BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/MC/RM/2022-23/21420]

UNDER SECTION 19-H (2) OF DEPOSITORIES ACT 1996 READ WITH RULE 5 OF DEPOSITORIES (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005

In respect of –

1. **Central Depository Services Limited (CDSL) (PAN No.: AAACC6233A)** having address at Unit No. A2501, Marathon Futurex, Mafatlal Mills Compound, N.M. Joshi Marg, Lower Parel (East), Mumbai - 400013

In the matter of Karvy Stock Broking Limited

BACKGROUND

1. Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') initiated adjudication proceedings under Section 19G of the Depositories Act, 1996, against Central Depository Services Limited (hereinafter referred as "**Noticee/NSDL**"), for alleged violation of the following:
   a) intent of the SEBI letter dated February 21, 2006 and the provisions of regulation 17 read with regulation 98 of the SEBI (Depositories and Participants) Regulations, 2018, (hereinafter referred to as the D&P Regulations, 2018) read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the SEBI (Depositories and Participants) Regulations, 1996 (hereinafter referred to as the D&P Regulations, 1996) read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.
   b) Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (2016 Circular), and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read with Clause 1 of the Code of Conduct for Depositories, along with regulation 14A of the D&P Regulations, 1996 read with Clause 1 of Code of Conduct for Depositories.

c) Regulation 17 of the D&P Regulations, 2018 read with Clauses 2 and 5 of the Code of Conduct for Depositories.

d) regulation 17 read with regulation 98 of the D&P Regulations, 2018 read with Clauses 2, 5 and 10 of the Code of Conduct for Depositories along with regulation 14A of the D&P Regulations, 1996 read-with Clauses 2, 5 and 10 of Code of Conduct for Depositories.

APPOINTMENT OF ADJUDICATING OFFICER

2. Shri Amit Pradhan was appointed as Adjudicating Officer under Section19H of the Depositories Act read with Rule 3 of the Depositories (Procedure For Holding Inquiry And Imposing Penalties) Rules, 2005 (hereinafter be referred to as the **'Adjudication Rules'**), *vide* Order dated April 19, 2021 to inquire into and adjudge under Section 19G of Depositories Act, the aforesaid alleged violations against the Noticee. Subsequently, vide order dated June 18, 2021, the undersigned was appointed as Adjudicating Officer and the appointment was communicated vide communique dated June 21, 2021.

SHOW CAUSE NOTICE, REPLY AND HEARING

3. Show Cause Notice No. EAD-2/AP/VS/10131/2021 dated May 10, 2021 (hereinafter be referred to as, the "**SCN**") was served upon the Noticees under Rule 4 of the Adjudication Rules read with Section 19H of the Depositories Act to show cause as to why an inquiry should not be held and penalty not be imposed upon the Noticee under Section 19G of the Depositories Act for the aforesaid alleged violations.

4. The allegations levelled against the Noticees in the SCN are summarized as below:

5. SEBI along with National Stock Exchange of India Limited (hereinafter referred to as "NSE") and Bombay Stock Exchange Limited (hereinafter referred to as "BSE") conducted a joint inspection of Karvy Stock Broking Limited (hereinafter referred to as "KSBL") from June 2019. Subsequently, a forensic auditor was appointed by NSE and preliminary report was forwarded by NSE to SEBI on November 2019,

based on which SEBI passed an ex-parte ad-interim order dated November 22, 2019 and a confirmatory order dated November 29, 2019 (‘Orders’) on the non-compliances observed with respect to the pledging/ misuse of client securities by KSBL.

6. During the preliminary examination on the role of Exchanges and CDSL in the matter of KSBL, following findings related to CDSL were observed:
    a) CDSL did not provide information (pledge details with respect to demat accounts of KSBL) when sought by NSE (vide letters dated January 02, 2017 and September 22, 2017), during the course of inspections of KSBL which is contrary to the intent of the SEBI circular dated September 26, 2016 and SEBI letter dated February 21, 2006. It was also observed that CDSL did not approach SEBI for any clarification on the SEBI letter dated February 21, 2006.
    b) CDSL failed to notice that demat accounts were not tagged as per the prescribed nomenclature laid down in para 2.3 to the annexure of the SEBI circular dated September 26, 2016.

7. In order to ascertain the role of CDSL in the matter related to KSBL and compliance by it in respect of applicable regulatory norms, SEBI sought the following information from CDSL:
    a) Reason for not providing the pledge related data of KSBL, when sought by NSE.
    b) Compliance by CDSL with relevant clauses of SEBI circular dated September 26, 2016 on Enhanced supervision of Stock Brokers/ Depository Participants.
    c) Compliance by CDSL with relevant clauses of SEBI circular dated December 17, 2018 on Early Warning Mechanism to prevent diversion of client securities.
    d) Inspection observations and complaints in respect of misuse of clients’ assets by KSBL.

8. CDSL submitted its reply vide emails dated October 23, 2020, January 06, 2021, January 09, 2021, February 02, 2021, February 10, 2021, February 17, 2021, February 18, 2021 and February 25, 2021. Based on the CDSL response, SEBI examined the matter and made certain preliminary findings. The preliminary findings and SEBI's observations based on CDSL response are summarized as under:

9. **<u>Preliminary Finding No. 1:</u>** NSE vide email dated January 02, 2017 sought pledge details with respect to all demat accounts of KSBL from CDSL. CDSL did not respond to NSE. On September 22, 2017, NSE sought details of securities pledged in the client account of KSBL from CDSL. CDSL vide email dated October 30, 2017 refused to provide the information by citing SEBI letter dated February 21, 2006. CDSL did not approach SEBI for any clarification on the SEBI letter dated February 21, 2006.

10. Based on CDSL response, SEBI observed as under:

11. NSE through its email dated January 02, 2017 and September 22, 2017 had sought pledge related information of KSBL/its clients from CDSL. NSE's email dated September 22, 2017 specifically highlighted that the purpose of seeking data is to ensure that client securities with members is safe in light of then observed instances involving misuse of client assets. However, CDSL did not provide the same citing that, as per SEBI letter dated February 21, 2006, CDSL has been advised to share with stock exchanges data pertaining to off-market transfers of beneficial owner account holders only and pertaining to Beneficiary Owners whose holding crosses particular limit with the stock exchanges, and not that related to Trading Member.

12. Para 2 of the said letter, which directs Depositories to share data with Exchange, mentions that Depositories are required to provide the 'requisite information' to the Stock Exchanges as and when sought by them. The direction here does not limit or specifically refer to the information mentioned at Para 1 of the letter. Further, as

per letter, *"…it could be inferred that upon stock exchanges seeking relevant information on a case to case basis for their investigation cases or analysis, the depositories were required to provide the requisite information to BSE and NSE*". As such, both the Depositories were under an obligation to provide the pledge related information of KSBL/its clients to NSE when the same was sought by NSE. However, by not providing the pledge related information to NSE, when specifically sought, CDSL has not complied with letter and intent of SEBI letter dated February 21, 2006.

13. Furthermore, even if the comments of CDSL that, 'SEBI letter dated February 21, 2006 did not mention sharing pledge related details', were to be accepted, it is stated that the said letter did not specifically constrain CDSL to share data beyond the scope of the letter. As such, CDSL could have provided the concerned pledge related information of KSBL/its clients to NSE when the same was sought by NSE towards ensuring safety of client assets. CDSL reliance on the SEBI letter dated February 21, 2006 for not providing the concerned data to NSE is not justified.

14. Further, in case of CDSL having any doubt in respect of sharing pledge related data with Exchanges, on account of data confidentiality clause in its bye-laws or otherwise, it could have proactively sought necessary clarification from SEBI in this regard. However, CDSL have cited that they did not approach SEBI for any clarification as there was no ambiguity about the contents of the SEBI letter dated February 21, 2006.

15. It was also observed that when NSE specifically sought KSBL's pledge details twice from CDSL in the year 2017 and also highlighted the purpose of this exercise is to ensure safety of client assets in NSE's email dated September 22, 2017, if CDSL would have responsibly provided the concerned information to NSE or at least sought clarification/permission in this regard from SEBI, the misuse in client securities by KSBL would have perhaps come to light much earlier, enabling SEBI and/or Exchanges to take appropriate measures to protect investors' interest.

16. However, by neither providing pledge related details of KSBL/its clients to NSE when specifically sought by NSE in the year 2017, nor seeking necessary clarification from SEBI in this regard, prior to denying NSE to provide concerned information of KSBL, CDSL failed to take appropriate measures towards protecting the interests of investors, and also failed to have a proactive and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market.

17. **Therefore, in view of the above, it was alleged that CDSL has violated intent of the SEBI letter dated February 21, 2006 and violate the provisions of regulation 17 read with regulation 98 of the SEBI (Depositories and Participants) Regulations, 2018, (hereinafter referred to as the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the SEBI (Depositories and Participants) Regulations, 1996 (hereinafter referred to as the D&P Regulations, 1996) read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.**

18. **<u>Preliminary Finding No. 2:</u>** CDSL failed to notice that demat accounts were not tagged as per the prescribed nomenclature as laid down in para 2.3 to the annexure of the SEBI circular dated September 26, 2016.

19. Based on CDSL response to the finding, SEBI observed as under:

20. As per Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016, all demat accounts held by the stock brokers were required to be assigned the appropriate nomenclature as the following “Name of Stock Broker- Pool Account / Client Account / Proprietary Account / Collateral Account”, reflecting the purpose of those demat accounts. As per Clause 2.3.1 of Annexure to this circular, Stock Exchanges and/or Depositories are required to ensure that all existing demat accounts of stock brokers are assigned appropriate nomenclature. Further, as per Clause 2(a) of SEBI circular dated June 22, 2017, nomenclature of proprietary

demat accounts was made voluntary and, all those demat accounts which did not meet the nomenclature, as prescribed under Clause 1 of SEBI Circular dated September 26, 2016, would be deemed to be proprietary.

