

WTM/AB/SEBI/MIRSD/HO/35/2019

**SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: ANANTA BARUA, WHOLE TIME MEMBER
EX PARTE-AD-INTERIM ORDER**

UNDER SECTIONS 11(1), 11(4) AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATION 35 OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008.

IN RESPECT OF:

S. No.	Name of the Entity	PAN
1.	Karvy Stock Broking Limited	AABCK5190K

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1. Karvy Stock Broking Limited (hereinafter referred to as “**KSBL**”/ “**Stock Broker**”/ “**Noticee**”) is registered with SEBI as a stock broker with registration number INZ000172733. KSBL is a member registered with National Stock Exchange of India Ltd. (hereinafter referred to as “**NSE**”) and BSE Ltd. (hereinafter referred to as “**BSE**”) for its stock broking activities. KSBL is also registered as a Depository Participant (hereinafter referred to as “**DP**”) with SEBI registration number IN-DP-CDSL-175-2015 and is a member of NSDL and CDSL. Address of registered office of KSBL is Plot No. 31/P, Karvy Millenium, Nanakramguda, Financial District, Gachibowli, Hyderabad, Telangana – 500032.
 2. NSE has forwarded a preliminary report to SEBI on November 22, 2019 on the non-compliances observed with respect to the pledging/misuse of client securities by KSBL. NSE has also stated that detailed report in the matter will be submitted shortly. The said preliminary report is the result of the limited purpose inspection of KSBL conducted by NSE on August 19, 2019 covering a period from January 01, 2019 onwards. Key findings made in the said report are as under:

- (i) KSBL did not report the DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) in the filings made by it from January, 2019 to August, 2019. The said DP account was observed to be categorised as Beneficiary Client and was opened on December 20, 2000;
- (ii) KSBL credited the funds raised by pledging of client securities to 6 of its own bank accounts (“**Stock Broker-own Account**”) instead of the “**Stock Broker-Client Account**” and further has not reported these 6 own bank accounts (“Stock Broker-own Account”) to Exchange which is required to be reported under the provisions of enhanced supervision, as stipulated under SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016;

S.No	Bank Name	Bank Account No.
1	HDFC BANK LTD	210130000134
2	ICICI BANK LIMITED	405034104
3	INDUSIND BANK LTD.	606014011496
4	AXIS BANK LIMITED	916030054913843
5	KOTAK MAHINDRA BANK	11210382
6	HDFC BANK LTD	00210140000014

- (iii) The securities lying in the aforesaid DP account of KSBL, actually belong to the clients which are the legitimate owners of the pledged securities. Therefore, KSBL did not have any legal right to create a pledge on these securities and generate funds. Even if, the client securities were pledged, it should be only for meeting the obligation of the respective clients only, which was not observed in this case;
- (iv) KSBL has sold excess securities (securities not available in DP account) to the tune of Rs. 485 Crore through 9 related clients till May 31, 2019. Further, KSBL has also transferred excess securities to 6 out of these 9 related clients to the tune of Rs. 162 Crores till May 31, 2019. On subsequent verification, it was observed that securities worth Rs. 257.08 Crore, pledged on behalf of 4 clients out of the aforesaid 9 clients, were unpledged during June 1, 2019 to August 22, 2019 and securities worth of Rs. 217.85 Crores were recovered by KSBL from 4 out of the said 9 client accounts. KSBL have also purchased securities in

