

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTION 12(3) OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATION 27 OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008

In respect of:

S. No.	Name of the Noticee	Registration no.
1.	IIFL Securities Limited (earlier known as India Infoline Limited)	INZ000164132

Background in brief

1. India Infoline Limited (hereinafter referred to as “IIFL”/“**Company**”/“**Noticee**”) is registered with Securities and Exchange Board of India (hereinafter referred to as “**SEBI**”) as a stock broker with registration number INZ000164132. IIFL is also a member of the stock exchanges viz. the BSE Limited (hereinafter referred to as “**BSE**”), National Stock Exchange of India Ltd. (hereinafter referred to as “**NSE**”), Multi Commodity Exchange of India Limited (hereinafter referred to as “**MCX-SX**”) and United Stock Exchange of India. Further, it is also registered with SEBI as a depository participant (in short ‘**DP**’) and is working as a DP of National Depository Services Limited (hereinafter referred to as “**NSDL**”) and Central Depository Services (India) Ltd. (hereinafter referred to as “**CDSL**”). Along with these, IIFL is also registered with SEBI as a research analyst, an investment advisor, a mutual fund and as a portfolio management service provider.

2. SEBI had conducted a thematic inspection of the books of accounts of IIFL during the period of January 30 to February 03, 2014 (hereinafter referred to as '**Thematic Inspection**') wherein the records and the processes of IIFL during the period of April 01, 2011 to December 31, 2013 were inspected. The purpose of the said inspection was to examine as to whether IIFL was working in compliance with the provisions of the SEBI Circular ref. SMD/SED/CIR/93/23321 dated November 18, 1993 (hereinafter referred to as the "**SEBI 1993 Circular**") as well as SEBI circular ref. MRD/DoP/SE/Cir-11/2008 dated April 17, 2008 as far as segregation of funds and securities of clients are concerned. In the said inspection conducted at the Corporate Office of IIFL viz. B Wing, Trade Centre, Kamala Mills Compound, off Senapati Bapat Marg, Lower Parel, Mumbai, it was noticed that the actions of IIFL were not in compliance with the provisions of the aforementioned SEBI 1993 circular read with clauses A(1), A(2) and A(5) of the code of conduct for stock brokers as stipulated in Schedule II of the Securities and Exchange Board of India (Stock Broker) Regulations, 1992 (hereinafter referred to as "**Broker Regulations**") as the records of IIFL were found to be lacking in the following aspects:
- 2.1. Failure to segregate its own funds from clients' funds;
 - 2.2. Misuse of credit balances in clients' funds for the benefit of clients having debit balance; and
 - 2.3. Inappropriate designation of the client bank accounts.
3. Based on the outcome of the above limited inspection, it was decided to have a comprehensive inspection of books of accounts of IIFL and the same was conducted on a series of dates including August 7, 12-13, 21-22, 26, 27 and September 19, 2014 (hereinafter referred to as '**Comprehensive Inspection**') simultaneously at 4 different offices of IIFL including at its aforementioned corporate office, two branch offices and office of a sub-broker of IIFL. The said

comprehensive inspection was conducted in order to examine if IIFL was maintaining its books of accounts and other records in the manner required to be maintained under the Broker Regulations and whether the said maintaining of records were in compliance with the provisions of securities laws, regulations, rules, circulars, bye-laws and directions issued by SEBI and the stock exchanges from time to time. The findings of this comprehensive inspection were supplemented by three (3) supplementary inspections, covering the aforesaid total period covered under *Thematic Inspection* and *Comprehensive Inspection* viz. April 01, 2011 to June 30, 2014, and additionally one more inspection was also done covering a period from April 01, 2015 to January 31, 2017, as per the details given below:

#	Type and date of inspection	Period of inspection	Place inspected (if any)	Purpose of inspection
1.	Supplementary Inspection I	April 01, 2011 to June 30, 2014	Data was requisitioned through emails.	Examination of sample top 20 days with highest pay-in obligation of the <i>Company</i> on proprietary account along with clients' obligation to the stock exchange. (hereinafter referred to as " Supplementary Inspection I ")
2.	Supplementary Inspection II	April 01, 2011 to June 30, 2014	Data was requisitioned through emails.	Examination of sample top 105 days with highest pay-in obligations of the <i>Company</i> on proprietary account and clients' obligation to the stock exchange. (hereinafter referred to as " Supplementary Inspection II ")

#	Type and date of inspection	Period of inspection	Place inspected (if any)	Purpose of inspection
3.	Supplementary Inspection III	April 01, 2011 to June 30, 2014 (except the days which were inspected during Supplementary Inspection I and II)	Data was requisitioned through emails.	Examination was carried out to calculate the wrongful gains made by IIFL during the entire period of inspection except the days already inspected at the time of Supplementary Inspections I and II. (hereinafter referred to as “ Supplementary Inspection III ”)
4.	Inspection (Dates of inspection: March 27, 30 and 31, 2017)	April 01, 2015 to January 31, 2017	Data was requisitioned through emails.	Examination was carried out to verify whether IIFL has complied with the regulations and circulars issued in respect of segregation of funds and securities of clients. (hereinafter referred to as “ March 2017 Inspection ”)

4. In light of the findings and violations of provisions of law observed during the course of these six inspections, two separate enquiry proceedings were initiated against the *Notinee* in terms of provisions of Securities and Exchange Board of India (Intermediaries) Regulations, 2008 (hereinafter referred to as ‘**Intermediaries Regulations**’). While the violations alleged on the basis of Thematic Inspection, Comprehensive Inspection and Supplementary Inspections I and II were covered under the first Enquiry Proceedings (hereinafter referred to as ‘**Enquiry Proceeding I**’), the violation alleged on the basis of Supplementary Inspection III and March 2017 Inspection were dealt with in second Enquiry Proceedings (hereinafter referred to as ‘**Enquiry Proceeding**

II'). In accordance with the provisions of Intermediaries Regulations, two separate Show Cause Notices (in short 'SCNs') dated May 02, 2017 and October 28, 2021 were issued by the Designated Authority (in short 'DA') to the *Noticee* with respect to *Enquiry Proceeding I* and *Enquiry Proceeding II* respectively. In the meanwhile, the *Noticee* had filed separate settlement applications under the available mechanism, expressing its willingness to settle the findings covered and allegations made under *Enquiry Proceeding I* and *Enquiry Proceeding 2* respectively. The said Settlement Applications were, however, rejected by SEBI and such decision of rejection of the aforementioned settlement applications was communicated to the *Noticee* vide email dated August 23, 2021.

5. Subsequently, both the Enquiry Proceedings were resumed for further proceedings. It is noticed that in response to the SCNs dated May 02, 2017 (*Enquiry Proceeding I*) and October 28, 2021 (*Enquiry Proceeding II*), the *Noticee* had submitted its replies vide letters dated December 22, 2017 (refuting the allegations made in SCN dated May 02, 2017) and on January 29, 2022 (refuting the allegations made in SCN dated October 28, 2021). Thereafter, a personal hearing was granted to the *Noticee* on March 14, 2022 and, during the said personal hearing, the *Noticee* sought some time to make his post hearing submissions, which was duly granted by the DA. Subsequently, a common post hearing letter dated March 30, 2022 was submitted by the *Noticee*, dealing with the allegations made in both the SCNs viz. the SCNs dated May 02, 2017 and October 28, 2021.
6. Taking in account all the findings mentioned in the inspection reports, observations of SEBI, allegations mentioned in the two SCNs dated May 02, 2017 and October 28, 2021 and the various submissions of the *Noticee*, two separate enquiry reports dated April 29, 2022 and May 27, 2022 were submitted by the DA in terms of provisions of Regulation 26 of Intermediaries Regulations with respect to the *Enquiry Proceedings I* and *Enquiry Proceedings II* respectively. In both

these enquiry reports, having considered the oral as well as written submissions advanced by and on behalf of the *Noticee*, the DA has recommended to cancel the certificate of registration of the *Noticee*.

7. Pursuant to the submissions of the reports by the DA recommending cancellation of certificate of registration of the *Noticee*, two separate post-enquiry SCNs were issued to the *Noticee* on July 18, 2022 (dealing with the violations dealt with in *Enquiry Proceedings I*) and on July 04, 2022 (dealing with the violations dealt with in *Enquiry Proceedings II*), in terms of provisions of Regulation 27(1) of the Intermediaries Regulations.
8. The allegations levelled against the *Noticee* in the aforementioned two SCNs dated July 18 and July 04, 2022 as well as in the enquiry reports dated April 29, 2022 and May 27, 2022 are the following;
 - 8.1. It was noticed that, out of the 45 client bank accounts examined during inspections, 26 client bank accounts were not titled as “client account”. This was despite the fact that BSE had issued a warning to the *Noticee* with respect to the aforesaid issue. While the *Noticee* had submitted evidence of renaming of certain accounts as “client account”, the Enquiry Report I found out that there was one account with Citi Bank, which the *Noticee* has claimed to have been closed, but no evidence showing closure of the said account has been submitted by the *Noticee*. Similarly, the *Noticee* didn’t make any submissions regarding its account with South Indian Bank. In view of this, it has been alleged that the *Noticee* has violated provisions of the SEBI 1993 Circular by failing to designate bank accounts used for client transactions as client accounts.
 - 8.2. It was seen that funds were regularly being transferred from client bank accounts and clients’ dividend accounts to the Pool/Control Accounts of IIFL, which were managed and controlled by IIFL as its own bank account.

At the same time, funds were transferred from *Noticee's* own bank accounts to the same control accounts, where clients' funds were also being collected, and then to the settlement account of the stock exchange/clearing house. In light of this, it has been alleged that the *Noticee* has violated the provisions of the SEBI 1993 Circular by failing to segregate client funds, mixing its own funds with client funds by transferring its own funds and client funds to common pool accounts which are owned by the *Noticee*, and then to common control account which was the actual pool account for purpose of settlement of trades.

8.3. Further, the inspection team also observed that funds lying in these Pool/Control Accounts were *inter alia* being used by IIFL for its own purposes including for the following types of transactions:

- 8.3.1. Investments in and redemptions of mutual funds units, investment in bonds, metal trusts and IIFL income opportunities fund.
- 8.3.2. Transfers to and from IIFL Commodities.
- 8.3.3. Transfers to and from for insurance.
- 8.3.4. Transfers to and from IIFL Wealth Management Ltd.
- 8.3.5. Transfers to and from IIFL Realty Ltd.
- 8.3.6. Transfers to and from foreign remittance expenses.
- 8.3.7. Transactions pertaining to fixed deposits, inter-corporate deposits, overdraft, bank charges (for XT-border wire FT) and transactions with other group companies of IIFL, etc.
- 8.3.8. Transfers to and from bank accounts categorized by IIFL as expenses and salary account;

In light of this, it was alleged that IIFL has violated provisions of the SEBI 1993 Circular by mixing clients' funds with its own funds in Pool/Control Account and by using those mixed funds for its own purposes.

8.4. It was also observed that in certain instances, funds pay out from the stock exchange towards client trades were not transferred to the designated “client bank account”. Further, ‘G’ value¹ of trades on a number of days had come out negative. Therefore, it is alleged that the funds of credit balance clients of IIFL were being utilized for settlement obligations of debit balance clients.

8.5. Similar to the above, it was also observed during inspection that the funds transferred from own account of IIFL to the settlement account were less than the proprietary trade obligation of the *Noticee*. When calculation was made keeping in mind the funds of IIFL and its collateral available with the Exchanges, it was alleged that IIFL had misutilized the credit clients’ funds for the settlement obligation of its proprietary trades.

8.6. Therefore, in summary, it is alleged that IIFL had violated the provisions of the SEBI 1993 Circular by the following acts:

- (i) By mixing clients’ funds with proprietary funds by routing transactions through common control accounts; and
- (ii) By utilizing funds of credit balance clients for settlement obligation of debit balance clients; and
- (iii) By utilizing funds of credit balance clients for settlement obligation of proprietary trades; and

9. In view of the aforesaid allegations that have been brought in the two enquiry reports and corresponding SCNs, the *Noticee* was called upon to show cause as to why suitable directions should not be issued against it in terms of recommendation given by DA or any other direction that is deemed fit in the facts and circumstances of the matter.

¹ G value is basically the comparative calculation of liabilities of a stock broker towards its clients who are having credit balance in the records of the stock broker and the funds available with the stock broker at the end of a day. G value being negative means that the funds available with the stock broker are lesser than its liabilities towards its credit balance clients. The same has been elaborately discussed in later paragraphs of the Order.

10. Both the post enquiry SCNs dated July 18, 2022 and July 04, 2022 were delivered to the *Noticee* at its email address. In response to that, the *Noticee* has submitted a common reply dated October 31, 2022. Thereafter, as the recommendation made by DA was for cancellation of registration of the *Noticee* in both the enquiry reports, a common personal hearing was granted to the *Noticee* in respect to both the aforementioned post-enquiry SCNs, in terms of provisions of Regulation 27(4) of Intermediaries Regulations. The said hearing was scheduled on January 10, 2023, which was duly attended by the Authorized Representatives of the *Noticee*. During the personal hearing, the *Noticee* has reiterated the submissions made through its reply dated October 31, 2022 and further sought time to make post-hearing submissions which was duly granted. Subsequently, the *Noticee* made its post hearing submissions vide letter dated January 12, 2023.
11. The submissions of the *Noticee* before me, by way of two separate letters dated October 31, 2022 and January 12, 2023, that are relevant for the purpose of instant proceedings, are captured in brief hereunder:
- 11.1. At the start, the *Noticee* has brought to my attention that two separate adjudication orders have been passed by SEBI against it for the same alleged violations as mentioned in the two enquiry reports and the Adjudicating Officer has imposed a penalty of INR 1 Crore in each of these adjudication orders. Against these Orders, the *Noticee* has preferred Appeals before Securities Appellate Tribunal (in short '**SAT**'). The said Appeals have been admitted by the Hon'ble SAT and interim stay has been granted against the two aforesaid adjudication Orders. The *Noticee* has submitted that the subject matter of the present Enquiry Reports is identical to the matters pending before the Hon'ble SAT.
- 11.2. Subsequent to the aforementioned information, the *Noticee* has made a preliminary submission that the very basis of the allegation of misuse of

clients' funds in both the Enquiry Reports is a retrospective application of a method, which was introduced by SEBI for the first time in September 2016. Using the said methodology and prescription, it has been wrongly alleged that there has been misuse of clients' funds during 2011-2017, a period when the said Circular dated September 26, 2016 had not even come into force.

11.3. Coming back to the merits of the matter, the *Noticee* has submitted that, on November 18, 1993, SEBI issued a circular (SEBI/SED/CIR/93/23321) prescribing maintenance of separate client accounts and also prescribing in detail as to in what cases funds/securities can be deposited/withdrawn from client accounts etc. Subsequent to this, the *Noticee* has been subjected to over 100 inspections by BSE, NSE and SEBI over last 18 years (i.e. from the time of its incorporation till 2017) of its carrying the business of a stock broker and no fault has been found by any agency pointing out mistakes, if any, in the manner of calculation of the clients' funds by the *Noticee* or the process being followed by the *Noticee* while transferring clients' funds to the Exchanges/clearing corporations or *vice-versa*.

