Explained: How SEBI Arrived At All The Penalties In The Franklin Templeton Case

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SEBI decides the penalty based on the fraud and whether the offense was committed repeatedly

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Over the past week, the Securities and Exchange Board of India (SEBI) imposed monetary penalties on Franklin Templeton, its trustees and some of its senior officials. The fines were between 50 lakh and Rs 4 crore. The house was additionally asked to return the fund management fees it had earned between June 2018 and April 2020. Vivek Kudva, the head of Asia-Pacific distribution and his wife Roopa Kudva, a finance professional (but not an employee of the fund house), were also asked to return Rs 22.64 crore. The amount is a part of their investments in the six wound-up debt schemes that they had withdrawn just days before the closure.

But how did SEBI decide the quantum of fines that the accused had to pay? Here's how they went about the task.

Did fund managers make unlawful gains?

Did the fund managers make genuine investment mistakes or did they commit a fraud? That's the moot question that SEBI first tries to address. It looks at three aspects.

SEBI'S PENALTIES ON FRANKLIN TEMPLETON

Person/entity	Penalty (₹ cr)	Money to be returned (₹ cr)
Franklin Templeton India AMC	5	512
Vivek Kudva	4	22.64
Roopa Kudva	3	
FT Trustee Services Ltd	3	NA
Sanjay Sapre	2	NA
Santosh Kamath	2	NA
Kunal Agarwal	1.5	NA
Sumit Gupta	1.5	NA
Pallab Roy	1.5	NA
Sachin Padwal Desai	1.5	NA
Umesh Sharma	1.5	NA
Saurabh Gangrade	0.5	NA

Source: SEBI orders

One, the amount of the disproportionate gains that the accused had. Two, did it cause losses to investors and, if yes, how much? Three: is it a repeated offence?

If SEBI establishes fraud or unlawful gains – insider trading or front-running – it imposes a higher penalty. But Franklin Templeton did not commit a fraud. The fund managers had not pocketed any gains. Instead, SEBI observed that fund managers had taken excessive risk “in their single-minded pursuit of reaping high yields.”

How are unfair gains treated?

The Kudva couple had withdrawn large sums of money just days before the fund house had wound up the debt schemes. Vivek had also withdrawn his mother’s money.

SEBI found that Kudva knew exactly of the poor state of the six debt schemes. The schemes were wound-up on April 23. But the Kudva couple withdrew their money by April 3.

Still, that’s not fraud as per SEBI regulations. It said that other investors didn’t lose just because the Kudva couple withdrew their own money. But it termed their action as an ‘unfair trade practice’ because they knew more about the deteriorating nature of the schemes than did investors. This gave them the edge and they decided to capitalise on it.

Before SEBI calculated their fines, it said that the Kudva couple must also pay up the unfair gains they made. In other words, how much would the Kudva couple have got, had they remained invested in the schemes, just like all their investors? Looking at the schemes that they withdrew from and the amount its other investors have got so far, SEBI said that the couple must return back their excess gains; Rs 22.64 crore.

Deciding the penalty

The penalty has to compensate for the enormity of the crime committed. The adjudicating officer at SEBI has the final say about how large or small the penalty should be.

To decide the nature of violations, SEBI falls back on the mutual fund guidelines and various rules it issues over the years. But to decide the exact penalty, it refers to its own SEBI Act. All the violations are classified into broad categories like failure to furnish the correct information, failure to invest as per the original guidelines laid down, and so on. Each of these sections in the SEBI Act defines the lower and upper limit of monetary penalties. Typically, the minimum penalty is Rs 1 lakh and the maximum can go up to Rs 1 lakh for each day that SEBI observes the violation was committed, subject to a maximum of Rs 1 crore.

SEBI found Franklin Templeton mutual fund guilty on all the five violation categories. Since the maximum penalty under each of these categories is Rs 1 crore, SEBI fixed the maximum penalty, under its own rules, at Rs 5 crore for Franklin Templeton. “Mutual fund investments are all about transparency in information about the schemes. Any violation which affects that, attracts stern measures,” says Ashish Bhakta, founding partner, ANB Legal.

For the trustees, CEO and fund managers, SEBI grouped together their misdeeds under three broad categories. Here again, the maximum penalties have been fixed at Rs 1 crore each. It fined the trustees Rs 3 crore; the maximum limit, given that trustees have a fiduciary responsibility.

Sapre and Kamath were fined Rs 2 crore each and the remaining fund managers Rs 1.50 crore each. Sumit Agrawal, founding partner, Regstreet Law Advisor and former SEBI officer says that the higher the responsibility, the higher is the penalty. “The fund managers work for the fund house. The AMC board has to take trustees’ approval, but the fund house is responsible for managing the money, and hence the fund house usually faces the maximum penalty,” he says.

Agrawal says that some amount of subjectivity is bound to come in when it comes to deciding the penalty. There is no straight jacketed formula and judicious discretion is to be applied in each case. SEBI sees a fund manager’s salary, experience and individual role before deciding the penalty. “It has to strike a balance – send a strong signal, and yet be fair,” he says.