BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: KAMLESH C. VARSHNEY, WHOLE TIME MEMBER

ORDER

Under sub-section (3) of section 15-I read with section 19 of the Securities and Exchange Board of India Act, 1992

In respect of:

HSBC Asset Management (India) Private Limited

PAN: AABCH0007N

(**Erstwhile L & T Investment Management Limited**

PAN: AABCC5819R)

In the matter of Inspection of L & T Mutual Fund

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A. Background

1. Present proceeding has emanated from a Show Cause Notice dated November 06, 2023 (hereinafter referred to as "***SCN***") issued by the Securities and Exchange Board of India (hereinafter referred to as "***SEBI***") under sub-section (3) of section 15-I of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "***SEBI Act, 1992***") to HSBC Asset Management (India) Private Limited (hereinafter referred to as "***HSBC/ Noticee***") calling upon to show cause as to why the order dated August 23, 2023 passed by the Adjudicating Officer (hereinafter referred to as "**AO**"), should not be examined and revised under sub- section (3) of section 15 (I) of SEBI Act, 1992 and penalty should not be imposed in terms of section 15HB of the SEBI Act, 1992.

2. At the outset, it is felt that facts that have led to the issuance of the aforementioned SCN against *Noticee* need to be stated in brief and the same are narrated hereunder.

3. SEBI had appointed an independent auditor M/s Ummed Jain & Co. to conduct an inspection of L&T Mutual Fund for the period April 01, 2019 to March 31, 2021. L & T Investment Management Limited (hereinafter referred to as (**"*AMC***"), was the Asset Management Company of L&T Mutual Fund. Pursuant to the inspection, an Inspection Report (hereinafter referred to as "***IR***") was submitted to SEBI on July 15, 2022. It is noted that the AMC was subsequently acquired by HSBC Group and the name of the asset management company of L & T Mutual Fund was changed to HSBC Consultancy Services (India) Limited w.e.f. May 17, 2023. Subsequently, HSBC Consultancy Services (India) Limited was merged into HSBC Asset Management (India) Private Limited, effective from October 16, 2023. Accordingly, the present proceeding is being conducted against HSBC Asset Management (India) Private Limited. For the reasons elaborated above and for the purposes of

this order, the AMC which has now merged and become the asset management company of HSBC is being referred to as the ***Noticee***.

4. Based on findings of the inspection, it was noticed that asset management companies were required to maintain records in support of each investment decision which would include the data, fact and opinion leading to that decision. Since, anomalies were observed in creating, maintaining record and rationale for the investment decision, an adjudication proceeding was initiated against the *Noticee* under section 15HB of the SEBI Act, 1992 and a show cause notice dated March 20, 2023 and a supplementary show cause notice dated June 16, 2023 were issued, *inter alia*, alleging as under:

   4.1. *Noticee* had not properly recorded its investment decisions as per terms of the SEBI circular no. MFD/CIR/6/73/2000 dated July 27, 2000 (hereinafter referred to as "**July 2000 Circular**") as it had failed to maintain records containing data, facts and opinion in support of each scrip wise investment decisions;

   4.2. *Noticee* had not recorded the detailed reasons in subsequent purchase and sale in the same scrip;

   4.3. *Noticee* had not established a mechanism to ensure and verify that due diligence is being exercised while making investment decisions in terms of the aforesaid SEBI Circular and further to be in compliance with its own Investment Policy Manual and thereby violated SEBI circular no. MFD/CIR/6/73/2000 dated July 27, 2000, sub-regulation (2) of regulation 25 of the of the Securities and Exchange Board of India (Mutual Funds) Regulations, 1996 (hereinafter referred to as "**MF Regulations**")and clause 9 of Fifth Schedule – Part A of the MF Regulations;

5. The AO, vide its order dated August 23, 2023 (hereinafter referred to as the "**AO Order"**), disposed of the said proceeding and exonerated the *Noticee*, *inter alia*, by observing the following in the said order:

5.1. Relying on internal notings, it was held that *July 2000* Circular lacks clarity with regard to the details that has to be considered by the AMC while making subsequent investment decision and further the noting was proposing for issuance of a clarification, hence, the violation is not established.

5.2. It was also held that there are no timelines given in the MF Regulations or *July 2000* Circular prescribing timelines for updating Research Report and therefore, in the absence of time line, it may not be right to hold the *Noticee* liable for not updating.

5.3. Further, it took note of the submission of the *Noticee* that there was monitoring of stocks of the investee companies and therefore, in the absence of evidence contrary to the above claim of the *Noticee,* the AO Order held that the allegation of lack of due diligence by not updating the research report thereby violating sub-regulation (2) of regulation 25 of the MF Regulations and clause 9 of Fifth Schedule – Part A of MF Regulations did not stand established.

6. The AO order has been examined by SEBI to ascertain whether the order is erroneous to the extent it is not in the interest of the securities market and *inter alia,* the following has been observed -

6.1. *Noticee* had not produced any record(s) detailing the reasons and documents in support including data, facts, and opinions leading to the investment decisions taken in Sadbhav Engineering Limited, which was alleged to be in violation of the *July 2000* Circular.

6.2. Reasons were not properly recorded for the subsequent investment decisions i.e. sale in the scrip of Sadbhav Engineering Ltd., Hindustan Zinc Ltd. and Vodafone Idea Ltd. Whereas there were simple recitals viz; "*need to raise cash for tactical reasons*", "*Reducing Exposure*" and "*Switching to better opportunities*" respectively. However, there was no basis and evidence to support such recital to consider the decision as proper and in compliance with the relevant provisions of the *July 2000* Circular.

6.3. The AO had erred in exonerating the *Noticee* merely relying on the submission that the *Noticee* was actively tracking the investee companies and that it has maintained data, facts and opinion leading to its each investment decisions, when the same had not got support of any evidence.

6.4. AO had grossly erred in relying on internal noting to record that the *July 2000* Circular lacks clarity and a clarification is under contemplation. In this respect, the AO had gone beyond the show cause and relied upon a document as an evidence extraneous to the issue under consideration.

7. Accordingly, having examined the AO Order, the SCN dated November 06, 2023 has been issued in exercise of the power under sub-section (3) of section 15-I of the SEBI Act, 1992, calling upon the Noticee to show cause as to why the said AO Order should not be revised and appropriate penalty should not be imposed under the provisions of section 15HB of the SEBI Act, 1992 for the alleged violation of sub-regulation (2) of regulation 25 of the MF Regulations and clause 9 of Fifth Schedule – Part A of MF Regulations and SEBI Circular dated July 27, 2000.