11.4. Moving on to the alleged violations one by one, the *Noticee* has started its submission by first refuting the allegation that two of its Bank accounts of Citi Bank and South Indian Bank, which were "client accounts", did not contain the words "client" in the title of these accounts. In this regard, the *Noticee* has made its submissions regarding these two bank accounts in following terms:

11.4.1. The Citi Bank Account could not be relabeled as Client Bank Account due to operational issues posed by Citi Bank. Therefore, the *Noticee* has closed the account. In support of this, the *Noticee* has submitted a copy of the letter/email evidencing the closure of the said bank Account.

11.4.2. Insofar as the account with South Indian Bank is concerned, the *Noticee* has submitted that the nomenclature in the said account was indeed changed to Client Account. Subsequently, the said account was also closed on January 07, 2021. In support of this, the *Noticee* has submitted a copy of the letter/email evidencing the closure of the said bank Account.

11.5. Keeping these facts and evidences on record, the *Noticee* has submitted that the allegation is a technical and venial one and does not warrant any punitive intervention of nature like the one recommended by the DA. Summarizing the whole issue, the *Noticee* has submitted that, out of the 45 client accounts flagged by SEBI during inspection, 42 accounts were already designated by it as the Client accounts before submission of *Enquiry Report I* by the DA and for rest of three client accounts, in one account, the nomenclature was indeed changed, in another account, the bank posed issues and in the third instance, it is an acknowledged position that it was solely used as a client account in full compliance with the 1993 Circular. Therefore, there was no intention on the part of the *Noticee* not to label the clients' accounts appropriately. The account number of these three accounts were reported to the stock exchanges as client accounts and there has never been a single allegation of any unauthorized use of funds from these accounts.

11.6. With respect to the allegation of pooling of clients' and its own funds in pool/control accounts with Citi Bank, Axis Bank, ICICI Bank and HDFC Bank, the *Noticee* has firstly contended that the pool accounts were not 'clients' accounts'. Secondly, the moneys transferred from clients' accounts to pool accounts were for transfer to settlement account and therefore was "money properly required for payment to or on behalf of clients", which

was permissible under SEBI 1993 Circular, and no fault can be found with the transfer of said money from clients' accounts to pool accounts.

- 11.7. The *Noticee* has further submitted that Clauses 1(C) and 1(D) of SEBI 1993 Circular deal with credits to and debits from "client account" only. Therefore, the restrictions mentioned in SEBI 1993 Circular apply only to "client accounts" and there is nothing in the said Circular, which prohibits a Stock Broker from keeping a middle layer of pool account before transferring the monies to settlement account and the same is a factor of internal control and procedure of the *Noticee*.
- 11.8. Notwithstanding these submissions, the *Noticee* has intimated that, with effect from April 2014, it had shifted its proprietary trading under separate membership namely 5paisa Capital Limited (formerly IIFL Capital Limited). Therefore, from April 2014 onwards, the *Noticee* was neither undertaking proprietary trading nor were there any instances of usage of clients' funds for settlement obligations towards proprietary positions. As a result, there has not been a single trade in the proprietary account of the *Noticee* since April 01, 2014. Therefore, any apprehension of mixing of client funds and own funds at this stage is hollow and without any basis.
- 11.9. At the same time, to segregate the broking business from investment banking and investments in its subsidiaries, it has been submitted that the *Noticee* had restructured the holding company with effect from February 2014, whereby the broking business was demerged into a 100% subsidiary with the name India Infoline Ltd. and investment related business has been kept with the holding company i.e. IIFL Holdings Ltd.
- 11.10. It has further been submitted that the *Noticee* had simultaneously implemented the process of pool account balance reconciliation and has ensured a system-based tracking and maintenance of balances in clients'

bank accounts to ensure that the net credit balances of clients' accounts are maintained in the clients' bank accounts separately and exclusively. For that purpose, it was maintaining separate bank accounts for pooling clients' funds whereas for its own funds, separate bank accounts are maintained. The aforesaid clients' accounts are separate from its own bank accounts from where any shortfall in clients' pay-in are made. This ensures that the pool accounts are maintained only for pay-in and pay-out of clients' funds and its own funds are transferred from/to separate bank account.

11.11. Placing these details on record, the *Noticee* has emphasized that in any case, the issue of mixing of clients' funds with its own funds is a historical relic and, post restructuring of IIFL group in 2014, there is no chance of reoccurring of the aforementioned aberrations. Nevertheless, the inspection reports of NSE and BSE do not record any adverse observations regarding the non-segregation of clients' funds from own funds, pay-in and pay- out of clients' funds etc., hence, the apprehension of SEBI is unfounded.

11.12. With respect to repeated findings of misuse of credit balance clients' funds for purpose of debit balance clients as well as for proprietary trading, the *Noticee* has submitted that the period of inspection for Supplementary Inspections I and Supplementary Inspection II was same viz. April 1, 2011 to June 30, 2014.

11.13. Regarding the allegation of misuse of funds, the *Noticee* has sought to draw attention to the fact that the Enhanced Supervision Circular of SEBI was issued on September 26, 2016 and the same was made effective from July 01, 2017. This shows that these aforesaid two supplementary inspections relate to a period when the Enhanced Supervision Circular had not even come into force.

- 11.14. The *Noticee* has strenuously contended that the formula for calculation of position of clients' funds were introduced for the first time through the Enhanced Supervision Circular and the said Circular of 2016 is not a mere reiteration of SEBI 1993 Circular.
- 11.15. In support of this contention, the *Noticee* has submitted that, while calculating the value of the bank guarantee, the 2016 Circular and the Enquiry Reports have taken only the funded portion of the bank guarantee and have completely ignored the non-funded portion. Conversely, the contemplation of exclusion of non-funded portion of bank guarantee was introduced for the first time by way of the Enhanced Supervision Circular dated September 26, 2016 and the same was never a part of the SEBI 1993 Circular.
- 11.16. Prior to Enhanced Supervision Circular dated September 26, 2016, Bank Guarantee was considered as cash and cash equivalent while giving margin as the said amount is available to the exchange as and when they want it. This was clearly mentioned in SEBI circular dated June 20, 2003. The same has been reiterated by SEBI in its Circular dated February 23, 2005.
- 11.17. The *Noticee* has further responded to the allegation that how it chooses to fund the temporary deficit of debit balance clients to the Exchange was an internal matter of the *Noticee*. In support of this contention, the *Noticee* has put forward an example that if it had obtained an Over Draft or a Cash Credit facility from its bank and instead of a bank guarantee and if it had preferred to use that Over Draft facility to make payments to the Exchanges instead of placing Bank Guarantees, SEBI would have no fault in its fund utilization. Logically, there is no difference between a Fixed Deposit and a Bank Guarantee given to the Exchange as both of them entitle the Exchanges to recover the full amount as and when it becomes

due and is necessary. Therefore, the system of using only the funded portion of bank guarantee is faulty.

- 11.18. In support of its submission that the Enhanced Supervision Circular was not a mere reiteration of the SEBI 1993 Circular, the *Noticee* has also stated that SEBI had to extend the timelines for implementation of the Enhanced Supervision Circular and BSE and NSE had to issue a plethora of clarifications on the implementation of the said circular. If the Enhanced Supervision Circular was nothing but a mere reiteration of SEBI 1993 Circular, there was no question of giving such extensions and clarifications.
- 11.19. In fact, whenever SEBI issues a circular, which is in continuation of previous circulars, the same is explicitly stated in the later circular. However, no such iteration has been made evident in Enhanced Supervision Circular of 2016 that it is in continuation with 1993 Circular.
- 11.20. As a consequence of these submissions, the *Noticee* has submitted that if the 100% of the Bank Guarantee is considered, there is hardly any client shortfall. Alternatively, if net creditors are considered then too there is no shortfall of funds.
- 11.21. Regarding the Enquiry Reports' seeking reliance on the findings of the Hon'ble SAT made in the matter of *Arihant Capital Markets Ltd. vs. SEBI (Appeal No. 521 of 2019, decided on October 21, 2021)*, the *Noticee* has submitted that the appellant in that case had used the funds of its clients for the payment of dues of its associates and/or group company, etc., and the ground of retrospective use of the said formula of Enhanced Supervision Circular of 2016 was being taken for the first time in appeal. The case of the *Noticee* is distinguishable on facts from the abovementioned matter. At the same time, penalty of INR 5 Lakhs was imposed in the case of *Arihant Capital (supra)*, whereas the punishment of cancellation of registration of

certificate is severest and incompatible to the aberrations observed qua the acts of the *Noticee* in the present matter.

11.22. In the end, the *Noticee* has submitted that the methodology of calculation for the purpose of computing misuse of clients' funds was made applicable only in July 2017. Since that time, the *Noticee* has been following the same methodology, reorganized its affairs and evidently there is no allegation that after the implementation of the enhanced supervision circular, the *Noticee* has ever had Negative 'G value'.

Background of the matter and Preliminary Objections

12. Having summarized the submissions of *Noticee*, it is important to narrate in brief, the background facts which have ensued the matter to reach the extant stage, before proceeding to examine and adjudicate the issues in the matter. To begin with, it is noticed that SEBI had conducted thematic inspection of IIFL from January 30, 2014 to February 03, 2014 at the office of IIFL at Senapati Bapat Marg, Lower Parel, Mumbai. The purpose of the *Thematic Inspection* was to examine as to whether the acts of IIFL were in compliance of the provisions of the SEBI 1993 Circular and SEBI circular dated April 17, 2008 with respect to segregation of funds and securities of clients, during the period of April 01, 2011 to December 31, 2013. In the said inspections, SEBI noticed that IIFL had not nomenclated 26 of its 45 clients' accounts as 'client account' in bank record despite issuance of a warning by BSE.

13. It is noticed that the system of assigning a clear-cut nomenclature of clients' accounts was introduced in order to prevent misuse of clients' funds lying in these accounts. It was also prescribed to facilitate conducting a Regulatory exercises, such as inspections, to become easier in the light of clear cut identification of clients' accounts. Also, it would be easier to find out usage of funds from those clients' account and to prevent mischief on the part of a stock broker, if any, to

hide some of the clients' accounts from regulatory oversight.

14. Therefore, upon finding evidence of wrong nomenclature having been assigned to the clients' bank accounts, it was felt necessary to examine the possibility of misuse of clients' funds by IIFL from these accounts. For the said end, SEBI conducted a *Comprehensive Inspection* of IIFL for the period of April 01, 2013 to June 30, 2014. The said comprehensive inspection was carried out simultaneously at three offices of IIFL viz. its earlier mentioned Corporate Office, and two of its branch offices, and the office of one of its sub-brokers was also inspected. The said inspection was conducted on various dates in the months of August and September 2014. The purpose of comprehensive inspection was to examine if IIFL was maintaining its books of accounts and other books in the manner required under the Stock Broker Regulations and if it was in compliance with the provisions of other securities laws, regulations, rules, circulars, bye-laws and directions issued by SEBI and the stock exchanges from time to time.
15. In the said comprehensive inspections, SEBI found out that IIFL was following a complicated procedure of transfer of funds wherein, it had opened four accounts with Axis Bank, Citi Bank, HDFC Bank and ICICI Bank, all were nomenclated as 'control accounts'. IIFL was collecting funds of its own as well as of its clients in the aforesaid four accounts, before transferring funds to 'Exchange Settlement Accounts', maintained by IIFL. Thus, IIFL was mixing funds of its own with its clients' funds before transferring them in 'Exchange Settlement Accounts' and was also found making payments for its own overheads and investments from the said control accounts.
16. Upon finding evidences of mixing of funds and usage of money from such mixed funds for proprietary use of the *Noticee*, a need was felt to examine if clients' funds were being misused after such mixing. To that end, Supplementary Inspection I of IIFL was carried out, wherein examination of a sample of top 20 days with the

highest pay-in obligation of IIFL in its own proprietary account along with clients' obligation to the stock exchange during the period of April 01, 2011 to June 30, 2014, was undertaken. The said examination was done to assess if the funds of credit balance clients of IIFL were misused for its debit balance clients or for its own proprietary trades. In the data collected from IIFL, it has been noticed that there were 5 days on which funds transferred by IIFL from its own account were less than its proprietary obligations. Therefore, a data of 10 days, including those 5 days wherein funds transferred by IIFL were less than proprietary obligation and also for another 5 days immediately after these days, were sought from IIFL. From the examination of these data, misutilization of funds of clients having credit balance, for settlement obligation of clients having debit balance for 7 days out of these 10 days was observed.

17. Upon finding evidences of misuse of credit balance clients' funds, Supplementary Inspection II of IIFL was carried out, for the same period as was adopted for Supplementary Inspection I wherein, sample data of top 105 days (besides the data of days collected earlier in Supplementary Inspection I) with highest pay-in obligations of IIFL on its proprietary account as well as towards clients' obligation to the stock exchanges was obtained. In the said Supplementary Inspection II, out of a sample of 105 days, it was noticed that IIFL had misutilized the funds of clients having credit balances to meet the settlement obligation of debit balance clients for 101 days which amounts to 96% of the total selected sample days. At the same time, IIFL was also found to have misutilized the funds of credit clients for the settlement obligation of its own proprietary trades on 13 days.

18. Further, upon finding misuse of funds of credit balance clients for the benefit of debit balance clients and also for its proprietary trades, in order to identify the true extent of misuse of clients' funds, Supplementary Examination III of IIFL

was carried out for the same period as that of the earlier two supplementary inspections, during which data for all the trading days except for the earlier collected 115 days (10 days in Supplementary Inspection I and 105 days in Supplementary Inspection II) was collected. In these 695 trading days, for which data was collected, IIFL was found to have misused the credit clients' funds for the settlement obligation of debit balance clients on 687 days which was 98.85% of the total aforesaid sample days. At the same time, on 29 days, IIFL was also found to have misused the funds of credit clients for the settlement obligation of proprietary trades.

19. Finally, one more round of Inspection was carried out on March 27, 30 and 31, 2017 for the period of April 01, 2015 to January 31, 2017 during which an examination was carried out so as to verify as to whether IIFL was in compliance with the regulations and circulars issued in respect of segregation of funds and securities of clients during the next two Financial Years, subsequent to period of first five inspections. On a sample based analysis of top 30 days that have witnessed highest turnover/pay-in obligations during the two Financial Years viz. FY 2015-16 and 2016-17, IIFL was again found to be misusing credit balance clients' funds for settlement obligation of debit balance clients on all these 30 highest turnover/pay- in obligation days.