21. In this regard, CDSL merely facilitated change in sub-type/ account category instead of change in nomenclature of the BO account. The nomenclature / name of the BO account holder was left unchanged, even where the concerned demat accounts were tagged by the stock brokers as per Clause 1.2 of Annexure to SEBI circular dated September 26, 2016. The same is reflected in demat account details of KSBL shared by CDSL with Stock Exchanges. Implementation of SEBI directions by CDSL in the manner of change in existing category/type-subtype, in place of change in nomenclature of the account, is thus not in accordance with Clauses 1.1 and 1.2 read with Clause 2.3.1 of Annexure to SEBI circular dated September 26, 2016.

22. Further, as per Clause 2 (a) of SEBI Circular dated June 22, 2017, all those demat accounts which did not meet the nomenclature, as prescribed under Clause 1 of Annexure to SEBI Circular dated September 26, 2016, would be deemed to be proprietary. In this regard, for six KSBL's accounts at CDSL's end that were not tagged as on October 20, 2020, have been tagged as 'deemed proprietary' by CDSL, as also noted when the KSBL related details was shared with NSE via e-mail dated November 01, 2017.

23. **Therefore, it was alleged that CDSL is not in compliance with Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along with regulation 14A of the D&P Regulations, 1996 read with Clauses 1, 2 and 5 of Code of Conduct for Depositories.**

24. **<u>Preliminary Finding No. 3:</u>** In terms of SEBI Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2018/153 dated December 17, 2018, Depositories

are *inter alia* required to put in place an Early Warning Mechanism and sharing of information between Stock Exchanges, Depositories and Clearing Corporations to detect the diversion of clients' securities by the stock broker at an early stage so as to take appropriate preventive measures, as mentioned below:

As per Clause 8 of the circular, *"Based on the analysis of the early warning data, if it is established that the stock broker's financial health has deteriorated and/ or he has made unauthorized transfer of funds / securities of the client, in such cases Stock Exchanges / Depositories shall jointly take preventive actions on the stock broker which may include one or more of, but not limited, to the following:*

8.1 Actions to be initiated by the Stock Exchanges:

…

8.2 Actions to be taken by the Depositories:

a) Restriction on further pledge of client securities from the client's account by freezing the stock broker client account for debit.

b) Imposition of 100% concurrent audit on the depository participant.

c) Cessation / restriction on uses of Power of Attorney (POA) given to stock broker by clients mapped to such brokers only to meet settlement obligation of that client. Clients to issue instructions electronically or through Delivery Instruction Slip (DIS) for delivery of shares for off market transfers.

8.3. Any other measures that Stock Exchanges / Clearing Corporations / Depositories may deem fit."

25. In respect of the above circular, an Standard Operating Procedure (SOP) has been framed by MIIs detailing the sequence of steps to be followed by MIIs based on the type of alert generated and sent to SEBI vide e-mail dated January 16, 2019. In this regard, vide SEBI meeting with MIIs dated January 24 2019, whose minutes were circulated by SEBI vide email dated January 25, 2019 and the SOP was also approved by SEBI.

26. Based on response of CDSL to the finding, SEBI observed as under:

27. Clause 8 of SEBI Circular dated December 17, 2018 stipulates that if it is established that the stock broker's financial health has deteriorated and/or he has made unauthorized transfer of funds / securities of the client, in such cases Stock Exchanges / Depositories shall jointly take preventive actions on the stock broker. Considering that depositories have shared the alerts with the Stock Exchanges and Clearing Corporations it is indicated that they could have acted against KSBL only after the completion of examination by stock exchanges as per SOP. Further, based on SEBI approved SOP, considering alerts sent by Depositories, Stock Exchanges need to carry-out initial examination and send intimation to other MIIs under uniform action mechanism.

28. It is, however, observed that even though various alerts were generated at the depositories end since February 2019, the only action noted to be taken by Depositories is sharing the same with Stock exchanges / Clearing Corporations for further necessary action. CDSL took steps against KSBL only after MIIs meeting held on Nov 9, 2019. Herein, they have only shared the holding/transaction/pledge related information with other exchanges, but have not taken other steps to protect interest of investors, except for restraining Karvy DP from opening new demat accounts w.e.f. November 11, 2019. However, while KSBL was consistently transferring clients' securities in its proprietary demat account and then subsequently pledging them, CDSL merely shared the numerous and serious alerts signaling the same with the Stock Exchanges / Clearing Corporations. It did not take any proactive measures to stop such a misuse of its depository system by KSBL and safeguard the interest of investors in the securities market, and thereby efficiently discharging its regulatory functions. Further, based on the early warning signals/ alerts received at their end, if CDSL had promptly acted upon the alerts, they could have protected assets of several investors.

29. **Therefore, in view of the above, it was alleged that CDSL was not in compliance with regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories.**

30. **<u>Preliminary Finding No. 4:</u>** Based on Information sought from CDSL with respect to inspection observations and complaints in respect of misuse of clients' asset by KSBL as a DP, SEBI observed as under:

31. During the period from May 2015 to June 2019, four regular inspections of KSBL as DP were conducted by CDSL, apart from any special purpose inspection. However, the inspection observations (if any) were rudimentary and limited to KYC/KRA in case of CDSL. Further, during these inspections, CDSL did not find a single instance of mis-utilisation of client securities. This is despite receiving various complaints as well as interim/confirmatory order of KSBL related matter highlighting mis-utilisation of client assets by KSBL through depository system, with KSBL itself being DP of those accounts. This reflects casual approach adopted by CDSL during such inspections and ineffectiveness on their part to identify any instance of malpractice adopted by KSBL in these inspections.

32. Even though CDSL was receiving varied complaints alleging mis-utilisation of securities against KSBL, CDSL merely forwarded the complaints to DPs and other Depository / MIIs. Further, it was accepting the reasons cited by DPs that these transfers were on the basis of DIS signed by client / POA whose copies were sent to concerned client, and in case of erroneous transfer to other demat account, securities have been credited back to clients' account. Despite repetition of complaints of like nature, thorough examination of these complaints was not noted to be carried out by CDSL, highlighting the casual approach in processing alerts of such serious nature.

33. In view of the above it was observed that CDSL adopted casual approach and failed to conduct proper due diligence while processing investor complaints as well as while conducting inspection of KSBL as a DP, and ensuring that conduct of its DP is in a manner that will safeguard the interest of investors and the securities market. If CDSL had effectively conducted inspections of KSBL as a DP and examined complaints received in respect of KSBL as a DP seriously, the issue of misuse of client's securities would have surfaced earlier, thereby enabling SEBI

and/or Exchanges to take timely action towards safeguarding interest of investors. However, failure to take such appropriate measures in respect of KSBL as a DP highlights lack of proactive and responsible attitude towards ensuring that conduct of its DPs is in a manner that safeguards the interests of investors, integrity of the depository system and the securities market.

34. **Therefore, in view of the above, it was alleged that CDSL is not in compliance with regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 2, 5 and 10 of the Code of Conduct for Depositories along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 2, 5 and 10 of Code of Conduct for Depositories.**

35. The aforesaid alleged violations, if established, make the Noticee liable for monetary penalty under Section 19G of the Depositories Act, 1996.

36. In response to SCN dated May 10, 2021 Noticee requested additional time for filing of reply to SCN. Noticee filed reply to SCN vide letter dated July 07, 2021.

37. Opportunity of Hearing before undersigned was provided to the Noticee through video conferencing on December 17, 2021. Upon request of Noticee for rescheduling of the personal hearing, the hearing was rescheduled to January 07, 2022. The Personal hearing on January 07, 2022 was attended by Authorised Representative of the Noticee, viz. Mr. Sharan Jagtiani, Senior Advocate, Mr. Rahul Dwarkadas, Partner, Ms. Silpa Nair Senior Associate, Mr. Rahil Shah, Associate, Mrs. Nayana Ovalekar, Chief Regulatory Officer, Mr. Nilay R. Shah, Group Company Secretary and Head Legal, and Ms. Shilpita Sahoo, Assistant Manager. The Authorised representative of the Noticee reiterated the submissions made by the Noticee in its reply and post hearing submitted SEBI AO order dated July 28, 2021.

38. The submissions made by the Noticee are summarized as below:

39. Noticee submitted that the SCN has made bald and unsubstantiated allegations against CDSL by suggesting that CDSL has not acted pro-actively in the interest of the investors, as required under the Code of Conduct for Depositories, in the matter of KSBL. In making such allegations, the SCN has not taken into account the fact that all the findings of SEBI against KSBL primarily pertain to diversion of client securities by KSBL in its capacity as a stock-broker i.e. a member of the stock exchange, and the SCN has, thereby, erroneously not considered the limited scope of CDSL's functions and obligations as a Depository under the applicable laws and the various Circulars issued by SEBI. The SCN has also relied upon an incorrect interpretation of SEBI's letter dated 21st February 2006 for alleging noncompliance by CDSL thereof. It submitted that, as demonstrated hereinafter, contrary to what has been stated in the SCN, CDSL has strictly complied with all its obligations under the Depositories Act, D&P Regulations, CDSL's Bye-Laws (as approved by SEBI) and the Circulars issued by SEBI from time to time.

40. CDSL highlighted the email dated 23rd June 2020 addressed by NSE to SEBI, wherein SEBI has been specifically informed that based on the inspection conducted in the year 2019, no pledging of securities by KSBL has been carried out through any of its demat accounts held with CDSL.

41. Further, the interim order of SEBI dated 22nd November 2019 and confirmatory order of SEBI dated 29th November 2019 also refer to KSBL's Demat Account with Client ID 11458979 through which client securities were pledged by KSBL. The said demat account of KSBL is held with NSDL and not CDSL. Therefore, the suggestion sought to be made in the SCN that if CDSL had provided the pledge related information to NSE, the misuse of securities by KSBL would have come to light earlier enabling SEBI to protect investors' interests, is baseless and lacks any merit.

42. Confidentiality Obligations of CDSL: Without prejudice to the above, it submitted that in addition to directions/letters/circulars issued by SEBI from time to time,

CDSL is also bound by the terms of its own Bye-Laws which are approved by SEBI. CDSL's Bye-Law No.10.2.2 provides as under:

"10.2.2 CDSL, participants, Issuers, RTAs, Clearing Corporations and Clearing Members may provide or disclose such details, particulars, data or information relating to any Beneficial Owner and/or his account as may be required or directed in writing by any court, tribunal, Central or State Government, SEBI or any other regulatory or revenue authority empowered by law in that behalf or to the concerned Issuer and/or RTA or Clearing Corporation or as may be required for compliance with any obligations in law or for enforcement of any of its rights or for protection of its interest without reference or recourse to the other or to the concerned Beneficial Owner provided however that save and except as aforesaid, none of them shall divulge or permit or suffer to be disclosed any such details, particulars, data or information to any party or person and shall hold such details, particulars, data and information in strict confidence."

43. CDSL is, therefore, mandated to hold information relating to any Beneficial Owner and their demat accounts in strict confidence and is not entitled to disclose the same except in the circumstances enumerated in Bye-Law No. 10.2.2 above, when such information is required or directed in writing by any court, tribunal, Central or Statement Government, SEBI or any other regulatory or revenue authority empowered by law in that behalf.

44. Further, in the event any information is to be so disclosed to any third party (other than any court or regulatory authority), the prior consent of the Beneficial Owner would be required to be taken. If the information is required to be disclosed to any court or regulatory authority, no such consent is required if specific directions to disclose such information have been issued by the court or regulatory authority. In such circumstances, CDSL was not permitted to share confidential pledge related information of KSBL with NSE, being a stock exchange, in the absence of specific directions being passed in that regard by any of the aforesaid authorities enumerated in Bye-law No. 10.2.2.

45. In any event, as a Depository, CDSL is obligated to protect the privacy of the Beneficial Owners and is required to take all reasonable and necessary measures to protect the confidentiality of the information in relation to the Beneficial Owners and their demat accounts.

46. A perusal of the SEBI's Letter dated 21st February 2006 indicates that "data regarding off market transactions above 1,00,000 shares and information on beneficial owners whose holding crosses 5% or beneficial owners who hold more than 5% and have transferred 2% or more" was being furnished by CDSL and NSDL to SEBI on a monthly basis and this information was in turn being forwarded by SEBI to NSE and BSE. It is clear from the aforesaid letter that it was the provision of such specific information which was 'reviewed' in a weekly surveillance meeting held by SEBI, wherein a suggestion appears to have been made by the stock exchanges to SEBI that since such data is required only for investigations, they would 'prefer' to obtain such information on a case-to-case basis for any investigation instead of on a 'monthly' basis. Accordingly, SEBI agreed with the suggestion made by the stock exchanges and also directed that the information be provided directly by the Depositories to the stock exchanges without routing the same through SEBI.

47. Therefore, from a plain reading of the terms of the aforesaid letter dated 21st February 2006, it is evident that the data which is required to be shared by NSDL and/or CDSL directly with NSE and/or BSE is limited to the information specified in the first paragraph of the said letter and as reproduced above. The second paragraph of the said letter cannot be read dehors the contents of the first paragraph. The first paragraph specifically states that a particular issue was 'reviewed' and accordingly, a decision was taken. The said letter cannot be interpreted to state that while the provision of specific information by the Depositories was reviewed at a surveillance meeting, a decision was taken in relation to any information sought by the stock exchanges.

48. Contrary to the clear and unambiguous interpretation of SEBI's Letter dated 21st February 2006, the SCN seeks to rely upon an erroneous interpretation of SEBI's letter by stating that any information requested by stock-exchanges from CDSL ought to have been given by CDSL. Such an interpretation would render the first paragraph of the said letter redundant. In the event SEBI required CDSL to provide any and all information requested by the stock exchanges, SEBI could have issued a general letter stating the same without referring to the specific information in the first paragraph and without any reference to the weekly surveillance meeting held.

49. It is, therefore, incorrect and erroneous to state that any and all data/information required by BSE and/or NSE in addition to the data/information specified in the aforesaid letter was to be furnished by CDSL and/or NSDL without recourse to SEBI, in accordance with the terms of SEBI's Letter dated 21st February 2006. It submitted that SEBI's interpretation that the term "requisite information" in the said letter implies that CDSL and/or NSDL are obligated to provide any and all information required by NSE and/or BSE is entirely at odds with the clear and unambiguous language employed in the said letter and would also go against the very purpose behind issuance of such letter which is clearly enumerated in the first paragraph of such letter.

50. CDSL submitted that SEBI's letter dated 21st February 2006 ought to be given an interpretation as evident from the plain reading of the letter as a whole, i.e. only data in relation to off market transfers and information related to beneficial owner accounts may be freely shared by the Depositories with the stock exchanges. Therefore, any other information to be sought by BSE and/or NSE from CDSL would necessarily be required to be routed through SEBI, as such information would be confidential information which CDSL would not be permitted to disclose under its own Bye-Laws as mentioned hereinbefore. It submitted that had CDSL provided such information to NSE, the same would have resulted in a gross violation of its own Bye-Laws which are also duly approved by SEBI.

51. Consequently, CDSL by its email dated 30th October 2017 addressed to NSE, categorically informed NSE of its inability to provide the pledge related information requested by NSE in view of SEBI's letter dated 21st February 2006. Pertinently, no response was received from NSE in response to such email addressed by CDSL.

52. CDSL submitted that it has consistently complied with its Bye-Laws in relation to sharing of confidential information, subject to any directions issued by SEBI from time to time in relation thereto. In fact, in compliance with SEBI's letter dated 21st February 2006, CDSL has developed an online facility wherein access is provided to stock exchanges through a 'login ID- password' mechanism, to information referred to in the said letter. This was done with a view to facilitate ease of access and timely provision of information for investigation purpose to the stock exchanges. This facility was released by CDSL on 19th August 2016 and has since been utilized by the stock exchanges to obtain urgent information from CDSL within the confines of the information referred to in SEBI's letter dated 21st February 2006. Thus, it has always been the intent of CDSL to help in investigations by stock exchanges by providing timely information provided that the same is permitted to be disclosed by CDSL under the directions issued by SEBI from time to time, read with CDSL's Bye-Laws as approved by SEBI.

53. It submitted that the aforesaid interpretation of SEBI's Letter dated 21st February 2006 has been acknowledged by SEBI in as much as, even post the issuance of the said Letter, if any other type of data is to be shared by Depositories with the stock exchanges, specific directions have been issued by SEBI from to time. For instance, during the surveillance meeting held on 19th July 2019, Depositories were instructed to share with the stock exchanges any information as sought by the stock exchanges with respect to examination of funding to Ultimate Beneficial Owners who are recipients of off-market transfer in Initial Public Offer scrips. The matter of sharing data with stock exchanges was discussed in the surveillance meeting dated 24th October 2019 and Depositories were advised to promptly provide data/details to the exchanges for examination/investigation purposes.

Further, in the surveillance meeting dated 22nd November 2019, it was decided that the Depositories shall identify all stock brokers who may have pledged securities of more than Rs. 50 Crores (other than pledges to Clearing Corporations, to begin with) and share such data with stock exchanges. Thus, whenever specific directions are issued by SEBI, the same have been duly complied with by CDSL from time to time.

54. With reference to SEBI's contention that CDSL did not approach SEBI for any clarification in respect of the directions contained in the letter dated 21st February 2006, it submitted that according to CDSL, the terms of the said letter are unambiguous, as described herein above. Further, considering the fact that even after the issuance of such letter, SEBI has been issuing specific directions from time to time whenever it requires Depositories to disclose any specific information to the stock exchanges, CDSL did not deem it necessary to obtain any clarifications from SEBI in relation thereto. In addition, prior to refusing to provide information to NSE, CDSL had also held discussions with NSDL who shared the same interpretation of SEBI's Letter as CDSL. SEBI was also informed about such discussions between the Depositories vide CDSL's email dated 23rd October 2020.

55. In any event, it was always open to NSE to approach SEBI directly and seek directions to be passed by SEBI to CDSL to provide the requisite information. It is patently unfair on the part of SEBI to foist the responsibility of seeking a clarification from SEBI (in relation to the information required by NSE) on CDSL whereas it is NSE who desired to obtain such information and could very well have routed its request for the same through SEBI. In fact, a perusal of SEBI's preliminary findings dated 21st July 2020 clearly indicate that even SEBI was of the view that NSE ought to have approached SEBI for clarification.

56. CDSL's interpretation of SEBI's letter dated 21st February 2006 has been followed by CDSL since the issuance of the said letter till date however no objection has been raised either by the stock exchanges or by SEBI except through the present

SCN. In view of the express bar contained in CDSL's Bye-Laws coupled with the clear language employed in SEBI's letter dated 21st February, 2006, the contention in the SCN that CDSL has failed to take appropriate measures towards protecting the interest of investors and/or that CDSL failed to have a proactive and responsible attitude towards safeguarding the interests of investors and/or the integrity of the depository system and/or the securities market, are wholly baseless and lack any merit.

57. Assuming whilst denying that the second paragraph of SEBI's Letter dated 21st February 2006 is to be read as a general direction to the Depositories to disclose any and all information to the stock exchanges, as is suggested in the SCN, the same would constitute an ultra vires blanket delegation of SEBI's powers through a mere administrative direction.

58. In light of the aforesaid, CDSL denied that by not providing the information requested by NSE, CDSL has violated the intent of SEBI's Letter dated 21st February 2006 and/or Regulation 17 and Regulation 98 of the D&P Regulations, 2018 and/or Clauses 1, 2 and/or 5 of the Code of Conduct read with Regulation 14A of the D&P Regulations, 1996.

59. In respect of allegation with respect to assigning of nomenclature to demat accounts in terms of SEBI Circular dated 26th September 2016 read with SEBI Circular dated 20th December 2016 on Enhanced Supervision of Stock Brokers/ Depository Participants following was submitted:

60. As per SEBI's circular dated 26th September 2016, certain directions were issued to the stock exchanges and the depositories including inter alia guidelines for uniform nomenclature to be followed by stock brokers for naming/tagging of bank and demat accounts. The relevant clauses of the same are reproduced as under:

"1. SEBI constituted a committee on "Enhanced Supervision of Stock Brokers", which included Stock Exchanges, Depositories and Brokers. With a view to

implement the recommendations, the guidelines as Annexed to this circular are being issued. The guidelines cover the following broad areas:

I. Uniform nomenclature to be followed by stock brokers for Naming/Tagging of Bank and Demat Accounts and the reporting of such accounts to the Stock Exchanges/Depositories.

… ”

“Annexure

1.1. Bank accounts and Demat accounts maintained by all stock brokers shall have appropriate nomenclature to reflect the purpose for which those bank/demat accounts are being maintained.

1.2 The nomenclature for bank accounts and demat accounts to be followed is given as under:

…

1.2.3. Demat account(s) which hold clients' securities shall be named as "Name of Stock Broker- Client Account".

1.2.4. Demat account(s), which hold own securities of the stock broker, shall be named as "Name of Stock Broker-Proprietary Account".

1.2.5. Demat account(s), maintained by the stock broker for depositing securities collateral with the clearing corporation, shall be named as "Name of Stock Broker-Collateral Account".

1.2.6. Demat account(s) held for the purpose of settlement would be named as " Name of Stock Broker - Pool account".

………

2. Reporting of Bank and Demat accounts maintained by Stock Broker:

…………

2.2 The stock brokers shall inform the Stock Exchanges of existing and new demat account(s) in the following format:

2.3 Stock Exchanges and/or Depositories, as the case may be, shall ensure the following:

2.3.1 All existing demat accounts maintained by stock brokers are assigned the appropriate nomenclature as mentioned above, within three months from the date of this circular.

……

2.3.7. Any non-compliance/non-reporting in this regard by the stock broker shall attract penal action as per the provisions of Stock Exchanges.

…”

61. Noticee submitted that SEBI's Circular dated 26th September 2016 was evidently intended to enhance the supervision of stock-brokers and ensure that the stock exchanges (who monitor the operations of stock-brokers) have inter alia adequate visibility over the type of demat accounts of the stock-brokers. Consequently, it mandated stock-brokers to 'name/tag' their demat accounts as prescribed in the said Circular and maintain such uniform nomenclature. Depositories and stock exchanges were required to ensure that the nomenclature change is carried out within the time specified in the said Circular.

62. Subsequently, the said Circular was modified by another Circular issued by SEBI on 22nd June 2017, wherein Clause 1.2.4 was deleted and it was stated that the naming/tagging of proprietary accounts of stock-brokers is voluntary. Further, the said Circular stated that in the event of any demat account of the stock-broker not falling within Clauses 1.2.3, 1.2.5, 1.2.6 would be deemed to be a proprietary demat account of the stock-broker.

63. Tagging introduced by CDSL in compliance with the SEBI Circular: It is submitted that on the day of issuance of the SEBI Circular dated 26th September 2016, CDSL provided for stock-broker' demat accounts to have sub-status codes as Pool Account, Client Margin Account and Client Beneficiary Account.

64. Pursuant thereto, in order to comply with the directions of SEBI under its Circular dated 26th September 2016, with effect from 5th December 2016, CDSL bonafidely introduced some new sub-status codes and modified the then existing sub-status codes, as stated below:

    (i) CDSL introduced sub-status codes for stock-broker's Proprietary and Collateral Accounts;

(ii) Description of sub-status code 'Client Margin Account' was changed to 'Client Account';

(iii) Sub-status code of stock-broker's 'Client Beneficiary' accounts was changed to 'Client Account';

(iv) New account opening with sub-status code 'Client Beneficiary' was discontinued;

(v) For the stock-broker's accounts opened till 3rd December 2016, a one-time modification window was provided to stock-brokers to change sub-status code to either 'Client' or 'Proprietary' or 'Collateral' through their Depository Participants till 25th December 2016 which was further extended till 30th June 2017 (on account of the SEBI circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/138 dated 20th December 2016).

65. A communique dated 22nd November 2016 was issued by CDSL to all its Depository Participants in this regard to ensure that the demat accounts of stock-brokers were tagged as per the nomenclature prescribed in the SEBI Circular dated 26th September 2016. It is pertinent to mention here that the type of demat account has always been identified based on the sub-status codes, for instance, HUF account, corporate account, bank account, broker settlement account, broker account for margin funding, broker account for early pay-in, etc. Thus, even in the instant case, sub-types were introduced for demat accounts, in compliance with the SEBI Circular dated 26th September 2016.

66. Facility made available to stock-exchanges to get information on the type of demat accounts of stock-brokers: Further, the aforesaid SEBI Circular dated 26th September 2016 stated the following:

"Annexure ……. 2.3.8. Based on the list of stock brokers (including PANs) provided by the respective stock exchanges, Depositories shall also provide stock broker-wise details of all the demat accounts opened by a stock broker to the concerned Stock Exchanges to facilitate reconciliation with the data submitted by the stock broker".

67. To comply with the aforesaid direction and to avoid manual intervention, a facility was made available by CDSL to the stock exchanges whereby the stock exchanges through their "Easi" login can upload the PAN and request the details of demat accounts of the stock-brokers maintained with CDSL for the uploaded PANs. This facility could be used by the stock exchanges as and when the same was required.

68. In addition, with effect from 1st July 2017, CDSL started categorizing all the demat accounts opened by stock-brokers as 1) Pool Account 2) Client Account 3) Proprietary Account / Deemed Proprietary and 4) Collateral Account and such categorization was also highlighted to the stock exchanges in the information provided through the "Easi" login facility as described hereinbefore. Further, if the stock exchanges requested for the said data through email in the initial period, the same was provided through email. The Depository Participants of CDSL were also directed to inform their trading member clients regarding the same, through the Communique dated 22nd November 2016.

69. Further, in terms of the Circular dated 26th September 2016, CDSL had shared the information relating to the accounts of the depository participants (including KSBL) with NSE during F.Y. 2017-18 wherein such practice followed by CDSL was clearly highlighted to NSE.

70. The intent of the SEBI Circular dated 26th September 2016 was to enhance supervision of stock-brokers by ensuring that stock-exchanges (which monitor the operations of stock-brokers) are aware of the type of accounts which are held by the stock-brokers. Consequently, with effect from 5th December 2016, CDSL and its depository participants have ensured compliance with the nomenclature requirements and ensured that stock exchanges are provided with such information. The SCN seeks to merely make some technical contentions, that too belated, to suggest that the nomenclature requirements were not complied with by CDSL, without taking into account the fact that the intent and purpose of the said Circular has been fully complied with by CDSL.

71. In light of the above, it submitted that CDSL fully complied with the SEBI Circular dated 26th September 2016 in as much as the requirement of tagging of demat accounts of trading members in accordance with the purpose for which the demat account is being maintained was implemented by CDSL by tagging the demat account through specific sub-status codes. Further, as per the provisions of the SEBI Circular dated 22nd June 2017, it was voluntary to tag proprietary demat accounts of brokers as 'Stock Broker – Proprietary Account" and any demat account of stock-brokers which did not fall under the other type of accounts would be deemed to be proprietary. Consequently, the proprietary demat accounts of KSBL were not tagged and were to be deemed as proprietary. In fact, despite such non-tagging being permitted by SEBI, CDSL ensured that when such accounts were reported to stock exchanges, the same were reported as 'deemed proprietary'.

72. CDSL submitted that it has therefore fully complied with SEBI's Circular dated 26th September 2016 read with SEBI's Circular dated 22nd June 2017 and is consequently, not in violation of Regulation 17 and/or 98 of the D&P Regulations and/or Clauses 1, 2 and/or 5 of the Code of Conduct read with Regulation 14A of the D&P Regulations, 1996.

73. Allegations with respect to early warning mechanism to prevent diversion of client securities: As per SEBI Circular dated 17th December 2018, SEBI decided to put in place an early warning mechanism for stock exchanges, clearing corporations and depositories to detect diversion of client securities by stock-brokers at an early stage and take appropriate measures. It is pertinent to note at the outset that the said Circular was issued to monitor the activities of a stock-broker to ensure that there is no diversion of client securities by them. As a matter of fact, stock-members are members of stock exchanges and are governed by the Bye-Laws of stock exchanges. The role of Depositories under the said Circular was to share the relevant information with the stock exchanges and take limited actions as has been

specified in the said Circular. The relevant clauses of the SEBI Circular dated 17th December 2018 are as under:

"*7. Alerts triggered at one Stock Exchange/ Clearing Corporation/ Depository through early warning mechanism shall be immediately shared with other Stock Exchanges/ Depositories with respect to the stock-broker/ depository participant.*

8. Based on the analysis of the early warning data, if it is established that the stock broker's financial health has deteriorated and/or he has made unauthorized transfer of funds/securities of the client, in such cases, stock Exchanges/Depositories shall jointly take preventive actions on the stock broker which may include one or more of, but not limited to, the following:

…

8.2 Actions to be taken by the Depositories:

a) Restriction on further pledge of client securities from the client's account by freezing the stock broker client account for debit.

b) Imposition of 100% concurrent audit on the depository participant.

c) Cessation/restriction on uses of Power of Attorney (POA) given to stock broker by clients mapped to such brokers only to meet settlement obligation o that client. Clients to issue instructions electronically or through Delivery Instruction Slip (DIS) for delivery of shares for off market transfers.

…."

74. In terms of the said Circular, meetings were held between the stock exchanges, depositories and clearing corporations and a Standard Operating Procedure ("SOP") was formulated which, upon receipt of comments from SEBI, was finalized. The SOP laid down the various thresholds for the generation of early warning alerts as required under the said Circular. The SOP specified the requisite action to be taken by the stock exchanges and the depositories in the event of a breach of such thresholds. Pertinently, the SOP contained the remarks made by Depositories as to the applicability/inapplicability of each of the early warning signals to Depositories.

75. Consequently, under the SOP, it was decided amongst the stock exchanges, clearing corporations and depositories as to the alerts which are required to be generated by each of them and the subsequent actions which needs to be taken pursuant to such alerts. In accordance with the said Circular and the SOP, the Depositories were required to generate alerts and inform the stock exchanges, who were thereafter required to assess such alerts and determine if any subsequent actions were needed to be taken against a stock-broker. In fact, while the said Circular specifies certain actions which were to be taken by Depositories, such actions were to be taken as a part of joint action by stock exchanges and depositories and only pursuant to a determination that a stock-broker's financial health has deteriorated and/or he has made unauthorized transfer of funds/securities of the client.

76. Accordingly, several alerts were provided by CDSL to the stock exchanges in relation to KSBL during the period from time to time and the same has also been acknowledged in the SCN. It is also an admitted position that immediately post the meeting of all MIIs on 9th November 2019, CDSL was sufficiently pro-active to take the following necessary steps in accordance with the said Circular, some of which were even prior to the interim order passed by SEBI on 22nd November 2019:

    (i) KSBL was restrained from opening new demat accounts w.e.f. 11th November 2019;
    (ii) 100% concurrent audit of KSBL was initiated w.e.f. 11th December 2019;
    (iii) Powers of Attorney given by the clients of KSBL were disabled w.e.f. 22nd November 2019; and
    (iv) KSBL's corporate demat account was frozen w.e.f. 27th October 2020 and 8th December 2020.

77. It is a matter of fact that unlike Depositories, stock-exchanges (of which stockbrokers are members) have visibility of all the operations of a stock-broker and would therefore, play a major role in determining if the financial health of a stockbroker has deteriorated or there has been an authorized transfer of securities of a client by a stock-broker. Such determination cannot be done by a depository

on its own. Consequently, the allegations made in the SCN that the Depository should have been proactive in taking action, in addition to generation of alerts, has no substance and lacks any merit. The SCN does not contain any material particulars of the actions which CDSL should have taken and merely seeks to make bare allegations against CDSL in this regard.

78. In light of the above, it submitted that CDSL has taken all steps within its capacity as a Depository towards prevention of diversion of client securities by KSBL as a stock-broker and has fully complied with its obligations under the SEBI Circular dated 17th December 2018 as well as under Regulation 17 of the D&P Regulations, 2018 and/or Clauses 2 and/or 5 of the Code of Conduct read with Regulation 14A of the D&P Regulations, 1996.

79. Allegation with respect to inspection observations and complaints in respect of misuse of client assets by KSBL : The SCN seeks to allege that based on the inspections conducted by CDSL of KSBL as a depository participant during the period from May 2015 to June 2019, CDSL's findings were rudimentary and limited to Know Your Clients ("KYC"). It has been stated in the SCN that CDSL did not find a single instance of mis-utilisation of client securities despite receiving various complaints as well as the interim/confirmatory order of KSBL related matter highlighting the misutilization of client assets by KSBL. It has been accordingly alleged in the SCN that CDSL adopted a casual approach during inspections and has been ineffective in identifying any instance of malpractice adopted by KSBL in any of CDSL's inspections.

80. It submitted that the SCN has merely made bald allegations against CDSL stating that the findings of CDSL inspections were 'rudimentary' and that CDSL adopted a 'casual approach' while processing investor complaints and conducting inspections of KSBL. The SCN has been unable to point out any relevant provision which has not been complied with by CDSL except broadly stating that CDSL has acted in violation of the Code of Conduct for Depositories under the D&P Regulations. No material particulars whatsoever have been relied upon in the SCN

to substantiate such allegations. The SCN has not identified any demat account through which client securities were mis-utilised by KSBL and which was inspected by CDSL without making any observations.

81. Further, the last annual inspection of KSBL was conducted by CDSL in July 2019 for the period till May 2019 at which time neither the interim order of SEBI dated 22nd November 2019 nor the confirmatory order of SEBI dated 29th November 2019 were passed. In addition, from 2016 to May 2019, there were 11 complaints received against KSBL under the caption 'misuse of securities' and in none of such complaints, any error on part of KSBL was found. Therefore, the allegations that CDSL's inspections did not make any observations regarding misuse of client securities despite the interim/confirmatory order of SEBI with respect to KSBL and the complaints received till May 2019, have no merit and are baseless.

82. It is also pertinent to note that as a Depository, CDSL has visibility over the functions of KSBL as a Depository Participant but not as a stock-broker. The functions of KSBL as a stock-broker are monitored only by the concerned stock-exchange of which KSBL (as a stock-broker) is a member. Consequently, the inspections conducted by CDSL are also strictly restricted to the operations of KSBL as a Depository Participant. In this regard, a distinction ought to be drawn between 'unauthorized transfer' and 'unauthorized trading'. 'Unauthorized transfer' pertains to the role of a Depository Participant and thereby comes within the purview of Depositories. On the other hand, 'unauthorized trading' pertains to the role of a stock-broker and falls within the domain of inspection of such stock-broker by the stock-exchanges. For carrying out a transfer of securities, a Depository Participant is merely required to ensure that the DIS has been executed by either the Beneficial Owner himself or a person holding a Power of Attorney on behalf of such Beneficial Owner. Any other concerns with respect to the issuance and exercise of such Power of Attorney need not be looked into by a Depository Participant or a Depository. Such concerns ought to be inspected by stock-exchanges as a part of their inspection of stock-brokers. It is submitted that

accordingly, as demonstrated hereinafter, CDSL has carried out inspection of KSBL and has made the requisite observations in the inspection reports.

83. Methodology for inspection of Depository Participants: CDSL conducts inspections of depository participants on an annual basis. CDSL has an Inspection Manual for the inspection of Depository Participants which lays down various safeguards to ensure that the effectiveness of the inspection. Inspection is conducted with respect to certain material aspects of the functions of a Depository Participant which include but are not limited to the following:

(i) Account opening and KYC documentation - individual, corporate, clearing members etc.

(ii) Change in Beneficial Owner details and Account closures/Account shifting;

(iii) Dematerialization and Rematerialization - Collecting physical certificates from the Beneficial Owners and forwarding it to the Issuers/RTAs after proper processing and follow-up, if required;

(iv) Issuance and Processing of Delivery Instruction - Account transfers (On and off market transfers);

(v) Pledge/Hypothecation;

(vi) Freezing/Unfreezing of Accounts, transmission of Accounts and Powers of Attorney ("POA") provided by Beneficial Owners;

(vii) Fees and Charges for depository services;

(viii) Compliance with SEBI Regulations, CDSL Bye-Laws, Operating Instructions and communiqués;

(ix) Records maintained for recording and redressal of investor grievances/complaints;

(x) Systems, procedures, records keeping, level of client service etc. available/followed by the depository participant; and

(xi) Exceptional events like loss of certificate in transit, auction of securities due to non-execution of instructions, execution of instructions without proper authorization from the Beneficial Owners etc.

84. Pertinently, since inspection is a time bound process, the same is carried out on a sample basis and both the Depositories have decided upon a sampling plan for the same. Various safeguards have been put in place to ensure than the sample chosen is adequately reflective of the functions carried out by the Depository Participant.

85. The aforementioned sampling plan and the methodology for inspection followed by CDSL has been known to SEBI since 9th January 2009 through a letter of even date addressed by CDSL to SEBI. In fact, in its inspection report for F.Y. 2012-13, SEBI has itself acknowledged and explained such method followed by the Depositories for inspection of Depositories.

86. Inspection of KSBL: In the case of KSBL, 1000 DIS were chosen as sample in each year, wherein such samples were inspected by CDSL on each of the aforesaid parameters. Based on the sample chosen for inspection, duly signed DIS were made available by KSBL for verification and it was observed that the transactions were executed on the basis of the DIS which were either signed by the Beneficial Owner himself or the POA holder. Accordingly, inspection reports were prepared by CDSL for each year without any observation on the processing of DIS.

87. It submitted that as demonstrated hereinbefore, neither is it feasible nor is CDSL obligated to carry out an inspection of each transaction carried out by a Depository Participant. The inspection of any Depository Participant by CDSL is limited to the samples chosen for such inspection by the internal auditor of CDSL, which are considered to be reflective of all transactions carried out by the Depository Participant. Accordingly, in full compliance with the relevant laws and rules and regulations, CDSL regularly inspected the samples chosen for KSBL and arrived at findings based on such inspection. Since CDSL did not find any errors or infirmities in the processing of DIS in the 1000 samples chosen every year, no observations were made by CDSL in the inspection reports of such years.

88. Pertinently, for the period from 2016 to 2019, internal auditors of KSBL had also conducted internal audit of KSBL and no observations were made by them against KSBL in relation to unauthorized transfers of securities. It may be noted that the internal audit of Depository Participants is conducted on a half yearly basis by an independent Chartered Accountant or Company Secretaries firm appointed by the Depository Participant.