B. <u>Hearing and Submissions</u>

8. In response to the SCN, reply vide letter dated December 22, 2023 was furnished. Thereafter, the *Noticee* was provided an opportunity of personal hearing on February 28, 2024 and the same was availed by the *Noticee*'s authorized representative Mr. P. N. Modi, Senior Advocate. Subsequently, the *Noticee* made post-hearing submissions

vide letter dated March 12, 2024. The submissions of the Noticees are summarised as under;

8.1. The *Noticee* submitted that the SCN is without jurisdiction and not sustainable in law. The *Noticee* also submitted that under sub-section (3) of section 15-I, the power of SEBI has not been extended to review the decision of the AO in case of a full and complete exoneration of the *Noticee.*

8.2. It has been submitted that SCN contains factually incorrect and misconceived narration as it records that relevant documents and material pertaining to the initial investment decisions were seen and noted, whereas it records for the subsequent sale decisions as cryptic and not as exhaustive or extensive.

8.3. The *Noticee* also pointed out that during inspection the auditor had perused the records of the *Noticee* and that the Supplementary Show Cause Notice dated June 16, 2023 also records the documentary evidence and records of the analyst's research reports in each of the 3 scrips mentioned therein.

8.4. Further, the *Noticee* submitted that there was a previous research report dated August 10, 2018 which had been duly prepared and was in the record even when the investment was done. *Noticee* also submitted that the report was prepared in August 2018 and was updated in July 2019 and July 2020. Thus, when the investment decision was taken in April 2019, there was a supporting research report and active tracking in place for the said scrip.

8.5. It is the case of the *Noticee* that the July 2000 Circular clearly limits the requirement for detailed due diligence and maintenance of records *qua* the initial "investment decisions" and that for subsequent investments and sales, only simple reasons have to be recorded. The *Noticee* also submitted that for all subsequent purchases and sales, only 'reasons' are required, as

were maintained by AMC. Thus, the said July 2000 Circular itself uses different language to clearly describe the difference in the requirements between the first purchase in a scrip and the subsequent purchases and sales in that scrip.

8.6. *Noticee* submitted that the said circular provides for investment, which includes only buying and not the selling, hence, even reason is not required to be recorded for sale of securities

8.7. *Noticee* submitted that when non-compliance may expose a party to penalties, Regulations must be strictly interpreted as per their "plain language". In this regard, *Noticee* referred to the findings of the Hon'ble Supreme Court made in the matter of *Franklin Templeton Trustee Services (P) Ltd. v. Amruta Garg* [(2021) 6 SCC 736].

8.8. With respect to the interpretation of the *July 2000 Circular*, the *Noticee* submitted that the law has to be clear to enable parties to comply, and if there is any ambiguity by which the concerned provision lends itself to more than one interpretation, then at the most the authority may clarify the position and the interpretation to be adopted, but cannot penalize any party for acting as per their interpretation of the said provision. In support of the submission, the *Noticee* referred to the judgements in the matter of *Tolaram Relumal and Anr. v. State of Bombay* [(1955) 1 SCR 158]; *Chairman, SEBI v. Shriram Mutual Fund* [(2006) 68 SCL 216 (SC)]; *Siddharth Chaturvedi v. SEBI* [(2016) 12 SCC 119]; *Hindustan Steel v. State of Orissa* [1969(2) SCC 627] to contend that if two possible and reasonable constructions can be put upon a penal provision, the court must lean towards that construction which exempts the subject from penalty rather than the one which imposes penalty.

8.9. *Noticee* also submitted that allegations of lack of adequate reasons relate only to sale decisions in 3 scrips, for which the drop box recorded cryptic reasons for which detailed reasons were provided in the proceeding before the AO and that SEBI has found no fault with such reasons. The *Noticee* submitted that the findings in the AO Order are perfectly valid, correct, proved by the record and merit no interference under sub-section (3) of section15-I of the SEBI Act, 1992.

8.10. The *Noticee* referred to the internal recording wherein SEBI itself states and contends that the said circular is in dire need of modification and is unclear on the issue as to whether detailed reasons have to be recorded for the subsequent investments and sales. As per the *Noticee* it is imperative that the rules, regulations, circulars etc. of the regulators must stipulate the requirements clearly to ensure that the market clearly understands what is expected, failing which no party can be penalized for any alleged breach.

8.11. Further, the *Noticee* submitted that the allegations in the SCN amount to a regulatory intervention in *bona fide* business decisions and the AO had correctly held that regulatory intervention in such cases is not warranted. *Noticee* submitted that such allegations are only raised *qua* investments which resulted in a loss and not *qua* investments which resulted in profits, even though the investment / disinvestment process, documentation and methodology was the same.

8.12. *Noticee* mentioned that more detailed reasons would be recorded in response to a show cause as compared to a mere internal recording of disinvestment reasons, particularly since there is no prescribed standard of the extent of details required to be recorded as per SEBI's Regulations and Circulars.

8.13. *Noticee* also submitted that it is incorrect to contend that no supporting evidence was supplied. Further, the reasons given by the *Noticee* were never disputed or denied nor was the *Noticee* called upon to produce evidence of the said facts, since the same are matters of common knowledge and in the public domain.

8.14. *Noticee* contended that it is untenable for a regulator to sit in appeal over commercial decisions of a mutual fund or to seek to penalise a mutual fund for its decisions which are admittedly bona fide, merely on the ground of allegedly inadequate written records of the reasons for the decisions, as if mutual funds are expected to write out detailed reasons like a judicial decision despite the fact that there is no such requirement prescribed.

8.15. The *Noticee* submitted that it had followed a robust investment decision procedure even in respect of the said three scrips referred to in the SCN and that Research Reports were, in fact, prepared before the initial investment was done in these scrips.

8.16. *Noticee* submitted that it follows all the requisite standards of governance, and all checks and balances are in place to ensure that the *Noticee*'s fund managers exercise proper due diligence while investing and at the same time the fund managers have the necessary flexibility to take investment decisions to respond to real-time events to disinvest when deemed fit to protect the interests of unit holders.

8.17. *Noticee* mentioned that the said SCN merely repeats the allegations with respect to the investments and sales by three schemes of the *Noticee* in three companies which had resulted in losses viz. (i) Investments by L&T Value Fund in Hindustan Zinc Limited, (ii) Investments by L&T Infrastructure Fund in Sadbhav Engineering Limited and (iii) Investments by L&T Midcap

Fund in Vodafone Idea Limited. The SCN does not even allege that there was any deficiency or *mala fides* in the *Noticee'*s decisions nor does it identify the error in the reasoning of the AO's Order and simply assails it on specious and untenable grounds.

8.18. With respect to the allegation that the *Noticee* did not produce any documents indicating active tracking of its investments, *Noticee* submitted that the research analysts kept the fund managers updated about any developments in the company/sector, any change in earnings, valuations etc. and that the updates are given either as part of in-person discussions or exchanged on emails. The research analysts also maintain a one-page investment thesis on portfolio stocks, apart from maintaining valuation sheets which are also used in discussions on a regular basis.

8.19. The *Noticee* submitted that the facts and circumstances of the case do not warrant imposition of any penalty or any adverse observations or directions against the *Noticee*. In support of the submission, the *Noticee* referred to the judgement of Hon'ble Supreme Court in the matter of *Siddharth Chaturvedi v. SEBI* [(2016) 12 SCC 119].

8.20. *Noticee* submitted that there is no allegation of any *malafide* or manipulation or any other mischief. Hence, it is appropriate to restrict action to issuing a clarification and imposition of penalty is not warranted.