20. In all these inspections, certain contraventions have been observed on the basis of which, two separate Enquiry Proceedings had been initiated against IIFL, which resulted into two separate Enquiry Reports and in both the reports the DA has recommended cancellation of certificate of registration of IIFL as a stock broker. The violations so observed can be broadly classified into the following heads :-

20.1. Failure to appropriately nomenclate clients' bank accounts,

20.2. Mixing of its own funds with clients' funds and use of those mixed funds

for own use,

20.3. Misuse of funds of clients having credit balances for the benefit of clients having debit balances,

20.4. Misuse of funds of clients having credit balances for settlement of proprietary trades.

21. Before moving ahead, I find that the *Noticee* had initially raised a number of preliminary objections before the DA, which have been duly dealt with by the DA in Enquiry Reports I and II. I don't find any necessity to reiterate the said objections and the grounds for their rejection by the DA, in the present order, more so in light of the fact that those objections have not been raised by the *Noticee* in its submissions before me nor has it pointed out any illegality or irregularity in the observations of DA with respect to his dealing of those preliminary objections.

22. However, the *Noticee* has submitted that two separate adjudication orders have already been passed against it on the facts similar and identical to the present proceedings. It is noticed that in both the aforementioned matters, vide Adjudication Orders dated May 20, 2022 and May 30, 2022, penalties of INR 1 Crore were imposed upon the *Noticee* in each of these proceedings. Against these Orders, the *Noticee* has stated to have preferred appeal before the Hon'ble SAT which, vide its order dated July 18, 2022, has stayed the operation of the said Adjudication Orders, in following terms:

“3. Considering the facts and circumstances that have been brought on record, in the meanwhile, the appellant shall deposit 50% of the penalty amount within six weeks from today. The amount so deposited shall be kept in an interest bearing account which shall be subject to the result of the appeal. If the 50% of the penalty amount is deposited, the balance amount shall not be recovered during the pendency of the appeal. The urgency application is disposed of.”

Having gone through the same, it is observed that the Hon'ble Tribunal has stayed the operation of the Adjudication Orders by stating that, in case the *Noticee* deposits 50% of total penalty amount within six weeks from the date of the aforementioned order, no steps shall be taken by SEBI during the pendency of the appeal to recover the balance 50% of amount imposed under the respective orders passed by the Adjudicating Officer imposing monetary penalty. Even though, the instant proceedings have arisen out of same facts and allegations, it is very much permissible under the framework of the SEBI Act as there is no restriction on initiation of adjudication and enquiry proceedings simultaneously. In any event, the present proceedings are different from the aforementioned Adjudication Orders and the stay granted by Hon'ble SAT on the implementation of the said Adjudication Orders does not come in the way of continuation of the present proceedings.

23. Now, coming to the first issue of failure of the *Noticee* to properly name the clients' bank accounts i.e. names of some of the bank accounts where clients' funds were kept were not observed to be in terms of the requirement of SEBI 1993 Circular. In this regard, I find that clause 1(B) of the SEBI 1993 Circular clearly states that every member broker is required to pay money to an account kept in the name of the member wherein the title should include the word "client".

24. I find it necessary to mention here that inspection of records of any market intermediary is a time bound exercise, wherein the regulator is constrained of time. Keeping this fact in light, SEBI has introduced a number of measures over the period to ease out regulatory exercises with respect to compliance of law by respective market intermediaries so that maximum details can be scrutinized in minimum possible time.

25. In this regard, I find it necessary to mention at this stage itself, that the

requirement of assigning proper nomenclature to the bank accounts, where clients' money is kept by a stock broker, was introduced as one of the tools to prevent misuse of clients funds and for the purpose of ease of regulatory oversight for SEBI as well as the stock exchanges, as this would make it easy to identify such accounts on the basis of their nomenclature, and examine the misuse of such clients' funds lying in those accounts, if any. At the same time, it becomes difficult for an errant stock broker to hide such accounts in which it had deposited clients' funds and had misused the same.

26. In this context, I note that SEBI had noticed in the course of *Thematic Inspection* that the *Noticee* had not designated 26 bank accounts as "client account", wherein it was depositing clients' funds. I note that after the aforesaid inspection, IIFL had informed SEBI vide its letter dated July 11, 2014, that it had submitted the request to its bankers for changing the title of the aforesaid 26 bank accounts to "client account" and provided supporting document which contained status of 45 bank accounts. I find from the Enquiry Report I dated April 29, 2022 that the DA had accepted the submissions of IIFL that it had changed title of 24 out of these 26 clients' accounts. However, with respect to the two clients' bank accounts the *Noticee* was still in the process of changing the title to "client bank account". The said two bank accounts were of Citi Bank (Account No. 857764118) and South Indian bank (Account No. 25073000002308), wherein the process of changing of title of bank accounts was not completed.

27. In this circumstance, the *Noticee* had submitted before the DA that it had closed its Citi Bank Account, as the said account could not be relabeled as "Client Account" due to operational issues posed by the Citi Bank. However, in support of the above claim, no evidence was submitted by the *Noticee* before the DA. In this respect, it is further noticed that the *Noticee*, in its reply dated October 31, 2022, has submitted a copy of the letter/email dated July 09, 2022, perusal of

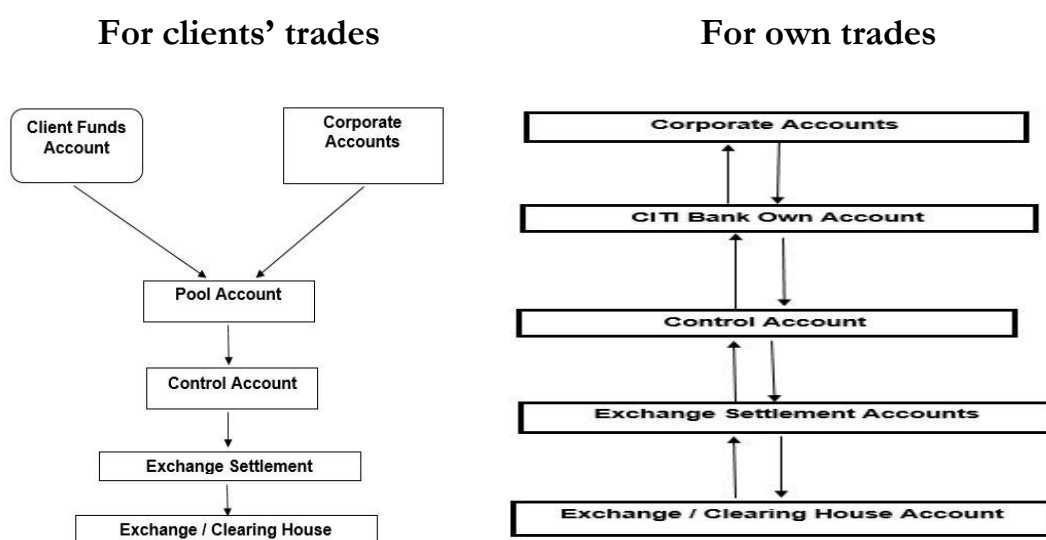
which shows that Citi Bank has intimated that the name of the account was changed to 'India Infoline Limited Client A/C' on January 10, 2018. Under the circumstances, no infirmity can be observed in the observation of the DA that was made based on available evidence and the claim of the *Noticee* was lacking in supporting evidences at that time so as to have its acceptance by the DA as the said evidence was not placed before the DA. However, at the same time, the evidence placed on record now before me can't be overlooked and brushed aside completely. Having considered the same, it is observed that the said account with Citi Bank was nominated as Client account as on January 10, 2018 and therefore, it was classified as client accounts' by the *Noticee* only from January 10, 2018.

28. Insofar as the account with South Indian Bank is concerned, the *Noticee* has submitted that the nomenclature in the said account was indeed changed to Client Account. Subsequently, the said account was also closed on January 07, 2021. In support of this, the *Noticee* has submitted a copy of the email dated July 11, 2022 from South Indian Bank, evidencing the closure of the Account and the fact of change of name of the aforementioned account can also be traced out from the said email submitted by the *Noticee*. However, from the perusal of the evidence submitted in support of the same, it is observed that while the said email confirms that the name in the said bank account was changed as per the requirement of SEBI 1993 Circular, it does not disclose the exact date of such change of name of the said account. Having considered all these facts together, I find that the *Noticee* was in violation of the provisions of Clause 1(B) of SEBI 1993 Circular for a considerable period of time, in respect of which a total of 26 such bank accounts were identified by SEBI during *Thematic Inspection* wherein the *Noticee* had kept clients' money and withdrew the same and yet without properly nomenclating the said bank accounts in the manner prescribed by SEBI 1993 Circular. The same is evident from the fact that the *Noticee* has carried out necessary corrective steps only subsequent to issuance of Inspection Report of

Thematic Inspection. Therefore, the *Noticee* itself has implicitly admitted that it was not in compliance with the provisions of Clause 1(B) of SEBI 1993 Circular for a considerable point of time.

29. Moving on to the *Comprehensive Inspection*, I find that certain violations with respect to settlement of clients' funds have been observed during the *Comprehensive Inspection*. During this inspection, the *Noticee* had explained the procedure followed by it for settlement of clients' funds. The procedure adopted by the *Noticee* was that, in order to meet the pay-in obligations of clients, it used to transfer the funds from clients' accounts as well as from its own accounts to four different accounts, nomenclated as 'Pool Accounts'. Subsequently, from the said 'Pool Accounts', money was transferred to a common account, nomenclated as 'Control Account'. At the same time, the *Noticee* was transferring funds for its own proprietary trades to the 'Control Account'. From the 'Control Account', the money was eventually transferred to the stock exchange settlement account, which account was used by the *Noticee* to settle the trades of its own as well as of its clients. The above mechanism is explained through the flowchart given below:

Diagram 1: Flow of funds in the records of IIFL



30. It has been alleged on the basis of the findings during *Comprehensive Inspection* that

the *Noticee* had four accounts nomenclated as 'Pool Accounts' viz. Citi Bank pool account bearing account no. 340369173, Axis Bank pool account bearing account no. 4010300022224, ICICI Bank pool account bearing account no. 451000496 and HDFC Bank pool account bearing account no. 00600130000728. It was noticed during *Comprehensive Inspection* that funds were being flown out from the aforesaid Pool Accounts and the same were being used for own purposes of IIFL such as investment in mutual funds, transfers to group companies, foreign remittance expenses, salary and accounts etc. On the basis of this finding, it has been alleged that the *Noticee* has mixed its own funds with its clients' funds in complete violation of the provisions of the SEBI 1993 Circular and it has been noticed that such mixed funds (that includes clients' funds also) have been used by the *Noticee* for its own purposes such as investments, vendor payments, salary etc.

31. I find that the *Noticee* in its reply before the DA has claimed that though the money from the Pool Accounts were used for investments, vendor payments, salary etc., however, while using the same, funds of clients were not used. It has further been submitted that it had its own surplus funds lying deposited in the Pool Account, which were used for the above mentioned purposes and it had not used the clients' funds lying in the Pool Accounts for such purposes. The above submission, though looks impressive on its face, however, I am constrained to observe that such an explanation is evasive in nature and is fraught with contradictions as the *Noticee* has failed in its replies before the DA as well as before me to address the specific allegations levelled against it.
32. It is noticed that the allegation levelled against the *Noticee* in the SCN is that the *Noticee* was not keeping the fund of its clients separately and depositing the funds of clients and its own funds in common Pool Accounts and thereafter, the said mixed funds were used to meet various obligations that included; settlement of

clients' trades; its own trading obligations as well as non-trading purposes, which is in violations of SEBI 1993 Circular. In its submissions before me refuting the above allegation, the *Notinee* has contended that SEBI 1993 Circular nowhere prohibits keeping a middle layer of pool account before transferring monies to settlement account, and the same was done by the *Notinee* as a part of its internal control and procedures. It has been contended that the restriction mentioned in SEBI 1993 Circular apply only on clients' accounts and there is no prohibition upon a broker to maintain a pool/control account.

33. In this regard, first of all I note that clause 1 of SEBI 1993 Circular in specific term makes it compulsory for a stock broker "to keep the money of the clients in a separate account and their own money in a separate account." Further, clause 1(D) of the aforementioned circular lays down the circumstances in which, funds can be withdrawn from clients' accounts and the said permitted circumstances are the following:

- (i) money required for payment to or on behalf of clients; or
 - (ii) for or towards payment of a debt due to the Member from clients; or
 - (iii) money drawn on client's authority, or
 - (iv) money in respect of which, there is a liability of clients to the Member,
- However, the above stated permitted circumstances allowing withdrawal of money from clients' accounts should not, in any case, exceed the total amount of the money so held for the time being for each such client.

Reading the two provisions together, it is evident that there was no ambiguity and the law was explicitly providing that clients' funds cannot be co-mingled with proprietary funds and further, funds of clients cannot be used for purposes other than those mentioned therein and in none of the case, a stock broker was permitted to use the funds of any client for its own purpose.

34. Keeping this position of law in sight, I find from the *Comprehensive Inspection* that

the *Noticee* was undisputedly placing its own funds as well as its clients' funds in the four Pool Accounts opened and maintained with Citi Bank, Axis Bank, ICICI Bank and HDFC Bank. It has also been seen that out of the collected funds, the *Noticee* was using the same for several of its own purposes such as Investments in mutual funds units, bonds, metal trusts, IIFL income opportunities fund; transfers to and from IIFL Commodities, insurance, IIFL Wealth Management Ltd., IIFL Realty Ltd., foreign remittance expenses; transfers to and from bank accounts categorized by IIFL as expenses and salary account etc. It is found from the afore cited provisions of law that clients' funds were required to be kept and maintained separately and not permitted to be mixed with any other funds so as to make them vulnerable to be used for purposes other than those mentioned in the circular. However, it remains beyond dispute that the *Noticee* had not kept the funds of clients separately and instead, had mixed them with its own funds in the Pool Account and the funds lying with the said Pool Accounts were in turn used for various sundry purposes other than dealing in securities.

35. In this regard, the only submissions of the *Noticee* was that it was using its own funds from the aforesaid Pool Accounts and the funds of its clients were not used for meeting the aforementioned expenses and therefore, there is no violation of law in such usage. Before moving forwards, it is found necessary to reiterate that the extant law in this regard, in very unambiguous terms provides that every Stock Broker is required to keep the money of its client separately from its own money, in separate accounts and the said regulatory provision has not carved out for any exception for mixing of funds of clients with its own funds. As far as the justification that funds of clients were not used to meet its personal/proprietary obligations, it is well established fact that money is fungible i.e. money of two persons can be replaceable with each other and the same is mutually interchangeable. Fungibility can also be defined as the ability of a good or asset to be interchanged with other individual goods or assets of the same type.

Fungibility implies equal value between the assets. This means that money, once collected from two or more persons and kept in one Pool, becomes unidentifiable and it cannot be identified as to which part of money belongs to whom. In these scenarios, the arguments of the *Noticee* hold no ground that it was using its own money only and not the money of its own clients, as the said Pool Accounts into which funds of clients and the *Noticee* were being transferred did not have any means to demarcate and distinguish the funds of the clients from that of the *Noticee*. Thus, after mixing of funds in one Pool account, it becomes difficult to pin point as to which part of such pooled funds belongs to which client and which part belongs to the *Noticee*. This also means that money of clients of a stock broker, so mixed with other funds, becomes susceptible to misuse by the operator of such a pooled account. Keeping in mind the possibility of such mischief that may be committed by stock Brokers, SEBI had mandated the prohibition of mixing of funds of clients' with the brokers' own funds to avoid misuse of clients' funds by stock broker.

36. It is further observed that the above provision was brought in effect in the year 1993 itself and the *Noticee*, despite being aware of the aforementioned requirement of law, was continuously using funds from the Pool Accounts for its own purposes and to meet its own expenses. These funds comprised of funds received from its clients as well as own funds of the *Noticee*. Assuming its claim of using only its own funds to meet the aforementioned expenses of the *Noticee* to be correct, I see no reason as to why the *Noticee* used the funds from the Pool Accounts to meet its personal obligations when it could have very well used funds directly from its own accounts to meet its proprietary or personal expenses. However, the use of funds from the Pool Accounts (which also contained clients' funds) for its own purposes has certainly paved the way for the possible misuse of clients' funds by the *Noticee*, glimpses of which were noticed in the subsequent Supplementary Inspections I, II and III and in the Enquiry Reports I and II of

DA, which I have dealt with in detail in the later paragraphs of this Order. Nevertheless, irrespective of whether the *Noticee* has utilized the funds of its clients to meet its own obligation, I find that the *Noticee* has failed to refute the allegation made in the SCN that it has not kept the funds of its clients separately from its own funds and has used the mixed funds to meet its own trading obligations as well as for the purposes of meeting various other expenses which are not permitted under the SEBI 1993 Circulars.

37. In the light of the above discussion, I find that, by mixing its own funds with client funds and by not keeping the money of its clients in a separate and distinct account, the *Noticee* has violated the provisions of clause 1 and 1(D) of the SEBI 1993 Circular.

38. However, I also note from the submissions of the *Noticee* that, from 2014 onwards, it has implemented the process level changes to ensure seamless flow of funds from/to client accounts and from/to exchange settlement account. As a part of said change, the *Noticee* had segregated its proprietary trading into a separate membership, viz:- 5paisa Capital Limited (formerly IIFL Capital Limited). At the same time, it has also indulged in withdrawal of funds towards brokerage charges, depository charges etc. from the client pool account to *Noticee's* own account on a fortnightly basis.

39. The *Noticee* has also segregated its broking business from investment banking business and its own investments in its subsidiaries. For the said purpose, the *Noticee* has submitted to have restructured the holding company, whereby the broking business was demerged into a 100% subsidiary with the name India Infoline Ltd. and all the investment related business has been transferred to the holding company named as IIFL Holdings Ltd.

40. The *Noticee* has also submitted to have streamlined the process of pool account balance reconciliation and it has implemented a system based tracking and

maintenance of balances in client bank accounts. For this purpose, the *Noticee* is stated to have been maintaining separate bank accounts for pooling client funds and for its own funds. These accounts are separate from its own bank accounts from where, any shortfall in clients pay-in obligations are made. This ensures that the pool accounts are being maintained to meet only for pay-in and pay-out obligations of clients and its own funds are transferred from/to separate bank accounts.

41. Now moving on to the Supplementary Inspections I, II and III, I find that the same were conducted in the light of the suspicion that arose due to finding of mixing of clients' funds with proprietary funds by the *Noticee*. The suspicion was regarding misuse of clients' funds for its own purposes, as money was being mixed in pool accounts and money was flowing out for meeting *Noticee's* own expenses. Therefore, SEBI initially sought data for a sample of 10 trading days during Supplementary Inspection I, including the data regarding aggregate value of debit balances of all clients, aggregate value of credit balances of all clients, total fund balance available in all clients' bank accounts and aggregate value of collaterals deposited with clearing corporations in the form of cash and cash equivalents etc.
42. On the basis of the data, it was observed that the aggregate of the 'end of day' balance in all clients' accounts along with the collaterals deposited with the clearing corporation/clearing member was less than aggregate clients' credit balances as per the clients' ledgers. Therefore, it has been alleged that the funds of credit balance clients were misutilized by the *Noticee* for settlement obligation of debit balance clients for 7 days out of these 10 sample trading days for which data was collected during Supplementary Inspection I.
43. As noted earlier, considering the above findings, it was thought proper to expand the scope of examination and therefore, in order to examine the extent of misuse

of clients' funds, more specifically funds of clients who were having credit balances in the records of the *Noticee*, data for top 105 days with the highest pay-in obligations of the *Noticee* on proprietary account and those of clients' obligations to the stock exchanges was obtained from the *Noticee*, as it was felt that there was more probability of misuse of clients' funds on the days when the *Noticee* had maximum settlement obligation towards the stock exchanges/clearing corporations.

44. Upon analysis of the data for the aforementioned dates taken up for inspection on a sample basis, SEBI observed that, out of the aforementioned sample of 105 days, the *Noticee* had misutilized the credit clients' funds for the settlement obligation of debit balance clients for 101 days which amounted to 96% of the total number of selected sample days. It was found from inspection that the amount of credit clients' funds misutilized by the *Noticee* during these 101 sample days ranged from INR 1.09 crores to INR 397.02 crores. At the same time, SEBI also observed that, out of 105 sample days for which data was collected during Supplementary Inspection II, the *Noticee* had also misused credit balance clients' funds for 13 days, for fulfilling settlement obligation of its own proprietary trades.
45. Looking at the extent of misuse and the amount misused by the *Noticee* for funding its own trades and for funding of the trading of its debit balance clients, out of the money deposited by credit balance clients, it was decided to examine the extent of wrongdoing by the *Noticee*. Therefore, data for all the trading days during the inspection period, except for the days for which data was already examined during the Supplementary Inspection I and II, were sought by SEBI during Supplementary Inspection III, which resulted into the *Noticee* furnishing data in respect of 695 trading days.
46. From the analysis of such data as submitted by the *Noticee* during the Supplementary Inspection III, it has been noticed that out of the 695 trading days

under examination, the *Noticee* had misused the credit clients' funds for the settlement obligation of debit balance clients on as many as 687 days which constituted 98.85% of all sample days, as indicated above, and the amount of such funds misutilised by the *Noticee* ranged from INR 0.58 crores to INR 309.23 crores during these 687 trading days. At the same time, for 29 days out of these 695 days, the *Noticee* was also found to have misused funds of credit balance clients towards the settlement obligation of its proprietary trades.

47. Thereafter, during the March 2017 inspection, SEBI attempted to examine if the said mistilization of funds of credit balance clients had stopped after the aforesaid inspection period (April 01, 2011 to June 30, 2014) or the same wrongful practice continued even after that period. For the said purpose, SEBI sought data from the *Noticee* in respect of top 15 trading days that witnessed highest turnover/pay-in obligation of the *Noticee* during each of the two Financial Years viz. 2015-2016 and 2016-2017 implying thereby, data was called for a total number of 30 trading days, spread over a period of two years recording high turnover/pay-in obligation for the *Noticee*.
48. Upon analysis of the said data, SEBI observed that, out of the said sample 30 days of Financial Years 2015-16 and 2016-17, the *Noticee* had misused the credit clients' funds for meeting the settlement obligations of debit balance clients for all those 30 days which amounted to 100% of the total selected sample days. Upon examination of the amount that the *Noticee* had misutilized on these days, it was found that, the *Noticee* had misused the credit clients' funds in the range of INR 26.04 crores to INR 294.73 crores as noticed on those selected sample days.
49. On the basis of all these observations, it has been alleged that, by using the funds of credit balance clients for settlement obligation of debit balance clients as well as for settlement obligation of its own proprietary trades, the *Noticee* has violated the provisions of SEBI 1993 Circular:-

50. Before moving further, it is pertinent to explain the methodology adopted by SEBI for calculating the use or misuse of clients' funds in the present matter and the same is tabulated as below:

Table 1: Calculation method for misuse of clients' funds

Date	Aggregate Clients Debit Balances as per Trial Balance (After adjusting for open bills & uncleared cheques)	Aggregate Clients Credit Balances as per Trial Balance (After adjusting for open bills & uncleared cheques)	Total of Client Bank Balances	Collateral Deposited with Exchanges by IIFL	Total Cash available with Exchange after adjusted 50% BG	Total Cash available with broker	Broker used client funds
	A	B	C	D	E	F=E+C	G=F-B

In all the calculations, the aforementioned formulated table has been used in one or other minor variations, with the basic principle being maintained as per the provisions of SEBI 1993 Circular regarding permitted usage of clients' funds.

51. The idea behind the aforementioned calculation is that for every 100 Rupees deposited by a client with a stock broker, the stock broker should be able to provide account of every single rupee used by it towards the trade obligations of such client.

52. In this regard, I find it necessary to mention here that at the end of every trading day, a stock broker may have a client having credit balance in his account and also may have certain clients having debit balances in their books. Credit balance clients are those clients of the stock broker to whom the stock broker owes payment after the settlement of trades of that particular day. This may be due to their having deposited money in the ledger of stock broker or due to them being seller of certain securities on that particular trading day. Debit balance clients are those clients which owe funds to the stock broker (clients which are under obligation to pay to the stock broker) due to their trading of securities on the stock exchange on the said trading day or due to their previous debit balances in the ledger of a stock broker. As far as these debit balance clients are concerned, the stock broker is allowed to provide margin money to them to enable them to

trade in securities, within the permitted limit, as prescribed by relevant provisions of law, issued by SEBI from time to time. However, the funds for such margin funding are required to be arranged by stock broker on its own. The stock broker is not allowed to use funds of clients having credit balances in the ledgers of the stock broker, to fund either the trades of its own or for the trades of its clients which are having debit balances in its ledger. This principle was implicitly laid down in SEBI 1993 Circular wherein a list of specific circumstances was provided under which the funds were allowed to be withdrawn from the account of a clients.

53. For further elaboration, I find it necessary to mention here that the SEBI 1993 Circular provides that no money shall be drawn from clients' accounts other than under the following circumstances –

- a. money required for payment to or on behalf of clients or for or towards payment of a debt payable to the Member/Broker from clients or money drawn on client's authority, or money in respect of which there is a specific liability of clients to the Member/Broker, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client;
- b. such money belonging to the Member/Broker as may have been paid into the client account for the purpose of opening or maintaining the account or a cheque or draft received by the Member/Broker representing in part money belonging to the client and in part money due to the Member/Broker.; and
- c. money which may by mistake or accident have been paid into such account other than such amounts that are required to be paid into clients account.

It clearly shows that there is a prohibition on withdrawal of money from one client's account for the purpose of meeting trade obligations or otherwise of another client. Thus, the funds of credit balance clients can never be used for

purposes other than those specifically mentioned and permitted under SEBI 1993 Circular. The above mentioned circular does not permit the usage of funds of clients to meet the settlement or other obligation of either the stock broker or other clients of the stock broker who are lacking funds in their accounts maintained with the Stock Broker to meet their obligations arising out of their trading in securities.

54. Keeping the aforesaid principle in mind, I note that, at any point of time, the funds available with a stock broker are kept in two forms viz. in the form of balance in clients' bank account maintained with the stock broker or in the form of deposits being made by the stock broker with the exchange/clearing corporation, be it in any form like cash, Fixed Deposit, Bank Guarantee etc.
55. Emerging out of the aforementioned principle, that the funds of credit balance clients cannot be used for debit balance clients, is another principle, which is relevant for the present proceedings, which says that at no point of time, the funds available with a stock broker should be less than the aggregate of its liabilities towards its credit balance clients. To simplify this, I take a numerical example. Let's say that a stock broker has assets worth INR 100 lying with stock exchange/clearing corporation. At the same time, it has INR 100 lying in its clients bank accounts. Supposing at the end of a trading day, the stock Broker is liable to give INR 130 to its credit balance clients. This means that out of INR 200 in its hands, INR 130 belong to its credit balance clients and the rest is its own money, which the Broker is free to use for its own purposes or to fund its debit balance clients.
56. Now taking into consideration another scenario, with the same INR 200 balance in the hands of the stock broker, the liability of the stock broker towards its credit balance clients at the end of trading day is INR 230. This means that the broker should have had at least INR 230 in its hands at that moment (end of trading day)

as the same belonged to its credit balance clients and the said money was not allowed to be used by the stock broker for any other purposes. The fact that money in the hand of stock broker is less than INR 230, it shows that money of its credit balance clients have been taken away to use for purposes not authorized under SEBI 1993 Circular. In that scenario, it is presumed that the stock broker has misused the funds of credit balance clients to the extent to INR 30 (INR 230-INR 200) most likely to fund the trades of debit balance clients or to fund its own proprietary trades or for any other possible use that is not permissible under the exiting rule.

57. Taking this example ahead, I now take up two scenarios. Firstly, I take a scenario wherein the liabilities of debit balance clients of the broker are more than INR 30. In that scenario, it is presumed that the funds of credit balance clients have been misused for the trading of debit balance clients. This presumption is drawn on the rationale that no person (stock broker) will fund the trades of its debit balance clients at the cost of its own proprietary trades. Normally, a stock broker will fulfill its own obligations first from its own money, before putting its own money for its debit balance clients. In such a scenario, it is natural corollary that the stock broker will have to arrange external resources to fund its debit balance clients. In that situation, the stock broker will attempt to use funds of its credit balance clients, already available within its reach & control, to fund the trades of its debit balance clients, even though the same is not allowed under the law.

58. Moving on to the second scenario, I note that the liabilities of debit balance clients of the stock broker is less than INR 30. However, the funds missing from the records of the stock broker are INR 30. This leads to the next level presumption that the broker, after funding its debit balance clients, has misused the funds of credit balance clients to fund its own proprietary trades.

59. Keeping the aforesaid logical principles in mind and superimposing the same on

the data pertains to the *Noticee* as gathered during the inspection and posted in Table 1, the principle explained above through an example would require that the total available funds i.e. cash and cash equivalents with the stock broker (including clients' balances) and with the clearing corporation/clearing member **(F)** should always be equal to or greater than credit Clients' funds as per the ledger balances **(B)**. This means that the calculation of $G = F - B$ must always be in positive.

60. In a scenario where the 'G' value comes out to be in negative, such negative value certainly would imply that the total available funds with the stock broker are less than the ledger credit balances of the clients or in other words, lower than its liability towards its credit balance clients. Such negative value of G clearly indicates utilization of credit clients' funds for other purposes i.e. funds of credit balance clients being utilized either for settlement obligations of debit balance clients or for the stock brokers' own purposes. Thereafter, the absolute value of G is compared with debit balance of all clients as per client ledger **(A)**. If the absolute value of **(G)** is lesser than the liability of debit balance clients towards the stock broker **(A)**, then the stock broker has possibly utilized funds of credit balance clients towards settlement obligations of debit balance clients to the extent of value of G. If the absolute value of **(G)** is greater than liability of debit balance clients of stock broker **(A)**, then the stock broker has possibly utilized a part of funds of credit balance clients towards settlement obligations of debit balance clients and the remaining part for its own purposes. Therefore, in case the amount has been used for other purposes, the same shall reflect in "G Value" (mentioned at the last column of Table 1) being negative and its comparison with the liability of debit balance clients of the stock broker.

61. I note that the *Noticee* has submitted that the allegation of violation of provisions of SEBI 1993 Circular has been based on retrospective application of SEBI

Circular ref. no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016, (mandating calculation of 'G' value as explained above) which was made applicable from July 01, 2017. As per the submissions of the *Noticee*, the method of calculation of 'G Value', the negative value of which denotes that the funds of clients having credit balance in their accounts have been misused by the stock broker, was brought to be enforced for the first time in the aforementioned SEBI Circular dated September 26, 2016. Therefore, any calculation of misutilization of funds using the said formula for the period of operation of the *Noticee* from April 2011 to January 2014 would amount to retrospective application of SEBI Circular dated September 26, 2016.

62. In this regard, I find from Enquiry Reports I and II that the DA has already comprehensively dealt with and rejected this submission of the *Noticee*. In support of his observations, the DA has also cited certain Orders of the Hon'ble SAT such as Order dated October 21, 2021 of the Hon'ble SAT passed in the matter of *Arihant Capital Markets Ltd. vs. SEBI (Appeal No. 521 of 2019)* wherein the said contention was categorically rejected by the Hon'ble SAT in the following terms:

"8. The learned counsel for the appellant submitted before us that in the show cause notice the respondent had relied on a formula which, in fact, was not in existence at the time of the disputed period but was incorporated in circular dated September 26, 2016 which is brought into effect from July 1, 2017. He submitted that the formula would show that so far as the bank guarantee is concerned, only 50% of the same is required to be considered and not 100% which has been considered in the cases of Axis Bank as detailed (supra).

....

10. Upon hearing both sides and upon perusing the relevant circulars, in our view, the order cannot be faulted with. The earlier circular had clearly stated that the funds of the client cannot be applied for any other purposes. The appellant's case was that the funds were applied by it for the dues for their associates, group company, etc. Now, during the arguments only, the issue of

nonexistence of formula in the previous circular is brought up. In fact, the said formulization is nothing but the crystallization of the earlier circular.”

63. The *Noticee* has made a meek attempt before me to distinguish the aforementioned Order of the Hon’ble SAT on the ground that in *Aribant Capital (supra)*, the allegation was of misuse of clients’ funds by way of diversion of such funds to the group company, associates, subsidiaries, directors of the stock broker and their family members whereas no such allegation is there in the present matter. However, the above submission is not convincing enough to be considered favorably, as any utilization of funds beyond the purposes mentioned under Clause 1(D) of SEBI 1993 Circular amounts to misuse of such funds and consequently, leads to violation of such provision of law. The purpose for which such funds have been misutilized is irrelevant for establishment of a violation.
64. The *Noticee* has also submitted that in *Aribant Capital (supra)*, the contention of retrospective use of Enhanced Supervision Circular dated September 26, 2016 was raised at the very last stage before the Hon’ble SAT. I find that the said submission is without any merit as the said submission was properly considered and rejected by the Hon’ble SAT and the Hon’ble Tribunal has categorically held that the said formulation under the 2016 circular is nothing but the crystallization of the intent of earlier circular, as the 2016 circular has not laid down any new law but only crystalized the existing provision and made its reporting mandatory.
65. Further, I find it necessary to explain the purpose of SEBI 1993 Circular and the formula iterated under Enhanced Supervision Circular dated September 26, 2016. It is a well-established fact that the relation between a stock broker and its clients is of trust. Believing that the stock broker will act in the best interest of its clients, a client deposits his money with the stock broker believing that his interest will be protected in the best possible manner. Keeping such trust reposed by the client in view, the law was framed wherein, the stock brokers were instructed to use the

funds of its clients only for certain purposes listed out in Clause 1(D) of SEBI 1993 Circular. Subsequently, vide circular issued on September 26, 2016, a sophisticated alerting and reconciliation mechanism was created wherein the stock brokers have been mandated to regularly furnish data to the stock exchanges regarding utilization of clients funds. For the said purpose, dedicated portals and other facilities have also been created by stock exchanges. Through this method, a regular supervision of stock brokers has been made possible to detect and deal with the instances of misutilization of clients' funds, which has already been prohibited under SEBI 1993 Circular.

66. I find it necessary to point out at this stage that the formula given under the Enhanced Supervision Circular dated September 26, 2016 has been in practice even prior to issuance of the said Circular and is nothing but a numerical iteration of the principles already laid down under SEBI 1993 Circular. The purpose of issuing the 'Enhanced Supervision Circular' dated September 26, 2016, as the name *ipso facto* suggests, was to create a sophisticated alerting and reconciliation mechanism for monitoring of clients' funds for detection as well as prevention of possible misuse of funds of the clients by the stock brokers. The said method of supervision was created to fill the vacuum that existed between day to day use/misuse of funds by stock broker and periodic regulatory inspection. For the said purpose, a whole new IT infrastructure was also created at the end of stock exchanges and the stock brokers were mandated to furnish data to stock exchanges as per the mandate of Enhanced Supervision Circular dated September 26, 2016, on regular basis viz. weekly and monthly. Therefore, what new has been brought in through the above circular is a new reporting mechanism and backhand calculation by stock exchanges of the data being furnished by stock brokers, in order to examine the usage or misuses of funds of clients by the stock brokers. In fact, the implementation of the above circular was delayed for some time so as to provide adequate time to stock exchanges to create necessary IT

infrastructure and to allow stock brokers to get themselves and their IT systems familiarized and integrated with the platforms of stock exchanges through which they were required to furnish the requisite data as per the aforesaid formulation. As the above circular was not laying down any new law and was only a method to calculate the misuse of funds, if any, it is not correct to submit that a new regulation has been brought into effect for the first time vide the aforementioned circular of September, 2016, and enforcement of the same on the *Noticee* in the present matter would amount to a retrospective application of law.

67. The fact of use of this formula prior to issuance of Enhanced Supervision Circular dated September 26, 2016 can be better established from the fact that, as far as the present matter is concerned, the formula was used for the first time during Supplementary Inspections. I note that the findings of Supplementary Inspection I, were intimated by SEBI to the *Noticee* vide a letter dated July 06, 2015, much prior to notification of Enhanced Supervision Circular dated September 26, 2016, wherein the *Noticee* was advised to submit its comments/explanations on the findings of irregularities/violations as observed in Supplementary Inspection I. The *Noticee* submitted its response to the findings of Supplementary Inspection I by letter dated July 14, 2015 wherein it had made its submissions based on the extant provisions of law and no mention of Enhanced Supervision Circular dated September 26, 2016 was found in the said letter, as the said circular was not in existence till that time. In addition to that, the data sought to find out misuse of clients' funds by the *Noticee* were also sought using the said format during Supplementary Inspections I, II and III and the afore noted misuse of clients' funds were calculated by SEBI during the aforementioned supplementary inspections, only after using the said formula given under Table 1, even when all these three supplementary inspections were completed prior to issuance of Enhanced Supervision Circular dated September 26, 2016. This clearly shows that the formula was already in practice in SEBI to

monitor the usage of clients' funds and the *Noticee's* contention that Enhanced Supervision Circular dated September 26, 2016 had brought out a new formula is not backed by facts and material available on record and the same is also not supported by the judicial pronouncements.

68. I find it necessary to once again reiterate that Enhanced Supervision Circular dated September 26, 2016 has not introduced any new law for calculation of utilization (or misutilisation) of clients' funds by the stock brokers. It has only specified the mechanisms for the stock exchanges to monitor the utilization of clients' funds lying with the stock brokers through a sophisticated alerting and reconciliation mechanism based on objective parameters, to detect any misutilization of clients' funds. This fact is further strengthened from a close reading of the annexures to the said circular which, *inter alia*, reads that "*Stock Exchanges shall put in place a mechanism for monitoring clients' funds lying with the stock broker to generate alerts on any misuse of clients' funds by stock brokers....*" Therefore, the contention of the *Noticee* regarding retrospective use of Enhanced Supervision Circular dated September 26, 2016 does not require any further consideration.

69. I further note that the *Noticee* has submitted that the formula established under Enhanced Supervision Circular dated September 26, 2016 brings out certain new provisions which were not there in SEBI 1993 Circular. Specifically, the *Noticee* has pointed out that prior to the aforementioned Circular dated September 26, 2016, the full value of bank guarantee was taken into consideration while calculating the use/misuse of clients' funds by a stock broker. However, for the first time, SEBI introduced the concept of using only the funded portion of bank guarantee for the calculation of use/misuse of clients' funds through Enhanced Supervisions Circular dated September 26, 2016. Had the entire value of bank guarantee been used for calculation, not a single incident would have been found where 'G Value' would have been determined as negative, thereby indicating that

there was no misuse of clients' funds by the *Noticee*. In support of this, the *Noticee* has submitted recalculated data with respect to all the trading dates wherein it has been alleged that there was a misuse of clients' funds. Further, in support of its submission that the whole bank guarantee was required to be considered for calculation of use of clients' funds, the *Noticee* has submitted copies of SEBI circulars dated June 20, 2003 and February 23, 2005, for reference.

70. From the examination of the said circulars referred to and relied upon by the *Noticee* to submit that the requirement of using only funded portion of bank guarantee in calculation of usage of clients' funds was brought out for the first time in SEBI Circular dated September 26, 2016, it is observed that these two circulars dated June 20, 2003 and February 23, 2005 were issued for the purpose of calculation of margin requirement of a Trading cum Clearing Member (in short 'TCM') under clearing corporations' risk management framework. In this regard, it is noted that the SEBI Circular dated June 20, 2003 had allowed stock brokers/TCM to deposit bank guarantee for the purpose of margin deposited with the clearing corporations, and had also allowed to use the whole part of bank guarantee for the purpose of calculation of margin deposited by the stock broker.
71. At the same time, the *Noticee* appears to have been confused between the aforementioned two circular cited by it (dated June 20, 2003 and February 23, 2005) and SEBI Circulars dated November 18, 1993 and September 26, 2016. The objective behind the two set of circulars, first set being Circulars of 1993 and 2016 and second set being Circulars of 2003 and 2005, were completely different. For the same reasons, different methods of calculation have been used in these two sets of circulars. In this regard it is noted that, the set of 2003 and 2005 Circular laid down norms for calculation of exposure being provided by a clearing corporation to a TCM, basis deposit of assets by such TCM with clearing corporations. The said calculation is made on the basis of risk management

framework of the stock exchanges, wherein the primary consideration is the exposure being provided to a stock broker/TCM which should not be so much that it causes stress on risk management system of clearing corporations in case of default by the said TCM. As the calculation in such a scenario is based on probable default by the TCM, the full value of bank guarantee is taken into consideration as, in case of default by the said TCM like the *Notinee*, the invocation of bank guarantee would entitle the stock exchange to get the full value of bank guarantee, irrespective of the fact that the entire value in the bank guarantee was not funded by stock broker. The recovery of non-funded portion of bank guarantee by the bank from the stock broker (TCM) is governed by the contractual terms between bank and the stock broker concerned, and has no adverse impact on the liability of the bank to honour its Bank Guarantee to the stock exchange/clearing corporation. On the other hand, the set of 1993 and 2016 Circulars were issued for the purpose of calculation of use of clients funds in day to day settlement of clients' trades. For the same calculation, a strict interpretation has deliberately been taken as the non-funded portion of bank guarantee cannot be taken into consideration to calculate the extent of usage or non-usage of clients funds as the said non funded part of bank guarantee is neither a part of clients' funds nor has been created on the basis of own funds of stock broker and therefore is nothing but an accounting creation not backed by any real funding but based on the comfort level that exists between banks and its clients. The said bank guarantee doesn't come into picture until the stock broker defaults and the said bank guarantee can be invoked only by the clearing corporation against the defaulted amount by the Stock Broker (TCM) and such non-funded portion of bank guarantee remains unutilized for all practical purposes as the same cannot be utilized in day by day settlement of trades of the clients. The non-funded portion of bank guarantee actually represents the funds of the bank, which has been provided as a facility by a bank to the stock broker

on the basis of its relationship with such Stock Broker. The same doesn't become part of stock brokers' available fund for utilization in day-to-day settlement of its trades (on behalf of its clients or for its own trades) unless and until the bank guarantee is invoked which will happen only when the Stock Broker defaults and the said funds then becomes available for the use of the clearing corporation against the default of the stock broker. Therefore, as the non-funded portion of bank guarantee doesn't come either under clients' funds or stock broker's own funds and the same is basically a part of bank's funds, the said funds finds no space in the calculation of funds actually available at the disposal of the Broker for use on a day-to-day basis of its operation.

72. A stock broker cannot be allowed to play the mischief of using the non-funded portion of a bank guarantee in order to artificially inflate the quantum of funds and to show it as available with it for its business operation since, only the deposits made by its clients and tangible funds arranged by it on its own are the actual money available with it for day to day settlement of trades and it is on those actual funds available with the stock Broker that the provisions of SEBI 1993 Circular apply. For the purpose of calculation of the use of clients' funds, a comparison of liabilities of stock broker in its ledger is required to be made with all the funds available in the records of stock broker, be it in clients' bank account or the funds lying with clearing corporation. Such fund to fund comparison provides the real picture about the use of clients funds by the stock broker. In such a calculation, funds cannot be compared with 'guarantee', and only the funded portion of bank guarantee can be taken into consideration (as the same is actually backed by funds) to examine the usage of clients funds. The non-funded portion of bank guarantee is banks' own funds and cannot fall in the bracket of either the clients' funds or stock broker's own funds. At the same time, the right of clearing corporation on the non-funded portion of bank guarantee doesn't kick in till such bank guarantee is invoked, which happens only in a default case

scenario and has no role to play in day to day settlement of trades of the stock broker as well as that of its clients. Allowing such non-funded portion of bank guarantee to creep into the calculation of usage of clients' funds would allow the stock brokers to play with the funds of credit clients in the garb of availability of bank guarantee, while not touching or invoking the bank guarantee at all for the purpose of day to day settlement of proprietary as well as clients' trades.

73. For the said reasons as explained above, I find that the submission of the *Noticee* that non-funded portion of bank guarantee should be included in the calculation of usage of clients' funds i.e. 'G Value' doesn't hold any ground and such inclusion of non-funded portion will work only to hide the misuse of clients funds in a situation wherein it has not actually used its bank guarantee at all and instead has used the funds of credit balance clients to fund the trades of debit balance clients. All these will work against the spirit of SEBI 1993 Circular and would allow the *Noticee* to misuse the clients' funds by taking shelter under the plea of availability of bank guarantee in its hands and such partly-funded bank guarantees can also be ever-greened by the stock broker based on its good rapport with the bank just to show availability of funds at its disposal for settlement that can never be used for day-to-day settlement. I cannot allow the *Noticee* to continue such mischief which the SEBI 1993 Circular intended to end.

