SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Under Sections 11(1), 11(4), 11B(1), 11B(2) and 11(4A) of the SEBI Act, 1992, read with Rule 5 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995

In Re: SEBI (Stock Brokers) Regulations, 1992, and SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to the Securities Market) Regulations, 2003

In respect of SCN SEBI/HO/IVD/ID3/OW/P/2019/32853/1 dated December 09, 2019

Name of Noticee	Particulars	PAN
IL&FS Securities Services Limited (ISSL)	Clearing Member	AABCI5580K

In the matter of alleged fraudulent transfer of Mutual Fund units from client accounts by Allied Financial Services Pvt. Ltd.

BACKGROUND

1. SEBI received the following complaints against Allied Financial Services Pvt. Ltd. (hereinafter referred to as **"Allied/ AFSPL"**), a Depository Participant of NSDL, alleging fraudulent/ unauthorized transfer of mutual fund units (hereinafter referred to as **"MF Units"**):

   1.1. Complaint dated February 08, 2019, from Finsec Law Advisor on behalf of clients Dalmia Cement East Limited (hereinafter referred to as **"DCEL"**) and OCL India Limited (hereinafter referred to as **"OCL"**) alleging fraudulent transfer of MF Units worth Rs. 344.07 crores by AFSPL (these complainants are hereinafter collectively referred to as the **"Dalmia Group"**) and

1.2. Dalmia Group, vide letter dated February 27, 2019, alleged that ILFS Securities Services Limited (hereinafter referred to as **"ISSL/ Noticee"**), a clearing member of NSE Clearing Limited, was also involved in the fraudulent transfer of MF Units from the accounts of DCEL and OCL.

2. SEBI conducted an investigation into the matter for the period from February 20, 2017, till February 08, 2019 (hereinafter referred to as the **"investigation period/ IP"**) to determine violations of any provisions of the SEBI Act, 1992 ("**SEBI Act**"), SEBI (Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 2003 ("**PFUTP Regulations**"), SEBI (Stock Brokers) Regulations, 1992 ("**SB Regulations**"), bye-laws/ regulations/ rules of the NSE Clearing Limited ("**NCL**") and relevant circulars issued by SEBI. As part of the investigation, SEBI received the copies of the following reports related to the Noticee:

2.1. Special review carried out by Grant Thornton to look into the dealings of the Noticee with AFSPL (Grant Thornton was appointed by the Noticee itself for this audit) and

2.2. NCL's Inspection Report with respect to functioning of the Noticee as a clearing member.

<u>SHOW CAUSE NOTICE</u>

3. Pursuant to conclusion of the investigation, vide Show Cause Notice (SCN) dated December 09, 2019, the following factual and legal allegations were made against the Noticee:

3.1. There were certain irregularities while on-boarding AFSPL by the Noticee. The said irregularities were:

3.1.1. Different CA certificates with different financial statements and shareholding patterns were submitted by AFSPL to MCA/ NSE and to the Noticee.

3.1.2. Anomalies noted in the KYC pertaining to existing relationship of AFSPL with the IL&FS group.

3.1.3. Anomalies noted regarding income of AFSPL in the KYC.

3.1.4. Noticee ignored significant unusual increase in the asset size of AFSPL during FY 2017-18.

3.1.5. Noticee ignored AFSPL having multiple doubtful transactions with related parties where the recovery was doubtful.

3.2. In terms of Regulations 11.3.1 of Chapter 11 of NCL F&O Regulations, a Clearing Member ("**CM**") is required to do proper due diligence when establishing relationship with a new client. Also, CMs must take reasonable steps to assess the background, genuineness, financial soundness of such person and his objectives, which was not done in the instant case. In view of the aforesaid, *prima facie*, non-compliance with respect to carrying out proper due diligence was observed when the Noticee established relationship with AFSPL which has allegedly resulted in violation of Clauses A(2) & A(5) of the Code of Conduct as specified in Schedule II of Regulation 9(f) of the SEBI (Stock Brokers) Regulations, 1992 (hereinafter referred to as the **"Broker Regulations"**) read with Regulation 10F of the Broker Regulations and Regulation 11.3.1 of Chapter 11 of NCL F&O Regulations.

3.3. There were four (04) instances where collateral was released by the Noticee to AFSPL without corresponding reduction in exposure/ margin requirements. The aforesaid instances of release of collaterals over weekends were unusual. The said release of collateral by the Noticee helped AFSPL to make Dalmia Group believe that their MF Units were intact in their respective demat accounts. Details of which are as under:

Date	Total Margin	Cash	Securities	MF Amount Released	Total Collateral	Shortfall on Saturday and Sunday
30-Dec-17	1,81,27,20,261.54	71,62,00,000.00	3,40,27,11,266.92	3,29,62,41,561.48	82,26,69,705.44	99,00,50,556.10
31-Dec-17	1,81,27,20,261.54	71,62,00,000.00	3,40,27,11,266.92	3,29,62,41,561.48	82,26,69,705.44	99,00,50,556.10
31-Mar-18	3,25,99,58,458.67	1,00,30,00,000.00	3,50,79,16,668.34	3,35,05,98,756.50	1,16,03,17,911.85	2,09,96,40,546.82
01-Apr-18	3,25,99,58,458.67	1,00,30,00,000.00	3,50,79,16,668.34	3,35,05,98,756.50	1,16,03,17,911.85	2,09,96,40,546.82

3.4. It was also observed that intra-day limits provided by the Noticee to AFSPL were enhanced without sufficient collateral inflow (naked benefit) and were reduced at end of the day. During July 02, 2018, to December 27, 2018, there were 65 instances/ trading days where total amount of intra-day benefit extended to AFSPL by the Noticee amounted to Rs. 2417.87 crores. The same had resulted in increased risk for the Noticee. In view of the same, it is alleged that there was a failure to collect margin by the Noticee from AFSPL in accordance with Regulation 4.5.1 of NCL Regulations (F&O segment). In view of the above, *prima facie*, non-compliance by the Noticee with respect to collection of margin was observed which is in violation of Clauses A(2) and A(5) of the Code of Conduct as specified in Schedule II of Regulation 9(f) read with Regulation 10F of the Broker Regulations and Regulation 4.5.1 of Chapter 4 of NCL F&O Regulations.

3.5. The Noticee opened trading terminal for AFSPL and allowed them to roll over their position during January 2019, specifically after the termination notice was issued to AFSPL by the Noticee. In terms of Bye-Law 3 of Chapter IX of NCL (F&O Segment) Bye-Law, the Noticee had the option to close-out the positions in the month of January 2019 after failure by AFSPL to pay the margins. Therefore, the Noticee by allowing AFSPL to roll over their position even after termination of their contract has, *prima facie*, violated Clauses A(2) and A(5) of the Code of Conduct as specified in Schedule II of Regulation 9(f) read with Regulation 10F of the Broker Regulations and Bye-Law 3 of Chapter IX of NCL (F&O Segment) Bye-Law.

3.6. Inter Corporate Deposits (ICDs), interest on ICDs, loan to IL&FS Employee Welfare Trust, interest on loan, sundry debtors were not considered under the header "doubtful debts and advances" for calculation of networth by the Noticee. Instances of the same are as under:

Sr. No.	Particulars
1	Networth as on September 30, 2018, after deducting ICDs, interest on ICDs, loan to IL&FS Employee Welfare trust, Interest on loan, Impact of IND AS and Sundry Debtors of Rs. (154.06) Cr., Networth as on September 30, 2018, is Rs. 53.01 Cr. As against Networth submission of member of Rs. 207.07 Cr.
2	After deducting ICDs amounting to Rs. 750 Cr., Networth as on March 31, 2018 is Rs. (573.01) Cr., as against Networth submission of member of Rs. 176.99 Cr.

3.7. If the Noticee had duly considered the aforesaid ICDs under the head doubtful debts and advances, it would have revealed the shortfall in its networth and thereby resulting into non-compliance of Rule 12 of Chapter IV of the Rules of NSE Clearing Limited. Since the Noticee has failed to meet the minimum networth, the same is, *prima facie*, in violation of Clauses A(2) and A(5) of the Code of Conduct as specified in Schedule II of Regulation 9(f) read with Regulation 10F of the Broker Regulations and Rule 12 of Chapter IV of the Rules of NSE Clearing Limited.

4. It has been alleged in the SCN that the aforesaid actions/ lapses of the Noticee have allegedly facilitated AFSPL in executing fraudulent transfer of MF Units from the account of DCEL, OCL and another entity named Novjoy Emporium Pvt. Ltd. (NEPL). Therefore, it is alleged that the Noticee has violated Regulation 3(a) and 4(1) of the PFUTP Regulations.

5. In view of the above allegations, the Noticee is called upon to show cause as to why:

5.1. Appropriate directions under Sections 11B(1) and 11(4) read with Section 11(1) of the SEBI Act, 1992, should not be issued against it for the alleged violations of the aforementioned provisions of the Broker Regulations and the PFUTP Regulations.

5.2. Appropriate directions for imposing penalty under Section 11B(2) and 11(4A) read with Sections 15HA and 15HB of the SEBI Act, 1992, should not be issued against it for the alleged violations of the aforementioned provisions of the Broker Regulations and the PFUTP Regulations.

REPLY, WRITTEN SUBMISSION AND ADDITIONAL SUBMISSION:

6. I note that the SCN has been duly delivered to the Noticee and its reply was received vide letter dated January 16, 2020. The Noticee sought inspection of documents, which was also granted. Opportunity of personal hearing was also granted to the Noticee, initially on May 21, 2020, which was adjourned, due to administrative exigencies to, June 26, 2020, and November 02, 2020, respectively. The Noticee sought adjournment of the personal hearing on grounds of non-availability of senior counsel and accordingly, the hearing was adjourned to November 18, 2020.

7. In the hearing held on November 18, 2020, the Noticee raised issues related to jurisdiction of SEBI due to presence of orders of the Hon'ble NCLAT in respect of the IL&FS Group and its group companies, including ISSL, which granted an interim stay on institution/ continuation of suits or proceedings against them. It was submitted that the present proceedings before the WTM of SEBI were quasi-judicial proceedings and were covered by the moratorium granted vide the order of the Hon'ble NCLAT. The Noticee prayed that SEBI should first pass an order deciding whether it has the jurisdiction to adjudicate on the issues under the SCN in view of the moratorium order against IL&FS Group and its subsidiaries.

8. After, due consideration of the submissions of the Noticee, SEBI, vide its order dated January 08, 2021, held that it has the jurisdiction to proceed to determine whether the Noticee has violated the regulatory provisions mentioned in the SCN. It was also held that SEBI has the jurisdiction to determine the monetary and non-monetary liabilities of the Noticee in the event it is found that the Noticee is in violation of regulatory provisions; however, the enforcement of the liability, if any, shall be subject to the orders of the Hon'ble NCLT/ Hon'ble NCLAT/ Appellate Authority from NCLAT.

9. Subsequently, the Noticee preferred an appeal before the Hon'ble Securities Appellate Tribunal (SAT) against the above-mentioned order of SEBI, which was dismissed by the Hon'ble SAT vide its order dated April 06, 2021. The Noticee has informed that it has preferred a Civil Appeal in the Hon'ble Supreme Court, which is pending. Thereafter, the personal hearing of the Noticee took place on April 12, 2021, wherein the Noticee made its submissions on merits. Written submissions were received vide email dated May 05, 2021, and another hearing, with respect to a limited point of their submissions, was held on June 01, 2021. Submissions post this hearing have been received vide letter dated June 14, 2021.

ISSUES FOR CONSIDERATION:

10. Before proceeding further, as part of its submissions, the Noticee has raised certain preliminary objections to these proceedings, which are dealt with below.

Civil Appeal pending in the Hon'ble Supreme Court:

11. In view of the Civil Appeal pending in the Hon'ble Supreme Court, the Noticee has prayed that SEBI should refrain from passing any final order in this matter until the Civil Appeal is heard and disposed of. I note here that while the Hon'ble Supreme Court heard the appeal on May 11, 2021, no stay has been granted on the current proceedings; however, it has been directed that any orders passed by the SEBI shall

be subject to the further order passed by the Court. Hence, this Order shall be subject to the order passed by the Hon'ble Supreme Court.

No evidence furnished on how movement of MF units is linked with Dalmia Group:

12. The Noticee, in its reply dated January 16, 2020, had submitted that no evidence has been furnished on how the movement of MF units were linked to the Dalmia Group and the same has not been elaborated in the SCN. Hence, the same demonstrates that the allegation is merely conjecture. Subsequent to the personal hearing granted on April 12, 2021, certain documents in support of the allegation as to how the movement of MF units is linked to the Dalmia Group were provided to the Noticee.

13. The Noticee was also afforded another opportunity of personal hearing to put forth its oral submissions on these documents, which was held on June 01, 2021, and subsequently the Noticee has contended the following in this regard:

    13.1. It is alleged in the purported complaint filed by the Dalmia Group that the transaction statements/ demat ledger statements were incorrect. As alleged fraud is yet to be decided, SEBI ought not to rely on these demat ledger statements.

    13.2. Documents have been furnished in an improper manner and demonstrate an inconsistent approach by SEBI. These documents were not provided when ISSL sought inspection of documents relied upon while issuing the SCN. At the hearing on April 12, 2021, SEBI categorically made a statement that no further documents are being relied upon other than the documents already furnished. On this basis, the hearing in the SCN proceeded and the matter was reserved for orders. These documents were provided subsequently.

    13.3. Therefore, clearly even as per SEBI, the documents did not form the basis for issuance of the SCN. However, after the final hearing was complete, SEBI has provided the documents purporting that the documents substantiate the allegation that release of collateral by ISSL helped AFSPL make Dalmia believe

that the MF Units were intact in their demat accounts. The same indicates that SEBI is attempting to supplement the record on the basis of which the SCN was issued by introducing documents at a belated stage.

13.4. Without prejudice to the foregoing, SEBI has adopted an a-probatory and re-probatory stance while furnishing documents, which cannot be countenanced given that SEBI is a Tribunal in so far as it exercises power under Section 11B (2) and 11 (4A) of the SEBI Act.

14. In this regard, I note that the complaint of the Dalmia Group has only formed the trigger for the investigation in the instant matter, including into the role of ISSL. The extant SCN has been issued after the investigation has been carried out. The transaction statements for the demat accounts of DCEL and OCL have been provided by NSDL, which is a front line regulator, and I have no reason to doubt their authenticity unless the Noticee provides any evidence that there is a flaw or defect in these statements.

