BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
ADJUDICATION ORDER NO. Order/PM/PA/2022-23/16602

UNDER SECTION 23-I OF THE SECURITIES CONTRACTS (REGULATION) ACT, 1956 READ WITH RULE 5 OF THE SECURITIES CONTRACTS (REGULATION) (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005

In respect of:

India Infoline Limited
(Now known as IIFL Securities Ltd.)

Registration no: INZ000164132

A. BACKGROUND

1. India Infoline Limited (hereinafter referred to as **"IIFL"/"Company"/ "Noticee")** is *inter alia* registered with Securities and Exchange Board of India (hereinafter referred to as "**SEBI")** as a member of BSE Limited (hereinafter referred to as "**BSE**"), National Stock Exchange of India Ltd. (hereinafter referred to as "**NSE**"), Multi Commodity Exchange of India Limited and United Stock Exchange of India. Further, it is also registered as a (i) depository participant of National Depository Services Limited (NSDL) and Central Depository Services (India) Ltd. (CDSL); (ii) research analyst; (iii) investment advisor; (iv) mutual fund; and (v) portfolio management service provider.

2. SEBI had conducted multiple inspections of the books of accounts of IIFL and found that IIFL had allegedly violated the provisions of SEBI circular bearing reference no. SMD/SED/CIR/93/23321 dated November 18, 1993 (hereinafter referred to as the "**SEBI 1993 Circular**") and clauses A(1), A(2)

and A(5) of the code of conduct for stock brokers as stipulated in Schedule II read with regulation 9(f) of the Securities and Exchange Board of India (Stock Broker and Sub-Broker) Regulations, 1992 (hereinafter referred to as "**Broker Regulations**") by misusing credit balance of client funds for debit balance client funds.

3. The details of the inspections undertaken are tabulated below:

#	Type and date of inspection	Period of inspection	Place inspected (if any)	Purpose of inspection
1.	Thematic inspection (<u>Dates of inspection</u>: January 30-31, 2014 to February 03, 2014)	April 01, 2011 to December 31, 2013	B Wing, Trade Centre, Kamala Mills Compound, Off Senapati Bapat Marg, Lower Parel, Mumbai – 400013.	Examine whether IIFL has complied with the provisions of the SEBI 1993 Circular and SEBI circular dated April 17, 2008 with respect to segregation of funds and securities of clients. (this inspection is hereinafter referred to as "**Thematic Inspection**").
2.	Comprehensive inspection along with NSE and BSE (<u>Dates of inspection</u>: August 7, 2014, August 12-13, 2014, August 21-22, 2014, August 26, 2014 and September 19, 2014)	April 01, 2013 to June 30, 2014	Corporate office of IIFL: IIFL Centre, Kamala City, Senapati Bapat Marg, Lower Parel, Mumbai – 400013. Branch office of IIFL: C-34, Ground Floor, Shyam Kamal, C Wing, Agrawal Market, Vile Parle (East), Mumbai – 400057. Branch office of IIFL: Kesar Krupa 1st Floor, above Saraswat Bank, Chandravarkar Road, Borivali (W), Mumbai – 400092. Sub broker office: A-1, Akruti Elegance, 90 Feet Road, Mulund (East) Mumbai – 400081.	Examine whether IIFL has maintained books of accounts and other books in the manner required under the SEBI (Stock Brokers) Regulations, 1992 and complied with the provisions of securities law, regulations, rules, circulars, bye-laws and directions issued by SEBI and the stock exchanges. (this inspection is hereinafter referred to as "**Comprehensive Inspection**").
3.	Supplementary Inspection I	April 01, 2011 to June 30, 2014	Data was requisitioned through emails.	Examination of sample top 20 days with highest pay-in obligation of the Company on proprietary account along with client's

#	Type and date of inspection	Period of inspection	Place inspected (if any)	Purpose of inspection
				obligation to the stock exchange. (this inspection is hereinafter referred to as "**Supplementary Inspection I**").
4.	Supplementary Inspection II	April 01, 2011 to June 30, 2014	Data was requisitioned through emails.	Examination of sample top 105 days with highest pay-in obligations of the Company on proprietary account and clients obligation to the stock exchange. (this inspection is hereinafter referred to as "**Supplementary Inspection II**").
5.	Supplementary Inspection III	April 01, 2011 to June 30, 2014 (except the days which were inspected during Supplementary Inspection I and II)	Data was requisitioned through emails.	Examination was carried out to calculate the wrongful gains made by IIFL during the entire period of inspection except the days already inspected during Supplementary Inspection I and II. (this inspection is hereinafter referred to as "**Supplementary Inspection III**").
6.	Inspection (<u>Dates of inspection</u>: March 27, 30 and 31, 2017)	April 01, 2015 to January 31, 2017	Data was requisitioned through emails.	Examination was carried out to verify whether IIFL has complied with the regulations and circulars issued in respect of segregation of funds and securities of clients. (this inspection is hereinafter referred to as "**March 2017 Inspection**").

4. Inspection findings of Thematic Inspection, Comprehensive Inspection, Supplementary Inspection I, Supplementary Inspection II and Supplementary Inspection III covering the period from April 01, 2011 to June 30, 2014 are part of the first adjudication proceedings initiated against the Company (hereinafter referred to as "**Adjudication Proceedings 1**") and inspection findings of the March 2017 Inspection covering the period from

April 01, 2015 to January 31, 2017 are part of the second adjudication proceedings initiated against the Company (hereinafter referred to as "**Adjudication Proceedings 2**").

5. With respect to inspection findings of the Thematic Inspection, the Comprehensive Inspection, the Supplementary Inspection I, and the Supplementary Inspection II, enquiry proceedings were also initiated and a show cause notice (hereinafter referred to as "**SCN**") dated May 02, 2017 was served on the Company. Thereafter, IIFL successfully filed settlement applications bearing nos. 4034/2019 and 4038/2019 on May 29, 2019 (hereinafter referred to as "**Settlement Applications**") under SEBI (Settlement of Administrative and Civil Proceedings) Regulations, 2014 (hereinafter referred to as "**Settlement Regulations**") for settling all pending adjudication and enquiry proceedings. Accordingly, in terms of the provisions of the Settlement Regulations, Adjudication Proceedings 1 and Adjudication Proceedings 2 were kept in abeyance till the disposal of Settlement Applications. Subsequently, the said Settlement Applications were rejected by the competent authority and the rejection was communicated to the Company *vide* email sent on August 23, 2021. In view of the above, Adjudication Proceedings 1 and Adjudication Proceedings 2 were resumed by the undersigned.

6. *Vide* order dated May 20, 2022, the undersigned passed an order with respect to Adjudication Proceedings 1 bearing reference no. Order/PM/PA/2022-23/16489 (hereinafter referred to as "**Adjudication Proceedings 1 Order**"). This adjudication order pertains to Adjudication Proceedings 2.

B. APPOINTMENT OF ADJUDICATING OFFICER

7. SEBI appointed the undersigned as the adjudicating officer vide order dated October 11, 2018 under section 23-I of Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "**SCRA**") read with rule 3 of the

Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as the "**SCRA Adjudication Rules**") to inquire into and adjudge against the Company under section 23D of the SCRA and regulation 26 (xiii), (xv) and (xvi) of the Broker Regulations for the alleged violation stated in paragraph 2 above.

C. SHOW CAUSE NOTICE, REPLY AND HEARING

8. A SCN dated October 28, 2021 was served on the Noticee under rule 4 of the SCRA Adjudication Rules to show cause as to why an inquiry should not be initiated and penalty should not be imposed under section 23D of SCRA and regulation 26(xiii), (xv) and (xvi) of the Broker Regulations for the alleged violation. The allegations levelled in the SCN have been summarized below:

8.1. During the March 2017 Inspection, sample of top 15 days each for highest turnover/pay-in obligation of the Company during the financial years 2015-2016 and 2016-2017 was selected for inspection *i.e.,* total 30 days. The rationale for selecting the aforesaid sample days was that there is more probability for misuse of client funds by the Company on the days when the Company had maximum obligation to the stock exchange. For this purpose, the settlement account of the Company was verified for the selected days for the pay-in made by the Company on clients obligation to the stock exchange.

8.2. In the context of the paragraph above, to verify the misuse of client funds, for the aforesaid sample days, date wise details of client funds lying with the Company was sought through a reconciliation process. The details sought from the Company are provided below:

A: Total fund balance available in all client and settlement bank accounts maintained by the Company.

B: Aggregate value of collateral deposited with clearing corporations and/or clearing broker (in cases where the trades are settled through clearing broker) in form of cash and cash equivalents (FD, BG, *etc).*

C: Aggregate value of credit balances of all clients as obtained from trial balance across stock exchanges (open bills of clients adjusted as the Company follows trade day billing).