74. The *Noticee* has also contended that net creditors balance [i.e. balance of total credit balance clients (column B in Table 1)- funds required for total debit balance clients (column A in Table 1)] should be considered instead of aggregate credit client balance while calculating the value of "G". However, if the aforesaid parameter is adopted for calculation of funds available for usage of clients' trades, then it would completely validate a stock broker's use of excess funds of one client to meet the liability of another client, which is completely contrary to the requirements of the SEBI 1993 Circular and would go against the letter and spirit

of the said Circular. I find that a similar contention was raised before the Hon'ble SAT in the matter of *Sushil Financial Services Pvt. Ltd. vs. SEBI*, (*Appeal No. 196 of 2016*), where, vide its decision dated November 06, 2019, the Hon'ble Tribunal has held that:

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

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

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

75. Once the aforesaid contentions of the *Noticee* are negated, I find no merit in the contentions of the *Noticee* against the calculation of 'G' value as depicted in SCN dated May 02, 2017 as well as in SCN dated October 28, 2021 and in Annexures 2, 3 and 4 of the said SCN dated October 28, 2021. The following clearly establishes the violations of SEBI 1993 Circular by the *Noticee*:

75.1. From the sample data collected for 10 trading days during Supplementary Inspection I, I find that the *Noticee* had misutilized the credit clients' funds for settlement obligation of debit balance clients for 7 trading days. The

misutilization of credit clients' funds by the *Noticee* for settlement of trades of clients having debit balance ranged from INR 12.95 crores to INR 100.02 crores for the selected sample of trading days as per the calculations made below:

In INR and Crores											
#	Date	Aggregate Clients Debit Balances as per Trial Balance (After adjusting for open bills & uncleared cheques)	Aggregate Clients Credit Balances as per Trial Balance (After adjusting for open bills & uncleared cheques)	Total of Client Bank Balances	Collateral Deposited with Exchanges by IIFL			Total Cash available with Exchange after adjusted 50% BG	Total Cash available with broker (E+C=F)	Broker used client funds (F- B=G)	
		A	B	C	D			Total	E	F	G
					Cash	FD	BG				
1	20/06/2013	247.44	371.06	22.62	70.99	3.5	522	596.49	335.49	358.11	(12.95)
2	21/06/2013	243.13	337.74	30.22	70.99	3.5	522	596.49	335.49	365.71	27.97
3	18/06/2013	199.42	353.83	15.55	51.99	3.5	522	577.49	316.49	332.04	(21.79)
4	19/06/2013	212.84	369.27	13.40	54.99	3.5	522	580.49	319.49	332.89	(36.38)
5	24/06/2013	276.28	326.17	43.03	70.99	3.5	522	596.49	335.49	378.52	52.35
6	25/06/2013	264.49	325.05	25.85	70.99	3.5	522	596.49	335.49	361.34	36.29
7	23/10/2013	167.05	364.23	14.46	1.7	6.85	510	518.55	263.55	278.01	(86.22)
8	24/10/2013	167.52	352.44	8.54	1.7	6.85	510	518.55	263.55	272.09	(80.35)
9	27/12/2012	180.33	423.26	27.73	98.34	2.6	505	605.94	353.44	381.17	(42.09)
10	28/12/2012	182.24	398.18	22.72	20.34	2.6	505	527.94	275.44	298.16	(100.02)

For example, in the aforementioned table, on June 20, 2013, the total liability of the *Noticee* towards its credit balance clients was INR 371.06 Crores (mentioned at column B) whereas total cash available with the *Noticee* on the said day was INR 358.11 Crores only (mentioned at column F) which was nothing but addition of clients bank accounts balances (mentioned at column C) and the funds kept by the *Noticee* with the clearing corporation (calculated at column E after deducting the non-funded portion of bank guarantee from the funds deposited by the *Noticee* with clearing corporation based on the rational logic as explained aforesaid). Ultimately, I find that there is a deficit of INR 12.95 Crores between the aggregate liabilities of the *Noticee* towards its credit balance clients and the funds available with it. This clearly shows

that the funds of such credit balance clients have been misused for the settlement of other trades. As the liabilities of debit balance clients (mentioned at column A) are more than the deficit found in the records of the *Noticee*, it is presumed that the deficit amount was utilized for the settlement of trades of debit balance clients.

75.2. From the sample data collected in respect of 105 trading days during Supplementary Inspection II, the *Noticee* is found to have misutilized the credit clients' funds for settlement obligation of debit balance clients for 101 days, which amounts to 96% of the total selected sample days. The misutilization of credit clients' funds by the *Noticee* for the trades of clients having debit balances ranged from INR 1.09 crores to INR 397.02 crores for the selected sample days as per calculations below:

(In INR and Crores)										
#	Date	Aggregate clients' debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients' credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total of client bank balances	Collateral deposited with exchanges by IIFL				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with exchanges i.e. cash+ FD +50% BG]	Broker used credit clients' funds for debit clients purpose (E-B=F)
		A	B	C	D			Total	E	F
					Cash	FD	BG			
1	10-Mar-14	183.49	337.63	10.94	12.54	7.65	446.10	466.29	254.19	(83.45)
2	13-Mar-12	485.20	646.71	20.25	23.59	28.30	355.10	406.99	249.69	(397.02)
3	6-Jan-12	185.45	407.96	8.30	35.09	22.50	345.10	402.69	238.43	(169.53)
4	16-May-14	266.77	462.27	18.83	75.29	1.65	509.10	586.04	350.32	(111.95)
5	28-Apr-11	352.63	461.97	29.29	35.47	-	270.00	305.47	199.76	(262.20)
6	27-May-14	254.47	541.59	23.73	30.29	1.65	529.10	561.04	320.22	(221.37)
7	13-Jan-12	200.83	423.78	8.01	7.09	32.50	345.10	384.69	220.15	(203.63)
8	8-Aug-11	304.15	476.23	12.71	3.17	-	350.00	353.17	190.88	(285.35)
9	26-Dec-11	196.61	405.04	6.60	7.09	22.50	355.10	384.69	213.74	(191.30)
10	26-Apr-11	388.46	474.46	40.61	15.47	-	270.00	285.47	191.08	(283.38)
11	31-Jan-12	181.77	483.80	6.62	17.09	32.50	345.10	394.69	228.75	(255.05)
12	16-Jun-14	253.45	494.51	28.56	13.29	1.65	538.10	553.04	312.55	(181.96)
13	18-Apr-11	384.33	486.46	25.56	36.12	0.87	253.50	290.49	189.30	(297.16)
14	23-Sep-11	322.89	513.74	19.13	55.59	-	413.60	469.19	281.52	(232.22)
15	10-Jun-14	245.96	569.45	21.55	58.29	1.65	538.10	598.04	350.54	(218.91)

(In INR and Crores)										
#	Date	Aggregate clients' debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients' credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total of client bank balances	Collateral deposited with exchanges by IIFL				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with exchanges i.e. cash+ FD BG]	Broker used credit clients' funds for debit clients purpose (E-B=F)
		A	B	C	D			Total	E	F
					Cash	FD	BG			
16	23-Feb-12	253.28	527.59	10.60	50.59	28.30	355.10	433.99	267.04	(260.55)
17	11-Apr-14	145.69	375.08	40.68	20.39	1.65	489.10	511.14	307.27	(67.81)
18	5-Jul-12	141.09	404.60	5.92	66.18	0.80	370.10	437.08	257.95	(146.64)
19	19-May-11	365.95	441.46	26.91	10.47	-	330.00	340.47	202.38	(239.08)
20	13-May-14	93.10	386.13	19.28	40.29	1.65	489.10	531.04	305.77	(80.36)
21	11-Nov-11	302.75	450.19	7.97	7.09	27.50	365.10	399.69	225.10	(225.08)
22	4-Oct-11	277.02	438.65	11.27	5.59	-	413.60	419.19	223.66	(215.00)
23	4-May-11	406.19	436.22	39.06	2.47	-	320.00	322.47	201.53	(234.69)
24	20-Mar-14	156.86	318.16	18.11	20.54	7.65	466.10	494.29	279.35	(38.81)
25	18-Apr-13	169.91	362.95	18.69	42.99	3.50	532.10	578.59	331.23	(31.72)
26	12-Mar-13	216.14	327.01	20.31	17.49	2.50	532.10	552.09	306.35	(20.66)
27	21-Feb-12	236.34	512.16	13.02	48.94	28.30	355.10	432.34	267.81	(244.36)
28	10-Apr-12	181.32	412.17	7.23	23.59	28.30	345.10	396.99	231.67	(180.50)
29	26-Mar-12	509.87	362.99	21.84	39.59	28.30	355.10	422.99	267.28	(95.71)
30	2-May-11	412.13	476.22	29.00	45.47	-	270.00	315.47	209.47	(266.76)
31	5-Sep-11	222.81	418.50	10.43	5.19	10.00	333.60	348.79	192.42	(226.08)
32	29-Aug-11	254.42	381.64	10.96	5.09	-	323.60	328.69	177.84	(203.80)
33	9-Aug-11	303.65	377.66	28.77	25.32	-	383.60	408.92	245.89	(131.78)
34	19-Apr-11	386.31	476.84	20.96	46.12	0.87	253.50	300.49	194.70	(282.14)
35	27-Jul-11	289.79	425.12	9.53	15.61	-	351.70	367.31	200.99	(224.13)
36	16-Jan-12	209.51	414.33	8.35	7.09	32.50	345.10	384.69	220.49	(193.84)
37	13-Sep-11	280.15	452.47	13.02	29.19	10.00	333.60	372.79	219.00	(233.46)
38	27-Mar-12	468.37	347.06	17.04	26.59	28.30	355.10	409.99	249.48	(97.58)
39	12-Sep-11	267.22	449.42	11.69	18.19	10.00	333.60	361.79	206.68	(242.75)
40	2-Nov-11	255.15	493.63	6.49	7.09	20.00	365.10	392.19	216.12	(277.51)
41	20-May-14	298.10	551.26	20.91	100.29	1.65	509.10	611.04	377.41	(173.85)
42	21-Jan-13	232.34	390.21	7.77	13.79	2.60	520.10	536.49	284.22	(105.99)
43	7-Oct-11	233.27	418.90	16.58	5.59	-	413.60	419.19	228.97	(189.94)
44	19-Jun-14	287.13	491.25	21.84	13.29	1.65	538.10	553.04	305.83	(185.42)
45	12-Jun-14	313.95	504.53	32.68	58.29	1.65	538.10	598.04	361.68	(142.85)
46	13-Dec-11	243.59	422.82	8.63	7.09	32.50	355.10	394.69	225.77	(197.05)
47	4-Jul-12	138.36	406.67	6.02	46.07	0.80	345.10	391.97	225.44	(181.24)
48	21-Nov-11	336.92	417.03	26.98	7.09	32.50	365.10	404.69	249.12	(167.91)
49	11-Apr-11	338.46	535.15	12.62	36.12	0.87	253.50	290.49	176.35	(358.80)
50	12-Jul-12	163.42	400.34	8.76	97.87	0.10	400.10	498.07	306.78	(93.56)
51	30-Nov-11	176.04	423.40	7.93	7.09	32.50	345.10	384.69	220.07	(203.33)
52	24-Nov-11	283.99	455.48	16.35	7.09	32.50	345.10	384.69	228.49	(226.99)

(In INR and Crores)										
#	Date	Aggregate clients' debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients' credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total of client bank balances	Collateral deposited with exchanges by IIFL				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with exchanges i.e. cash+ FD BG]	Broker used credit clients' funds for debit clients purpose (E-B=F)
		A	B	C	D			Total	E	F
					Cash	FD	BG			
53	24-Apr-12	235.74	373.01	7.29	36.08	28.30	325.10	389.48	234.22	(138.79)
54	19-Oct-11	285.16	422.71	9.09	6.59	-	413.60	420.19	222.48	(200.23)
55	27-Sep-11	232.20	485.18	12.39	5.59	-	413.60	419.19	224.77	(260.41)
56	16-Mar-12	517.56	468.58	22.30	20.59	28.30	355.10	403.99	248.74	(219.84)
57	23-May-13	217.25	441.21	13.69	34.99	3.50	532.10	570.59	318.24	(122.98)
58	13-Feb-12	205.07	512.29	13.14	29.09	28.30	345.10	402.49	243.07	(269.22)
59	12-Jun-13	207.41	356.70	11.63	19.99	3.50	522.10	545.59	296.17	(60.53)
60	9-May-12	272.21	346.56	12.05	68.58	13.30	340.10	421.98	263.98	(82.58)
61	4-Apr-13	150.03	323.47	14.96	27.49	2.50	532.10	562.09	311.01	(12.47)
62	25-Jul-13	187.93	349.11	16.41	54.99	3.50	522.10	580.59	335.95	(13.16)
63	1-Mar-13	266.12	326.42	16.33	40.49	2.50	520.10	563.09	319.38	(7.04)
64	9-Dec-11	238.86	446.77	9.28	7.09	32.50	355.10	394.69	226.42	(220.35)
65	12-Mar-14	171.85	353.15	24.61	12.54	7.65	446.10	466.29	267.86	(85.30)
66	4-Dec-12	205.39	470.52	13.90	70.84	2.60	495.10	568.54	334.89	(135.63)
67	30-May-14	293.39	521.20	19.25	14.29	1.65	538.10	554.04	304.24	(216.95)
68	21-Oct-11	297.82	460.52	13.76	6.59	-	413.60	420.19	227.15	(233.38)
69	29-Sep-11	231.97	454.62	10.54	5.59	-	413.60	419.19	222.93	(231.69)
70	27-Sep-12	161.20	471.44	5.69	46.78	2.60	485.10	534.48	297.62	(173.82)
71	14-Sep-11	289.90	450.22	13.28	42.19	10.00	333.60	385.79	232.26	(217.95)
72	19-Aug-13	207.76	324.30	26.03	19.57	0.50	540.10	560.17	316.15	(8.15)
73	21-Jul-11	270.93	424.96	7.48	27.17	-	330.00	357.17	199.65	(225.31)
74	27-Jul-12	187.97	331.00	7.27	5.28	0.10	490.10	495.48	257.70	(73.29)
75	18-Dec-13	175.88	343.67	14.12	6.39	6.85	400.10	413.34	227.41	(116.26)
76	15-Dec-11	247.91	402.96	9.62	7.09	32.50	355.10	394.69	226.75	(176.21)
77	1-Dec-11	181.09	391.66	8.85	7.09	32.50	355.10	394.69	225.99	(165.67)
78	15-Jun-12	155.40	367.97	8.32	34.33	0.80	370.10	405.23	228.50	(139.47)
79	9-Jan-12	274.23	415.18	5.90	7.09	22.50	365.10	394.69	218.03	(197.15)
80	4-Feb-14	207.98	326.60	18.17	2.39	6.85	421.10	430.34	237.96	(88.63)
81	4-Sep-13	195.80	323.34	11.55	14.56	0.50	528.60	543.66	290.91	(32.43)
82	6-May-13	143.39	406.30	5.32	34.99	3.50	532.10	570.59	309.86	(96.44)
83	28-Feb-12	286.09	480.54	9.80	42.09	28.30	355.10	425.49	257.74	(222.80)
84	23-May-14	306.06	528.30	21.95	40.29	1.65	519.10	561.04	323.44	(204.85)
85	28-May-12	218.70	373.32	8.66	29.58	0.80	370.10	400.48	224.09	(149.23)
86	19-Dec-11	266.97	400.49	10.25	7.09	32.50	355.10	394.69	227.39	(173.10)
87	16-Aug-11	299.36	408.19	10.53	23.83	-	484.40	508.23	276.56	(131.62)
88	3-Jan-14	170.56	389.73	19.76	22.39	6.85	400.10	429.34	249.06	(140.67)
89	24-Jul-12	172.90	372.81	8.29	63.02	0.10	490.10	553.22	316.47	(56.34)

(In INR and Crores)										
#	Date	Aggregate clients' debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients' credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total of client bank balances	Collateral deposited with exchanges by IIFL				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with exchanges i.e. cash+ FD BG]	Broker used credit clients' funds for debit clients purpose (E-B=F)
		A	B	C	D			Total	E	F
					Cash	FD	BG			
90	25-Oct-12	213.01	428.96	10.62	22.28	2.60	445.10	469.98	258.05	(170.91)
91	27-Aug-12	208.64	384.81	3.87	20.10	2.60	520.10	542.80	286.62	(98.18)
92	28-Aug-13	212.58	296.24	15.04	9.56	0.50	540.10	550.16	295.15	(1.09)
93	4-May-12	237.08	357.37	24.86	49.58	18.30	325.10	392.98	255.29	(102.08)
94	5-Oct-11	262.14	432.60	5.77	5.59	-	413.60	419.19	218.15	(214.45)
95	19-May-14	246.49	417.49	21.70	90.29	1.65	509.10	601.04	368.19	(49.30)
96	17-Jan-13	236.63	410.88	14.24	22.79	2.60	520.10	545.49	299.68	(111.20)
97	20-Mar-12	501.16	427.46	11.27	18.59	28.30	355.10	401.99	235.71	(191.76)
98	28-Sep-12	175.05	444.90	9.79	44.28	2.60	485.10	531.98	299.23	(145.67)
99	17-May-12	249.90	351.19	13.59	53.58	0.80	350.10	404.48	243.03	(108.17)
100	5-Jul-11	260.80	437.31	16.92	11.47	-	330.00	341.47	193.39	(243.92)
101	6-Jun-14	285.67	523.31	18.32	38.29	1.65	538.10	578.04	327.31	(195.99)

For example, in the aforementioned table, on June 06, 2014, the total liability of the *Noticee* towards its credit balance clients was INR 523.31 Crores (mentioned at column B) whereas total cash available with the *Noticee* on the said day was INR 327.31 Crores only (mentioned at column E) which was nothing but addition of clients bank accounts balances (mentioned at column C) and the funds kept by the *Noticee* with the clearing corporation (calculated at column E itself after deducting non-funded portion of bank guarantee from funds deposited by the *Noticee* with clearing corporation for the reasons as explained above). Ultimately, I find that there is a deficit of INR 195.99 Crores between the liabilities of the *Noticee* towards its credit balance clients and funds available with it. This clearly shows that the funds of such credit balance clients have been misused for settlement of other trades. As the liabilities of debit balance clients (mentioned at column A) are more than the deficit found in the records of the *Noticee* (calculated at column F), it can be

surely presumed that the deficit amount was utilized for settlement of trades of debit balance clients.

75.3. From the sample data collected in respect of 105 trading days during Supplementary Inspection II, the *Noticee* is also found to have misutilized the credit clients' funds for settlement obligation of its own proprietary trades for 13 days. The misutilization of credit clients' funds for settlement of proprietary trades of the *Noticee* ranged from INR 2.02 crores to INR 73.28 crores for the selected sample days as per the calculations below:

#	Date	Aggregate clients debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total of client bank balances	Collateral deposited with exchanges by IIFL				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + collateral with exchanges i.e Cash+FD+ 50%BG]	Broker used credit client fund for debit clients purpose (E-B=F)	Broker used Client fund for own purpose (F-A=G)
					A	B	C	D			
Cash	FD	BG									
1	13-Jan-12	200.83	423.78	8.01	7.09	32.50	345.10	384.69	220.15	(203.63)	(2.80)
2	31-Jan-12	181.77	483.80	6.62	17.09	32.50	345.10	394.69	228.75	(255.05)	(73.28)
3	23-Feb-12	253.28	527.59	10.60	50.59	28.30	355.10	433.99	267.04	(260.55)	(7.27)
4	5-Jul-12	141.09	404.60	5.92	66.18	0.80	370.10	437.08	257.95	(146.64)	(5.56)
5	21-Feb-12	236.34	512.16	13.02	48.94	28.30	355.10	432.34	267.81	(244.36)	(8.02)
6	5-Sep-11	222.81	418.50	10.43	5.19	10.00	333.60	348.79	192.42	(226.08)	(3.27)
7	2-Nov-11	255.15	493.63	6.49	7.09	20.00	365.10	392.19	216.12	(277.51)	(22.36)
8	4-Jul-12	138.36	406.67	6.02	46.07	0.80	345.10	391.97	225.44	(181.24)	(42.88)
9	11-Apr-11	338.46	535.15	12.62	36.12	0.87	253.50	290.49	176.35	(358.80)	(20.33)
10	30-Nov-11	176.04	423.40	7.93	7.09	32.50	345.10	384.69	220.07	(203.33)	(27.29)
11	27-Sep-11	232.20	485.18	12.39	5.59	-	413.60	419.19	224.77	(260.41)	(28.21)
12	13-Feb-12	205.07	512.29	13.14	29.09	28.30	345.10	402.49	243.07	(269.22)	(64.15)
13	27-Sep-12	161.20	471.44	5.69	46.78	2.60	485.10	534.48	297.62	(173.82)	(12.62)

For example, in the aforementioned table, on September 27, 2012, the total liability of the *Noticee* towards its credit balance clients was INR 471.44 Crores (mentioned at column B) whereas total cash available with the *Noticee*

on the said day was INR 297.62 Crores only (mentioned at column E) which was nothing but addition of clients bank accounts balances (mentioned at column C) and funds kept by the *Noticee* with the clearing corporation (calculated at column E itself after deducting non-funded portion of bank guarantee from funds deposited by the *Noticee* with clearing corporation). Ultimately, I find that there is a deficit of INR 173.82 Crores between the liabilities of the *Noticee* towards its credit balance clients and the funds available with it. This clearly shows that the funds of such credit balance clients have been misused for settlement of other trades. Now in the present case, the liabilities of debit balance clients were INR 161.20 Crores only (mentioned at column A), which is less than the deficit found viz. INR 173.82 Crores. This gives rise to the next presumption that the funds left after being used to settle the trades of debit balance clients for INR 161.20 crores were utilized for settlement of proprietary trades of the *Noticee*. Such amount of funds utilized for settlement of proprietary trades comes out to be INR 12.62 Crores (mentioned at column G).

75.4. From the data collected in respect of 695 trading days during Supplementary Inspection III, the *Noticee* had misutilized the credit clients' funds for settlement obligation of debit balance clients for 687 days which amounts to 98.85% of the total trading days during the inspection period (April 01, 2011 to June 30, 2014) sans the days for which data had already been collected in Supplementary Inspection I and II. The misutilization of credit clients' funds by the *Noticee* ranged from INR 0.58 crores to INR 309.23 crores for those selected trading days. As the data for those trading days is quite large in number, a fact that has not been disputed by the *Noticee*, for the sake of brevity, I refrain from reproducing the said data here.

75.5. From the data collected with respect to 695 trading days during

Supplementary Inspection III, it is observed that the *Noticee* had also misutilized the credit clients' funds for settlement obligation of its own proprietary trades on 29 days. The misutilization of credit clients' funds for settlement of proprietary trades of the *Noticee* ranged from INR 0.26 crores to INR 42.51 crores during these 29 days as per the calculation below:

In INR and in Crores only											
#	Dates	Aggregate client debit balances as per trial balances (Debtors)	Aggregate client credit balances as per trial balances (Creditors)	Total client bank balance	Collaterals deposited with all exchanges by IIFL with supporting documents of exchanges				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with Exchanges] Cash+FD+ 50% BG]	Broker used credit client fund to debit clients purpose (E=B-F)	Broker used client fund for own purpose (F+A=G)
		(after adjusting for open bills & uncleared cheques)	(after adjusting for open bills & uncleared cheques)								
		A	B		D				E	F	G
					Cash	FD	BG	Total			
1	30-Jun-2011	238.76	482.80	8.22	363.50	13.11	0.00	376.61	203.08	(279.71)	(40.95)
2	29-Dec-2011	228.79	474.85	36.76	345.10	10.12	22.50	377.72	241.92	(232.93)	(4.14)
3	12-Jan-2012	216.19	442.18	7.02	345.10	8.29	32.50	385.89	220.35	(221.82)	(5.64)
4	19-Jan-2012	237.74	453.24	6.91	325.10	13.29	32.50	370.89	215.25	(237.99)	(0.26)
5	23-Jan-2012	233.30	477.45	8.50	345.10	8.29	32.50	385.89	221.84	(255.61)	(22.32)
6	25-Jan-2012	243.98	514.00	10.81	345.10	33.29	32.50	410.89	249.14	(264.85)	(20.88)
7	30-Jan-2012	250.51	510.46	7.29	345.10	18.29	32.50	395.89	230.63	(279.83)	(29.31)
8	02-Feb-2012	246.73	500.17	11.53	345.10	25.29	32.50	402.89	241.86	(258.31)	(11.58)
9	03-Feb-2012	255.13	498.54	12.32	345.10	15.29	32.50	392.89	232.66	(265.88)	(10.75)
10	06-Feb-2012	253.89	507.24	5.71	345.10	30.29	32.50	407.89	241.05	(266.19)	(12.30)
11	07-Feb-2012	238.19	515.60	7.56	345.10	22.29	32.50	399.89	234.90	(280.71)	(42.51)
12	09-Feb-2012	269.26	503.69	5.22	345.10	27.29	28.30	400.69	233.35	(270.34)	(1.08)
13	10-Feb-2012	269.34	534.27	9.06	345.10	30.29	28.30	403.69	240.20	(294.07)	(24.72)
14	14-Feb-2012	265.29	529.55	17.47	345.10	31.09	28.30	404.49	249.41	(280.14)	(14.85)
15	15-Feb-2012	276.77	538.29	6.42	355.10	34.39	28.30	417.79	246.66	(291.63)	(14.86)
16	16-Feb-2012	284.82	546.98	-8.28	355.10	56.64	28.30	440.04	254.20	(292.77)	(7.95)
17	28-Jun-2012	185.68	412.42	4.58	370.10	34.73	0.80	405.63	225.16	(187.26)	(1.58)
18	20-Sep-2012	176.91	465.31	4.98	485.10	17.18	3.30	505.58	268.02	(197.29)	(20.39)
19	26-Sep-2012	205.68	492.41	7.27	485.10	28.18	3.30	516.58	281.31	(211.10)	(5.42)
20	08-Oct-2012	221.03	493.37	7.60	445.10	33.68	3.30	482.08	267.14	(226.23)	(5.20)
21	02-Dec-2013	145.31	431.46	9.38	445.60	6.48	6.85	458.93	245.51	(185.95)	(40.64)
22	03-Dec-2013	145.96	411.39	15.13	445.60	10.48	6.85	462.93	255.26	(156.13)	(10.17)
23	04-Dec-2013	142.27	407.58	13.09	445.60	10.48	6.85	462.93	253.21	(154.37)	(12.10)
24	06-Dec-2013	141.21	396.04	15.89	420.60	10.48	6.85	437.93	243.52	(152.52)	(11.31)
25	09-Dec-2013	159.55	409.21	13.92	420.60	10.48	6.85	437.93	241.55	(167.66)	(8.11)

In INR and in Crores only											
#	Dates	Aggregate client debit balances as per trial balances (Debtors) (after adjusting for open bills & uncleared cheques)	Aggregate client credit balances as per trial balances (Creditors) (after adjusting for open bills & uncleared cheques)	Total client bank balance	Collaterals deposited with all exchanges by IIFL with supporting documents of exchanges				Total funds available with broker after adjusted 50% of BG [Client bank balances (C) + Collateral with Exchanges] Cash+FD+ 50% BG]	Broker used credit fund to debit clients purpose (E=B-F)	Broker used client fund for own purpose (F+A=G)
		A	B	C	D				E	F	G
					Cash	FD	BG	Total			
26	10-Dec-2013	162.55	405.31	12.07	420.60	10.48	6.85	437.93	239.70	(165.61)	(3.06)
27	11-Dec-2013	170.55	425.67	14.66	420.60	10.48	6.85	437.93	242.29	(183.38)	(12.83)
28	02-Jan-2014	157.50	400.97	8.62	400.60	20.45	6.85	427.90	236.23	(164.75)	(7.25)
29	12-May-2014	148.27	436.89	20.20	489.60	16.30	1.65	507.55	282.95	(153.94)	(5.67)

75.6. From the data collected in respect of 30 trading days during March 2017

Inspection, the *Noticee* is found to have misutilized the credit clients' funds for settlement obligation of the debit balance clients on all those 30 days.

The misutilization of credit clients' funds by the *Noticee* for settlement of debit balance clients ranged from INR 26.04 crores to INR 294.73 crores for the afore stated selected days as per the calculation below:

In INR and In Crores only													
#	Date	Bank balances (Client & settlement bank a/c)			Cash collaterals with all exchanges				Aggregate clients credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total funds available with broker after adjusted 50% of BG	Broker used credit client fund to debit clients purpose {(A+B)-C=G} If G negative balance	% Misuse
		A			B				C	D	Total (A+B)	G	G/C*100
		Client bank balance	Settlement bank balance	Total	BG (50%)	Cash	FD	Total					
1	10-Jul-15	163.46	0.19	163.65	250.05	5.42	4.35	259.81	610.90	227.66	423.46	(187.44)	30.68
2	26-Aug-15	87.85	0.24	88.09	250.05	149.52	3.49	403.06	764.95	341.53	491.15	(273.80)	35.79
3	01-Sep-15	122.39	0.14	122.53	250.05	22.55	2.48	275.08	590.97	271.00	397.61	(193.36)	32.72
4	03-Sep-15	81.55	0.05	81.60	250.05	22.55	2.48	275.08	555.15	280.89	356.68	(198.47)	35.75
5	18-Sep-15	227.81	0.02	227.83	250.05	17.55	4.90	272.50	735.22	324.16	500.33	(234.89)	31.95

In INR and In Crores only													
#	Date	Bank balances (Client & settlement bank a/c)			Cash collaterals with all exchanges				Aggregate clients credit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Aggregate clients debit balances as per trial balance (after adjusting for open bills & uncleared cheques)	Total funds available with broker after adjusted 50% of BG	Broker used credit client fund to debit clients purpose {(A+B)-C=G} If G negative balance	% Misuse
		A			B				C	D	Total (A+B)	G	G/C*100
		Client bank balance	Settlement bank balance	Total	BG (50%)	Cash	FD	Total					
6	23-Sep-15	204.33	0.03	204.35	250.05	17.55	4.90	272.50	686.99	306.48	476.85	(210.13)	30.59
7	16-Oct-15	79.06	0.34	79.40	250.05	4.07	4.58	258.69	586.89	342.31	338.09	(248.80)	42.39
8	19-Oct-15	87.59	0.37	87.95	250.05	4.07	4.58	258.69	594.13	329.07	346.64	(247.48)	41.66
9	27-Nov-15	93.30	0.06	93.37	250.05	8.04	4.04	262.13	569.46	326.20	355.50	(213.96)	37.57
10	22-Dec-15	177.25	0.06	177.32	250.05	4.07	5.04	259.15	597.62	277.09	436.47	(161.15)	26.97
11	14-Jan-16	134.11	0.11	134.23	250.05	63.98	5.04	319.07	653.83	369.78	453.30	(200.53)	30.67
12	03-Feb-16	66.04	0.21	66.25	250.05	65.56	5.54	321.14	571.28	342.18	387.39	(183.89)	32.19
13	29-Feb-16	95.19	0.23	95.42	250.05	91.65	5.44	347.13	579.45	302.16	442.55	(136.90)	23.63
14	10-Mar-16	187.51	0.39	187.90	250.05	78.07	5.94	334.05	619.89	273.85	521.95	(97.94)	15.80
15	31-Mar-16	309.22	0.03	309.25	250.05	59.14	5.44	314.63	649.92	300.56	623.88	(26.04)	4.01
16	17-May-16	183.28	0.63	183.92	241.55	99.61	4.01	345.17	621.68	314.80	529.08	(92.60)	14.90
17	23-May-16	101.90	0.67	102.57	241.55	115.19	4.01	360.75	587.52	329.53	463.32	(124.20)	21.14
18	25-May-16	166.23	0.67	166.90	241.55	146.57	4.01	392.13	689.79	348.60	559.03	(130.76)	18.96
19	08-Jul-16	121.60	0.37	121.97	246.55	75.20	4.01	325.76	657.94	421.11	447.73	(210.20)	31.95
20	29-Aug-16	192.47	0.56	193.04	246.55	54.87	7.51	308.93	671.65	417.36	501.97	(169.68)	25.26
21	12-Sep-16	309.06	0.00	309.07	246.55	144.81	17.51	408.87	902.54	439.63	717.94	(184.60)	20.45
22	14-Sep-16	59.55	0.00	59.56	246.55	242.31	17.01	505.87	849.31	437.54	565.43	(283.88)	33.42
23	15-Sep-16	191.94	0.00	191.95	246.55	242.31	17.01	505.87	783.73	438.88	697.82	(85.91)	10.96
24	18-Oct-16	162.59	0.00	162.59	246.55	97.89	16.22	360.66	685.75	349.59	523.25	(162.50)	23.70
25	10-Nov-16	74.54	0.00	74.55	246.55	83.87	16.22	346.64	690.89	508.28	421.18	(269.71)	39.04
26	11-Nov-16	147.05	0.00	147.05	246.55	83.87	16.22	346.64	684.95	429.86	493.69	(191.25)	27.92
27	15-Nov-16	153.28	0.00	153.28	246.55	111.94	16.22	374.71	714.22	431.85	528.00	(186.22)	26.07
28	25-Nov-16	201.36	0.00	201.37	246.55	92.78	16.72	356.05	700.36	349.33	557.41	(142.95)	20.41
29	05-Dec-16	39.49	0.00	39.49	246.55	43.71	16.72	306.98	641.20	351.26	346.47	(294.73)	45.97
30	16-Dec-16	47.12	0.00	47.13	246.55	65.50	16.22	328.27	621.75	339.02	375.40	(246.35)	39.62

76. All the above cited calculations have not been factually challenged by the *Notinee* except for the submissions made by it to protest against the exclusion of non-funded portion of the Bank Guarantees and the so called retrospective application of the aforesaid calculation which has already been dealt with above in the present order. Therefore, these calculations clearly show that the *Notinee* has misused funds of clients having credit balances in their accounts maintained

in the ledger of the *Noticee* to fund trades of clients who were having debit balances in its records. The said funding of debit balance clients' trades using funds of credit balance clients have been done by the *Noticee* on a total of 795 trading days out of 809 total trading days covered for examination during the inspection period viz. April 01, 2011 to June 30, 2014 and on 30 trading days during April 01, 2015 to January 31, 2017.

77. At the same time, the *Noticee* had also used funds of clients having credit balances in its ledgers to fund its own proprietary transactions on 42 trading days during the inspection period viz. April 01, 2011 to June 30, 2014. Taking into account the aforementioned data, I do not find any difficulty in holding that the *Noticee*, by misusing the moneys of credit clients to fund the trades of clients having debit balance in its records as well as for its own proprietary trades, has violated the provisions of the Clause 1(D) of SEBI 1993 Circular.

78. Lastly, it has been alleged in the SCN that the *Noticee* has also breached Clauses A(1), (2) & (5) of the Code of Conduct provided under Schedule II read with Regulation 9 of the Stock Broker Regulations, which every registered stock broker is obligated to adhere to.

79. Clause A(1) of the aforementioned Code mandates a stock broker to maintain high standards of integrity, promptitude and fairness in conduct of its business. However, the lack of promptitude or rather intentional belatedness on the part of IIFL in assigning appropriate nomenclature to the bank accounts held on behalf of and to deposit clients' funds separately, as evidenced from the fact that the last of such accounts was properly nomenclated only in 2018 i.e. 25 years after the issuance of the circular, doesn't need any further elaboration. At the same time, its lack of fairness in dealing with its clients is writ large in the light of its misconduct of mixing of funds of its clients with its own funds in the pool accounts and, thereafter, using such mixed funds for its own proprietary

purposes. Due to fungibility of money, as explained at length earlier, it is not possible to clearly identify the usage of clients funds out of such mixed funds by the stock broker for its own purposes, but, at the same time, the said behavior of the *Noticee* can, by no stretch of imagination, be called as fair behavior towards its clients. In the end, the facts of the present matter clearly show that IIFL had acted in complete disregard of the legitimate interests of its credit balance clients and has not only benefitted itself but also provided benefits to its debit balance clients at the cost of its credit balance clients by using funds of credit balance clients to settle its own proprietary trades as well as the trades of its debit balance clients to the tune of hundreds of crores of rupees. Such usage of credit clients' funds for its proprietary trades as well as trades of its debit balance clients smacks of glaring indulgence in fraudulent misappropriation of such credit clients' funds, by which, IIFL has made a mockery of its fiduciary duty towards its clients as a market intermediary. In the light of all the facts narrated in the present Order, lack of integrity, promptitude and fairness in the acts of IIFL are self-evident and writ large from the very acts of IIFL as have been elucidated elaborately in the foregoing paragraphs. Under the circumstances, in my considered view, it is not difficult to hold in the facts of the present matter, that IIFL has violated the provisions of Clause A(1) of Code of Conduct given under Schedule II of Stock Broker Regulations.

80. Clause A(2) of Code of Conduct for Stock Brokers mandates a stock broker to act with due skill, care and diligence in conduct of its business. In this regard, by now it is well established that IIFL has acted in a manner which, by no stretch of moderation, can be called careful and diligent. In fact, it has acted in flagrant disregard of basic due diligence expected from a stock broker registered with SEBI. It has been adequately exposed in the series of inspections conducted by SEBI in the present matter that the *Noticee* has not only delayed implementation of provisions of SEBI 1993 Circular in its true spirit by 25 years, it has

continuously been found involved in unauthorized use of credit clients' funds for the purpose of meeting the obligations arising out of its proprietary trades as well as the trades of debit balance clients. The fact of lack of care and diligence is clearly manifest in the light of the fact that despite SEBI's finding that the *Noticee* was misusing the funds of its credit balance clients for settlement of its proprietary trades as well as the trades of its debit balance clients during the period of April 2011 to June 2014, the said violations were again noticed during March 2017 Inspection for the period of FY 2015-16 and 2016-17. These findings again make it loud and clear about the visible lack of care and diligence on the part of the *Noticee*, despite the findings of misuse of credit clients' funds that were noticed and pointed out to it during the previous three supplementary inspections and it strengthens my observations that the *Noticee* did not even make any attempt to correct its wrongdoings already brought to its notice and the same wrongdoing was caught once again. This clearly shows that the entire business operation of IIFL was being conducted in complete disregard to various laws and circulars issued by SEBI and Stock Exchanges. This fact itself speaks volumes that IIFL was not acting with due care and diligence while conducting its business and therefore, has undoubtedly violated the provisions of Clause A(2) of Code of Conduct for Stock Brokers.

81. Clause A(5) of Code of Conduct for Stock Brokers mandates a stock broker to abide by all the provisions of SEBI Act and rules, regulations issued by the Government, SEBI and the Stock Exchange. In this regard, it has now been abundantly established above that IIFL has violated various provisions of SEBI 1993 Circular on multiple occasions as elaborately discussed in the present order, hence, as a corollary to the same, it can be confidently concluded that IIFL has also violated the provision of Clause A (5) of Code of Conduct for Stock Brokers.

82. In view of all the aforesaid, I find no hesitation in holding that IIFL has acted in

violation to the provisions of Regulation 9(f) read with Clauses A(1), A(2) and A(5) of Code of Conduct for Stock Brokers prescribed under Schedule II of Stock Broker Regulations.

83. I find that the *Noticee* had cited before the DA a number of orders of Hon'ble SAT, SEBI Whole Time Members as well as orders passed by Adjudicating Officers. Having gone through the two Enquiry Reports, it is observed that all these Orders have been properly and elaborately distinguished by DA in his Reports and I am fully satisfied by the factors mentioned by the DA while distinguishing these orders. Given the fact that these cases have not been raised by the *Noticee* again before me, I find no necessity to reproduce all these judicial decisions and factually distinguish them again in this order.

84. In the end, to sum up, I observe that the *Noticee* has flagrantly violated the provisions of SEBI 1993 Circular in various ways to clearly disregard the basic premise of the said circular both in letter and spirit in complete defiance of Regulatory instructions. The *Noticee* firstly didn't assign its accounts appropriate nomenclature wherein it was keeping clients' monies so as to clearly label them as 'client accounts'. Additionally, it was mixing clients' funds with its own funds before using those mixed funds for its own proprietary usage. In the end, it was using funds of its credit balance clients' to not only fund trades of its debit balance clients but also to fund its own trades. This clearly demonstrates an utter disregard to the provisions of SEBI 1993 Circular by the *Noticee* at least during the period of April 01, 2011 to January 31, 2017. The said disregard and violation of provisions of SEBI 1993 Circular has further have, as a consequence, led to the violation of Clauses A(1), A(2) and A(5) of Code of Conduct for Stock Broker as given in Schedule II read with Regulation 9(f) of Stock Brokers Regulations.

85. I find it necessary to mention here that the *Noticee* claims itself to be a large broker having thousands of retail clients and a number of institutional clients, to whom

it provided services. In such a case, responsibility to follow the provisions of Securities Laws falls all the more on its shoulders as the final consequences of misuse of funds of its clients by a large broker like the *Noticee* would have been far graver as compared to the violations committed by some small level brokers since any default on the part of the *Noticee* would have affected the interest of large number of clients-both retail and institutional, leading to a certain likelihood of a drastic fall in trust, in the functioning of securities market that SEBI has been trying to build over the last three decades. Any such erosion of trust in Capital Market would dissipate decades of efforts of Government of India and SEBI to create a safe, reliable and credible capital market in India and would possibly inflict a huge dent on Indian Economy as well. While the *Noticee* has brazenly contended that the misdeeds of it didn't lead to default, as a regulator, SEBI is required to be proactive in stopping these kinds of mishaps and audacious misconduct from recurring. SEBI cannot afford to be reactive and wait for a default to happen to take action upon such misdeeds as the *Noticee* is trying to persuade and impress upon me.

86. However, simultaneously, I also take note of the submissions of the *Noticee* that it has already taken certain corrective steps to stop these wrongdoings from happening in maintenance of its books of accounts so as to avoid such breaches/violations to occur on any future occasions. In the list of the measures so far taken by it, the *Noticee* has highlighted the following measures before me:

86.1. The *Noticee* has submitted that it has already transferred its proprietary trades to a completely different stock broking entity. Therefore, there is no chance of either mixing of its own trading funds with clients' funds or funding of such proprietorship trades from the funds available with it from its clients.

86.2. The *Noticee* has also submitted that the IIFL group has already restructured its business wherein all the investment related activities have been transferred to the holding company of IIFL viz. IIFL Holdings Ltd. and the stock broking business has been kept with the *Noticee*. Therefore, there can be no investment either in group companies or in any other place from the accounts of the *Noticee*.

86.3. The *Noticee* has also submitted that it has been following the provisions of Enhanced Supervision Circular dated September 26, 2016 in letter and spirit since the day it has come into force i.e. July 01, 2017. In support of this, the *Noticee* has submitted that no finding of any such non-compliance has been noticed by regulators viz. SEBI or the Stock Exchanges in any inspection subsequent to implementation of the aforementioned circular.

87. In these circumstances, I find that the violation by way of assigning wrong nomenclature to the 'clients accounts' has been remedied by the *Noticee* and the same has also been noted in the earlier part of the present Order. Further, the violation committed by way of mixing of funds of clients with its own funds has not been observed in March 2017 Inspection. Further, I find no instance of misuse of clients funds by the *Noticee* placed before me which has occurred subsequent to implementation of Enhanced Supervision Circular dated September 26, 2016.

88. Therefore, while the past acts of the *Noticee* had not been in tune with the established prudent market practices or with the regulatory instructions and the *Noticee* has not conducted its affairs as a genuine market intermediary as unearthed during the repeated inspections conducted by SEBI, which have been already highlighted above at length, it has however now demonstrated its attempts to atone itself by correcting its wrongdoings and to suggest that the said violations have not continued as of now. In such circumstances, while action against the

Noticee is necessary to be taken in the light of gravity of violations committed by it, a direction for the cancellation of certificate would be too disproportionate a punishment for not only the *Noticee* itself but also to its clients, both retail and institutional, as well as act antagonistic to the development of the securities market at a whole.

Order

89. Keeping the aforesaid observations in view, in exercise of powers conferred on me under Section 12 (3) of the SEBI Act read with Regulations 27 and 28 of the Intermediaries Regulations, 2008, and upon consideration and an overall appreciation of the facts and circumstances as above, I hereby prohibit IIFL Securities Limited [SEBI Registration No.: INZ000164132], from taking up/onboarding any new client for a period of two (2) years in respect of its business as a stock broker. With this direction, I dispose of the extant enquiry proceedings and the SCNs dated July 18 and July 04, 2022 against the *Noticee*, i.e. IIFL Securities Limited that have emanated from the two Enquiry Reports dated April 29 & May 27, 2022 respectively.

90. This Order, thus, disposes of the two enquiry proceedings initiated against the *Noticee* following six inspections conducted by SEBI into the affairs of the *Noticee*.

Sd/-

Date: June 19, 2023

S. K. MOHANTY

Place: Mumbai

Whole Time Member

Securities And Exchange Board Of India