15. With regard to the manner in which these documents have been furnished, I note the following:

15.1. The Noticee had sought inspection of documents and an opportunity for the same was provided to it. Thereafter, the Noticee, vide its reply dated January 16, 2020, raised the issue that the necessary evidence to link the movement of the MF units with the Dalmia Group has not been provided. In light of this contention, the relevant documents were provided to the Noticee.

15.2. Further, the issue raised by the Noticee that it was denied the opportunity to make oral submissions with respect to these documents has also been addressed by providing it another opportunity of personal hearing for the same. The Noticee has duly availed the same and has made additional written submissions subsequent to the same.

16. The proceedings before the quasi-judicial forum are driven by the principles of natural justice in view of the fact that the procedures mentioned in the Civil Procedure Code, except expressly provided under the SEBI Act, is not applicable. In such proceedings, SEBI needs to ensure that no prejudice is caused to the Noticee and that principles of natural justice have been followed at all times. From the above, I note that no prejudice has been caused to the Noticee as (a) the documents relevant to establish the allegation have been provided to it and (b) it was also given an opportunity to make its oral and written submissions on these documents. I note that at no stage has the Noticee been deprived of an opportunity to defend itself against the allegations made in the SCN and there is no violation of the principles of natural justice that are required to be followed in such proceedings. Further, as already decided by SEBI vide Order dated January 08, 2021, it is not a Tribunal and this Order has also been upheld by the Hon'ble SAT, while appeal against the same is pending in the Hon'ble Supreme Court

Request for cross-examination:

17. The Noticee had, vide email dated June 24, 2020, requested that ISSL be permitted to cross-examine the signatories to the complaints relied in the SCN as well as the author of the limited inspection report by the NSE Clearing Limited. It was submitted that as the SCN relies on the statements set out in the complaints of the third parties and the statements recorded in the inspection report, ISSL was entitled to cross-examine such persons. Without this opportunity, SEBI cannot rely upon the complaints and the limited inspection report. In this regard, I note the following:

    17.1. The complaints of the Dalmia Group and NEPL, which are annexures to the SCN, have not been relied upon for the allegations made in the SCN against ISSL and in the present proceedings. These complaints formed the trigger for the investigation in the instant matter, including into the role of ISSL. Hence, I note that there is no requirement of providing cross-examination in this regard.

17.2. With regard to the NCL Inspection Report, which is also an annexure to the SCN, I note that certain findings of this report have been relied upon for the allegations made in the SCN. These allegations are mentioned at paras 3.3 (return of collateral by ISSL to AFSPL) and 3.6 (discrepancies in networth of ISSL). In this regard, I note the following:

17.2.1. SEBI has not relied on any part of the NCL report that contains any statement(s) made by the inspection team of NCL in the report or findings that have been arrived at on the basis of any statement(s) of the officials of NCL. Further, I note that SEBI has not recorded the statement of any of the officials of NCL as part of its investigation.

17.2.2. I further note that the inspection team of NCL has collected data, which has been provided by ISSL itself, and based on analysis of this data, have arrived at their findings. For e.g., with regard to the allegation of return of collateral by ISSL, the NCL report mentions that the demat statement of ISSL was analyzed for transactions w.r.t. AFSPL. With regard to the allegation of discrepancy in networth of ISSL, the NCL report mentions that information was sought from ISSL to examine the impact of ICDs on its networth and the findings have been derived from this information itself. These findings are not based on statements of any person.

17.2.3. Hence, the findings arrived at by the inspecting team of NCL are based on data which was provided by the Noticee. Further, NCL sought comments of ISSL w.r.t. its findings and I note that the Noticee has given the same reply that it has given to this SCN. I note that at no stage of these proceedings has the Noticee contested the accuracy of the figures/ data mentioned in these findings. It has not raised any discrepancy for e.g., on the amount of MF units released, shortfall in margin, etc. I also note that being the Clearing Member of AFSPL, ISSL already has the data w.r.t. Total Margin, Cash and Securities for the dates mentioned in the table.

17.2.4. SEBI, after considering the relevant information/ data from NCL Report and the submissions of ISSL to the same, has also arrived at these findings as part of its investigation into the matter.

17.3. Hence, in view of the above, I note that there is no scope for cross examination of the persons sought to be cross examined by the Noticee.

Fraud has not been crystallized by SEBI:

18. In this regard, the Noticee has submitted the following:

18.1. SEBI has not completed its investigation into the fraud and has not even initiated the proceeding to crystalize the fraud perpetrated. Therefore, ISSL cannot be made liable for facilitating the fraud.

18.2. The Hon'ble SAT, vide its Order dated July 03, 2019, while recording that *"…Whether there has been a fraudulent transfer of mutual funds units by Allied to ISSL is a question which is required to be decided by some authority."*, directed SEBI to determine this question. Instead, SEBI has challenged this order before the Hon'ble Supreme Court, which is presently pending. Therefore, presently, SEBI has admittedly not conducted and/ or completed an inquiry/ investigation to determine whether there was a fraudulent transfer of MF units to ISSL. Hence, it would be incongruous, beyond reason to conduct these proceedings.

18.3. SEBI's confirmatory order dated May 17, 2019, holds that an independent investigation is ongoing by SEBI to inter alia look into the transfers of MF units. This fact is recorded in the NCL order dated June 24, 2019, and in the order of the Hon'ble Supreme Court dated March 16, 2021. Even in the personal hearing, when queried, SEBI has categorically admitted that the investigation is not complete. Hence, it would be contrary to basic principles of law to conduct a hearing for alleged facilitation of fraud. Therefore, the present proceedings against ISSL are untenable and ought not to be continued.

19. In this regard, I note the following:

19.1. With respect to the reference made to the order of the Hon'ble SAT, I note that this order pertains to the application for annulment of trades entered into by AFSPL in the month of December 2018. The application for trade annulment was made by ISSL on the grounds that the contracts entered into by AFSPL in December 2018 were based on fraudulently transferred collaterals and that the same was not in the interest of the securities market. The parties to these proceedings also included DCEL, OCL, AFSPL and 44 other investors. The Hon'ble SAT has held that whether the MF units used as collateral for the December 2018 contracts were fraudulently transferred from AFSPL to ISSL is a question which has to be decided by some authority. SEBI has been directed to hear all the parties concerned and take a conscious decision by a reasoned and speaking order. I note that SEBI's appeal against this order is pending in the Hon'ble Supreme Court.

19.2. The present SCN issued to ISSL is, inter alia, for adjudging whether the Noticee has facilitated AFSPL in executing fraudulent transfer of MF Units from the account of DCEL, OCL and another entity named Novjoy Emporium Pvt. Ltd. (NEPL). The allegations of fraud and facilitation of fraud can be alleged concurrently. It is not a *sine qua non* for allegation of facilitation of fraud, that the determination of fraud should have been crystallized before the allegation of facilitation is levelled.

19.3. Further, the submission of the Noticee that SEBI admitted during personal hearing that the investigation into the transfer of MF units is incomplete is not correct. It was communicated to the Noticee during the personal hearing that the investigation into the alleged fraudulent acts of AFSPL has been completed and an SCN has been issued to AFSPL. This SCN has been disposed of by order dated July 02, 2021.

19.4. There is no requirement that SEBI was required to first determine the role of AFSPL and then proceed against ISSL. Investigation into the allegations made by DCEL, OCL and NEPL have resulted into issuance of SCN to AFSPL, which has since been disposed of, and also to ISSL. The extant SCN alleges how the Noticee has facilitated AFSL in the execution of fraudulent transfer of MF units from the accounts of DCEL, OCL and NEPL.

Examination into the possible collusion between AFSPL and Directors and/ or officials of the Dalmia Group:

20. In this regard, the Noticee has submitted the following:

20.1. AFSPL, in its affidavit submitted before the Hon'ble Supreme Court of India, has laid down details of alleged nature of business relationship existing between DCEL and AFSPL. The Hon'ble Supreme Court, after considering all allegations and counter allegations by and between ISSL, Dalmia and AFSPL, while considering an interlocutory application in the appeal filed by SEBI, has categorically opined that substantial doubts have been raised by the Dalmia Group and ISSL regarding each other's involvement/collusion with Allied in perpetrating the alleged fraud.

20.2. Therefore, the role of Dalmia Group also needs thorough examination by SEBI and other regulatory authorities as possibility of collusion between AFSPL and Director and/ or officials of DCEL cannot be ruled out. SEBI has issued an SCN without having done this investigation. The FIR filed by the Dalmia Group also contains material mis-statements including the role of ISSL as an intermediary.

20.3. In cases where there are allegations of fraud, all parties allegedly privy to the fraud ought to be joined. Therefore, AFSPL and Dalmia also ought to have been made a party to the present proceedings. It is noted that the PFUTP Regulations prevents acts of commission and omission, which are fraudulent or unfair in

nature. The facilitation of fraud is an “act” of “omission” or “commission”, which itself is treated as fraudulent as per the PFUTP Regulations if it facilitates any other fraud.

20.4. The objective of the PFUTP Regulations is to prevent the commission of “facilitation” in the same way the other fraudulent “act” or “omission” which is facilitated by the facilitating act or commission. Therefore, even if the facilitated act does not get fructified, it does not make the “facilitating act or omission” legal and/ or permissible. In other words, for a proceeding against the “act” of facilitation, it is not material whether the facilitated act of fraud has fructified or not and/ or who have participated in such facilitated act of fraud. Whether the same has fructified is not material for a proceeding against the Noticee for an allegation of commission of fraudulent conduct of facilitation. The facilitator is not required to be aware of the entire gamut of fraudulent act facilitated by him. However, there should be circumstances that raise red flags requiring further enquiry to be made, which the facilitator choses to not to make. Raising of relevant queries would have brought to his actual knowledge, the gamut of fraud regarding which he was not actually aware. The omission to make such enquiry despite the circumstances of red flags, coupled with the acts of commission, taints the act as facilitation. As facilitation itself is fraud separate from the fraudulent act which is facilitated, the contention that AFSPL, Dalmia all parties allegedly privy to the fraud ought to be joined in the present proceedings is not sustainable.

21. In this regard, I note that many of the allegations and counter-allegations between the Dalmia Group and AFSPL fall within the realm of a private dispute between the two. SEBI is not a forum for the adjudication of such private disputes. The complaint of Dalmia Group is already pending adjudication before the Hon’ble Court of the Chief Metropolitan Magistrate, New Delhi, having jurisdiction to decide on the issue of forgery. The present proceedings are meant for only the allegations made in the in

the present SCN. In the extant SCN, the allegations are whether the act(s) of the Noticee facilitated AFSPL in execution of fraudulent transfer of MF units from the accounts of DCEL, OCL and NEPL and whether such act of the Noticee is in violation of provisions of securities laws. It may be noted even if such collusion is there, it would not unsustain the allegations of the facilitation against the Noticee. In other words the extent of allegation against the Noticee does not get nullified or diluted, if there was a collusion between employees and/ or office bearers of the Dalmia Group.

22. I note here that the allegations levelled against the employees and/ or office bearers of the Dalmia Group, at the present stage, are currently at the allegations stage. Needless to say, if any of these allegations subsequent to fact finding result into violation of the PFUTP Regulations, the same will be dealt with suitably. The same cannot be determined in these proceedings as they are not covered in the scope of the current SCN.

23. From the material available on record, I note the following chronology of events in the extant matter:

Sr. No.	Date	Event
1	November 14, 2017	TM-CM agreement executed between AFSPL and ISSL
2	December 06, 2017	Start of business with AFSPL
3	December 30, 2017	MF units worth Rs. 329.62 crores released by ISSL to AFSPL at the request of AFSPL, while positions of AFSPL against this collateral was outstanding
4	January 01, 2018	MF units returned by AFSPL to ISSL before start of trading
5	March 31, 2018	MF units worth Rs. 335.06 crores released by ISSL to AFSPL at the request of AFSPL, while positions of AFSPL against this collateral was outstanding
6	April 02, 2018	MF units returned by AFSPL to ISSL before start of trading
7	December 26, 2018	AFSPL sold NIFTY Option contracts in the F&O segment of NSE
8	December 27, 2018	AFSPL sold NIFTY Option contracts in the F&O segment of NSE
9	December 31, 2018	Email correspondence between AFSPL and ISSL regarding MF units, with copy marked to Mr. Bijay Agrawal of Dalmia Group.

Sr. No.	Date	Event
10	January 30, 2019	Email from NSDL referring to complaints of clients of AFSPL and requesting ISSL to inform NSDL before releasing any funds/ securities to AFSPL
11	December 09, 2019	SCN issued to ISSL by SEBI
12	December 26, 2019	ISSL requested for inspection of documents
13	December 27, 2019	SEBI provided inspection of relevant documents
14	November 18, 2020	Hearing of ISSL on grounds of jurisdiction of SEBI
15	January 08, 2021	SEBI order on jurisdiction
16	April 12, 2021	Hearing of ISSL on merits of SCN
17	April 19, 2021	Additional documents in support of the allegation provided to ISSL by email
18	May 11, 2021	Order of Hon'ble Supreme Court directing that order of SEBI in the matter would be subject to orders of the Court
19	June 01, 2021	Hearing of ISSL on additional documents

24. I have perused the SCN, replies, written submissions and other materials available on record. On perusal of the same, the following issues arise for consideration. While each issue is dealt with separately under different headings, for the sake of brevity, the replies of the Noticee are also dealt with under each issue, where relevant.

24.1. **Issue No. 1: Whether the allegation that the Noticee, by releasing collateral to AFSPL in an unwarranted manner, helped AFSPL in making the Dalmia Group believe that their holdings were intact in their respective demat accounts, as made out in the SCN, stands established?**

24.2. **Issue No. 2: Whether the allegation that Noticee has facilitated fraudulent conduct on part of AFSPL, including fraudulent transfer of MF units, stands established?**

24.3. **Issue No. 3: If Issue Nos. 1 and/ or 2 are answered in the affirmative, whether the same is in violation of provisions of PFUTP Regulations?**

24.4. **Issue No. 4: Whether the allegations of (a) lack of due diligence while on-boarding AFSPL as a client, (b) providing enhanced intra-day limits to AFSPL, (c) opening the trading terminal of AFSPL and permitting roll-over of positions and (d) shortfall in networth of ISSL, as made out in the SCN, stand established? If yes, whether any of these allegations also facilitated AFSPL in executing fraudulent transfer of MF units from the account of DCEL, OCL and NEPL?**

24.5. **Issue No. 5: If answer to Issue Nos. 3 and/ or 4 above is in the affirmative, then whether any directions are required to be issued against the Noticee?**

Issue No. 1: Whether the allegation that the Noticee, by releasing collateral to AFSPL in an unwarranted manner, helped AFSPL in making the Dalmia Group believe that their holdings were intact in their respective demat accounts, as made out in the SCN, stands established?