D: Aggregate value of debit balances of all clients as obtained from trial balance across stock exchanges (open bills of clients adjusted as the Company follows trade day billing).

G: (A+B)-C: Negative value depicts extent of misuse of client funds by the Company for debit balance clients or for own purpose.

8.3. On perusal of the data submitted by the Company, it was observed that the Company had misused credit client balance funds for settlement obligation of debit balance clients. The detailed analysis of the 30 days examined is tabulated below:

Date	**Bank balances (Client & settlement bank a/c)**			**Cash collaterals with all exchanges**				**Aggregate clients credit balances as per trial balance (after adjusting for open bills & uncleared cheques)**	**Aggregate clients debit balances as per trial balance (after adjusting for open bills & uncleared cheques)**	**Total funds available with broker after adjusted 50% of BG**	**Broker used credit client fund for debit clients purpose {(A+B)-C=G} If G negative balance**	**% Misuse**
	A			**B**				**C**	**D**	**Total (A+B)**	**G**	**G/C*100**
	Client bank balance (In Crs)	**Settlement bank balance (In Crs)**	**Total (In Crs)**	**BG (50%)**	**Cash**	**FDR**	**Total**					
10-Jul-15	163.46	0.19	163.65	250.05	5.42	4.35	259.81	610.90	227.66	423.46	(187.44)	30.68
26-Aug-15	87.85	0.24	88.09	250.05	149.52	3.49	403.06	764.95	341.53	491.15	(273.80)	35.79
01-Sep-15	122.39	0.14	122.53	250.05	22.55	2.48	275.08	590.97	271.00	397.61	(193.36)	32.72
03-Sep-15	81.55	0.05	81.60	250.05	22.55	2.48	275.08	555.15	280.89	356.68	(198.47)	35.75
18-Sep-15	227.81	0.02	227.83	250.05	17.55	4.90	272.50	735.22	324.16	500.33	(234.89)	31.95
23-Sep-15	204.33	0.03	204.35	250.05	17.55	4.90	272.50	686.99	306.48	476.85	(210.13)	30.59
16-Oct-15	79.06	0.34	79.40	250.05	4.07	4.58	258.69	586.89	342.31	338.09	(248.80)	42.39
19-Oct-15	87.59	0.37	87.95	250.05	4.07	4.58	258.69	594.13	329.07	346.64	(247.48)	41.66

Date	Bank balances (Client & settlement bank a/c)			Cash collaterals with all exchanges				Aggregate clients credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total funds available with broker after adjusted 50% of BG	Broker used credit client fund for debit clients purpose {(A+B)-C=G} If G negative balance	% Misuse
	A			B				C	D	Total (A+B)	G	G/C*100
	Client bank balance (In Crs)	Settlement bank balance (In Crs)	Total (In Crs)	BG (50%)	Cash	FDR	Total					
27-Nov-15	93.30	0.06	93.37	250.05	8.04	4.04	262.13	569.46	326.20	355.50	(213.96)	37.57
22-Dec-15	177.25	0.06	177.32	250.05	4.07	5.04	259.15	597.62	277.09	436.47	(161.15)	26.97
14-Jan-16	134.11	0.11	134.23	250.05	63.98	5.04	319.07	653.83	369.78	453.30	(200.53)	30.67
03-Feb-16	66.04	0.21	66.25	250.05	65.56	5.54	321.14	571.28	342.18	387.39	(183.89)	32.19
29-Feb-16	95.19	0.23	95.42	250.05	91.65	5.44	347.13	579.45	302.16	442.55	(136.90)	23.63
10-Mar-16	187.51	0.39	187.90	250.05	78.07	5.94	334.05	619.89	273.85	521.95	(97.94)	15.80
31-Mar-16	309.22	0.03	309.25	250.05	59.14	5.44	314.63	649.92	300.56	623.88	(26.04)	4.01
17-May-16	183.28	0.63	183.92	241.55	99.61	4.01	345.17	621.68	314.80	529.08	(92.60)	14.90
23-May-16	101.90	0.67	102.57	241.55	115.19	4.01	360.75	587.52	329.53	463.32	(124.20)	21.14
25-May-16	166.23	0.67	166.90	241.55	146.57	4.01	392.13	689.79	348.60	559.03	(130.76)	18.96
08-Jul-16	121.60	0.37	121.97	246.55	75.20	4.01	325.76	657.94	421.11	447.73	(210.20)	31.95
29-Aug-16	192.47	0.56	193.04	246.55	54.87	7.51	308.93	671.65	417.36	501.97	(169.68)	25.26
12-Sep-16	309.06	0.00	309.07	246.55	144.81	17.51	408.87	902.54	439.63	717.94	(184.60)	20.45
14-Sep-16	59.55	0.00	59.56	246.55	242.31	17.01	505.87	849.31	437.54	565.43	(283.88)	33.42
15-Sep-16	191.94	0.00	191.95	246.55	242.31	17.01	505.87	783.73	438.88	697.82	(85.91)	10.96
18-Oct-16	162.59	0.00	162.59	246.55	97.89	16.22	360.66	685.75	349.59	523.25	(162.50)	23.70
10-Nov-16	74.54	0.00	74.55	246.55	83.87	16.22	346.64	690.89	508.28	421.18	(269.71)	39.04
11-Nov-16	147.05	0.00	147.05	246.55	83.87	16.22	346.64	684.95	429.86	493.69	(191.25)	27.92
15-Nov-16	153.28	0.00	153.28	246.55	111.94	16.22	374.71	714.22	431.85	528.00	(186.22)	26.07
25-Nov-16	201.36	0.00	201.37	246.55	92.78	16.72	356.05	700.36	349.33	557.41	(142.95)	20.41
05-Dec-16	39.49	0.00	39.49	246.55	43.71	16.72	306.98	641.20	351.26	346.47	(294.73)	45.97
16-Dec-16	47.12	0.00	47.13	246.55	65.50	16.22	328.27	621.75	339.02	375.40	(246.35)	39.62

8.4. From the aforesaid table, it was observed that the total available funds with the Company *i.e.,* column A+B was less than the ledger credit balance of its clients *i.e.,* column C. Herein, the negative value of "G" column indicates that the Company utilized clients funds for other purposes *i.e.,* funds of credit balance clients were being utilized for settlement obligations of debit balance clients.

8.5. Further, it was observed that out of the sample 30 days, the Company had misused the credit client funds for the settlement obligation of debit balance clients for 30 days which amounts to 100% of the total selected sample days.

The Company had misused the credit client funds in the range of Rs 26.04 crores to Rs 294.73 crores for the selected sample days for which the percentage of misuse ranged from 4.01% to 45.97%.

In view of the above, it was alleged that by using the funds of credit balance clients for settlement obligation of debit balance clients, the Company has violated the provisions of SEBI 1993 Circular and clauses A(1), A(2) and A(5) of the code of conduct specified under Schedule II read with regulation 9(f) of the Broker Regulations.

9. The Company submitted its reply to the SCN *vide* letter dated January 29, 2022. Further, the Noticee submitted its additional submissions *vide* letter dated March 30, 2022. The aforesaid replies of the Noticee have been considered and summarized below for convenience:

9.1 <u>Multiple proceedings should not have been initiated against the Noticee</u>

(i) Two enquiry and two adjudication proceedings have been initiated against the Noticee which could have been clubbed together under one comprehensive proceeding. Initiation of multiple proceedings in respect of similar observations made in the inspection and supplementary inspections is regulatory overreach, abuse of discretionary power vested with SEBI and perverse action loaded with arbitrariness.

(ii) Imposition of monetary penalty along with recommendation of disciplinary penalty under SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as the "**Intermediaries Regulations**") is unwarranted, baseless, excessive and disproportionate. In the matter of M/s Motilal Oswal Financial Services Limited, decision dated February 28, 2020, the adjudicating officer had imposed a penalty of Rs 17,00,000 wherein the facts and the allegations were similar to the present case, however, in the said case only adjudication proceedings were initiated. As opposed to that, enquiry as well as adjudication proceedings have been initiated in the present case. Therefore, no recommendation should be made under the Intermediaries Regulations.

9.2 IIFL has not violated provisions of SEBI 1993 Circular

(i) Noticee has been in compliance with applicable circulars at all times in accordance with industry practice. The alleged findings under the SCN does not make a reference to any specific provision of the SEBI 1993 Circular, which shows that the inspection team has not understood the facts of the case and the specific provisions of the SEBI 1993 Circular.

(ii) In support of the above, the Noticee has furnished an analysis in tabular form with respect to compliance with each of the provisions of the SEBI 1993 Circular.

9.3 IIFL was following the same practice as the rest of the broking industry with respect to client funds from November 18, 1993 till June 30, 2017

(i) As per the SEBI 1993 Circular, client bank account (pool account) is a dedicated bank account wherein all the client funds through pay-in and pay-outs from the stock exchanges are gathered. From 1993 till the modification effected through the SEBI circular bearing reference no. SEBI/HO/MIRSD/MIRSD2/CIR/2016/95 dated September 26, 2016 (hereinafter referred to as "**Enhanced Supervision Circular**"), the entire broking industry including the Noticee had maintained a client funds pool account, into which all client payments received towards pay-in/pay-out to/from stock exchanges settlement accounts were made. The aforesaid is enabled as per clause 1(B) of SEBI 1993 Circular.

(ii) In case of a shortfall in the pool account in meeting the exchange/client obligations, the broker would meet the same through transfer of his own funds, fixed deposits, bank guarantees as and when required, failing which there would be a default. This was publically known to SEBI through its inspections. The aforesaid practice cannot be considered as misuse of client funds, rather, it is to ensure that minor differences do not cause any harm to its clients and investors.

(iii) In a single consolidated client funds pool account, there is no differentiation between the funds received/paid from/to clients and the stock exchange. All stock brokers, including IIFL, continued to receive funds from debtors/exchange and pay to creditors/exchange on a continuous basis and so the balances were always dynamic in nature.

(iv) The entire broking industry has been following similar practice of monitoring on net creditors basis (*i.e,* total creditors – total debtors) with respect to the funds available in client bank accounts and with stock exchanges.

9.4 Retrospective application of Enhanced Supervision Circular

(i) Law cannot have retrospective application unless the statute provides the same specifically. Under the SEBI Act, SEBI does not have any provision which authorizes it to make regulations or issue circulars which have retrospective application.

(ii) The inspection period pertains to the period beginning from April 01, 2015 to January 31, 2017, and the Enhanced Supervision Circular was made effective from July 01, 2017. By applying the methodology prescribed under the said circular to the aforesaid inspection period, SEBI has attempted to retrospectively apply the provisions of the said circular and levelled charges on the Noticee. The principles and the table provided under the Enhanced Supervision Circular were not made available under the SEBI 1993 Circular. Prior to the Enhanced Supervision Circular, IIFL and the entire broking industry were utilizing client pool account for debit balance clients and the monitoring was done on net client fund basis.

(iii) Under the provisions of Enhanced Supervision Circular, SEBI had prescribed the methodology and format of calculation of client fund balances as per the ledger, adjustments thereon and the fund balances available in the client bank accounts, settlement accounts and exchange deposits *etc*. As per the revised SEBI circular, the following modifications were stipulated for calculation of client funds balances which were not present before September, 2016, and therefore, the same was not being practiced by any broker:

(a) Only 50% of the value of bank guarantees would be considered towards fund balances (*i.e.,* only the funded portion); and

(b) Ledger gross credit balances in client accounts would be compared with client bank accounts and stock exchange accounts instead of comparison with the ledger net credit balance.

(iv) Enhanced Supervision Circular which came into effect from July 01, 2017 is not a mere reproduction of the SEBI 1993 Circular as it contains substantial new prescriptions and modifications/clarifications with respect to methodology, calculations, formats, maintenance of accounts, reconciliation, monitoring and reporting *etc.* Enhanced Supervision Circular cannot be made applicable retrospectively against the Noticee when the circular itself states that it shall come into effect prospectively. The Noticee has cited the following two judgments of the Hon'ble Supreme Court in support of the above:

(a) Binani Industries Ltd Kerala vs. Assistant Commissioner of Income Taxes, VI Circle, Bangalore & Ors. (Appeal civil 1784 of 2007), decision dated April 04, 2007; and

(b) SEBI vs. Alliance Finstock Ltd. & Ors. (Civil appeal no. 4493 Of 2006), decision dated November 03, 2015.

(v) Bank guarantee is considered as cash equivalent upto its full value (without any haircut) by stock exchanges in respect of margin and exposure purposes. Further, stock exchanges have recourse to the full amount of bank guarantee upon invocation in case of any contingency. Therefore, full value of bank guarantee should be considered in calculating the total available funds. The practice that only funded portion of the bank guarantee would be considered was stipulated for the first time in the Enhanced Supervision Circular. However, the calculation made in March 2017 Inspection considers 50% of the bank guarantee even though the inspection period is before the Enhanced Supervision Circular had come into effect. Thus, by considering 50% bank guarantee in its inspection, SEBI has retrospectively applied the norms of Enhanced Supervision Circular.

(vi) The revised working for the 30 days of March 2017 Inspection after taking into account 100% of the bank guarantee and net creditors balance is provided below as follows:

Date	Aggregate clients debit balances as per trial balance (after adjusting for open bills, uncleared cheque)	Aggregate clients credit balances as per trial balance (after adjusting for open bills, uncleared cheque)	Net creditors	Bank balances (client & settlement bank a/c)	Cash collaterals with all exchanges				Total cash available with broker after considering BG @100%	Excess of available cash over net creditors (shortfall)
	A	B	C	D	E				F	G
					BG (100 %)	Cash	FDR	Total		
10-Jul-15	227.66	610.90	383.24	163.65	500.10	5.42	4.35	509.86	673.51	290.27
26-Aug-15	341.53	764.95	423.42	88.09	500.10	149.52	3.49	653.11	741.20	317.78
1-Sep-15	271.00	590.97	319.97	122.53	500.10	22.55	2.48	525.13	647.66	327.69
3-Sep-15	280.89	555.15	274.26	81.60	500.10	22.55	2.48	525.13	606.73	332.47
18-Sep-15	324.16	735.22	411.06	227.83	500.10	17.55	4.90	522.55	750.38	339.32
23-Sep-15	306.48	686.99	380.51	204.35	500.10	17.55	4.90	522.55	726.90	346.39

Date	Aggregate clients debit balances as per trial balance (after adjusting for open bills, uncleared cheque)	Aggregate clients credit balances as per trial balance (after adjusting for open bills, uncleared cheque)	Net creditors	Bank balances (client & settlement bank a/c)	Cash collaterals with all exchanges				Total cash available with broker after considering BG @100%	Excess of available cash over net creditors (shortfall)
	A	B	C	D	E				F	G
					BG (100 %)	Cash	FDR	Total		
16-Oct-15	342.31	586.89	244.58	79.40	500.10	4.07	4.58	508.74	588.14	343.56
19-Oct-15	329.07	594.13	265.06	87.95	500.10	4.07	4.58	508.74	596.69	331.63
27-Nov-15	326.20	569.46	243.25	93.37	500.10	8.04	4.04	512.18	605.55	362.29
22-Dec-15	277.09	597.62	320.53	177.32	500.10	4.07	5.04	509.20	686.52	365.99
14-Jan-16	369.78	653.83	284.04	134.23	500.10	63.98	5.04	569.12	703.35	419.30
3-Feb-16	342.18	571.28	229.10	66.25	500.10	65.56	5.54	571.19	637.44	408.34
29-Feb-16	302.16	579.45	277.29	95.42	500.10	91.65	5.44	597.18	692.60	415.31
10-Mar-16	273.85	619.89	346.04	187.90	500.10	78.07	5.94	584.10	772.00	425.97
31-Mar-16	300.56	649.92	349.37	309.25	500.10	59.14	5.44	564.68	873.93	524.56
17-May-16	314.80	621.68	306.89	183.92	483.10	99.61	4.01	586.72	770.63	463.75
23-May-16	329.53	587.52	257.99	102.57	483.10	115.19	4.01	602.30	704.87	446.88
25-May-16	348.60	689.79	341.19	166.90	483.10	146.57	4.01	633.68	800.58	459.40
8-Jul-16	421.11	657.94	236.83	121.97	493.10	75.20	4.01	572.31	694.28	457.45
29-Aug-16	417.36	671.65	254.29	193.04	493.10	54.87	7.51	555.48	748.52	494.22
12-Sep-16	439.63	902.54	462.91	309.07	493.10	144.81	17.51	655.42	964.49	501.58
14-Sep-16	437.54	849.31	411.77	59.56	493.10	242.31	17.01	752.42	811.98	400.22
15-Sep-16	438.88	783.73	344.85	191.95	493.10	242.31	17.01	752.42	944.37	599.52
18-Oct-16	349.59	685.75	336.17	162.59	493.10	97.89	16.22	607.21	769.80	433.63
10-Nov-16	508.28	690.89	182.61	74.55	493.10	83.87	16.22	593.19	667.73	485.12
11-Nov-16	429.86	684.95	255.09	147.05	493.10	83.87	16.22	593.19	740.24	485.15
15-Nov-16	431.85	714.22	282.37	153.28	493.10	111.94	16.22	621.26	774.55	492.18
25-Nov-16	349.33	700.36	351.03	201.37	493.10	92.78	16.72	602.60	803.96	452.93
5-Dec-16	351.26	641.20	289.94	39.49	493.10	43.71	16.72	553.53	593.02	303.08
16-Dec-16	339.02	621.75	282.73	47.13	493.10	65.50	16.22	574.82	621.95	339.21

(vii) The calculation above demonstrates that there was no shortfall of net creditors balance compared with the balance available in client banks, clearing member and the stock exchanges on any of the identified days.

(viii) The Noticee has further highlighted that (a) all the debtors of the Noticee were in the normal course of business; (b) the Noticee was fully covered by collaterals of the clients in case of non-receipt of payment from clients; (c) actions as per company policy were undertaken to make the necessary recovery; (d) the Noticee had always issued pay-outs to the clients as per the client requests/settlement periods; (e) no instances have been observed by SEBI and the stock exchanges in the past where Noticee has been unable to make payment to clients on the settlement dates due to insufficient funds; and (f) there has not been any client complaint against the Noticee for denial of limits of fund and securities withdrawal. The above shows that client funds were utilized only for stock exchange settlement purposes or for pay-out to clients which is within the scope of regulations and circulars issued by SEBI and stock exchanges.

(ix) When the Enhanced Supervision Circular came into being, the entire broking industry voiced their difficulties in implementing the same as moving from the earlier practice of maintaining a single pool account for routing client funds through pay-ins and payouts of the stock exchanges posed serious challenges. In support of the same, the Noticee has furnished:

(a) Copy of SEBI circular dated December 20, 2016 extending timeline for implementing provisions of Enhanced Supervision Circular;

(b) Copies of press reports regarding the Enhanced Supervision Circular.

(x) Until 2017, there were more than 100 annual inspections, inquiries, visits *etc.* conducted by SEBI/NSE/BSE *etc.* and no adverse interpretation or findings on client funds utilization as alleged in the SCN were communicated to the Company, which shows that SEBI has attempted to retrospectively impose revised methodology prescribed under the Enhanced Supervision Circular.

(xi) In support of the paragraphs above, the Noticee has furnished an analysis in tabular form regarding whether provisions of Enhanced Supervision Circular were reiteration/modification of provisions of SEBI 1993 Circular or whether they were new provisions. The analysis concludes that that the principles and formats provided under the Enhanced Supervision Circular were either new provisions or substantial modifications of the provisions of the SEBI 1993 Circular.

9.5 <u>Noticee has complied with the requirements of the Enhanced Supervision Circular and extant circulars/guidelines</u>

(i) With effect from April 2014, the Company had segregated its proprietary trading into separate membership namely 5paisa Capital Limited (formerly IIFL Capital Limited), thereby ensuring total segregation of funds.

(ii) Noticee has fully implemented the system prescribed under the Enhanced Supervision Circular. In support of the above, the Noticee has furnished copies of compliances and reporting of balances for July, 2017 and August, 2017. Further, the Noticee had promptly implemented and complied with the extant guidelines at any point of time. The aforesaid was verified during the joint inspection conducted by SEBI, stock exchanges and depository in June, 2019, and no violations alleged in the SCN were observed by the inspection team.

(iii) Noticee has further relied on the following orders wherein Hon'ble SAT had noted the prompt rectification or implementation and dropped the proceedings:

(a) Order in the matter of M/s. DSE Financial Services Ltd. (Appeal no. 153 of 2012) dated September 11, 2012.

(b) Order in the matter of UPSE Securities Limited vs. SEBI (Appeal no. 109 of 2011) dated July 25, 2011.

9.6 Similar breaches in the following cases were held by SEBI as technical lapses not warranting substantive punishment. SEBI had only served a letter of warning in the following cases:

(i) Order passed by the Whole Time Member in the matter of M/s. J. M. Morgan Stanley Retail Services Pvt. Ltd. dated June 02, 2004.

(ii) Order passed by Chairman in the matter of M/s. Bama Securities Ltd. dated June 04, 2004.

(iii) Order passed by Whole Time Member in the matter of M/s. Bakliwal Investment dated May 18, 2004.

Further, the Noticee has submitted that Hon'ble SAT in the matter of Chona Financial Services Pvt. Limited dated August 23, 2004, modified penalty to a warning with respect to an appellant who was *inter alia* charged with the allegation of non-segregation of client funds and misutilization of client account.

9.7 The following adjudication orders should be taken into account which have similar facts and allegations as the present case and where minimal penalties were imposed by the adjudicating officer:

S.No	Adjudication order details
1.	Bearing reference no. Order/SS/VS/2019-20/5169 in the matter of Allvin Securities Limited dated October 24, 2019
2.	Bearing reference no. Order/SS/SK/2019-20/5168 in the matter of SPFL Securities Limited dated October 24, 2019
3.	Bearing reference no. EAD/BD/BM/2019-20/5284 in the matter of M/s Paterson Securities Private Limited dated October 31, 2019.
4.	Bearing reference no. EAD/ BJD/VS/2018-19/1581 in the matter of M/s Anand Rathi Share and Stock Brokers Limited dated November 27, 2018.
5.	Bearing reference no. EAD-2/DSR/RG/ 319/2014 in the matter of Keynote Capital Limited dated December 18, 2014.
6.	Bearing reference no. Order/PM/NK/2019-20/6988 in the matter of M/s Motilal Oswal Financial Services Limited dated February 28, 2020.
7.	Bearing reference no. Order/PM/NK/2019-20/6989] in the matter of M/s Nirmal Bang Securities Private Limited dated February 28, 2020.
8.	Bearing reference no. SD/AO/36/2011 in respect of M/s Mansukh Securities and Finance Limited dated November 02, 2011.
9.	Bearing reference no. Order/PM/NK/2018-19/1778 in respect of M/s Bikash Sureka dated December 28, 2018.
10.	Bearing reference no. RA/CB/381/2018 in respect of M/s Dani Shares and Stocks Pvt. Limited dated May 09, 2018.
11.	Bearing reference no. Order/AA/AR/2019-20/6314 in respect of Satco Capital Markets Ltd dated December 30, 2019.
12.	Bearing reference no. PM/AO/NK-13/2017 in respect of M/s Systematix Shares & Stocks (I) Limited dated December 20, 2017.
13.	Bearing reference no. Order/SM/AR/2018-19/667 in respect of Yoke Securities Ltd. dated May 30, 2018.

10. *Vide* email sent on November 22, 2021, the Noticee requested inspection of certain documents in relation to Adjudication Proceedings 2. *Vide* email sent on January 06, 2022, the Noticee was *inter alia* informed that inspection of an intermediary is an interactive process wherein the inspection team visits the intermediary and collects the data or requests for data through emails (as the situation warrants), analyses the said data and prepares inspection report. The findings of the said inspection report after approval of the competent authority is shared with the concerned intermediary for providing explanations/comments on the inspection findings from the inspection report. Thereafter, depending on the gravity of the misconduct, the inspection team either accepts the explanations/comments to the inspection findings provided by the intermediary and recommends no action or rejects the explanation/comments to the inspection findings provided by the intermediary and recommends action. Thus, the Noticee is considered to be well-versed with the documents which have been relied upon in the SCN as the same are arising from the aforesaid process. In light of the above, the Noticee was informed that the documents provided to it along with the SCN

are sufficient for it to submit a reply in line with the principles of natural justice. *Vide* the same email, the Noticee was granted a hearing opportunity on January 13, 2022.

11. *Vide* email sent on January 06, 2022, the Noticee again requested for inspection of documents along with request for rescheduling the aforesaid hearing granted. *Vide* email sent on January 08, 2022, the Noticee was informed that no additional facts or documents have been brought on record since the last email was sent by the undersigned which would make the undersigned deviate from its earlier stance. The Noticee was informed again that the documents requested for inspection are documents which either have been provided by it or prepared based on the data provide by it, thus, the Noticee is well aware of its contents for submitting an efficacious reply. Further, taking into account the reasons cited by the Noticee for rescheduling the hearing, the Noticee was informed that the hearing date is postponed to a date which shall be intimated subsequently.

12. *Vide* notice of hearing sent *vide* email on February 18, 2022, the Noticee was granted a hearing opportunity on February 25, 2022. *Vide* email sent on February 21, 2022, the authorized representatives of the Noticee (hereinafter referred to as "**ARs**") requested for adjournment of the aforesaid hearing due to unavailability of their counsel. Therefore, the hearing granted on February 25, 2022 was rescheduled to March 14, 2022. In view of COVID-19, the hearing was scheduled through video conferencing on cisco webex platform. On March 14, 2022, the hearing was conducted wherein the ARs appeared before me through video conference and reiterated the submissions made by the Noticee *vide* letter dated January 29, 2022 with respect to Adjudication Proceedings 2. Further, the ARs sought further time till March 21, 2022 for making additional submissions, which was acceded to. As stated before, the Noticee submitted its additional submissions *vide* letter dated March 30, 2022.

D. CONSIDERATION OF ISSUES AND FINDINGS

13. After considering the facts of the case, I find that the issues that arise for consideration in the instant matter are as follows:

   I. **Issue No. I**: Whether the Noticee has violated the provisions of the SEBI 1993 Circular and clauses A(1), A(2) and A(5) of the code of conduct for stock brokers as stipulated in Schedule II read with regulation 9(f) of Broker Regulations?

   II. **Issue No. II**: If yes, whether the violation, on the part of the Noticee would attract monetary penalty under section 23D of SCRA?

   III. **Issue No. III**: If the answer to Issue No. II is in affirmative, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in section 23J of SCRA read with rule 5(2) of SCRA Adjudication Rules?

14. Before beginning with the contentions raised by the Noticee on merits, I find it appropriate to address two preliminary contentions raised by the Noticee. The same preliminary contentions have been dealt by me in Adjudication Proceedings 1 Order. However, since the preliminary contentions raised questions the initiation of the proceedings altogether, at the cost of repetition, I have reproduced my findings herein. *First,* the Noticee has contended that initiation of two enquiry and two adjudication proceedings against the Noticee is perverse, as the aforesaid proceedings could have been clubbed under one comprehensive proceeding. In this regard, as tabulated in paragraph 3 above, total of six inspections were conducted with respect to the affairs of the Noticee. The inspection period with respect to five out of the six inspections pertains to the period from April 01, 2011 to June 30, 2014. The said five inspections are namely, Thematic Inspection, Comprehensive Inspection, Supplementary Inspection I, Supplementary Inspection II and

Supplementary Inspection III. As stated before, the allegations arising from the findings of the aforesaid five inspections are clubbed under Adjudication Proceedings 1, and the allegations arising out of the inspection period pertaining to the period from April 01, 2015 to January 31, 2017 (*i.e*, March 2017 Inspection), is covered under Adjudication Proceedings 2. As regards the two enquiry proceedings, the first enquiry proceedings were initiated based on the findings of Thematic Inspection, Comprehensive Inspection, Supplementary Inspection I and Supplementary Inspection II, pursuant to which a SCN dated May 02, 2017 was issued. Thereafter, Supplementary Inspection III and the March 2017 Inspection was conducted, therefore, the aforesaid two inspections form part of the second enquiry proceedings. Taking into account the aforesaid, I find that initiation of two separate adjudication proceedings is justified on the ground of different inspection periods, and initiation of two separate enquiry proceedings is justified due to the subsequent inspections undertaken.

15. *Second*, the Noticee has argued that imposition of penalty under adjudication proceedings along with recommendation of disciplinary action under enquiry proceedings is baseless and excessive. The Noticee has cited the decision of adjudicating officer in the matter of M/s Motilal Oswal Financial Services Limited, decision dated February 28, 2020, wherein according to the Noticee, on similar set of facts, only adjudication proceeding was initiated. In this regard, I find that the correct position has been aptly summarized by Hon'ble Securities Appellate Tribunal, in the case of ***Grishma Securities Private Limited and Ors. vs. SEBI*** (Appeal No. 151 of 2013) dated October 28, 2013. In this case it was argued by the appellant that initiation of adjudication and enquiry proceedings on the same set of facts and evidence is impermissible in law. In context of the above, Hon'ble SAT held the following:

"It is pertinently noted that the adjudication proceedings may lead to monetary penalty or even exoneration of the appellants. Whereas, the enquiry proceedings have the potential of leading to appropriate disciplinary action against the appellants in case the charges are proved in the enquiry. <u>There is no categorical challenge to such parallel proceedings</u>…….

……Once an Inquiry Officer or an Adjudicating Officer is appointed as per law to conduct an enquiry into the alleged misconduct of a company or a market player, as the case may be, he or she acts as an independent, neutral and impartial umpire despite being on the rolls of the SEBI. As long as he holds such responsibility, he or she is supposed to perform a quasi-judicial task dispassionately. However, he or she has to conform to the principles of natural justice and also discharge the said functions within the parameters prescribed by the rules and regulations or an Act of Parliament failing which alone his or her findings or conduct may be questioned and not otherwise.

Therefore, keeping in view the scheme of the SEBI Act, 1992, we have no hesitation in holding that a subjective decision as to when and where regulatory intervention is required is the sole prerogative of the regulator. Undoubtedly, such a decision has to be rational and is to be based on a prima facie and bonafide satisfaction as to the existence of certain alleged irregular or illegal facts/happenings or circumstances supposedly taking place or prevailing in the affairs of a company….." (emphasis supplied)

Considering the above, I find that it is the exclusive right of SEBI to decide which proceedings should be initiated in a particular matter. Thus, the preliminary contentions of the Noticee deserve to be rejected.

I. Issue No. I: Whether the Noticee has violated the provisions of the SEBI 1993 Circular and clauses A(1), A(2) and A(5) of the code of conduct for stock brokers as stipulated in Schedule II read with regulation 9(f) of the Broker Regulations?

16. For facility, the relevant extracts of the provisions alleged to be violated by the Noticee are provided below:

SEBI 1993 Circular

1. *It shall be compulsory for all Member brokers to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the Member broker is taking a position as a principal will be allowed to be made from the client's account. The above principles and the circumstances under which transfer from client's account to Member broker's account would be allowed are enumerated below.*

A] Member Broker to keep Accounts: Every member broker shall keep such books of accounts, as will be necessary, to show and distinguish in connection with his business as a member –

i. Moneys received from or on account of each of his clients and,

ii. the moneys received and the moneys paid on Member's own account.

B] Obligation to pay money into "clients accounts". Every member broker who holds or receives money on account of a client shall forthwith pay such money to current or deposit account at bank to be kept in the name of the member in the title of which the word "clients" shall appear (hereinafter referred to as "clients account"). Member broker may keep one consolidated clients account for all the clients or accounts in the name of each client, as he thinks fit: Provided that when a Member broker receives a cheque or draft representing in part money belonging to the client and in part money due to the Member, he shall pay the whole of such cheque or draft into the clients account and effect subsequent transfer as laid down below in para D (ii).

C] What moneys to be paid into "clients account". No money shall be paid into clients account other than –

i. money held or received on account of clients;

ii. such money belonging to the Member as may be necessary for the purpose of opening or maintaining the account;

iii. money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of para D given below;

iv. a cheque or draft received by the Member representing in part money belonging to the client and in part money due to the Member.

D] What moneys to be withdrawn from "clients account". No money shall be drawn from clients account other than –

i. money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the Member from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the Member, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client;

ii. such money belonging to the Member as may have been paid into the client account under para 1 C [ii] or 1 above.

E] Right to lien, set-off etc., not affected. Nothing in this para 1 shall deprive a Member broker of any recourse or right, whether by way of lien, set-off, counter-claim charge or otherwise against moneys standing to the credit of clients account.

***2.** It shall be compulsory for all Member brokers to keep separate accounts for client's securities and to keep such books of accounts, as may be necessary, to distinguish such securities from his/their own securities. Such accounts for client's securities shall, inter-alia provide for the following:-*

a. Securities received for sale or kept pending delivery in the market;

b. Securities fully paid for, pending delivery to clients;

c. Securities received for transfer or sent for transfer by the Member, in the name of client or his nominee(s);

d. Securities that are fully paid for and are held in custody by the Member as security/margin etc. Proper authorization from client for the same shall be obtained by Member;

e. Fully paid for client's securities registered in the name of Member, if any, towards margin requirements etc;

f. Securities given on Vyaj-badla. Member shall obtain authorization from clients for the same.

Broker Regulations

Conditions of registration.

9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely,-

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

SCHEDULE II

CODE OF CONDUCT FOR STOCK BROKERS [Regulation 9]

A. General.

(1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

(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.

17. I note that with respect to March 2017 Inspection, the period taken for inspection was from April 01, 2015 to January 31, 2017, wherein total 30 days were examined. It was alleged in the SCN that out of the sample 30 days examined, the Noticee misused funds of credit balance clients for settlement obligation of its debit balance clients for 30 days and the total misutiilization was in the range of Rs 26.04 crores to Rs 294.73 crores as total funds available with broker (*i.e.,* column A+B in the table provided in paragraph 8.3 above) was less than ledger credit balance of clients *(i.e.,* column C in the table provided in paragraph 8.3 above). Since the aforesaid calculation resulted in a negative value *(i.e.,* column G in the table provided

in paragraph 8.3 above), it was concluded that the said value indicates the extent of misutilization of client funds. It has been alleged in the SCN that the percentage of misuse ranged from 4.01% to 45.97%.

18. The Noticee has contended that the practices followed by the Noticee were in line with the practices followed by the rest of the broking industry. All stock brokers, including IIFL, continued to receive funds from debtors/stock exchange and pay to creditors/ exchange on a continuous basis. In case of a shortfall in the pool account in meeting the exchange/client obligations, the broker would meet the same through transfer of his own funds, fixed deposits, bank guarantees as and when required, failing which there would be a default. Further, the Noticee has claimed that in a single consolidated client funds pool account, there is no differentiation between the funds received/paid from/to clients and the stock exchange. All stock brokers, including IIFL, continued to receive funds from debtors/exchange and pay to creditors/exchange on a continuous basis and so the balances were always dynamic in nature. I find that the aforesaid contention of the Noticee amounts to admission that it was using its credit balance funds for its debit balance clients for the sake of running an efficient business and timely pay-in of client obligation. I find that if stock brokers are given liberty to pay into and withdraw from the client account as and when they please, it would set a bad precedent as only in cases where an inspection has been carried out SEBI would discover that the stock broker has withdrawn in excess. It is important to bear in mind that clause 1(D) of the SEBI 1993 Circular specifies exact circumstances when money can be withdrawn from the client account. The aforesaid clause is dealt in detail in the subsequent paragraphs. It is pertinent to mention here that *vide* letter dated January 20, 2016 and in its reply to the SCN, the Noticee has admitted the charge levelled against it that it had used credit balance client funds for debit balance client funds, the relevant extract of the Noticee’s admission from the aforesaid letter is reproduced below:

“d) Accordingly, we submit that utilization of client funds towards clients debit balance are in compliance with set systems and process by the Exchanges. The same is followed in the industry”

Further, the admission of the Noticee present at paragraph 7.1(h) of its reply is reproduced below verbatim:

"We reiterate that prior to July 01, 2017 i.e. the date of implementation of revised process as per SEBI circular on enhanced risk based Supervision Circular dated September 26, 2016 with regard to utilization of client funds, <u>IIFL and the entire broking industry were following the utilization of the client pool account fund balances towards the debit balances clients</u> and the monitoring of the ledger balances and fund balances were made based on net clients funds." (emphasis supplied)

19. The Noticee has contended in its reply is that there has been retrospective application of the Enhanced Supervision Circular in the present case as the SEBI 1993 Circular does not specify the manner of calculation or adjustment or methodology for arriving at client balances. The Noticee has contended that even though the inspection period pertains to the period from April 01, 2015 to January 31, 2017, SEBI has attempted to retrospectively apply the provisions of the Enhanced Supervision Circular which came into effect from July 01, 2017. According to the Noticee, the aforesaid is also evident from the fact since 2000 more than 100 inspections have been conducted, however, findings on client funds utilization were found in 2017. It has further submitted that the following two considerations emerged out of the aforesaid circular which have been applied retrospectively in the present case:

(a) Considering 50% of the value of bank guarantees towards fund balances (*i.e.* only the funded portion) instead of the entire value of bank guarantee as stock exchanges have recourse to the full amount of bank guarantee upon invocation in case of any contingency; and

(b) Comparing ledger gross credit balances in client accounts with the client bank accounts and stock exchange accounts instead of comparing the ledger net credit balance (*i.e,* total creditors – total debtors) with the client bank accounts and stock exchange accounts which was the industry wide practice.

The Noticee has furnished a revised table for the 30 days of March 2017 Inspection after taking into account 100% of the bank guarantee and net creditors. I find that the principles based on which the revised table has been provided were dealt by me in Adjudication Proceedings 1 Order, however, as this is one of the major contentions based on which the defence of the Noticee rests, I have reproduced my findings from the aforesaid order herein.

20. With respect to the aforesaid contention, it is pertinent to note that clause 1(D) of the SEBI 1993 Circular provides what money can be withdrawn from the client account. The said clause does not allow any stock broker to use funds available in its credit balance client accounts for its debit balance clients. Thus, assuming that the format/calculation used for inspections in the instant case came into effect in July, 2017 due to Enhanced Supervision Circular, the Noticee cannot claim ignorance of the requirement to comply with clause 1(D) of SEBI 1993 Circular. In my opinion, it cannot be said that the principles contained in the Enhanced Supervision Circular are new principles altogether. As brought out above, the purposes for which client funds can be used was already incorporated in clause 1(D) of the SEBI 1993 Circular. The principles based on which the misutilization calculation has been arrived at in the present case have always been a part of the working during inspections of stock brokers relating to segregation of funds and securities under the SEBI 1993 Circular. The Enhanced Supervision Circular codifies and streamlines the principles already enumerated in the SEBI 1993 Circular.

21. I have perused the judgments of the Hon’ble Supreme Court cited by the Noticee in support of the aforesaid contention, namely, *Binani Industries (supra) and Alliance* Finstock *Ltd. (supra)*. At this juncture, I find it appropriate to rely on the following orders passed by Hon’ble SAT wherein it has dismissed the aforesaid contention:

(i) Kantilal Chhaganlal Securities Pvt. Ltd. vs. SEBI (Appeal No. 391 of 2020) decision dated March 24, 2022: In this order, the inspection period was from April 01, 2014 to December 2015. Similar to the facts of the present case, the adjudicating officer had found that the appellant had violated the provisions of SEBI 1993 Circular by misutilizing client funds for other purposes. During the appeal before Hon'ble SAT, it was argued by the appellant that the Enhanced Supervision Circular was applied retrospectively in the case for imposing penalty. The Hon'ble SAT held the following:

"Having heard the learned counsel for the parties, we find that the contention raised by the appellant is patently erroneous. In this regard paragraph 1.D of the 1993 Circular states as under:-….

The aforesaid indicates that the broker shall not use funds of clients for any purpose other than client's own use…..

The aforesaid contemplates imposition of penalty in case of failure to segregate their own funds from that of the clients fund.

We find that the AO has dealt with the objection raised by the appellant and has held that the appellant has violated the 1993 Circular read with Regulation (26)(xiii) of the Brokers Regulations, 1992. In our opinion, the findings given by the AO in this regard does not suffer from any error of law." (emphasis supplied).

(ii) Arihant Capital Markets Ltd. vs. SEBI (Appeal No. 521 of 2019) decision dated October 21, 2021: In this appeal, the period of inspection was from April 01, 2014 to March 11, 2016. The Hon'ble SAT held as follows:

"The learned counsel for the appellant submitted before us that in the show cause notice the respondent had relied on a formula which, in fact,

was not in existence at the time of the disputed period but was incorporated in circular dated September 26, 2016 which is brought into effect from July 1, 2017. He submitted that the formula would show that so far as the bank guarantee is concerned, only 50% of the same is required to be considered and not 100% which has been considered in the cases of Axis Bank as detailed (supra).

Upon hearing both sides and upon perusing the relevant circulars, in our view, the order cannot be faulted with. <u>The earlier circular had clearly stated that the funds of the client cannot be applied for any other purposes. The appellant's case was that the funds were applied by it for the dues for their associates, group company, etc. Now, during the arguments only, the issue of nonexistence of formula in the previous circular is brought up. In fact, the said formulization is nothing but the crystallization of the earlier circular.</u>

<u>In the circumstances, there is no merit in the appeal</u>. The appeal is, therefore, dismissed without any order as to costs." (emphasis supplied)

In light of the above, I find that the contention of the Noticee that there has been retrospective application of Enhanced Supervision Circular in the present matter lacks merit.

22. The Noticee has contended that the entire portion of the bank guarantee should be considered as opposed to only 50% considered by the inspection team. I find that the value of bank guarantee is considered to be 50% (half) since the funds deposited with the bank for availing the bank guarantee is only 50%. Basis 50% of the funds deposited by the stock broker with the bank, the bank provides 100% bank guarantee. I note that during the inspections the Noticee has acknowledged that bank guarantees are issued to it with 50% cash margin under lien to the bank and supporting evidence in this regard has also been provided. Thus, I cannot accept the argument of the Noticee that 100% of the bank guarantee should be considered. Further,

Noticee's contention that the concept of considering 50% bank guarantee is arising out of Enhanced Supervision Circular, and therefore, it should not be applied to the facts of the present case is not logical as it is a matter of fact that the Noticee has deposited 50% as collateral for obtaining 100% bank guarantee. I am unable to understand how 100% of bank guarantee can be considered under total funds available with the stock broker, when in fact, it is has not given the entire 100% as collateral.

23. The Noticee has also contended that net creditors balance (*i.e,* total creditors-total debtors) should be considered instead of aggregate credit client balance while calculating the value of "G". I find that if the aforesaid interpretation is adopted, then it would mean that a broker paying from the excess funds of one client to meet the liability of another client is acceptable, which is completely contrary to the requirements of the SEBI 1993 Circular which in clause 1(D) envisages withdrawing money out of client account only in specific situations. I find that a similar contention was raised before the Hon'ble SAT in the matter of ***Sushil Financial Services Pvt. Ltd. vs. SEBI***, (Appeal No. 196 of 2016), decision dated November 06, 2019, wherein it held that:

"As regards the second charge, the appellant explained that only some of credit balances of all credit clients should not be considered for verifying funds lying in the bank accounts as the same would be in isolation, because pay-in and pay-out happens on net basis and hence even debit balances of all debit clients should be considered. Emphasizing on the net basis pay-in and pay-out, the appellant contended that settlement at member level shall not be considered and thus, the allegation that the credit funds of the clients was used is wrong. The AO however observed that the submission cannot be accepted as the funds of credit balance client was used for obligation of debiting balance client. Further, it was pointed that the account of the credit balances clients account had eroded by adopting the said practice. It was found that the said practice was in violation of SEBI circulars dated November 18, 1993 and August 27, 2003.

In our view, while the violation as regard the first charge is admitted by the appellant, <u>the explanation regarding the second charge is not acceptable. The clients account cannot be tinkered with that for pay-in and pay-out on net basis of the appellant.</u>

In the present case, what we find is that the appellant has accepted the cash transactions from SGCPL and vice versa. <u>As regards the second charge, the same is also established</u>, in view of the admission by the appellant by terming it as practice" (emphasis supplied)

24. The Noticee has further highlighted that the following factors show that client funds were utilized by the Noticee for stock exchange settlement purposes or for pay-out of clients which is within the scope of circulars and regulations issued by SEBI and stock exchanges: (a) all the debtors of the Noticee were in the normal course of business; (b) the Noticee was fully covered by collaterals of the clients in case of non-receipt of payment from clients; (c) actions as per company policy were undertaken to make the necessary recovery; (d) the Noticee had always issued pay-outs to the clients as per the client requests/settlement periods; (e) no instances have been observed by SEBI and the stock exchanges in the past where Noticee has been unable to make payment to clients on the settlement dates due to insufficient funds; and (f) there has not been any client complaint against the Noticee for denial of limits of fund and securities withdrawal. I find that all of the aforesaid factors do not affect the main charge against the Noticee that it had used credit balance funds for its debit balance clients. The establishment of the aforesaid violation is not contingent on the aforesaid factors. SEBI 1993 Circular *inter alia* prescribes money that can be paid into and withdrawn from client account, it does not permit the broker to venture outside its scope taking into account entire financial status of the stock broker *i.e,* whether the broker had adequate debtors or mechanism to pay off the liabilities to its clients. Further, the requirement to adhere to the provisions of SEBI 1993 Circular is a statutory requirement, and the Noticee was duty bound to adhere to it, irrespective of any client complaints. Thus, I find that the factors

cited by Noticee above at best considered may be considered as mitigating factors.

25. The Noticee has contended that the alleged findings under the SCN does not make a reference to any specific provision of the SEBI 1993 Circular, which shows that the inspection team has not understood the facts of the case and the specific provisions of the SEBI 1993 Circular. I find that not specifying the exact provisions of the SEBI 1993 Circular alleged to have been violated by the Noticee does not reflect on the competency of the inspection team regarding understanding the facts of the current case and/or the provisions of SEBI 1993 Circular. I find that such a bald statement is unwarranted. I find that the acts of the Noticee established in the preceding paragraphs clearly falls foul of clause 1(D) of the SEBI 1993 Circular. On a joint reading of the allegation levelled in the SCN and the aforesaid clause, it becomes sufficiently clear that the Noticee has violated clause 1(D) of the SEBI 1993 Circular. Thus, I find that this submission of the Noticee does not have any bearing on the outcome of the present proceedings.

26. The Noticee has provided a tabular analysis with respect to compliance of the Noticee with each of the clauses of SEBI 1993 Circular (annexure 4 of its reply). I find that merely putting no adverse findings were alleged in the SCN for each of the clauses of SEBI 1993 Circular does not help the case of the Noticee. Further, as recorded above, the Noticee has also not been able to explain the reasoning for negative value of “G” column observed in the March 2017 Inspection. Thus, I find that submitting such a hollow analysis of compliance with the provisions of SEBI 1993 Circular is a futile attempt which does not deserve any further deliberation.

27. The Noticee has submitted that since April, 2014, it has segregated its proprietary trading into separate membership ensuring total segregation of funds. The March 2017 Inspection found that the Noticee was using its credit balance client funds for its debit balance clients. It does not mention that the Noticee was using credit client funds for proprietary purposes, thus, this

submission does not have relevance in context of Adjudication Proceedings 2.

28. The Noticee has submitted that it has fully implemented the system prescribed under the Enhanced Supervision Circular and it has also furnished copies of compliances and reporting of balances for July, 2017 and August, 2017. The Noticee has further submitted that the compliance with extant guidelines/circulars of the Noticee was verified at the time of joint inspection taken by SEBI, stock exchanges and depository in June, 2019. At the outset, copies of reporting submitted for July, 2017 and August, 2017 are not legible copies. Further, as the provisions of Enhanced Supervision Circular started coming into effect beginning from April 01, 2017 and the period of March 2017 Inspection ends at January 31, 2017, I do not find myself in a position to assess the level of compliance of the Noticee after the last date of inspection. Similarly, with respect to the submission of the Noticee that joint inspection undertaken in June, 2019 did not allege any adverse findings, without going into the findings of the said inspection, I find that the Noticee has not taken efforts to correct its practices when the same was highlighted during Supplementary Inspection I, Supplementary Inspection II, Supplementary Inspection III as recorded in Adjudication Proceedings 1 Order. Further, as stated above, the findings of the March 2017 Inspection show that the violations observed in the previous inspections were continuing, thus, I find that taking shelter under findings of 1 inspection (*i.e,* June 2019 inspection) does not negate the violations observed in the previous 4 inspections (*i.e,* Supplementary Inspection I, Supplementary Inspection II, Supplementary Inspection III and March 2017 Inspection).

29. Further, the Noticee has relied upon the decisions of Hon'ble SAT in M/s. DSE Financial Services Ltd. (Appeal no. 153 of 2012), dated September 11, 2012 and UPSE Securities Limited vs. SEBI (Appeal no. 109 of 2011), dated July 25, 2011 to submit that in view of prompt rectification/implementation by the broker, the proceedings should be dropped. To begin with, relying on my observations recorded in Adjudication Proceedings 1 Order and the inability

of the Noticee to successfuly rebut the allegation levelled in the present SCN, I staunchly disagree that the Noticee was able to rectify the deficiencies observed atleast until January, 2017. Notwithstanding the above, I have perused the aforesaid orders. My observations with respect to the said orders have been recorded in Adjudication Proceedings 1 Order as well. I find that the aforesaid orders are distinguishable on facts. *Firstly*, in DSE Financial Services Ltd. *(supra)*, the violation committed by the broker was failure to maintain records in the manner specified, and in UPSE Securities Limited *(supra),* the violation committed by the broker was (i) allotting of more than one terminal to the same user at different addresses; and (ii) not allotting unique client code to clients, the aforesaid violations are nowhere related to the violations involved in the present matter. *Secondly*, even if the principle laid down by Hon’ble SAT in the aforesaid matters is to be considered that every minor irregularity/technical violation does not warrant punitive action, I find that by no stretch of imagination misutilization ranging upto Rs. 294.73 crores can be considered as minor irregularity or technical violation on the part of the Noticee.

30. With respect to the cases cited by the Noticee in paragraph 9.6 above, wherein it has been held that non segregation of client funds and/or misutilization of client funds amount to technical lapses and for which a letter of warning was issued as punishment, my findings which were also recorded in Adjudication Proceedings 1 Order, are provided below:

(i) With respect to the order passed by Chairman in the matter of M/s. Bama Securities Ltd. dated June 04, 2004 and by the Whole Time Member in the matter of M/s. J. M. Morgan Stanley Retail Services Pvt. Ltd. dated June 02, 2004, I find that the said cases did not contain the allegation that the broker had mistutilized client funds, thus, the fact that letter of warning was issued in the aforesaid matter has no bearing in the present case as the allegations itself are different.

(ii) In the order passed by Whole Time Member in the matter of M/s. Bakliwal Investment, dated May 18, 2004, I note that the inspection period was from the year 1999 to 2000. Further, with respect to similar allegations, the Whole Time Member had *inter alia* recorded the following:

"4.1.4 The broker mis-used client account by adjusting one account with another without proper authorization. The broker had submitted that the authorizations / consent letters were filed but were not produced. The broker further submitted that all the clients whose accounts were adjusted with another were sister concerns. The submission of the broker on this issue is not satisfactory. The broker should not have misused client account by adjusting one account with another without proper authorization irrespective of the number of cases where it was done or the fact that all the clients were sister concerns.

4.1.6 Broker had used clients' bank account accounts for the purpose other than what is stipulated. The broker had submitted that Global Trust Bank had directly debited demat charges and bank guarantee commission to its account without an instruction from the broker. The broker further submitted that Global Trust Bank was instructed not to carry on such debits. However, the broker failed to produce any document to show such debits were credited back. I find that there were only 11 transactions of small amount and in only one bank i.e., Global Trust Bank."

I find that the aforesaid case can be distinguished on two grounds. *First*, with respect to misusing client funds, in the aforesaid case there has been no finding regarding the range of misutilization, whereas in the present case, the range of misutilization is between Rs 26.04 crores to Rs 294.73 crores, therefore as it is not on record what the misutilization amount was in the aforesaid case, I find that it cannot be compared with the present case. *Second*, with respect to using clients bank account for other purposes, I find that it has been recorded in the aforesaid case that the concerned transactions were of miniscule amount, however, the same cannot be said in the present case in light of the misutilization range cited above.

(iii) The Noticee has also placed reliance on the order passed by the Hon'ble SAT in the matter of Chona Financial Services Pvt. Limited dated August 23, 2004, wherein the Hon'ble SAT had modified the penalty to a warning with respect to an appellant who was *inter alia* charged with the allegation of non-segregation of client's fund and misutilization of client account. I note that the aforesaid case was distinguished by Hon'ble SAT itself in ***K. Seetharam vs. SEBI*** (Appeal No: 86 of 2005) decision dated July 07, 2005, wherein it held that:

"The appellant has requested to cancel the penalty considering the facts and circumstances of the case. He has further stated in the appeal that where similar violations along with other violations had occurred, this Tribunal has reduced the penalty to a mere warning. He has cited the following judgments of the Tribunal:

i. Intech Shares and Stock Brokers Vs. SEBI
ii. Sumedha Fiscal Services Ltd. Vs. SEBI
iii. Prakash K. Shah Shares and Securities Pvt. Ltd. Vs. SEBI
iv. Bakliwala Investment
v. J.M. Morgan Stanley Retail Services Pvt. Ltd.
vi. Bama Securities
vii. Shyama Sundar Dalmia Vs. SEBI
viii. Sanjay C. Bakshi
ix. Mahesh Kothari Shares and Stock Brokers Pvt. Ltd.
x. Kumesh Sawney
xi. <u>Chona Financial Services Pvt. Ltd.</u>

10. <u>We have gone through the documents submitted by the appellant and the facts of the case. We have also gone through some of the judgments cited in the appeal. While it is a fact that in all these cases</u>

the Tribunal has modified the order of the respondent but we must admit that each case is a different case and decision is taken on the facts and circumstances of each case. *Each order sets out detailed finding and reasons for taking action or imposing the penalty. In this particular case we have to examine basically two issues. (emphasis supplied)*

31. Taking into account the previous paragraphs, I am unable to accept the revised table for 30 days furnished by the Noticee. I find that Noticee has violated provisions of the SEBI 1993 Circular and clauses A(1), A(2) and A(5) of Schedule II of the Broker Regulations by using credit client funds for settlement obligation of debit balance clients which resulted into misutilization ranging from Rs 26.04 crores to Rs 294.73 crores and percentage of misutilization ranging from 4.01% to 45.97%. The Noticee has relied upon 13 adjudication orders, as mentioned in paragraph 9.7 above, to contend that in similar facts and allegations minimal penalties have been imposed. I have perused the contents of the aforesaid orders as well as the penalties levied therein. On an overall evaluation of the allegations and response of the Noticee, I note that using credit balance client funds for settlement obligation of debit balance clients is a grave violation. Further, misutilisation to the extent of Rs 294.73 crores is a substantially high amount. By using credit client funds, the Noticee has gone beyond the realm of lack of due diligence and acted in clear defiance of the requirement prescribed by SEBI. The Noticee being a registered intermediary is supposed to adhere to fair practices and maintain a high degree of professionalism, however, it is crystal clear from the preceding paragraphs that the Noticee has acted in deliberate disregard of its obligations and has put the interests of lakhs of investors in jeopardy.

II. **Issue No. II: If yes, whether the violation, on the part of the Noticee would attract monetary penalty under section 23D of SCRA?**

III. **Issue No. III: If the answer to Issue No. II is in affirmative, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in section 23J of SCRA read with rule 5(2) of SCRA Adjudication Rules?**

32. Since violation of provisions of SEBI 1993 Circular and clauses A(1), A(2) and A(5) of the code of conduct for stock brokers as stipulated in Schedule II read with regulation 9(f) of Broker Regulations by the Noticee is established, I am of the view that the same warrants imposition of monetary penalty upon the Noticee under section 23D of SCRA and regulation 26 (xiii), (xv) and (xvi) of the Broker Regulations, text of which is provided below:

32.1. **SCRA**

Penalty for failure to segregate securities or moneys of client or clients.

23D. *If any person, who is registered under section 12 of the Securities and Exchange Board of India Act, 1992 (15 of 1992) as a stock broker or sub-broker, fails to segregate securities or moneys of the client or clients or uses the securities or moneys of a client or clients for self or for any other client, he shall be *[liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees].*

***Substituted for the words "liable to a penalty not exceeding one crore rupees" by the Securities Laws (Amendment) Act, 2014, w.e.f 08-09-2014.*

32.2. **<u>Broker Regulations</u>**

Liability for monetary penalty.

*26. A stock broker **[***] shall be liable for monetary penalty in respect of the following violations, namely—*

(xiii) Failure to segregate his own funds or securities from the client's funds or securities or using the securities or funds of the client for his own purpose or for purpose of any other client.

(xv) Failure to comply with directions issued by the Board under the Act or the regulations framed thereunder.

(xvi) Failure to exercise due skill, care and diligence.

*** The words "or a sub-broker" was omitted by SEBI (Stock Brokers and Sub-Brokers) (Second Amendment) Regulations, 2018 w.e.f 01-04-2019.*

33. While determining the quantum of penalty, the following factors stipulated in section 23J of SCRA have to be given due regard:

(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; and

(c) the repetitive nature of the default.

34. The material available on record has not quantified the amount of disproportionate gain or unfair advantage made by the Noticee as a result of

the default, however, the range of misutilisation of the Noticee extends upto Rs 294.73 crores. The inspection has also not quantified the loss caused to the investors. With respect to the repetitive nature of the default, as brought out before in Adjudication Proceedings 1 Order, the violations committed by the Noticee have been observed over multiple inspections, thus, it would be appropriate to consider them as repetitive.

E. ORDER

35. After taking into consideration all the facts of the case including that the misutilisation amount extends upto Rs 294.73 crores, the contentions of the Noticee and my findings recorded above, in exercise of powers conferred upon me under section 23-I(2) of SCRA read with rule 5 of the SCRA Adjudication Rules, I hereby impose a penalty of Rs. 1,00,00,000 (Rupees One Crore Only) upon the Noticee *i.e.,* India Infoline Limited *(now known as IIFL Securities Ltd.)* under section 23D of SCRA and regulation 26 (xiii), (xv) and (xvi) of the Broker Regulations.

36. The said penalty imposed on the Noticee, as mentioned above, is commensurate with the violation committed by the Noticee and acts as a deterrent factor for the Noticee and others in protecting the interest of investors.

37. The Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of demand draft in favor of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, or through online payment facility available on the SEBI website **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, the Noticee may contact the support at portalhelp@sebi.gov.in.

38. The Noticee shall forward the said demand draft or the details / confirmation of penalty so paid through e-payment to the Division Chief, Enforcement Department-I, DRA-III, SEBI, in the format given in table below:

1.	Case name	
2.	Name of payee	
3.	Date of payment	
4.	Amount paid	
5.	Transaction no	
6.	Bank details in which payment is made	
7.	Payment is made for	Penalty

39. In terms of rule 6 of the SCRA Adjudication Rules, copies of this order are sent to the Noticee and SEBI.

Date: May 30, 2022
Place: Mumbai

PRASANTA MAHAPATRA
ADJUDICATING OFFICER