8.21. No mechanism to verify exercising of due diligence- Neither L&T's investment policy manual nor SEBI rule/ regulation/ circular mandated updating research report on a quarterly basis. It cannot be alleged that the due diligence related to tracking of investments can only be by way of updating research reports every quarter once the quarterly financial results are declared.

C. ***Consideration of Issues and Findings***

9. Having considered the AO Order passed in respect of the *Noticee*, the SCN issued in exercise of power under sub- section (3) of Section 15-I of the SEBI Act, 1992, submissions made by the *Noticee* and other material available on record, the main issue that arises for consideration is whether the AO has erred and passed order that is erroneous to the extent it is not in the interest of the securities market.

10. Before proceeding to examine the matter on its merit, I note that the *Noticee* has raised certain preliminary objections which, in my opinion, warrants to be dealt with at the initial stage itself.

11. ***Sebi has no power to review in case of complete exoneration***

11.1. I note that the *Noticee*, in the submissions, has submitted that under sub-section (3) of section 15-I of SEBI Act, 1992, the power of SEBI is not permitted to be extended to recall and revise the decision of the AO in cases where the proceeding ends in according complete exoneration to an entity from all charges. The said submission is based on the usage of the wording in the provision providing for enhancement of penalty. According to the *Noticee*, since, it was exonerated and no penalty was imposed, therefore there is no instance of enhancement of penalty. The submission does not stand to legal scrutiny. I find that similar issue came up for consideration before the Hon'ble Securities Appellate Tribunal (hereinafter referred to as "***Hon'ble SAT/ Tribunal***"), in the matter of *Samco Securities Ltd. vs. Securities and Exchange Board of India*. In this case, order dated March 30, 2022 was passed in appeal No. 493 of 2021 wherein the Hon'ble Tribunal, *inter alia*, had examined the power of SEBI to recall order in exercise of power under sub-section (3) of section 23-I of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to a "***SCR Act***"). The Hon'ble SAT, in the said order, have held as under;

"*11. It was urged that the provision of Section 23I of the SCR Act can only be invoked when a lesser penalty is to be enhanced. It was contended that, in the instant case, a finding has been given that no violation has been committed by the appellant and, therefore, no penalty could be imposed. It was, thus, contended that in the absence of any penalty being imposed, the question of enhancement of the penalty does not arise and consequently Section 23I of the SCR Act could not be invoked. In our view, this interpretation made by the appellant is patently erroneous. Section 23I of the SCR Act empowers SEBI to call for and examine the record of any proceedings and if it considers that the order is erroneous, it can issue a notice. The word 'erroneous' would include an order where the authority has found that there was no violation of the SEBI laws. On this principle, if the authority has not imposed any penalty and if the order is found to be erroneous, it can be re-examined and can be opened under Section 23I of the SCR Act and an appropriate order of penalty, if any, could be passed if found to have violated the SEBI's laws. The submission that Section 23I of the SCR Act could only be used to enhance the penalty where a lesser penalty was imposed is erroneous. In this regard, in* ***Bhavani Mills Ltd. vs. State of Tamil Nadu [(1991) SCC online Madras 730],*** *it was held that the word 'enhance' is wide enough to enhance the penalty from zero to something."*

11.2. I note that the provisions of sub-section (3) of section 23-I of the SCR Act is identical/ analogous to sub-section (3) of section 15-I of the SEBI Act, 1992. Accordingly, the observations made by the Hon'ble SAT in the order discussed at paragraph 11.1 *supra,* is relevant and applicable *mutatis mutandis* to the present proceeding as well. In the extant matter, the *Noticee* has been exonerated in the AO Order and no penalty was imposed. Thus, it is clear that SEBI has the power to review an order even if the same has resulted in

exoneration of an entity. In view of the same, I find that the contention of the *Noticee* is not tenable and the same cannot be sustained.

12. Moving on to the issue for consideration, I note that the SCN, *inter alia,* has made charges against the *Noticee* regarding failure to exercise due diligence in the investment decisions that pertain to the three scrips namely Sadbhav Engineering Ltd., Vodafone Idea Ltd. and Hindustan Zinc Ltd.

13. The relevant facts with respect to investment/sale done by the *Noticee* which are subject matter of contention in the SCN are detailed below.

Sadbhav Engineering Ltd.

13.1. With respect to Sadbhav Engineering Ltd., it was observed that INR 17.73 Crore was invested during the period from April 25, 2019 to May 08, 2019. It is pertinent to note that the Research Report dated July 31, 2019 was available in which the annual audited financial data for the FY 2018-19 was considered and a buy recommendation at INR 141 was given by the Research Analyst. Though, the company reported net losses in the 4 preceding financial years (including 2018-19) as per consolidated financials but the Research Analyst took reference of standalone financials only in his Research Report which shows net profit whereas consolidated annual report shows net loss. It was observed that the analyst's presentation was not correct as the consolidated financials was not considered in the Research Report. It was also observed that all shares of Sadbhav Engineering Ltd. were sold on April 23, 2020 after holding for approximately one-year thereby booking a loss of INR 14.97 Crore i.e. approximately 84% of the funds invested. The Fund Manager had cited reason as '*Need to raise cash for tactical reasons*' for selling the holdings without giving detailed reasons.

13.2. In the proceeding before the AO, the *Noticee* had, *inter alia*, submitted that the decision to sell was taken during the pandemic when there was nationwide lockdown to reduce further loss. It was also submitted that the decision was a commercial decision taken by the *Noticee* and it does not require regulatory intervention.

Hindustan Zinc Ltd.

13.3. Similarly, I note that in the case of Hindustan Zinc Ltd., the Research Report dated July 21, 2020 had recommended for buying the shares at a price of INR 183 for 'medium and long term horizon'. Thereafter, on August 7, 2020, L&T Value Fund had invested INR 16.28 Crore to purchase shares of Hindustan Zinc Ltd. It was observed that all the shares of Hindustan Zinc Ltd. were sold during the period September 14, 2020 to September 17, 2020 at an average rate of INR 223.87 per share thereby booking a loss of INR 1.61 Crore. The reason provided for the sale was given as '*Switching to better opportunities*' and '*Need to raise cash for Tactical Reasons'*.

13.4. The *Noticee*, during the proceedings before the AO, submitted that uncertainty regarding the delisting of Vedanta shares, pledging of its holding in Hindustan Zinc, Hon'ble Supreme Court allowing arbitration proceedings against the government for Vedanta taking full control of Hindustan Zinc Ltd. etc. led to taking a view to exit the holding. As per their investment policy, Research Analyst is expected to write a detailed research report once every twelve months. Publication of annual report does not have any bearing on this process.

Vodafone Idea Ltd.