25. The Noticee has denied the allegation and its submissions in support of the same are as below:

Movement of MF units is not linked to the Dalmia Group:

25.1. The manner in which movement of MF units is linked to the Dalmia Group has not been elaborated upon in the SCN. The Demat Ledger Statements have no link to the alleged fraud perpetrated by Allied. SEBI has not furnished the corresponding demat statements of AFSPL.

25.2. The statements furnished reflect movement of MF units between AFSPL and DCEL/ OCL on a frequent basis. They also show that there were frequent dealings between AFSPL and DCEL/ OCL, however, no details are available.

25.3. Hence, the entire allegation that transactions on the dates was intended to give an impression as if the MF units were always sitting in the demat account of DCEL/ OCL is untenable.

25.4. SCN is completely vague and does not furnish details and/or particulars of the MF units aggregating to the collateral that was transferred on the dates mentioned.

ISSL permits return of collateral at request of clients:

25.5. Bare perusal of SCN shows that there are only two instances where collateral has been alleged to have been released by ISSL without corresponding reduction in exposure/ margin.

25.6. With reference to SEBI's email dated November 21, 2019, to NCL, it is stated that, "ISSL allowed AFSPL to withdraw collateral amounting to Rs. 243 crores and deposit back on the same ***without any decrease in limit.***" (emphasis applied). This does not accurately reflect the contents of the GT Report where it is stated that, *"…we cannot comment upon if in all instances, the margin limit was reduced against the withdrawal of collateral as the data of N-mass is not available."*. Therefore, to substantiate this allegation, it is incumbent upon SEBI to provide the relevant underlying documentary evidence and without such evidence, the allegation that collateral was released without corresponding reduction in exposure/ margin requirement cannot stand.

25.7. ISSL follows a practice under which collateral can be returned to all its empaneled TMs upon receipt of request from client. Accordingly, collateral was returned to AFSPL upon receipt of withdrawal request from AFSPL as the client. This was a general practice followed for all TMs and was not restricted to AFSPL alone. There was no special understanding or arrangement with AFSPL for this purpose. Further, the return of collateral to AFSPL was not restricted specifically to quarter ending December 2017 and March 2018 end only. ISSL effected return of collateral on the receipt of a request from its client as is the general practice. There is no substance in the insinuation that ISSL returned collateral to AFSPL only during quarter endings. Moreover, movement of collateral, as seen from the transaction statements of DCEL and OCL, was facilitated even prior to AFSPL being empaneled as a TM with ISSL.

25.8. In the two instances where collateral was released to AFSPL on the weekend, the securities were received on the next trading day in the morning, prior to commencement of trading, thereby ensuring sufficiency of collateral towards margin requirement. This fully vindicates ISSL's stand. As this practice was followed for all TMs and not specifically for AFSPL alone, there was no requirement of approval.

25.9. It is not the case in the SCN that such a practice is specifically barred under the extant regulations. No rule or regulation was cited even during the personal hearing. SCN refers to Regulation 4.5.1 of the NCL F&O Regulations, which states:

> *Margin from the Constituents*
>
> *4.5.1 The F&O Clearing Members shall demand from its constituents the margin monies which the clearing member has to provide under these Regulations in respect of dealings done by the F&O Clearing Members for such constituents.*

25.10. Clearly, the only obligation imposed by this Regulation is that a CM must demand collateral/ margin money from its constituents. This regulation cannot be stretched to imply that releasing and re-depositing of collateral over the weekend is not permissible.

No movement reflected in majority of MF units disputed by Dalmia Group:

25.11. Upon going through the complaint filed by Dalmia Group, out of the 6 MF Units alleged to have been unauthorizedly transferred, 1 set relates to DCEL and 5 sets relate to OCL.

25.12. The Demat Ledger Statements of OCL and DCEL contains information on 15 and 6 sets of MF Units respectively. No movement is reflected in 8 out of the 15 MF Units detailed in the statements of OCL on the dates mentioned. It is also submitted that no movement is reflected in 4 sets out of the 6 sets of disputed units during the dates. While the allegations in the SCN pertain to all the MF units claimed by Dalmia Group, of all the MF units that were allowed to

be withdrawn in the aforesaid instances, only one set of units belongs to the disputed MF units. Thus, given that 4 sets of 6 the disputed units did not show any movement on the relevant dates, it is clear that the movement of MF Units has no bearing on the alleged fraud allegedly perpetrated on Dalmia.

Majority of MF units redeemed by Dalmia Group:

25.13. Majority of the MF Units that were transferred during the relevant period were eventually redeemed by Dalmia. Particularly, of these 7 sets of MF Units that were transferred during the relevant period in relation to OCL, 6 set of MF Units were actually redeemed on or before September 2018. Similarly, with respect to DCEL, 1 out of the 2 MF Units that were moved during the relevant period were redeemed. There cannot be any case or cause of alleged fraud being perpetrated in respect of the MF Units that were redeemed.

25.14. The sufficiency or insufficiency of collateral or whether AFSPL submitted alternate or additional collateral on the subsequent dates when the MF Units were redeemed is completely irrelevant to the alleged fraud and has no bearing on the charge framed by SEBI. 7 sets of MF Units were returned to AFSPL and eventually redeemed by Dalmia. On such instances, AFSPL furnished additional/ alternate collateral in the form of shares and mutual fund units (a majority of which are not reflected in the Demat Ledger Statements of DCEL/ OCL disclosed by SEBI). On one instance, no additional collateral was furnished.

Movement of MF units seen even before AFSPL became a client of ISSL:

25.15. Statements furnished by SEBI clearly show that MF Units were being transferred in and out of DCEL/OCL's accounts to the account of AFSPL, much prior to ISSL becoming AFSPL's clearing member i.e., much prior to December 2017. This indicates that that DCEL/ OCL/ Dalmia were aware of the movement of the MF Units in and out of their accounts. There are various

measures/ safeguards available for a demat account holder to monitor the activities in the account. Besides Dalmia Group would have multiple demat accounts with various depository participants. It is therefore inconceivable that they did not have an effective mechanism to track CAS or other measures available to monitor such transactions across demat accounts. Therefore, release of collateral cannot be viewed as facilitating any alleged fraud by AFSPL.

25.16. ISSL as a clearing member does not have access to demat accounts of DCEL/ OCL. If there is any instance of fraud alleged against AFSPL in its capacity as DP, then as a clearing member the Noticee is not concerned with that activity of AFSPL at all.

Limitations of GT Report:

25.17. The GT Report expressly states that its author does not have access to any details of the dealings between AFSPL and DCEL/ OCL. The report mentions limitations expressly set out by the author. Besides, ISSL's request for cross examination of the author of the GT Report was not acceded to. Therefore, the GT Report cannot be relied upon in any manner whatsoever. Further, the report with reference to Annexures 17 and 18 thereto only notes "potential anomalies … with regards to transactions in collateral movement of AFSPL". These transactions, even if unusual, cannot amount to the alleged fraud.

25.18. It is pertinent to note that in the last 6 entries set out in the GT Report at Annexure 18, there is movement from demat account of Noticee to Allied over the weekend, however, as per the Demat Ledger Statements, there is no corresponding movement from the account of Allied to that of OCL. This clearly breaks the link that SEBI is attempting to establish.

26. It has been submitted that, therefore, the allegation that the movement facilitated AFSPL in leading Dalmia Group to believe that their units were in their account is purely conjectural and based on surmises. No knowledge (much less motive) can be

attributed to the Noticee. Such a correlation is, at best, accidental/ coincidental and cannot, by any stretch of imagination be used to draw any adverse inference against ISSL.

27. Before proceeding further, I note that it would be appropriate to first show how the weekend release and re-deposit of collateral is linked to the Dalmia Group.

28. The table in the SCN shows the amount of MF units, which were being used as collateral, released to AFSPL by ISSL. The following documents were provided to the Noticee to establish the link of the movement of MF units with the Dalmia Group:

    28.1. **Transaction statement of the demat accounts of DCEL and OCL for the entire investigation period (obtained from NSDL)** – these documents contain relevant information such as date of credit/ debit of securities, quantity of securities credited/ debited and the details of the entity from where credit of securities was received and to which entity securities were transferred upon debiting the account.

    28.2. **Annexure 18 of the GT Report** – this annexure provides a break-up of the collateral that was released to AFSPL by ISSL on the weekend. The break up contains the name of the MF scheme whose units were released, the amount of units released, the date on which they were released and the date on which the same were re-deposited with ISSL.

29. At the outset, I note that the Noticee has not contested the release of the collateral over weekends. In fact, it has accepted the same. However, it contended that it followed such a practice for all its clients upon their request. Further, the Noticee has not contested any of the figures mentioned in the table mentioned in the SCN. Hence, the first leg of the release of MF units i.e., movement of MF units from ISSL to AFSPL, is not in dispute. Similarly, the Noticee has not disputed the return of the MF units from

AFSPL. As regards the second leg i.e., the movement of MF units after AFSPL has received them from ISSL, I note the following:

29.1. ISSL released collateral, which is composed of MF units, to AFSPL on a day which is a trading holiday. In the instant case, these dates are December 30, 2017, and March 31, 2018. On the same dates, there is a corresponding credit of the same number of units of the MF scheme, which was released by ISSL, into the account of DCEL or OCL. The same can be seen by comparing Annexure 18 of the GT Report and transaction statement of DCEL/ OCL, as given by NSDL.

29.2. Similarly, before the start of the next trading day, the same number of units of the same MF scheme are debited from the account of DCEL/ OCL and returned to ISSL. The same can be seen by comparing Annexure 18 of the GT Report and transaction statement of DCEL/ OCL, as given by NSDL.

29.3. The movement of MF units on December 30, 2017, and January 01, 2018, is shown below:

ISIN of MF scheme released	Name of MF Scheme whose units were released	From Annexure to GT Report				From transaction statement of DCEL/ OCL received from NSDL		
		Movement	Date of release	Whether trading holiday	Quantity released (units)	Movement	Date of credit	Quantity credited (units)
INF174K01FA2	Kotak Flexi Debt A Growth	ISSL to AFSPL	30-Dec-17	Yes	1,74,22,150.00	AFSPL to OCL	30-Dec-17	1,73,94,915.00
INF204K01CG1	Reliance Floating Rate Fund-Growth Plan	ISSL to AFSPL	30-Dec-17	Yes	1,88,84,050.00	AFSPL to OCL	30-Dec-17	1,88,83,672.00
INF209K01785	Birla Sun Life Short Term Fund	ISSL to AFSPL	30-Dec-17	Yes	39,88,296.00	AFSPL to OCL	30-Dec-17	39,88,296.00
INF740K01656	DSP Blackrock Short Term Fund	ISSL to AFSPL	30-Dec-17	Yes	2,62,10,945.00	AFSPL to OCL	30-Dec-17	2,62,10,945.00
INF740K018P2	DSP Blackrock Ultra Short Term Fund	ISSL to AFSPL	30-Dec-17	Yes	6,30,38,860.00	AFSPL to OCL	30-Dec-17	1,26,02,182.00
						AFSPL to DCEL		5,04,35,849.00
INF789F01QA4	UTI Short Term Income Fund Institutional Plan	ISSL to AFSPL	30-Dec-17	Yes	1,57,24,682.00	AFSPL to OCL	30-Dec-17	1,57,24,193.00
INF917K01CL8	L&T Short Term Opportunities Fund	ISSL to AFSPL	30-Dec-17	Yes	3,35,45,152.00	AFSPL to OCL	30-Dec-17	2,21,52,459.00
						AFSPL to DCEL	30-Dec-17	1,13,92,693.00

* The minor difference between the number of units credited into the account of OCL is to ensure that the statement will reflect the correct investment of OCL.