- 5 out of the respective 9 client accounts amounting to Rs. 228.07 Crore during the period from June 1, 2019 to September 8, 2019. KSBL had undertaken the recovery/purchase of securities to recoup the securities shortfall. KSBL has thus violated SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 and Clauses A (1) & (3) of the code of conduct prescribed for Stock Brokers under Regulation 9 of SEBI (Stock Brokers & Sub Brokers) Regulations, 1992 (hereinafter referred to as “**Stock Broker Regulations**”);
- (v) KSBL has transferred securities worth Rs. 27.8 Crore, off-market, from the beneficial owner accounts (**BO accounts**) of 156 clients who have not executed a single trade with them. Further, securities worth Rs. 116.3 Crore were observed to have been transferred from 291 clients who have not traded with KSBL since June 01, 2019;
- (vi) *Prima facie* a net amount of Rs. 1096 crores has been transferred by KSBL to its group company i.e. Karvy Realty Private Limited between from 01-April 2016 to 19-October-2019.
- (vii) Further, KSBL has sold excess securities (securities not available in DP account) to the tune of Rs. 485 Crore through 9 related clients till May 31, 2019. Further, Karvy has also transferred excess securities to 6 out of these 9 related clients to the tune of Rs. 162 crores till May 31, 2019. On subsequent verification, it is observed that securities worth Rs.257.08 crores pledged on behalf of 4 clients out of the aforesaid 9 clients, were unpledged during June 1, 2019 to August 22, 2019 and securities worth of Rs. 217.85 Crore were recovered by KSBL from 4 out of the said 9 client accounts. KSBL have also purchased securities in 5 out of the respective 9 client accounts amounting to Rs. 228.07 Crore during the period from June 1, 2019 to September 8, 2019. The details of 9 clients are as under:

S. No.	Client PAN	Client Code	Client Name	Relation with KSBL
1	AAACK4247L	306184	KARVY CONSULTANTS LIMITED	Direct subsidiary
2	AAACW4200H	A020091	WIZARD INSURANCE SERVICES P LTD	Having common email ids under the
3	AAACZ1892J	A020004	ZENITH INSURANCE SERVICES PRIVATE LIMITED	

S. No.	Client PAN	Client Code	Client Name	Relation with KSBL
4	AABCB8927H	A020005	BUOYANT INSURANCE SERVICES PRIVATE LIMITED	domain name of karvy.com and having common addresses in the UCC records.
5	AABCN5526A	A08002	NOVA WEALTH MANAGEMENT SERVICES PVT LTD	
6	AABCV4837C	HBH5691	VITALINK WEALTH ADVISORY SERVICES PVT LTD	
7	AACCC0267C	A020002	CLASSIC WEALTH MANAGEMENT SERVICES PRIVATE LTD	
8	AACCC2342L	A020006	CHAMPION INSURANCE SERVICES PRIVATE LIMITED	
9	AACCP6255D	A0200098	PELICON WEALTH ADVISORY SERVICES PVT LTD	

3. It has also been intimated by NSE that it has appointed a forensic auditor to examine in detail the cases of misuse of client funds and securities by KSBL. In the said report, NSE has requested SEBI to take appropriate and expeditious action in the matter.
4. I find that to prevent the misuse of clients' securities by the stock broker, Clause 2 of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 provides that it shall be compulsory for all member brokers to keep separate accounts for client's securities and to keep such books of accounts, as may be necessary, to distinguish such securities from his/their own securities. Such accounts for client's securities shall, *inter-alia* provide for the following:-
 - (i) Securities fully paid for, pending delivery to clients;
 - (ii) Fully paid for client's securities registered in the name of Member, if any, towards margin requirements etc.
5. Also, SEBI Circular No. MRD/DOP/SE/Cir – 11/2008 dated April 17, 2008 *inter-alia* provides that brokers should have adequate systems and procedures in place to ensure that client collateral is not used for any purposes other than meeting the respective client's margin requirements/pay-ins. Brokers should also maintain records to ensure proper audit trail of use of client collateral.

