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SEBI IMPOSES 2 YEAR RESTRICTION, ₹5 CRORE PENALTY for irregularities in running of the six closed debt schemes

Franklin Barred from Launching Debt Funds

FT says it strongly disagrees with findings, may file appeal in SAT

Our Bureau

Mumbai: The Securities and Exchange Board of India (Sebi) has barred Franklin Templeton Asset Management from launching debt schemes for two years and has imposed a penalty of ₹5 crore.

The regulator has asked the fund house to refund to unitholders investment management and advisory fees it collected between June 4, 2018 and April 23, 2020 along with interest of the six wound-up debt schemes. This amounts to over ₹12 crore, which must be paid to the unitholders within 21 days.

The Sebi order relates to the fund

Debt Schemes and the Crisis



house's decision to shut down six debt schemes in April 2020 that resulted in ₹26,000 crore of investor money getting locked for upto 10 months.

Sebi alleged in its order on Monday that it observed several irregularities in the running of the six debt schemes inspected, contrary to the interests of the unitholders. It said the irregularities also extend to failures to

exercise due diligence, carry out valuation of securities and ensuring a robust risk management framework. Sebi has initiated adjudication proceedings against certain employees of Franklin Templeton, including the chief executive officer, chief compliance officer and directors.

Franklin Templeton said it intends to file an appeal against the Sebi order in Securities Appellate Tri-

bunal (SAT). "We strongly disagree with the findings in the SEBI order," said a Franklin spokesperson. "We place great emphasis on compliance and believe that we have always acted in the best interest of unitholders and in accordance with regulations. Our commitment to India remains steadfast."

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Kudvas Barred from Markets

Our Bureau

Mumbai: Sebi on Monday barred Vivek Kudva, the Asia-Pacific head of Franklin Templeton AMC, and his wife Roopa Kudva, managing director at Omidyar Network India, from accessing the securities markets for one year. It also ordered them to pay fines of ₹4 crore and ₹3 crore, respectively, for withdrawing investments in six debt plans ahead of their unprecedented closure in April last year.

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Franklin Barred

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Sebi in its show cause notice to the fund house had alleged that the six debt schemes inspected had similarity in investment pattern by subscribing to bonds where Franklin has subscribed more than 70% of the issue and the securities were lower-rated.

It alleged these deals were negotiated where the fund house subscribed to close to 100% of the issuance and failed to pay specific attention to the term sheets of such privately placed securities. "The interest rate reset clauses in the securities were drafted in a manner which provided exclusive discretion to the Issuer to propose interest rate reset, as a result of which, in the instance of no proposal from Issuer for revision in rates or where cap rate is agreed to, the investor had no exit option from the securi-

ty," said Sebi whole time member G Mahalingam in a 100-page order.

Such unilateral interest rate reset clauses in the term sheets adversely affects the valuation, it said.

"The Noticee (Franklin) has defended its position by citing the existence of 'commercial understanding' between itself and the Issuer but it needs to be borne in mind that a commercial understanding cannot be enforced in a Court of law in the absence of clearly documented covenants," Sebi said.

The regulator said the fund house committed lapses in calculation of Macaulay duration to push long-term papers into short-duration schemes. Macaulay duration is a measure of interest rate risk of a bond and indicates the weighted average pay-back period for the investor.

"By deliberate misapplication of shorter duration, the Noticee (Franklin) has been able to push the long-duration papers into the shorter-duration debt schemes. While this has

been resorted to for the purpose of generating a higher yield for the portfolio, the debt schemes inspected have been misrepresented to investors as short-duration schemes," Sebi said.

Sebi noted that the inspected debt schemes had exposure to total illiquid securities in the range of 73% to 85% in May, 2019, and in the range of 85% to 94% in January, 2020.

Sebi alleged that Franklin made investments which were similar to giving loans to issuers. "The Noticee's decision to remain invested in such illiquid securities is a strong pointer to the (commercial) arrangement of lending money to the issuer for the pre-decided time or until the issuer repays. The resultant failure to manage liquidity exacerbated the redemption pressures," the order said.

The regulator also alleged that the fund house had largely relied on inter scheme transfers (IST) and market sale for meeting liquidity requirement for redemptions.

Sebi Bars Kudvas from Markets

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The Securities and Exchange Board of India (Sebi) also directed Vivek Kudva, his wife and mother to put ₹22 crore into an escrow account.

They had cumulatively redeemed units amounting to ₹30 crore in the wound-up debt plans while in possession of material non-public information, something Sebi held as 'unfair' trade practice.

"Directors are not prohibited from trading in the units of the schemes managed by the AMC, (but) they should ensure that such trading conforms to ethical and moral standards and legal norms expected to be complied (with) by a person entrusted with quasi-fiduciary responsibilities," Sebi whole-time member G

Mahalingam said in his order. "Redemption of units by a director of the AMC of a mutual fund, while being privy to material non-public information, cannot be considered fair conduct."

The regulator also alleged that Vivek Kudva passed on material non-public information to his

wife, using which she also redeemed her units in an unfair manner.

The markets watchdog Monday barred Franklin Templeton Asset Management from launching debt plans in India for two years.

The curbs relate to the fund house's decision to shut down six debt investment programmes in April 2020, a move that resulted in ₹26,000 crore of investor funds being stuck for up to 10 months.