ISIN of MF scheme released	Name of MF Scheme whose units were released	From transaction statement of DCEL/ OCL received from NSDL				From Annexure to GT Report		
		Movement	Date of debit	Whether trading holiday	Quantity debited (units)	Movement	Date of re-deposit	Quantity re-deposited (units)
INF174K01FA2	Kotak Flexi Debt A Growth	OCL to AFSPL	01-Jan-18	No	1,73,94,915.00	AFSPL to ISSL	01-Jan-18	1,74,22,150.00
INF204K01CG1	Reliance Floating Rate Fund-Growth Plan	OCL to AFSPL	01-Jan-18	No	1,88,83,672.00	AFSPL to ISSL	01-Jan-18	1,88,84,050.00
INF209K01785	Birla Sun Life Short Term Fund	OCL to AFSPL	01-Jan-18	No	39,88,296.00	AFSPL to ISSL	01-Jan-18	39,88,296.00
INF740K01656	DSP Blackrock Short Term Fund	OCL to AFSPL	01-Jan-18	No	2,62,10,945.00	AFSPL to ISSL	01-Jan-18	2,62,10,945.00
INF740K018P2	DSP Blackrock Ultra Short Term Fund	OCL to AFSPL	01-Jan-18	No	1,26,02,182.00	AFSPL to ISSL	01-Jan-18	6,30,38,860.00
		DCEL to AFSPL	01-Jan-18	No	5,04,35,849.00	AFSPL to ISSL	01-Jan-18	
INF789F01QA4	UTI Short Term Income Fund Institutional Plan	OCL to AFSPL	01-Jan-18	No	1,57,24,193.00	AFSPL to ISSL	01-Jan-18	1,57,24,682.00
INF917K01CL8	L&T Short Term Opportunities Fund	OCL to AFSPL	01-Jan-18	No	2,21,52,459.00	AFSPL to ISSL	01-Jan-18	3,35,45,152.00
		DCEL to AFSPL	01-Jan-18	No	1,13,92,693.00	AFSPL to ISSL	01-Jan-18	

30. The movement of MF units on March 31, 2018, and April 02, 2018, is shown below:

ISIN of MF scheme released	Name of MF Scheme whose units were released	From Annexure to GT Report				From transaction statement of DCEL/ OCL received from NSDL		
		Movement	Date of release	Whether trading holiday	Quantity released (units)	Movement	Date of credit	Quantity credited (units)
INF174K01FA2	Kotak Flexi Debt A Growth	ISSL to AFSPL	31-Mar-18	Yes	1,73,94,915	AFSPL to OCL	31-Mar-18	1,73,94,915
INF204K01CG1	Reliance Floating Rate Fund-Growth Plan	ISSL to AFSPL	31-Mar-18	Yes	1,88,83,672	AFSPL to OCL	31-Mar-18	1,88,83,672
INF209K01785	Birla Sun Life Short Term Fund-Growth	ISSL to AFSPL	31-Mar-18	Yes	39,88,296	AFSPL to OCL	31-Mar-18	39,88,296
INF740K01656	DSP Blackrock Short Term Fund-Growth	ISSL to AFSPL	31-Mar-18	Yes	2,62,10,945	AFSPL to OCL	31-Mar-18	2,62,10,945
INF740K018P2	DSP Blackrock Ultra Short Term Fund-Reg-Growth	ISSL to AFSPL	31-Mar-18	Yes	6,30,38,031	AFSPL to OCL	31-Mar-18	1,26,02,182
						AFSPL to DCEL	31-Mar-18	5,04,35,849
INF789F01QA4	UTI Short Term Income Fund Institutional Plan Growth	ISSL to AFSPL	31-Mar-18	Yes	1,57,24,193	AFSPL to OCL	31-Mar-18	1,57,24,193
INF917K01CL8	L&T Short Term Opportunities Fund	ISSL to AFSPL	31-Mar-18	Yes	3,35,45,152	AFSPL to OCL	31-Mar-18	2,21,52,459
						AFSPL to DCEL	31-Mar-18	1,13,92,693

ISIN of MF scheme released	Name of MF Scheme whose units were released	From transaction statement of DCEL/ OCL received from NSDL				From Annexure to GT Report		
		Movement	Date of debit	Whether trading holiday	Quantity debited (units)	Movement	Date of re-deposit	Quantity re-deposited (units)
INF174K01FA2	Kotak Flexi Debt A Growth	OCL to AFSPL	02-Apr-18	No	1,73,94,915	AFSPL to ISSL	02-Apr-18	1,73,94,915
INF204K01CG1	Reliance Floating Rate Fund-Growth Plan	OCL to AFSPL	02-Apr-18	No	1,88,83,672	AFSPL to ISSL	02-Apr-18	1,88,83,672
INF209K01785	Birla Sun Life Short Term Fund-Growth	OCL to AFSPL	02-Apr-18	No	39,88,296	AFSPL to ISSL	02-Apr-18	39,88,296
INF740K01656	DSP Blackrock Short Term Fund-Growth	OCL to AFSPL	02-Apr-18	No	2,62,10,945	AFSPL to ISSL	02-Apr-18	2,62,10,945
INF740K018P2	DSP Blackrock Ultra Short Term Fund-Reg-Growth	OCL to AFSPL	02-Apr-18	No	1,26,02,182	AFSPL to ISSL	02-Apr-18	6,30,38,031
		DCEL to AFSPL	02-Apr-18	No	5,04,35,849	AFSPL to ISSL	02-Apr-18	
INF789F01QA4	UTI Short Term Income Fund Institutional Plan Growth	OCL to AFSPL	02-Apr-18	No	1,57,24,193	AFSPL to ISSL	02-Apr-18	1,57,24,193
INF917K01CL8	L&T Short Term Opportunities Fund	OCL to AFSPL	02-Apr-18	No	2,21,52,459	AFSPL to ISSL	02-Apr-18	3,35,45,152
		DCEL to AFSPL	02-Apr-18	No	1,13,92,693	AFSPL to ISSL	02-Apr-18	

31. The above tables clearly show how the weekend release and re-deposit of MF units by ISSL to AFSPL has a corresponding link with the demat accounts of the Dalmia Group. The MF units have been released on a non-trading day from ISSL to AFSPL and on the same day, the same amount of units are credited to the demat accounts of DCEL/ OCL and thereafter, at the start of the next trading day, the same transaction is reversed i.e., the same number of units are debited from the accounts of DCEL/ OCL, credited to AFSPL and then re-deposited with ISSL.

Significance of the weekend release and re-deposit of collateral:

32. The significance of the above mentioned weekend release and re-deposit of collateral from ISSL to AFSPL and subsequent link with the demat accounts of DCEL and OCL has to be seen in the context of the dates on which this movement of MF units has taken place viz., December 30, 2017 (end of quarter for December 2017) and March 31, 2018 (end of financial year 2017-18).

33. I note that OCL was a listed company till the time of its amalgamation with Odisha Cement Ltd. (now known as Dalmia Bharat Ltd.) in October 2018. Similarly, DCEL was a step-down subsidiary of Dalmia Bharat Ltd., which is a listed entity (as per the annual report of Dalmia Bharat Ltd. for FY 2016-17). Hence, the investments of OCL and DCEL in mutual funds would be considered when the unaudited and audited financial statements for OCL and Dalmia Bharat Ltd. are being finalized by statutory

auditors. There may be a possibility that statutory auditors, apart from relying on holding statements sent by AFSPL, may also like to independently verify that the holdings are actually available in the demat accounts. One way in which an independent verification could be done was by seeking a holding statement, as on December 31, 2017, and March 31, 2018, for the accounts of DCEL and OCL directly from NSDL.

34. In view of the above mentioned movement of MF units, if the statutory auditors had sought to do such independent verification, then as on December 31, 2017, and March 31, 2018, the investments of DCEL and OCL in MF units would be seen to be intact in their respective demat accounts. Hence, not only the statutory auditors but even the companies i.e., DCEL and OCL would be under the impression that their investments in MF schemes kept in demat accounts opened with AFSPL are intact. Therefore, the above exercise of release of collateral exactly a day prior to end of December quarter and a day prior to end of financial year 2017-18 facilitated that any independent verification by the statutory auditors or even by DCEL and OCL would show that the units are intact in the demat accounts, whereas in fact, the MF units were "encumbered" and due to be returned to ISSL on the very next trading day.

35. This finding is further enforced by the following:

35.1. Release of units of DSP Blackrock Ultra Short Term Fund (ISIN-INF740K018P2): As seen from the table above, on December 30, 2017, 6,30,38,860 units of this MF scheme were released from ISSL to AFSPL. From examination of the subsequent movement of these units, it is seen that 1,26,02,182 units were moved to demat account of OCL, while 5,04,35,849 units were moved to the demat account of DCEL.

35.2. Further perusal of the transaction statement of OCL and DCEL shows that OCL was always holding 1,26,02,182 units of DSP Blackrock Ultra Short Term Fund

(ISIN- INF740K018P2) from the beginning i.e., from May 16, 2017, when these units were first credited into the account. Similarly, DCEL was always holding 5,04,35,849 units of this scheme from very beginning i.e., May 31, 2017.

35.3. Hence, the exact amount of MF units was credited to the demat accounts of OCL and DCEL to facilitate that there would be no discernible discrepancy if statutory auditors independently verified the holdings when preparing the financial statements.

35.4. Similarly, precise movement of units of L&T Short Term Opportunities Fund (ISIN: INF917K01CL8), in terms of quantity, can be seen between ISSL and AFSPL and followed by movement from AFSPL to demat accounts of DCEL and OCL.

35.5. Further, it can be seen that on the very next trading day after quarter end and financial year end, i.e., January 01, 2018, and April 02, 2018, the same number of MF units have been moved back from the accounts of DCEL and OCL and re-deposited with ISSL, since the position taken against these MF units was outstanding. On repeatedly being given an opportunity during hearing, to explain this peculiar behaviour, the only reply given was that it was at the behest of the client and that the collateral was returned. On being given an opportunity to explain how such a request of a client can supercede prudent risk management, the reply given was that it was done on the basis of relationship, which I note in this case was less than a month old. It was submitted that since the MF units came back, the same is evidence that trust in the relationship was well placed. Noticee was given an opportunity to furnish data to show that this magnitude of risk was taken qua other clients as well, in the normal course of business. However, the Noticee failed to furnish any such data.

36. Hence, it is clear that the only objective to be achieved from this release of collateral was to ensure that the MF units were available in the demat accounts of DCEL and OCL, as on December 31, 2017, and March 31, 2018.

37. In view of the above, I conclude that the release and re-deposit of MF units by ISSL during December 2017 quarter end and March 2018 financial year end was done in order to help AFSPL to make the Dalmia Group believe that their MF units were intact in their respective demat accounts.

38. The submissions of the Noticee vis-à-vis this allegation are dealt with as below:

38.1. The submission that the movement of MF units is not linked to the Dalmia Group cannot be accepted as a clear link between the two has been demonstrated above. Noticee had ample opportunity to make submissions on the same.

38.2. With regard to requirement of furnishing demat statements of AFSPL, I note that these statements would merely show receipt of MF units from ISSL, same day debit to demat accounts of DCEL/ OCL and accordingly, reverse transactions on the next trading day. No additional information, in the current context will be provided by these statements, beyond the statements already furnished to the Noticee.

38.3. The details and/or particulars of the MF Units, which formed part of the collateral released on December 30, 2017, and March 31, 2018, are provided in Annexure 18 to the GT Report. This Report is an annexure to the SCN.

38.4. With regard to submission that collateral has been released on only two dates, I note from the table that the release/ repatriation of collateral has occurred on the following dates:

December 2017 quarter end

Date	Day	Collateral released	Collateral repatriated	Remarks
December 29, 2017	Friday	No	-	Positions outstanding against the collateral
December 30, 2017	Saturday	Yes	-	Still outstanding
December 31, 2017	Sunday	-	-	Still outstanding
January 01, 2018	Monday	-	Yes	Still outstanding

March 2018 FY and quarter end

Date	Day	Collateral released	Collateral repatriated	Remarks
March 30, 2018	Friday	No	-	Positions outstanding against the collateral
March 31, 2018	Saturday	Yes	-	Still outstanding
April 01, 2018	Sunday	-	-	Still outstanding
April 02, 2018	Monday	-	Yes	Still outstanding

38.5. From the above, while the Noticee may be correct in saying that the collateral was released only on two instances, I note that the positions taken against the collateral remained outstanding in four instances viz., December 30 and 31, 2017, and March 31 and April 01, 2018.

38.6. With reference to submission that allegation that collateral was released without corresponding reduction in exposure/ margin requirement cannot stand, I note the following:

38.6.1. The finding of release of collateral over weekends is also part of the GT Report, wherein it has been qualified that GT is unable to comment if margin limit was reduced against the withdrawal of collateral. For the instances mentioned in the SCN, the margin requirement and shortfall, after release of collateral, is as below:

Amount in rupees crores

Date	Day	A = Total Margin required for outstanding position	B = Total Collateral available with ISSL (Cash + Securities)	C = MF Amount Released	D = Shortfall on Saturday and Sunday (B-A)
29-Dec-17	Friday	181.27 (at end of trading hours)	411.89 (at end of trading hours)	-	

Date	Day	A = Total Margin required for outstanding position	B = Total Collateral available with ISSL (Cash + Securities)	C = MF Amount Released	D = Shortfall on Saturday and Sunday (B-A)
30-Dec-17	Saturday	181.27	82.27	329.62	99
31-Dec-17	Sunday	181.27	82.27	329.62	99
01-Jan-18	Monday	181.27	411.89 (at start of trading hours)	-	-
29-Mar-18	Friday	326 (at end of trading hours)	451 (at end of trading hours)	-	-
31-Mar-18	Saturday	326	116	335	210
01-Apr-18	Sunday	326	116	335	210
02-Apr-18	Monday	326	451 (at start of trading hours)	-	-

38.6.2. The fact that there was a shortfall in the margin requirement shows that the release of the collateral was unwarranted. The same amount of collateral was reinstated in both instances in order to maintain sufficient collateral against the positions taken by AFSPL. Further, the Noticee, being the CM for AFSPL, also has the data regarding its margin requirement, as on end of trading hours on December 29, 2017, and March 29, 2018. If indeed the collateral was released AFTER corresponding reduction in margin requirement/ exposure limit, then ISSL could have submitted this data in support of its submissions. I note that no such submissions have been made.

38.7. With reference to submission that ISSL follows a practice of releasing collateral at request of its clients, I note that the Noticee has not denied the release of collateral to AFSPL. In fact, the Noticee has accepted that it followed a general practice of returning collateral to any client who makes such a request. I note here that collateral is maintained by a client with a Clearing Member (CM) against its open position(s). The Noticee appears to have accepted that it followed a practice where it would return collateral to its clients, at their request, even when there is a position outstanding against the said collateral.

38.8. It is of serious concern that the Noticee, being a Clearing Member, has expressed such a cavalier attitude towards the issue of collection and release of margin/ collateral. Margin collection is the very foundation on which the integrity of the entire markets rests. It is nothing short of shocking to hear a Clearing Member refer to the practice it follows, as submitted by the Noticee. As a CM, the Noticee collects collateral from its clients and posts the collateral with the Clearing Corporation towards margin obligations. The Noticee performs a vital role in risk management for the entire trading and settlement mechanism put in place in the securities market. Such a practice of returning collateral to a client while positions taken against that collateral are open goes against the core principle of risk management that positions/ exposure shall be provided only against adequate collateral/ margin. Once the collateral has been released to the TM, ISSL has no control over it and in the eventuality that the TM does not return the collateral before start of trading hours, then the Noticee would be bound to post its own funds/ securities in lieu of the collateral it has released and potentially absorb losses to that extent. I note that the amount of shortfall in margin on release of collateral was Rs. 99 crores and Rs. 210 crores, which is not a small amount by any yardstick. In the event that there are any adverse market movements, then the CM would potentially need to absorb the loss. To explain the magnitude of risk that the Noticee has exposed itself to, the following may be seen:

38.8.1. Suppose an investor takes a position in the market, say to buy futures of a stock, worth Rs. 1 lakh. The entire system needs to be sure that he would honor this commitment, for otherwise, no trade in the market can be guaranteed.

38.8.2. Since our markets follow a month end delivery system for all futures and options contracts, this investor has till month end to settle his position. During this time, if the price of the futures comes down, by say 10%, the investor has an incentive to default on his payment of Rs. 1 lakh,

because he can now buy the same futures at Rs. 90,000/-, i.e., at 10% less.

