BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/BM/JR/2024-25/ 30665]

UNDER SECTION 15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995; AND UNDER SECTION 23-I OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 READ WITH RULE 5 OF SECURITIES CONTRACTS (REGULATION) (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005.

In respect of

IIFL Securities Limited

PAN: AAACI7397D

Background

1. Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") had conducted inspection of IIFL Securities Limited (hereinafter referred to as "**Noticee**" / "**IIFL**" / "**the Company**") from August 18, 2022 to August 25, 2022 to look into various compliance requirements adhered by the Noticee. The inspection was conducted for the period beginning April 01, 2022 to July 31, 2022 (hereinafter referred to as "**inspection period**").

2. Based on the findings of Inspection conducted by SEBI and the response of the Noticee dated October 29, 2022 submitted to SEBI, certain alleged non-compliances were observed of SEBI (Stock Broker) Regulations, 1992 ("**Brokers Regulations**") and various circulars issued therein. The extracts of the violation

alleged to have been committed by the Noticee and corresponding provision of the securities law are given in the tabulation below:

Sr. No.	Alleged Violations (summarized)	Regulatory provisions
A	Monthly / Quarterly settlement of Funds and Securities	SEBI circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009, clause 8.1.1 and 8.1.4 of SEBI circular Ref no. SEBI/HO/MIRSD /MIRSD2/CIR /P/2016/95 dated September 26, 2016 and SEBI/HO/MIRSD/ DOP/P/CIR/2021/577 dated June 16, 2021.
B	Stock Reconciliation	SEBI Circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008
C	Closure of Client Collateral Account	SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 February 25, 2020 and SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/143 dated July 29, 2020
D	Client Unpaid Securities Account Verification	Clause 4.2 of CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019
E	Reporting and short collection of Margin	Point No. 6 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011 and Clause (iii) to Annexure of SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020
F	Passing of Penalty on Short Reporting of Margin	Clause A (2) & (5) of Schedule II read with Regulation 9(f) of Brokers Regulations. SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019 and SEBI Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127

Sr. No.	Alleged Violations (summarized)	Regulatory provisions
		dated July 20, 2020 read with Clause 15 to Annexure A of NSE circular NSE/INSP/45191 dated July 31, 2020
G	Verification of Daily Margin Statements	Clause 2.4 of SEBI Circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008
H	Margin Trading Funding Verification	Clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017
I	Analysis of Weekly Bank Balances and Cash & Cash Equivalents	SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016
J	Engaged in Fund based activity other than broking activity	8(3)(f) of Securities Contracts (Regulation) Rules, 1957 read with Point 7 of BSE notice no. 20220107-45 dated 07 Jan'2022
K	Member is engaged as a principal or employee in a business other than that of securities involving personal financial liability	Rule 8(3)(f) of Securities Contract (Regulation) Rules, 1957, SMD/POLICY/CIR-6 dated May 7, 1997 read with NSE circular NSE/COMP/50957 dated January 07, 2022 and BSE Notice No.20220107-45 D January 07, 2022

APPOINTMENT OF ADJUDICATING OFFICER

3. SEBI, vide order dated March 14, 2024, appointed the undersigned as the Adjudicating Officer under Section 15-I of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "**SEBI Act**") read with Rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as '**Adjudication Rules 1995'**) and also under Section 23-I of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as '**SCRA'**) read with Rule 3 of Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as '**SC(R)A**

Adjudication Rules 2005'), (both the rules collectively to be known as '**Adjudication Rules')** to inquire into and adjudge under the provisions of section 23H of SCRA and section 15HB of the SEBI Act, the alleged violations of SCRR, Brokers Regulations and various circulars issued therein, alleged to have been committed by the Noticee.

SHOW CAUSE NOTICE, REPLY AND HEARING

4. Show Cause Notice (hereinafter being referred to as the "**SCN**") dated April 15, 2024 was issued to Noticee in terms rule 4(1) of Adjudication Rules to show cause as to why an inquiry should not be initiated against Noticee and why penalty, if any, should not be imposed under section 23H of SCRA and section 15HB of SEBI Act on the Noticee for the aforesaid violations alleged to have been committed by it.

5. The Noticee, vide letter dated June 6, 2024 replied to the SCN stating, inter alia, the following:

Monthly / Quarterly settlement of accounts

- *The requirement of settlement of accounts was put in place to ensure that excess funds of the clients do not remain with the trading members on the basis of the practice of erstwhile running accounts where there was no such requirement, as a result of which some trading members misused the clients funds for their own trading or for funding other clients.*
- *In respect of the alleged observation, you will appreciate that all the accounts selected for scrutiny were settled, however there was a delay in settlement in case of 29 instances. Of the 29 instances, 15 instances are such where the delay is up to 5 days and this may happen on account of weekends and holidays.*
- *As regards the other instances it may be appreciated the delay was inadvertent and the accounts have been eventually settled which shows the bonafides of our company.*
- *The instances recorded in the SCN are extremely negligible and do not form a martial part of the entire activity as it involves only 29 clients which comes to a negligibly small 0.003% of the total settlement done by us during the IP.*

- *Delay in issuance of retention statement beyond 5 days in **case** of 16 of the 533 instances:*
- *Sending of retention statement is an automated process and the same happens within the stipulated time.*

- *However due to some technical reasons, in case of 16 instances of the 533 sample instances, there **was a** delay beyond 5 days only in issuance of retention statement and not in settlement of accounts which is of utmost importance.*
- *In case of 6 instances, the statements are sent within 7 or 8 days instead of 5 days (permitted period for sending the statement), which should be treated as compliant as there were holidays in between.*
- *For other instances, the delay in sending retention statements may be because of soft bounce and/or technical issues faced while sending statements. Further, the instances are very minuscule i.e. 1.88% (10/ 533 instances).*
- *It is humbly submitted that we issue daily margin statements and all other requisite documents. The daily margin statement contains complete details of the available funds and securities aiong with margin consumption. The information is similar to the retention statement where these 3 details are critical and are shared with the clients. It can therefore be construed that we have passed on the important requisite information to the clients in the form of daily margin statements.*
- *Non-issuance of retention statement for 14 out of 533 instances:*
- *Due to some technical issue, the statements were not sent to these clients. Above all none of the clients have ever complained against us for non• receipt of retention statement or mismatch of information reflected in the daily margin statement.*
- *We have a process of Enterprise Risk Management where the Risk Committee reviews all areas of operations and prefers to pay special attention to observations highlighted during inspection. This ensures improvement in processes to ensure non-recurrence of such instance.*

Incorrect retention statement sent to SWATIJNN:

- *We are required to settle the accounts of the clients on a quarterly basis and this client was settled on July 6, 2021*

- *The payment of amount was included in the retention statement as it was towards settlement of account. The amount of Rs. 18,00.54,246.60 was given as a payout to the clients bank account and the same is reflecting in the clients ledger statement. The said amount does not include any interest as alleged in the SCN. Further the receipt of Rs.18,00,00.000.00 on July 07, 2021 was towards the possible transactions that the client would have preferred to carry out in the trading account. Hence, the amount received on July 7. 2021 was rightly not included in the retention statement as on July 06, 2021.*
- *It may be appreciated that this is a one off case of some technical error which has not been repeated again.*
- *We have a process of Enterprise Risk Management where the Risk Committee reviews all areas of operations and prefers to pay special attention to observations highlighted during inspection. This ensures improvement in processes to ensure non-recurrence of such instance.*

Non-settlement of 338 inactive clients amounting to Rs. 4,95,110.06

- *The requirement of settlement of accounts was implemented vide MIRSD/ SE /Cir-19/2009 dated December 3, 2009 and several circulars have been issued thereafter like SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 201, SEBI/HO/MIRSD/DOP/P/CIR/2022/101 dated July 27, 2022 etc.*
- *All these circulars are made applicable to the dealings as Trading Members, but not to MF distribution business while acting as an AMFI registered distributor.*
- *Of the 338 instances of non-settlement of accounts, in 330 accounts, the clients have availed only MF distribution services under our AMFI registration code.*
- *It may be noted that the MF accounts balance may be used for future transactions including SIPs and therefore not required to be settled.*
- *We therefore humbly submit that the requirement of settlement was not applicable to these 330 clients who had availed our services only as MF distributor.*
- *4 accounts were not settled for valid reasons. Only in case of balance 4 accounts an amount of Rs. 285.46 remained unsettled due to technical reasons, but were eventually settled in a short span of time and therefore the observation may kindly be dropped.*

- *We have a process of Enterprise Risk Management where the Risk Committee reviews all areas of operations and prefers to pay special attention to observations highlighted during inspection. This ensures improvement in processes to ensure non-recurrence of such instance.*

Stock Reconciliation

- *Reconciliation is necessary to identify the differences and does not mean both have to match. For instance, "cheques issued but not deposited" is a reconciliation record for difference between bank book and bank statement.*
- *On July 29, 2022, these clients preferred an early repay the above shares. Despite the fact that the shares were delivered from the Client DP Account the same were considered in our Back Office Holding report as the normal repay date was July 30, 2022 and hence there is a mismatch with Demat holding. During this period the stock remained as a reconciliation item as aforesaid which is a correct treatment.*
- *We therefore deny that we have failed to carry out reconciliation as alleged in SCN.*
- *Reconciliation is the process of identifying the entries that resulted in a difference and does not mean exact matching of 2 statements. If that was so then there was no reason for reconciliation in accounting or book keeping. Reconciliation means matching the difference with identified records and the same has been done in this case as evident from the aforesaid submission.*
- *Without prejudice to the forgoing, we humbly request SEBI to consider it as a one of case and the same is a very small portion 0.01% of the entire holding of 2,67,10,170 shares of a value about Rs. 120.73 Crores and the reason for the same is also identified. However, it is not a case that we are unaware of the reasons of differences.*

Closure of Client Collateral Account

- *effective from August 31, 2020, all Client Margin/ Collateral accounts have to be discontinued and all the margin collection has to be through Margin Pledge Accounts.*
- *Our demat account no. 12044700, 11416964 is a Corporate TM/CM CMPA (Trading Member/ Clearing Member Client Margin Pledge Account) which was opened on July 27, 2020 under new guidelines issued by SEBI/ Exchanges and therefore not required to be closed.*

- *With regards to our demat account no 12044700, 11417379 it is submitted that we could not close the account as we had 38 shares of Fairchem Organics Limited pledged in his account. The said account had no free security balance but pledge balance of ISIN no. INE0DNW01011 (Fairchem Organics Limited) which was received on account of corporate action. The account was never used for any other purpose after August 31, 2020 and after identifying the beneficial owner of original pledged shares, the shares received on account of corporate action was unpledged/ transferred to the clients demat account and the said account was closed on 20 October 2022. Hence, there is no violation of any of the circulars.*
- *It needs to be appreciated that the accounts were mandated to be closed so as to prevent their use and in the current case the account was never put to use for holding clients shares after August 31, 2020 and hence there is no violation.*
- *We have a process of Enterprise Risk Management where the Risk Committee reviews all areas of operations and prefers to pay special attention to observations highlighted during inspection. This ensures improvement in processes to ensure non-recurrence of such instance.*

Client Unpaid Securities Account Verification

- *In case of 9 clients, they held normal trading account as well as MTF account with us. The transactions under scrutiny are MTF transactions and not normal trading transactions. SEBI has relied on the normal ledger to suggest that client did not have debit balance The securities purchased under MTF facility are required to be pledged in favour of 'Funded Securities Demat Account', which is possible only after the client provides us the OTP confirmation of advance pledge. The stock is thereafter transferred to the clients demat account so that it automatically gets pledged in the favour of Funded Securities Demat Account'. If the payout is released without OTP confirmation then the securities will not be pledged in the favour of 'Funded Securities Demat Account' and consequentially will result in a credit risk and violation of Margin Trading requirement. Therefore the shares were rightly transferred to GUSA account till the OTP confirmation was received or the normal ledger shows credit balance. In respect of 9 instances, the clients have not provided OTP confirmation by T+2 days. Hence, the shares were held in GUSA Account. Consequently upon normal ledger shows the credit balance, the shares were immediately transferred to the Demat account.*

- *In respect of 2 clients, the securities were sold on July 27, 2022. However excess shares were received in pool account on July 29, 2022. The said excess shares were transferred to CUSA account on the same day as it cannot be retained in the pool account. On reconciliation, the said shares were delivered to the client on August 01, 2022.*
- *For 2 clients viz. 56547746 and SIRIGTS5 inadvertently shares were held in CUSA account on behalf of these clients and upon reconciliation the shares were transferred to the client's demat accounts.*
- *In respect of 4 clients, the shares were inadvertently held in CUSA account.*
- *Without prejudice to the forgoing it is submitted that the requirements of CUSA was put in place to ensure that the shares of the clients are adequately segregated and not misused or co-mingled with the shares given as margin. In the current case the shares of the clients have been kept safely and have been transferred to them as and when the details were made available by the clients. We therefore humbly submit that we have not violated any clause of circular CIR/HO/MIRSO/DOP/CIR/P/2019/75 dated June 20, 2019 as alleged or at all and the same be dropped.*
- *We have a process of Enterprise Risk Management where the Risk Committee reviews all areas of operations and prefers to pay special attention to observations highlighted during inspection. This ensures improvement in processes to ensure non-recurrence of such instance.*

Reporting and short collection of Margin

- *In respect of 4 instances in FO segment and 3 instances of CD segment for wrong margin collection, we submit that there is no wrong reporting as alleged or at all.*

Passing of Penalty on Short Reporting of Margin

- *The SCN does not include the client wise date wise detail of the instances hence we are unable to furnish a case wise explanation. However it is common knowledge that the Clearing Corporations were treating SPAN+ Exposure Margin as upfront margin on a position basis and not at the time of trade.*
- *The VAR and SPAN files are released multiple times during the day and at the end of the day. If a client transacts in the morning. he has to pay upfront margin applicable at that time and his trade takes place. However the Exchanges have*

somehow treated as margins applicable at the end of the day / max margin of the day as upfront margins, which is grossly beyond the requirements of upfront margin.

- *Even further in case the clients have not traded and merely carry forward their positions from one day to another, the SPAN and ELM keeps on changing and in these cases the latest applicable margins are treated to be "Upfront Margin" which is completely against the established principle that "Upfront Margin means the margin applicable at the time of the trade.*
- *We therefore submit that we have not violated any requirement of collection of upfront margin.*

Verification of Daily Margin Statements

- *It is alleged that the ledger balance in case of 2 instances is incorrect in the Daily Margin Statement (DMS). We state that the ledger balance in the OMS is correct.*

Margin Trading Funding Verification

- *As per the Q 12 of the FAQs annexed in Annexure A of the circular NSE/COMP/48531 dated June 9, 2021 the brokers can fund to a maximum as under*

  *"The maximum allowable exposure shall be within the self-imposed prudential limits and shall not, in any case, exceed the borrowed funds and 50% of his "net worth". The term **"exposure"** shall mean the aggregate outstanding margin trading amount in the books of the Member for all his clients at any given point of time."*
- *Our networth as on March 31, 2022 was Rs. 673.52 Crores.*
- *50% of our net worth comes to Rs. 336.76 Crores*
- *Our total borrowing can be 5 times our networth i.e. Rs. 3,367.59 Crores and our actual borrowing on July 13, 2022 (date of verification) is Rs. 267.68 Crores.*
- *Consequentially we can allow an exposure of Rs. 604.44 Crores to our clients (336.76 + 267.68).*
- *On July 13, 2022 the aggregate outstanding margin trading amount (exposure) was Rs. 513.14 Crores.*

- *From the above documents and information, it can be observed that the total exposure is less than the permitted maximum allowable exposure and therefore we humbly submit that we have not breached the limit of maximum allowable exposure and we have not violated CIR/MRD/DP/54/2017 dated June 13, 2017 as alleged or at all.*

Analysis of Weekly Bank Balances and Cash & Cash Equivalents

- *Of the above in first 3 instances, the balance reported by us was in excess of available balance. This was on account of the fact that we included un-cleared amounts inadvertently. However it needs to be appreciated that the G remained positive inspite of considering a higher amount to the credit of these clients.*
- *In the last instance, it is submitted that the amount of Rs. 39,99,99,000 was maintained in a separate margin deposit account other than the normal trading account of the client and as a result the same was not included as there was no specific guideline to include this separate ledger while reporting the amounts. However after being guided by the Exchanges, we have started including the balance in margin deposit account while reporting.*
- *Without prejudice to the forgoing it is submitted that the errors, if any, have not resulted in violation of any of the principles of enhanced supervision circular nor have resulted in any adverse impact on the clients.*

Engaged in Fund based activity other than broking activity

- *In the current case the clients have given margin for transacting in securities markets as per the applicable guidelines.*
- *The margin deposit is provided by the client in their normal trading ledger. As such deposits are provided by only selective clients, the same is separately maintained in separate ledger to identify such amount considering the amount of interest payable on the same. The clients are eligible for trading exposure/ limit, on such deposit and are subject to quarterly/ monthly settlements as well as reporting of such balances on a weekly basis. Thus the nature of such deposits is completely different from the Point 7 (Any arrangement with registered clients to borrow funds/loans.) of Exchange notice no. 20220107-45 dated 07 Jan'2022*
- *Basis the margin deposit the clients have carried out transactions from time to time.*

- *From the regulations of BSE and NSE, it is evident that the payment of interest to clients as per mutually agreed terms is permitted and therefore no fault can be found with payment of interest.*
- *In fact the clearing corporation also pays interest to the trading members @ 3.5% on Cash Deposits.*
- *As regards creation of FD, it is submitted that we have large amount of FDs, which are placed with banks and clearing corporations and a part of it is allocated to the respective clients. Making a separate FD for each client it neither warranted nor feasible and not even mandated in any of the regulations.*
- *The payments made to clients on a day to day basis are as per the request of the client and do not constitute interest. Without prejudice to the forgoing, presuming that the amount paid is towards the interest, the same is permitted under the extant regulations and there is no restriction on payment of interest on a daily basis or otherwise.*
- *With regards to the funds being received by client from IIFL Finance Ltd. it is submitted that IIFL Finance Ltd. is a NBFC duly registered with RBI, separate independent entity duly regulated by RBI. It is possible that some of our clients would have approached IIFL Finance Ltd. for funding l. However. it is important to note that there is no restriction on clients to do borrowing from any NBFC including IIFL Finance Limited. The client may be receiving the money from IIFL Finance or any other bank/NBFC in their bank account where we have no control. However, we ensure to receive the funds only from the client's registered bank account. There is no fault on the part of the broker in case the client approaches any bank/NBFC independently.*
- *Merely because the clients have borrowed from IIFL finance does not render the transaction illegal or termed as being initiated from our side. There may be many other clients who would have borrowed from some other banks / NBFC. However, the same would go unnoticed by SEBI. It is to be noted that arranging funds for transactions is the responsibility of the client and the source thereof is left to the discretion of the client. No fault can be found with us for the same.*

Member is engaged as a principal or employee in a business other than that of securities involving personal financial liability

- *We state that investment of surplus funds, generated as a consequence of securities business, with an NBFC or subsidiaries cannot lead to an inference that we are engaged as a principal in business other than that of securities involving personal financial liability. The funds were invested from our account and there is nothing on record to indicate that these transactions was a loan, the same was for investment of own funds.*
- *Further as trading members we are allowed to create fixed deposits, though these are not securities under the SCRA. We have huge amount of bank deposits and these deposits fetch us a meagre interest. Alternatively, we had invested our surplus funds in inter corporate deposits with IIFL Facilities Services Ltd., Livlong Insurance Brokers Ltd., IIFL Management Services Ltd. and IIFL Finance Ltd. from time to time which is purely in form of investments of our own surplus funds. It was similar to investment in liquid funds with a bank or mutual fund purely to earn interest on available surplus funds.*
- *Regulation 8(3)(f) mandates that no person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if he engages either as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability.*
- *It is surely not the business of our company to lend money to other people. In the current case all 3 entities are our wholly owned subsidiaries i.e. there is a parent child / siblings relationship between them.*
- *Money given by a parent to his child / sibling surely does not qualify to be a business as it is neither the occupation, nor the profession nor the trade of the parent/ sibling to lend to his child.*
- *In the light of the above, the allegation of doing a business other than securities business does not hold good and therefore it is evident beyond doubt that we have not violated Regulation 8(3)(f).*
- *It is humbly submitted that investment in inter corporate deposits is specifically permitted under the extant laws and the same is evident from the submission below:*
    - *The net worth calculation as per LC Gupta Committee report requires certain deductions to be made.*

- *One such deduction pertains to "Any amount given in the nature of Loans, advances, Inter corporate deposits given to associates including subsidiaries / group companies of the member.*
- *If the contention of the SCN is to be treated to be correct then the Newtorth Calculation would have not included such a provision of having a specific deduction of ICD from _networth. The fact that it is to be deducted from networth and then the criteria of networth is to be met clearly substantiates that the*

➢ *With regards to allegation of violating SEBI Circular No. SMD/POLICY/CIR-6//97 dated May 07, 1997 it is submitted as under: This cicular exempts certain business activities from being disqualified under Rule 8(1)(f) and 8(3)(f). As aforesaid our investment in ICD is not our business activity but an investment similar to bank FDs and therefore does not fall under the purview of this circular.*

6. The Noticee had applied for settlement in the matter on June 27, 2024. However, vide email dated July 19, 2024, the undersigned was informed that the said settlement application was withdrawn by the Noticee.

7. In the interest of natural justice, an opportunity of personal hearing was given to the Noticee on July 5, 2024 vide notice dated June 20, 2024. The Noticee appeared on the scheduled date and reiterated the submissions made vide letter dated June 6, 2024.

CONSIDERATION FOR ISSUES, EVIDENCE AND FINDINGS

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

ISSUE I- Whether Noticee has violated provisions of securities law by not complying with regulatory provisions regarding:-

i. Monthly / Quarterly settlement of Funds and Securities

ii. Stock Reconciliation
iii. Closure of Client Collateral Account
iv. Client Unpaid Securities Account Verification
v. Reporting and short collection of Margin
vi. Passing of Penalty on Short Reporting of Margin
vii. Verification of Daily Margin Statements
viii. Margin Trading Funding Verification
ix. Analysis of Weekly Bank Balances and Cash & Cash Equivalents
x. Engaged in Fund based activity other than broking activity
xi. Member is engaged as a principal or employee in a business other than that of securities involving personal financial liability

ISSUE II- Does the violation, if any, attract monetary penalty under section 15HB of the SEBI Act and section 23H of SCRA?

ISSUE III- If so, how much penalty should be imposed taking into consideration the factors mentioned in section 15J of the SEBI Act and section 23J of SCRA?

9. Before proceeding further, it will be appropriate to refer the provisions of law referred to in the SCN. The same are reproduced hereunder:

SEBI circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009
https://www.sebi.gov.in/legal/circulars/dec-2009/dealings-between-a-client-and-a-stock-broker-trading-members-included_2891.html

clause 8.1.1 and 8.1.4 of SEBI circular Ref no. SEBI/HO/MIRSD /MIRSD2/CIR /P/2016/95 dated September 26, 2016

8.1.1. There must be a gap of maximum 90/30 days (as per the choice of client viz. Quarterly/Monthly) between two running account settlements.

8.1.4. Statement of accounts containing an extract from client ledger for funds & securities along with a statement explaining the retention of funds/securities shall be sent within five days from the date when the account is considered to be settled.

SEBI/HO/MIRSD/ DOP/P/CIR/2021/577 dated June 16, 2021

https://www.sebi.gov.in/legal/circulars/jun-2021/settlement-of-running-account-of-client-s-funds-lying-with-trading-member-tm-_50570.html

SEBI Circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008

https://www.sebi.gov.in/legal/circulars/apr-2008/collateral-deposited-by-clients-with-brokers_6922.html

SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 February 25, 2020

https://www.sebi.gov.in/legal/circulars/feb-2020/margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_46082.html

SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/143 dated July 29, 2020

https://www.sebi.gov.in/legal/circulars/jul-2020/implementation-of-sebi-circular-on-margin-obligations-to-be-given-by-way-of-pledge-re-pledge-in-the-depository-system_47190.html

Clause 4.2 of CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019

4.2 With regard to securities that have not been paid for in full by the clients (unpaid securities), a separate client account titled –"client unpaid securities account" shall be opened by the TM/CM. Unpaid securities shall be transferred to such "client unpaid securities account" from the pool account of the concerned TM/CM.

Point No. 6 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011

6. If during inspection it is found that a member has reported falsely the margin collected from clients, the member shall be penalized 100% of the falsely reported amount along with suspension of trading for 1 day in that segment.

clause (iii) to Annexure of SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020

(iii) The member shall have to report the margin collected from each client, as at EOD and peak margin collected during the day, in the following manner:

a) EOD margin obligation of the client shall be compared with the respective client margin available with the TM/CM at EOD.

AND

b) Peak margin obligation of the client, across the snapshots, shall be compared with respective client peak margin available with the TM/CM during the day.
Higher of the shortfall in collection of the margin obligations at (a) and (b) above, shall be considered for levying of penalty as per the extant framework.

Clause A (2) & (5) of Schedule II read with Regulation 9(f) of Brokers Regulations

9. Conditions of registration

(f) he shall at all times abide by the Code of Conduct as specified in Schedule II;

(2) Exercise of due skill and care : A stock-broker shall act with due skill, care and diligence in the conduct of all his business

(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019
https://www.sebi.gov.in/legal/circulars/nov-2019/collection-and-reporting-of-margins-by-trading-member-tm-clearing-member-cm-in-cash-segment_45011.html

SEBI Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020
https://www.sebi.gov.in/legal/circulars/jul-2020/framework-to-enable-verification-of-upfront-collection-of-margins-from-clients-in-cash-and-derivatives-segments_47101.html

Clause 15 to Annexure A of NSE circular NSE/INSP/45191 dated July 31, 2020

15. In case of short reporting of margin/margin on consolidated crystallized obligation/MTM, Can member pass on the penalty to the clients?
In case of failure (cheque not cleared or margin requirement not met by the client) on part of the client resulting which penalty is levied by the Clearing Corporation on the member for short reporting of client upfront margins/ margin on consolidated crystallized obligation/MTM losses, member may pass on the actual penalty to the client, provided he has evidences to demonstrate the failure on part of the client .Wherever penalty for short reporting of upfront*

margin/ margin on consolidated crystallized obligation/ MTM losses is being passed on to the client relevant supporting documents for the same should be provided to the client.

**Member cannot pass on the penalty w.r.t. short collection of upfront margin to client.*

Clause 2.4 of SEBI Circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008

2.4 Brokers should issue a daily statement of collateral utilization to clients which shall include, inter-alia, details of collateral deposited, collateral utilised and collateral status (available balance / due from client) with break up in terms of cash, Fixed Deposit Receipts (FDRs), Bank Guarantee and securities.

Clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017

17. The maximum allowable exposure of the broker towards the margin trading facility shall be within the self imposed prudential limits and shall not, in any case, exceed the borrowed funds and 50% of his "net worth".

SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016

https://www.sebi.gov.in/legal/circulars/sep-2016/enhanced-supervision-of-stock-brokers-and-depository-participants_33334.html

8(3)(f) of Securities Contracts (Regulation) Rules, 1957

8.The rules relating to admission of members of a stock exchange seeking recognition shall inter alia provide that:

(3) No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if—

(f) he engages either as principal or employee in any business other than that of

Securities or commodity derivatives except as a broker or agent not involving any personal financial liability, provided that—

(i) the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on business on the stock exchange either as an individual or as a partner in a firm,

(ii) in the case of those members who were under the rules in force at the time of such application permitted to engage in any such business and were actually so engaged on the date of such application, a period of three years from the date of the grant of recognition shall be allowed for severing their connection with any such business,
(iii) nothing herein shall affect members of a recognised stock exchange which are corporations, bodies corporate, companies or institutions referred to in items [(a) to (n)of sub-rule (8)].

SMD/POLICY/CIR-6 dated May 7, 1997

https://www.sebi.gov.in/legal/circulars/may-1997/to-e-ds-presidents-m-d-of-all-stock-exchanges_19140.html

NSE circular NSE/COMP/50957 dated January 07, 2022

https://nsearchives.nseindia.com/content/circulars/COMP50957.pdf

BSE Notice No.20220107-45 D January 07, 2022

https://www.bseindia.com/markets/MarketInfo/DispNewNoticesCirculars.aspx?page=20220107-45

FINDINGS

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

ISSUE I: (a)-Whether Noticee has violated provisions of securities law by not complying with regulatory provisions regarding:-

A) Monthly/ Quarterly settlement of client funds and securities

i) It has been alleged that in 29 instances out of 96 sample taken, there was a gap of more than 90 days in the settlement done for the clients.

ii) It was also alleged that in 16 instances out of 533 sample taken the Noticee has sent the retention statement beyond 5 days of settlement and in 14 instances the Noticee has not sent the retention statement out of 533 sample taken.

iii) It was alleged that Noticee has generated and sent incorrect retention statement to client code SWATIJNN as the payment of July 7, 2021 for Rs. 18,00,54,246.6 (Amount including interest) is reflected in the retention statement on July 6, 2021. However the receipt of Rs.18,00,00,000/- on July 7, 2021 was not shown by the Noticee.

iv) It was observed that the Noticee has not done the payout of 338 inactive clients amounting to Rs. 4,95,110.06 within the prescribed timeline.

v) In view of the above, it is alleged that the Noticee has violated SEBI circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009, clause 8.1.1 and 8.1.4 of SEBI circular Ref no. SEBI/HO/MIRSD /MIRSD2/CIR /P/2016/95 dated September 26, 2016 and SEBI/HO/MIRSD/ DOP/P/CIR/2021/577 dated June 16, 2021.

vi) The Noticee submitted that all the accounts selected for scrutiny were settled but there was a delay in case of 29 instances. The Noticee admitted that the delay was inadvertent.

vii) The Noticee further admitted that due to technical reasons there was delay beyond 5 days in issuance of retention statement. However, the Noticee submitted that it issues daily margin statements wherein complete details of available funds and securities is provided. Therefore, the information was already passed on to the clients. Similarly, due to some technical issue, statements were not sent in 14 instances. However, the clients were issued daily margin statements with complete details of the available funds and securities.

viii) In regard to the incorrect retention statement issued to client code SWATIJNN, the Noticee admitted that it was one off case of some technical error which was not repeated again.

ix) Further, in case of payout not done to 338 inactive clients, the Noticee submitted that the requirement was not valid for 330 clients as they were exclusively MF clients. In regard to 4 clients , the payout was not done due to issues with their bank accounts and in case of 4 clients due to technical reasons

x) I observed that the Noticee has admitted to the allegations stated in the SCN in respect of monthly/ quarterly settlement of client funds and securities stating that there was some technical error. It is only in regard to the failure to retention statement that it submitted that the information was already provided to the Noticees vide daily margin statement. I find that the circulars specifically mandates brokers to settle accounts and issue retention statements on a timely basis. However, the Noticee failed to do so. Further, in regard to payout not done to 338 inactive clients, I find that 330 of them were exclusively MF clients. However, in regard to the balance 8 inactive clients, the Noticee should have taken more effort to get all the proper details in a timely manner so that the payout could be done. While the Noticee has now taken corrective action, it is noted that the Noticee failed to settle the funds and securities on a monthly/ quarterly basis.

xi) Therefore, the allegation of violation of SEBI circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009, clause 8.1.1 and 8.1.4 of SEBI circular Ref no. SEBI/HO/MIRSD /MIRSD2/CIR /P/2016/95 dated September 26, 2016 and SEBI/HO/MIRSD/ DOP/P/CIR/2021/577 dated June 16, 2021 by the Noticee stands established.

B) <u>Stock reconciliation</u>

i) It is alleged that the Noticee did not do periodic reconciliation of client securities lying in DP accounts with back office holding and also reported incorrect quantity in weekly holding statement in one instance for 1835 shares valued at Rs.11,69,078.50.

ii) In view of the above, it is alleged that the Noticee has violated Clause 2.3 of SEBI Circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008.

iii) The Noticee submitted that reconciliation means to identify the differences and does not mean both have to match. In this case, the difference was due to clients preferring an early repay and the same were considered in the Back Office Holding report.

iv) I note that stock reconciliation is a critical process for all brokers to ensure that their physical inventory count matches the recorded data in their systems to make correct

reporting to the exchange. It was essential for the Noticee to reconcile 1835 shares in both the statements i.e. client DP account and back office holding report. The Noticee also admitted that it was one off case and very small portion 0.01% of the entire holding of 2,67,10,170 shares valued at Rs. 120.73 crores. I note that the Noticee has now taken corrective measure.

v) I find that in this 1 instance, Noticee failed to reconcile 1835 shares and hence the allegation of violation of Clause 2.3 of SEBI Circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008 by the Noticee stands established.

C) <u>Closure of Client Collateral Account</u>

i) On verification of demat accounts reported by the Noticee to the Exchange with the demat statements received from the depositories, it is alleged that Noticee has not closed demat accounts tagged as 'Client Collateral' by August 31, 2020.

ii) In view of the above, it is alleged that Noticee has violated SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 February 25, 2020 and SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/143 dated July 29, 2020.

iii) The Noticee submitted that the demat account no. 12044700 11416964 is a corporate TM/CM which was opened on July 27, 2020 and therefore not required to be closed. Further, Noticee submitted that demat account no. 12044700 11417379 had 38 shares of Fairchem Organics Limited pledged in his account. After identifying the beneficial owner, the shares received on account of corporate action was unpledged/ transferred to the clients demat account and the said account was closed on 20 October 2022.

iv) I note that in regard to demat no. 12044700 11416964, in terms of the circular the Noticee was under the obligation of closing the account by August 31, 2020. There was no exceptions provided in the circular which exempted from not closing such accounts. In regard to demat no. 12044700 11417379, I note from the account statement that the 38 pledged shares of Fairchem Organics Limited in the account was credited on October 1, 2020 which was after the deadline provided in the circulars from closure of client margin/ collateral accounts. Therefore, the submissions of the Noticee cannot be accepted. While the Noticee has now taken

corrective action, it is noted that the Noticee failed to close the client collateral account within the timeline.

v) In view of the above, I find that the allegation of violation of SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 February 25, 2020 and SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/143 dated July 29, 2020 by the Noticee stands established.

D) Client Unpaid Securities Account Verification

i) It is observed that Noticee has transferred securities to Client Unpaid Securities Account of even those clients who have credit balance in their funds ledger as on July 31, 2022 in respect of 36 clients (Value of Securities lying in CUSA - Rs. 21,35,545.45/-).

ii) In view of the above, it is alleged that Noticee has violated Clause 4.2 of CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019.

iii) The Noticee submitted that in case of 8 clients, the securities could not be transferred to the clients as their registered demat account was closed/ freezed. After receipt of new demat account details, the stocks were transferred.

iv) It further submitted that in case of 9 clients MTF ledger balance was in debit and pending OTP confirmation of advance pledge. If the payout was released without OTP confirmation then the securities would not be pledged and consequentially would be credit risk. Therefore, the shares were transferred to CUSA till the OTP confirmation was received.

v) In respect of 4 clients, they had debit balance and their shares were transferred to CUSA till their ledger balance became positive. In respect of 2 clients, the securities, excess shares were received in the pool account on sale of shares which were transferred to CUSA account. The shares were inadvertently held in the CUSA account in respect of 6 clients. In respect of 7 clients, no shares were held in CUSA account.

vi) I note that there was credit balance in the client ledger of the 8 clients. Hence, I cannot accept the submission of the Noticee that the shares were kept in the CUSA account in respect of 8 clients as their demat account were closed/ freezed. When

there is credit balance in the clients' ledgers, the Noticee should have known that there were alternate demat accounts of the clients and should have taken the effort to get the shares transferred. Further, in regard to 9 clients' MTF ledger accounts, no supporting evidence was provided to the inspection team or during the adjudication proceedings indicating that they were MTF clients. Additionally, the Noticee admitted that in case of 6 clients the shares were inadvertently transferred to the CUSA account. I note that the Noticee has now taken corrective action.

vii) In view of the above, I find that the allegation of violation of Clause 4.2 of CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 by the Noticee stands established.

E) Reporting and short collection of Margin

i) It is alleged that the Noticee in the FO segment has reported short margin collection amounting to Rs.15,74,602.6/- for one client and also reported wrong margin collection amounting to Rs.71,07,829.10 /- in FO Segment for 4 clients. Further, it is alleged that the Noticee has reported wrong margin collection amounting to Rs. 9,82,03,589.35/-in CM Segment for 3 clients.

ii) In view of the above, it is alleged that the Noticee has violated Point No. 6 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011 and Clause (iii) to Annexure of SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020.

iii) The Noticee submitted that in respect of 4 instances in FO segment and 3 instances of CD segment for wrong margin collection, there is no wrong reporting.

iv) The explanation provided by the Noticee regarding wrong collection of margin was analysed. The explanation provided in FO segment for 4 clients and in CM segment for 2 clients are accepted. However, in case of 1 client in the CM segment it is noted that the required highest peak margin was Rs.30,96,38,890.26, but the Noticee collected only Rs.16,44,67,649.

v) In view of the above, I find that the allegation of violation of Point No. 6 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011 and Clause (iii) to Annexure of SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020 by the Noticee stands established.

F) Passing of Penalty on Short Reporting of Margin

i) It is alleged that the Noticee has passed on penalty to clients on account of short reporting of upfront margins amounting to Rs. 24,22,676.11/- in CM Segment for 26 clients, Rs. 56,00,170.04 in FO Segment for 13 clients and Rs. 5,19,994.81 in CD segment for 15 clients.

ii) In view of the above, it is alleged that Noticee has violated Clause A (2) & (5) of Schedule II read with regulation 9(f) of Brokers Regulations, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019 and SEBI Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 read with Clause 15 to Annexure A of NSE circular NSE/INSP/45191 dated July 31, 2020

iii) Noticee submitted that upfront margin is the margin that is required to be collected before the trade and in such case the rates of margin should be those as applicable at the time of trade. However, the Exhanges have treated as margins applicable at the end of the day/ max margin of the day as upfront margin which is completely against the established principle.

iv) I find that the Noticee has given ambiguous reply and not addressed the issue raised in the SCN regarding the passing of penalty on short reporting of upfront margin. The Noticee has not given any reason why it had passed on penalty to clients on account of short reporting of upfront margins amounting to Rs. 24,22,676.11/- in CM Segment for 26 clients, Rs. 56,00,170.04 in FO Segment for 13 clients and Rs. 5,19,994.81 in CD segment for 15 clients.

v) In the absence of any submission in this regard I hold that the allegation of violation of Clause A (2) & (5) of Schedule II read with regulation 9(f) of Brokers Regulations, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019 and SEBI Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 read with Clause 15 to Annexure A of NSE circular NSE/INSP/45191 dated July 31, 2020 by the Noticee stands established.

G) Verification of Daily Margin Statements

i) It is observed that the Noticee has reported incorrect ledger balance in daily margin statement sent to client for 2 clients amounting to Rs. 1,80,12,353.17/-.

ii) In view of the above, it is alleged that Noticee has violated Clause 2.4 of SEBI Circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008.

iii) The Noticee submitted that the ledger balance in the DMS is correct.

iv) From the supporting documents provided by the Noticee during the adjudication proceedings, it is noted that the Noticee had provided a different copy of the daily margin statement to the inspection team wherein it had also admitted that there was an inadvertent error.

v) In view of the above, the allegation of violation of Clause 2.4 of SEBI Circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008 by the Noticee stands established.

H) Margin Trading Funding Verification

i) It is observed that in one instance on July 13, 2022 during the period of inspection, the Noticee breached maximum allowable exposure limit toward Margin Trading Fund at aggregate level by Rs. 5,55,14,403.88/-.

ii) In view of the above, it is alleged that Noticee has violated clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017.

iii) Noticee submitted that as per clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017, the aggregate outstanding margin trading amount (exposure) was Rs. 513.14 crore which was within the limit.

iv) I find that as per clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017 the maximum allowable exposure towards margin trading facility shall be within self imposed prudential limits and shall not exceed the borrowed funds and 50% of its net worth.

v) I note that the networth of the Noticee as on March 31, 2022 was Rs. 673.52. Therefore, 50% of it was Rs.336.76 crore. Further, I find that the Noticee submitted that its actual borrowing on July 13, 2022 (date of verification) is Rs. 267.68 crore. Hence, it can allow exposure upto 604.44 crore (336.76 + 267.68).

vi) However, I find that the Noticee has interpreted “exposure” as total funded value of stocks under margin trading less cash collateral provided by clients. Such narrow interpretation of “exposure” is detrimental to the integrity of the market. Further, the Noticee has not submitted any supporting document which specifies the actual borrowing of the Noticee on July 13, 2022. In the absence of such crucial supporting document I find that the allegation of violation of clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017 by the Noticee stands established.

I) Analysis of Weekly Bank Balances and Cash & Cash Equivalents

i) It was alleged that Noticee has incorrectly reported the data towards client ledger balances & clear balances & Bank Balances.

- Incorrect reporting towards client ledger balances (A)- 1 Client & Shortage reported Rs.39,99,99,000/-
- Incorrect reporting towards client ledger balances (clear B) - 3 Clients & Excess reported Rs. 9,74,67,000/-.

ii) In view of the above, it is alleged that Noticee has violated SEBI circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/ 95 dated September 26, 2016.

iii) The Noticee submitted that in 3 instances, it was entered inadvertently although G remained positive and in 1 instance due to absence of any guideline amount was maintained in a separate margin deposit account.

iv) I note that the Noticee has admitted that in 4 instances there was incorrect reporting towards client ledger balances. In view of the same, I find that the allegation of violation of SEBI circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/ 95 dated September 26, 2016 by the Noticee stands established.

J) <u>Engaged in Fund based activity other than broking activity</u>

i) During inspection it was observed that the Noticee was maintaining two separate ledgers i.e. Margin Deposit Ledger and Trading Ledger for 136 clients. The stock broker has paid interest of Rs.17,43,37,506/- to 136 clients under mutually agreed fund based arrangement.

ii) It was observed that Noticee was taking deposit for additional margin requirement in this ledger & paying interest on the said amount. While verifying Margin Deposit ledger, it is was observed that the Noticee was collecting funds from all the 20 sample clients repeatedly, and paying them interest on the same amount at mutually agreed rate between Noticee & Client. It was observed that Rs. 15,51,15,394 interest was paid to the 20 sample clients. The interest was paid at approximately 4-5% per annum.

iii) It was also observed that the Noticee is collecting undertaking for the said deposit wherein the client specifically instructed Noticee to create FD for a specific period. It is noted from the said ledgers that no FD has been created. Noticee did not submit any proof/evidence regarding the same.

iv) It was also observed that client's fund deposited in Trading ledger is being utilized towards trading and day-to-day margin requirement. Along with this trading activity, intraday funding was also observed in this account as Noticee was collecting fund from clients in this ledger and paying the aforesaid amount along with some additional amount on daily basis which seems to be interest.

v) It was observed in client's Trading Ledger that certain large amount were being credited and debited repetitively, with certain additional amount which appears to be interest on same day with narration ending with the character "@ " and observed that entries posted with the character "@" does not relate with client's trading activity.

vi) On verification of certain client's bank account statement, all the above transactions with @ separator were found to be related to IIFL Finance Ltd i.e. client was receiving funds from IIFL Finance Ltd (NBFC) and simultaneously paying the same amount to the Noticee. The interest paid by Noticee for the above amount was approximately 11% per annum.

vii) In view of the above, it is alleged that the Noticee has violated rule 8(3)(f) of Securities Contracts (Regulation) Rules, 1957 read with Point 7 of BSE notice no. 20220107-45 dated 07 Jan'2022.

viii) The Noticee submitted that deposits are provided by selective clients as margin deposit, which are parked separately and interest is paid on such deposit and such deposits are considered clients' credit balances and clients are eligible for trading exposure/limit on such deposit. The Noticee further submitted that interest is paid

on such margin deposit in accordance with Exchange Regulation and claim that there is no violation in such practice.

ix) In BSE notice no. 20220107-45 dated January 7, 2022 it is, inter alia, specifically stated "…*it is observed that members are engaged in businesses other then securities or commodity derivatives business like entering loan arrangement with clients/ entities, collecting money in the form of deposit or otherwise by offering fixed/ guaranteed/ periodic returns orally or in writing, extending corporate guarantees etc. which is in contravention of Rule 8(3)(f) of SCRR*."

x) Accordingly, Noticee creating single FD and paying the interest to its clients or clients borrowing money from IIFL Finance Limited and depositing it with the Noticee and Noticee paying interest on such amounts, clearly falls under such exceptions and can be construed as activities that are in non-compliance with rule 8(3)(f) of SCRR. Further, it is also observed that the Noticee has entered into an arrangement with registered clients which is on violation of Point 7 of BSE notice no. 20220107-45 dated 07 Jan'2022.

xi) In view of the above, I find that the allegation of violation of rule 8(3)(f) of SCRR read with Point 7 of BSE notice no. 20220107-45 dated 07 Jan'2022 stands established.

K) <u>Member is engaged as a principal or employee in a business other than that of securities involving personal financial liability</u>

i) During inspection, it was observed that the Noticee invested in the following associate companies to the tune of payment of Rs. 853 crore. The details of the payment is as under:

Amount in Cr.

Sr. No.	Name of Entity	Opening Balance as on 1st April, 2021(Rs.)	Payment during the inspection period (Rs.)	Receipt during inspection period (Rs.)	Interest Received during inspection period	Closing Balance as on 31st July 2022
1	IIFL Facilities Services Limited	0	149.85	149.85	0.22	0
2	Livlong Insurance Brokers Limited (Formerly IIFL Insurance Brokers Limited)	0	0.05	0.05	0.00	0
3	IIFL Management Services Limited	51.4	503.18	554.58	8.07	0
4	IIFL Finance Limited (Formerly known as IIFL Holdings Limited)	0	200	200	0.07	0
	Total	**51.4**	**853.08**	**904.48**	**8.36**	0

ii) In view of the above, it is alleged that Noticee has violated rule 8(3)(f) of Securities Contract (Regulation) Rules, 1957, SMD/POLICY/CIR-6 dated May 7, 1997 read with NSE circular NSE/COMP/50957 dated January 07, 2022 and BSE notice no. 20220107-45 D January 7, 2022.

iii) The Noticee submitted that the said amount was its own surplus fund which was invested in inter corporate deposits with the said companies. Instead of making fixed deposits with the banks which fetches meagre interest, Noticee had invested in ICDs.

iv) I note that the Noticee had made ICDs with its associates / group companies. The Noticee has also earned interest. In view of the same, Noticee's submission that it had lent to the associate / group companies to earn interest on its surplus funds, is acceptable.

v) SEBI Circular No. SMD/Policy/Cir-6 dated May 07, 1997 also clarifies that that borrowing and lending of funds, by a trading member*, in connection with or incidental*

to or consequential upon the securities business, would not be disqualified under rule 8(3)(f) of SCRR.

vi) Further, NSE Circular No. NSE/COMP/50957 dated January 07, 2022 clarifies that entering into any arrangement for extending loans or giving deposits / advances to any entity, including group companies such as subsidiaries & associates etc., not in connection with or incidental to or consequential upon the securities/ commodity derivatives business, would be construed as non-compliance of rule 8(3)(f) of SCRR.

vii) I note that the Hon'ble SAT, in the matter of Magnum Equity Broking Limited vs. National Stock Exchange of India Limited dated November 29, 2023 (Appeal No 461 of 2022), where it was inter-alia observed that *"10. In our view, investment of surplus funds, generated as a consequence of securities business, with an NBFC registered with RBI cannot lead to an inference that the Appellant is engaged as a principal in business other than that of securities involving personal financial liability. The Respondent Committee given a clear finding that the funds were advanced from the account of the Appellant therefore there is no dispute that the funds were their own moneys…."*

viii) From the aforementioned regulatory provisions, Noticee's submissions and observations of the Hon'ble SAT, I am of the view that the lending of surplus funds, which are generated as a consequence of the securities business, with the intent to earn interest, cannot be considered non-compliance of Rule 8(3)(f) of Securities Contract (Regulations) Rules, 1957. Further, there is no observation that the surplus funds were not owned funds of the Noticee.

ix) In view of the above, I find that the allegation of violation of rule 8(3)(f) of Securities Contract (Regulation) Rules, 1957, SMD/POLICY/CIR-6 dated May 7, 1997 read with NSE circular NSE/COMP/50957 dated January 07, 2022 and BSE notice no. 20220107-45 D January 7, 2022 by the Noticee does not stand established.

ISSUE II- Does the violation, if any, attract monetary penalty under section 15HB of the SEBI Act and 23H of SCRA?

11. From the foregoing, I am of the view that Noticee is in violation of:-

a) SEBI circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009, clause 8.1.1 and 8.1.4 of SEBI circular Ref no. SEBI/HO/MIRSD /MIRSD2/CIR /P/2016/95 dated September 26, 2016 and SEBI/HO/MIRSD/ DOP/P/CIR/2021/577 dated June 16, 2021.
b) Clause 2.3 of SEBI Circular MRD/DoP/SE/Cir-11/2008 dated April 17, 2008
c) SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/28 February 25, 2020 and SEBI circular SEBI/HO/MIRSD/DOP/CIR/P/2020/143 dated July 29, 2020
d) Clause 4.2 of CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019
e) Point No. 6 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011 and Clause (iii) to Annexure of SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020
f) Clause A (2) & (5) of Schedule II read with Regulation 9(f) of Brokers Regulations. SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019/139 dated November 19, 2019 and SEBI Circular No. SEBI/HO/MRD2/DCAP/CIR/P/2020/127 dated July 20, 2020 read with Clause 15 to Annexure A of NSE circular NSE/INSP/45191 dated July 31, 2020
g) Clause 2.4 of SEBI Circular MRD/DoP/SE/Cir- 11/2008 dated April 17, 2008
h) Clause 17 of SEBI circular CIR/MRD/DP/54/2017 dated June 13, 2017
i) SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016
j) 8(3)(f) of Securities Contracts (Regulation) Rules, 1957 read with Point 7 of BSE notice no. 20220107-45 dated 07 Jan'2022

12. In context of the above, I refer to the observations of Hon'ble Supreme Court in the matter of *Chairman, SEBI vs. Shriram Mutual Fund {[2006] 5 SCC 361}* wherein the Hon'ble Court had observed: "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. A breach of civil obligation which attracts penalty in the nature of fine under the provisions of the Act and the Regulations would immediately attract the levy of penalty irrespective of the fact whether contravention must made by the defaulter with guilty intention or not.''

13. Therefore, the aforesaid violations committed attract monetary penalty under section 15HB of the SEBI Act for violations (a) to (i) of para 11 and section 23H of SCRA for violation (j) of para 11. The text of provision is reproduced hereunder:

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

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

Section 23H of SCRA: - Penalty for contravention where no separate penalty has been provided:

Whoever fails to comply with any provision of this Act, the rules or articles or bye-laws or the regulations of the recognised stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

ISSUE III- If so, how much penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act and 23J of SCRA?

14. While determining the quantum of penalty under SEBI Act, it is important to consider the factors stipulated in section 15J of the SEBI Act and 23J of SCRA which reads as under:

Factors to be taken into account by the adjudicating officer under SEBI Act

15J. 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

Factors to be taken into account by the adjudicating officer under SCRA.

23J. While adjudging the quantum of penalty under section 23-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.

15. The material available on record has not quantified the amount of disproportionate gain or unfair advantage, if any, made by the Noticee and the loss, if any, suffered by the investors as a result of its failure nor has it been alleged by SEBI. As regard to the repetitive nature of the default, there is nothing on record to show that the nature of default by the Noticee is repetitive.

16. I find that the Noticee was under a statutory obligation to abide by and comply with the provisions of the Circulars / directions issued by SEBI and stock exchanges, which they failed to do during the inspection period. The very purpose of the said provisions is to deter wrongdoing and promote ethical conduct in securities market. Noticee being a registered intermediary is expected to take the statutory compliances seriously and take extra care to maintain a high degree of professionalism in the conduct of their business. The violations as established above certainly deserve imposition of penalty.

ORDER

17. Having considered the facts and circumstances of the case, the factors mentioned in section 15J of SEBI Act and also taking into account judgment of the Hon'ble

Supreme Court in SEBI vs. Bhavesh Pabari (2019) 5 SCC 90 and in exercise of power conferred upon me under section 15I of the SEBI Act and section 23I of SCRA read with Rule 5 of the Adjudication Rules I hereby impose the following penalty:

Under section	**Penalty Amount**
15HB of SEBI Act	Rs.9,00,000/- (Rupees Nine Lakh only)
23H of SCRA	Rs.2,00,000/- (Rupees Two Lakh only)
TOTAL	**Rs.11,00,000/- (Rupees Eleven Lakh only)**

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

18. Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order through online payment facility available on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link: ENFORCEMENT → Orders → Orders of AO → PAY NOW. In case of any difficulties in payment of penalties, Noticee may contact the support at portalhelp@sebi.gov.in.

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

BARNALI MUKHERJEE
Digitally signed by BARNALI MUKHERJEE
Date: 2024.08.21 14:49:11 +05'30'

DATE: August 21, 2024
PLACE: MUMBAI

BARNALI MUKHERJEE
ADJUDICATING OFFICER