13.5. With respect to investment in the shares of Vodafone Idea Ltd., it was observed that the Research Report dated December 2, 2019 recommended investment in the said company for medium and long term. It was observed that L&T Midcap Scheme made investment of INR 61.59 Crore in Vodafone Idea Ltd. on December 04, 2019. However, all shares were sold after 44 days and 70 days at an average rate of INR 4.51 per share thereby booking a huge loss of INR 25.43 Crore. The reason provided for sale was given as '*Reducing Exposure*' and '*Switching to better opportunities*'. It was also observed that no detailed reasons were recorded by the Fund Manager for selling at a huge loss within a short period of holding. Further, it was observed that though the annual report of Vodafone Idea Ltd. for 2018-2019 was available on July 26, 2019, but it was reviewed on December 2, 2019.

13.6. During the proceedings before the AO, the *Noticee* had submitted that Hon'ble Supreme Court in January 2020 had rejected the review petition filed by telecom operators including Vodafone Idea Ltd. on AGR dues. For Vodafone Idea Ltd., the ruling meant that it would be saddled with a huge financial liability in excess of Rs. 50,000 crores. Due to this negative development, the fund manager chose to ignore the recommendation in the research report and sold the shares intending to reduce the loss.

14. Based on available record, the investment (buy/sale) of the *Noticee* in the above three scrips with details of price, quantity and reason are summarised in the table below:

Table No. 1

Instrument Name	Portfolio	Trade Date	Buy Qty	Buy Value	Sell Qty	Sell Value	Rationale recorded/ Mandatory remarks
Hindustan Zinc Ltd	**L&T India Value Fund**	07-Aug-20	6,55,000	16,28,05,046			Investment Purchase
Hindustan Zinc Ltd	**L&T India Value Fund**	14-Sep-20			2,59,615	5,90,87,413	Switching to better opportunities
Hindustan Zinc Ltd	**L&T India Value Fund**	15-Sep-20			2,61,387	5,82,84,884	Switching to better opportunities
Hindustan Zinc Ltd	**L&T India Value Fund**	17-Sep-20			1,33,998	2,92,61,880	Need to Raise Cash For Tactical Reasons
Loss						**(1,61,70,869)**	
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	25-Apr-19	5,00,802	11,76,88,432			Investment Purchase
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	26-Apr-19	1,97,500	4,72,78,478			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	30-Apr-19	4,488	10,73,724			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	02-May-19	8,742	20,54,366			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	03-May-19	2,772	6,50,889			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	06-May-19	809	1,91,542			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	07-May-19	14,219	33,41,075			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	08-May-19	22,258	50,82,090			Increasing Exposure
Sadbhav Engineering Ltd.	**L&T Infrastructure Fund**	23-Apr-20			7,51,590	2,76,74,012	Need to Raise Cash For Tactical Reasons
Loss						(14,96,86,584)	
Vodafone Idea Ltd	**L&T Mid Cap Fund**	04-Dec-19	8,00,00,000	61,49,61,205			Investment Purchase
Vodafone Idea Ltd	**L&T Mid Cap Fund**	17-Jan-20			2,11,50,000	9,38,42,087	Reducing Exposure
Vodafone Idea Ltd	**L&T Mid Cap Fund**	12-Feb-20			5,88,50,000	26,67,76,570	Switching to better opportunities
Loss						(25,43,42,548)	

15. In view of the above investment decisions of the *Noticee*, based on the inspection, it has been noticed that the acts of the *Noticee* were not in compliance with the provisions as alleged in the show cause issued while initiating the adjudicating proceeding. As the said adjudication proceeding resulted in exonerating *Noticee* on alleged erroneous ground, this SCN has been issued pointing out the illegality and erroneousness in the order passed by AO. On careful perusal of the allegations, it is observed that violations against the *Noticee* as per the SCN can be sub-divided into three heads -

(i) non-maintenance of records in support of each investment decision indicating data, facts and opinion leading to that decision,

(ii) not properly recording the reasons for subsequent investment decisions as stipulated in the extant SEBI Circular dated July 27, 2000 and

(iii) not establishing a mechanism to verify that due diligence was being exercised while making investment decisions

16. For the aforesaid acts and omission, *Noticee* has been alleged to have violated the July 2000 Circular and the relevant provisions of the MF Regulations. Before proceeding further, the text of the relevant provisions of the SEBI Act,1992, the MF Regulations and the July 2000 Circular are reproduced below-

SEBI Act, 1992

Power to adjudicate.

15-I. [(3) The Board may call for and examine the record of any proceedings under this section and if it considers that the order passed by the adjudicating officer is erroneous to the extent it is not in the interests of the securities market, it may, after making or causing to be made such inquiry as it deems necessary, pass an order enhancing the quantum of penalty, if the circumstances of the case so justify:

Provided that no such order shall be passed unless the person concerned has been given an opportunity of being heard in the matter:
Provided further that nothing contained in this sub-section shall be applicable after an expiry of a period of three months from the date of the order passed by the adjudicating officer or disposal of the appeal under section 15T, whichever is earlier.]

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.

MF Regulations

25. Asset management company and its obligations
(2) The asset management company shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business.

FIFTH SCHEDULE
Code of Conduct
Part A

9. Trustees and the asset management company shall render at all times high standards of service, exercise due diligence, ensure proper care and exercise independent professional judgment."

SEBI Circular No. MFD/CIR/ 6 / 73 /2000 dated July 27, 2000

All Mutual Funds Registered with SEBI/ Unit Trust of India

Dear Sirs,

Re : Recording of investment decisions by Mutual Funds

Some of the inspection reports of mutual funds indicate substantial depletion of assets of some of the schemes. We have also come across instances wherein the companies have never paid interest and principal amount to mutual funds particularly when the securities were bought on private placement basis. While going through the portfolio statements of the mutual funds, we find non-performing assets (NPAs) and some of the scrips valued at a negligible amount. All this is reflected in the NAVs of the mutual funds.

Sub-regulation (2) of Regulation 25 of SEBI (Mutual Funds) Regulations, 1996 stipulates that the asset management company (AMC) shall exercise due diligence and care in all its investment decisions as would be exercised by other persons engaged in the same business. With a purpose to implement the regulation in an effective manner and to bring about transparency in investment decisions, the AMCs are hereby advised to maintain records in support of each investment decision which will indicate the data, facts and opinion leading to that decision. While the AMC boards can prescribe broad parameters for investments, it is important that the basis for taking individual scrip wise investment decision in equity and debt securities should be recorded. While there should be a detailed research report analysing various factors for each investment decision taken for the first time, the reasons for subsequent purchase and sales in the same scrip should be recorded. The contents of the research reports may be decided by the asset management companies and the trustees.

AMC boards may develop a mechanism to verify that due diligence is being exercised while making investment decisions. They may pay specific attention in case of investment in unlisted and privately placed securities, unrated debt securities, NPAs, transactions where associates are involved and the instances where there is poor performance of the schemes.

The AMCs shall report the compliance of the above in their periodical reports to the trustees and the trustees shall report to SEBI in their half-yearly reports. Trustees may also check its compliance through the independent auditors or internal/statutory auditors or other systems developed by them…….

17. From the above, it can be seen that sub regulation (2) of regulation 25 of MF Regulations provides for every asset management company to exercise due diligence and care in all its investment decisions. The July 2000 Circular, in order to bring transparency in investment decision and to ensure effective implementation of the MF Regulations, requires asset management companies to do certain acts including maintaining records in support of each investment decision, recording reason for subsequent purchase/ sale and establishing mechanism for due diligence. The issue in this case is whether AO correctly appreciated the satisfaction of the above requirements by the Noticee. Same is discussed in the subsequent paragraphs.

Non-maintenance of records in support of each investment decision indicating data, facts and opinion leading to that decision

18. From the SCN, it is seen that one of the charges against the *Noticee* is that the *Noticee* had not produced any record(s) detailing the reasons and documents including data, facts and opinions leading to the investment decisions taken in the scrip of Sadbhav Engineering Ltd. More specifically, it is alleged that the initial investment in the case of Sadbhav Engineering Ltd. was done without having support of any Research

Report, which was alleged to be in violation of July 2000 Circular and that the AO erred in appreciating the same.

19. On perusal of the July 2000 Circular, I note that the said Circular mandates AMCs to maintain records in support of each investment decision and such report should include data, facts and opinion leading to that decision. The Circular also mandates a detailed research report analysing various factors for each investment decision when it is taken for the first time and recording of reason is made essential under the said circular for subsequent purchase and sales in the same scrip.

20. Having noticed the same, it is observed that in the case of investment by *Noticee* in the scrip of Sadbhav Engineering Ltd., there was a Research Report dated July 31, 2019 prepared based on annual audited financials for the FY 2018-19. In the said Research Report, a buy recommendation at Rs.141 was recommended by the Analyst. However, the records as ascertained in the course of inspection and as made available before me, it is observed that the initial investment of INR 17.73 Crore was made in the equity shares of said company by the *Noticee* at the average price of INR 235.98 per share during the period from April 25, 2019 to May 08, 2019, whereas the Research Report was dated July 31, 2019 i.e. after the initial investment was done in the scrip of Sadbhav Engineering Ltd. The above facts also got recorded by the AO while disposing of the adjudication proceedings.

21. The *Noticee*, in its submissions countered the abovementioned charge by stating that the same are factually incorrect and misconceived. The *Noticee* also referred to the observations made by the Auditor during inspection and also the notice issued by the AO wherein it was *inter alia* mentioned that detailed reasons were noted for the initial investment decisions.

22. I have perused the observations made by the Auditor in the Inspection Report. The Auditor, in the Inspection Report*, inter alia*, mentioned that the AMC maintains the

data, facts and opinion leading to decision in case of first-time investment. In my opinion, it appears to be a general observation made by the Auditor and not specific to the investment under consideration. The same is evident from the fact that show cause issued in the matter does not make allegation about the absence of research report for investment except in the case of Sadbhav Engineering Ltd. In this respect, it is further noted that the following has been mentioned by the Auditor with respect to the inspection parameter "***whether the investment note/ report/ record covers the discussion, data facts regarding the investment company along with the guarantor and parent company etc***.":

> *"The data facts regarding the investment company are recorded in this regard we observed following issues while reviewing the research reports of few companies which were considered while investing in that company:*
>
> *a) Sadbhav Engg. Ltd.:*
>
> *Review of Research Report: The review of research report dated 31.07.2019 was available in which the annual audited financial data for the FY 2018-19 were considered and a buy recommendation at Rs. 141 given by the Analyst…… Analyst has reported net profit of Sadbhav Engineering Ltd. in his research report dated 31.07.19 during the year 2018-19:*
>
> *……*
>
> *2.* ***The review report does not have reference of earlier review/ research report****.*
>
> *3. No evidence available for sharing the said report to Fund Managers."* (Emphasis supplied)

23. I note that inspection was conducted for the period April 01, 2019 to March 31, 2021. Accordingly, the Research Report dated July 31, 2019 was made available to the Auditor during the period of inspection. As seen from the above observation, even the

Research Report dated July 31, 2019 did not make any reference to any earlier review/ research report which dealt with the data/facts of the investment company i.e. Sadbhav Engineering Ltd. On perusal of the response provided by the Noticee to the Auditor (as recorded in the Inspection Report), I note that the Noticee has neither made any reference to any previous research report, nor contended the understanding of the Auditor that the Research Report dated July 31, 2019 was the relevant Research Report for making the initial investment in the scrip of Sadbhav Engineering Ltd.

24. Further, I note that notices issued by the AO specifically refer to the Research Report dated July 31, 2019 in which the Research Analyst had recommended to buy the shares of Sadbhav Engineering Ltd. at INR 141. In this respect, the Supplementary show cause notice dated June 16, 2023 issued by the AO clearly states at page 5 "*The relevant research report pertaining to the security was available is dated 31.07.2019, in which the annual audited financial data for the FY 2018-19 were considered…….The review report does not have reference of earlier review/research report.*" I note that in the previous proceedings, the Research Report dated July 31, 2019 was referred to as the '***relevant research report'*** and the same has not been contended by the Noticee in the said proceedings before AO.

25. As noted above, July 2000 Circular in an unambiguous term, mandate that the decision taken for the first time to make investment requires to be supported by a detailed research report analysing various factors. As regard the investment in the scrip of Sadbhav Engineering Ltd. is concerned, it is observed that the research report referred to justify the investment is subsequent to the investment made in that scrip. It can be said that the said Research Report dated July 31, 2019 cannot be the basis for investing in the securities issued by Sadbhav Engineering Ltd., during the period of April – May 2019. It is observed that there is no evidence of the *Noticee* relying upon any detailed Research Report analysing various factors, which led to the investment decision in securities of Sadbhav Engineering Ltd., and therefore, the AO erred in exonerating the *Noticee* by holding that investment in the scrip was having the support

of a detailed research report. The AO Order is also wrong on the count that it had exonerated Noticee while relying on research report which was subsequent to the initial investment. In view of the above, the finding of the AO deserve revisiting while in exercise of power under sub-section (3) of section 15I of the SEBI Act, 1992.

26. During the personal hearing on February 28, 2024, this fact was specifically pointed out to the *Noticee* that the AO Order referred to the Research Report dated July 31, 2019 which recommended buying shares of Sadbhav Engineering Ltd. @ INR 141 per share, whereas the investment was made in April-May 2019 i.e. prior to the said Research Report @ about INR 236 per share. I note that the *Noticee*, in its submission dated March 12, 2024, *inter alia*, referred to a previous research report dated August 10, 2018 and stated that the same had been duly prepared and updated in July 2019 and July 2020 and the Research Report dated August 10, 2018 was in the record even when the investment was done. The *Noticee* also submitted that the period of inspection identified by SEBI was from April 1, 2019 to March 31, 2021 and therefore only data after April 1, 2019 was recorded by the inspection team and inadvertently, the Research Report dated July 31, 2019 got referred and relied upon in the proceeding.

27. I find it difficult to accept the above argument of the *Noticee* that the Research Report dated July 31, 2019 was inadvertently referred and relied upon in the proceeding. This can be confirmed from the fact that vide email dated October 06, 2022, SEBI had, *inter alia,* requested the *Noticee* to provide the copy of research report based on which investments were made in the securities of Sadbhav Engineering Ltd. In response to the same, the Noticee, vide email dated October 12, 2022, forwarded the copy of the research report dated July 31, 2019. It is pertinent to note that the *Noticee* had not relied upon or mentioned about the Research Report dated August 10, 2018 in the proceeding before the AO. It appears that the *Noticee*'s argument is that there was a Research Report dated August 10, 2018 available on record, which was the basis for investment in the scrip of Sadbhav Engineering Ltd. I note that there was ample scope

for the *Noticee* to mention about the Research Report dated August 10, 2018 during the adjudication proceedings to justify its investment decision but it was not done. I also note that nowhere the *Noticee* had submitted during the adjudication proceedings that the initial investment was made on the basis of the recommendation made in the said Research Report dated August 10, 2018.

28. Even assuming that the investment decision was made on the basis of the Research Report dated August 10, 2018, there is a time gap of nine months between the Research Report dated August 10, 2018 and the investment date i.e. April- May 2019. It is difficult to accept the proposition that investment was made on the basis of nine months old report which was not updated to take into consideration the prevalent market conditions. Under the circumstances, I find it difficult to accept that proper due diligence was carried out for making this investment. In view of the above, I am of the opinion that the submission in para 21 of this order about detailed reasons being noted for the initial investment decision, is not tenable to accept when the research report dated August 10, 2018 was not even made available to the Auditor.

29. I find that the above facts have not been taken into consideration by AO while coming to the conclusion to exonerate the *Noticee*. AO infact relied on July 2019 Report to justify investment of April- May 2019. This is clearly erroneous and prejudicial to the interest of the securities market.

Not properly recording the reasons for subsequent investment decisions as stipulated in the extant July 2000 Circular

30. Another charge against the *Noticee* as per the SCN is that proper reasons with respect to subsequent purchase and sale in the same scrips were not recorded. The above allegation stems from the fact that the *Noticee* used standard phrases in support of each subsequent buying/ selling of a security. The same is also narrated in Table No. 1 above. The SCN pointed out that the reasons mentioned for subsequent investment

decisions in the scrips of Sadbhav Engineering Ltd., Hindustan Zinc Ltd. and Vodafone Idea Ltd., were limited to the phrases such as “need to raise cash for tactical reasons”, “Reducing Exposure” and “Switching to better opportunities”, which is not in compliance with the relevant provisions of the said July 2000 Circular.

31. The SCN also asserts that the AO had erroneously accepted the submissions given by the *Noticee* as justified reasons for the subsequent purchase/ sale, without appreciating the fact that those reasons were not the reasons recorded for the said investment decisions at the time of investment. Further, it was observed in the SCN that even though the fund manager had the discretion to go against research analyst’s recommendations, however, no record(s) detailing the reasons and documents in support including data, facts and opinions leading to those decisions, had been maintained and furnished to justify such decisions. Further, it has been alleged that the AO had erred in relying on an internal suggestion to bring more clarity in the provisions of July 2000 Circular regarding subsequent purchase / sale decisions as a ground to accord exoneration by recording that the said circular lacks clarity.

32. It is observed that the *Noticee* advanced various submissions regarding interpretation of the July 2000 Circular. As per *Noticee*, the said Circular is clear regarding the requirement of recording detailed reasons for the initial investment and it also provides ‘reasons’ to be recorded for subsequent purchase and sale in a scrip. The *Noticee* claimed that the same was performed by the *Noticee*. It was also argued that the said circular provides for investment, which includes only buying and not the selling, hence, even reason is not required to be recorded for sale of securities. The *Noticee*s has pointed out that as per SEBI’s internal observations, there is lack of clarity with respect to the content to be recorded for subsequent buy or sale of shares. The *Noticee* also submitted that in case there is any ambiguity or more than one interpretation is plausible, remedy lies in issuing a clarification and not levying penalty.

33. With respect to the subsequent purchase/ sale decision, the July 2000 Circular states “***the reasons for subsequent purchase and sales in the same scrip should be***

***recorded**."* I note that the July 2000 Circular mandates recording of "reasons" for the subsequent purchase and sale in the same scrip. I note that the *Noticee* has recorded standard phrases in support of each subsequent buying/selling of a security under the head "Mandatory remarks" as seen in Table No. 1 and not provided proper reasons for the same.

34. It is observed that the purpose of the July 2000 Circular is to achieve transparency in the investment decisions of any asset management company, which takes decision over the money mobilised or pooled from the public at large. Such companies are not risking their own money but risking thousands of investors' hard-earned money and therefore, as custodian of funds, they are accountable to the public at large with respect to their decision making process. July 2000 Circular in clear terms provides that whenever an asset management company decides to invest in any scrip/ asset of a company for the first time, it requires to have a detailed research report to justify such investment decision. The said circular further states that for subsequent decision in the same asset/scrip, asset management company requires to record the reason. Here, for subsequent decision in the same asset/scrip, no detailed separate research report is required. However, the asset management company is required to show the proper reason based on which subsequent decision was made. It is pertinent to clarify that the decision may be right or wrong and should not be questioned on hindsight merely because it resulted in a loss. However, the instant proceeding is not questioning the commercial decision for incurring loss. It is noted that the said July 2000 Circular in specific terms direct that reasons for every purchase and sale, subsequent to the first investment is required to be maintained.

35. Now, coming back to the facts of the matter, it is observed that investments made by the *Noticee* in all the three scrips were later on sold and for which, no record(s) detailing the reasons, had been maintained and furnished to justify such decisions. There is no dispute that for subsequent sale, there is requirement of recording reason. Records before me show that *Noticee* had used phrases such as "need to raise cash

for tactical reasons", "Reducing Exposure" and "Switching to better opportunities" and submitted the above as a reason to be in compliance with the relevant provisions of the said July 2000 Circular. It has been submitted that recording of above is sufficient compliance of the said circular as the circular, unlike first investment, does not require for any detailed research report for subsequent purchase or sale. The AO has also found the above as sufficient compliance more so on the ground that circular is not clear.

36. A careful perusal of the July 2000 Circular provides for reasons to be recorded for subsequent purchase and sale in a scrip. It can't be overlooked that the object of the July 2000 Circular is to make asset management company accountable to public whose money, they are managing on their behalf and for which they charge investment management fees. The very purpose of the July 2000 Circular is to require AMCs to maintain proper reasons in support of each of their investment decision, so as to enable the AMC to produce the same when called upon to justify the reasons for their investment decisions. Just recording standardized phrases alone, cannot be treated as compliance with the provisions of July 2000 circular. Therefore, it may not be right to hold that mere recording of phrase *sans* the justification behind the phrase is sufficient compliance of the *July 2000 Circular*.