38.8.3. In order to protect the sanctity of the trade already contracted at Rs. 1 lakh and to be able to guarantee settlement of the same, the clearing corporations of the exchanges insist on a certain amount of margin to be collected from the investor.

38.8.4. Broadly speaking, the amount of margin to be collected is computed based on a statistical model, which estimates the possible movement in the price of these futures so that on most days, even if the investor defaults and does not honor his commitment, the loss is no more than the margin already collected. In the example above, let us assume that the margin to be collected was 15%. This can be furnished in the form of cash or collateral (including MF units).

38.8.5. This ensures that the investor does not have an incentive to default in the above scenario of 10% reduction in price because, while he may buy the futures at the new price of Rs. 90,000/-, his margin of Rs. 15,000/- would be utilized to cover the loss of Rs 10,000/- and thus the effective cost to him would still be Rs. 1 lakh.

38.8.6. Also, it ensures that even if the investor does default, the clearing corporation can still settle the trade by making good the Rs. 10,000/- to the counterparty to the trade by utilizing Rs. 10,000/- out of the total margin of Rs. 15,000/- of the investor.

38.8.7. This is the key risk management mechanism of the market and without it, trades in the market can never be guaranteed.

38.8.8. The reason that SEBI regulations stipulate that Clearing Members like the Noticees have to demand the margin/ collateral from their constituents is that the minimum networth requirement of CMs is very low compared to the amount of risk that they bring to the market and thus it is stipulated that margin be collected from each constituent contributing to the risk.

38.8.9. Collecting margin from its constituents and retaining the same right though till the time the position of the constituent is open is not a trivial matter that can be dispensed with “at the request of a client”. If there is a shortfall in collection and retention of margin and the client defaults, the entire ensuing liability falls on the balance sheet of the CM.

38.9. In the current case, the shortfall of margin of Rs. 99 crores on 31/12/2017 and Rs. 210 crores on 31/03/2018, implies that the Noticee took a risk that in case the client did not return the collateral on Monday morning and if there was a loss in the position of the client, the Noticee would need to itself absorb a loss of Rs. 99 crores and Rs. 210 crores, respectively.

38.10. When asked about who approved a potential loss to ISSL of Rs 100 Cr and Rs 200 Cr on those dates, the Noticee, in a cavalier fashion has responded to say that since this is done all the time, it did not need internal approval.

38.11. I note here that Regulation 4.5.1 of the NCL F&O Regulations requires a CM to demand collateral/ margin money from its trading members. While the regulation does not state that such weekend release of collateral is not permissible, I note that such a statement is not required in the first place. By the very nature of the principle of margin collection, it is clear that such release of collateral, which has been obtained for positions taken by the TMs, is not permissible. The entire concept of collection of margins is to minimize risk and in no way can it be construed that release of collateral over a weekend, when positions are open, is permissible (unless ofcourse, ISSL was motivated by an “understanding” or “arrangement” with AFSPL). I note that the responses of the Noticee are shocking to say the least. In view of the above, I hold that the Noticee is in violation of the above mentioned Regulation 4.5.1 of the NCL F&O Regulations.

38.12. With respect to the submission that only one set of MF units showed any movement on the relevant dates and redemption of various MF units by Dalmia Group, I note the following:

38.12.1. The Noticee is referring to the units of the MF schemes, which are mentioned in the complaint of the Dalmia Group. I note that there are 5 unique MF schemes mentioned in the complaint. The Noticee has submitted that out of these 5 MF schemes, units of only one scheme were part of the collateral that was released over weekends. Further, majority of the MF units that were part of the release of collateral were eventually redeemed by the Dalmia Group. Hence, the movement of MF units has no bearing on the alleged fraud allegedly perpetrated on Dalmia.

38.12.2. I note that the demat accounts of DCEL and OCL received units of MF schemes after the accounts were opened. These units were finally transferred to ISSL and given as collateral. Subsequently, units of new MF schemes were credited to the demat accounts, which were also given as collateral to ISSL, while some units were released by ISSL and subsequently redeemed. It has already been determined that how the release of collateral helped AFSPL make DCEL and OCL believe that their holdings were intact in their demat accounts. Substitution of collateral and redemption of MF units by the Dalmia Group does not alter or change the fact that part of the collateral that was returned to AFSPL was unwarranted and done in order to facilitate AFSPL to make the Dalmia Group believe that their units were intact in their demat accounts.

38.13. With respect to the submission that movement of MF units is seen even before AFSPL became a client of ISSL, I note that the SCN pertains to the role of ISSL after it became the CM for AFSPL. One of the ways in which AFSPL achieved a facade of showing that the MF units were not being used as

collateral/ margin when in fact they were so used, was by ensuring the holdings were available in the accounts as on December 31, 2017, and March 31, 2018. It has already been demonstrated above how the release of collateral by ISSL helped AFSPL in making the Dalmia Group believe that their holdings are intact in their accounts. Hence, in light of the facts and circumstances mentioned above, the submission of the Noticee that as a clearing member it is not concerned with the DP activities of AFSPL also cannot be accepted on the same grounds.

38.14. With respect to the limitations of the GT Report, I note the following:

38.14.1. I note that Grant Thornton was asked by the Audit Committee of IL&FS to review the dealings of ISSL with AFSPL. Part of the scope of this task was to review the adequacy of collaterals maintained by ISSL on behalf of AFSPL. The finding relevant to this SCN is given in Annexure 18 to the GT Report. I also note that the GT Report mentions the certain limitations and disclaimers.

38.14.2. However, I note here that Annexure 18 of the GT Report, which is being relied upon in this SCN, does not form the sole basis for the allegations made in the SCN. The finding of release of collateral is also mentioned in the inspection report of NCL, which also shows the shortfall in margin. In any event, as pointed out earlier, the Noticee had full access to its own data to dispute the finding of shortfall in margin collection on release of collateral. But it has not presented any such defense i.e., the Noticee has not disputed the contents of Annexure 18. Hence, I note that the disclaimers mentioned in the GT Report do not bar the use of Annexure 18 for the purpose of these proceedings.

38.14.3. The GT Report mentions that the transactions pertaining to the return of collateral are unusual. It has already been shown how these transactions were totally unwarranted and hugely risky to ISSL. It has

also been shown how these transactions helped AFSPL in making the Dalmia Group believe that the MF units were intact in their demat accounts. It has also been shown how such movement of collateral is in contravention of the basic principle of risk management of allowing positions only against adequate collateral/ margin.

38.14.4. The 6 instances in Annexure 18 referred to by the Noticee are not relevant to the present proceedings.

39. I note that the Noticee is a Clearing Member and is required to abide by the Code of Conduct, which has been prescribed in Schedule II of the Broker Regulations. This requirement is prescribed under Regulation 9(f) in Chapter II of the Broker Regulations and the provisions of this Chapter are also applicable to Clearing Members. The relevant clauses are mentioned below:

Conditions of registration.

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

…

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

SCHEDULE II
Securities and Exchange Board of India (Stock Brokers 84[***])
Regulations, 1992
CODE OF CONDUCT FOR STOCK BROKERS
[Regulation 9]

A. General.

…
(2) Exercise of due skill and care : A stock-broker shall act with due skill, care and diligence in the conduct of all his business.
…
(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

40. The above conduct of ISSL in releasing collateral to AFSPL, without any corresponding reduction in exposure/ margin requirements, shows that ISSL has not exercised due skill, care and diligence while conducting its business. Further, as detailed above, the Noticee has violated Regulation 4.5.1 of the NCL F&O Regulations as it has released collateral to AFSPL, without any corresponding reduction in exposure/ margin requirements i.e., during these instances when it released collateral, the Noticee was not holding adequate margin for the trades of AFSPL. Hence, the Noticee has not complied with a statutory requirement. In view of the same, I hold that the Noticee is in violation of Clauses A(2) and A(5) of the Code of Conduct specified in Schedule II and Regulation 9(f) of the Broker Regulations.

41. In view of the above, I conclude the following:

41.1. There is a clear link between the release of collateral by ISSL to AFSPL and its re-deposit during the December 2017 quarter end and March 2018 financial year end, and the release of the units by AFSPL to the demat accounts of DCEL and OCL.

41.2. The release of collateral by ISSL to AFSPL helped the Dalmia Group believe that the MF units were intact in their respective demat accounts, as on December 31, 2017, and March 31, 2018.

41.3. The release of collateral by ISSL resulted in a shortfall in margin collection of approx. Rs. 99 crores and Rs. 210 crores in end December 2017 and end March 2018, respectively, and the same was wholly unwarranted and demonstrates that the release was without corresponding reduction in margin requirement/ exposure limit.

41.4. This unwarranted release of collateral is in violation of Regulation 4.5.1 of the NCL F&O Regulations. The Noticee is in violation of Clauses A(2) and A(5) of

the Code of Conduct specified in Schedule II and Regulation 9(f) of the Broker Regulations.

41.5. The explanations given by the Noticee to justify its actions are absolutely shocking in the context of the magnitude of the risk resulting from shortfall in margin collection of Rs. 99 crores and Rs. 210 crores in December 2017 and March 2018, respectively.

Issue No. 2: Whether the allegation that Noticee has facilitated fraudulent conduct on part of AFSPL, including fraudulent transfer of MF units, stands established?

42. With regard to the allegation that ISSL has facilitated fraudulent conduct on part of AFSPL, including fraudulent transfer of MF units, the Noticee has denied that it has violated the provisions of the PFUTP Regulations. The submissions of the Noticee in support of the same are as below:

Evidence in support of this allegation not provided:

42.1. SCN does not set out the explanation as to how this conclusion has been made. Indirect references to the conduct of ISSL in facilitating the acts of AFSPL have been made; however, SEBI has equally accepted that all documents in relation to investigation into the movement of MF units, investigations into the claims of AFSPL, etc., have not been made available. It is incumbent upon SEBI to peruse and take into account and also provide the same to ISSL.

42.2. The allegations made in the SCN are vague and unsubstantiated and therefore ought to be disregarded. SEBI has not produced any evidence in support of this grave allegation. It is a settled position of law that proceedings based on vague and unspecific allegations are in contravention of the principles of natural justice and any order passed thereon is wholly vitiated. This position has been affirmed by the Hon'ble Supreme Court in Canara Bank & Ors. v. Debashish Das & Anr.,

reported in (2003) 4 SCC 557, and Commissioner of Central Excise v. Brindavan Beverages reported in (2007) 5 SCC. 3884. As regards the PFUTP violation, it is submitted that:

42.2.1. It is clear that the SCN does not make any specific allegation or particularize the details of the alleged facilitation of fraud. This is contrary to established law which sets forth that allegation of fraud must be substantiated.

42.2.2. None of the alleged actions or lapses of ISSL, whether individually or collectively, demonstrate fraud.

42.2.3. The SCN does not provide/ offer any link or evidence that in any way establishes "alleged facilitation of fraud" by ISSL. Moreover, there is no indication of any reason as to why the instances set out therein establish that ISSL allegedly facilitated the fraud perpetrated.

ISSL is not aware of the transactions between AFSPL and Dalmia Group:

42.3. ISSL received the MF units as part of collateral from the registered demat account of AFSPL maintained with NSDL and the standard practice that collateral has been placed from this registered demat account has been ensured by ISSL. Noticee cannot be expected to have any visibility whatsoever on the transactions that would have been conducted by AFSPL as a DP.

42.4. ISSL did not have any reason to believe or the means to determine that the MF units were obtained by AFSPL fraudulently. In terms of the agreement, AFSPL confirmed that it had requisite title, free from any encumbrances, on the margins it provided and that such ownership rights upon the margins would have deemed to have been transferred to ISSL once they are furnished to ISSL.

42.5. It is clear that ISSL was yet another victim of the alleged acts of AFSPL and deserves to have its interests preserved by regulators.

42.6. The release and re-posting of collateral has happened almost 1 year/ 9 months prior to January 2019 i.e., when Dalmia Group alleged that it became aware of

the fraud for the first time. In this interval, two emails (one is dated December 31, 2018) were addressed by AFSPL to ISSL, marking Dalmia a copy, where it is stated clearly that the disputed MF units were deposited with ISSL. This demonstrates that the Dalmia Group and its Directors and/ or officials were well aware that the MF units were being handed over as collateral by AFSPL to ISSL for F&O trading. Since reference to amalgamation of OCL and DCEL has been made, the reason why this issue was not discovered or raised earlier needs to be provided. There is no demonstrable nexus between the withdrawal and reposting of collateral and the alleged fraud facilitated by ISSL.

43. To substantiate its case, the Noticee has further referred to judgments of the Hon'ble Supreme Court (in cases of Bank of India v. Degala Suryanarayana reported in AIR 1999 SC 2407; Nandakishore Prasad v State of Bihar reported in [l978] 3 SCC 366; Union of India v. H.C. Goel reported in AIR1964 SC 364; Razikram v. J.S. Chouhan reported in AIR 1975 SC 667; and Amba Lal v. Union of India reported in AIR 1961 SC 264) wherein it has been crystallized that:

43.1. Mere conjecture or surmise cannot sustain finding of guilt.

43.2. Minimum requirement of rules of natural justice should be observed to arrive at a conclusion on the basis of some evidence i.e., evidential material, which with some degree of definiteness points to the guilt of the delinquent in respect of the charges against him. Suspicion cannot be allowed to take place of proof even in domestic inquiries.

43.3. Disciplinary authority, in forming an opinion, must be guided by the doctrine of benefit and is under an obligation to record a finding of guilt only upon being satisfied beyond reasonable doubt. It would be impermissible to reach a conclusion on the basis of preponderance of evidence/ surmise/ conjecture/ suspicion. It will be essential to consider the dimension regarding mens rea.

43.4. Burden of proof is on the authority and they have to bring home the guilt to the person alleged to have committed a particular offence under the said Acts by adducing satisfactory evidence.

44. The Noticee has further referred to the following judgments of the Hon'ble SAT:

44.1. The Hon'ble SAT has in its judgment Sterlite Industries (India) Ltd. v. SEBI reported in (2001) 45 CLA 195 (SAT) held that merely, probablizing or endeavoring to prove the fact on the basis of preponderance of probability and incomplete circumstantial evidence is not sufficient to establish a serious charge of fraud and fraudulent act. The aforesaid settled principle of law has also been observed by SAT. The relevant extract is as follows

"… holding the appellant guilty of indulging in price manipulation has stated that 'creation of false market and price manipulation is a very serious offence'. Evidence merely probabalising and endeavouring to prove the fact on the basis of preponderance of probability is not sufficient to establish such a serious offence of market manipulation. When such a serious offence is investigated and the charge is established, the fall out of the same is multifarious...Mere conjunctures and surmises are not adequate to hold a person guilty of such a serious offence."