89. Investor complaints received against KSBL as a Depository Participant: With reference to investor complaints received by CDSL against KSBL, it submitted that during the period from 2016 to 2019, around 200 complaints were received by CDSL from investors against KSBL and the same were duly forwarded by CDSL to KSBL for necessary resolution. Out of the aforesaid, only 25 complaints were received in relation to 'misuse of client securities' by KSBL. In 21 out of the 25 complaints, KSBL informed CDSL that the transactions were carried out based on the DIS received as signed by the Beneficial Owner or its POA holder.

90. Alerts raised by CDSL in relation to investor complaints: Further, with reference to 4 out of the aforesaid 25 cases, it was noted that KSBL provided a common clarification that the Beneficial Owners had issued a POA in favour of their stock brokers and as per instructions from such stock-broker, the securities were debited from the demat account of the Beneficial Owners. CDSL was informed that on receipt of the complaint, KSBL verified the same with the stock-broker and found that the transfer was carried out due to a certain error at the stock-broker's end. Upon noticing such error, the same securities were credited back to the respective demat account of the Beneficial Owners. In light of the said nature of explanation given by KSBL as the Depository Participant of CDSL, the necessary alerts were generated and the stock exchanges were intimated about such complaints for their necessary action in compliance with the SEBI Circular dated 17th December 2018.

91. SEBI's Circular dated 17th December 2018 and the SOP formulated thereafter required the Depositories to generate alerts from time to time and for the stock-exchanges to analyze such alerts to determine if the financial health of the stock-

broker had deteriorated and/or there were unauthorized transfer of funds/securities of the client by such stock-broker. It is only pursuant to such determination that the stock-exchanges and Depositories were to take joint action against such stock-brokers.

92. Pertinently, the SOP formulated pursuant to the said SEBI Circular required Depositories to raise an alert to the stock exchanges and clearing corporation in the event of receipt of more than 10 complaints for unauthorized transactions which are not resolved within 15 days. However, in the best interests of the investors, CDSL volunteered to raise alerts even at the receipt of 5 complaints of unauthorized transactions which are not resolved within 15 days. Despite such thresholds not having been met, CDSL took into account the nature of the explanation given by KSBL as a depository participant, and promptly informed the stock-exchanges about the 4 complaints received against CDSL. Such actions on part of CDSL further demonstrate its prompt actions in the interest of the investors quite contrary to the allegations made in the SCN.

93. On 10th January 2020, a Show Cause Notice was issued by CDSL to KSBL and pursuant thereto, KSBL was terminated as a depository participant on 25th November 2020 by CDSL on account of inter-alia 201 (Two hundred and One) complaints lodged by the beneficial owners/investors against KSBL (either through the SEBI SCORES web platform or through the web portal of CDSL) not being resolved by KSBL. Pertinently, none of the aforesaid 201 complaints pertained to unauthorized transfer of securities.

94. It submitted that as demonstrated hereinabove, CDSL has complied with all its obligations under Regulations 17 and/or 98 of the D&P Regulations, 2018 and/or Clauses 1, 2 and/or 5 of the Code of Conduct read with Regulation 14A of the D&P Regulations, 1996, in this regard. Consequently, CDSL ought not be subjected to any inquiry under Rule 4 of the Adjudication Rules read with Section 19H of the Depositories Act and is not liable to pay any penalty under Section 19G of the Depositories Act.

95. In light of the aforesaid, it submitted that the allegations made in the SCN have been made without considering the limited scope of CDSL's functions and obligations as a Depository under the applicable laws and the various Circulars issued by SEBI, and are therefore unsustainable. The SCN has also failed to appreciate material facts and has misinterpreted CDSL's obligations under directions issued by SEBI.

96. As the inquiry in the matter has been completed, I now proceed to decide the case on the basis of SCN issued, replies made by the Noticees and material available on record.

CONSIDERATION OF ISSUES AND FINDINGS

97. The issues that arise for consideration in the instant matter are:

Issue No. I (a) Whether Noticee violated intent of the SEBI letter dated February 21, 2006 and the provisions of regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

b) Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

c) Regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories.

d) regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 2, 5 and 10 of the Code of Conduct for Depositories along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 2, 5 and 10 of Code of Conduct for Depositories.

Issue No. II If yes, whether the failure, on the part of the Noticees would attract monetary penalty under Section 19G of Depositories Act? And

Issue No. III If yes, what would be the monetary penalty that can be imposed upon the Noticees taking into consideration the factors stipulated in Section 19-I of the Depositories Act read with Rule 5(2) of the Adjudication Rules?

Issue No. I **(a) Whether Noticee violated intent of the SEBI letter dated February 21, 2006 and the provisions of regulation 17 read with regulation 98 of D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.**

98. NSE vide email dated January 02, 2017 sought from Noticee, the details of pledge done by KSBL from all KSBL's DP accounts during January 2016 to December 2016 in order to undertake an internal analysis of KSBL. However, Notice did not respond to the request of NSE.

99. NSE vide its email dated September 22, 2017 informed Noticee about the half year Risk Based Supervision (RBS) assessment for the FY 2016-17 being conducted by it then, for the top 25 members with highest scores. The aforesaid NSE email highlighted that in light of recent instances (then) involving misuse of client assets by members, the details of the securities pledged from the client accounts of the members was required by NSE in order to verify the availability of client securities with the members. KSBL was one of the aforesaid 25 members for whom NSE was carrying out RBS assessment and had sought the details of the securities pledged from its client accounts. In response, Noticee vide email dated October

30, 2017 refused to provide information by citing the dated February 21, 2006 (hereinafter referred as '**SEBI 2006 letter'**)

100. It is alleged in the SCN that if the information regarding pledge was provided by Noticee to NSE, the misuse of client securities by KSBL would have come to light much earlier. It is also alleged that the para 2 of the SEBI 2006 letter did not constrain CDSL to share data beyond scope of letter, and if there was any doubt or confusion in this regard, Noticee could have proactively approached SEBI for clarification of doubts or guidance, however it is noted that Noticee on neither of the occasions, approached SEBI in regard to the NSE requests, and allegedly did not comply with letter and intent of SEBI 2006 letter, and thereby violated provisions of regulation 17 read with regulation 98 of D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

101. In this regard, I note that Para 1 of the SEBI 2006 letter provides the background of the context on which the letter was issued, i.e. the practice followed at that time, wherein information pertaining to off-market transactions required for investigations by exchanges was shared with exchanges by depositories through SEBI, which was reviewed in weekly surveillance meeting held on February 06, 2006 (minutes of meeting is not available on records). Para 2 of the letter refers to the fact that the information provided by depositories through SEBI was a market wide data, not specific to any entity or case, and exchanges would prefer seeking relevant information from the depositories on a case to case basis for their investigation or analysis.

102. From the reading of SEBI 2006 letter, in the context, it is evident that the Noticee was already providing market wide data regarding off market transactions to exchanges through SEBI, it's just that SEBI directed Noticee to directly provide exchanges the off market transaction data with the information for specific beneficial owners when they receive such requests from exchanges for their

investigation and analysis. The reading of the SEBI 2006 letter, does not indicate that its 2nd para gave omnibus approval to exchange for seeking any information for any purpose from depository, and directed Noticee to provide the same. Rather, the letter seems to have accepted the suggestion of exchanges that rather than current practice of sharing 'market wide off market transaction data basis certain parameters' with the exchanges (through SEBI), 'specific off market transaction data' for certain entities as required by exchanges may be provided.

103. The SEBI 2006 letter thus changed the existing practice of sharing the data of off market transactions with exchanges in two ways:

a) In place of market wide off market transaction data (basis certain parameters), specific data for off market transactions of entities required by exchanges on case to case basis may be provided

b) Exchanges to raise requests directly with Noticee, Noticee to share information directly with exchanges.

104. Therefore, I find merit in the contention of the Noticee that Para 2 of the SEBI 2006 letter is in context of data mentioned at Para 1, and is not a blanket provision going beyond scope of the 'relevant information'. I also note that since the 2006 SEBI letter, the information pertaining to off market transactions were provided to exchanges as and when requested by the exchanges without any instance of other information being sought until January 02, 2017. I note that sharing of information pertaining to off market transactions was routine and was taking place since 2006, and it was only in year 2017 that the NSE sought information related to pledge transactions of a trading member from the Noticee. This shows that the information shared earlier as per practice was different from the information sought in NSE emails dated January 2, 2017 and September 22, 2017.

105. Noticee has also submitted that CDSL's bye-law no.10.2.2 mandated Noticee to hold information relating to any Beneficial Owner and their demat accounts in strict confidence and Noticee is not entitled to disclose the same except in the circumstances when such information is required or directed in writing by any

court, tribunal, Central or Statement Government, SEBI or any other regulatory or revenue authority empowered by law in that behalf. Noticee submitted that there was no statutory requirement on Noticee to share the information with the exchanges without any written directions from SEBI or court.

106. I note that Section 18 of the Depositories Act empowers SEBI to call for information from depositories for enquiry and inspection. Chapter IV of the Depositories Act on 'Enquiry and Inspection' gives power to SEBI to "call for information and enquiry". The relevant part of Section 18 under Chapter IV is reproduced below:

18. Power of Board to call for information and enquiry

(1) The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing,—

(a) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require;

(b) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.

107. It is clear from the NSE email dated January 02, 2017 referring to carrying out internal analysis of KSBL that the information was required for the purpose of making an enquiry into the pledging of shares by KSBL during January 2016 to December 2016.

108. Similarly, in the NSE email dated September 22, 2017 referring to client funds and securities placed by the client being available with the member, information was sought of the securities pledged from the client accounts of the top 25 members with highest risk scores as per the half year Risk Based Supervision (RBS) assessment for the FY 2016-17. Thus, information was sought for making enquiry in order to verify the availability of client securities with the members.

109. Therefore, the information sought through the aforementioned two emails was not in the normal course but for the purpose of making enquiry was to shares pledged by KSBL and availability of client securities with the top 25 members with highest risk scores. A perusal of Section 18 of the Depositories Act makes it clear that the power to seek information from depositories for the purpose of enquiry rest with SEBI. The Depositories Act in Section 13 enables sharing of information between the depository and the issuer or its RTA regarding the beneficial owners of the shares issued by the issuer. Information of beneficial shareholding of any person in any company is held by the depository in trust and the Depositories Act does not enable sharing of such information except as authorized under Section 18.

110. In view of the aforementioned authorization to call for information from a depository for the purpose of enquiry given in Section 18 of the Depositories Act to SEBI, I find that the SEBI 2006 letter authorized Noticee to share specified information regarding off market transactions, and cannot be construed as blanket authorization to share any information other than off market transactions. NSE in the aforesaid two emails had sought information on all the accounts of KSBL where shares were pledged and securities pledged from the client accounts (i.e. broker accounts which were tagged as client accounts and holding client securities) of the top 25 members with highest risk scores as per the half year Risk Based Supervision(RBS). This information was outside the scope of authorization in the SEBI 2006 letter.

111. I also take note of Noticee's submission that CDSL's bye-law no.10.2.2 mandated Noticee to hold information relating to any Beneficial Owner and their demat accounts in strict confidence and Noticee was not entitled to disclose the same except in the circumstances when such information is required or directed in writing by any court, tribunal, Central or Statement Government, SEBI or any other regulatory or revenue authority empowered by law in that behalf.

112. The stand taken by depositories (including Noticee) that the directions given by SEBI in past (SEBI 2006 letter) for sharing the information directly with exchanges was not in regard to sharing pledge transactions of members, was clearly communicated to NSE. Noticee has contended that it did not have any doubt regarding the interpretation of the SEBI 2006 letter and since NSE didn't follow up on its pledge detail requests post refusal, it had no reason to approach SEBI for any intervention/clarification.

113. In view of the above, I find that it cannot be held that the intent of the SEBI letter dated February 21, 2006 was violated by the Noticee when it did not respond to the requests made by NSE in its 2 emails dated January 2, 2017 and September 22, 2017.

114. Regulation 17 of D&P Regulations, 2018, read with its regulation 98 mandates depository to abide by the Code of Conduct as specified in the Part D of the schedule. The Clauses 1, 2 and 5 of the aforesaid Code of Conduct for Depositories, is as follows:

1. A depository shall always abide by the provisions of the Act, Depositories Act, 1996, Rules, Regulations, circulars, guidelines and any other directions issued by the Board.

2. A depository shall take appropriate measures towards investor protection and education of investors.

5. A depository shall take a proactive and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market.

115. Similarly, regulation 14A of D&P Regulations, 1996, mandates depository to abide by the Code of Conduct as specified in the Sixth Schedule. The Clauses 1, 2 and 5 of Code of Conduct for Depositories, is as follows:

1. A depository shall always abide by the provisions of the Act, Depositories Act, 1996, Rules, Regulations, circulars, guidelines and any other directions issued by the Board.

2. A depository shall take appropriate measures towards investor protection and education of investors.
5. A depository shall take a proactive and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market.

116. As per code of conduct for depositories, inter alia Noticee shall take appropriate measures towards investor protection shall take a proactive and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market. In view of the same, it was alleged that Noticee did not proactively approached SEBI for clarification on the issue and given the issue involved identification of misuse of client securities and thereby alleged to be in violation of provisions of code of conduct. Further, if SEBI had been alerted immediately on the need for the Depositories data, the default would have come to light much earlier enabling SEBI to take appropriate measures.

117. In this regard, it is pertinent to note that the impugned demat account no. 11458979 from which pledging of client securities was done by KSBL, was held with NSDL, and not with Noticee. Hence, on factual grounds, it cannot be stated that had the Noticee provided the pledge related information to NSE, the misuse of securities by KSBL would have come to light. Further, I note that to proactively help in investigations by stock exchanges, Noticee had provided a 'login ID- password' mechanism for surveillance department of BSE and NSE in August 2016, through which exchanges could have sought required information.

118. Having noted the above, the issue to be decided is whether it was the responsibility of the Noticee to inform SEBI that the request made by NSE was declined by it. It has been established in the preceding paras that the SEBI 2006 letter did not authorize Noticee to provide information beyond the that specified in the letter i.e. information on off-market transactions. It was thus incumbent on the party seeking information, i.e. NSE to raise the issue before SEBI. It is not the case that merely because the Noticee was the repository of data on pledge of shares, it was required

to be aware of potential wrong doing involving pledge of shares. I take note of the contention by the Noticee that as per Depository Act and regulations, the depositories have not been conferred or attributed with the regulatory role in respect of pledge transactions of securities by clients, but are supposed to check only if it is carried in the manner specified.

119. The stock exchanges being front line regulator for stock brokers were responsible for supervision of their members including for confirming compliance relating to client securities maintained by brokers and pledging thereof with extant regulatory provisions and circulars. Hence, if any specific information/data was crucial for the exchanges to verify the compliance of its broker members, any refusal of such information by depositories, put onus on exchanges to follow up with the request for information with depositories and escalate the matter with SEBI.

120. In view of the above, I find that violation of provisions of regulation 17 read with regulation 98 of D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories by Noticee is not established.

(b) Whether Noticee violated provisions of Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (Circular 2016), and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clause 1of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1 of Code of Conduct for Depositories

121. In terms of clause 1.1 and 1.2 of the annexure to the 2016 circular, *inter alia* it is mandated that the demat accounts maintained by all stock brokers shall have appropriate nomenclature (Stock Broker-Client Account, Stock Broker-Proprietary Account, etc.) reflecting the purpose for which the accounts are being maintained. Further, the clause 2.3 of the annexure to the 2016 circular mandates that the

Stock exchanges and/or Depositories as the case maybe, shall *inter alia* ensure that as per clause 2.3.1 all existing demat accounts maintained by stock brokers are assigned proper nomenclature, within three months from the date of the circular (the timelines were revised through subsequent circulars to be effective from April 01, 2017 and again through clarification on June 22, 2017).

122. Further in terms of Clause 2(a) of SEBI circular dated June 22, 2017 naming proprietary demat accounts of the stock broker as 'Stock Broker-Proprietary Account' was made voluntary. Further it was also clarified that demat account which do not fall under the Clauses,1.2.3, 1.2.5 , and 1.2.6 would be deemed to be proprietary.

123. Towards compliance of 2016 circular by Noticee, CDSL's facilitated change in sub-status instead of change in nomenclature of the BO account. Thus is alleged in the SCN to be not in accordance with the 2016 circular.

124. Noticee in its reply has contended that Circular 2016 was intended to enhance the supervision of stock-brokers and ensure that the stock exchanges (who monitor the operations of stock-brokers) have inter alia adequate visibility over the type of demat accounts of the stock-brokers. Consequently, it mandated stock-brokers to 'name/tag' their demat accounts as prescribed in the said Circular and maintain such uniform nomenclature. From September 26, 2016 CDSL provided for stock-broker' demat accounts to have sub-status codes as Pool Account, Client Margin Account and Client Beneficiary Account. To comply with 2016 Circular, from 5th December 2016, CDSL introduced some new sub-status codes and modified the then existing sub-status codes. Further, through 'Easi Login' facility, stock exchanges by uploading PAN of a stock broker could obtain details of demat accounts of the stock brokers maintained with the Noticee, as and when required. As well as with effect from July 01, 2017, Noticee started categorizing all the demat accounts opened by stock-brokers as 1) Pool Account 2) Client Account 3) Proprietary Account / Deemed Proprietary and 4) Collateral Account, and this information was available to stock exchanges through 'Easi Login' facility and

emails. In view of the above, Noticee contended that the requirement of tagging of demat accounts of trading members in accordance with the purpose for which the demat account is being maintained was implemented by CDSL by tagging the demat account through specific sub-status codes. Even for non-tagging being permitted by SEBI for proprietary accounts as per June 2017 circular, CDSL ensured that when such accounts were reported to stock exchanges, the same were reported as 'deemed proprietary'.

125. On perusal of the 2016 circular, I note that it provides guidelines for uniform nomenclature to be followed by stock brokers for naming/tagging of bank and demat accounts and the reporting of such accounts to the Stock Exchanges/Depositories. Clause 1 of the annexure to 2016 circular refers to 'naming/tagging of bank and demat accounts by stock broker', but its sub-clauses in regard to nomenclature only prescribes how a bank/demat account should be named, i.e. in 'Stock Broker- Pool Account', 'Stock Broker- Client Account', 'Stock Broker- Proprietary Account', 'Stock Broker- Pool Account', 'Stock Broker- Collateral Account'. While there is no reference of tagging in the clause 1 of the annexure, clause 2, sub clause 2.2 in the format specified for stock brokers for informing Stock Exchanges of existing and new demat account(s), 6th column heading refers 'Sub-type/tag of Demat Account (Proprietary/ Client/ Pool/ Collateral)'. The circular thus inter-changeably uses the terms nomenclature, naming, tagging and sub-type to refer to how the demat accounts are to be named and tagged.

126. Further, clause 2.3 of the 2016 circular mandates that the Stock Exchanges and/or Depositories, as the case may be shall ensure that the nomenclature guidelines are adhered by the stock brokers within the timelines specified. Clause 2.3.1 states that "*All existing demat accounts maintained by stock brokers are assigned the appropriate nomenclature as mentioned above, within three months from the date of this circular.* The 3 month deadline was subsequently extended as mentioned in preceding paras. Clause 2.3.4 stated that "*All new bank and demat accounts opened by the stock brokers shall be named as per the above given nomenclature*

and the details shall be communicated to the Stock Exchanges within one week of the opening of the account." The circular thus refers to 'assigning of nomenclature' for old accounts and 'named as per give nomenclature' for new accounts. This seems to indicate possible difference in method of assigning nomenclature to existing accounts vis-a-vis naming of new accounts.

127. In this regard, I note that Noticee put in place a facility to appropriately tag demat accounts opened by stock brokers using separate sub-status. Further the point 3 of CDSL communique dated November 22, 2016 provides as follows:

*"………………It may please be noted that as the appropriate nomenclature as mentioned in the abovementioned SEBI circular can be tagged with the help of separate sub-status, **DPs are not required to do any change in name of the demat account** to give effect to the aforementioned SEBI circular…………..."*

128. From the above, it is evident that Noticee clearly stated in its circular that it was implementing the SEBI guidelines on nomenclature by tagging demat accounts through sub-status codes, reflecting the purpose of the demat accounts, and not changing the name of the account itself.

129. Point 3 of CDSL communique dated November 22, 2016, clearly illustrated the interpretation of the SEBI 2016 circular adopted by the Noticee. This communique was issued to all its DPs of CDSL and was available in the public domain and was in knowledge of SEBI. There is nothing on records to indicate that SEBI contradicted the implementation or interpretation of SEBI 2016 circular by Noticee or made any observations on the method adopted to assign the required nomenclature by to Noticee. Further, I note that the tagging of accounts by Noticee in sub-status categories served the purpose of the identification of the accounts as per specified nomenclature in order to achieve the intent of the 2016 circular. In view of the above, I find that Noticee did not dilute the compliance of SEBI 2016 circular.

130. Further, I note that Noticee provided details of broker demat accounts with their sub-status under the 2016 circular to exchanges, and all the untagged accounts, which as the June 2017 Circular were deemed to be proprietary account, were specifically tagged as 'deemed proprietary'.

131. In view of the above, <u>violation of provisions Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (Circular 2016), and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clause 1of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1 of Code of Conduct for Depositories by Noticee is not established.</u>

(c) Whether Noticee violated provisions of Regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories.

132. It is alleged in the SCN that despite various alerts generated pursuant to Early Warning Mechanism (EWM), by CDSL post implementation of SEBI circular dated Dec 17, 2018 (December Circular) and receipt of investor complaints, Noticee did not take proactive steps to prevent misuse of depository system by KSBL, in violation of Regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories.

133. In response, Noticee has contended that in accordance with the SEBI Circular dated 17th December 2018 and the SOP formulated in terms of said circular, the Noticee generated alerts and informed the stock exchanges. I note that the SOP was formulated pursuant to meeting held on January 24, 2019 which was duly approved by SEBI on January 24, 2019. The SOP clearly defined the trigger (parameter) of each early warning alert as set out in the December Circular.

134. The December Circular required the Noticee to share alerts with stock exchange as specified in clause 3.2 of the Circular. I note that Noticee provided alerts to

exchanges on monthly basis from February 2019 onwards, and it is not the case that Noticee failed to provide such alerts. Stock exchanges were required to analyze alerts to determine if these indicated unauthorized transfers and share the same with other stock exchanges and depositories and take joint preventive action as per para 8 of the December circular. Further, as per SOP, stock exchanges were mandated to analyze and assess whether the trading members are in default and if yes, issue disablement notice. It is only thereafter that depositories could initiate action as per para 4.16 to 4.20 of SOP. I note that it is not the case that exchanges shared their analysis and suggested joint preventive action which the Noticee failed to take or that the Noticee failed to follow comply with the SOP.

135. Noticee has stated that several alerts were provided by CDSL to the stock exchanges in relation to KSBL during the period from time to time and the same has also been acknowledged in the SCN. It also stated that from 2016 to 2019, there were 25 complaints received against KSBL-DP alleging ‘misuse of securities’. I note that CDSL dealt with these complaints by seeking response of KSBL-DP. I take note of these factual submissions of the Noticee. Based on the submissions of the Noticee, I find that no case is made out that Noticee did not act on the alerts generated as was required of it under the SOP issued pursuant to the December circular. I find it relevant to note that the misuse of client securities by KSBL took place through an account held in NSDL and hence, it was not even possible for any of the alerts to throw up any signals from the accounts with CDSL relating to misuse of securities by KSBL.

136. In view of the above, I find that the material on records does not establish that Noticee is in violation of regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories.

(d) Whether Noticee violated provisions of Regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 2, 5 and 10 of the Code of Conduct for Depositories along-with regulation 14A of the

D&P Regulations, 1996 read-with Clauses 2, 5 and 10 of Code of Conduct for Depositories.

137. It is alleged in the SCN that Noticee adopted casual approach while conducting the inspection of KSBL DP and examining complaints of investors, and could not observe the misutilization of client assets by KSBL. Noticee merely forwarded the complaints to DP and accepted reasons like POA/DIS signed by authorized person/erroneous transfers/ shares returned in respect of unauthorized transfers, and did not notice the misutilisation and did not conduct thorough examination.

138. In response, Noticee has stated that SCN has not pointed out, any relevant provision which has not been complied with by Noticee on inspections, any evidence to substantiate allegations, or identified any demat account through which client securities were mis-utilised by KSBL and which was inspected by CDSL without making any observations. Noticee has submitted that in the case of KSBL, 1000 DIS were chosen as sample in each year, wherein such samples were inspected by CDSL on each of the aforesaid parameters. Based on the sample chosen for inspection, duly signed DIS were made available by KSBL for verification and it was observed that the transactions were executed on the basis of the DIS which were either signed by the Beneficial Owner himself or the POA holder. Accordingly, inspection reports were prepared by CDSL for each year without any observation on the processing of DIS.

139. Noticee also submitted that the regulatory role of Noticee while inspecting the KSBL-DP was limited to inspect ‘unauthorized transfer’ not ‘unauthorised trading’, The inspections by Noticee is carried out on sampling basis and the methodology used is known to SEBI. During inspections, it was noted that for all the sample chosen for each inspection, duly signed DIS were made available by KSBL for verification and it was observed that the transactions were executed on the basis of the DIS which were either signed by the Beneficial Owner himself or the POA holder. Further, in respect of complaints, where the transfers were on account of

error at KSBL stock broker end, alerts were generated and stock exchanges were intimated.

140. Noticee also stated that during the period from 2016 to 2019, around 200 complaints were received by CDSL from investors against KSBL and the same were duly forwarded by CDSL to KSBL for necessary resolution. Out of the aforesaid, only 25 complaints were received in relation to 'misuse of client securities' by KSBL. In 21 out of the 25 complaints, KSBL informed CDSL that the transactions were carried out based on the DIS received as signed by the Beneficial Owner or its POA holder.

141. With reference to 4 out of the aforesaid 25 cases, it was noted that KSBL provided a common clarification that the Beneficial Owners had issued a POA in favour of their stock brokers and as per instructions from such stock-broker, the securities were debited from the demat account of the Beneficial Owners. CDSL was informed that on receipt of the complaint, KSBL verified the same with the stock-broker and found that the transfer was carried out due to a certain error at the stock-broker's end. Upon noticing such error, the same securities were credited back to the respective demat account of the Beneficial Owners. In light of the said nature of explanation given by KSBL as the Depository Participant of CDSL, the necessary alerts were generated and the stock exchanges were intimated about such complaints for their necessary action in compliance with the SEBI Circular dated 17th December 2018.

142. Clause 2, 5 and 10 of Code of Conduct for Depositories state as follows:

> *2. A depository shall take appropriate measures towards investor protection and education of investors.*
>
> *5. A depository shall take a proactive and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market.*
>
> *10. A depository shall monitor the compliance of the rules and regulations by the participants and shall further ensure that their*

conduct is in a manner that will safeguard the interest of investors and the securities market.

143. It is evident from Clause 10 that the monitoring of compliance by the depository is with reference to the depository participant and not the stock broker. The act of misuse of client securities was carried out by KSBL stock broker, by transferring client securities held in its KSBL demat account no. 12691085 (categorized as Stock Broker-Client account) to KSBL proprietary account no. 11458979, from where it pledged the securities. These actions were performed by the stock broker who was under the regulatory purview of stock exchanges.

144. Clause 2 and 5 are general in nature relating to investor protection and proactive attitude for safeguarding the interest of investors. In this context, I take note of the actions taken by the Noticee as enumerated in previous paras. On inspection carried out by Noticee, the allegation is that Noticee did not find a single instance of misutilisation of client securities. In this regard, I note that as stated above, misutilisation of client securities by a stock broker was under the purview of exchanges and not depositories. It is not the case that securities were misutilised by the DP, or that the DP was complicit with the stock broker for unauthorized transfer of securities. I find that material on record does not bring out what the Noticee was reasonably expected to do but failed to do as part of its inspections. Therefore, it cannot be held that Noticee adopted casual approach while conducting the inspection of KSBL DP.

145. With regard to handling of complaints by depositories, I note that as mentioned above, complaints were received in respect of KSBL –DP and Noticee took reasonable steps to address the complaints received. In view of the above, there is insufficient evidence to establish that Noticee handled investors’ complaints against KSBL in casual manner.

146. In view of the above, I find that the material on record is insufficient to establish that Noticee is in violation of <u>Regulation 17 read with regulation 98 of the D&P</u>

Regulations, 2018 read-with Clauses 2, 5 and 10 of the Code of Conduct for Depositories along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 2, 5 and 10 of Code of Conduct for Depositories.

147. As the violations alleged against the Noticee are not established, issues II and III do not merit consideration.

ORDER

148. In view of the findings noted in the preceding paragraphs, the adjudication proceedings initiated against the Noticee i.e. Central Depository Limited vide SCN dated May 10, 2021 are disposed of.

149. Copy of this Adjudication Order is being sent to the Noticee and also to SEBI in terms of Rule 6 of the Adjudication Rules.

DATE: November 25, 2022
PLACE: MUMBAI

MANINDER CHEEMA
ADJUDICATING OFFICER