37. As regard to the findings of AO that July 2000 Circular lacks clarity, it is observed that the said finding is erroneous as the AO had completely misunderstood the circular and erred in appreciating the intent of the circular. I have noted above that there was no dispute as regard to having a detailed research report for first investment in a scrip and it is observed that there is no lack of clarity with respect to subsequent purchase or sale decision. In this regard, it is observed that there is well settled principle that in case of any doubt or ambiguity in interpreting a provision, authority should resort to purposive or mischief rule to uncover the reason and objective behind the provision. Instead of giving narrow interpretation, authority should attempt to resolve the ambiguities by reference to overall purpose of the provision. It is a trite law that in case

of doubt that a provision is having ambiguities, court/authority should take interpretation that foster the object behind the legislation and not to prefer one that defeat the purpose that the statute/provision intends to achieve. An interpretation that suppresses the mischief and advance the object should be preferred. Having noted the same, I find that the circular is clear in providing that the first investment in a scrip is required to have support of a detailed research report and each subsequent purchase or sale decision ought to have the support of reason to arrive at, backed by facts. Thus, mere recording of a phrase and not having a supportive evidence to arrive at the conclusion would not be held to be a good compliance of the mandate warranted under the July 2000 Circular.

38. As regard the finding arrived at in the order under review by the AO relying on the internal note to record that July 2000 Circular lacks clarity and requires clarification, it is observed that mere reliance on the internal note having an opinion of one officer, to arrive on the conclusion of ambiguity is erroneous. Views expressed in internal note without the approval of competent authority are just an opinion of an officer and cannot be the basis to conclude it as being the views of the department. In this respect it is observed in the matter *of Sethi Auto Service Station vs Delhi Development Authority* 2009 (1) SCC 180, the Hon'ble High Court of Delhi has held as under;

> *"It is trite to state that notings in a departmental file do not have the sanction of law to be an effective order. A noting by an officer is an expression of his viewpoint on the subject. It is no more than an opinion by an officer for internal use and consideration of the other officials of the department and for the benefit of the final decision-making authority. Needless to add that internal notings are not meant for outside exposure. Notings in the file culminate into an executable order, affecting the rights of the parties, only when it reaches the final decision-making authority in the department; gets his approval and the final order is communicated to the person concerned."*

39. The view held above was further affirmed by the Hon'ble Supreme Court of India in the matter of *SEBI vs Prebon Yanabe (I) Limited* (C.A No 7607/2005- DoD-03/11/2015) holding that "*We have already noted that Sethi Auto Service Station enunciates that file notings cannot be relied upon with the intent of binding the concerned Authority or Department*."

40. In view of the above observations, it is viewed that the said internal note is a mere expression of views of an officer and not an approval of the competent authority, based on which a benefit, if any, accrued to the *Noticee* may be extended. Thus, the AO has erred in coming to the conclusion in exonerating the *Noticee* while observing that the circular needs clarification on the sole basis of the statement/proposal made by an officer in an internal noting. Such a conclusion is not only erroneous but also detrimental to the interest of securities market.

Not establishing a mechanism to verify that due diligence was being exercised while making investment decisions

41. The other charge against the *Noticee* is that the *Noticee*, by not updating the Research Reports on a quarterly basis, despite the availability of updated financial statements of investee companies, has failed to continuously track its active stocks as stipulated in its approved investment policy manual. Thus, it has been alleged that the *Noticee* had not established a mechanism to verify that due diligence was being exercised while making investment decisions, in terms of the provisions of July 2000 Circular.

42. As mentioned in the preceding paragraphs, the Board of the AMC approved Investment policy manual stating that apart from detailed analysis of financial statements, each analyst would actively monitor the companies in his / her respective sector and the companies in active coverage would be tracked very closely and would have detailed research reports / notes. Further, the Investment policy manual also

stated that large universe of stocks shall be actively tracked and reviewed on a continuous basis by the equity team to ensure pro-active research and effective fund management.

43. It is noticed that the AO, in its Order observed that there are no timelines given in the MF Regulations or Circular prescribing timelines for updating research report and therefore, allegation can't be sustained. In this respect, the SCN alleges that the AO erroneously accepted the submission of the *Noticee* that there was active monitoring of stocks of the investee companies e.g. in case of Vodafone, decision to divest was taken in a period of less than the quarterly review due to telecom tariff hike and Vodafone's review petition on the AGR case was dismissed by the Hon'ble Supreme Court. Thus, the observation of the AO that there was nothing on records to negate the claim of the *Noticee* and that the alleged violation of sub regulation (2) of regulation 25 of MF Regulations and clause 9 of Fifth Schedule – Part A of MF Regulations by the *Noticee* did not stand established, was challenged in the SCN

44. I note that the review of the AO Order under sub-section (3) of section 15-I of the SEBI Act, 1992 was also recommended on the ground that in the proceedings before AO, AMC could not produce any documents to indicate active tracking of the stocks/investee companies, especially in case of scrip of Sadbhav Engineering Ltd. in compliance with their approved investment manual by the Board of the *Noticee* itself and also to indicate due diligence has been exercised in the investment decisions in compliance with sub-regulation (2) of regulation 25 of the MF Regulations.

45. I note that the *Noticee*, in its replies, submitted that there was no mandate for updating Research Report on a quarterly basis either in L&T's investment policy manual or SEBI rule/ regulation/ circular. As per the *Noticee*, it cannot be alleged that the due diligence related to tracking of investments can only be by way of updating research reports every quarter once the quarterly financial results are declared.

46. On consideration of the material available on record and the submissions made by the *Noticee*, I do not find merit in the submission of the *Noticee* that there is no requirement to update Research Report on a quarterly basis as per the relevant provisions of law or L&T's investment policy manual. I note that the Investment Policy Manual of the AMC clearly mentions "*Every company under coverage is expected to be met by the analyst at least <u>once a quarter</u> either through one on one meeting, conference call or through group meetings."* With respect to the issue of actively tracking of the stocks/ investee companies, I note that the periodical financial statements of Sadbhav Engineering Ltd. were available in public domain and were accessible by the AMC. However, the Annual Report of 2019- 20 was reviewed on July 31, 2020 by Analysts. The previous Research Report is dated July 31, 2019. It is also noted that by the time the investee company i.e. Sadbhav Engineering Ltd. was reviewed by the Analyst on July 31, 2020, all the holdings in the said scrip were already sold by the AMC. On perusal of the relevant material, I am of the opinion that even if there is a mechanism in place which was evident by the formulation of the investment policy manual of the AMC, there should be evidence/ material to support the requirement of policy manual of AMC. Requirement is "expected to be met" once a quarter. Whether that was done and what was the result of such meeting is expected to be documented in the spirit of the July 2000 Circular.

47. It goes on to show that there was a mechanism on paper but there is no evidence to indicate that same was being followed/monitored in actuality. Even though the *Noticee*, in its submissions have mentioned that the research analysts used to keep the fund managers updated about any developments in the company/sector, any change in earnings, valuations etc. and that those updates were given either as part of in-person discussions or exchanged on emails, however, no material has been furnished in support of the above submission. Under the circumstances, I find that no material has been placed on record in support to show and substantiate the periodical meeting by the analyst and tracking of investment. The main purpose of the issuance of July 2000

Circular is mentioned in the said Circular itself i.e. maintenance of records indicating that due diligence is exercised by the AMC.

