

**BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. Order/BM/GN/2023-24/25912]**

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

In respect of:

Karvy Capital Limited

PAN: AAACG4544N

In the matter of

**Role of Karvy Capital Limited in the matter of NCDs issued by Utkarsh Small Finance
Bank Limited.**

BACKGROUND:

1. Securities and Exchange Board of India (hereinafter referred to as “SEBI”) examined the transaction of Karvy Capital Limited (hereinafter referred to as “**KCL**” / “**Company**” / “**Noticee**”) in the unsecured Non-Convertible Debentures (**NCDs**) of Utkarsh Small Finance Bank Limited (hereinafter referred to as **USFB**) and prima facie observed violation of provisions of Regulation 13, 14, 15(4) of the Securities And Exchange Board of India (Portfolio Managers) Regulations, 1993 (hereinafter referred to as SEBI (PMS) Regulations, 1993) read with Clause 1 and 3 of Schedule III and V of SEBI (PMS) Regulations, 1993.

APPOINTMENT OF ADJUDICATING OFFICER

2. The undersigned has been appointed as the Adjudicating Officer vide Order dated February 27, 2023 under Section 15-I of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as **SEBI Act**) and Rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as “**SEBI Adjudication Rules**”) to enquire into and adjudge under the provisions of Section 15HB of SEBI Act, 1992, the alleged violations of provisions Regulation 13, 14, 15(4) of the SEBI (PMS) Regulations, 1993 read with Clause 1 and 3 of Schedule III and V of SEBI (PMS) Regulations, 1993.

SHOW CAUSE NOTICE, REPLY AND HEARING

3. Show Cause Notice (hereinafter referred to as “**SCN**”) dated March 13, 2023 was issued to the Noticee under rule 4(1) of the SEBI Rules to show cause as to why an inquiry should not be held against it in terms of Rule 4 of SEBI Rules read with Section 15-I of SEBI Act and penalty, if any, be not imposed on Noticee under Section 15HB of the SEBI Act.
4. The allegations levelled against the Noticee are summarized below:
5. SEBI had examined the issuance of NCDs by USFB through private placement basis. During the examination, it was observed that KCL in capacity of NBFC had structured the NCDs of USFB and charged fees from USFB.
6. On the basis of the examination, following are observed:
 - (i) KCL is a SEBI registered portfolio manager (INP000004524) and Karvy Capital Limited A/c Excel Portfolio is a discretionary strategy offered under its PMS services.
 - (ii) KCL in capacity of NBFC structured the NCDs for USFB for which it received an advisory fee of Rs.98,55,000/-. Thereafter, KCL in capacity of PMS subscribed to 2500 unsecured NCDs of Rs. 1,00,000/- each on behalf of its clients on July 11, 2018 amounting to Rs.25 Crores and transferred the same to its 355 PMS clients on July 20, 2018. Therefore, there was an alleged inherent conflict of interest in the dual role played by KCL as a structurer of the deal and also as an investor on behalf of their clients through its PMS arm.
 - (iii) In the Disclosure document dated February 2018 , KCL had disclosed to its clients about buying securities from its NBFC arm at a price as may deem fit by the PMS, the disclosure does not mention any thing about the role and the alleged conflict of interest. However, subsequent to query from SEBI, disclosure document was amended on April 2021 detailing about the role of NBFC division in structuring the securities and that PMS Division may buy the securities of issuer companies wherein NBFC division is involved in such structuring and about receipt of payment from the issuer which could be structured as an advisory fee, discount on such debentures/ securities.

- (iv) Regarding the aforesaid, KCL vide its email dated May 04, 2022 inter-alia submitted that keeping in mind the interest of their clients' and the underlying spirit behind the making of the disclosures, after finding that disclosures contained in disclosure document of February 2018 may not have been adequate, they have revised the disclosures contained in disclosure document of April 2021.
- (v) Further, KCL has further submitted that no complaints were received by them regarding the "possible source of conflict" in the said transaction.
- (vi) It was also confirmed by the PMS that there were separate earmarked teams for deal structuring and for portfolio management and hence there was no conflict of interest as per the PMS. It is further informed that the restructuring desk of KCL (NBFC arm) was closed in FY 2019.
7. Since KCL in capacity of NBFC structured the NCDs for USFB for which it received an advisory fee of Rs.98,55,000/-, thereafter, KCL in capacity of PMS subscribed to 2500 unsecured NCDs, compliance with Regulation 15(4) of SEBI (Portfolio Managers) Regulation 1993 was examined which states
- The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities*
8. It is alleged that KCL did not initially present to its clients, complete and clear factual position about activities of its NBFC arm and linkages with the PMS arm, especially with respect to advisory fees received by the entity in capacity of NBFC for structuring the NCDs for USFB for an amount of Rs.98,55,000. Disclosures made in Disclosure Document dated February 2018 to its clients about buying securities from its NBFC arm at a price as may deem fit by the PMS did not indicate the advisory fees that will be received by the entity in capacity of NBFC for structuring NCDs that will be acquired on behalf of the client. KCL-PMS allegedly has not provided any details as to disclosures made to its clients regarding the nature and amount of fees received in structuring such securities and conflict of interest involved before the acquisition of such securities on behalf of its PMS clients. KCL-PMS has not provided any details as to disclosures made regarding the nature and amount of fees received in structuring such securities and conflict of interest involved immediately post such acquisition to clients. Only after enquiry by SEBI, disclosure document was amended in April 2021.

9. Thus, it is alleged that KCL-PMS has failed to comply with Clause 3 to Schedule III read with Regulation 13 of the SEBI (Portfolio Managers) Regulations, 1993 which inter-alia requires PMS to either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers. Further, it was specified that the portfolio manager is required to disclose to the clients, possible source of conflict of interest, while providing unbiased services. A portfolio manager shall not place his interest above those of his clients. Further, Clause 1 to Schedule III, specifies that a portfolio manager shall observe high standards of integrity and fairness in all his dealings with his clients, which is also allegedly not complied with.
10. Further, Regulation 14 read with Schedule V of the PMS Regulations, the portfolio manager may make any other disclosures, which in its opinion are material for the investor. Further, the disclosure document must inter-alia include disclosure of conflict of interest related to services offered by the manager. Since the nature and amount of fees received in structuring such securities and conflict of interest involved in acquisition of such securities not adequately disclosed to its PMS clients in Disclosure Document to enable the clients to make informed decision regarding their investment, the same is allegedly not in compliance with Regulation 14 of SEBI (PMS) Regulations, 1993.
11. Regulation 15(4) of SEBI (Portfolio Managers) Regulation 1993 states that *the portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities*. KCL in the capacity of NBFC Structured the NCDs for USFB for which it received an advisory fee of Rs.98,55,000/- and subsequently the clients' money were invested by KCL in the same securities, which it had structured. The same allegedly indicates *benefit derived by KCL out of the client's funds or securities*. The same is alleged to be in non-compliance with Regulation 15(4) of the SEBI (PMS) Regulations, 1993.
12. In view of the above, it is alleged that Noticee has violated Regulation 13, 14, 15(4) of the SEBI (PMS) Regulations, 1993 read with Clause 1 and 3 of Schedule III and Schedule V of SEBI (PMS) Regulations, 1993.
13. The SCN was issued at the last known address of Noticee through Speed Post Acknowledgment Due (SPAD) which was delivered. SCN was also sent through Digitally Signed E-mail dated March 17, 2023 which was delivered and the delivery of the notice is on record. Vide hearing notice dated April 03, 2023, opportunity of hearing was given to

the Noticee on April 13, 2023. Hearing Notice was issued to the Noticee through SPAD was delivered and Hearing Notice was also sent through Digitally Signed E-mail dated April 03, 2023 which was delivered and the delivery is on record. Vide email dated April 06, 2023 Noticee submitted the reply dated April 06, 2023, which is summarized below-

- (i) Noticee submitted that the relevant disclosures in the Disclosure document were already there (which were subsequently revised in deference to the apprehensions expressed by SEBI during the course of inspection in April 2021) and there was no conflict of interest as alleged. The allegations in the Notice are based on incomplete appreciation of events as have transpired in the matter, specifically - that the decision to invest in the NCDs of UFSB was a commercially sound decision, that the investments in NCD's of UFSB continue to reap benefits for the investors, that there are no complaints from clients with regard to said investment.

Preliminary submissions- Delay in issuance of SCN

- (ii) Noticee submitted that the present proceedings suffer from enormous laches. The alleged violations relate to period July 2018 and the SCN has been issued in March 23 (i.e. after almost 5 years). Clearly, there has been extraordinary inordinate delay in the issuance of SCN. The aforesaid inordinate delay has severely prejudiced them and the said inordinate delay has not been explained by SEBI. Noticee submitted that on this ground alone, the SCN proceedings needs to be and ought to be discontinued and SCN needs to be dropped.
- (iii) Noticee submitted that even though there is no period of limitation prescribed in the SEBI Act and Regulations for the completion of investigations or for the issuance of a show cause notice or for completion of the SCN proceedings, the authority is required to exercise its powers within a reasonable period. Noticee submitted that the facts of the present case will amply demonstrate that the powers have not been exercised within a reasonable period and therefore, in the facts and circumstances of the case, proceedings need to be discontinued and dropped and no penalty need be imposed.
- (iv) Noticee referred to the Orders passed by the Hon'ble Securities Appellate Tribunal in the matters of Ashlesh Guntantbhai Shah Vs SEBI (SAT Appeal no 169 of 2019), Ashok

Shivlal Rupani and anr. Vs SEBI (SAT Appeal no 417 of 2018) and Shriram Insight Share Brokers V/s. SEBI (Appeal No.559 of 2020).

Background

- (v) Noticee submitted that KCL is an Asset Management Company offering Portfolio Management (PMS) and Alternative Investment (AIF) Services. KCL has been registered with Reserve Bank of India ('RBI') to carry on the business of Non-Banking Financial Institution ("**NBFC**") with effect from March 24, 1998. KCL is registered with SEBI as a Portfolio Manager vide registration number INP000004524.
- (vi) Noticee submitted that the teams for KCL-NBFC Division (now discontinued) and KCL-PMS Division were separate and distinct, with no team overlap. Both the business verticals of KCL, had clearly identified area of operations and allocation of responsibilities.

Investment by KCL-PMS Division in NCD's of USFB, Disclosures in Disclosure document and Performance of Investment

- (vii) Noticee submitted that in 2018, the PMS team had, after conducting requisite due diligence, identified USFB's rated, listed, unsecured, non-convertible debentures, as an investment opportunity. Investment into the NCD's of USFB was identified as per the mandate of the Excel strategy, as detailed in the RDD and per the laid down Investment guidelines. Post identification, PMS team had invested into these NCD's bearing ISIN INE735W08012 on behalf of the Investors, by subscribing to 2500 unsecured NCDs of Rs. 1,00,000/- each on behalf of its clients on July 11, 2018, amounting to Rs.25 Crores and transferring the same to its 355 PMS clients on July 20, 2018.
- (viii) Noticee submitted that KCL in its capacity as an NBFC, had in the ordinary course of its business, advised USFB regarding NCD issuance and structured the same, wherein it had inter alia rendered following services viz (a)the various fund raising methods; (b)the best suited options (given the market conditions and the financial/operational health of the SME); (c) the contours of the deal;(d)the legal requirements involved and legal compliances to be made etc. For providing the said services, KCL- NBFC Division had received an advisory fee of Rs.98,55,000/- from USFB.

- (ix) Noticee further submitted that given the potential overlap in the activities of KCL-NBFC Division and KCL-PMS Division, a standard disclosure was already made in the Disclosure Document at the relevant time (i.e. February 2018) wherein it was inter alia disclosed that KCL-PMS Division may buy securities from its NBFC arm (i.e. KCL-NBFC Division) at a price as it may deem fit. The said disclosure was, upfront made to the investors clearly disclosing that there may be potential transactions between KCL-PMS division and KCL-NBFC division pertaining to securities involved in the PMS investments.
- (x) Noticee further submitted that the investment decision of KCL-PMS Division in the NCD's of UFSB has proved to be sound and successful, since clients have made money by making the investment. USFB has been regularly paying interests and there has been no default on its part. All dues have been paid by USFB on time without any delay. Noticee also submitted that the effective return of the bond for the investors since onboarding (July 2018) is 11.00% IRR and the comparative return on the S & P BSE India Bond Index since July 2018 is 8.05%. Clearly, identification of UFSB for making investments and decision to invest on behalf of clients in the NCDs of UFSB has turned out to be a sound decision and a profitable investment.
- (xi) Significantly, there are no complaints from any of the PMS clients with regard to investments made by KCL- PMS Division in the NCO's issued by UFSB.

SEBI Inspection in 2021

- (xii) Noticee submitted that during the course of inspection by SEBI in April 2021, SEBI had raised concerns with regard to adequacy of disclosures and that there was 'conflict of interest' arising from activities of KCL- NBFC Division and KCL- PMS Division, in context of investments made in NCDs of UFSB.
- (xiii) Noticee submitted that from the reading of the disclosures made in 2018, it would be evident that they had inter alia disclosed : (a) that there are different divisions in KSBL including PMS Division, NBFC Division; (b) that there could arise occasions wherein PMS division may buy securities from NBFC Division (which in normal course of business purchases securities).

- (xiv) Noticee submitted that since concerns were raised with regard to alleged disclosures and conflict of interest, KCL-PMS Division had suo motu, (despite disclosures being there in the Disclosure Document regarding potential transactions between KCL-PMS Division & KCL-NBFC Division pertaining to securities involved in the PMS Investments), as a matter of abundant caution, inter alia, keeping in mind the interest of their clients' and the underlying spirit behind the making of the disclosures, revised the disclosures contained in disclosure document of April 2021. Vide the revision in the Disclosure document in April 2021, KCL-PMS Division had inter alia disclosed, that KCL-NBFC Division may have a role in structuring the securities, that KCL-PMS Division may buy the securities of issuer companies wherein KCL-NBFC division is involved in such structuring etc.
- (xv) Noticee submitted that from the disclosures made in April 2021 it is clear that, KCL-NBFC Division /or other entities belonging to Karvy Group may associate themselves with issuer companies, for structuring of the securities in relation to securities, for preparation of the term sheets and related documents, for appointment of key agents such as trustee, escrow agent, legal counsel etc. Further, for the said services the KCL- NBFC Division /or other entities belonging to Karvy Group may receive a payment from the issuer which could be structured as an advisory fee, discount on such debentures/ securities or a combination of the two.
- (xvi) Thus, Noticee submitted that the alleged irregularity or technical lapse, if any, in the disclosures made in the Disclosure document, was cured and rectified, way back in April 2021.
- (xvii) Noticee denied that they had not provided complete and clear factual position about activities of their NBFC arm and linkages with the PMS arm to our clients as alleged. The disclosure regarding the relationship was already there in the Disclosure document, wherein disclosures regarding potential transactions between KCL-PMS Division & KCL-NBFC Division pertaining to securities involved in the PMS Investments were already there. Noticee submitted that it is not possible to make all possible disclosures. Fact is whatever was reasonably required to be disclosed, was disclosed. Further, Noticee submitted that there was no conflict of interest as alleged. When a single entity is having different registrations, such kind of situations are bound to crop up, wherein one arm is dealing with the other arm of the same entity.

But, that cannot be a ground to view the transactions of different arms with each other suspiciously. Noticee further submitted that it is not the case that bogus investment without any due diligence has been fastened on to the investors and the investment in question was made by KCL-PMS Division, only after rigorous due diligence. Noticee submitted that there is nothing to suggest that there actions, judgment, and/or decision-making in terms of making investment in the NCD's of UFSB, was not unbiased or that they have compromised the decision-making process in any manner.

(xviii) Noticee denied that they have failed to comply with Clause 3 to Schedule III read with Regulation 13 or the provisions of Regulation 14 read with Schedule V or the provisions of Regulation 15(4) of the PMS Regulations, as alleged.

(xix) Noticee reiterated that they had made all the disclosures which in their opinion were material for the investors. At the relevant time, given the disclosures already existing in the disclosure document (wherein disclosure regarding potential transactions between KCL-PMS Division & KCL-NBFC Division pertaining to securities involved in the PMS Investments were made) , they never felt that there was any conflict of interest arising from KCL as an NBFC receiving fees for structuring securities .Noticee denied that as a consequence of non-disclosure of alleged conflict of interest, the investors have not been in a position to take an informed decision. Noticee said that the allegation is sweeping, bald and in the air. Noticee submitted that while alleging that they have deprived the investors from taking an informed decision, it has been totally ignored and overlooked that they are a 'Discretionary Portfolio Manager'. In the capacity of 'Discretionary Portfolio Manager', they can exercise any degree of discretion as to investment of funds and management of portfolio of securities of the clients. At the relevant time, they were aware that the KCL-NBFC Division was involved in the structuring of NCD's. As a 'Discretionary Portfolio Manager', they had bonafide , without in any manner being influenced by presence of KCL-NBFC Division is structuring the NCD's, taken the decision to invest in the NCD's of UFSB after doing the requisite due diligence and nobody has disputed that wisdom of their investment decision, which has proved to be commercially sound and investor friendly.

(xx) Noticee denied that they have derived any direct or indirect benefit out of the client's funds or securities as alleged. There is absolutely no supporting material for the same.

The fees earned by KCL NBFC were legitimate fees for the bonafide services

rendered by it in the ordinary course to UFSB. Said fees cannot be branded as 'benefit derived by KCL out of the client's' funds or securities as erroneously alleged.

- (xxi) Noticee submitted that KCL was operating in two separate activities viz. NBFC activity & PMS activity. Advisory fees were received by KCL-NBFC Division for the services rendered by it to the Issuer i.e. UFSB. Further, the fees had nothing to do with the KCL- PMS Division' activities. Admittedly, KCL-PMS Division has not received any fees from UFSB. Therefore, the issue of KCL-PMS Division, as a Portfolio Manager, '*deriving any benefit out of the client's funds or securities*' cannot and does not arise. Decision of KCL-PMS Division to invest in the NCD's of UFSB was an independent decision and had nothing to do with the fees received by KCL-NBFC Division for the advisory fees received by it from UFSB. Noticee denied that as portfolio manager they have derived any benefit out of the client's funds or securities, as alleged.

14. AR of the Noticee attended the hearing on the scheduled day and reiterated the submission made vide reply dated April 06, 2023 and the AR further sought time till April 18, 2023 for making the additional submissions. Vide email dated April 17, 2023, Noticee submitted the additional reply dated April 17, 2023 and made the following submissions-

Adequate disclosures-regarding potential conflict of interest already there in the Disclosure Document.

- (i) Noticee submitted that the disclosures regarding potential conflict of interest were already made in the Risk Disclosure Document ("RDD"). In this context, they referred to the following clauses:

"5.4 Investment in Group I associate companies

The Portfolio Manager/Fund Manager may invest in Securities of the associate/group companies subject to the applicable laws/ regulations/ guidelines. These investments will be carried out to achieve the investment objectives and strategies and in .the normal course of investment activity subject to the applicable laws/regulations.

The Portfolio Manager/Fund Manager may invest in any unlisted securities of any associate/group companies of the Portfolio Manager/ promoter. The Portfolio

Manager/Fund Manager may also invest in privately placed securities issued by Associate/Group companies of the promoter,

5.6 Conflict of interest

Karvy Capital Limited, Portfolio Manager is also the Investment Manager to a Category III Alternate Investment Fund (AIF). Since the entity is the same, the management for both the portfolio management division and Investment Management division remains the same. However, the personnel such as fund manager(s), teams involved in order generation and execution will be independent of the personnel involved in the same activity for portfolio management services.

Further, the services offered by the Investment Manager under the AIF offering and the Portfolio Management services to clients are inherently very different. The key difference is that as of now Portfolio management invests in low/unrated/low rated debt instruments while the AIF invests in High Quality instruments. The AIF fund will invest in high quality corporate, sovereign and tax-free bonds across various maturities with high credit rating. Derivative transactions would also be considered in these strategies. The PMS portfolio would primarily consist of debt securities, preference capital, commercial paper, tax free bonds and pass through certificates which may be listed or unlisted and would be of moderate quality.

Nonetheless, the management will provide their guidance and insight with relation to monitoring of overall functioning of both the AIF and portfolio management services and their broad macro views on the investment front shall be used for both. Therefore there is no conflict of interest in both these activities.

The portfolio manager being an NBFC purchases securities as a part of its routine business activity. These securities may be bought for investment or trading purposes, Therefore Karvy Capital as discretionary portfolio manager may buy the securities from Karvy Capital limited {NBFC}. These securities would be purchased at a price deemed fit by the portfolio manager and may also at times be at a premium depending on the demand for the security. Additionally, depending on reasons such as demand for the security prevalent at the time of purchase by Karvy Capital as discretionary portfolio manager from itself as an NBFC, the portfolio manager may get different prices for the same security. Effectively it is a possibility

that the price of the security bought by the portfolio manager in the above manner may differ interse the clients of the portfolio manager on account of the same being bought at different points of time. Karvy Capital Limited, discretionary portfolio manager shall ensure that its rationale for all its decisions to purchase securities in the abovesaid manner shall be documented and approved by its Investment Committee".

- (ii) Noticee submitted that from the above, it is clear that they had upfront disclosed that they may as Portfolio Managers, make investments in the securities of the associate/group companies, in the normal course of investment activity. Further, they had also disclosed to the clients that they may buy securities (as Portfolio Managers) from themselves in their capacity as NBFC. Thus, in essence and spirit they had broadly, if not specifically in granular detail, upfront disclosed to there clients, that:
 - a) there is a potential possibility that they may end up making investments or interfacing with our associate/group companies, while making investments on behalf of there clients;
 - b) that there is a potential possibility of intersection of activities of KCL- PMS Division and KCL- NBFC Division, while making investments on behalf of there clients.
- (iii) Noticee submitted that as a portfolio manager, nothing could be worse case of 'conflict of interest' then investing in their own associate/group company. Evidently, same was upfront disclosed. The aforesaid clearly demonstrates their intention of faithfully disclosing the potential conflicts of interest, and not hiding or suppressing anything from the clients.
- (iv) Therefore, Noticee submitted that, disclosure regarding 'conflict of interest', as alleged in the Notice, was already there and there was no requirement of making separate disclosure regarding involvement of KCL-NBFC Division with Issuer Company and receipt of advisory fees by it from the issuer company.
- (v) Noticee submitted that the present case is at the highest a case of inadequate disclosure (wherein potential possibility regarding involvement of KCL-NBFC Division with issuer company and regarding receipt of advisory fees by it from issuer company was not disclosed), and the same was merely a technical/inadvertent lapse, which was

immediately cured once it was brought to their attention during the course of inspection by SEBI. Further, the same has not impacted the interests of their clients in any manner.

(vi) Noticee reiterated that they have not compromised or undermined the interest of clients in any manner and not derived any benefit either direct or indirect. Further Noticee reiterated that alleged non- disclosure about conflict of interest is mere technical lapse, in this context Noticee referred to the observations of Hon'ble Securities Appellate Tribunal in the matters of UPSE Securities Ltd vs SEBI (Order dated 25.7. 2011) and Religare Securities Ltd vs SEBI (Order dated 16.6.2011).

(vii) Noticee submitted that, given the aforesaid background of alleged lapse and its nature- i.e. technical and procedural, the proceedings may be dropped and no penalty be imposed. In this context Noticee referred to observations of the Hon'ble Supreme Court in the matter of Hindustan Steel vs State of Orissa [(1969} 2 SCC 627].

ISSUES FOR CONSIDERATION, EVIDENCE AND FINDINGS

15. I have taken into consideration the facts and circumstances of the case and the material available on record. The issues that arise for consideration in the present case are:

ISSUE I: Whether Noticee violated the provisions of Regulation 13, 14, 15(4) of the SEBI (PMS) Regulations, 1993 read with Clause 1 and 3 of Schedule III and Schedule V of SEBI (PMS) Regulations, 1993.

ISSUE II: Does the violation, if any, on part of the Noticee attract penalty under Section 15HB of SEBI Act?

ISSUE III: If so, how much penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act?

16. Before proceeding further, it will be appropriate to refer to the relevant provisions:

SEBI (Portfolio Managers) Regulations, 1993

Code of Conduct

13. Every Portfolio Manager shall abide by the Code of Conduct as specified in Schedule III.

14. Contract with clients and disclosures.—

(1) (a) The portfolio manager shall, before taking up an assignment of management of funds or portfolio of securities on behalf of a client, enter into an agreement in writing with such client clearly defining the inter relationship, and setting out their mutual rights, liabilities and obligations relating to management of funds or portfolio of securities containing the details as specified in Schedule IV.

(b) The agreement between the portfolio manager and the client shall, inter alia, contain:

(i) the investment objectives and the services to be provided;

(ii) areas of investment and restrictions, if any, imposed by the client with regard to the investment in a particular company or industry;

(iii) type of instruments and proportion of exposure;

(iv) tenure of portfolio investments;

(v) terms for early withdrawal of funds or securities by the clients;

(vi) attendant risks involved in the management of the portfolio;

(vii) period of the contract and provision of early termination, if any;

(viii) amount to be invested subject to the restrictions provided under these regulations;

(ix) procedure of settling client's account including form of repayment on maturity or early termination of contract;

(x) fees payable to the portfolio manager;

(xi) the quantum and manner of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is out sourced);

(xii) custody of securities [and goods];

(xiii) in case of a discretionary portfolio manager a condition that the liability of a client shall not exceed his investment with the portfolio manager;

(xiv) the terms of accounts and audit and furnishing of the reports to the clients as per the provisions of these regulations; and

(xv) other terms of portfolio investment subject to these regulations.

(2) (a) The portfolio manager shall provide to the client, the Disclosure Document as specified in Schedule V, along with a certificate in Form C as specified in Schedule I, at least two days prior to entering into an agreement with the client as referred to in sub-regulation (1).

(b) The Disclosure Document, shall inter alia contain the following—

(i) the quantum and manner of payment of fees payable by the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is out sourced);

(ii) portfolio risks;

(iii) complete disclosures in respect of transactions with related parties as per the accounting standards specified by the Institute of Chartered Accountants of India in this regard;

(iv) the performance of the portfolio manager:

Provided that the performance of a discretionary portfolio manager shall be calculated using weighted average method taking each individual category of investments for the immediately preceding three years and in such cases performance indicators shall also be disclosed;

(v) the audited financial statements of the portfolio manager for the immediately preceding three years.

(c) The contents of the Disclosure Document shall be certified by an independent chartered accountant.

(d) The portfolio manager shall file with the Board, a copy of the Disclosure Document before it is circulated or issued to any person and every six months thereafter or whenever any material change is effected therein whichever is earlier, along with the certificate in Form C as specified in Schedule I.

(3) (a) The portfolio manager shall charge an agreed fee from the clients for rendering portfolio management services without guaranteeing or assuring, either directly or indirectly, any return and the fee so charged may be a fixed fee or a return based fee or a combination of both.

(b) The portfolio manager may, subject to the disclosure in terms of the Disclosure Document and specific permission from the client, charge such fees from the client for each activity for which service is rendered by the portfolio manager directly or indirectly (where such service is out sourced).]

15. General responsibilities of a Portfolio Manager- (4) The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities.

SCHEDULE III

Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993

[Regulation 13]

CODE OF CONDUCT-PORTFOLIO MANAGER

1. A portfolio manager shall, in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers.

3. A portfolio manager shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment. The portfolio manager shall either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers.

He shall disclose to the clients, possible source of conflict of duties and interests, while providing unbiased services. A portfolio manager shall not place his interest above those of his clients.

SCHEDULE V
DISCLOSURE DOCUMENT
[Regulation 14]

General instructions

1. This Disclosure Document is to be given to the prospective client along with the account opening form (as per Format I) at least two days in advance of signing of the agreement.

2. This Disclosure Document is to be filed with the Board before it is circulated or issued to any person and every six month thereafter or whenever any material changes are effected therein.

3. This model Disclosure Document enumerates the minimum disclosure requirements to be contained in the disclosure document. The portfolio manager may make any other disclosures, which in its opinion are material for the investor, provided that such information is a statement of fact and is not presented in an incomplete, inaccurate or misleading manner. It should also be ensured that inclusion of such information does not, by virtue of its nature or manner of presentation, hamper understanding of any information that is required to be included under the model disclosure document.

The model Disclosure Document specifies only the nature of the disclosures that should be contained under various heads in the disclosure document, and is not intended to describe the layout or language to be contained therein.

17. Before proceeding with the matter on merits, I first deal with the preliminary submission of the Noticee that there has been an unexplained inordinate delay in issuance of SCN, proceedings did not initiate within reasonable time, and this inordinate delay has severely prejudiced the noticee. In this regard, it may be mentioned that the Investigation as regards the violation Securities Law is an exhaustive, time consuming process, which may require detailed analysis of the case facts. I note that the case was initiated in November 2021. Thereafter various communication was made with the Noticee till May 16, 2022. The

aforesaid examination was concluded in January 2023 and thereafter adjudication proceedings were initiated in February 2023. The undersigned was appointed Adjudicating Officer in the matter on February 27, 2023 and the SCN was issued on March 13, 2023. Hence, there has been no delay in the issuance of the SCN. Notwithstanding the same, I also note that there is no provision with prescribed time limit in the SEBI Act or Regulations which may have the effect of prohibiting SEBI from taking action by issuing Show Cause Notice or passing any order beyond a particular period of time in a given case.

18. In this regard, I place reliance on the judgement of the Hon'ble Supreme Court in the case of Adjudicating Officer, SEBI vs. Bhavesh Pabari (decided on February 28, 2019) in which it was held that:

“There are judgments which hold that when the period of limitation is not prescribed, such power must be exercised within a reasonable time. What would be reasonable time would depend upon the facts and circumstances of the case, nature of the default/statute, prejudice caused, whether the third party rights had been created etc.”

19. I also place reliance on the judgement of Hon'ble Securities Appellate Tribunal (SAT) in the matter of Girraj Kumar Gupta HUF (Appeal No. 424/ 2019) dated August 11, 2021, wherein Hon'ble SAT held that, *“We find that the investigation started in the year 2015 which involved examining several entities in the order logs, trade logs, off market transactions and gathering evidence from the Stock Exchange. The show cause notice was issued in the October, 2017 and accordingly we find that there is no inordinate delay in the initiation of the proceedings. The contention raised is, thus, erroneous and cannot be accepted.”*

20. In view of the aforesaid and placing reliance on the aforesaid judgements, I find that SCNs in the present proceeding have been issued within a reasonable period of time and there has been no delay in issuance of SCN. I note that in the case of Bharat J Patel & Others vs. SEBI, decided vide order dated September 8, 2020, the Hon'ble SAT ('Hon'ble Securities Appellate Tribunal') had emphatically iterated that “whether delay has caused prejudice to the parties would depend on the facts of each case.” I note that the Noticee have merely stated that prejudice has been caused to them due to the alleged delay. As there has been no delay the contention of the Noticee is not tenable.

21. I now proceed to deal with the merits of the case in respect of the alleged contraventions by Noticee.

FINDINGS

22. On perusal of the material available on record and giving regard to the facts and circumstances of the case and submissions of the Noticee I record my findings hereunder:

ISSUE I: Whether Noticee violated the provisions of Regulation 13, 14, 15(4) of the SEBI (PMS) Regulations, 1993 read with Clause 1 and 3 of Schedule III and Schedule V of SEBI (PMS) Regulations, 1993.

23. SEBI had examined the issuance of NCDs by USFB through private placement basis. During the examination, it was observed that KCL in capacity of NBFC had structured the NCDs of USFB and charged fees from USFB.

24. During examination it was observed by SEBI that KCL is a SEBI registered portfolio manager (INP000004524) and Karvy Capital Limited A/c Excel Portfolio is a discretionary strategy offered under its PMS services.

25. KCL in capacity of NBFC structured the NCDs for USFB for which it received an advisory fee of Rs.98,55,000/-. Thereafter, KCL in capacity of PMS subscribed to 2500 unsecured NCDs of Rs. 1,00,000/- each on behalf of its clients on July 11, 2018 amounting to Rs.25 Crores and transferred the same to its 355 PMS clients on July 20, 2018. Therefore, there was an alleged inherent conflict of interest in the dual role played by KCL as a structurer of the deal and also as an investor on behalf of their clients through its PMS arm.

26. In the Disclosure document dated February 2018 , KCL had disclosed to its clients about buying securities from its NBFC arm at a price as may deem fit by the PMS, the disclosure does not mention any thing about the role and the alleged conflict of interest. However, subsequent to the examination by SEBI, disclosure document was amended on April 2021 detailing about the role of NBFC division in structuring the securities and that PMS Division may buy the securities of issuer companies wherein NBFC division is involved in such structuring and about receipt of payment from the issuer which could be structured as an advisory fee, discount on such debentures/ securities.

27. Since KCL in capacity of NBFC structured the NCDs for USFB for which it received an advisory fee of Rs.98,55,000/-, thereafter, KCL in capacity of PMS subscribed to 2500 unsecured NCDs, compliance with Regulation 15(4) of SEBI (Portfolio Managers) Regulation 1993 was examined which states:

The portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities

28. It is alleged in the SCN that KCL did not initially present to its clients, complete and clear factual position about activities of its NBFC arm and linkages with the PMS arm, especially with respect to advisory fees received by the entity in capacity of NBFC for structuring the NCDs for USFB for an amount of Rs.98,55,000. Disclosures made in Disclosure Document dated February 2018 to its clients about buying securities from its NBFC arm at a price as may deem fit by the PMS did not indicate the advisory fees that will be received by the entity in capacity of NBFC for structuring NCDs that will be acquired on behalf of the client. KCL-PMS allegedly has not provided any details as to disclosures made to its clients regarding the nature and amount of fees received in structuring such securities and conflict of interest involved before the acquisition of such securities on behalf of its PMS clients and post such acquisition to clients. Only after enquiry by SEBI, disclosure document was amended in April 2021.

29. In view of the above, it is alleged in the SCN that Noticee has violated Regulation 13, 14, 15(4) of the SEBI (PMS) Regulations, 1993 read with Clause 1 and 3 of Schedule III and Schedule V of SEBI (PMS) Regulations, 1993.

30. I note that the regulation 13 of the SEBI (PMS) Regulations, 1993 provides that *“Every portfolio manager shall abide by the Code of Conduct as specified in Schedule III.”*

31. Clause 1 and Clause 3 of Schedule III of SEBI (PMS) Regulations, 1993 provides as follows-

Clause 1- A portfolio manager shall, in the conduct of his business, observe high standards of integrity and fairness in all his dealings with his clients and other portfolio managers.

Clause 3- A portfolio manager shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment. The

portfolio manager shall either avoid any conflict of interest in his investment or disinvestment decision, or where any conflict of interest arises, ensure fair treatment to all his customers. He shall disclose to the clients, possible source of conflict of duties and interests, while providing unbiased services. A portfolio manager shall not place his interest above those of his clients.

32. Clause 1 and Clause 3 of Schedule V of SEBI (PMS) Regulations, 1993 provides as follows-

Clause 1 - This Disclosure Document is to be given to the prospective client along with the account opening form (as per Format I) at least two days in advance of signing of the agreement.

Clause 3- This model Disclosure Document enumerates the minimum disclosure requirements to be contained in the disclosure document. The portfolio manager may make any other disclosures, which in its opinion are material for the investor, provided that such information is a statement of fact and is not presented in an incomplete, inaccurate or misleading manner. It should also be ensured that inclusion of such information does not, by virtue of its nature or manner of presentation, hamper understanding of any information that is required to be included under the model disclosure document.

The model Disclosure Document specifies only the nature of the disclosures that should be contained under various heads in the disclosure document, and is not intended to describe the layout or language to be contained therein.

33. I observe from the findings made during examination by SEBI as also from the submission of the Noticee, that KCL in its capacity as an NBFC advised USFB regarding NCD issuance and structured the same and rendered the following services-

- a) The various fund raising methods,
- b) The best suited options,
- c) The contours of the deal,
- d) The legal requirements involved and legal compliances to be made etc.

34. For providing the above services, Noticee had received an advisory fee of Rs. 98,55,000/- from USFB. Subsequently, Noticee in capacity of PMS subscribed to 2500 unsecured

NCDs of Rs. 1,00,000/- each on behalf of its clients on July 11, 2018 amounting to Rs.25 Crores and transferred the same to its 355 PMS clients on July 20, 2018.

35. Further, I note that as per clause 3 of Schedule III of SEBI (PMS) Regulation, 1993, the portfolio manager shall avoid any conflict of interest in his investment and if any conflict of interest has been arose then the noticee shall disclose to the clients, possible source of conflict of duties and interests, while providing unbiased services. Further, I note that as per clause 3 of Schedule V of SEBI (PMS) Regulation, 1993, PMS may make any other disclosure which in its opinion are material for the investor, however, such information should be a statement of fact and is not presented in an incomplete, inaccurate or misleading manner. In the disclosure made by the Noticee in 2018, Noticee had disclosed that Karvy Capital as discretionary portfolio manager may buy the securities from Karvy Capital limited (NBFC), however, the disclosure document of KCL in 2018 to its clients about buying securities from its NBFC arm at a price as may deem fit by the PMS did not indicate the advisory fees that will be received by the entity in capacity of NBFC for structuring NCDs of USFB and conflict of interest involved before the acquisition of such securities on behalf of its PMS clients. Therefore, I observe that the disclosure made in February 2018 was incomplete and inaccurate and did not disclose to the clients source of conflict of interests.
36. Subsequently, disclosure document was amended by the Noticee in April 2021, wherein the Noticee had disclosed that the KCL-NBFC division may buy the securities of issuer companies wherein KCL-NBFC division is involved in such structuring etc. and for providing the services the KCL-NBFC division / or other entities belonging to Karvy Group may receive a payment from the issuer as an advisory fee. This amendment was made only after the lapse was pointed out to the Noticee by SEBI.
37. Noticee submitted that the disclosure regarding conflict of interest was already there in the disclosure document dated February 22, 2018. In this regard, I note that the disclosure made by the Noticee in February 2018 mentioned that *“The portfolio manager / Fund Manager may invest in any unlisted securities of any associate/group companies of the Portfolio Manager/ promoter”*. On a reading of the disclosure it is very clear that this disclosure did not inform investors about the conflict of interest involved, which would enable the investors to take informed decision. Subsequently, on bringing the fact to the Noticee by SEBI, Noticee revised the disclosure document in April 2021 and the conflict of

interest was spelled out clearly in the said disclosure as admittedly the disclosure was inadequate. Hence the submission of the Noticee is not tenable.

38. Further, I observe that Clause 3 of Schedule III of SEBI (PMS) Regulation, 1993 the Noticee shall disclose to the clients, possible source of conflict of duties and interests, while providing unbiased services, and a portfolio manager shall not place his interest above those of his clients. Whereas, in the present case, the Noticee had structured the NCDs issuance by the USFB and received a fee for the same, subsequently had invested in the said NCDs from the fund received from its clients. In view of the same I observe that the Noticee has put its interest above those of its clients by investing the funds of its PMS clients in the NCDs structured and facilitated by itself and without disclosing about the same to its clients.

39. I note that Noticee has submitted that the KCL-NBFC division and KCL-PMS division were separate and distinct, with no team overlap. Both the business verticals of KCL, had clearly identified area of operations and allocation of responsibilities. I note that although the KCL-NBFC division and KCL-PMS division may be separate and distinct, however I note that the Noticee is a single entity and working under one umbrella having only different registrations as NBFC and PMS. In view of the same, the argument of the Noticee that KCL-NBFC division and KCL-PMS division were separate and distinct is not tenable.

40. Further, I observe that as per Regulation 14 read with Schedule V of the PMS Regulations, the portfolio manager may make any other disclosures, which in its opinion are material for the investor, but such information is a statement of fact and is not presented in an incomplete, inaccurate or misleading manner. Further, the disclosure document must inter-alia include disclosure of conflict of interest related to services offered by the manager. However, I observe that the nature and amount of fees received in structuring such securities and conflict of interest involved in acquisition of such securities was vast and not adequately disclosed by the Noticee to its PMS clients in Disclosure Document to enable the clients to make informed decision regarding their investment.

41. I further note that regulation 15(4) of SEBI (Portfolio Managers) Regulation 1993 states that the portfolio manager shall not derive any direct or indirect benefit out of the client's funds or securities. However, KCL in the capacity of NBFC Structured the NCDs for USFB and received an advisory fee of Rs.98,55,000/- and subsequently the Noticee as a portfolio

manager invested the money received from its PMS clients in the same NCDs issued by USFB, which it had structured. Thus there was a benefit derived by the Noticee through NBFC arm.

42. I note that the Noticee in reply to the SCN vide reply dated April 06, 2023 has submitted that the fees earned by KCL NBFC were legitimate fees for the bonafide services rendered by it in the ordinary course to UFSB. Said fees cannot be branded as 'benefit derived by KCL out of the client's' funds or securities as erroneously alleged. However, this contention of the Noticee is not tenable, as already narrated above, Noticee derived the benefit through its NBFC arm.
43. I further note that, in reply to the SCN, vide reply dated April 06, 2023, Noticee submitted that In the capacity of 'Discretionary Portfolio Manager', it can exercise any degree of discretion as to investment of funds and management of portfolio of securities of the clients. However, I observe that discretion can be exercised while investing in securities and not for not providing adequate disclosures and deriving benefit out of its activities. In view of the same I observe that the Noticee as a portfolio manager did not exercise its role prudently and in compliance of the regulation and thus violating the various provisions of SEBI (PMS) regulation, 1993.
44. In view of the same, I observe that the Noticee is in violation of regulation 13, 14 and 15(4) of SEBI (PMS) Regulation, 1993 read with clause 1 and Clause 3 of Schedule III and Schedule V of SEBI (PMS) regulation, 1993.

ISSUE II: Does the violation, if any, on part of the Noticee attract penalty under Section 15HB of SEBI Act?

45. As has been established in the foregoing paragraphs that Noticee has violated the provisions of regulation 13, 14 and 15(4) of SEBI (PMS) Regulation, 1993 read with clause 1 and Clause 3 of Schedule III and Schedule V of SEBI (PMS) regulation, 1993.
46. The Hon'ble Supreme Court of India in the matter of SEBI vs. Shri Ram Mutual Fund inter alia held *"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.”

47. Therefore, I am convinced that it is a fit case for imposition of penalty under the provisions of Section 15HB of the SEBI Act which reads as given below:

48. Section 15HB of SEBI Act: - Penalty for contravention where no separate penalty has been provided:

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

ISSUE III: If so, how much penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act?

49. While determining the quantum of penalty under sections 15HB of the SEBI Act and it is important to consider the factors stipulated in section 15J of SEBI Act which reads as under:-

15J - Factors to be taken into account by the adjudicating officer

While adjudging quantum of penalty under section 15-I, 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.”

50. In the present matter, it is noted that no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of the defaults by Noticee. It is not possible from the material available on record to ascertain the disproportionate gain or unfair advantage made by the Noticee or the amount of loss caused to an investor or group

of investors as a result of the default. Correct and timely disclosures are an essential part of the proper functioning of the securities market and failure to do so results in preventing investors from taking well-informed decisions. Noticee as a registered intermediary needs to adhere to the rules and regulations as prescribed by SEBI and maintain a high degree of professionalism in the conduct of their business. Nature of default by the Noticee to adhere to the laid down obligations as observed in this case would compromise the regulatory framework and should be dealt with by imposing monetary penalty so as to send an effective message to the market participants as a whole.

ORDER

51. Having considered the facts and circumstances of the case, the material available on record, the factors mentioned in Section 15J of the SEBI Act taking note of Section 15HB of the SEBI Act, and also taking into account judgment of the Hon'ble Supreme Court in *SEBI vs. Bhavesh Pabari (2019) 5 SCC 90* and in exercise of power conferred upon me under section 15-I of the SEBI Act, 1992 read with rule 5 of the SEBI Rules, 1995, I hereby impose following penalty under section 15HB of the SEBI Act, 1992 on the Noticee:

S. No.	Name of entity	Penalty Provisions	Penalty (Rs.)
1	Karvy Capital Limited	Section 15HB of SEBI Act, 1992	1,50,000/- (Rs. One Lakh Fifty thousand only)

52. I am of the view that the said penalty is commensurate with the lapse/omission on the part of the Noticee.

53. The Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order 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. In case of any difficulties in payment of penalties, Noticee may contact the support at portalhelp@sebi.gov.in.

54. 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.

55. In terms of the provisions of rule 6 of the SEBI Rules, a copy of this order is being sent to the Noticee and also to the Securities and Exchange Board of India.

Place: Mumbai

Date: April 25, 2023

BARNALI MUKHERJEE
ADJUDICATING OFFICER