6. Also, SEBI Circular No. MRD/DOP/SE/Cir – 11/2008 dated April 17, 2008 provides that Brokers should be able to produce the following records during inspection:
- (i) Receipt of collateral from client and acknowledgement issued to client on receipt of collateral.
 - (ii) Client authorization for deposit of collateral with the exchange / clearing corporation / clearing house towards margin.
 - (iii) Record of deposit of collateral with exchange / clearing corporation / clearing house.
 - (iv) Record of return of collateral to client.
 - (v) Credit of corporate action benefits to clients.
7. Also, SEBI Circular No. SEBI/HO/MRD/DP/CIR/P/2016/13 dated December 16, 2016 provides that the member shall transfer securities from pool account to the respective beneficiary account of their client within 1 working day after the pay-out day. The securities lying in the pool account beyond the stipulated 1 working day shall attract a penalty at the rate of 6 basis point per week on the value of securities.”
8. Also, SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016, on enhanced supervision provides uploading of clients' fund balance and securities balance by the Stock Brokers on Stock Exchange system and specifically provides as under:
- (i) The Stock Exchanges shall put in place a mechanism and ensure that stock brokers upload the following data on a monthly basis for every client onto each Stock Exchange system where the broker is a member.
 - (ii) Exchange-wise end of day fund balance as per the client ledger, consolidated across all segments and also net funds payable or receivable by the broker to/from the client across all Exchanges.
 - (iii) End of day securities balances ISIN wise (as on last trading day of the month) and End of day securities balances (as on last trading day of the month) consolidated ISIN wise (i.e., total number of ISINs and total number of securities across all ISINs).

- (iv) ISIN wise number of securities pledged, if any, and the funds raised from the pledging of such securities and consolidated number of securities pledged (i.e., total number of ISINs and total number of securities across all ISINs), if any and the funds raised from the pledging of such securities.
 - (v) The stock broker shall submit the aforesaid data within seven calendar days of the last trading day of the month to the Stock Exchange.
 - (vi) Each Stock Exchange shall in turn forward the corresponding information to clients via Email/SMS.
9. Also, transfer of securities between "Name of the Stock Broker - Client Account" and individual client's BO account, "Name of the Stock Broker – Pool Account" and "Name of the Stock Broker – Collateral Account" is permitted. Transfer of securities between "Name of the Stock Broker - Client Account" to "Name of the Stock Broker - Proprietary Account" is permitted only for legitimate purposes such as, implementation of any Government/Regulatory directions or orders, in case of erroneous transfers pertaining to client's securities, for meeting legitimate dues of the stock broker, etc. For such transfer of securities, stock broker is required to maintain a stock transfer register clearly indicating the day-wise details of securities transferred.
10. Also, a stock broker is entitled to have a lien on client's securities to the extent of the client's indebtedness to the stock broker and the stock broker may pledge those securities. Pledge of such securities is permitted, only if, the same is done through Depository system in compliance with Regulation 58 of the SEBI (Depositories and Participants) Regulations, 1996 (since repealed) [Regulation 79 of SEBI (Depositories and Participants) Regulations, 1996. In this regard, SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 provides as follows:
- (i) Securities of only those clients can be pledged who have a debit balance in their ledger.
 - (ii) Funds raised against such pledged securities for a client shall not exceed the debit balance in the ledger of that particular client.

- (iii) Funds raised against such pledged securities shall be credited only to the bank account named as "Name of the Stock Broker - Client Account".
 - (iv) The securities to be pledged shall be pledged from BO account tagged as "Name of the Stock Broker - Client Account".
11. Also, a stock broker is prohibited from granting further exposure to the clients when debit balances arise out of client's failure to pay the required amount and such debit balances continues beyond the fifth trading day, as reckoned from date of pay-in, except, in accordance with the margin trading facility provided vide SEBI Circular No. CIR/MRD/DP/54/2017 dated June 13, 2017 or as may be issued from time to time.
12. Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 on Handling of Clients' Securities by Trading Members/Clearing Members, *inter-alia* provides as follows:
- (i) The securities received in pay-out against which payment has been made by clients, shall be transferred to the demat account of the respective clients within one working day of the pay-out. Such securities shall be transferred directly from the pool account of the TM/CM to the demat account of the respective client;
 - (ii) With regard to securities that have not been paid for in full by the clients (unpaid securities), a separate client account titled – “client unpaid securities account” shall be opened by the TM/CM. Unpaid securities shall be transferred to such “client unpaid securities account” from the pool account of the concerned TM/CM;
 - (iii) The securities kept in the ‘client unpaid securities account’ shall either be transferred to the demat account of the respective client upon fulfilment of client’s funds obligation or shall be disposed of in the market by TM/CM within five trading days after the pay-out. The unpaid securities shall be sold from the Unique Client Code (UCC) of the respective client. Profit/loss on the sale transaction of the unpaid securities, if any, shall be transferred to/adjusted from the respective client account;

- (iv) In case the clients' securities are kept in the 'client unpaid securities account' beyond seven trading days after the pay-out, the depositories shall under their bye-laws levy appropriate penalties upon such TM/CM which shall not be permitted to be recovered from the client; and
 - (v) SEBI Circular No. CIR/MRD/DP/54/2017 (on Comprehensive Review of Margin Trading Facility) dated June 13, 2017 specifies that TM/CM shall maintain separate client wise ledger for funds and securities of clients availing margin trading facility. Accordingly, the securities that are bought under Margin Trading Facility, shall be kept in a separate account titled as – 'Client Margin Trading Securities Account'.
13. Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 *inter-alia* provides that clients' securities lying with the Trading Member(hereinafter referred to as "**TM**")/Clearing Member (hereinafter referred to as "**CM**") in "client collateral account", "Client Margin Trading Securities account" and "client unpaid securities account" cannot be pledged to the Banks/NBFCs for raising funds, even with authorization by client as the same would amount to fund based activity by TM/CM which is in contravention of Rule 8(1)(f) & 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.
14. Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 provides that the client's securities already pledged in terms of Clause 2.5 of SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 read with Clause 2(c) of SEBI Circular No. CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 shall, by August 31, 2019, be either unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed of after giving notice of 5 days to the client.
15. Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 mandated Stock Exchange, Clearing Corporations and Depositories to put in place a mechanism for monitoring of the following:

- (i) Handling of unpaid clients' securities by the TM/CM – Mechanism of matching of transfer of securities with the securities obligation as obtained from the clearing corporation with respect to the following:
 - a. Securities transferred from the client unpaid securities account to the pool account;
 - b. Securities transferred from the client unpaid securities account to the concerned client account;
 - c. Securities transferred from pool account to the concerned client account.
- (ii) All the DP accounts tagged as “Stock Broker – Client Account” are wound up before August 31, 2019.
- (iii) Securities lying with TM/CM in client collateral account, client margin trading securities account and client unpaid securities account shall not be permitted to be pledged/transferred to Banks/NBFCs for raising funds by TM/CM.

SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 was to come into effect from September 01, 2019. However, based on the representation received from the brokers stating that they have to transfer the client securities to respective client accounts after getting released from respective NBFCs and Banks and also to open new demat accounts which will take some time, the date of coming into force of the said circular was extended to October 01, 2019.

- 16. Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 which came into force on October 01, 2019 all TM and/or CM are required to transfer the clients' securities received in pay-out to clients demat account within one working day. In case the client does not pay for such securities received in pay-out, then the TM/CM shall be entitled to retain those securities up to five trading days after pay-out. Further, where the client fails to meet its funds pay-in obligation within five trading days from payout day, the TM/CM shall liquidate the securities in the market to recover its dues. Under no circumstances, the securities of the clients received in pay-out, can be retained by the TM/CM beyond five trading days and/or can be used for any other purpose.
- 17. Thus, the facts of this case need to be looked at in the light of aforesaid legal position regarding the handling of clients' securities by the stock broker. In the present case, the report of NSE observes that KSBL has misused power of attorney given by its clients. KSBL has sold client

securities in the market in disguised manner through own controlled entities and have used the funds for its own purposes. KSBL in order to hide its misdeed has not even reported this DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) in the submissions made by it to NSE from January, 2019 to August, 2019. It is only during inspection by NSE, this account came to notice. NSE report finds that there are numerous transactions in DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) whereby securities of the clients have been moved. Securities of clients received in pay out are transferred from the pool account to this account and also securities lying in the demat account of the client(s) are also transferred into and from this account misusing power of attorney given by the client.

18. The securities lying in the aforesaid DP account actually belong to the clients which are the legitimate owners of the securities. Therefore, KSBL did not have any legal right to create any kind of pledge on these securities. Even if the client securities were pledged, it should have only been for meeting the obligation of the respective clients which was not observed in this case. Considering the issue of misuse of clients' securities by KSBL in unauthorized manner, for its own use and purposely not disclosing the DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) to the Exchanges in their reporting create a serious doubt on the conduct and integrity of KSBL.
19. The acts of KSBL are *prima facie* in violation of Stock Broker Regulations, SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993, SEBI Circular No. MRD/DOP/SE/Cir – 11/2008 dated April 17, 2008, SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016, SEBI Circular No. SEBI/HO/MRD/DP/CIR/P/2016/13 dated December 16, 2016, SEBI Circular No. CIR/MRD/DP/54/2017 dated June 13, 2017, SEBI Circular No. CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 and Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019, as discussed above.
20. Therefore, there is need for urgent regulatory intervention to prevent further misuse of clients' securities.
21. Under the above circumstances, I, in exercise of powers conferred upon me under Sections 11(1), 11(4) and 11B read with Section 19 of the SEBI Act, 1992 and Regulation 35 of SEBI

(Intermediaries) Regulations, 2008, by way of this ex parte ad interim order, pending forensic audit, hereby issue the following directions:

- (i) KSBL is prohibited from taking new clients in respect of its stock broking activities;
- (ii) The Depositories i.e. NSDL and CDSL, in order to prevent further misuse of clients' securities by KSBL, are hereby directed not to act upon any instruction given by KSBL in pursuance of power of attorney given to KSBL by its clients, with immediate effect;
- (iii) The Depositories shall monitor the movement of securities into and from the DP account of clients of KSBL as DP to ensure that clients' operations are not affected;
- (iv) The Depositories shall not allow transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) with immediate effect. The transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) shall be permitted only to the respective beneficial owner who has paid in full against these securities, under supervision of NSE; and
- (v) The Depositories and Stock Exchanges shall initiate appropriate disciplinary regulatory proceedings against the Noticee for misuse of clients' funds and securities as per their respective bye laws, rules and regulations;

- 22. The findings recorded in the order are based on the *prima facie* examination of facts and prima facie violation of securities law, as observed above.
- 23. The present order has been passed under disciplinary proceedings against the Noticee for the *prima facie* violations of the Securities Laws, as mentioned in the order above. The observations in this order does not *ipso facto* entitle any client of the Noticee to claim their funds, stocks and securities, which claims are to be taken by such clients with the concerned stock exchanges/depositories in accordance with their respective bye-laws.
- 24. KSBL may file its objections/reply, if any, within twenty-one (21) days from the date of receipt of this Order. In the event the Noticee intend to avail an opportunity of personal hearing, it may appear before the Securities and Exchange Board of India at its Head Office at SEBI Bhavan - II,

Plot No.C4-A, G Block, Bandra Kurla Complex, Bandra (East), Mumbai-400051 on December 16, 2019 at 02:30 PM. In the event of the Noticee failing to file reply within 21 days of receipt of this order or failing to appear before SEBI on the aforesaid date and time, the preliminary findings recorded in this Order and directions at para 21 above shall be deemed to be confirmed against the Noticee automatically, without any further orders.

25. This order shall come into force with immediate effect. A copy of this order shall be forwarded to the Noticee, Stock Exchanges, Depositories and Registrar and Transfer Agents of Mutual Funds to ensure that the directions given above are strictly complied with.

Sd/-

Place: Mumbai

ANANTA BARUA

Date: November 22, 2019

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA