**BEFORE THE ADJUDICATING OFFICER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**

**[ADJUDICATION ORDER NO.: Order/VV/NK/2022-23/22511-22512]**

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

**In respect of:**

| | |
|---|---|
| **Noticee no. 1**<br>**DSP Investment Managers Private Limited**<br>**(PAN: AAACD3069K)**<br>Mafatlal Centre, 10th & 11th Floor, Nariman Point, Mumbai, Maharashtra 400021 | **Noticee no. 2**<br>**DSP Trustee Private Limited**<br>**(PAN: AAACD3070G)**<br>Mafatlal Centre, 10th & 11th Floor, Nariman Point, Mumbai, Maharashtra 400021 |

**In the matter of practice of charging TER to AMC books by DSP Mutual Fund**

**Facts of the Case:**

1. DSP Mutual Fund in its Compliance Test report (hereinafter referred to as "**CTR**") for quarter end of March 2022 and Half Yearly Trustee Report (hereinafter referred to as "**HYTR**") for the period ending March 2022, inter-alia informed Securities and Exchange Board of India (hereinafter referred to as "**SEBI** ") that total expense as a percentage to Average Asset under Management (hereinafter referred to as "**AAUM**") was higher than the Total Expense Ratio (hereinafter referred to as "**TER**") charged to the scheme, DSP Nifty 50 ETF (hereinafter referred to as "**the scheme**"), and the excess expenses were borne by the DSP Investment Managers Private Limited (hereinafter referred to as "**Noticee no. 1/AMC**"). The reason of excess

expense borne by AMC is due to competitive market and increasing of TER would have restricted ability to increase Scheme's AUM.

2. Thereafter, SEBI carried out Analysis of practice of charging TER of DSP Nifty 50 ETF to AMC books by DSP Mutual Fund and it was observed that:
    2.1. Noticee No. 1 has violated SEBI Circular dated October 22, 2018 (hereinafter referred to as "**SEBI TER Circular**").
    2.2. DSP Trustee Private Limited (hereinafter referred to as "**Noticee no. 2/Trustees of DSP Mutual Fund/Trustees**") has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.

3. Thus, in view of the above, SEBI initiated adjudication proceedings against :
    3.1. Noticee no. 1 under the provisions of 15E read with 15HB of SEBI Act, 1992 for the alleged violations of SEBI Circular dated October 22, 2018
    3.2. Noticee no. 2 under the provisions of 15D (b) read with 15HB of SEBI Act, 1992 for the alleged violations of Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.

## Appointment of Adjudicating Officer

4. The Undersigned is appointed as Adjudicating Officer in the matter vide *communication-order* dated September 29, 2022 under Section 15 I of SEBI Act read with Rule 5 of SEBI (Procedure for Holding Inquiry and imposing penalties) Rules, 1995 (hereinafter referred as **'AO Rules'**) to inquire and adjudicate upon the aforesaid violations by the Noticee no. 1 and 2 under section 15E read with 15HB of SEBI Act, 1992 and under section 15D (b) read with 15HB of SEBI Act, 1992 respectively.

## Show Cause Notice and Reply

5. Show cause notices dated October 25, 2022 ("**SCNs**") was issued to the Noticees under Rule 4(1) of the Adjudication Rules to show-cause as to why an inquiry should not be initiated against them through SPAD and duly delivered to the Noticees.

6. Following has been *inter-alia* alleged in the SCNs:

***1.*** *DSP Mutual Fund in its Compliance Test report (hereinafter referred to as "CTR") for quarter end of March 2022 and Half Yearly Trustee Report (hereinafter referred to as "HYTR") for the period ending March 2022, inter-alia informed Securities and Exchange Board of India (hereinafter referred to as "SEBI ") that total expense as a percentage to Average Asset under Management (hereinafter referred to as "AAUM") was higher than the Total Expense Ratio (hereinafter referred to as "TER") charged to the scheme, DSP Nifty 50 ETF (hereinafter referred to as "the scheme"), and the excess expenses were borne by the DSP Investment Managers Private Limited (hereinafter referred to as "Noticee no. 1/AMC").*

***2.*** *Details of the scheme viz. DSP Nifty 50 ETF along with information provided by AMC, is mentioned below.*

***2.1.*** *DSP Nifty 50 ETF details submitted by AMC vide email dated June 30, 2022* ***(Annexure 1)*** *are as follows:*

| | |
|---|---|
| *NFO duration* | *Date of Launch: December 06, 2021*<br>*Closing Date: December 17, 2021* |
| *NFO collection* | *INR 11.81 Crores* |
| *Date of scheme open for subscription / redemption with AMC* | *December 30, 2021* |

***2.2.*** *CTR and HYTR for the period ending March 2022* ***(Annexure A)*** *mentions that the actual TER charged under DSP Nifty 50 ETF was 0.07% as against actual expense incurred by the scheme i.e., 0.16%. The reason of excess expense borne by AMC is due to competitive market and increasing of TER would have restricted ability to increase Scheme's Asset under Management (hereinafter referred to as "AUM".*

***2.3.*** *Vide email dated June 22, 2022* ***(Annexure B)****, AMC provided data with respect to DSP Nifty 50 ETF, which comprising of daily AUM of the Scheme, total TER % charged to scheme, total Expense charged to the scheme, total expense incurred by the Fund and difference (shortfall) recovered from AMC. Summary of the same is as follows:*

| ***Particulars*** | ***Amount (INR)*** |
|---|---|
| *Expense Incurred* | *94,182.47* |
| *Expense charged to scheme* | *40,944.37* |
| *Shortfall recovered from AMC* | *53,238.10* |

***2.4.*** *AMC vide email dated June 30, 2022* ***(Annexure B)*** *has provided the detailed reasons which inter-alia states the following:*

*2.4.1. Index/ETF schemes incur expenses like Index Charges, R&T Fees, Custody Fees, IAP etc. Some expenses like Index charges are fixed in terms of minimum amount to be paid to the Index provider irrespective of the AUM. Further, the scheme has to mandatorily accrue 2 bps for investor education which has been reduced to 1 bps effective July 1, 2022. Therefore, the operating cost of the scheme as % of AUM, if all expenses are to be borne by the scheme, will be high initially when the scheme is scaling up its AUM.*

*2.4.2.* *The operating cost (as % to AAUM) for DSP Nifty 50 ETF (the scheme) at current average asset under management (INR 21.79 crores as on March 31, 2022) is ~ 16 bps. The scheme is in the process of scaling up its AUM. Therefore, the only option for the scheme to absorb full expenses would be to raise the TER which will make it an outlier in terms of TER and tracking error. It is seen that certain Index/ETF funds such as Nifty50, Sensex are way below maximum SEBI permissible limits.*

*2.4.3.* *If TER is increased, it will further discourage investors to invest in this scheme and thus restrict its capability to increase the AUM.*

*2.4.4.* *With increase in the AAUM, the operating expenses as % to AAUM will gradually reduce and the total scheme expenses will be below the TER charged.*

*2.4.5.* *AMC informed that in ensuring the spirit of SEBI Circular SEBI/HO/IMD/DF2/CIR/P/2018/137 dated October 22, 2018, no management fees will be charged in the scheme until the scheme is able to absorb total scheme expenses.*

***2.5.*** *Further, Trustee Officer of DSP Trustee Private Limited (hereinafter referred to as "Noticee no. 2/Trustees of DSP Mutual Fund") vide email dated July 13, 2022* ***(Annexure C)*** *had provided the following in respect of scheme expenses borne by AMC:*

*2.5.1.* *In view of the range of TER charged by similar scheme of other mutual funds and given the passive nature of the scheme, Trustees find it appropriate to align the TER of DSP Nifty 50 ETF with other similar schemes in the industry and consequently getting the excess scheme expenses beyond the TER reimbursed by the AMC. Further, Trustees informed that the subject was deliberated at AMFI and a representation dated October 21, 2020 was also made to SEBI by AMFI in respect of Expenses Paid by ETFs & Index Funds from the scheme.*

*2.5.2.* *The excess amount borne by DSP Nifty50 ETF in a year is expected to be INR 100,000 crs which as a percentage of the aggregate AUM of all other schemes of DSP Mutual Fund of INR 100,000 crs is insignificant. Further, the above practice will be only for short term till the time the scheme scales up the AUM to a size which will enable it to absorb the costs within the TER range charged by other similar schemes in the industry. In the case of DSP Nifty 50 ETF, that AUM size would be around INR 75 crs.*

*2.5.3.* *Further, the above principle shall be adopted for any other passive index fund or ETF where the scheme TER seems to be significant outlier in terms of the range of TER charged by similar schemes in the industry.*

***<u>Following is observed on the basis of Analysis of practice of charging TER of DSP Nifty 50 ETF to AMC books by DSP Mutual Fund:</u>***

***3.*** *In terms of Regulation 52(6) (b) of SEBI (Mutual Funds) Regulations, 1996, the maximum permissible TER in case of an index fund scheme or exchange traded fund including the investment and advisory fees shall not exceed 1.00 per cent of the daily net assets. Though DSP Nifty 50 ETF (the scheme) can charge upto 1% as TER to the scheme, it is observed that, AMC has charged 0.07% to the scheme as against actual expense incurred by the scheme was 0.16%. Further, it is informed by AMC that the reason of excess expense is borne by AMC is due to competitive market and increasing of TER would have restricted ability to increase Scheme's AUM.*

***4.*** *Thus, it is observed that, the aforesaid AMC practice is not in line with SEBI Circular dated October 22, 2018, which mandates that all scheme related expenses including commission paid to distributors, by whatever name it may be called and in whatever manner it may be paid, shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the*

*Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route.*

***5.*** *Further, SEBI Circular dated March 25, 2019 allows AMCs to pay the expenses that are very small in value but high in volume out of AMC's books upto a maximum of 2 bps of respective scheme AUM. In the given instance, even if this 2 bps is considered, it is observed that, the expenses borne by AMC is on higher side.*

***6.*** *Although SEBI Circular dated October 22, 2018 mandates to pay all scheme related expenses from the scheme, Regulation 52(7) of SEBI (Mutual Funds) Regulations, 1996 permits that any expenditure in excess of the limits specified in sub-regulations (6) and (6A) shall be borne by the asset management company or by the trustee or sponsors. However, in the instant matter, it is observed that, AMC has not even exhausted the maximum permissible total expense ratio permitted under Regulations 52 (6) and (6A) of SEBI (Mutual Funds) Regulations, 1996 in the case of DSP Nifty 50 ETF and hence Regulation 52(7) of SEBI (Mutual Funds) Regulations, 1996 is not applicable.*

***7.*** *In respect of the AMFI representation dated October 21, 2020, it is observed that there is no communication by SEBI to the Mutual Fund industry / AMFI on any policy change on the subject, in line with the representation of AMFI in respect of Expenses Paid by ETFs & Index Funds from the scheme.*

***8.*** *Thus, in view of the above, it is alleged that, AMC by bearing excess expenses of the scheme has violated the provisions of aforesaid SEBI Circulars which requires that all scheme related expenses shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route.*

***9.*** *AMC / Trustee Company has also submitted that they would continue bearing the excess expenses till the time, the scheme attains a particular size of AUM wherein by charging competitive TER, AMC would be able to meet the expenses incurred by the scheme. Thus, it is observed that, the AMC / Trustee Company has indicated to continue the practice of bearing excess expenses in the books of AMC which is not line with the SEBI Circulars.*

***10.*** *Further, Regulation 18(9) of SEBI (Mutual Funds) Regulations, 1996 states that the trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations. Regulation 77 of SEBI (Mutual Funds) Regulations, 1996 mentions that in order to remove any difficulties in the application or interpretation of these regulations, the Board shall have the power to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians. Thus, in view of the aforementioned, it is alleged that, Noticee no. 2 by not ensuring the compliance with aforesaid circulars by AMC has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996.*

***11.*** *In view of aforesaid observations and findings, it is alleged that:*

*a) Noticee No. 1 has violated SEBI Circular dated October 22, 2018.*

*b) Noticee no. 2 has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.*

***12.*** *The relevant provisions of Regulation 52 (6) and (6A), 52(7), 18(9) and 77 of SEBI (Mutual Funds) Regulations, 1996 and SEBI Circular dated October 22, 2018 are annexed to this Notice as* ***Annexure-D****.*

***13.*** *In view of the above, SEBI felt satisfied that there are sufficient grounds to inquire and adjudicate upon the aforesaid violations by the Noticee no. 1 and 2. By a communication-order dated September 29, 2022 Shri Vijayant Kumar Verma has been appointed as Adjudicating Officer to inquire into and adjudge under section 15E read with 15HB of SEBI Act, 1992 against Noticee No. 1 and under section 15D (b) read with 15HB of SEBI Act, 1992 against Noticee No. 2. (Copy of communication order is enclosed as* ***Annexure-E*** *for reference).*

***14.*** *Accordingly, this notice to show cause (hereinafter referred to as 'SCN') is being issued to you, the Noticee no. 1 and 2, in terms of rule 4(1) of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as 'Adjudication Rules') read with section 15I of the SEBI Act, with regards to violations of SEBI Circular dated October 22, 2018 by Noticee No. 1 and violation of Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018 by Noticee no. 2). You are, thus, called upon to show cause as to why an inquiry should not be held against you in terms of rule 4 of the Adjudication Rules and penalty be not imposed under section 15E read with 15HB of SEBI Act, 1992 against Noticee No. 1 and under section 15D(b) read with 15HB of SEBI Act, 1992 against Noticee No. 2 for the aforesaid alleged violations. The provision of section 15D(b), 15E and 15HB of the SEBI Act are as follows:*

***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 failure to observe rules and regulations by an asset management company.***

***15E.*** *Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company 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.*

7. Noticees were provided 14 days to reply to SCNs from the date of receipt of the SCNs. In this regard, Noticees, vide email dated November 10, 2022 requested for extension of time for submission of reply to SCNs till November 25, 2022. The request of Noticees was acceded to by me.

8. Subsequently vide email and letter dated November 23, 2022, Noticees submitted their reply to SCNs.

## Common reply of Noticees is summarized below:

1. *We refer to the captioned SCN issued to the Noticees.*
2. *At the outset, we submit that the SCN does not disclose a contravention that seems to be worthy of imposition of penalty.*
3. *The SCN primarily alleges that:*

**a.** *Notice 1 has, with a passive scheme DSP Nifty 50 ETF, allegedly violated the SEBI circular dated October 22, 2018 bearing reference no. SEBI/HO/IMD/DF2/CIR/P/2018/137 on 'Total Expense Ratio (TER) and Performance Disclosure of Mutual Funds' ("**SEBI TER Circular**"), which entails all scheme related expenses being paid only from the scheme within the regulatory limit of 1%, and prevents the asset management company, its associate, sponsor, trustee, or any other entity from funding such expenses; and*

**b.** *Noticee 2 has allegedly violated Regulation 18(9) read with Regulation 77 of the SEBI (Mutual Funds) Regulations,1996 ("**SEBI MF Regulations**"), which require the trustee company to ensure that all the activities of the asset management company are in accordance with the provisions of the SEBI MF Regulations and the circulars issued by SEBI (including but not limited to the SEBI TER Circular).*

4. *Therefore, the SCN calls upon the Noticees to show cause as to why an inquiry should not be held against the Noticees in accordance with Rule 4(1) of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 ("**SEBI Adjudication Rules**") read with Section 15I of the SEBI Act, 1992 ("**SEBI Act**") and why penalty should not be imposed upon:*

**a.** *Noticee 1 under Section 15E read with Section 15 HB of the SEBI Act; and*

**b.** *Noticee 2 under Section 15D(b) read with Section 15HB of the SEBI Act, for the alleged aforesaid violations.*

5. *At the threshold, it should be noted that Section 15HB would come into play only if there is no other penalty provision in Chapter VI-A that covers the contravention alleged. For both the Noticees, the provisions of other sections under Chapter VI-A have been invoked. In the same breath, Section 15HB, the residuary penalty provision which can be applied only if no other penalty provision is attracted, has also been invoked. As will be seen later in this response (i.e. paragraph 23(q)(ii) below), that Section 15D(b) would not apply to either an asset management company or a trustee company is a matter already covered by an order by a learned adjudicating officer of SEBI.*

***Factual Background - DSP Nifty 50 ETF***

6. *To assess the issues at hand better and for the sake of completeness, the Noticees would like to bring the following facts to the notice of the learned Adjudicating Officer before proceeding with their response:*

**a.** *DSP Nifty 50 ETF is an "exchange traded fund" that is meant to only invest in equity shares of such companies which from time to time constitute the Nifty 50 TRI index;*

**b.** *The new fund offer ("**NFO**") of DSP Nifty 50 ETF took place between December 6, 2021 and December 17, 2021;*

**c.** *The total initial corpus actually raised from the subscribers to the NFO of DSP Nifty 50 ETF was INR 11.81 crores i.e. as of December 17, 2021;*

**d.** *Since December 30, 2021, DSP Nifty 50 ETF has been open for further issuance of units. The assets under management ("**AUM**") of DSP Nifty 50 ETF as on December 30, 2021 was INR 11.89 crores;*

**e.** *As of March 31, 2022, the AUM was INR 22.59 crores;*

**f.** *As on March 31, 2022, the total expense incurred by DSP Nifty 50 ETF was INR 94,182.47, which as a percentage of average AUM was 0.16% (i.e. well below the regulatory limit of 1% in terms of the SEBI TER Circular);*

**g.** *The total expense ratio ("**TER**") charged to DSP Nifty 50 ETF was 0.07% (i.e. INR 40,944.37). The balance 0.09% (i.e. INR 53,238.10) was borne by Noticee 1;*

**h.** *The above data was expressly disclosed by (i) Noticee 1 in the Compliance Test Report ("**CTR**") submitted by it to SEBI for the quarter ending March 31, 2022; and (ii) Noticee 2 in the Half Yearly Trustee Report ("**HYTR**") submitted by it to SEBI for the half year ending March 31, 2022; and*

**i.** *The SCN issued by SEBI is based on the aforesaid suo moto and voluntary disclosures made by the*

*Noticees in the CTR and HYTR submitted by them.*

***Contentions and Submissions of the Noticees***

7. *In a nutshell, the Noticees humbly submit that there has been no violation of the SEBI TER Circular. The SCN appears to be based on an incorrect reading of the SEBI TER Circular.*
8. *To begin with, the very purpose, letter and spirit of the SEBI TER Circular must be appreciated. As stated in the SCN itself (at Paragraphs 3 and 6), the statutory limit for expenses at all times relevant to DSP Nifty 50 ETF (and the SCN) was 1%, in terms of Regulation 52(6)(b) of the SEBI MF Regulations. The expenses in relation to DSP Nifty 50 ETF is well within the limit of 1%.*
9. *Next, Regulation 52(7) of the SEBI MF Regulations makes it clear that if this limit of 1% is breached, the excess would have to be borne by the asset management company, or the trustee company or by the sponsors. Therefore, it is abundantly clear that the limit of 1% is not an absolute limit, which makes it, in the eyes of the law, a provision that imposes a "directory" obligation and not a "mandatory" obligation. Put differently, the 1% may be exceeded provided the excess is borne by the asset management company, or the trustee company or the sponsor. Therefore, there is no absolute bar on the asset management company bearing expenses.*
10. *Likewise, Regulation 52(5) of the SEBI MF Regulations even provides for excess expense outside the limits imposed under Regulation 52(2) or Regulation 52(4) to be borne by the asset management company or the trustee company or the sponsors. This is yet another pointer that an asset management company or a trustee company or a sponsor incurring expenses is not a matter of a prohibition at all. These are provisions that require them to mandatorily absorb any expense in excess, but by no means is the regulatory framework one of prohibiting absorption of expenses when within regulatory limits.*
11. *Interpreting the SEBI TER Circular issued pursuant to Regulation 52(1) can therefore never partake the character of any prohibition (whether express or implied) on the asset management company to absorb any expense of the scheme.*
12. *Applying the aforesaid position in law to the facts of the case, unless and until the expenses incurred by the DSP Nifty 50 ETF crosses 1% there is no question of there being any breach of any regulatory provision by the Noticees.*
13. *Now, applying the context of the explicit provisions of subordinate legislation (these are tabled in Parliament and are thereby an integral part of the SEBI Act to mark the legislation passed by Parliament be administered and operated), the provisions of the SEBI TER Circular must be considered. The portion of the SEBI TER Circular that is alleged to be offended is Paragraph A.1, which is extracted below:*

   *"A. Transparency in TER*

   *In order to bring transparency in expenses, reduce portfolio churning and mis-selling in mutual fund (MF) schemes, the following shall be adhered to:*

   *1. **<u>In terms of Regulation 52(1) of SEBI (Mutual Funds) Regulations, 1996</u>**, all scheme related expenses including commission paid to distributors, by whatever name it may be called and in whatever manner it may be paid, shall necessarily be paid from the scheme **<u>only within the regulatory limits and not from the books of the Asset Management Companies (AMC)</u>**, its associate, sponsor, trustee or any other entity through any route."*

   *[**Emphasis Supplied**]*
14. *Even a plain reading of the foregoing would show that Paragraph A.1 merely paraphrases Regulation 52(1) of the SEBI MF Regulations, which does not impose any prohibition on the asset management company bearing the expenses, and instead provides for a clear identification of the expenses and appropriation in the individual schemes. The provision is extracted below:*

   *"52 (1) All expenses should be clearly identified and appropriated in the individual schemes."*
15. *Therefore, Paragraph A.1 of the SEBI TER Circular has to be read within the context and meaning of Regulation 52(1) of the SEBI MF Regulations, which is essentially meant to, <u>inter alia,</u> identify clearly the expenses being incurred. Indeed, expenses are meant to be appropriated by the schemes but that would not imply a prohibition on expenses being absorbed by the asset management company, which would be a gratis conferment of a benefit to unitholders in full transparency, without any of the mischief sought to be cured by Paragraph A.1 of the SEBI TER Circular being attracted.*

16. *The idea behind the SEBI TER Circular is to curb malpractices in the payment of trail commission and any kickbacks to the investors i.e. to curb mis-selling and market abuse in the matter of distribution of units to investors. The said Paragraph A.1 essentially notices that commission may be paid to distributors by names not identified as commission, which is why it uses the phrase "by whatever name called" and "in whatever manner it may be paid". Such payments must be paid from scheme "only within regulatory limits". Essentially, the principle of law espoused in the SEBI TER Circular is also borne out by the opening portion under Paragraph A of the SEBI TER Circular, which is itself titled "Transparency in TER" and the stated objective is "in order to bring transparency in expenses, reduce portfolio churning and mis-selling in mutual fund schemes".*
17. *Given the facts in hand, it is beyond question that there has been any lack of transparency in expenses or any portfolio churning or any mis-selling in the context of DSP Nifty 50 ETF. The expenses that were borne by the Noticee No. 1 were well within the statutory regulatory limit and did not entail any opaqueness or lack of transparency in the incurring of expenses. Every head of expense for every rupee is well accounted for and even the explanation given is transparently available in the SCN itself.*
18. *There can never be any churning of portfolio since the scheme in question is an exchange traded fund that entails no discretion to hold any shares outside the proportion of securities holding afforded by the composition of the Nifty 50 TRI index. Consequently, there can be no mis-selling either.*
19. *Therefore, the wrong reading of the word "only" is what has appeared to have driven a regulatory adjudicatory proceeding in the instant case. The object of Paragraph A.1 is not to ensure that expenses are paid "**only** from the scheme" but that expenses are paid "**only** within regulatory limits". The SEBI TER Circular could never have envisaged that expenses are paid only from the scheme since Regulation 52(7) and indeed Regulation 52(5) of the SEBI MF Regulations explicitly provide that anything in excess could be borne by the asset management company or the trustee company or the sponsor. Therefore, unless the mischief sought to be cured by Paragraph A.1 of the SEBI TER Circular is attracted, there is no case for a strained reading of its contents to imply a prohibition on an asset management company gratis absorbing some expense in a fully transparent manner.*
20. *Therefore, the only manner of reading Paragraph A.1 is to see whether the objective of Paragraph A of the SEBI TER Circular is at all being attracted viz. mis-selling, lack of transparency in expenses and portfolio churning. If these facets are not even seen, there is no scope to allege that the Noticees have violated the SEBI TER Circular.*
21. *Indeed Paragraph 6 of the SCN has recorded that the maximum permissible expense ratio is not even exhausted in the instant case. Therefore, rather than stating that Regulation 52(7) of the SEBI MF Regulations is not attracted, the position in law is that such provision makes it mandatory for the scheme to be shielded from excess expenditure whereas nothing prohibits the scheme from being shielded from any portion of the expenditure, so long as there is total transparency in incurring of expenses, no portfolio churning of the investors and no mis-selling of units.*
22. *In this backdrop, whether there is any representation from AMFI and whether that is accepted or rejected may be regarded as not relevant to bring home a charge against the Noticees as alleged in the SCN. Suffice it to say, no violation has been established. The only suspected violation appears to have arisen out of an incorrect reading of the SEBI TER Circular, which is directly contradictory to the provisions, scope and intent of the SEBI MF Regulations and indeed the SEBI TER Circular itself.*
23. *The Noticees submit that they have always maintained the highest standards of integrity and fairness in all their dealings and conduct of business and taken all the decisions solely in the interest of the unitholders and development of a robust mutual funds market in India. The following additional facets are noteworthy:*
    a. *Both Noticee 1 and Noticee 2 have on their own accord and in line with the highest standards of compliance provided information on the total expenses incurred by DSP Nifty 50 ETF, the TER and the amounts borne by Noticee 1 in the CTR and the HYTR respectively;*
    b. *Such disclosures are aligned with the scope and objective of the SEBI TER Circular viz.*

*transparency in expenses;*

c. *Both the CTR and HYTR made reference to the SEBI TER Circular but it is submitted with the greatest respect that there can be no estoppel in law. It is a settled law that no person can be held to be in violation of a law on the premise that he believed (wrongly) that he had deviated from the law. The point about the disclosures made was to show transparently that the actual TER charged under DSP Nifty 50 ETF was 0.07% as against the actual expense incurred by the scheme which was 0.16%, which is in any case well within the regulatory limit of 1% applicable to passive fund schemes;*

d. *In any case, neither the CTR nor the HYTR would suggest any admission or a confession that there has been any violation of the SEBI TER Circular;*

e. *Without prejudice to anything contained above, if the SEBI TER Circular were to be read in the manner sought to be read in the SCN, the Noticees humbly request the learned Adjudicating Officer to note that the entire amount involved in the alleged violation is a very miniscule amount, both in absolute amounts and in percentage terms, warranting no penalty at all;*

f. *The excess amount that would be borne by DSP Nifty 50 ETF in a year if the entire 0.16% is charged as TER (instead of 0.07%) is expected to be INR 100,000. This is insignificant and inconsequential compared to the sum of all other schemes of DSP Mutual Fund which is above INR 100,000 crores. The quantum of the alleged violation is 0.00001% of the overall scheme size of DSP Mutual Fund and absorption of this amount by Noticee 1 does not affect the charges and TER for other schemes of DSP Mutual Fund. Such absorption would not in any case incentivise any mis-selling.*

   *In this regard, the Noticees submit that the reference in Paragraph 2.5.2 of the SCN is incorrect; the first reference to INR 100,000 crores should instead be "INR 100,000";*

g. *Noticee 1 is in compliance with the provisions of the SEBI TER Circular in letter and in spirit as the expenses borne by Noticee 1 have not been charged back as 'AMC fees' to DSP Nifty 50 ETF;*

h. *In this regard, a reference is made to the note that was presented to the SEBI board in relation to TER ("**Agenda Note**") (**enclosed as Appendix 2**). The Agenda Note noted that the practice of paying commissions from the books of the asset management committee and charging the same to equity schemes (as opposed to debt schemes) as 'AMC fees' results in, among other things, defraying the costs on direct investors and unhealthy competition in the mutual fund industry. The Noticees humbly request the learned Adjudicating Officer to note that no commission has been charged to DSP Nifty 50 ETF till date. It is in this context that the SEBI TER Circular must also be interpreted. SEBI's intention was to bring transparency and reduce mis-selling and unnecessary churn to investor's portfolio;*

i. *The very fact that Noticee 1 specified the DSP Nifty 50 ETF expenses borne by it in its CTR and did not charge back such expenses back to DSP Nifty 50 ETF shows Noticee 1's commitment towards increasing transparency in the securities market and avoiding unnecessary churn to the investors' portfolio. The Noticees reiterate that the total expense absorbed by Noticee 1 (i.e. INR 53, 238.10) is too insignificant and inconsequential to affect the charges and TER of other schemes of DSP Mutual Fund;*

j. *Some of the expenses incurred by DSP Nifty 50 ETF as on March 31, 2022 (e.g., index charges, custody fees etc.) were costs associated with its recent launch and the attempt to scale up its AUM from INR 11.89 crores in December 2021 to INR 22.59 crores in March 2022. Therefore the operating cost of DSP Nifty 50 ETF as a percentage of its AUM as on March 31, 2022 reflected a higher number;*

k. *In this regard it is also submitted that there are no common approaches in the industry around the treatment of benchmark costs. The Noticees understand that while many mutual funds attribute such costs as expenses of the scheme, others charge these as costs of the asset management company. Following a conservative approach, DSP Mutual Fund attributed the benchmark costs of DSP Nifty 50 ETF as the expenses of the scheme and not as costs of Noticee 1. This inclusion could increase the operating cost of DSP Nifty 50*

*ETF as a percentage of its AUM vis-à-vis its competitors who may not attribute such costs as expenses of the scheme. Noticee 1 did not want to burden the investors with the additional costs and therefore, in the interest of the investors, took a decision to bear these costs and charge a TER of only 0.07% to DSP Nifty 50 ETF;*

l. *The Noticees reiterate that no management fees will be charged to the scheme until the scheme is able to absorb the total scheme expenses;*

m. *SEBI has been making various efforts to deepen the market for passive funds and increase their uptake by investors as a low cost investment, and SEBI treats passive funds differently in certain aspects. In this regard, the Noticees request the learned Adjudicating Officer to refer to the SEBI circulars dated April 28, 2021 (circular reference no: SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/553), September 02, 2021 (circular reference no: SEBI/HO/IMD/IMD-IDOF5/P/CIR/2021/624) and May 23, 2022 (circular reference no: SEBI/HO/IMD/DOF2/P/CIR/2022/69) (**enclosed as Appendix 3**) whereby SEBI granted some exemptions to passive funds such as exchange traded funds (for instance, by its circular dated May 23, 2022, SEBI prescribed a lower charge for investor education and awareness initiatives for exchange traded funds and index funds (i.e. 1bps of daily net assets of the scheme) vis-à-vis the charges applicable to other schemes (i.e. 2bps of daily net assets of the scheme)). The intention of Noticee 1 by absorbing the expenses was to solely keep the TER competitive to attract investors and scale up the AUM;*

n. *The Noticees humbly submit that they have not made any disproportionate gain or unfair advantage, wherever quantifiable, as a result of Noticee 1 absorbing these expenses. Further, no loss has been caused to an investor or group of investors of any of the schemes of DSP Mutual Fund as a result of the alleged default (and instead, as a result of Noticee 1 absorbing the additional amount of 0.09%, the expenses charged to the existing investors in DSP Nifty 50 ETF have actually been lowered);*

o. *In this regard, a reference is also made to the orders passed by the adjudicating officers of SEBI (as set out in sub-paragraph (q ) below) wherein the adjudicating officers have set aside the show cause notice issued to asset management companies and trustee companies and have not imposed penalties for minor irregularities and deficiencies noticed during the course of inspection, including by taking into account the factors set out in Section 15 J of the SEBI Act (which includes the amount of disproportionate gain or unfair advantage, the amount loss caused to the investors and repetitive nature of the default);*

p. *The adjudicating officers have also refrained from imposing penalties in cases where the discrepancy or illegality was minor in nature and such discrepancy or illegality did not result in disproportionate gain or unfair advantage to the noticees and loss to the investors; and*

q. *The following orders would be relevant:*

i. *In the matter of Indiabulls Mutual Fund (**enclosed as Appendix 4**), the adjudicating officer, among other things, relied on the observation of Hon'ble Securities Appellate Tribunal ("**SAT**") in the matter of UPSE Securities v/s SEBI (**enclosed as Appendix 4**) and decided not impose penalty on the asset management company and the trustee company. The relevant Paragraph is extracted below:*
*"20. In the instant proceedings, I am inclined to be guided by the observation of Hon'ble SAT in the matter of UPSE Securities Ltd. v/s SEBI, wherein the Hon'ble SAT has observed that "the object of carrying out inspection of the books of accounts and records of any intermediary including a stock exchange or its subsidiaries is to ensure compliance with the provisions of the Act, Rules, Regulations, By-laws and circulars issued from time to time which are meant to regulate the securities market. Every little irregularity/deficiency noticed during the course of the inspection is not culpable and does not call for initiation of penalty proceedings. The purpose of inspection in quite a few cases could be better achieved if the inspecting team at the time of the inspection were to advise the erring entity..." I do not find it a fit case for imposing monetary penalty, Perhaps notices should be more careful in future in compliance with directives issued by SEBI from time to time."*

ii. *In the matter of Indiabulls Mutual Fund, the adjudicating officer further held that penalty under Section 15D(b) cannot be imposed on a trustee company. The relevant Paragraph is extracted below:*
*"It may be noted that under Section 15D(b), penalty can be levied against a Mutual Funds registered with the Board who fails to comply with the terms and conditions for issuance of certificate of registration.* ***Therefore penalty under section 15 D(b) does not applies to AMC and the Trustee of a Mutual Fund****. Penalty may be imposed upon AMC and Trustee of Mutual Fund under section 15 HB of the SEBI Act 1992 which provides for penalty upon whoever fails to comply with any provisions of this Act, the rules or the regulations made or direction issued by the board thereunder for which no separate penalty has been provided."*

iii. *In the matter of Kotak Mahindra Mutual Fund (****enclosed as Appendix 5****), the adjudicating officer, among other things, relied on the observation of Hon'ble SAT in the matter of Religare Securities Limited v/s SEBI (****enclosed as Appendix 5****) and decided not to impose penalty on the asset management company and the trustee company for minor violations by the asset management company and the trustee company. The relevant Paragraph is extracted below:*
*"22. Considering the above, I am of the view that the discrepancies in this regard are in the category of minor irregularity considering the facts and circumstances discussed hereinabove. Further, the discrepancies in the instant case are not serious so as to impose a monetary penalty and thus, no penalty need to be imposed for such discrepancies in light of the judgement of Hon'ble Securities Appellate Tribunal in the matter of Religare Securities Ltd. Vs. SEBI, Order dated June 16, 2011, wherein it has been inter-alia held that:*

*"5. It must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We also cannot lose sight of the fact that every minor discrepancy/irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities /deficiencies to the intermediary at the time of inspection and making it compliant. This will, of course, depend on the nature of the irregularity noticed and we hasten to add a caveat that it is not being suggested that if any serious lapse is found during the course of the inspection, the Board should not proceed against the delinquent"."*
*The aforementioned adjudicating officer's order was further confirmed by SEBI's whole time member by an order dated May 31, 2019 (enclosed as Appendix 5).*

***Additional Contentions and Submissions of Noticee 1***

24. *The Penalty provisions under both Section 15E and Section 15HB of the SEBI Act have been invoked against Noticee 1. The relevant provisions have been extracted below:*
*"****Penalty for failure to observe rules and regulations by an asset management company.***
*15E. Where any asset management company of a mutual fund registered under this Act, fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies, such asset management company 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."*
25. *In this context, Noticee 1 humbly submits that:*

a. *There is no failure on the part of Noticee 1 as contemplated in Regulation 15E. On the contrary, and as outlined in the response, Regulation 52 of the SEBI MF Regulations specifically contemplates and allows an asset management company to absorb expenses of a scheme. An asset management company is mandatorily required to bear such expenses in excess of the regulatory limits, and there is no prohibition against absorbing expenses when these are within the regulatory limits;*

b. *Without prejudice to anything contained above, even if the SEBI TER Circular were to be interpreted in a manner interpreted in the SCN, Noticee 1 has complied with the provisions of the SEBI TER Circular in letter and spirit. As stated earlier, the intention of the SEBI TER Circular is to curb malpractices in the payment of trail commission and any kickbacks to the investors i.e. curb mis-selling and market abuse in the matter of distribution of units to investors. In spirit with the efforts taken by SEBI to curb churning of portfolio of investors, Noticee 1 humbly requests the learned Adjudicating Officer to note that Noticee 1 did not charge back the expenses borne by it as 'AMC fees' to DSP Nifty 50 ETF and that no commission has been charged to DSP Nifty 50 ETF till date. The sole intention of Noticee 1 to absorb the 0.09% expenses was to keep the TER of DSP Nifty 50 ETF competitive to attract investors and scale up the AUM and not churn the portfolio of the investors; and*

c. *Section 15HB can only be invoked where other penalty provisions have not been attracted. As provisions of Section 15E have already been invoked against Noticee 1, Noticee 1 humbly submits that provisions of Section 15HB cannot be invoked against it.*

26. *In the context of the penalty under Section 15E of the SEBI Act, Noticee 1 submits that while determining the quantum of penalty it would be pertinent for the adjudicating officer to consider the relevant factors stipulated in Section 15J of the SEBI Act, which reads as under:*

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

    *15J. While adjudging quantum of penalty under 15-I or section 11 or section 11B, the Board or the adjudicating officer shall have due regard to the following factors, namely :—*

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

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

    *(c) the repetitive nature of the default.*

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

27. *In this regard, Noticee 1 humbly submits that it has not made any disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the alleged default. The amount of the alleged default is too miniscule and insignificant to have any impact on other schemes of the DSP Mutual Fund or incentivize mis-selling. Further, no loss has been caused to an investor or group of investors as a result of the alleged default (and instead, as a result of Noticee 1 absorbing the additional amount of 0.09%, the expenses charged to the existing investors in DSP Nifty 50 ETF have actually been lowered).*

28. *Noticee 1 reiterates that, being an asset management company, it has always maintained the highest standards of integrity and fairness in all its dealings and conduct of business and taken all the decisions solely in the interest of the unitholders and development of a robust mutual funds market in India. Further Noticee 1 has always complied with the letter and spirit of law and the SEBI MF Regulations.*

***Additional Contentions and Submissions of Noticee 2***

29. *The penalty provisions under both Section 15D(b) and Section 15HB of the SEBI Act have been invoked against Noticee 2. The relevant provisions of Section 15D(b) have been extracted below (for relevant extract of Section 15HB, please see paragraph 24 above):*

    *"**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; "*

*[**Emphasis Supplied**]*

*30. In this context, Noticee 2 submits that:*

**a.** *There has been no violation of any terms and conditions of the certificate of registration. The issue at hand is whether expenses can be absorbed by the asset management company or the trustee within regulatory limits. There is no scope of any allegation that the certificate of registration has been violated. Therefore Section 15(D)(b) has no application;*

**b.** *The Adjudicating Officer in the matter of Indiabulls Mutual Fund has held that penalty under Section 15D(b) would not apply to a trustee company. For details, please see paragraph 23(q)(ii) above; and*

**c.** *Section 15HB can only be invoked where other penalty provisions have not been attracted too. As provisions of Section 15D(b) have already been invoked against Noticee 2, Noticee 2 humbly submits that provisions of Section 15HB cannot be invoked against it.*

*31. Without prejudice to anything contained above, Noticee 2 submits that no penalty should be imposed on it either under Section 15D(b) or Section 15HB as it has not violated Regulation 18(9) read with Regulation 77 of the SEBI MF Regulations (as alleged in the SCN). The relevant provisions of the SEBI MF Regulations have been extracted below:*

*"**Rights and obligations of the trustees***

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

***Power of the Board to issue clarifications***

*77. In order to remove any difficulties in the application or interpretation of these regulations, the Board shall have the power to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians."*

*32. In this context, Noticee 2 submits that:*

**a.** *By absorbing the expenses of DSP Nifty 50 ETF within regulatory limits, Noticee 1 has not violated the provisions of the SEBI TER Circular. As outlined in the response, there is no prohibition on the asset management companies from absorbing expenses of the scheme (even when these are within the regulatory limits) under the SEBI TER Circular;*

**b.** *Without prejudice to anything contained above, even if the SEBI TER Circular were to be interpreted in a manner interpreted in the SCN, Noticee 2 is of the view that Noticee 1 has complied with the provisions of the SEBI TER Circular in letter and spirit as (i) no expense has been charged back by Noticee 1 to DSP Nifty 50 ETF till date, and (ii) no commission has been charged to DSP Nifty 50 ETF till date; and*

**c.** *Noticee 2 has, at all times, ensured that the activities of Noticee 1 are conducted in accordance with the SEBI MF Regulations (and all the circulars issued by SEBI thereunder).*

*33. In the context of the penalty to be imposed against Noticee 2, Noticee 2 humbly submits that while determining the quantum of penalty it would be pertinent for the adjudicating officer to consider the relevant factors stipulated in Section 15J of the SEBI Act (for relevant extract of Section 15J, please see paragraph 26 above).*

*34. In this regard, Noticee 2 humbly submits that it has not made any disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the alleged default. The amount of the alleged default is too miniscule and insignificant to have any impact on other schemes of the DSP Mutual Fund or incentivize mis-selling. Further, no loss has been caused to an investor or group of investors as a result of the alleged default (and instead, as a result of Noticee 1 absorbing the additional amount of 0.09%, the expenses charged to the existing investors in DSP Nifty 50 ETF have actually been lowered).*

*35. Noticee 2 reiterates that, being a trustee of a mutual fund, it has always maintained the highest standards of integrity and fairness in all its dealings and conduct of business and taken all the decisions solely in the interest of the unitholders and development of a robust mutual funds market in India. Further Noticee 2 has always exercised due diligence and its independent professional judgement to ensure that Noticee 1 complies with the letter and spirit of law and the SEBI MF Regulations at all times.*

***Prayer***

*36. In light of the above circumstances, the Noticees humbly submit that (a) no case of violation has been made out in the SCN, which deserves to be discharged; (b) no inquiry is required to be held against the Noticees in accordance with Rule 4(1) of the SEBI Adjudication Rules read with Section 15I of the SEBI Act; and (c) no penalty is warranted against Noticee 1 under Section 15E read with Section 15 HB of the SEBI Act and against Noticee 2 under Section 15D(b) read with Section 15HB of the SEBI Act, for the alleged violations.*

*As stated earlier, there is no scope at all to invoke Section 15HB of the SEBI Act, when specific provisions in Section 15D(b) and Section 15E have been invoked against the Noticees. The SCN does not even spell out what is the basis of invoking Section 15HB of the SEBI Act.*

*37. Without prejudice to anything contained in this letter, the Noticees reserve the right to make further submissions and/or to modify any additional grounds in the reply. Needless to say, the Noticees would request a personal hearing in the matter to explain the aforesaid and demonstrate why neither an inquiry is warranted, nor any contravention being established if inquiry is to be held, for any penalty to be imposed.*

**Hearing**

9. In order to comply with the principles of natural justice, an opportunity of hearing through Webex, was granted to the Noticees on December 06, 2022 before the undersigned. The Authorised Representatives of the Noticees appeared for hearing on December 06, 2022 and reiterated the written submissions made vide email and letter dated November 23, 2022 by the Noticees.

**Consideration of Issues**

10. I have carefully perused the charges levelled against Noticees in the SCN, Reply of the Noticees, all the documents/material available on record and Scheme Information document of scheme available on DSP Mutual Fund website. In the instant matter, the following issues arise for consideration and determination:

**Issue – I**:-. Whether:

a) Noticee No. 1 has violated SEBI Circular dated October 22, 2018.
b) Noticee no. 2 has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.

**Issue – II**:- Does the violation, if any, on the part of

a) Noticee No. 1 attract monetary penalty under section 15E read with 15HB of SEBI Act, 1992?

b) Noticee No. 2 attract monetary penalty under section 15D (b) read with 15HB of SEBI Act, 1992?

**Issue – III**:- If so, what would be the quantum of monetary penalty that can be imposed on Noticees taking into consideration the factors mentioned in Section 15J of the Act?

## Findings

**Issue – I:- Whether**

**a) Noticee No. 1 has violated SEBI Circular dated October 22, 2018.**

**b) Noticee no. 2 has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.**

11. Before proceeding with the merits of the case, it is felt appropriate here to deal with the Penal Provisions in respect of the alleged violations by the Noticees as mentioned in the SCN:

11.1. Noticee 1 under Section 15E read with Section 15 HB of the SEBI Act; and

11.2. Noticee 2 under Section 15D(b) read with Section 15HB of the SEBI Act,

I have also taken note of the submissions of Noticees with respect to penalty provisions imposed upon Noticees, which *inter-alia* states that, *Section 15HB would come into play only if there is no other penalty provision in Chapter VI-A that covers the contravention alleged. For both the Noticees, the provisions of other sections under Chapter VI-A have been invoked. In the same breath, Section 15HB, the residuary penalty provision which can be applied only if no other penalty provision is attracted, has also been invoked. As will be seen later in this response (i.e. paragraph 23(q)(ii) below), that Section 15D(b) would not apply to either an asset management company or a trustee company is a matter already covered by an order by a learned adjudicating officer of SEBI.*

12. In this regard, I note that under Section 15E of the SEBI Act, penalty can be levied upon asset management company of a mutual fund registered under the SEBI Act

who fails to comply with any of the regulations providing for restrictions on the activities of the asset management companies and, under Section 15D(b) of the SEBI Act, penalty can be levied against a Mutual Fund registered with the Board who fails to comply with the terms and conditions for issuance of certificate of registration.

13. In my view, I note that, violations as alleged against Noticee no. 1 and 2 in the SCN do not fall within the contours of section 15E and 15 D(b) of the SEBI Act respectively, in the instant adjudication proceedings. In view of the same, I do not hold Noticee no. 1 and 2 liable for penalty under section 15E and 15 D(b) of the SEBI Act. However, the instant inquiry and, adjudication proceedings can be limited to the extent of section 15HB of the SEBI Act. Accordingly, in exercise of the powers conferred upon me under Section 15-I(2) of the SEBI Act read with Rule 5 of the SEBI Adjudication Rules, I proceed to adjudicate this matter under 15HB of the SEBI Act for the alleged violations by the Noticees which provides for penalty upon whoever fails to comply with any provisions of this Act, the rules or the regulations made or direction issued by the board thereunder for which no separate penalty has been provided.

14. I shall now evaluate the allegations made against the Noticees in the SCN on merit. To begin with, I note that, Noticees in its reply have contended the alleged violation of SEBI TER Circular by stating it as wrong reading of the word “only” by SEBI and further stated that there is no absolute bar on the asset management company bearing expenses within the regulatory limit of TER of 1% also. In this regard, Noticees have mentioned the Regulation 52(1), Regulation 52(6)(b),SEBI TER Circular and also mentioned Regulation 52(7), Regulation 52(5) of SEBI (Mutual Funds) Regulations, 1996 which stipulates conditions in which Expenses can be borne by asset management company or the trustee company or the sponsors of Mutual Fund.

15. At this juncture, it is important to mention that, as per Regulation 52(1) of the SEBI MF Regulations, all expenses should be clearly identified and appropriated in the individual schemes. Further, in terms of Regulation 52(6)(b) of the SEBI MF Regulations, I note that, the regulatory limit for expenses at all times relevant to DSP Nifty 50 ETF is 1% and it is clearly laid down in the provisions of SEBI TER Circular dated October 22, 2018 that, **all scheme related expenses** including commission paid to distributors, by whatever name it may be called and in whatever manner it may be paid, shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route. I also note that, Regulation 52(7) of SEBI (Mutual Funds) Regulations, 1996 permits that any expenditure in excess of the limits specified in sub-regulations (6) and (6A) shall be borne by the asset management company or by the trustee or sponsors. Thus, from the conjoint reading of abovementioned regulations and circulars, I note that, the AMC can absorb the expenses as per Regulation 52(7) in excess of limits specified in sub-regulations (6) and (6A). However, in the instant case, scheme has not even exhausted the maximum permissible TER of 1% permitted under Regulations 52 (6) and (6A) of SEBI (Mutual Funds) Regulations, 1996 of the scheme and scheme expenses has been paid from AMC book i.e., 0.09% of the scheme expenses out of 0.16%.

*16.* Noticees has referred to Agenda Note presented to the SEBI board in relation to SEBI TER Circular dated October 22, 2018 and has also stated that, *Given the facts in hand, it is beyond question that there has been any lack of transparency in expenses or any portfolio churning or any mis-selling in the context of DSP Nifty 50 ETF;* in the same context Noticee has further stated that*, no commission has been charged to DSP Nifty 50 ETF till date.*

17. In this regard, firstly, I note that the said the scheme is ETF and Investor directly buy and sell units of ETF on stock exchange, thus, there is no question of commission to

be charged to the ETF scheme. Upon perusing the agenda note, I note that, the said agenda note also mentions about the varied practices followed by Mutual Funds in charging TER to the Scheme and purpose of the SEBI TER Circular was to *inter-alia* bring in the transparency in charging of expenses to the scheme by necessarily paying all the scheme related expenses only within the regulatory limits of schemes and not from the books of asset management company, its associate, sponsor, trustee, or any other entity through any route. In the instant matter, I note that, there is no denial by Noticees and in fact it has stated in CTR and HYTR that, Noticee no. 1 has paid 0.09% expense of the scheme while actual expenses incurred by scheme was 0.16% (within the regulatory limit of 1% applicable to scheme's TER) and charged only 0.07% of TER of scheme which I find is incorrect charging of TER of scheme as mandated in the SEBI TER Circular.

*18.* Noticee has contended that, *neither the CTR nor the HYTR would suggest any admission or a confession that there has been any violation of the SEBI TER Circular* and *The point about the disclosures made was to show transparently that the actual TER charged under DSP Nifty 50 ETF was 0.07% as against the actual expense incurred by the scheme which was 0.16%, which is in any case well within the regulatory limit of 1% applicable to passive fund schemes*. In this regard, I note that, AMCs do exception reporting on a bi-monthly basis to SEBI in its Compliance Test Reports (CTR) which furnishes the non-compliance only and this exception report is placed before the Trustee(s) and thus, Noticees in its CTR and HYTR for the period ending March 2022 to SEBI has *inter-alia* reported that, *The actual TER charged under DSP Nifty 50 ETF was 0.07% as against actual expense incurred by the scheme i.e., 0.16%. The reason of excess expense borne by AMC is due to competitive market and increasing of TER would have restricted ability to increase Scheme's AUM* (Asset under Management). Thus, the said argument of Noticees is not of much assistance in light of exception reported in the CTR and HYTR periodically to SEBI. Further, I note from the submissions of the Noticees to SEBI that, it has in fact admitted that, *the actual expense of Scheme was 16 bps and was* *higher than the TER of similar schemes in the industry, if the full expense of the scheme was absorbed by Scheme then it would be an outlier in terms of TeR and tracking error in comparison to similar schemes in the industry*. *Thus, the decision to bear the expense of 0.09% of the scheme by Noticees was to align the TeR of DSP Nifty 50 ETF with other similar schemes in the industry.*

19. Noticees have also stated that, *Some of the expenses incurred by DSP Nifty 50 ETF as on March 31, 2022 (e.g., index charges, custody fees etc.) were costs associated with its recent launch and the attempt to scale up its AUM from INR 11.89 crores in December 2021 to INR 22.59 crores in March 2022. Therefore, the operating cost of DSP Nifty 50 ETF as a percentage of its AUM as on March 31, 2022 reflected a higher number;*

    *In this regard it is also submitted that there are no common approaches in the industry around the treatment of benchmark costs. The Noticees understand that while many mutual funds attribute such costs as expenses of the scheme, others charge these as costs of the asset management company. Following a conservative approach, DSP Mutual Fund attributed the benchmark costs of DSP Nifty 50 ETF as the expenses of the scheme and not as costs of Noticee 1. This inclusion could increase the operating cost of DSP Nifty 50 ETF as a percentage of its AUM vis-à-vis its competitors who may not attribute such costs as expenses of the scheme. Noticee 1 did not want to burden the investors* with *the additional costs and therefore, in the interest of the investors, took a decision to bear these costs and charge a TER of only 0.07% to DSP Nifty 50 ETF;*

    *The Noticees reiterate that no management fees will be charged to the scheme until the scheme is able to absorb the total scheme expenses;*

20. In this regard, I do not find merit in the contention of Noticees as Regulation 52(1) of the SEBI MF Regulations mandates that, *All expenses should be clearly identified and appropriated in the individual schemes*. Further, I note that, scheme information document (SID) dated October 31, 2022 of scheme available on DSP MF website

mentions about what comprises the New Fund Offer (NFO) expenses of scheme and also states that, *NFO expenses of floating the Scheme will be borne by the AMC*. Noticees have also not specified the percentage of 16bps, which according to Noticees was attributable to scheme's recent launch and do not fall under the purview of Regulation 52(1). Also, Noticees have failed to provide any proof to substantiate the different approaches in the industry around the treatment of benchmark costs. However, I note that, it has submitted the range of TER (0.05% - 0.12%) charged by similar scheme of other mutual funds to SEBI. This clearly indicates the intent of Noticees that, *The intention of Noticee 1 by absorbing the expenses was to solely keep the TER competitive to attract investors and scale up the AUM* , since the scheme's expense was in actual 0.16% whilst it has disclosed TER of 0.07%.

21. Noticees has stated that, *SEBI has been making various efforts to deepen the market for passive funds and increase their uptake by investors as a low cost investment, and SEBI treats passive funds differently in certain aspects*. In this regard, Noticee has requested to refer the SEBI circulars dated April 28, 2021 (circular reference no: SEBI/HO/IMD/IMD-I/DOF5/P/CIR/2021/553), September 02, 2021 (circular reference no: SEBI/HO/IMD/IMD-IDOF5/P/CIR/2021/624) and May 23, 2022 (circular reference no: SEBI/HO/IMD/DOF2/P/CIR/2022/69. I note that the circulars dated April 28, 2021 and September 02, 2021 cited by Noticees do not in anyway provide plausible explanation for defying the SEBI TER circular. Further, the Circular on Development of Passive Funds dated May 23, 2022 inter-alia states the reduction of investor education and awareness charges from 2 bps to 1 bps for ETFs/ Index Funds and I also note that, the said circular came into force with effect from July 01, 2022 while the CTR and HYTR pertains to period ending March 31, 2022. Nevertheless, even if this 1 bps reduction is considered, I note that, AMC has borne the 9 bps of expenses of scheme even before the effect of this circular. Also, I note that, there is SEBI circular dated March 25, 2019, which allows AMCs to pay the expenses that are very small in value but high in volume out of AMC's books upto a

maximum of 2 bps of respective scheme AUM. However, in the given instance, even if this 2 bps is considered, I note that, the expenses borne by AMC is on higher side i.e., 9 bps.

22. Thus, after going through the conjoint reading of aforesaid circulars and regulations, I find that, the contentions put forth by the Noticees regarding contraventions as alleged in the SCN are nothing but an attempt to cover up their wrongdoing of charging incorrect TER to the scheme in order to align it with TER of similar schemes in industry to maintain it as competitive by misinterpreting the wordings of TER circular and attract investors in order to scale up its AUM. This practice of paying the expenses of the scheme from AMC books well within the regulatory limits will only be afforded by profitable AMCs or AMCs with deep pockets whereas small AMCs won't be able to borne such expenses from their books. Thus, the stated objective of SEBI TER Circular titled "Transparency in TER" is, "*in order to bring transparency in expenses, reduce portfolio churning and mis-selling in mutual fund schemes*" will get diluted with this varied practice of charging and disclosing incorrect TER of scheme which will create anomalies in the Mutual Fund industry and will lead to unhealthy competition in the mutual fund industry.

*23.* I note that Noticee has stated that, *Given the facts in hand, it is beyond question that there has been any lack of transparency in expenses or any portfolio churning or any mis-selling in the context of DSP Nifty 50 ETF.* In this regard, I note from the SID, which clearly mentions that*, "In accordance with SEBI circular dated October 22, 2018, all scheme related expenses including commission paid to distributors, by whatever name it may be called and in whatever manner it may be paid, shall be paid from the scheme only within the regulatory limits and not from the books of the AMC, or by the trustee or sponsors."* Further, it may be noted that TER of a scheme is one of the important parameters for investors while taking investment decisions. Since higher the TER, ceteris paribus, lower will be the return to the investors of scheme and vice-versa. Thus, if a scheme discloses lower TER whereas in reality the actual TER is higher, the disclosed TER is misleading. Therefore, when SEBI vide aforesaid Circular mandated charging of all the expenses to the respective Schemes, in a way it ensures application/disclosures of correct TER of the Scheme and Noticee no. 1 has absorbed 0.09% of expenses of scheme and charged TER of 0.07% to the scheme as against actual expense of 0.16% incurred by the scheme and thus, it is misleading to the investors by not disclosing correct TER of the scheme which in actual was 0.16%(16bps).

24. Therefore, In view of the above, I conclude that, Noticee no. 1, by paying 0.09% expenses of the scheme out of 0.16% from its own books within the regulatory limits of TER of 1% has violated the provisions of SEBI circular dated October 22, 2018, which requires that all scheme related expenses shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route.

25. I note that Regulation 18(9) of SEBI (Mutual Funds) Regulations, 1996 states that, the trustees shall ensure that all the activities of the asset management company are in accordance with the provisions of these regulations. Regulation 77 of SEBI (Mutual Funds) Regulations, 1996 mentions that in order to remove any difficulties in the application or interpretation of these regulations, the Board shall have the power to issue clarifications and guidelines in the form of notes or circulars which shall be binding on the sponsor, mutual funds, trustees, asset management companies and custodians. Thus, in view of the aforesaid , as the allegations levelled in the SCN against Noticee no. 1 stands established and considering the submissions of Noticee no. 2 in its Emails dated July 13, 2022, I conclude that, Noticee no. 2 have violated Regulation 18(9) read with Regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI Circular dated October 22, 2018.

**<u>Issue – II</u>**: - **Does the violation, if any, on the part of Noticees attract monetary penalty under 15HB of SEBI Act, 1992?**

26. It has been established in the preceding paragraphs that, Noticee no. 1 has violated SEBI circular dated October 22, 2018 and Noticee no. 2 have violated Regulation 18(9) read with Regulation 77 of SEBI (Mutual Funds) Regulations, 1996 and thus, I am satisfied that, Noticees are liable for penalty under section 15 HB of the SEBI Act 1992 for the aforementioned violations committed by them.

27. With respect to imposition of penalty, I note that Noticees have requested the undersigned to consider the amount of expense of scheme borne by AMC and also cited the AO order in the matter of *Indiabulls Mutual Fund* and AO and WTM order in the matter of *Kotak Mahindra Mutual Fund* wherein, no monetary penalty has been imposed on asset Management Company and the trustee company by the Adjudicating officer. In this regard, I note that the facts and circumstance of the cases are different from the instant case. Further, it may be noted that, though the expense amount of Rs. 53,238.10 borne by the AMC was miniscule in absolute terms, however, there is no iota of doubt that, the said noncompliance by Noticees is not merely a technical violation but is deliberate one to align the TER of scheme with other similar schemes in the industry and consequently getting the expenses of the scheme beyond the TeR charged, reimbursed by the AMC and the same is evident from emails to SEBI from Noticees, wherein they have explicitly stated that, *they would continue bearing the excess expenses of scheme till the time, the scheme attains a particular size of AUM wherein by charging competitive TER, AMC would be able to meet the expenses incurred by the scheme* and further, trustees in its email to SEBI has also stated that, *the same principle shall be adopted for any other passive index fund or ETF where the scheme TeR seems to be significant outlier in terms of the range of TeR charged by similar schemes in the industry.* Thus, the AMC / Trustee Company has clearly indicated to continue the practice of bearing excess expenses in the books of AMC so that the TER of scheme remains competitive in comparison to similar schemes in the industry which is clearly non-

compliance of SEBI TER circular which mandates that all scheme related expenses shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route.

28. Here, it is important to refer to the observation of the Hon'ble Supreme Court of India in the matter of SEBI Vs. Shri Ram Mutual Fund [2006] 68 SCL 216(SC) wherein it was observed that, "*In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant...*"

**<u>Issue – III</u>:- If so, what would be the quantum of monetary penalty that can be imposed on Noticees taking into consideration the factors mentioned in Section 15J of the Act?**

29. While determining the quantum of penalty under Section 15HB of the Act, it is important to consider the factors stipulated in Section 15J of the SEBI Act, 1992 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."*

30. It is noted that available records do not specify the disproportionate gains or unfair advantage made by the Noticees or the specific loss suffered by the investors due

to aforesaid violations by Noticees. The essence of compliances with SEBI circulars and regulations are mandatory, irrespective of the fact whether such non compliances result in causing any actual loss to any investor or not. It is trite law that when a rule, law, regulation demands for certain things to be done in a particular manner, those acts or things are required to be done in that specified manner only. Any deviation from complying with the rules or any action deviant from the manner prescribed under such rules and regulations, would be a sufficient ground for inviting penal action against such deviation or non-compliances.

31. I note that, though the amount of expense of scheme of Rs. 53,238.10/- borne by the AMC was miniscule, however, I cannot ignore the gravity of violations involved in the matter as TER of a scheme is one of the important parameters for investors while taking investment decisions. If a scheme discloses lower TER whereas in reality the TER is higher, the disclosed TER is misleading. Therefore, when SEBI vide aforesaid Circular mandated charging of all the expenses to the respective Schemes, in a way it ensures application/disclosures of correct TER of the Scheme. Further, this practice has the potential to create anomalies in the Mutual Fund industry as profitable AMCs or AMCs with deep pockets can afford to pay schemes expenses from AMC books whereas small AMCs won’t be able to borne such expenses from their books. Thus, having established that, AMC has violated SEBI circular dated October 22, 2018 by bearing expenses of the scheme well within the regulatory limits has violated the provisions of aforesaid SEBI Circular which requires that all scheme related expenses shall necessarily be paid from the scheme only within the regulatory limits and not from the books of the Asset Management Companies (AMC), its associate, sponsor, trustee or any other entity through any route and, that, Noticee no. 2 being Trustee of Mutual Fund has violated Regulation 18(9) read with regulation 77 of SEBI (Mutual Funds) Regulations, 1996 by not ensuring compliance of AMC with SEBI circular dated October 22, 2018 call for imposition of penalty.

## ORDER

32. In view of the above, after considering all the facts and circumstances of the case, the material available on record and also the factors mentioned in Section 15J of the SEBI Act as enumerated above, I, in exercise of the powers conferred upon me under Section 15-I (2) of the SEBI Act, 1992 read with Rule 5 of the Adjudication Rules, I hereby impose the following monetary penalties on Noticees:

| Noticee Name | Penalty | Charging Provisions |
|---|---|---|
| DSP Investment Managers Private Limited | ₹ 1,00,000 ( Rupees One Lakh only) | Section 15HB of SEBI Act |
| DSP Trustee Private Limited | ₹ 1,00,000 ( Rupees One Lakh only) | Section 15HB of SEBI Act |

33. I am of the view that the penalty is commensurate with the violation committed by the Noticees.

## Penalty Payment Options

34. The amount of penalty shall be paid either by way of demand draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, or by online payment through following path at SEBI website www.sebi.gov.in ENFORCEMENT → Orders → Orders of AO → Click on PAY NOW or at link https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html. In case of any difficulties in payment of penalties, the Noticee may contact the support at portalhelp@sebi.gov.in.

35. The said demand draft and its details or details of online payments made (in the format as given in table below) should be forwarded to "The Division Chief (Enforcement Department-1-DRA-4), the Securities and Exchange Board of India, SEBI Bhavan II, Plot No. C7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051."

| | |
|---|---|
| 1. Case Name : | |

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|---|---|
| 2. Name of Payee : | |
| 3. Date of Payment: | |
| 4. Amount Paid : | |
| 5. Transaction No. : | |
| 6. Bank Details in which payment is made : | |
| 7. Payment is made for :<br>(like penalties/ disgorgement/ recovery/ settlement amount and legal charges along with order details) | |

36. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, recovery proceedings may be initiated under section 28A of the SEBI Act, for realization of the said amount of penalty along with interest thereon, *inter alia,* by attachment and sale of movable and immovable properties.

37. In terms of Rule 6 of the SEBI Adjudication Rules, 1995, copy of this Order is sent to the Noticees and also to the SEBI.

**Date: December 29, 2022** **Vijayant Kumar Verma**

**Place: Mumbai** **Adjudicating Officer**