48. Further, as per *Noticee* it cannot be alleged that the due diligence related to tracking of investments can only be by way of updating research reports every quarter once the quarterly financial results are declared. With respect to the said submission, it is observed that while the submission appears proper, the active monitoring needs to be demonstrated by providing adequate credible/tangible evidence, without which the said submission cannot be accepted.

49. Lastly, I note that even the July 2000 Circular provides for the Board of asset management company to prescribe parameters for investment. It further provides for development of a mechanism to verify that due diligence is being exercised while making investment decision and in the instant case, Board of AMC has approved an investment manual in this regard. In this respect, asset management company is mandated to report the compliance to the trustees in periodical report and the trustee in turn is required to report to the SEBI about the compliance in their half- yearly reports. From the above, it is evident that the July 2000 Circular provides for submission of half- yearly report to the SEBI declaring the due compliance by asset management company with respect to the provisions including compliance with the mechanism developed by the Board of the AMC to verify that due diligence is being exercised with respect to investment decisions on an ongoing basis. Onus is on the AMC to maintain records indicating compliance with the mechanism developed by their Board to indicate that the due diligence was exercised. Hence, it may not be correct to hold that the circular was silent and no timeline was given in the MF Regulations or Circular for updating research report based on periodical reports.

50. In view of the above discussion and having considered the submissions advanced by Noticee, I find that the AO has erred in exonerating *Noticee* from the allegations basing its findings on above mentioned ground and the same is erroneous to the extent that

it is detrimental to the interest of securities market. I also find that the *Noticee* has not been successful in demonstrating that it acted diligently so far as investment decisions pertaining to the said three scrips are concerned and established a mechanism to monitor due compliance of the provisions as alleged in the SCN. Thus, the AMC is not in due compliance of the sub-regulation (2) of regulation 25 read with clause 9 of Fifth Schedule – Part A of the MF Regulations and July 2000 Circular.

51. I also note that the *Noticee*, in its submission has argued that the alleged defaults of the *Noticee*, assuming without admitting the interpretation of the said July 2000 Circular, were at the most only matters of a different plausible interpretation by the AMC and that the act of taking any regulatory action against the *Noticee* would be unjustified. The *Noticee* also referred to the orders passed by the Hon'ble SAT in the matter of *Religare Securities Limited v. SEBI* (In Appeal No. 23 of 2011 order dated June 16, 2011) and *UPSE Securities Limited v. SEBI* (In Appeal No. 109 of 2011 order dated July 25, 2011) in support of its submission that the purpose of inspection could be better achieved if the inspecting team at the time of the inspection were to advise the concerned entity to rectify any errors, instead of taking regulatory action. I have perused the orders passed by the Hon'ble SAT and I find that the observations, *inter alia,* were made with respect to minor discrepancies noticed during the course of the inspection of stock brokers, which do not call for initiation of penalty proceedings.

52. In the present proceedings, I find that the *Noticee* has erred in assuming that the defaults are minor in nature. The current proceeding is relating to the violations wherein the AMC is found failing in exercising due diligence in their investment decisions and in maintenance of records as mandated by SEBI. While on the matter, it is worthwhile to note that the Asset Under Management (AUM) of the Indian MF Industry has grown from INR 9.45 trillion as on April 30, 2014 to INR 57.26 trillion as on April 30, 2024 more than 6 fold increase in a span of 10 years. The same is due to trust reposed by the investors in the Mutual Funds and which is ensured by checks and balances built in by SEBI Regulations and Circulars' issued thereunder. Hence, it

is imperative on the part of Mutual Funds' and AMCs' which are dealing with the subscriptions made by the investors, especially retail investors, to ensure stringent compliance with regulatory requirements imposed by SEBI and to ensure compliance with the same in letter and in spirt. Hence, in my opinion, the said orders cited by the *Noticee* are not relevant in the present proceeding.

53. Based on the above discussion, it is held that AO has erred on the following three counts which are prejudicial to the interest of the securities market:
    i. Absence of detailed research report analysing various factors for initial investment decision taken in the scrip of Sadbhav Engineering Ltd.
    ii. Not properly recording the reasons for subsequent investment decision as stipulated in the extant July 2000 Circular
    iii. Not establishing a mechanism to verify that due diligence was being exercised while making investment decisions

54. Considering the above, I find that the abovementioned findings of the AO are erroneous to the extent that the same are not in the interests of the securities market Hence, I am inclined to set aside the abovementioned findings of the AO as discussed in the preceding paragraphs and accordingly impose suitable monetary penalty under section 15HB of the SEBI Act, 1992 for the abovementioned violations by the *Noticee*.

55. Further, in view of above discussion, I find that the allegation of violation of the provisions of sub-regulation (2) of regulation 25 of the MF Regulations read with clause 9 of Fifth Schedule – Part A of MF Regulations and SEBI Circular dated July 27, 2000 stand established thereby making the *Noticee* liable for penalty under section 15HB of the SEBI Act, 1992.

D*. <u>Order</u>*

56. I hold that the AO Order is erroneous and prejudicial to the interest of the securities market. Further, in exercise of the powers conferred upon me under sub-section (3) of section 15-I of the SEBI Act, 1992, I find that it would be sufficient to meet the end of justice in case the *Noticee* is visited with imposition of a monetary penalty of INR 5,00,000/- (Rupees Five Lakh Only) upon the *Noticee* under section 15HB of the SEBI Act, 1992.

57. The penalty shall be paid by way of demand draft drawn in favour of "SEBI – Penalties Remittable to Government of India" payable at Mumbai or by online payment through following path on the SEBI website: www.sebi.gov.in/ENFORCEMENT→ Orders → Orders of Chairman/ Members → Click on PAY NOW. The said payment shall be made within a period of forty-five (45) days from the date of receipt of this order.

58. The *Noticee* shall forward details of the demand draft or online payment made in compliance with the directions contained in this Order to the "The Chief General Manager, Investment Management Department (IMD), Supervision, Enforcement and Complaints Vertical, Securities and Exchange Board of India, SEBI Bhavan, Plot No. C 4- A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051" and also to e -mail id: tad@sebi.gov.in in the format as given in table below:

1.CASE NAME:	
2.NAME OF THE PAYEE:	
3.DATE OF PAYMENT	
4.AMOUNT PAID:	
5.TRANSACTION NO:	

6.BANK DETAILS IN WHICH PAYMENT IS MADE	
7.PAYMENT IS MADE FOR:PENALTY	PENALTY

59. In case of failure to pay the said amount of penalty within 45 days of receipt of this order, consequential proceedings including, but not limited to, recovery proceedings may be initiated 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. In case of any difficulties in payment of penalties, the *Noticee* may contact the support at portalhelp@sebi.gov.in.

60. A copy of this Order shall be served upon the *Noticee*.

-Sd-

DATE: July 25, 2024 **KAMLESH C. VARSHNEY**

PLACE: MUMBAI **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA