any open ended fund when an investor applies to the fund house to redeem or repurchase per the applicable cut off timing at an applicable NAV. In such a situation, as prescribed under Regulation 53(b) and the Master Circular, the AMC would be liable to interest. There has to be a clear certainty of the amount of the principal for one to calculate interest at prescribed rates. In an open ended fund the applicable NAV gives certainty to the* *principal amount due. 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 envision any action of repurchase/redemption by investors. The concept of cut off timing and applicable NAV accordingly does not exist. The AMC 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 Noticees deny any violation on that count.*

lxv. *Therefore, it is submitted that the allegations of the SCN that the AMC partially redeemed the FMPs at the end of their maturity and did not roll them over for a further period and therefore the investors have not been paid at full NAV within 10 working days on maturity of the FMPs leading to violations of the provisions of MF Regulations are completely baseless.*

lxvi. *Noticees have complied with all required provisions of the MF Regulations to ensure full redemption of at the end of maturity, the FMP are wound up at the end of maturity and dispatch of redemption or repurchase proceeds within 10 working days from date of redemption. It is submitted that the AMC has been fully compliant with the provisions of the MF Regulations and the Noticee No. 2 met all the regulatory requirements to ensure the same. It is submitted that there is in fact no violation of Regulation 25(6A), Regulation 33(4), Regulation 39(1) and Regulation 53(b) of the MF Regulations as alleged.*

lxvii. *Accordingly, Noticees 1 to 5 have denied the alleged violations.*

E. Creation of Segregation Portfolio

lxviii. *It is submitted that the allegation of the SCN that the current event of deferring payment of dues of the investment held in securities issued by the Issuers amounts to creation of segregated portfolio of the relevant Kotak FMP Series is completely baseless. Therefore, the allegation of the SCN against the Noticees that they failed to ensure compliance by the AMC of the MF Regulations is unfounded. It is submitted that the SEBI Circular dated December 28, 2018 on creation of segregated portfolio in mutual fund schemes sets out specific preconditions for the same. In addition, the SEBI Circular dated June 20, 2002, partially modified vide SEBI Circular dated September 24, 2019, which has set out specific guidelines for the registered mutual funds, 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. It is pertinent to note 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.*

lxix. *It is therefore submitted that the current event of deferring payment of dues of the investment held in securities issued by the Issuers, which has been envisaged by SEBI, does not amount to creation of segregated portfolio of Kotak FMP Series 127, 183, 187, 189, 193, and 194. Such allegations are completely baseless.*

lxx. *In light of the above, it is submitted that the current event of deferring payment of dues of the investment held in securities issued by Issuers does not amount to creation of segregated portfolio of relevant Kotak FMP Series schemes as the following preconditions set out in the SEBI Circular have not been satisfied:*

a. The rating at the time of investment was A+(SO) by Brickwork. Rating was downgraded to A(SO) by Brickworks on February 18, 2019. The rating did not get downgraded to below investment grade till date of maturity and it continues to maintain the same rating till date;

b. The AMC did not opt for creation of segregated portfolio as the schemes involved are close ended schemes and after maturity there is no concept of "main portfolio" and "segregated portfolio" as all realized amount except the amount invested in the Issuers was to be paid fully;

c. The schemes were launched before the circular came into effect and hence did not carry provisions for segregated portfolio with adequate disclosures;

d. Typically a segregation of a portfolio becomes relevant only when there is an open ended fund i.e. there are purchases and redemptions in a fund. In a close ended fund, there is no such situation. Segregation of a portfolio envisions an existing fund continuing sans the downgraded investments. In the present case there was no question of continuation of the existing fund. Thus, the principles of segregation are not relevant in a close ended fund as the body of investors remain the same at all points of time and there is clear equity amongst them;

e. Assuming while denying that its akin to a segregation, one needs to demonstrate impact to a certain body of investors, which in this case has not been alleged at all. Thus, its more a theoretical question without any practical negative implication to any one;

f. At the time close to maturity of scheme providing option to investors for exit within 30 days without payment of exit load, if any, would not have been created different results as the investors opting to exit also would not have benefitted, as in that case AMC would have opted to invoke the pledge on shares of Essel Group resulting in sub-optimal recovery.

lxxi. Accordingly, Noticees 1 to 5 have denied the alleged violations.

*F. **Compliance with Principles of Fair Valuation***

lxxii. It is submitted that since there was 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 AMC extended the term of the security held only for purpose of realizing the pending dues. Till the time the AMC received the revised term sheet, which was needed to receive price from independent third-party valuation agency, the AMC valued the securities on basis of a similar security of same issuer, i.e. Edison Utility Works Pvt. Ltd. Once the term sheet was finalized and submitted to independent third-party valuation agency the AMC relied upon the said valuation.

lxxiii. In accordance with MF Regulations, the AMC has the required valuation policy in place. Securities are valued as per price received from third party valuation agencies appointed by AMFI. The said third-party valuation of securities is received by the AMC on a daily basis from independent valuation agencies i.e. CRISIL and ICRA. These agencies have their independent model for calculation of valuation price of securities.

lxxiv. Subsequent to the extension of the maturity date, based on the revised cash flow and maturity date the securities were valued on the basis of the valuations provided by the third-party valuation agencies i.e. CRISIL and ICRA. These securities are currently valued at a yield of 25.40% - 25.50% against the issue *yield of 11.10%. The AMC believes that the securities are fairly valued based on the bids on similar papers in the secondary market as polled by the valuation agencies. It is pertinent to note that the schemes are close ended schemes and can only be redeemed on maturity and investors would not have any impact due to changes in valuation.*

lxxv. *The AMC could have valued the assets at zero given the fact that the payment was not received on due date. In which case, the NAV would have been hit fully to the extent of such investments. The AMC could have then taken appropriate action to realize the investments and pay off the investors on realization. This hypothetical action would in no have impacted the receivable by the investors.*

lxxvi. *In light of the above, it is submitted that the allegation of the SCN that when the AMC decided to extend the maturity, the securities should have been valued on the basis of principles of fair value and not amortisation, thereby leading to violations of the provisions of MF Regulations is completely baseless.*

lxxvii. *Accordingly, Noticees 1 and 2 have denied the alleged violations.*

G. ***Adequate disclosure to investors of FMP 127, 183, 187, 189, 193 and 194***

lxxviii. *It is pertinent to note that the AMC accepted a letter of intent dated February 7, 2019, issued by the Issuers on the precondition that it will be a part of the Committee of Lenders ("COL"). This letter of intent was an in-principle understanding between COL, Issuers and pledgers. This was not a binding agreement in itself as it was contingent upon on determination by the COL. The AMC continued to possess all the rights as per the terms of the prospectus.*

lxxix. *The said letter of intent also mentioned that in the event that the charter is not finalized and executed between the identified lenders within a period of seven business days (or such period as extended by the COL in consultation with the identified lenders) from February 7, 2019, the understanding set out therein shall fall away. Thus, while there was an understanding, it fell apart within seven business days as the COL was not concluded by the Issuers. This in itself did not mean that Issuers had defaulted leading to any adverse impact on unitholders and the position of the AMC remain unchanged between January 25, 2019 and February 14, 2019. It should be noted that the AMC continued discussions with* *the Issuers on providing other securities, guarantees on the security in which investments were made, in accordance with the guidance of the Board. During this period, the security cover was in excess of the amounts recoverable on the investment, albeit, lower than the committed security cover of 1.5 times. Considering the above, there was reasonable uncertainty to ascertain that there was any adverse impact to investors.*

lxxx. *Since no other options worked out, the AMC, on the basis of various discussions during the period of January to April, 2019 entered into an agreement with the issuer on April 6, 2019. This agreement captured upside sharing by the Issuers based on the realized value from Zee's strategic sale. The AMC has obtained a Personal Deed of Guarantee from Dr. Subash Chandra Goyal for the said security. This arrangement ensured that there would be no adverse impact to investors of the scheme. In fact, it provided for better terms to the unitholders with additional security of the personal guarantee of Dr. Subhash Chandra. It is pertinent to note that as soon as the structure of the abovementioned agreement was agreed upon, the AMC, in order to maintain transparency, informed the investor of the same, i.e. on April 5, 2019.*

lxxxi. *Further, the Noticee had also uploaded various communications dated April 12, 2019, August 2, 2019, September 9, 2019 and September 25, 2019 on its website, updating the investors on investment in debt instruments of shares of Essel Group in Kotak FMP Series 187, 189, 193 and 194.*

lxxxii. *The letter of intent dated February 7, 2019, i.e. an in-principle understanding between COL, Issuers and pledgers, which fell apart within seven business days, in itself did not mean that Issuers had defaulted leading to any adverse impact on unitholders and the position of the Noticee remain unchanged between January 25, 2019 and February 14, 2019. As such the same was not required to be informed to the unitholders.*

lxxxiii. *Accordingly, Noticees 1, 2 and 5 have denied the alleged violations.*

<u>Additional submissions</u>

lxxxiv. *The investments made were in "structured obligations" instruments. Rating agencies assigned the "SO" rating (now, the applicable symbol would be "Credit Enhanced" rating i.e. the "CE" rating). Even a mere reference to the rationale published by rating agencies for these structures, would show that the very rating* *of these instruments relies on structure / security of the underlying asset i.e. shares, which would then necessitate analysis and diligence on the underlying asset and the issuer of those assets.*

lxxxv. *SEBI Circular dated June 13, 2019 to Rating Agencies wherein CE was introduced, also recognised pledge of shares from third party(ies) as credit enhancement. In any financing transaction, the credit enhancement structures happens only when the issuer profile / financials are weak and hence the need of credit enhancements from third party. If we see other transaction in market of funding against shares, the financial position of issuers are disregarded. In almost all funding against shares transactions, doing due diligence on issuer of those shares is what would be relevant. Due diligence has to be on credit enhancement and the "structure" on which the "obligation" is based.*

lxxxvi. *Generally in transactions involving promoter funding the borrower entities have nominal companies and can be considered to be "weak" – they are meant to be special purpose vehicles. The primary comfort is on refinance / underlying structure.*

lxxxvii. *All Large Mutual Funds had Essel Exposure. There were other NBFCs and Banks which also had exposure and in total more than 20 lenders / investors were there. Hence, other investors/lenders have also relied on the underlying collaterals for funding this structures – indeed this is the only industry standard*

lxxxviii. *One could argue that shares being liquid, are better securities than non-liquid collaterals like plant, machinery etc. In fact, if one see the investment done by few other Fund Houses such as Aditya Birla Mutual Fund / Franklin Templeton Mutual Fund – the structures were weaker with lower cover of listed shares. As can be seen from the borrowing numbers, there were other lenders also (other than KMF) to these issuers. The other lenders/investors have also funded to these entities with this financials only. Hence, other lenders / investors must have taken the similar comfort as KMF has taken.*

lxxxix. *In case of Essel Group also in November 2018 the promoters had decided to divest upto 50% of their stake in Zee. The same was announced via press release dated November 13, 2018. As per press release the promoter expected the same to be conclude by March/April 2019. They had appointed Goldman Sachs as an* *investment banker for the same. But the sudden share price fall on 25th January 2019, jeopardized all the plans of promoters.*

xc. *As mentioned earlier in case of promoter financing the debt generally gets refinance unless the promoter sell some assets / divest their stake in companies.*

xci. *All the problems / issues happens in debt investment is not only account of fraud. There can be many reasons for the issues in underlying debt investments. Many other promoters have faced the issues of refinancing of promoters debt after above period and have sold the assets / divest stake in their companies to repay the debts. Hence, it can be seen from the above, it was systemic issue.*

xcii. *AMC has had a satisfactory track record of dealing with Essel Group*

xciii. *Various rating rationales for Essel Group, Emami Group, Asian paints Group, Adani Group, V G Siddharta Group has been attached which shows the asset cover of shares was in the range of 1.50 to 2 times. Hence, this was market practise to fund the transaction with asset cover in this range.*

xciv. *In SEBI Circular dated October 1, 2019, SEBI itself has considered backing of equity shares sufficient for entering into structured obligation. There are no additional conditions attached to it.*

xcv. *SEBI Circular dated July 27, 2000 states contents of research reports may be decided by the asset management companies and the trustees. No standard format is given. So SEBI itself did not specify financials as a key.*

xcvi. *Most of the Commercial Papers raised by corporate gets refinanced. Working capital financing is continuous requirement for most of the issuers.*

xcvii. *The Noticees have relied on the judgement of the Hon'ble Supreme Court in SEBI v. Bhavesh Pabari, (2019) 5 SCC 90 and have inter alia contended that there can be circumstances beyond those enumerated by clauses (a), (b) and (c) of Section 15-J which can be taken note of by the adjudicating officer while determining the quantum of penalty.*

xcviii. *It is therefore reiterated that the approach of deferred payment of a portion of the amounts due on the securities invested in, was not only legitimate and well provided for in the regulatory regime, but also it led to unitholders realising full value and all the money earned on the securities. This is what a mutual fund is supposed to pursue to the hilt. In fact, that decision has turned out to be right and every unitholder got the full funds, and that too in conformity with the regulatory* *framework. Therefore, even with the benefit of hindsight, imposition of monetary penalty would be a travesty and unfair, apart from being legally untenable, in any case.*

xcix. *The penal action to be taken by SEBI must be proportional to the alleged violations while bearing in mind compliance by the Noticee.*

c. *It is submitted that the Investment Committee acted with high standards of service, due diligence and proper care when considering the Investment Note and approving the same. On the maturity of the schemes the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of Issuers was paid to the unitholders. Since the AMC was expecting a recovery of the full amount due from the Issuers and intending to pay the unitholders with possible upside in proportion of the units, held back proportionate units and simply extended the time period for repayment of pending dues. Simpliciter, rescheduling of the date of maturity without any fresh investment being made in the said security (after maturity of the schemes) can by no means be considered fresh investment.*

ci. *The schemes matured on their respective maturity dates and the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers were redeemed. The structured obligation debt that was not liquid and could not be immediately realised, was realised subsequently and paid out as above, in line with the regulatory framework as explained in the reply to the show cause notice.*

cii. *In early September 2019, a portion of investment in securities issued by Essel Group was realized from the Essel promoters' stake sale to Invesco Oppenheimer Fund, and on receipt of said funds, it was paid to all unitholders on September 9, 2019. However, since only a part payment was received on said date, the AMC did not want to take a chance and thus invoked the pledge. On September 25, 2019, balance payment along with accrued interest was paid off to all the unitholders of the respective schemes after invoking the pledge and selling the shares held as security cover in the market. Therefore. with the benefit of hindsight also. this decision in fact turned out far more favourable to the unitholders.*

ciii. *Supplemental SCNs are not envisaged in the SEBI Act, 1992. And whenever Parliament has thought it fit to confer such power on a State agency to issue a supplementary show cause notice, the legislature has explicitly so provided. The very legislation that amended securities laws in 2018 (Finance Act, 2018) also amended the Customs Act, 1962 to specifically provide for issuance of supplementary notices and refrained from amending the SEBI Act. Reliance has been placed 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. When the Customs Act was amended in 2018, Parliament was aware of the SEBI Act and the SCRA too. In fact, the SCRA underwent an amendment by the very same Finance Act, 2018, and yet this facet of the law was not touched. It cannot be assumed that the SEBI Act not being amended to enable issuance of a supplemental notice after conduct of proceedings, is an omission or mistake by the legislature and Casus Omissus should not readily be inferred. Additionally, it is submitted that in this given scenario, the authority ought to justify the issuance of the Supp SCN at this stage – (i) after almost 3 years from the issuance of the SCN 2019; (ii) after almost 2 years and 8 months from issuance of SCN 2020; (iii) after conclusion of hearing before the Ld. Adjudicating Officer; and (iv) when no new material or subsequent event or change in circumstances has taken place that could prompt the issuance of the Supp SCN.*

<u>Personal Hearing</u>

9. The details of personal hearing conducted in the matter are detailed in the following paragraphs.

10. Vide hearing notice dated September 25, 2019, the Noticees were granted an opportunity of personal hearing in respect of SCN 1 before the erstwhile AO, Ms. Maninder Cheema on October 15, 2019 which was subsequently rescheduled to October 21, 2019 at the request of the Noticees. However, on account of October 21, 2019 being declared a holiday due to state assembly elections, the same was

rescheduled to October 24, 2019. Subsequently, at the request of the Noticees, the hearing was rescheduled to November 19, 2019. In the said hearing held on November 19, 2019, the authorized representatives (ARs) of the Noticees appeared and reiterated the submissions made by the Noticees in their earlier replies. Subsequently, in respect of SCN 1, vide email dated August 31, 2021, it was communicated to the Noticees that since considerable time had elapsed since the conclusion of hearing, the Noticees were being granted opportunity to make any additional submissions latest by September 15, 2021. Vide email dated September 14, 2021, the Noticees, *inter alia,* requested for additional time for making submissions and also requested for an opportunity of hearing. Accordingly, a hearing was held on October 12, 2021, in respect of SCN 1, before the erstwhile AO wherein the ARs submitted that that an appeal had been filed before the Hon'ble Securities Appellate Tribunal (**SAT**) in respect of Order dated August 27, 2021 passed by Whole Time Member, SEBI. Further, the earlier written submissions dated 14.10.2019, 24.10.2019 and 12.10.2021 filed by the Noticees were reiterated and the ARs also undertook to file additional submissions within a week.

11. Vide Hearing Notice dated November 29, 2021, Noticees 1 to 5 and 7 were granted an opportunity of personal hearing, in respect of SCN 2, before the undersigned on December 21, 2021. In the said hearing, the legal counsel on behalf of the aforesaid Noticees informed the undersigned of a hearing proceeding in a similar matter with the same allegations, which has been concluded before another AO. It may be noted that the Noticees, vide letter dated October 20, 2021, had *inter alia* requested for composite hearing and order in respect of SCNs 1 and 2. Vide SEBI's order dated December 08, 2021, the matter relating to SCN 1 was also assigned to the undersigned. Vide Hearing Notice dated March 23, 2022, the Noticees were granted an opportunity of hearing in respect of both SCN 1 and 2, on April 12, 2022. At the request of the Noticees, the same was rescheduled to April 18, 2022. However, due to certain exigencies, the hearing was rescheduled to April 25, 2022. In the said hearing held on April 25, 2022, the ARs reiterated the earlier replies dated 14.10.2019, 12.10.2019 and 08.02.2021

submitted by Noticee 1 and the earlier replies dated 23.10.2019, 12.10.2021, and 22.03.2021 filed by Noticees 2 to 7. Further, the ARs sought time of 2 weeks to file post hearing submissions, which was acceded to and Noticees were advised to file the additional submissions latest by May 10, 2022. Subsequently, pursuant to issuance of Supplementary SCN, Noticees were granted another opportunity of hearing on June 07, 2022. During the said hearing, the ARs reiterated the replies dated June 07, 2022 submitted by the Noticee 1 and Noticees 2 to 7. Further, during the hearing, reply dated February 08, 2021 of Noticee 1 highlighting the contentions relating to supply of documents, was discussed and the ARs said they would email their requirements. Further, regarding the details of the realization of investments made by the FMPs in the NCDs issued by Konti Infrapower & Multiventures Pvt Ltd and Edisons Utility Works Pvt Ltd, as sought by the undersigned during the hearing, the ARs stated that the same would be submitted by email. In this regard, time till June 08, 2022 was granted for submission of the aforesaid details through email. Accordingly, the hearing was concluded.

CONSIDERATION OF ISSUES, EVIDENCE AND FINDINGS

12. I have carefully examined the allegations made in the SCNs, material available on record, and the submissions made by the Noticees. I note that the allegations levelled against the Noticees are classified into the following categories:

    A. Lack of due diligence while investing in Essel Group Companies.
    B. Due Diligence while investing in Essel Group Companies (Investments in debt securities allegedly without research report and analysing various factors).
    C. Maturity date of the security exceeded the maturity date of schemes
    D. Partial redemption of FMPs at the end of their maturity periods and the FMPs not being wound up at the end of their maturities
    E. Creation of Segregated Portfolio
    F. Compliance with Principles of Fair Valuation
    G. Adequate disclosures to investors of FMP 127, 183, 187, 189, 193 and 194

13. In view of the above, the issues that arise for consideration in the present case are :

I. Whether the Noticee 1 has violated the following provisions:

I. Regulations 10 (a), 18(7),18(9) and 18(22) as well as Clauses 6 and 9 of the Code of Conduct in Fifth Schedule to MF Regulations

II. Regulations 10(a), 18(7),18(9) and 18(22) read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000

III. Regulations 10 (a), 18(7), 18(9) and 18(22), Clause 6 & 9 of the Schedule V of the MF Regulations read with SEBI Circular: SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008

IV. Regulations 10(a), 18(7), 18(9) and 18(22), Clause 9 of the Fifth Schedule of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations

V. Regulations 10(a), 18(7), 18(9), 18(22) and Clause 9 of the Fifth Schedule of MF Regulations read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018

VI. Regulations 10(a), 18(9), 18(22), 47, Clause 9 of the Fifth Schedule read with Eighth Schedule of the MF Regulations and SEBI Circular No. SEBI/IMD/CIR NO. 16/193388/2010 dated February 2, 2010 and SEBI Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012

VII. Regulations 10(a), 18(22), and 60 of the MF Regulations as well as Clause 2 of the Code of Conduct in Fifth Schedule of the MF Regulations

II. Whether Noticee 2 has violated the following provisions:

I. Regulation 25(6A), 25(6B), 25(16) of the MF Regulations read with Clause 6 and 9 of the Code of Conduct in Fifth Schedule of the MF

Regulations read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000

II. Regulation 25 (6A) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008

III. Regulation 25(6A) read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations

IV. Regulation 25(6A) read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018

V. Regulations 25 (6A), 25(19) and 47 of the MF Regulations read with Eighth Schedule of the MF Regulations and SEBI Circular No. SEBI/IMD/CIR NO. 16/193388/2010 dated February 2, 2010 as updated by Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012

VI. Regulation 25(6A) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations

III. Whether Noticee 3, 4, 6, and 7 have violated the following provisions :

I. Regulation 25(6B), 25(16) of the MF Regulations and Clause 6 and 9 of the Code of Conduct in Fifth Schedule of the MF Regulations

II. Regulation 25(6B) of the MF Regulations read with SEBI Circular: MFD/CIR/6/73/2000 dated July 27, 2000

IV. Whether Noticee 3 and 4 have violated the following provisions:

I. Regulation 25(6B) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008

II. Regulation 25(6B) of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations

III. Regulation 25(6B) read with SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018

V. Whether Noticee 5 has violated the following provisions:

I. Regulation 18(4)(d) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008

II. Regulation 18(4)(d) of the MF Regulations read with Regulations 33(4), 39(1) and 53(b) of the MF Regulations

III. Regulation 18(4)(d) of the MF Regulations read with SEBI Circular SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018

IV. Regulation 18(4)(d) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations

VI. Do the violations, if established, attract monetary penalty under Section 15D and 15HB of SEBI Act?

VII. If so, what would be the quantum of monetary penalty that can be imposed on the Noticees after taking into consideration the factors mentioned in Section 15J of the SEBI Act?

14. Before I proceed with the matter, it is pertinent to mention the relevant legal provisions alleged to have been violated by the Noticees and the same is reproduced below:

The MF Regulations

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;

Rights and obligations of the trustees.

18. (4) The trustees shall ensure before the launch of any scheme that the asset management company, has,—

(d) appointed a compliance officer who shall be responsible for monitoring the compliance of the Act, rules and regulations, notifications, guidelines, instructions, etc., issued by the Board or the Central Government and for redressal of investors grievances;

(7) The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme.

(9) The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations.

(22) The trustees shall abide by the Code of Conduct as specified in the Fifth Schedule.

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 <u>not contrary to the</u> <u>provisions of these regulations and the trust deed</u>.*

(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.*

(6A) *The Chief Executive Officer (whatever his designation may be) of the asset management company shall ensure that the mutual fund complies* *with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund.*

(6B) *The fund managers (whatever the designation may be) shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders.*

(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 subregulation (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;

Disclosures to the investors

60.*The trustee shall be bound to make such disclosures to the unitholders as are essential in order to keep them informed about any information which may have an adverse bearing on their investments.*

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.*

15. Before moving forward to discuss the matter on merits, I would like to deal with certain preliminary issues raised by the Noticees in their replies. The Noticees have contended that the SCN 2 is unnecessary and is issued with unexplained delay. It has been further contended that the issues at hand were already considered in the proceedings pursuant to SCN 1 to which detailed replies were filed and personal hearing was concluded. Noticees have also contended that merely because further FMPs that had not matured by then have subsequently matured, the Noticees have been vexed yet again in the proceedings initiated vide SCN 2. In this regard, I note that SCN 2 dated October 12, 2020 was issued for different set of FMPs viz. FMP series 187, 189, 193 & 194. I find it pertinent to note that the alleged irregularities in the aforesaid four FMP schemes came into the notice of SEBI at a later stage. I note that as per the examination report pertaining to FMP series 187, 189, 193 & 194, the said examination was undertaken post Kotak AMC's submissions vide letter dated November 06, 2019 that Kotak MF had also undertaken similar action (i.e. extension of maturity of debt securities of Essel group companies and deferment of payment) in the above four FMP schemes as was taken in the FMP series 127 and 189. Post the said information coming into the notice of SEBI, examination was initiated and information was sought vide emails sent to Kotak AMC in November and December 2019. Accordingly, pursuant to the said examination, alleged violations by the Noticees were also observed with respect to FMP series 187, 189, 193 & 194 pursuant to which,

adjudication proceedings were initiated vide the SCN 2 dated October 12, 2020. Thereafter, the Noticees were granted sufficient opportunities to file their replies and hearing in the matter. Further, at the request of the Noticees vide their letter dated October 19, 2021, the proceedings vide SCN 1 and SCN 2 were merged before a single AO, pursuant to which adequate opportunities for hearing and filing submissions were granted to the Noticees which were availed of by them. Thus, I find no merit in the contentions of the Noticees regarding delay in the matter.

16. I further note that the Noticees have also contended that supplemental SCNs are unsustainable and impermissible in law. Further, it has been contended that the authority ought to justify the issuance of Supplementary SCN at a belated stage as compared to issuance of SCN 1 in 2019 and SCN 2 in 2020, post conclusion of hearing before the AO and when no new material or subsequent event or change in circumstances has taken place. In support of their contention, the Noticees have 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. Upon perusal of the aforesaid provisions cited by the Noticees, 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. Likewise, 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, I note that 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, 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 issuance of supplementary SCN. 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 issuance of Supplementary SCN during enforcement proceedings. In the present case, with respect to the supplementary SCN, the Noticees were granted adequate opportunities for filing reply and attend personal hearing in the matter which were availed of by them. Therefore, I am of the opinion that principles of natural justice have been duly complied with in the instant proceedings and I note that no prejudice has been caused to the Noticees. Accordingly, I find no merit in the above contentions of the Noticees.

17. Having decided the preliminary objections raised by the Noticees, I now proceed to deal with the merits of the matter.

A. **Lack of due diligence while investing in Essel Group Companies**.

18. It has been alleged that there was lack of due diligence while making the investment decision while making investment by the six FMP schemes viz. FMP 127, 183, 187, 189, 193 and 194 in the ZCNCDs of the Issuers. The Noticees in their capacity as the Trustee, MD of Kotak AMC, fund managers and other signatories to the investment proposals of the FMPs 127, 183, 187, 189, 193 & 194 are thus alleged to have violated the provisions of the MF Regulations as well as SEBI circular MFD/CIR/6/73/2000 dated July 27, 2000.

19. I observe that the investment rationale for investment in debt securities of Konti and Edisons was stated in the e-mails dated April 22, 2019 and December 10, 2019 sent by Kotak AMC to SEBI, which, *inter alia,* mentions that the transaction was for funding

the promoters of Essel group companies where the security was in form of pledge of equity shares of Zee by its promoter, Cyquator (holding 22.8% of the total share capital of Zee). This pledge was providing 1.50 times cover of the exposure amount, which was to be topped up in case of any drop in share cover below 1.50 times.

20. On perusal of the notes of proceedings of the Investment Committee (**IC**) dated March 07, 2016 and May 18, 2016, it is observed that the investment plan was approved by Mr. Nilesh Shah, Managing Director of Kotak AMC, Ms. Lakshmi Iyer, Chief Invesment Officer (Debt) & Head Products of the Kotak AMC and Mr. Gaurang Shah (i.e. Noticees 2, 3 and 7 respectively). I further note that no reference was made to the financials and operations of the issuers in the investment plan. The Investment decision was only based on analysis of collateral (Zee). I further note that initial security cover was of 1.6 times by pledge of shares Zee, which was to be maintained as 1.5 times thereafter. There is, however, no rationale as to how 1.6 times security cover is adequate collateral / coverage. This transaction has been referred to as Loan against Shares where the collateral was in the form of pledge over shares of Zee. I also note that Investment Committee was of the view that repayment of its exposure was to be funded through a refinance and it took comfort from the reputation and track record of Essel Group in general and fundamentals, liquidity and performance of shares of Zee.

21. The Noticees have contended that the investments were made in "structured obligations" instruments and the pledge was the credit enhancement. It was further contended that due diligence has to be on credit enhancement and the "structure" on which the "obligation" is based. It was further contended that the primary comfort is on refinance / underlying structure. The Noticees have contended that the investment committee followed the procedures as per the scope approved by the Board of the AMC. It was further submitted that the investment in the NCDs was structured with a collateral in the form of pledge of shares. The main factor relied upon was the underlying collateral which is equity shares of Zee with minimum cover of 1.50 times. Further, it has been submitted that financials of Zee and Dish TV were provided in the Investment Note. There was no external research report on the Issuers which

was available in the market place. Therefore, the Investment Notes were based on AMC's own internal research. Further, the Noticees have contended that as the reliance was primarily on underlying securities, i.e. Zee shares, the Investment Notes focussed on the same including:

(a) details of market capitalisation, promoter holding, encumbrance on promoter holding, average daily turnover in shares etc.;
(b) shareholding pattern of Zee with dividend track record;
(c) share price movement of Zee for last four years; and
(d) last three years of financials of Zee and Dish and latest interim results.

22. In this regard, I note that the credit quality of a bond is primarily assessed by the repayment capacity of the issuer of the bond and any collateral/ pledge is a secondary factor in this regard. The assessment of repayment capacity of the Issuer would entail considering the financials, including cash flows, and the business operations of the issuers. The collateral/pledge by the issuer is an enabling clause and is only invoked in case of default on payment of maturity/interest. However, in the instant matter, Kotak AMC only mentions details about the collateral in the investment rationale. However, it is generally not in the interest of either of the parties to use collateral for repayment of such loans as, 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; and on the other side, the subscriber also may not recover the full amount of outstanding dues defaulted by the issuer even after liquidating all the collateral in the market. Hence, 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. Accordingly, while investing in debt securities, the collaterals should be 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. Accordingly, I note that high standards of service and due diligence require ensuring

proper care at the time of investment by assessing the adequacy of the collateral. In the instant matter, there is no recording of the rationale as to how 1.6/1.5 times security cover is adequate coverage/collateral for repayment. Neither has any justification been provided in the Investment notes as to how 1.6/1.5 times security cover was considered as adequate coverage/collateral for repayment nor have any explanation/rationale been advanced by the Noticees in this regard.

23. The Noticees have also not advanced any evidence to indicate that Kotak AMC 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 their investment.

24. Further, I note from the note dated May 18, 2016 of the IC, that it had mentioned the eventuality of promoters running out of shares to pledge in the following terms:

> *"There is no clarity on current 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%.****"*

Similar terms are also recorded in the note dated March 07, 2016 of the IC.

25. I note from the above that it was admitted in the notes to the Investment Committee that they were not aware of the 'share pledge-based borrowing numbers' of the promoters of Essel Group. I note that the said actual figures could have been sought from the promoters of Essel Group at the time of making huge investments especially since the FMP schemes were investing only on the strength of pledge of Zee shares with further requirement of top up. Further, the IC notes had mapped two scenarios wherein the promoters would run out of shares to be pledged. However, it has not been indicated that 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.

26. While the Noticees have not offered any rationale for accepting shares of Zee valued at 1.50 times of the outstanding investment as a cover and have not provided any explanation as to whether, in any extreme scenario leading to drastic fall in the price of scrip of Zee (as happened on January 25, 2019), the said cover was ever mapped by it to the recoverability of the outstanding investment as a prudent risk-management measure and whether the collateral cover of 1.50 times the outstanding investment was found sufficient in such mapping.

27. Further, with regard to the contentions of the Noticees that investment was carried out on the strength of collateral at 1.50 times the amount of outstanding investment, I find it relevant to note that 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 Zee on January 25, 2019. In view of the foregoing, I do not find the approach taken by Kotak MF while doing due diligence to be of high standards.

28. Further, on perusal of the approval notes notes dated March 07, 2016 and May 18, 2016 of the Investment Committee (IC) submitted by the Noticees, I note that the heading of the said investment notes read as *"Funding of Zee Group promoters against shares of Zee Entertainment Ltd.".* Further, I note that the internal approval note dated May 18, 2016 doesn't even specify the names of the issuers i.e. Konti and Edisons, and instead specifies Issuers only as "Promoter entities". I also note that the internal approval notes nowhere make a mention of any details about the debt securities

(ZNCDs) that were proposed to be issued by the Issuers. This clearly shows that due importance was not given regarding the Issuer entities. I further note that no reference was made to the financials and operations of the issuers in the investment plan and the same were also not recorded in the IC notes. I note that although Kotak AMC had submitted to SEBI that the financials of Konti were before the Investment committee decision on March 07, 2016, I note that no discussion/analysis on the same are recorded in the IC notes.

29. I note that Kotak AMC has also provided the annual reports of Edison for the FY ending 31st March 2015 and Konti for the FY ending 31st March 2013, 31st March 2014 and 31st March 2015. Further, Kotak AMC has provided the Private Placement Offer Letters (PPOL) of Konti dated March 11, 2016 & May 31, 2016 and of Edison dated March 21, 2016 & March 28, 2016. As per these annual reports and PPOLs, both Konti and Edison were loss making companies for all the three financial years (FY 2012-13 to FY 2014-15). The same are summarised as follows –

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

Financial Results of Edison

	2012-13	2013-14	2014-15
Revenue	-	13,56,056	41,684
Profit after Tax	-3,22,25,543	-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)	9,95,05,50,000	3,70,55,00,000	6,76,18,90,000

30. From the above annual financial figures, I note that both the Issuer companies were incurring continuous financial losses, with Konti and Edisons incurring losses of Rs. 23.71 cr and Rs. 57.84 cr during FY 2014-15 respectively. Further, the weak financial condition of the 2 Issuers, as evident from 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, clearly suggest that both the issuer companies did not have the strength to repay the investments from the ZCNCDs by the six FMP schemes from their own resources or from their future cash flows. From the available records, I do not find that any evidence of these critical factors having been taken into consideration by Kotak AMC while making investments into the ZCNCDs of the Issuers which point to lapse in basic due diligence by the mutual fund.

31. The Noticees have also contended that subscription to the ZCNCDs of the Issuers was done knowing that the loan repayment would take place by way of refinance. In the present case, I note that proper due diligence would entail that whether the Issuer companies even had the capacity to refinance, considering their financials were continuously in the red. The fact that Kotak AMC decided to go ahead with such investment decision even when financial of the Issuers showed a lack of strong business operations and extremely weak financials, indicates lack of care and due diligence on their part. The aforesaid also clearly shows that though being aware that the balance sheets of the Issuers were in a really bad shape, Kotak AMC was taking a huge risk by making an unreasonable assumption that the Issuers will be able to honour the ZCNCDs on time and will be able to make repayment of the invested

amount upon maturity of the ZCNCDs by way of refinance. In the present case, I note that the Issuers were not able to achieve any refinance facility when the ZCNCDs matured, leaving FMP schemes with little recourse. No refinance could be secured by the Issuers even in the extended period till September 30, 2019. Thus, I find that proper due diligence was not carried out in the present case.

32. Further, the Noticees have contended that the subscription to the ZCNCDs of the Issuers was based on the strength of collateral of shares of Zee pledged by the promoters of Zee. In support of its contention, the Noticees have submitted that Zee was part of the equity desk research for last 10 years and the AMC was confident of the strength of the company based on the extensive research done by its equity desk during that period. I note 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. Further, I also note that 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. In the present case, subscription to those ZCNCDs of Konti and Edison, only on the strength of collateral of Zee shares, shows the lack of primary due diligence that was required to be carried out by Kotak AMC. At this juncture, I note that Kotak MF which holds the funds of public (unit holders) in its fiduciary capacity and has a solemn 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, cannot afford to invest funds in a manner like LAS, which is specifically prohibited under the provisions of MF Regulations.

33. The Noticees have also contended that investments by mutual funds in structured obligations of Issuers secured by collateral in the form of equity shares is a concept well known and considered in SEBI's regulatory framework and the agenda for the meeting of the Mutual Fund Advisory Committee (**MFAC**), held on July 2, 2019,

squarely dealt with this subject. The Noticees have also contended that investment in securities on the basis of the pledge of shares as collateral is a market phenomenon. The Noticees have further contended that in case of fall in the value of the cover below the specified limit, AMCs should initiate necessary steps to ensure protection of the interest of the investors and thus, one can see that even now such investments are permitted albeit with a four times cover. In this regard, 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 of 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 for the six FMP schemes was far below the prescribed mandatory threshold of collateral cover in the form of equity cover in terms of the abovementioned circular. Further, it may be noted that the above circular 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 and the same cannot be substituted at any cost. Hence, due diligence and care cannot be overlooked by an AMC while investing the unit-holders' money in any company or in any debt instrument. As already discussed above, Kotak MF has grossly failed to take cognizance of the financials 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 Kotak MF was glaringly short of the threshold requirement of collateral equity cover as mandated in the abovementioned circular. Hence, I find that the reliance placed by the Noticees on the SEBI circular dated October 01, 2019 is grossly misplaced.

34. The Noticees have contended that there were other mutual funds which also had exposure to Essel Promoter funding and in the case of few other fund houses, the structures were weaker with lower cover of listed shares. It has been further contended that these mutual funds have seen defaults in their papers and are struggling to recover their investment. Noticee have also contended that other lenders/investors have also funded to the issuers with this financials only, hence, other lenders / investors must have taken the similar comfort as Kotak MF has taken and that other mutual funds have also subscribed to Essel group entities with share cover of 1.5x Zee shares. In this regard, I note that the current proceedings are with regards to the omissions and lapses observed w.r.t six FMP schemes of Kotak MF and are based on the material available on record. Hence the present case is unaffected by the investment activities of the other entities including other mutual funds. Further, proceedings, if any, against other mutual funds, are also independent from the present proceedings. It may also be noted that the acts or any lapses by other mutual funds does not preclude the present Noticees from acting in compliance with the regulatory requirements, and on this ground, the Noticees cannot be absolved. Finally, I note that the remit of the current proceedings are in terms of the adjudication order against the Noticees based on the material available, and given the above, the proceedings cannot travel beyond the authority granted therein.

35. While discharging the 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, but also has been a regulatory expectation that the duty of the Trustee and 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, caution, 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 since detailed information as well as research reports regarding these entities are not easily available in the market.

However, I note that Kotak MF, through its AMC, 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 collateral coverage of equity shares which again, by Noticees' 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, I hold that Kotak MF cannot be said to have provided high standards of service to its investors/unit-holders and ensured proper care while conducting due diligence of the two Issuers prior to taking an investment decision to subscribe to their ZCNCDs.

36. I note that Clause 9 of the Schedule V of the MF Regulations mandates that "*the trustees and the AMCs shall render high standards of service, exercise due diligence and ensure proper care*". In my view, high standards of service would require ensuring proper care at the time of investment by assessing the adequacy of the collateral and recording of the rationale as to how 1.6/1.5 times security cover is adequate coverage/collateral for repayment. I am also of the view that high standards of service would also require assessing of the credit quality of a bond of the issuers as well as repayment capacity of the issuer of the bond in the investment rationale. Accordingly, I find no merits in the above contentions made by the Noticees.

37. In the context of the six FMP schemes, I note that proceedings under Sections 11(1), 11(4) and 11B of the SEBI Act were held against the Kotak AMC, and vide order dated August 27, 2021, passed by the Whole Time Member (WTM) of SEBI, with regard to allegations against Kotak AMC i.e. – (i) Lack of due diligence and proper care leading to not rendering high standards of service, (ii) Failure to consider research report and analyse various factors, (iii) Non-disclosure of adverse information to the unit holders, (iv) Extension of maturity date of NCDs beyond the maturity date of the scheme, (v) Partial redemption and FMPs not wound up at the end of maturity, and (vi) Wrong method of valuation of securities, WTM has held Kotak AMC to have violated the relevant provisions of the MF Regulations and SEBI circulars.

38. I note that Noticee 1 has stated regarding its role that it is vested with a general power of superintendence over the AMC and that it is not supposed to engage in day to day management of the AMC. Further, it was contended that the MF Regulations also lay down parameters of specific diligence including, trustees shall obtain internal audit reports at regular intervals from independent auditors appointed by the trustees; trustees shall obtain compliance certificates at regular intervals from the AMC; trustees shall maintain records of the decisions of the trustees at their meetings and of the minutes of the meetings; etc. Thus it was contended that the Trustees are required to play a role of strategic direction rather than operational direction and consequently, implications of day to day decision making cannot be visited upon the Trustees. In this regard, I note that Regulation 10(a) of the MF Regulations requires that "*the registration granted to a mutual fund under regulation 9, shall be subject to the condition that the trustees, the sponsor, the asset management company and the custodian shall comply with the provisions of these regulations*". Similarly, Regulation 18(7), (9) & (22) of the MF Regulations provide that – "*(7) The trustees shall ensure that the transactions entered into by the asset management company are in accordance with these regulations and the scheme; and (9) The trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations; (22) The trustees shall abide by the Code of Conduct as specified in the Fifth Schedule*.". Further, the provisions of Clause 6 and 9 of the Code of Conduct specified in the Fifth Schedule of the MF Regulations state that "*(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*; and *(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"*. In terms of the aforesaid provisions, I find that the Trustees are also liable. I note that Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the transactions entered into and activities of Kotak AMC were in accordance with the provisions of the MF Regulations and the scheme document; and that investment decision is taken solely

in the interest of the unitholders. Thus, I find no merit in the aforesaid submissions of Noticee 1.

39. Regulation 25(6A) of the MF Regulations provide that, "*The Chief Executive Officer (whatever his designation may be) of the asset management company shall ensure that the mutual fund complies with all the provisions of these regulations and the guidelines or circulars issued in relation thereto from time to time and that the investments made by the fund managers are in the interest of the unit holders and shall also be responsible for the overall risk management function of the mutual fund*." Similarly, Regulation 25(6B) of the MF Regulations provide that, "*The fund managers (whatever the designation may be) shall ensure that the funds of the schemes are invested to achieve the objectives of the scheme and in the interest of the unit holders*."

40. I, thus, note that under various provisions of the MF Regulations (as provided in the paragraphs hereinabove), it is noted that the Noticees were responsible for exercising due diligence and professional judgment in running the affairs of the aforementioned plans to achieve their Investment Objectives. In view of the above, I hold that Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the transactions entered into and activities of Kotak AMC were in accordance with the provisions of the MF Regulations and the scheme document; and that investment decision is taken solely in the interest of the unitholders; and failed to render high standards of service and exercise due diligence, thus violating Regulations 10(a), 18(7), 18(9) and 18(22) as well as Clauses 6 and 9 of the Code of Conduct in Fifth Schedule to MF Regulations. Further, I hold that Noticee 2, being the Managing Director of Kotak AMC, failed to ensure that Kotak AMC complies with all provisions of MF Regulations, guidelines and circulars issued from time to time in relation thereto, that the investments made by the fund managers were in the interest of the unit holders, and that the investments were managed in keeping with the stated investment objectives in the interest of unitholders and with the high standards of service and due diligence required of Noticee 2, thus violating Regulations 25(6A) and 25(16) of the MF Regulations read with Clauses 6 and 9 of the Code of Conduct in Fifth Schedule of the MF Regulations. Further, I note

that the investment committee members have failed to exercise due diligence and care in its investment decision and thus, I hold that Noticees 2, 3 and 7, in their role as signatory to the approval note by the investment committee for investment in Zee/Essel group companies, have violated Regulations 25(6B) & 25(16) of the MF Regulations and Clauses 6 and 9 of the Code of Conduct in Fifth Schedule of the MF Regulations. Further, I hold that Noticees 3, 4 and 6, who were fund managers (irrespective of their designations) to the aforesaid investment proposals of the FMPs have failed to ensure that the funds of the FMPs were invested to achieve the objectives of the FMPs and in the interest of the unit holders with the high standards of service and due diligence required of them, thus violating Regulations 25(6B) & 25(16) of the MF Regulations and Clauses 6 and 9 of the Code of Conduct in Fifth Schedule of the MF Regulations.

B. Due Diligence while investing in Essel Group Companies (Investments in debt securities allegedly without research report and analysing various factors)

41. On perusal of the Investment Rationale provided by the Kotak AMC, I observe that Kotak AMC did not avail any external research report(s) available for investing in the ZCNCDs of issues such as Konti or Edisons.

42. It is also noted that no records were maintained by the Kotak AMC in support for its decisions for investing in the ZCNCDs of the aforesaid issuers apart from two factors, firstly, ZCNCDs were secured through pledge of shares of Zee by Cyquator, and secondly, external rating provided by credit rating agency, *Brickwork Ratings India Pvt. Ltd.*

43. I note that SEBI Circular No. MFD/CIR/6/73/2000 dated July 27, 2000, *inter alia,* mandates that –

> *"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 scripwise 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****.*

………. "

44. It is observed that securities of Edisons and Konti were privately placed and not listed. It is also observed that Kotak AMC had not given any material to indicate that it paid specific attention for its investments in Edisons and Konti. There is no evidence of any detailed research report analysing various factors, which led to the investment decision in securities issued by Konti and Edisons. Although financials of Issuer companies, *viz.* Edisons and Konti were provided to Kotak AMC along with the Private Placement Offer Letters (PPOLs), it is observed that there is no evidence of any analysis of financials of issuer companies in the investment rationale. Further, financials of Edisons and Konti indicate that the issuer companies were loss making companies in the preceding three years of issue, i.e. FY 2012-13, 2013-14 and 2014-15. Therefore, I note that Kotak AMC did not take aforesaid facts into consideration before making investment in securities of the issuer companies. It is noted that the requirement of exercising due

diligence and care includes requirement to pay specific attention and to have a detailed research report before an investment decision is made.

45. It is observed that 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.

46. It has been contended by the Noticees that there was no external research report available on the Issuers and consequently, the approach must be to assess and analyse whether what was done by the AMC was inappropriate or found wanting in a manner warranting these proceedings, and not whether there was any investment without external research. Further, it has been contended that as reliance was primarily on underlying securities, i.e. Zee shares, the Investment Notes focused on the same including:

    (a) details of market capitalisation, promoter holding, encumbrance on promoter holding, average daily turnover in shares etc.;
    (b) shareholding pattern of Zee with dividend track record;
    (c) share price movement of Zee for last four years; and
    (d) last three years of financials of Zee and Dish and latest interim results.

47. In this regard, I note that the Circular No. MFD/CIR/6/73/2000 dated July 27, 2000 referred to above doesn't prescribe a requirement of an independent or external 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 relating to the issuer entity. I note that such a research may be conducted by internal means also. The requirement of the circular is that the said research should be properly conducted and appropriately documented in a manner so as 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 taken.

In the instant case, while the investment notes based on its own internal research has been submitted by Kotak AMC to SEBI, it has failed to produce any research report regarding either Konti or Edison which the Investment Committee has supposedly perused and examined prior to taking a decision to invest in the ZCNCDs of the two Issuers. Further, while it has been contended that the Investment Notes have examined the shareholding pattern of Zee, share price movement of Zee, financials of Zee and Dish, I note that the research on the scrip of Zee or Dish TV cannot substitute the research reports required to be prepared on the Issuer companies. Therefore, I find that Kotak AMC failed to carry out proper research and failed to prepare a research report for examining those necessary factors pertaining to the two Issuer companies which deserved to be considered for making an investment decision.

48. Accordingly, I hold that Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the activities of and and transactions entered into by the Kotak AMC were in accordance with the MF Regulations and the Schemes, failed to exercise due diligence and care in decisions of investment in the securities of Edisons and Konti, and failed in taking investment decision based on detailed research reports and solely in the interest of unit holders, thus violating Regulation 10(a), 18(7), 18(9) and 18(22) of MF Regulations read with SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000. Further, I hold that Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with the provisions of the MF Regulations, guidelines and Circulars, that the investments made by the fund managers were in the interest of the unit holders, that the basis for taking individual scrip-wise investment decisions were recorded or that detailed research reports for each investment decision for initial and subsequent investments were prepared, thus violating Regulations 25(6A) of MF Regulations read with SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000. Further, I hold that Noticees 3, 4, 6, & 7, who were fund managers and other signatories to the aforesaid investment proposals of the FMPs, failed to ensure that the basis for taking individual scrip-wise investment decisions were recorded or that detailed research reports for each investment decision for initial and subsequent

investments were prepared, and that the funds of the schemes were invested to achieve the objectives of the scheme and in the interest of the unit holders, thus violating Regulation 25(6B) of the MF Regulations read with SEBI Circular no. MFD/CIR/6/73/2000 dated July 27, 2000.

C. <u>Maturity date of the security exceeded the maturity date of schemes</u>

49. It is alleged that the maturity date of the securities in which investment was done by the FMP schemes exceeded the maturity dates of the schemes. By extending the maturity of ZCNCDs of the Issuers beyond the maturity date of the FMP schemes, the Noticees were alleged to have violated the provisions of MF Regulations read with SEBI Circular No. SEBI/IMD/CIR No. 12/147132/08 dated December 11, 2008 as follows –

    i. Noticee 1 violated Regulation 10 (a), 18(7), 18(9) and 18(22), Clause 6 & 9 of the Schedule V of the MF Regulations read with SEBI Circular: SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

    ii. Noticee 2 violated Regulation 25 (6A) read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

    iii. Noticee 3-4 violated Regulation 25(6B) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

    iv. Noticee 5 violated Regulation 18(4) (d) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

50. In this regard, I observe that FMP 127, 183, 187, 189, 193 and 194 were close-ended debt schemes of Kotak MF, which were to mature on April 08, 2019, April 10, 2019, April 15, 2019, April 22, 2019, May 2, 2019 and May 15, 2019 respectively.

51. It is observed that Scheme Information Documents ("**SIDs**") of all the six FMP schemes state that -

"*The Scheme shall invest only in such securities which mature on or before the date of the maturity of the Scheme in accordance to SEBI Circular No. SEBI/IMD/ CIR No. 12/147132/08 dated December 11, 2008"*

52. However, I note that the following multilateral agreements dated April 06, 2019 were executed:

    i. Kotak Mahindra Mutual Fund (through KMAMCL - Lender) and Konti and Cyquator and Dr. Subhash Chandra (Personal Guarantor).

    ii. Kotak Mahindra Mutual Fund (through Kotak AMC - Lender) and Edisons and Cyquator and Dr. Subhash Chandra (Personal Guarantor)

53. It is observed that as per the aforesaid multilateral agreements, Kotak MF (through Kotak AMC), in consideration of Konti and Edison agreeing to make payment of the agreed upside to it from proceeds of Zee Stake Sale, has agreed to:

    a) Extend of maturity date of NCDs of the Issuers from 8th April, 2019 to 30th September, 2019; and

    b) Enter into this agreement for capturing the terms and conditions which would govern the inter-se relationship amongst the parties.

54. I note that as per SEBI Circular no. SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008, a close ended debt scheme shall invest only in such securities which mature on or before the date of the maturity of the scheme. As per the aforesaid provision, there is a restriction on a close ended debt scheme in investing in securities which would mature beyond the date of maturity of the close ended scheme. The objective behind such a restriction is that the close ended scheme is always required to be fully redeemed at the end of the maturity period. The same is also evident from the provisions of Regulation 33(4) of the MF Regulations, which states that "*A close ended scheme shall be fully redeemed at the end of the maturity period*". I also note that rolling over of the scheme is permitted subject to fulfilment of certain conditions which is as per the proviso to Regulation 33(4) of the MF Regulations, wherein it is stated that "***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.".* I find that there is no provision under MF Regulations which enables a FMP scheme to extend the maturity of securities in a scheme beyond the scheme maturity date; however there is a provision for "roll over" as mentioned aforesaid. In the present case, the FMP schemes in question were not rolled over, however Kotak MF has admittedly extended the maturity date of ZCNCDs of the Issuers by around 6 months, which was specifically prohibited by way of the aforesaid SEBI Circular dated December 11, 2008.

55. In this regard, the Noticees have contended that the AMC has complied with the provisions of January 5, 2000 circular read in conjunction with investments stated under schedule VII of the MF Regulations. It has further been stated that as regards alleged extension of maturity of schemes, it is evident that the scheme was not in existence after the scheduled maturity date of respective scheme. In this regard, I note that the Circular No. MFD/CIR/09/014/2000 dated January 05, 2000 refers to certain changes in MF Regulations including the Seventh Schedule which deals with general investment restrictions placed on mutual funds. I note that there is no allegation in the SCNs that the Mutual Fund has violated any provisions of the said circular. However, SEBI Circular dated December 11, 2008 has been issued specifically with respect to close ended schemes and is not pertaining to general investment restrictions but on the basic structure of a close ended scheme which has to be complied at all times. The SEBI Circular dated December 11, 2008 pertaining to close ended schemes lays down a fresh set of restrictions on investment in close-ended schemes as discussed above and the act of extending the maturity dates of the ZCNCDs beyond the maturity dates

of the FMP schemes is against the very spirit of the said circular. I also note that there is no contradiction between the SEBI Circular dated January 5, 2000 and the circular dated December 11, 2008. Thus, I find no merit in the above contentions of the Noticees.

56. The Noticees in their submissions have referred to provisions of Regulation 41(2)(a) and (b) of the MF Regulations and contended that the AMC had redeemed the realized value of investments in the scheme i.e. barring the portion of investments in NCDs of the Issuers, and efforts were being made to maximise the returns possible for the investors. It has been further contended that in early September 2019, part payment of the pending dues, was also paid to all unitholders of the respective schemes and on September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes. Noticees have further contended that with the benefit of hindsight also, this decision in fact turned out far more favourable to the unitholders. In this regard, I note that FMPs being close ended schemes are required to be fully redeemed and wound up on maturity in accordance with Regulations 33(4) and 39(1) of MF Regulations. Further, I note that the AMC 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. I also note that no option was provided to the investors/unit holders to give their consent or dissent to the proposed extension allowed by the mutual fund. Thus, I find no merit in the Noticees' contention that the decision turned out more favourable, as the Issuers, inspite of getting extension, were not able to fully repay the outstanding dues to the FMPs and Kotak AMC had to resort to invoking the pledge of Zee shares around September 25, 2019 in order to recover the dues. Further, I also find no merit in the Noticees' contention that the investors were paid back along with the accrued interest, as the Mutual Fund was in any case under a statutory as well as contractual obligation to pay back its investors. Since the six FMP schemes were close ended schemes, the investors were entitled to redeem their investment at the time of 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. Thus, I find no merit in the above contentions of the Noticees.

57. The Noticees have contended that the AMC initially invested only in securities which were maturing within the maturity of the schemes and an extension of time of repayment was not envisaged and the extension of time for repayment should not be construed as a fresh investment. In this regard, I note 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 for initial investment only. Therefore, at no point of time, the AMC 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. From perusal of the various multilateral agreements dated April 06, 2019 of the mutual fund with the Issuers, Cyquator and Dr. Subhash Chandra, I observe that Kotak MF has agreed for extension of maturity of the ZCNCDs from April 08, 2019 to September 30, 2019, in consideration of the Issuers agreeing to making payment of the agreed upside to the mutual fund from the proceeds of Zee stake sale. Therefore, I note that the extension of maturity of the debt securities is an active investment decision and constituted a positive action on the part of the mutual fund. Therefore, I find the above contentions of the Noticees are not valid.

58. Further, the AMC had paid the rest of the consideration, which was also a substantial part, to the unitholders on September 25, 2019 by selling the shares of Zee pledged with it. Hence, the rationale for not selling the pledged shares of Zee to pay off the unit holders at the time of maturity of the FMP schemes as contended by the Noticees is not acceptable. Further, many of the investors in the FMP schemes would have some planned requirement for deploying the sum immediately after the date of maturity of the schemes. For such cases, by not taking their consent for unilaterally extending the maturity dates of the NCDs of the Issuers, the investors have been made to suffer as

a result of Kotak MF unilaterally extending the maturity dates of the NCDs and not redeeming the scheme fully on the scheduled date of maturity.

59. I note that the Noticees have stated that SEBI itself recognizes such a "reschedulement" of maturity and the same can be found in the Master Circular under the chapter on "9.7 Guidelines for Identification and Provisioning for Non Performing Assets (Debt Securities)". I note that the said chapter is applicable in case of Non-performing assets ('**NPA**') which are classified so by the Mutual Fund. In the present case, I note that Kotak MF has not classified the investments in the ZCNCDs of the Issuers as NPA, hence, the said chapter in Master Circular is not applicable in the present case. Hence, I note that the reference to the said chapter in Master Circular is without any merit.

60. The Noticees have also contended that 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. It has also been further contended that 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 realization. In this regard, I note that SEBI Circular dated June 20, 2002 indeed deals with treatment and disposal of <u>illiquid securities/NPAs</u> at the time of maturity/ closure of the mutual fund scheme. The said provision clearly applies in cases where some of the securities either become NPA or due to their illiquidity the Mutual Fund is unable to dispose them off in the market. As mentioned previously, at no point of time, the ZCNCDs of the Issuers were declared and valued as NPA by Kotak MF. Further, it is not the case of the Noticees that the AMC had attempted to dispose off those ZCNCDs in the market but failed to do so. Therefore, I find that in the facts & circumstances of the present matter, the provisions of SEBI Circular dated June 20, 2002 are not applicable. The said circular shall also not apply in the present context, as with respect to the investments in the ZCNCDs of the issuers, Kotak MF had shares of Zee pledged with it as security cover which were

to be invoked in case of default. Further, the provisions of circular dated September 24, 2019 has come into effect on September 24, 2019 onwards i.e. post the maturity dates of the schemes and hence, are not applicable to the present case. In view of the aforesaid, I find that the Kotak MF's decision to extend date of maturity of all the 6 schemes was not in accordance with the provisions of the MF Regulations and circulars issued thereunder.

61. In view of the above, I hold that Noticee 1, being the trustee company of Kotak AMC, failed to ensure that the activities of and and transactions entered into by the Kotak AMC were in accordance with the MF Regulations and the Schemes, failed to exercise due diligence and care in decisions of investment in the securities of Edisons and Konti, and failed in investing in accordance with the investment objectives stated in the offer documents, thus violating Regulations 10(a), 18(7), 18(9) and 18(22) and Clauses 6 & 9 of the Schedule V of the MF Regulations read with SEBI Circular no. SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008. Further, I hold that Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with the provisions of the MF Regulations, guidelines and Circulars and that the investments made by the fund managers were in the interest of the unit holders, thus violating Regulation 25(6A) of MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008. Further, I hold that Noticees 3 & 4, who were fund managers as well as Chief Investment Officer (Debt) and Vice President of Kotak AMC, respectively, failed to ensure that the funds of the schemes were invested to achieve the objectives of the scheme and were in the interest of the unit holders, thus violating Regulation 25(6B) of the MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008. Further, I hold that Noticee 5, who was compliance officer of Kotak AMC, failed to monitor the compliance of the MF Regulations and various circulars issued thereunder, thereby, violating Regulation 18(4)(d) of MF Regulations read with SEBI Circular SEBI/IMD/Cir No. 12/147132/08 dated December 11, 2008.

D. <u>Partial redemption of FMPs at the end of their maturity periods and the FMPs not being wound up at the end of their maturities</u>

62. It is alleged that there was partial redemption of FMP schemes 127, 183, 187, 189, 193 and 194 at the end of their maturity and the FMPs were not wound up at the end of their maturities.

63. I note that during the examination, Kotak AMC had informed SEBI that the realized value of investment in the scheme (barring the portion of investments in NCDs of Essel group companies) have been paid to the unit holders on maturity. In early September 2019, part payment of the pending dues was also paid to all unitholders of the respective schemes. On September 25, 2019, balance payment along with accrued interest was paid off to the unitholders of the respective schemes.

64. It may be noted that Regulation 33(4) of the MF Regulations provides that a close ended scheme shall be fully redeemed at the end of 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 SEBI. Further, 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. However, I note that in the present matter, no such roll over has taken place in case of the six FMP schemes as allowed under the provisions of Regulation 33(4) of MF Regulations. Accordingly, in such circumstances, it is mandatory under Regulation 39(1) of MF Regulations for such close-ended scheme to be wound up on the expiry of maturity period and unitholders be redeemed.

65. Further, I note that Regulation 53(b) of MF Regulations provides that every mutual fund and asset management company shall despatch the redemption or repurchase proceeds within 10 working days from the date of redemption or repurchase.

66. As established earlier, the six FMP schemes were not wound up on the dates of maturity as required under Regulation 39(1) of MF Regulations. Also, as observed earlier, the six FMP schemes were not rolled over in terms of Regulation 33(4) of MF Regulations. As seen from records, payment of redemption amount was completed only in tranches on September 25, 2019.

67. From the aforesaid, it is observed that units of the 6 schemes were not fully redeemed at the end of their respective maturity periods and nor were they rolled over for a further period in terms of Regulation 33(4) of the MF Regulations. Therefore, it is observed that all the 6 schemes were not wound up on expiry of duration fixed in FMPs by Kotak MF which led to non-payment of full NAV within 10 working days on maturity of these 6 schemes.

68. The Noticees in their submissions have contended that the provision of Regulation 53(b) of MF Regulations applies only in the event of a redemption or a repurchase, and these apply only to open ended schemes when an investor applies to the fund house to redeem or repurchase within the applicable timing. In this regard, I note that 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. I also note that 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. Thus, I find no merit in the aforesaid contention of the Noticees. Further, I also note the key information memorandums of the six FMP schemes themselves have 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 admission on the part of Kotak MF of applicability of Regulation 53(b) of MF Regulations on these six FMP schemes and as such, I do not find any merit in the contentions of the Noticees in this regard.

69. Noticees have further contended that 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. It has been also contended that 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 realization. I note that the aforesaid contentions of the Noticees has been already dealt with in the previous part of this order and I find the said provisions are not applicable in the present case.

70. Further, I note that the Noticees have contended that in terms of SEBI Circular dated January 05, 2000, "*All investment restrictions shall be applicable at the time of making investment.*" . In this regard, I 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 taken by the AMC to extend maturity of ZCNCDs of the *Issuers* was an active investment decision taken *suo motu* which was in violation of the provisions of provisions of SEBI Circular dated December 11, 2008. Further, the contentions of the Noticees as regards "reschedulement" of maturity being provided in the Master Circular have already been dealt with in the earlier sections of this order.

71. Under the circumstances, the extant regulations require a mutual fund 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, Kotak MF has failed to complete the said process laid down by law, and 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.

72. Regulation 10(a) of the MF Regulations, inter alia requires the trustees, sponsor, asset management company and the custodian to comply with the provisions of MF Regulations. Similarly, Regulation 18(7), (9) and (22) of the MF Regulations require the trustees : to ensure that the transactions entered into by the asset management company are in accordance with the MF Regulations, to ensure that all activities of the asset management company are in accordance with the provisions of the MF Regulations and that the trustee shall abide by the Code of Conduct as specified in the Fifth Schedule of the MF Regulations. Similarly, Clause 9 of the MF Regulations require that trustees and asset management company shall, at all times, render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment.

73. In view of the above, I find that Noticee 1, being the trustee company of Kotak AMC, failed to ensure that: (i) FMP series 127, 183, 187, 189, 193 and 194 were fully redeemed at the end of maturity period or were rolled over in accordance with the provisions of MF Regulations; (ii) FMP series 127, 183, 187, 189, 193 and 194 were wound up on the expiry of duration fixed in the schemes, and (iii) despatch of redemption or repurchase proceeds within 10 working days from the date of redemption. Further, Noticee 1 also failed to ensure that the activities of Kotak AMC were in compliance with the MF Regulations and Circulars issued thereunder and it also failed to render high standards of service, exercise due diligence and proper care in decisions of Kotak AMC. Therefore, I hold that Noticee 1 has violated Regulation 10(a), 18(7),18(9) and 18(22), Clause 9 of the Fifth Schedule of the MF Regulations read with Regulation 33(4), 39(1) and 53(b) of the MF Regulations.

74. Further, I note that the Managing Director (MD) / CEO as the head of AMC is responsible for all the acts of the AMC and shall be held accountable accordingly. I find that Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that: (i) All the 6 schemes were fully redeemed at the end of maturity period or were rolled over in accordance with the provisions of MF Regulations; (ii) All the 6 schemes were wound up on the expiry of duration fixed in the schemes, and (iii) despatch of

redemption or repurchase proceeds within 10 working days from the date of redemption. Noticee 2 also failed to ensure Kotak AMC's compliance with provisions of MF Regulations. Therefore, I hold that Noticee 2 has violated Regulation 25(6A) read with Regulations 33(4), 39(1) and 53(b) of the MF Regulations.

75. Further, in terms of Regulation 25(6B) of the MF Regulations, the officials who are vested with responsibilities like fund managers, whatever the designation may be, shall be held accountable. I find that Noticees 3 and 4, who were fund managers as well as Chief Investment Officer (Debt) and Vice President of Kotak AMC, respectively, failed to ensure full redemption of all the 6 schemes, leading to Kotak AMC's failure in investment of the funds of the schemes in the interest of the unit holders. Therefore, Noticees 3 and 4 have violated Regulation 25(6B) of the MF Regulations read with Regulations 33(4), 39(1) and 53(b) of the MF Regulations.

76. Further, I hold that Noticee 5, who was a compliance officer of the Kotak AMC, failed to monitor the compliance of the MF Regulations by Kotak AMC, thereby, violating Regulation 18(4)(d) of the MF Regulations read with Regulations 33(4), 39(1) and 53(b) of the MF Regulations.

E. Creation of Segregated Portfolio

77. As brought out in the paragraphs hereinabove, it is observed that the Kotak AMC did not roll over any of the 6 schemes. At the same time, it is also observed that Kotak AMC did not pay full NAV to the investors of aforesaid six FMPs on the date of maturity of FMP schemes. As stated earlier, the complete payout was done only on September 25, 2019 to the investors and the same was done through invocation of the pledge of Zee shares, which had been pledged by the promoters of Zee.

78. Vide e-mails dated May 02, 2019 and December 10, 2019, Kotak AMC informed SEBI that all the 6 schemes were close-ended schemes launched before the SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/160 dated December 28, 2018 came into existence and therefore, they did not have provision for segregating portfolio as per the circular dated December 28, 2018.

79. It is also observed that Kotak AMC, in the communication dated April 05, 2019 to the investors had *inter alia* stated, "*We are working for optimal recovery from Konti & Edisons for the benefit of unitholders and are hopeful that such recovery will happen albeit with delay.*" It also stated that any realization from the said investments, will be shared proportionately with the unitholders subsequently.

80. I note that this action by Kotak AMC reveals de-facto creation of segregated portfolio from the scheme portfolio without having enabling provisions in the Scheme Information Document and without trigger of credit events as detailed in the SEBI Circular dated December 28, 2018.

81. In this regard, the Noticees have contended that there were certain preconditions set out in the SEBI Circular dated December 28, 2018 on creation of segregated portfolio and the following preconditions were not satisfied –

i. The rating did not get downgraded to below investment grade till date of maturity.

ii. The schemes were close ended schemes and after maturity there is no concept of "main portfolio" and "segregated portfolio".

iii. Typically a segregation of a portfolio becomes relevant only when there is an open ended fund i.e. there are purchases and redemptions in a fund. In a close ended fund, there is no such situation. In the present case there was no question of continuation of the existing fund. Thus, the principles of segregation are not relevant in a close ended fund as the body of investors remain the same at all points of time and there is clear equity amongst them.

iv. Assuming while denying that its akin to a segregation, one needs to demonstrate impact to a certain body of investors, which in this case has not been alleged at all. Thus, its more a theoretical question without any practical negative implication to anyone.

v. At the time close to maturity of scheme providing option to investors for exit within 30 days without payment of exit load, if any, would not have been created different results.

82. It has been contended that in light of the above, the conditions prescribed to create segregated portfolio were not met. It has thus been argued that the AMC's action did not amount to creation of segregated portfolio. However, from the facts of the present case, I note that part of the investments made by the FMP schemes were redeemed at the maturity dates and the corresponding payments were made to the investors upon maturity, whereas the pay-out of the units of the unit-holders corresponding to the investment in ZCNCDs of the two Issuers of Essel group was blocked and the said units were allowed to be redeemed only when payment was realized in the month of September 2019. This shows that for all practical purposes, the AMC 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 the Issuers wherein the AMC decided to extend the maturity period beyond the expiry dates of the FMP schemes. Accordingly, I note that in effect, the AMC created a segregated portfolio exclusively for those ZCNCDs issued by the Issuers 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 Kotak AMC, by segregating portfolio in its schemes, viz. FMP series 127, 183, 187, 189, 193 and 194 did not comply with SEBI Circular dated December 28, 2018 and thereby, violated the same.

83. Further, the Noticees have inter alia submitted that the Ld. Whole Time Member of SEBI in his Order dated August 27, 2021 against Kotak AMC has held that –

*"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***

<u>aforesaid violation as a technical violation, which may not be required to be proceeded further.</u>" *[Emphasis Supplied]*

84. In this regard, I note that the Noticees have also submitted that there was no implication on the investors. Considering the aforesaid submissions of the Noticees and also having regard to the observations of the WTM as stated in the aforesaid order, I note that a lenient view can be taken in respect of the alleged violations by the Noticees relating to creation of segregated portfolio and no penalty is warranted for the alleged violations by the Noticees in this regard.

F. <u>Compliance with Principles of Fair Valuations</u>

85. It has been alleged that when Kotak MF decided to extend the maturity, the securities should have been valued on the basis of principles of fair value and not amortisation, thereby leading to violations of the provisions of MF Regulations and SEBI circulars.

86. I note that during examination, Kotak AMC in its e-mail dated December 10, 2019 regarding the valuation of the aforesaid securities mentioned that for the period from 07/02/19 to 07/04/19, the securities of Essel group were valued on the basis of amortization. It was further mentioned that from 08/04/19 to 11/04/19, the securities were valued on the basis of similar securities yield and on all other days, the securities were valued based on the price provided by valuation agencies. Vide letters dated April 16, 2019 and April 18, 2019, the valuation agencies viz. ICRA Management Consulting Services Ltd and CRISIL provided SEBI with details of valuation of the securities of the Issuers (for the period from December 01, 2018 to April 15, 2019) wherein they mentioned that they have not provided the valuation during the period from April 07, 2019 to April 11, 2019. CRISIL has mentioned that during those period the securities were valued on amortization basis.

87. As stated earlier, in FMP 187, 189, 193 and 194, there are three securities of Essel Group entities i.e. ISIN - INE097P07070, INE582R07044 and INE582R07051, and in FMP 127 and 183, there were four securities of Essel Group entities i.e. ISIN -

INE097P07070, INE582R07044, INE097P07088 and INE582R07051, and the original maturity of all the above securities was April 08, 2019.

88. As noted in preceding paragraphs, Kotak AMC had decided to extend the maturity period of securities beyond April 08, 2019.

89. In this regard, Noticees have contended that since there was uncertainty, NCDs of the Issuers were consistently valued as per established valuation policy till maturity date i.e. 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 and from February 7, 2019 till the maturity date of respective scheme, the securities were valued on amortization basis. The Noticees have further contended that in accordance with MF Regulations, the AMC has the required valuation policy in place and securities are valued as per price received from third party valuation agencies appointed by AMFI. Further, the Noticees have submitted that subsequent to the extension of the maturity date, based on the revised cash flow and maturity date, the securities were valued on the basis of the valuations provided by the third-party valuation agencies i.e. CRISIL and ICRA and were valued at a yield of 25.40%-25.50% against the issue yield of 11.10%. Further the Noticees have contended that the schemes are close ended schemes and could only be redeemed on maturity and investors would not have any impact due to changes in valuation.

90. In this regard, I note that Regulation 25(19) of MF Regulations specifies that the AMC 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 publishes the same. Regulation 47 specifies that the mutual fund shall ensure that the AMC 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. In this regard, the Eighth Schedule lays down the principles of fair valuation which shall be followed by the Mutual Fund so as to ensure fair treatment to all investors including existing investors as well as investors seeking to purchase or redeem units of mutual funds in all schemes at all points of time. The clause (a) of the

Eighth Schedule states that the valuation of investments shall be based on the principles of fair valuation i.e. valuation shall be reflective of the realizable value of the securities/assets. Accordingly, I note that the Eighth Schedule clearly mandates 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.

91. I note that as per the provisions of SEBI circular SEBI/IMD/CIR No.16/ 193388/2010 dated February 02, 2010 as amended by SEBI circular Cir/IMD/DF/6/2012 dated February 28, 2012, when debt securities, with residual maturity of over 60 days are not traded on a particular valuation day, they shall be valued at benchmark yield/ matrix of spread over risk free benchmark yield obtained from agency(/ies) entrusted for the said purpose by AMFI. The above circulars also specify that all non-traded debt and money market securities, with residual maturity of up to 60 days only may be valued on amortisation basis. In the present case, it is observed that securities of the issuers were valued on amortization basis.

92. It is observed that pursuant to the extension in maturity of FMP series 127, 183, 187, 189, 193 and 194, effective maturity date of securities of Edisons and Konti was no longer less than 60 days from February 07, 2019 when letters of intent were exchanged with the Issuers and pledgers of Zee group. Subsequently, the maturity dates of the securities were extended to September 30, 2019.

93. With regard to the contention of the Noticees that since there was uncertainty relating to the ZCNCDs, the said securities were consistently valued as per established valuation policy till maturity date, I note that the uncertainty in predicting the future value of the securities would lead to a further downgrade in the current valuation of those securities. The same would lead to fall in price and rise of yield on these ZCNCDs. It may be further noted that the events that ensued from January 25, 2019 onwards including the fall in the price of Zee shares and the difficulties faced by the Essel group companies, would have suggested a clear possibility of default on the part of the Issuers. It is evident that such turn of events led to Kotak MF extending the

maturity dates of these ZCNCDs so as to prevent any such default. However, on perusal of the details of valuation of the securities of Issuers as provided vide Kotak AMC's email dated December 12, 2019, I note that there is no downward valuation of the ZCNCDs by Kotak AMC. In this regard, the details of valuation price of one of the ZCNCD (ISIN : INE097P07070) as provided by Kotak AMC to SEBI during examination during the period from January 15, 2019 to February 18, 2019, is reproduced below for illustration -

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 UTILITY 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) 08/04/2019 (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 UTILITY 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

94. Thus, I note that the valuation was not reflecting the realizable value of the securities which was against the mandate of principles of fair valuation. Further, from the valuation details submitted by Kotak AMC, I note that subsequent events of failure of committee of lenders (COL), which the Kotak AMC 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. I note that the valuation done by Kotak AMC, in the present case, was far away from the market realizable value of ZCNCDs issued by the Issuers and thus the same appears to be artificially inflated. Such disclosure of artificially inflated valuation of these securities has led to maintaining an overstated NAV on a continuous basis and the same appears to be an attempt 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.

95. I further note that during examination, Kotak AMC had submitted to SEBI that the Board of the AMC and Trustee were apprised of the adverse situation ensuing from the price fall of Zee shares on January 28, 2019 and their guidance was sought on the proposed action to be taken by AMC. It was further stated that the Board of AMC and Trustee deliberated on the matter and had agreed to execute the option to go with the majority of lenders on restructuring of debt securities and the Trustee Board had also advised to take personal guarantee from the promoters of Zee for payment of dues. Further during examination, Kotak AMC, vide emails dated May 03, 2019 and December 10, 2019 to SEBI had provided the letters of intent executed with the issuers and pledgers of Zee group on February 07, 2019 which showed that the mutual fund intended to restructure the securities and extend the maturity beyond April 08, 2019. Thus, it is clear that Kotak AMC, their Trustee and the KMPs were deliberating on extending the

maturity period of the securities beyond April 08, 2019. Further, I note from the minutes of the Board meeting of Kotak AMC on March 26, 2019 that the board of AMC discussed the matter regarding the investments made by the FMP schemes in Loan against shares of Issuers and decided to opt for the second option of restructuring. Thus, the aforesaid events show that there were deliberations regarding restructuring the ZCNCDs and extending the maturity of the ZCNCDs beyond April 08, 2019. Hence, I note that the Kotak AMC should not have valued the securities on amortization basis for the period from February 07, 2019 to April 07, 2019.

96. Thus, I note from the facts of the present case, that even after the decision of the Board of the AMC and Trustees to restructure the debt securities of the Essel group entities, the AMC continued to consider the original maturity date as April 08, 2019 and valued the securities based on amortization basis for the period from February 07, 2019 to April 07, 2019, in clear violation of the provisions of the MF Regulations 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.

97. Further, I note that the Noticees have contended that the schemes are close ended schemes and can only be redeemed on maturity and investors would not have any impact due to changes in valuation. In this regard, it is to be noted that in terms of Regulation 32 of MF Regulations, 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 Noticees that incorrect valuation would have made no impact on unitholders is without any merit.

98. Further, with regard to the contention of the Noticees that the AMC has the required valuation policy in place and securities are valued as per price received from third party valuation agencies appointed by AMFI, I note that as per the provisions of Regulation 25(19) of MF Regulations, 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 has been cast upon the AMC. Further, vide Regulation 47 of MF Regulations, 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. Therefore, while the work of valuation was delegated by the AMC 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 cannot be delegated to any third party. Accordingly, I find no merit in the said contentions of the Noticees.

99. In view of the above, I find that Noticee 1, being the trustee of Kotak AMC, failed to exercise due diligence and failed to ensure that Kotak AMC valued scheme investments fairly in compliance with applicable provisions of MF Regulations and SEBI Circulars dated February 02, 2010 as updated by SEBI Circular dated February 28, 2012. Therefore, I hold that Noticee 1 has violated Regulations 10(a), 18(9), 18(22), 47 of MF Regulations, Clause 9 of the Fifth Schedule read with Eighth Schedule of the MF Regulations and SEBI Circular No. SEBI/IMD/CIR NO. 16/193388/2010 dated February 2, 2010 and SEBI Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012.

100. Further, I note that the Managing Director (MD) / CEO as the head of AMC is responsible for all the acts of the AMC and shall be held accountable accordingly. In this regard, I hold that Noticee 2, being the Managing Director of Kotak AMC, failed to ensure that Kotak AMC complied with applicable provisions relating to fair valuation of scheme investments as provided under SEBI Circulars dated February 02, 2010 and February 28, 2012, thereby, violating Regulations 25 (6A), 25(19) and 47 of the MF Regulations read with Eighth Schedule of the MF Regulations and SEBI Circular No.

SEBI/IMD/CIR No. 16/193388/2010 dated February 2, 2010 as updated by Circular No. Cir/IMD/DF/6/2012 dated February 28, 2012.

G. <u>Adequate disclosures to investors of FMP 127, 183, 187, 189, 193 and 194</u>

101. It is alleged in the SCNs that Noticee 1, being a trustee of Kotak AMC, failed to disclose scheme related information, particularly regarding the adverse situation related to Essel Group companies, to its unitholders accurately and in a timely manner, despite being aware of the same since January 2019. Further it is alleged that Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with applicable provisions of the MF Regulations on disclosure of scheme related information to unitholders. Further, it is alleged that Noticee 5, being the Compliance Officer of the Kotak AMC, failed to monitor the compliance with applicable provisions of MF Regulations with respect to disclosure of scheme-related information to unitholders. Accordingly, the above Noticees were alleged to have violated the provisions of the MF Regulations.

102. I note that asset management company as well as trustee companies are required to render high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment, at all times. Such high standards of service require timely dissemination of material information relating to the schemes.

103. I note that, at the outset, there was a sharp fall of more than 25% in the price of the scrip of Zee on January 25, 2019 which brought down the collateral cover to below 1.50 times of the total outstanding investment amount, which had been agreed to between the Kotak AMC and the Issuers at the time of investment. During examination, it was submitted by Kotak AMC to SEBI that the top up in security cover were triggered by the Debenture Trustee (IDBI Trusteeship Services Ltd) and till January 25, 2019, the issuer/pledger had honored the entire top up requests as per stipulated terms and security cover was maintained. However, post the fall in level of security collateral on January 25, 2019, the Issuers showed their inability to pledge more shares so as to increase the cover to the mandated 1.50 times the outstanding investment.

104. From the reply of the Kotak AMC vide e-mail dated April 22, 2019 to SEBI during examination, I note that the Board of Directors of the Kotak AMC, along with other lenders had deliberated the issue of fall in share price of Zee in their meeting with the promoter of Essel Group on January 26, 2019. Consequent to their meeting with the promoters of Essel Group, the Board of Kotak AMC and Trustees agreed to execute the option to restructure the debt securities in the interest of unitholders on January 28, 2019. The Trustee Board also advised to take personal guarantee from the promoters of Zee for payments against their investments. I also note that Letters of intent were executed amongst Issuers, Kotak AMC, pledgers of Zee shares and committee of lenders on February 07, 2019 relating to restructuring of the debt securities of the Issuers.

105. However, I note that the breach of top up covenants by the Issuers immediately post the steep price fall on January 25, 2019 was disclosed to the unitholders only on April 05, 2019. The dates of communication to investors is as follows –

Name of Scheme	*No. of investors*	*Maturity date of Scheme*	*Date of communication to the investor*
Kotak FMP Series 127	640	08/04/2019	*05/04/2019*
Kotak FMP Series 183	1726	10/04/2019	*05/04/2019*
Kotak FMP Series 187	2134	15/04/2019	*05/04/2019*
Kotak FMP Series 189	519	17/04/2019	*10/04/2019*
Kotak FMP Series 193	1345	02/05/2019	*09/04/2019*
Kotak FMP Series 194	1373	15/05/2019	*05/04/2019*

106. With regard to the allegations, the Noticees have contended that Kotak AMC accepted a letter of intent dated February 7, 2019, issued by the Issuers on the precondition that it will be a part of the Committee of Lenders (“COL”), and the said letter was an in-principle understanding between COL, Issuers and pledgers, and was not a binding agreement in itself as it was contingent upon on determination by the COL.It has been further stated that the letter of intent mentioned that in case the charter was not finalized between the identified lenders within a period of seven business days, the

understanding set out therein shall fall away. It has been further submitted that no agreement was reached between the COL and the Issuers and the same did not mean that the Issuers had defaulted and the position of the AMC remained unchanged between January 25, 2019 and February 14, 2019. It has also been submitted that the security cover was in excess of the amounts recoverable on the investment but lesser than the committed security cover of 1.5 times. It has thus been submitted that there was reasonable uncertainty regarding any adverse impact to investors and since no other options worked out, Kotak AMC then basis various discussions during the period of January to April 2019 entered into an agreement on April 6, 2019 with the issuer capturing upside sharing by the Issuers based on the realized value from Zee's strategic sale and also obtained a Personal Deed of Guarantee from Dr. Subash Chandra Goyal for the said security. Further, it has been contended that this arrangement ensured that there would be no adverse impact to investors of the scheme and in fact, it provided for better terms to the unitholders with additional security of the personal guarantee of Dr. Subhash Chandra. Further, it was contended that it is pertinent to note that as soon as the structure of the abovementioned agreement was agreed upon, the AMC, in order to maintain transparency, informed the investor of the same, i.e. on April 5, 2019. Accordingly, the allegations were denied.

107. In this regard, I note that as per Regulation 60 of MF Regulations, the trustee shall be bound to make such disclosures to the unitholders as are essential in order to keep them informed about any information which may have an adverse bearing on their investments. As per the response received from Kotak AMC, it is observed that the problem relating to Essel Group was known to both the AMC and Trustees since January 2019. Kotak AMC along with other lenders had held meetings with Essel group promoters on January 26, 2019. I note that on January 28, 2019, Board of Kotak AMC and Noticee 1 deliberated on the matter and had agreed to execute the option to restructure the debt securities in the interest of unitholders. Trustee Board i.e. Noticee 1 had also advised to take personal guarantee from the promoters of Zee for payment of dues. I note that although this was a material event affecting the interest of the

investors, no disclosure was made to the investors in January, 2019. I note that disclosure was made to investors for the first time just few days before maturity of the scheme i.e. on around April 5, 2019 i.e. communication to investors were sent a few days before the maturity of the schemes and not at the time of decision made by AMC and Trustee i.e. in January 2019. Therefore, I find that the decision taken by trustees / AMC Board was not available to investors at the relevant time. The limited communication was made to investors only at the time of maturity of FMPs. I also note that Kotak AMC had submitted to SEBI that there were around 59 complaints received from investors regarding the four Kotak FMPs viz. FMP Series 187, 189, 193 and 194. Further, I note that Kotak AMC vide e-mails dated May 03, 2019 and December 10, 2019 to SEBI had provided letters executed with issuer and pledgers of Zee group on February 7, 2019. However, I note that the said decision was also not disclosed to the investors. In fact, there was no communication to the unitholders for more than 2 months subsequent to the credit event pursuant to the sudden fall in the share price of Zee. This shows that during this period the unitholders were not disclosed the material information which they should have been given and were left in a state of uncertainty about the fate of their investments.

108. From the foregoing, I note that the information of Essel promoters not providing additional cover when the margin call triggered, the decision of AMC and trustees to extend the maturity of the securities, and the letters of intent executed on February 7, 2019 and subsequent failure of COL to come to an agreement, all being information having adverse bearing on the investments of investors, was not communicated to the investors when the events took place. Thus, I find that sending the communication to the investors for the first time on April 5, 2019, just before the maturity of the schemes, does not achieve the intended purpose of disclosure to the investors as stipulated under the MF Regulations. Clause 2 of the Fifth Schedule of the MF Regulations required the Trustee and the AMC to make disclosures to the unitholders immediately after the occurrences of these developments, however, the AMC and trustee have admittedly not done so.

109. In view of the above, I find that Noticee 1, being a trustee of Kotak AMC, has failed to disclose scheme related information, particularly regarding the adverse situation related to Essel Group companies, to its unitholders accurately and in a timely manner, despite being aware of the same since January 2019. Thus, I find that Noticee 1 has violated Regulations 10(a), 18(22), and 60 of the MF Regulations as well as Clause 2 of the Code of Conduct in Fifth Schedule of the MF Regulations. I also note that the MD/CEO as head of AMC is responsible for all the acts of AMC and is accountable accordingly. In this regard, I note that Noticee 2, being the Managing Director of the Kotak AMC, failed to ensure that Kotak AMC complied with applicable provisions of the MF Regulations on disclosure of scheme related information to unitholders. Thus, I hold that Noticee 2 violated Regulation 25(6A) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations. Further, I find that Noticee 5, being the Compliance Officer of the Kotak AMC, failed to monitor the compliance with applicable provisions of MF Regulations with respect to disclosure of scheme-related information to unitholders. Thus, I hold that Noticee 5 violated Regulation 18(4)(d) of the MF Regulations read with Regulation 60 of the MF Regulations and Clause 2 of the Fifth Schedule of the MF Regulations.

Issue VI) ***Do the violations, if established, attract monetary penalty under Section 15D(b) and 15HB of SEBI Act?***

110. In this regard, I note that the Hon'ble Supreme Court of India in the matter of ***SEBI vs. Shri Ram Mutual Fund*** held that "*once the violation of statutory regulations is established, imposition of penalty becomes sine qua non of violation and the intention of parties committing such violation becomes totally irrelevant. Once the contravention is established, then the penalty is to follow.*"

111. In view of the foregoing and placing reliance on the aforesaid judgement, I note that the violations committed by the Noticees, as established above, make them liable for penalty under Section 15D(b) and 15HB of SEBI Act, which at the relevant time of commission of violations, read as under –

SEBI Act

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.*

Issue VII) ***If so, what would be the quantum of monetary penalty that can be imposed on the Noticees after taking into consideration the factors mentioned in section 15J of the SEBI Act?***

112. In this regard, the provisions of Section 15J of the SEBI Act and Rule 5 of the Adjudication Rules, require that while adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors namely; -

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default.

113. I observe, that the material available on record does not quantify any disproportionate gains or unfair advantage, if any, made by the Noticees and the losses, if any, suffered

by the investors due to such violations on the part of the said Noticee. With respect to the repetitive nature of the default, I find that no prior default by the Noticees is available on record. However, in the present case, lapses and violations have been observed on the part of the Noticees with regard to lack of due diligence and consequently negligence while investing in Essel Group Companies as well as with regard to maturity date of the security exceeding the maturity date of schemes, the six FMP schemes viz. FMP 127, 183, 187, 189, 193 and 19 not being wound up at the end of their maturities and being partially redeemed at the end of their maturity dates, non-compliance with Principles of Fair Valuation while valuing the ZCNCDs of the issuers, and inadequate disclosures to investors of the six FMP schemes. I note that the interests of the of the investors has been affected negatively on account of the aforesaid infractions on the part of Noticees.

114. It is noted that in the multi-tier structure of Mutual Fund, the trustees hold the funds on behalf of investors on trust and the AMC is entrusted with the responsibility of managing fund. The main role of the trustee is to ensure that the interest of the unit holders is protected while making sure that the mutual fund complies with all the regulatory requirements of SEBI. The Trustees are guardian of funds of investors and in order to protect the interest of all the investors, they are expected to exercise fiduciary duties of trust and ensure fairness to all investors. In order to enable the AMC to carry out its objectives, the MD / CEO, Chief Investment officer (CIO), Compliance Officer (CO) and the Fund Managers are expected to act diligently in the best interest of the unitholders by complying with the various regulatory provisions. It is pertinent to note that individuals who want to invest in the stock market but do not have expertise and time to do so, invest through a mutual fund so as to benefit from professional management, diversification of portfolio, liquidity, ease of investing and affordability. Thus, it is imperative for the Trustee and the persons at the helm of affairs viz., MD, CIO, CO and the Fund Managers at all times, to act diligently and faithfully in the best interest of the unitholders. Infirmities in their conduct and any non-compliance or deviation from the regulatory requirements, would derail the trust imposed by the

unitholders in the Mutual Fund and threaten the very structure of this industry. Therefore, I am of the view that appropriate penalty should be imposed on Noticees, given the gravity of the violations established against each of the Noticees, which would act as a deterrent for the Noticees and others.

ORDER

115. Having considered all the facts and circumstances of the case, the material available on record, the submissions made by Noticees and also the factors mentioned in Section 15J of SEBI Act, as enumerated above, I, in exercise of the powers conferred upon me under Section 15-I of the SEBI Act read with Rule 5 of the Adjudication Rules, hereby impose the following penalties on Noticee 1 under Section 15D(b) and 15HB of SEBI Act and Noticees 2 to 7 under Section 15HB of SEBI Act for the violations discussed in this order:–

Noticee	**Penal Provisions**	**Penalty (Rs.)**
Noticee 1 (Kotak Mahindra Trustee Company Limited)	Section 15D(b) and 15HB of SEBI Act	Rs. 40,00,000/- (Rupees Forty Lakh Only)
Noticee 2 (Mr. Nilesh Shah)	Section 15HB of SEBI Act	Rs. 30,00,000/- (Rupees Thirty Lakh Only)
Noticee 3 (Ms. Lakshmi Iyer)	Section 15HB of SEBI Act	Rs. 25,00,000/- (Rupees Twenty Five Lakh Only)
Noticee 4 (Mr. Deepak Agarwal)	Section 15HB of SEBI Act	Rs. 20,00,000/- (Rupees Twenty Five Lakh Only)
Noticee 5 (Ms. Jolly Bhatt)	Section 15HB of SEBI Act	Rs. 10,00,000/- (Rupees Ten Lakh Only)
Noticee 6 (Mr. Abhishek Bisen)	Section 15HB of SEBI Act	Rs. 15,00,000/- (Rupees Fifteen Lakh Only)
Noticee 7 (Mr. Gaurang Shah)	Section 15HB of SEBI Act	Rs. 20,00,000/- (Rupees Twenty Lakh Only)

116. The Noticees shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of Demand Draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, OR through online payment facility available on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link:

ENFORCEMENT → Orders → Orders of AO → PAY NOW.

117. The aforesaid Noticees shall forward said Demand Draft or the details / confirmation of penalty so paid to "The Division Chief (Enforcement Department - DRA-1), Securities and Exchange Board of India, SEBI Bhavan, Plot No. C – 4 A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051.". The Noticees shall also provide the following details while forwarding DD / payment information:

a) Name and PAN of the Noticee
b) Name of the case / matter
c) Purpose of Payment – Payment of penalty under AO proceedings
d) Bank Name and Account Number
e) Transaction Number

118. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, SEBI may initiate consequential actions including but not limited to recovery proceedings under section 28A of the SEBI Act, 1992 for realization of the said amount of penalty along with interest thereon, *inter alia*, by attachment and sale of movable and immovable properties.

119. In terms of Rule 6 of the Adjudication Rules, copy of this order is sent to the Notices and also to Securities and Exchange Board of India.

Date: June 30, 2022 **Soma Majumder**
Place: Mumbai **Adjudicating Officer**