44.2. Keeping the aforesaid principles and findings in perspective, the threshold of proving ISSL's facilitation of fraud has not been met. It is not SEBI's case that ISSL was aware that the MF Units belonged to Dalmia (let alone that they were fraudulently transferred from Dalmia). There is no allegation regarding any lack of vigilance or any fact which would indicate that ISSL could have become aware that the MF Units had been fraudulently transferred or that there was negligence/lack of due care etc. on ISSL's part.

44.3. In the case of Kasat Securities v SEBI reported in 2006 SCC OnLine SAT 205, the Hon'ble SAT while examining the issue of a broker aided/abetted fictitious trades being conducted by its clients held as follows:

"*The trades, on the face of it, appear to be fictitious and we shall proceed on that assumption. It is obvious that these trades were executed by the clients and the appellant acted only as a broker. If the appellant knew that the trades were fictitious then there would be no hesitation in upholding the finding of the Board that it aided and abetted the parties to execute fraudulent transactions. Having heard the learned counsel for the parties and after going through the record we are satisfied that this link is missing. There is no material on record to show that the appellant as a broker knew*

that the trades were fictitious or that the buyer and the seller were the same persons. Trading was through the exchange mechanism and was online where the code number of the broker alone is known and the learned counsel for the parties are agreed that it is not possible for anyone to ascertain from the screen as to who the clients were. This is really a unique feature of the stock exchange where, unlike other moveable properties, securities are bought and sold between the unknowns through the exchange mechanism without the buyer or the seller ever getting to meet. Therefore, it was not possible for the broker to know who the parties were. Merely because the appellant acted as a broker cannot lead us to the conclusion that it must have known about the nature of the transaction. There has to be some other material on the record to prove this fact. The Board could have examined someone from KIL to find out whether the appellant knew about the nature of the transactions but it did not do so. As a broker, the appellant would welcome any person who comes to buy or sell shares. The Board in the impugned order while drawing an inference that the appellant must have known about the nature of the transactions has observed that the appellant failed to enquire from its clients as to why they were wanting to sell the securities. We do not think that any broker would ask such a question from its clients when he is getting business nor is such a question relevant unless, of course, he suspects some wrong doing for which there has to be some material on the record."

44.4. Once again in the case of Indiabulls v SEBI reported in 2010 SCC OnLineSAT 323, the Hon'ble Tribunal while examining the same issue held that:

"As already observed, even if we assume that the appellant's clients had executed reverse trades with the same counter party for some mischief, we cannot impute knowledge of the same to the appellant when the anonymity of the trading system does not allow a broker to know who the counter party or counter party broker is. The screen based trading system provides complete anonymity and the trades are executed through the price order matching mechanism. In the instant case, no link other than broker client relationship between the appellant and its clients has been established, let alone any relation with the counter parties or the counter party brokers. Moreover, the appellant executed only 23 trades on behalf of 15 clients with a total close out difference of Rs. 35.44 lacs (positive) which have been called in question. Having regard to the fact that the appellant had executed 1,69,71,078 trades for 1,21,306 clients with a turnover of Rs. 1,11,659 crores during the investigation period we are of the view that in terms of materiality and substance this miniscule number of trades done on behalf of 15 clients were not likely to raise any alarm for the appellant with a client base of over 4,70,000 clients. In these circumstances, we cannot hold the appellant liable for the impugned trades."

44.5. Lastly, the Apex Court, in the case of SEBI v Rakhi Trading reported in (2018) 13 SCC Online 753 (while discussing a few of the aforesaid judgments and the law set out therein) held that

"As far as brokers are concerned, we are of the view that there is hardly any evidence on their involvement so as to proceed against them for violation of Regulation 7A of the Brokers Regulations and PFUTP Regulations. Merely because a broker facilitated a transaction, it cannot be said that there is violation of the Regulation. SEBI has not provided any material to suggest negligence or connivance on the part of the brokers. As held by this Court in Kishore R. Ajmera (supra), there are several factors to be considered. We would especially like to refer to the case of Angel Trading wherein the broker repeatedly wrote to the National Stock Exchange informing them about trades in the options segment that were executed at unrealistic prices and requesting them to put in mechanisms in the Options segment so that these trades are not allowed to enter the system. In the absence of any material provided by SEBI to prove the charges against the brokers, particularly regarding aiding and abetting fraudulent or unfair trade practices, we are of the opinion that the orders of SEBI against the brokers should be interfered with. Accordingly, the appeals filed against the brokers are dismissed"

44.6. Much like the aforesaid cases, ISSL too had no visibility of who ASFPL's clients were or who the MF Units originally belonged to (before its title/ ownership was transferred to ISSL). There is, therefore, no motive or intention that can be attributed to ISSL wanting to facilitate ASFPL's fraud. Accordingly, there is no violation of the PFUTP Regulations whether as alleged and/or otherwise by ISSL.

45. Before proceeding further, I would like to note here that the SCN alleges that ISSL facilitated AFSPL in the execution of fraudulent transfers of MF units from the account of a client namely, Novjoy Emporium Private Limited (NEPL). In this regard, I note that NEPL became a client of AFSPL in November 2018. SEBI, vide its order dated July 02, 2021, has determined how AFSPL executed fraudulent transfer of MF units from the demat account of NEPL, in a manner so as to keep NEPL under the impression that its holdings are intact. I find that ISSL had no role to play as far as transfers from demat account of NEPL are concerned. The present SCN also does not provide any details as to how ISSL facilitated the same. Hence, the allegation of facilitation of fraud, as far as MF units in the demat account of NEPL are considered, the same cannot be established.

46. As already established in the previous issue, it has been shown how the release of collateral by ISSL to AFSPL helped AFSPL in making the Dalmia Group believe that

the MF units were intact in their respective accounts. It has also been shown how the so-called practice of ISSL in releasing collateral over weekends at the request of its clients, while positions were open against that collateral is completely unwarranted, exposed ISSL to huge risks and is in violation of NCL F&O Regulations.

47. I note here the submission of ISSL that it was not aware of the transactions between AFSPL and the Dalmia Group. In this regard, I note the following:

47.1. The Noticee is a Clearing Member registered with SEBI to provide clearing and settlement services to its clients, the Trading Members. It is an important institution and has been active in the securities market for a number of years, dealing with a large number of clients and a huge amount of collateral as part of its services and is staffed with highly qualified people.

47.2. The TM-CM agreement between AFSPL and ISSL was executed on November 14, 2017, and Noticee commenced business with AFSPL from December 06, 2017. Within a period of just 24 days, simply on the basis of a claimed request received from AFSPL, the Noticee has returned collateral worth Rs. 329 crores to AFSPL, without corresponding reduction in the exposure/ margin requirement for the positions taken against that collateral. The release of collateral has resulted in a shortfall in margin of Rs. 99 crores at the end of December 2017 and Rs. 210 crores at the end of March 2018. This shortfall in margin has created a huge risk to the profit and loss and balance sheet of ISSL itself.

47.3. It is further observed that as per the KYC of AFSPL provided by ISSL, the networth of AFSPL, at the time of on-boarding, was only Rs. 3.14 crores. Despite being aware of the same, on December 30, 2017, ISSL has released collateral worth Rs. 329 crores to AFSPL, resulting in a margin shortfall of Rs. 99 crores. Further, on March 31, 2018, ISSL has returned collateral worth Rs. 335 crores to AFSPL, resulting in a margin shortfall of Rs. 210 crores, which

could have wiped out the entire networth of ISSL (declared as Rs. 177 crores, as on March 31, 2018).

47.4. Therefore, it is inconceivable that the Noticee was willing to take such a huge risk on its own books so early in its business relationship with AFSPL, merely on the basis of a claimed request made by AFSPL. Once the collateral was released by the Noticee, the control over it has been relinquished to AFSPL and in the event that AFSPL does not re-deposit the collateral before the start of the next trading day, the entire risk of the open positions would devolve on the Noticee.

47.5. Therefore, it can be concluded that the Noticee was willing to take such a huge risk because it had complete confidence that the collateral released by it would be returned by AFSPL before the start of the next trading day. This confidence cannot be simply based on any long established relationship with AFSPL as it became a client only in December 2017. Similarly, such confidence cannot be based on the financials of AFSPL as what was at risk was the entire networth of ISSL.

47.6. I note that these transactions of releasing collateral over a weekend with a certainty that it would return to ISSL before start of trading cannot serve any legitimate economic purpose to AFSPL. Despite being given repeated opportunities to offer an explanation for this, the Noticee has failed to offer any explanations. Thus, I conclude that there was no legitimate rationale for such transactions to take place. However, when seen along with the dates when these transactions have occurred i.e., December 2017 quarter end and March 2018 financial year end, upon preponderance of probability basis, the only reason why AFSPL required the MF units in its own demat accounts was in order to window dress financial statements. In other words, the only purpose that these transactions could have served for AFSPL was an illegitimate one.

48. Before the act of weekend release of collateral was carried out by the Noticee, there were enough red flags present for making enquiry into the reasons for such weekend transfers. The first red flag was the quantum of risk taken by the Noticee. The next red flag should have been raised on the request itself when a client asks for return of collaterals on the weekend because as mentioned above, such transactions can serve no legitimate economic purpose to AFSPL, if they . The fact that releasing those MF units during weekend could lead to a circumstance where AFSPL could deal with the MF units by either redeeming them or raising loan by using them as collateral would be known to the Noticee. Hence, necessarily, the Noticee ought to have ensured, through enquiry, that MF units are not going to be redeemed or used as collateral for loan. This circumstance would have necessitated further enquiry by the Noticee with AFSPL that the released MF units are not going to be used by AFSPL in any other manner that would result in circumstances that would prevent AFSPL from bringing back the MF units within two days. The existence of the possibility of the entire networth of the Noticee being wiped away, if MF units were not returned before the start of the next trading day that too from an entity which became a client just 24 days back would have necessitated the Noticee to enquire into the reasons for AFSPL seeking release of the MF units on the weekend.

49. Therefore, the circumstantial evidence clearly indicates that the Noticee was either aware of the purpose for which the release of units was sought by AFSPL or if such enquiry was done, it would have come to know about the purpose of the weekend transfer. Thus, on a preponderance of probability basis, there could be only two scenarios (a) either the Noticee was aware of the purpose behind the act of weekend transfer, which was to give fraudulent misrepresentation regarding the status of the MF units or (b) the Noticee deliberately omitted to enquire into the same, knowing well that its act of weekend transfer is for facilitation of some fraudulent or unfair practice. As already stated above, the facilitator is not required to be aware of the entire gamut of fraudulent act facilitated by him. Therefore, under both scenarios, I hold that the Noticee has facilitated fraudulent conduct on part of AFSPL, including fraudulent transfer of MF units.

Issue No. 3: If Issue Nos. 1 and/ or 2 are answered in the affirmative, whether the same is in violation of provisions of PFUTP Regulations?

50. It has already been shown how the subsequent movement of the collateral, after its release, is linked with the demat accounts of DCEL and OCL. The MF movement helped AFSPL in making the Dalmia Group believe that their holdings were intact in their demat accounts, as on December 31, 2017, and March 31, 2018. It has also been shown how the Noticee was either aware of the purpose behind the act of weekend transfer, which was to give fraudulent misrepresentation to the Dalmia Group regarding the status of the MF units in their demat accounts or it deliberately omitted to enquire into the same, knowing well that its act of weekend transfer is for facilitation of some unfair practice. Therefore, the Noticee has facilitated AFSPL in executing fraudulent transfer of MF units from the demat accounts of DCEL and OCL.

51. With regard to the above, a reference is made to the findings of the Hon'ble Supreme Court in the following matters:

51.1. In the matter of SEBI and Ors. vs. Shri Kanaiyalal Baldevbhai Patel and Ors. 2017 SCC Online SC 1148, wherein the Hon'ble Court held as follows:

> *"31. Although unfair trade practice has not been defined under the regulation, various other legislations in India have defined the concept of unfair trade practice in different contexts. A clear cut generalized definition of the 'unfair trade practice' may not be possible to be culled out from the aforesaid definitions. Broadly trade practice is unfair if the conduct undermines the ethical standards and good faith dealings between parties engaged in business transactions. It is to be noted that unfair trade practices are not subject to a single definition; rather it requires adjudication on case to case basis. Whether an act or practice is unfair is to be determined by all the facts and circumstances surrounding the transaction. In the context of this regulation a trade practice may be unfair, if the conduct undermines the good faith dealings involved in the transaction. Moreover the concept of 'unfairness' appears to be broader than and includes the concept of 'deception' or 'fraud'*
>
> *…*
>
> *60. Coupled with the above, is the fact, the said conduct can also be construed to be an act of unfair trade practice, which though not a defined expression, has to be*

understood comprehensively to include any act beyond a fair conduct of business including the business in sale and purchase of securities."

51.2. A similar finding was also made by the Hon'ble Supreme Court in the matter of SEBI vs. Rakhi Trading Pvt. Ltd. and other connected appeals decided on February 8, 2018 wherein the Hon'ble Court while dealing with provisions of Regulation 4(1) of PFUTP Regulations held as follows:

> *"35. Having regard to the fact that the dealings in the stock exchange are governed by the principles of fair play and transparency, one does not have to labour much on the meaning of unfair trade practices in securities. Contextually and in simple words, it means a practice which does not conform to the fair and transparent principles of trades in the stock market…"*
>
> *"…Securities market, as the 1956 Act provides in the preamble, does not permit "undesirable transactions in securities". The Act intends to prevent undesirable transactions in securities by regulating the business of dealing therein. Undesirable transactions would certainly include unfair practices in trade. The SEBI Act,1992 was enacted to protect the interest of the investors insecurities. Protection of interest of investors should necessarily include prevention of misuse of the market. Orchestrated trades are a misuse of the market mechanism. It is playing the market and it affects the market integrity".*

52. The test here is also to consider the effect of the Noticee not permitting such release of collaterals at December 2017 quarter end and March 2018 financial year end. If the Noticee had not released the collateral on these weekends, taking into the account the strong red flags, considering the probability of circumstances of an independent verification of holdings by statutory auditors taking place, DCEL and OCL, as legal entities, would have detected, at an advanced stage that the MF units in their demat accounts were being used as collateral.

53. The conduct of the Noticee undermines the good faith, ethical standards and integrity that it was expected to show, not only as a registered intermediary but also as an important part of the entire risk management framework for the securities market. Considering all the facts and circumstances surrounding the transactions between ISSL and AFSPL, I am of the view that the conduct of ISSL qualifies as an unfair trade practice and is prohibited under the PFUTP Regulations. Further, the manner of the

dealings of the Noticee in the MF units, which are securities, also deserves to be qualified as fraudulent as the same facilitated AFSPL in execution of fraudulent transfers of MF units from the demat accounts of DCEL and OCL.

54. The submissions of the Noticee vis-à-vis this allegation are dealt with as below:

54.1. With regard to the submission on conjectures/ surmise and that no evidence in support of this allegation has been provided, the Noticee referred to certain case laws in support of his argument. However, the following holding of Hon'ble Supreme Court of India in SEBI vs. Kishore R Ajmera et.al. decided on February 23, 2016 wherein the Hon'ble Court while deciding the matter under SEBI Act and PFUTP Regulations where there was no direct evidence forthcoming, held as follows:

"It is a fundamental principle of law that proof of an allegation levelled against a person may be in the form of direct substantive evidence or, as in many cases, such proof may have to be inferred by a logical process of reasoning from the totality of the attending facts and circumstances surrounding the allegations/charges made and levelled. While direct evidence is a more certain basis to come to a conclusion, yet, in the absence thereof the Courts cannot be helpless. It is the judicial duty to take note of the immediate and proximate facts and circumstances surrounding the events on which the charges/allegations are founded and to reach what would appear to the Court to be a reasonable conclusion therefrom. The test would always be that what inferential process that a reasonable/prudent man would adopt to arrive at a conclusion..."

54.2. I further note that the SCN clearly makes out a very specific allegation regarding ISSL having facilitated AFSPL in execution of fraudulent transfers of MF units from the demat accounts of DCEL and OCL. The actions/ lapses of ISSL that have led to the conclusion of this allegation have also been mentioned in the SCN and it has already been demonstrated/ substantiated how one of these acts viz., release of collateral by ISSL has facilitated the fraudulent conduct of AFSPL. Therefore, the allegations are not based on mere conjecture or surmise

and neither has the allegation been established on the basis of the same. The material required to establish/ substantiate this allegation has also been provided to the Noticee.

54.3. The submission that the Noticee is not aware of the transactions between AFSPL and Dalmia Group has been dealt with above. In view of the same, the submission of ISSL that it was also a victim of the alleged acts of AFSPL cannot be accepted.

54.4. As regards the submission that the the Dalmia Group and its Directors and/ or officials were well aware that the MF units were being handed over as collateral by AFSPL to ISSL for F&O trading, it may be noted even if such collusion is there, it would not unsustain the allegations of the facilitation against the Noticee. In other words, the extent of allegation against the Noticee does not get nullified or diluted, if there was a collusion between employees and/ or office bearers of the Dalmia Group.

54.5. With regard to the other judgments of the Hon'ble SAT, I note the following:

54.5.1. It is pertinent to note that the case laws quoted deal with facts and situations where, without the act of the broker executing the order, the fraud being committed by the clients cannot not happen. In that sense, the act of the broker is central to the market fraud. Further, the facilitation of fraud by broker happens through his permissible act of executing the orders for clients.

54.5.2. For instance in the case of Kasat Securities v SEBI, the Hon'ble SAT has held that no broker would ask its clients why they want to sell the securities unless the broker suspects some wrong doing because the same selling the securities was a permissible act. In the instant case, considering the extremely high risk that ISSL was taking on by releasing collateral, it is inconceivable that ISSL would not ask AFSPL the

reasons for seeking return of collateral worth Rs. 329 crores and Rs. 335 crores, more so, when this would have resulted in margin shortfall of hundreds of crores and the act itself was not permissible for this reason.

54.5.3. In such cases, the awareness of the broker that his broking services are used for facilitating a fraud is an essential requirement. However, the gamut of fraud alleged is not similar to the secondary market fraud where a broker stands as an intermediary between clients perpetrating the fraud. There are no such clients on both side of the Noticee in the current set of the allegations. The facilitation of the fraud in secondary market where the broker stands in middle cannot be compared to the allegation of facilitation of fraud against the Noticee, where the allegations are not between two different entities perpetrating the fraud. Further, the act of return of collateral is not a permissible act, per se, when there is an open position cannot be compared to the permissible act of execution of the orders by the brokers.

54.5.4. Therefore, the requirement of awareness of the broker that his permissible execution services are in fact facilitating a fraud, does not apply to an impermissible act of return of collateral when margin shortage is there.

54.6. Therefore, the facts and situations, which warrant the awareness for fraud as comprised in the case laws, are not present in the present allegation of facilitation. Therefore, it is my considerate view that the case laws cited are not applicable to the present factual allegations. Thus, in my humble opinion, the reference to these case laws is not relevant.

55. In view of the above, I conclude that the Noticee's conduct qualifies as an unfair trade practice and its manner of dealing with the MF units is fraudulent. Therefore, the Noticee is in violation of Regulations 3(a) and 4(1) of the PFUTP Regulations.

Issue No. 4: Whether the allegations of (a) lack of due diligence while on-boarding AFSPL as a client, (b) providing enhanced intra-day limits to AFSPL, (c) opening the trading terminal of AFSPL and permitting roll-over of positions and (d) shortfall in networth of ISSL, as made out in the SCN, stand established? If yes, whether any of these allegations also facilitated AFSPL in executing fraudulent transfer of MF units from the account of DCEL, OCL and NEPL?

56. Before proceeding further, the relevant clauses of the Code of Conduct prescribed for CMs are reproduced below:

SCHEDULE II
Securities and Exchange Board of India (Stock Brokers 84[***])
Regulations, 1992
CODE OF CONDUCT FOR STOCK BROKERS
[Regulation 9]

A. General.

…
(2) Exercise of due skill and care : A stock-broker shall act with due skill, care and diligence in the conduct of all his business.
…
(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

Allegation of irregularities while on-boarding of AFSPL:

57. The allegation and the submission of the Noticee is as below:

57.1. It was observed that different sets of the audited financial statements, for FY 2017-18, were submitted by AFSPL to ISSL and MCA, wherein the difference was in respect of the shareholding of AFSPL. Noticee has submitted that there is no requirement to verify financials with the MCA records. I note that as part of

Know Your Client (KYC) norms prescribed by SEBI, a registered intermediary is required to collect financial statements for corporate clients every year. I note that the Noticee has collected the same. There is no requirement of independent verification of the same. Hence, I note that there is no violation in this regard.

57.2. It was observed that one of the directors of IL&FS Milestone Realty Advisors Private Limited, a company of IL&FS Group ("**Milestone**") named Mr. Raj Narayn Bharadwaj was also a director in one of the companies of Nimbus Group named IIT Insurance Broking and Risk Management Private Limited ("**IIT Insurance**"). Nimbus India Limited ("**Nimbus**"), which is also one of the companies of the Nimbus Group, held majority shareholding of AFSPL from 1995 till 2017. It is alleged that this link between AFSPL and the Noticee was not highlighted in the KYC. The Noticee has submitted that:

57.2.1. Mr. Raj Narayan was a shareholder in AFSPL till November 2010 and was on the Board of IL&FS Milestone Realty Advisors Pvt. Ltd. till July 2007.

57.2.2. As AFSPL was on-boarded in November 2017, there is no potential link between IL&FS Group and AFSPL prior to November 2017.

57.3. I note here from publicly available records that while Mr. Raj Narayan continues to be a Director in Milestone, he was a Director in IIT Insurance only till November 2010 i.e., his link with the Nimbus Group was till November 2010. As AFSPL has been on-boarded in November 2017, there appears to be a mere technical violation that this link was not highlighted at the time of on-boarding. I note that benefit of doubt can be given to the Noticee in this regard.

57.4. It was observed that as part of the KYC, AFSPL marked its annual income for FY 2017-18 as Rs. 1-5 lakhs, while supporting financials showed that the income for FY 2017-18 was Rs. 17.04 lakhs. Hence, it is alleged that ISSL did not carry out proper verification of documents. The Noticee has submitted that

as part of the KYC, AFSPL declared annual income for FY 2017-18 as Rs. 1,71,226/-, while the range of annual income was marked as Rs. 1-5 lakhs, which is in order. Perusal of the documents shows that this is indeed the case. Further, the figure of Rs. 17.04 lakhs mentioned relates to Profit After Tax of AFSPL for FY 2016-17. Hence, I note that there is no violation in this regard.

57.5. It was observed that the Noticee ignored (a) significant unusual increase in the asset size of AFSPL during FY 2017-18 (from FY 2016-17) and (b) AFSPL having multiple doubtful transactions with related parties where the recovery was doubtful. The Noticee has submitted that the observation with respect to unusual increase in asset size is made on the basis of financial statements for FY 2017-18, which were made available to ISSL October 15, 2018. No such unusual increase was observed in statements for FY 2016-17. I note that this observation would come to the notice of ISSL after it has on-boarded AFSPL as a client and not at the time of establishing relationship, which was in November 2017. Hence, the charge of not exercising proper due diligence at time of account opening cannot be established in this regard.

58. As these allegations are not established, there is no requirement of dealing with the other submissions of the Noticee in this regard.

Allegation of providing enhanced intra-day limits to AFSPL:

59. With regard to allegation that the Noticee provided enhanced intra-day limits to AFSPL without sufficient collateral inflow (naked benefit), the Noticee has submitted the following:

59.1. It was a widely followed market practice by almost all brokers and not limited to ISSL. It was not a special dispensation to AFSPL and Noticee was following a common business practice and exercising reasonable due diligence in relation to the same. It is SEBI's own case that this has resulted in enhanced risk for

ISSL. The Noticee has made reference to issuance of NSE circular dated December 31, 2019, regarding guidelines/ clarifications on margin collection and reporting, and the resultant representations from the broking industry on the same.

59.2. It is misleading to say that ISSL allowed AFSPL to go up to more than 100% on multiple occasions without considering the broader details of average margin utilizations and instances where AFSPL's terminal was disabled by ISSL.

60. I note that the Noticee provided exposure limits to AFSPL without collecting adequate collateral in lieu of the same. As per Regulation 4.5.1. of the NCL F&O Regulation CMs are required to demand from its clients, the margin monies in respect of dealings done for such clients. While the submission of the Noticee that this practice was widely followed in the market does not grant it the exemption from collection of upfront margins for intraday trades, I note that subsequent to the NSE circular quoted by the Noticee, SEBI was in receipt of representations from market participants regarding collection of upfront margins in cash and derivatives segment. SEBI has then come out with a framework for collection of upfront margins in cash and derivatives segments to be implemented in a phased manner. I further note that this act has only enhanced the risk for ISSL in its day to day operations.

61. In view of the above, I hold that the Noticee, by providing enhanced intra-day limits to AFSPL, without collection of sufficient collateral for the same, has violated the provisions of Regulation 4.5.1 of the NCL F&O Regulations. In view of the discussion in para 60, the same shall be appropriately considered when levying of penalty. The Noticee is also in violation of Clauses A(2) and A(5) of the Code of Conduct specified in Schedule II read with Regulation 9(f) of the Broker Regulations.

Allegation of opening the trading terminal of AFSPL and permitting roll-over of positions:

62. It was observed that the Noticee opened trading terminal for AFSPL and allowed them to roll over their position during January 2019, specifically after the termination notice was issued to AFSPL by the Noticee. The Noticee had the option to close-out the positions in the month of January 2019 after failure by AFSPL to pay the margins.

63. The Noticee has submitted the following:

63.1. The Option contracts entered into by AFSPL in December 2018 were not liquid. AFSPL had also executed transactions in Nifty Futures Contracts for hedging. As per TM-CM agreement, prescribed by NCL, a CM has the right to initiate any action necessary to protect its interests. As a prudent business decision, ISSL did not close out the open positions in these contracts in January 2019, as the collateral available with ISSL adequately covered the un-crystallized losses of AFSPL. The alleged claims in relation to the MF units had not been raised yet.

63.2. NCL Bye-law provides a CM with discretion to take steps in certain cases. At first instance, in light of shortfall in margins, AFSPL was served with a termination notice.

63.3. At time of roll-over, ISSL was primarily concerned in mitigating potential losses. As a result, the request for rollover of hedged positions was allowed with a view to mitigate risk and protect the Noticee itself from suffering losses in case of adverse market movements.

63.4. Opening of the Trading Terminal for AFSPL in January 2019 is post the alleged fraud even as per Dalmia's case which occurred in or about December 2018.

64. I note that as per the termination notice dated January 08, 2019, served to AFSPL, the Noticee has mentioned that the agreement shall stand terminated w.e.f. February 08, 2019. AFSPL was advised to close-out or shift its open positions to some other CM on or before February 08, 2019. This notice was served due to the inability of AFSPL to provide additional collateral. It is alleged that although Noticee had the option to close out the open positions of AFSPL, it chose to allow AFSPL to carry

forward the open position even though AFSPL did not bring in additional collateral, which was the very reason for serving AFSPL with a termination notice.

65. In terms of Bye-law 3 of the NCL F&O Bye-laws, which refers to closing-out of constituent's account, it is stated that a clearing member may (a) assume or take over such deals to his own account as a principal at prices which are fair and justified by the condition of the market or (b) he may close-out in the open market and any expense incurred or any loss arising therefrom shall be borne by the constituent.

66. As regards the submission that the option contracts were illiquid, I note from the NCL Order dated June 24, 2019, regarding the annulment application of ISSL, it was submitted by NCL that the contracts having expiry on June 27, 2019, were traded on an ongoing basis between January 2019 and June 17, 2019. The Noticee could have closed out these positions in January 2019 itself. Hence, I hold that the Noticee is in violation of Bye-law 3 of the NCL F&O Bye-laws and Clauses A(2) and A(5) of the Code of Conduct specified in Schedule II read with Regulation 9(f) of the Broker Regulations.

Allegations pertaining to shortfall in networth of ISSL:

67. It was observed that if the Noticee had duly considered certain ICDs under the head of "doubtful debts and advances", then the same would have revealed the shortfall in its networth as on March 31, 2018, and September 30, 2018. Therefore, it has been alleged that the Noticee has failed to meet the minimum networth.

68. The Noticee has submitted the following:

68.1. It has followed the networth computation format provided by the NCL.

68.2. Calculation of networth was based on a bonafide understanding of the relevant provisions and was discussed in detail with NSE. As the advances were repaid fully, it fully vindicates the stance of ISSL.

68.3. Networth calculations of ISSL, which have no link with AFSPL, do not have any link to the alleged fraudulent transfer of MF units.

69. I note that the main allegation is whether the inter-corporate deposits (ICDs) had any impact on the networth of ISSL or not, as on March 31, 2018, and September 30, 2018. I note the following from Table 1 of Schedule VI of the Broker Regulations:

Segment	**Minimum networth for Clearing Member**
Equity Derivatives	Rs. 3 crores
Currency Derivatives	Rs. 10 crores

70. Further, the Broker Regulations also state:

Explanation: For the purposes of this Schedule, 'networth' shall mean paid up capital, free reserves and other securities approved by the Board from time to time but shall not include fixed assets, pledged securities, value of member's card, non-allowable securities (unlisted securities), bad deliveries, ***doubtful debts and advances (debts or advances overdue for more than three months or debts or advances given to the associate persons of the member)****, prepaid expenses, losses, intangible assets and 30% value of marketable securities* ***(Emphasis supplied)***

71. Hence, items that are classed as doubtful debts and advances i.e., debts/ advances overdue for more than three months or debts/ advances given to the associate persons of the member shall be excluded from the calculation of networth. The finding for networth as on March 31, 2018, is as below:

Criteria	**Amount (in Rs. Crores)**	**Remarks**	**Submission of Noticee**
Networth declared as on March 31, 2018	177		

Criteria	Amount (in Rs. Crores)	Remarks	Submission of Noticee
ICDs outstanding as on March 31, 2018	750	From annual report for FY 2017-18. Given to associate persons of ISSL (from annual report for FY 2017-18). Hence, ICDs are "doubtful debts and advances"	ICDs were classified under the category of "Unsecured, considered good unless stated otherwise" in audited statements for March 31, 2018, as per management estimate.
Networth should have been	-573		

71.1. While the submission of the Noticee may have been applicable when preparing financial statements for ISSL as a corporate entity, I note that for calculation of networth of ISSL in its capacity as a Clearing Member, the Noticee has to follow the procedure laid down in the Broker Regulations. As per the annual report of the Noticee, these ICDs were given to its associates and hence, as per the explanation given in the Broker Regulations, these ICDs came under the category of "doubtful debts and advances" and were required to be excluded for calculation of networth of ISSL as a clearing member.

71.2. Therefore, as on March 31, 2018, the networth of ISSL as a clearing member should have been declared as Rs. (573) crores and hence, it did not meet the minimum networth criteria.

72. The finding for networth as on September 30, 2018, is as below:

Criteria	Amount (in Rs. Crores)	Remarks	Submissions of Noticee
Networth declared as on September 30, 2018	207.07		
ICDs outstanding as on September 30, 2018	121	As per submission of Noticee to NCL	No reason to believe that ICDs were doubtful
Interest on ICDs	3.64	Computed based on data provided by Noticee	

Criteria	Amount (in Rs. Crores)	Remarks	Submissions of Noticee
Loan to IL&FS Employee Welfare Trust (EWT)	9.8	As per notes to financials of September 2018, it has been stated that due to adverse situation in IL&FS Group, there is uncertainty with respect to recovery of this amount. Hence, loan has been classified as doubtful by NCL.	Loan not classified as doubtful. Further, IL&FS Employee Welfare Trust is not a group company, though it has the same parent.
Interest on Loan to EWT	5.46	Computed based on data provided by Noticee	
Sundry Debtors outstanding for more than 3 months	7.7	No comments provided	
Impact of Ind AS	6.46	As per statement provided by Noticee	Till March 31, 2018, Generally Accepted Accounting Principle were followed. Indian AS were first used for preparing statements as on March 31, 2019.
Networth should have been	53.01		

72.1. As explained above, the submission of the Noticee w.r.t. ICDs cannot be accepted and they need to be excluded from the networth.

72.2. While IL&FS EWT may not be a group company, as per note to financials for September 2018, there is uncertainty with respect to recovery of the loan given to EWT. I note that this loan was disbursed in February 2011 and was to mature on March 2019. Hence, while it was not outstanding as on September 30, 2018, considering the adverse condition of the IL&FS Group, it would have been prudent to exclude the loan and the interest on it from calculation of networth as a clearing member.

72.3. The Noticee was required to adopt Ind AS from April 01, 2018; hence, networth for September 30, 2018, had to be prepared as per Ind AS and not as per Indian GAAP. The Noticee has not submitted any reason why it did not adopt Ind AS from April 01, 2018. Further, while accounts for FY 2018-19 were prepared using

Ind AS, the Noticee could have made a suitable provision for Ind AS adjustments when calculating its networth as on September 30, 2018. Hence, I find it reasonable to reduce the impact amount from the calculation of networth.

72.4. Hence, as on September 30, 2018, the networth of ISSL, as a clearing member, should have been declared as approximately Rs. 53.01 crores (considering the provision for Ind AS adjustment). Therefore, while ISSL has met the minimum networth criteria, it has incorrectly calculated its networth as a clearing member.

73. In view of the above, I note that the Noticee has not exercised due skill, care and diligence and has also not followed statutory requirements when calculating its networth. I hold that the Noticee is in violation of Clauses A(2) and A(5) of the Code of Conduct specified in Schedule II read with Regulation 9(f) of the Broker Regulations. Further, as regards non-maintenance of minimum networth as on March 31, 2018, I hold that the Noticee is also in violation of Rule 12 of Chapter IV of NCL Rules.

74. In summary, I note the following:

74.1. The allegations pertaining to irregularities at time of on-boarding AFSPL are not established.

74.2. The Noticee provided enhanced intra-day limits to AFSPL without sufficient collateral inflow.

74.3. The Noticee permitted roll-over of position of AFSPL despite having served it with a termination notice after its failure to pay margins.

74.4. The Noticee did not satisfy minimum networth criteria for a Clearing Member, as on March 31, 2018, and incorrectly calculated its networth, as on September 30, 2018.

Issue No. 4: If answer to Issue Nos. 1, 2 or 3 above is affirmative, then whether any directions are required to be issued against the Noticee?

75. As already held above, the answer to Issue Nos. 1, 2 and 3 are all in the affirmative. Hence, the violations of the following provisions of the securities laws have been determined:

75.1. Regulations 3(a) and 4(1) of the PFUTP Regulations.

75.2. Regulation 4.5.1 of the NCL F&O Regulations.

75.3. Rule 12 of Chapter IV of NCL Rules.

75.4. Bye-law 3 of the NCL F&O Bye-laws and

75.5. Clauses A(2) and A(5) of the Code of Conduct specified in Schedule II read with Regulation 9(f) of the Broker Regulations.

76. I note that once the contravention of any statutory provisions has been established, then the penalty is to follow. The Noticee has been show caused as to why:

76.1. Appropriate directions under Sections 11B(1) and 11(4) read with Section 11(1) of the SEBI Act, 1992, should not be issued against it for the alleged violations of the aforementioned provisions of the Broker Regulations and the PFUTP Regulations.

76.2. Appropriate directions for imposing penalty under Section 11B(2) and 11(4A) read with Sections 15HA and 15HB of the SEBI Act, 1992, should not be issued against it for the alleged violations of the aforementioned provisions of the Broker Regulations and the PFUTP Regulations.

77. Sections 15HA and 15HB are reproduced below:

SEBI Act

Penalty for fraudulent and unfair trade practices

15HA. If any person indulges in fraudulent and unfair trade practices relating to securities, he shall be liable to a penalty which shall not be less than five lakh rupees but which may extend to twenty-five crore rupees or three times the amount of profits made out of such practices, whichever is higher.

Penalty for contravention where no separate penalty has been provided*.*

15HB. Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which shall not be less than one lakh rupees but which may extend to one crore rupees.

78. I note that in view of the facilitation of fraud being a fraudulent and unfair trade practice, the Noticee is liable for monetary penalty under Section 15HA of the SEBI Act. For all other violations under the Broker Regulations, including the serious violation of returning of collateral when positions against the same are outstanding, which is in violation of the NCL Regulations and Code of Conduct prescribed under the Broker Regulations, the Noticee is liable for monetary penalty under Section 15HB of the SEBI Act.

79. The Noticee has submitted that assuming without admitting that there has been a minor/ technical violation by ISSL, as alleged by SEBI, then SEBI has to consider the criteria specified in Section 15J of the SEBI Act, 1992, when determining the quantum of penalty. It is submitted that none of the factors specified in Section 15J have been met:

79.1. ISSL has not obtained any disproportionate gain or advantage from its role as a CM. The SCN does not disclose any proof or evidence of the same.

79.2. No evidence, direct or indirect, that would suggest that the activities of ISSL caused any loss to a particular investor or group of investors.

79.3. ISSL has not committed any repetitive default in terms of the securities laws. There is no default by ISSL in the present case, much less a deliberate/ repetitive default. ISSL has always acted in good faith, being in full compliance with all applicable laws and has always co-operated with SEBI.

80. In light of the above, the Noticee has submitted that there is no justifiable ground or basis to impose a penalty on ISSL.

81. I note that the material on record does not show the Noticee having obtained any disproportionate gain or advantage due to its violations. Further, the default observed in releasing collateral to AFSPL has been observed on two dates and margin shortfall has been observed in four instances. While this default would not qualify as a repetitive default, I note that it is a deliberate default on the part of the Noticee.

82. As regards quantification of loss caused to any investor or group of investors, I note that it has been established that the Noticee facilitated AFSPL in execution of fraudulent transfers from the accounts of two clients viz., DCEL and OCL. There is no material on the loss caused any investor or group of investors.

83. Before proceeding further, I note that the entire IL&FS Group, including the Noticee, is undergoing a resolution process. Vide order dated January 08, 2021, it has been held SEBI has the jurisdiction to determine the monetary and non-monetary liabilities of the Noticee in the event it is found that the Noticee is in violation of regulatory provisions. This order of SEBI has been upheld by the Hon'ble SAT and appeal of the Noticee in the Hon'ble Supreme Court is pending. As directed by the Hon'ble Supreme Court, this Order shall be subject to any order passed by the Hon'ble Supreme Court

84. I note that it is essential to not only determine the violations of the Noticee but also the liability that arises out of the same so that the resolution plan for the IL&FS Group can take the same into account when deciding the course of action with respect to the Noticee. While I note that the same may also influence any future potential sale of the business of the Noticee to a new management, I am constrained by the fact that the determination of the liability for the violations of the Noticee is essential from the perspective of development and integrity of the securities market and protection of the rights of all market participants, including investors. It is essential to indicate to all market participants that such cavalier attitude towards the rules and regulations of the

securities market will not be tolerated and will attract commensurate action from the regulator.

85. It is of utmost important to consider the position of the Noticee in the entire securities market before deciding upon the quantum of penalty to be imposed. The Noticee, being a Clearing Member, plays a very vital role in the entire risk management framework that is in place for the trading, clearing and settlement of trades in the securities market. CMs assist in the clearing and settlement of trades by trading members on the F&O Segment and Clearing Corporations deal only with the CM and not with individual TMs. CMs are required to fulfil all margin requirements and pay-ins on a consolidated basis and in turn, they obtain adequate collateral for the same from their clients i.e., the TMs.

86. I note here that the Noticee has admitted to committing serious lapses in risk management by submitting that it followed a practice under which collateral can be returned to all its empanelled TMs, upon receipt of a request from the client. This shocking and cavalier approach towards an important element of risk management deserves an appropriate amount of penalty. It has also been established that the conduct of the Noticee is an unfair trade practice and that it has dealt with the MF units in a fraudulent manner. These are grave and serious findings and commensurate penalty is liable to be imposed on the Noticee.

87. However, as noted earlier, this Order shall be subject to any order passed by the Hon'ble Supreme Court, while enforcement of the liability and the order shall also be subject to the orders of the Hon'ble NCLT/ Hon'ble NCLAT/ Appellate Authority from NCLAT.

ORDER

88. In view of the above, I, in exercise of the powers conferred upon me under Sections 11(1), 11(4A), 11B(1) and 11B(2) of the SEBI Act, 1992, read with Section 19 of the SEBI Act, 1992, hereby issue the following directions:

88.1. *The Noticee is restrained from acquiring any new clients till a period of two (02) years from the date of this Order or if applicable, till the date of communication by SEBI on ceasing of the restraint to the Noticee on its request and on its production of proof of the order of the Competent Court/ Tribunal approving any resolution plan for the Noticee and that such resolution plan results in the change in the management or control of the Noticee to a person who was not a promoter or in the management or control of Noticee or related party of such a person during the time of the violations covered in this Order, whichever is earlier.*

88.2. *The Noticee shall undertake a comprehensive overhaul of all its procedures and policies, especially its Risk Management Policy. The Noticee shall implement necessary corrective measures to ensure that the violations observed are not repeated. The details of these steps taken shall be placed before the Board of Directors of the Noticee for their approval.*

88.3. *The following penalty is levied on the Noticee:*

Under Section	***Amount (in Rs.)***
Section 15HA of the SEBI Act, 1992	*25,00,00,000/- i.e., Rs. Twenty five crores only*
Section 15HB of the SEBI Act, 1992	*1,00,00,000/- i.e., Rs. One crore only*
Total	*26,00,00,000/- i.e., Rs. Twenty-six crores only*

89. The enforcement of this Order shall be subject to the following:

89.1. Directions of the Hon'ble Supreme Court in the Civil Appeal No. 1523 of 2021 filed by the Noticee against the order dated April 06, 2021, of the Hon'ble SAT and

89.2. Orders of the Hon'ble NCLT/ Hon'ble NCLAT/ Appellate Authority from NCLAT, if any, pertaining to the resolution process of the entire IL&FS Group.

90. A copy of this order shall be served upon the Noticee, the stock exchanges, depositories and the Clearing Corporations for necessary action and compliance with the above directions.

Sd/-

DATE: July 02, 2021 **MADHABI PURI BUCH**

PLACE: MUMBAI **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA