BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/MC/VS/2020-21/7529]

UNDER SECTION 23-I (2) OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 AND RULE 5 OF SECURITIES CONTRACTS (REGULATIONS) (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005.

In respect of –

Kantilal Chhaganlal Securities Private Limited [SEBI Registration Nos. (BSE INB/INF 010993239, NSE – INB/INF 230930138 and MCX-SX – INE260930138)]] having address at Vilco center, 'A' Wing, 2nd Floor, Near Garware House, 8, Subhash Road, Vile Parle (E), Mumbai - 400057

In the matter of Kantilal Chhaganlal Securities Private Limited

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BACKGROUND

1. Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') initiated adjudication proceedings against Kantilal Chhaganlal Securities Private Limited (registered with SEBI as a stock broker of NSE, BSE and MCX-SX) and hereinafter referred to as "**the Noticee / Broker / Kantilal"**) under Section 23D of the Securities Contracts (Regulation) Act, 1956 ("**SCRA**") for alleged violation of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 (hereinafter referred to as "**1993 Circular"**) and Section 23D of the SCRA.

APPOINTMENT OF ADJUDICATING OFFICER

2. SEBI appointed the undersigned as Adjudicating Officer (hereinafter referred to as "**AO**") under Section 23-I of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as **'SCRA'**) read with Rule 3 of the Securities Contracts (Regulations) (Procedure For Holding Inquiry and Imposing Penalties) Rules, 2005 ("**Adjudication Rules**") vide order dated February 27, 2019 to inquire into and

adjudge under Section 23D of the SCRA the aforesaid alleged violations carried out by the Noticee. The appointment of the AO was communicated vide order dated March 1, 2019.

SHOW CAUSE NOTICE, REPLY AND HEARING

3. Show Cause Notice No. EAD/EAD5/MC/CB/2019/14961 dated June 14, 2019 (hereinafter referred to as "**SCN**"), was issued to the Noticee in terms of Rule 4 (1) of the Adjudication Rules to show cause as to why an inquiry should not be held and penalty not be imposed against the Noticee in terms of Section 23D of SCRA, for the alleged violations of SEBI Circular no. SMD/SED/CIR/93/23321 dated November 18, 1993.

4. The allegations levelled against the Noticee in the SCN are summarized as below:-
    a) SEBI inspected the books and records of the Noticee, on a sample basis for data pertaining to the period between April 1, 2014 till December 2015 (hereinafter be referred to as, the "**Inspection Period**" or "**relevant period**").

    b) Upon analysis of client bank account statements, settlement accounts and other records for a sample period of 43 days during the relevant period, it was observed that the Noticee's accounts and records indicated non-compliance with the general principle of segregation of client funds from other clients' and broker's own funds, mandated in Section 23D of the Securities Contracts (Regulation) Act, 1956 ("SCRA") read with the provisions of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 ("the Circular").

    c) On 38 days, total cash and cash equivalents lying in the client and settlement bank accounts and with the stock exchange/ clearing corporation / clearing member at the end of the day were less than gross creditors as per trial balance. Amount of gross debtors was higher than the difference between gross creditors and aggregate cash/ cash equivalents available with the broker and the exchange.

d) This clearly indicates that the client funds were not utilized either for settlement of obligations of debit balance clients. Utilization of client funds towards debtors' obligation observed on these 38 dates was in the range from Rs.11,30,739 to Rs.15,43,44,045 with average improper utilization of Rs.3,09,81,174.

e) To ascertain whether funds of clients having credit balance are used as margin for proprietary trading or trading of clients having debit balances, it was verified whether the total client funds lying with the exchange are less than the sum of margin exposure granted to credit balance clients and free margin deposits with the exchange. It was observed that on 4 days out of 43 days for which relevant data was made available by the broker, the funds of credit balance clients were utilized for granting exposure to debit balance clients.

f) To illustrate, an analysis of account statements for May 12, 2014, reflected the following:-

Description	Amount (in Rs. crore)
Gross Creditors (Excluding unsettled trades and uncleared cheques) (C)	35.23
Bank account balances as per bank account statement:	
Client Account	3.72
Settlement Account	0.52
Sub-total (A)	4.24
Cash and cash Equivalents lying with the exchange (B)	15.61
A+B	**19.84**

AS (A+B) is less than C, misutilisation of client's fund for settlement of debit balance client's or proprietary obligations or own purposes (G)	**15.38**
Gross Debtors (Excluding unsettled trades and uncleared cheques) (D)	20.76
As G < D, G is utilised towards settlement of obligations of debtors	15.38
Free margin deposits with the exchange (MF)	5.34
Margin deposit utilised for granting exposure to credit balance clients (MC)	10.18
Client funds lying with the exchange = B, as C > (A+B)	15.61
Client funds utilized towards granting exposure to debit balance clients / proprietor =B – MC – MF (Positive value) **As B is greater than (MC + MF), there is misutilisation client's funds for granting margin exposure to proprietor or debit balance clients**	**0.09**
Proprietary Margin Obligation (P)	**0.06**
Non-funded part of Bank Guarantee	**5.46**
Aggregate value of own non-cash collaterals i.e. securities which have been deposited with the clearing corporations and/or clearing member (NC)	**0**
Clients funds utilised for proprietary margin obligation = (P-NF-NC) (Positive value)	**-5.45**
Client fund utilised for granting margin exposure to debtors (B -MC-MF) (Positive value)	**0.086**

g) It was observed that there was possible misutilisation of client's fund for settlement of debit balance clients' obligations in 38 instances – indicated by negative 'G' and 'D'. Possible misutilization of credit balance clients' funds for granting margin exposure to debit balance clients was also indicated in 4 out of 43 instances by a negative value of [P-NF-NC].

h) The abovementioned observations lead to the allegation of contravention of the provisions of Section 23D of the SCRA and the provisions of the Circular dated November 18, 1993.

i) In view of evidence indicating that - i) client funds of the Noticee had been utilized for settlement of obligations of debit balance clients on 38 out of 43 days and that (ii) the funds of credit balance clients were utilized for granting exposure to debit balance clients on 4 out of 43 days, it was alleged that the Noticee has contravened S. 23D of the SCRA read with the provisions of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993.

j) The alleged violations of the aforesaid provisions, if established, make the Noticee liable for monetary penalty under Sections 23D

5. Vide letter dated June 13, 2019 the Noticee sought time till July 20, 2019 for filing submissions with respect to the SCN. The said extension was granted to the Noticee.

6. Noticee filed a Settlement Application No. 4011/2019 in respect of the SCN dated May 22, 2019 subsequent to which the proceedings were kept on hold. However, vide e-mail dated January 15, 2020 the Noticee proposed to withdraw the settlement application. In terms of the request, vide e-mail dated January 16, 2020, SEBI communicated intimation of disposal of settlement application to the Noticee.

7. Subsequently, vide Hearing Notice No. SEBI/HO/EAD/EAD5/OW/P/2020/2294 dated January 16, 2020 the Noticee was given an opportunity of hearing on January 23, 2020.

8. The Noticee sought extension of time till February 5, 2020 to file reply and reschedulement of hearing to a subsequent date, which request was acceded to. Accordingly, an opportunity of personal hearing was granted to the Noticee on February 6, 2020.

9. During the hearing, the Noticee was represented by Mr Ajay Shah, Compliance Officer and Mr. Devang Gopani (hereinafter referred to as the “Authorised Representatives” of the Noticee.

10. The Noticee filed its submissions / reply dated February 11, 2020 in respect of the allegations levelled against it in the SCN . The key submissions of the Noticee are summarized as below:-

a) The Noticee came into existence in 1995 on account of its corporatization. However, as a trading member the Company had existed since 1954 as a stock broker. Currently, the company is a SEBI-registered Stock Broker, Depository Participant and Research Analyst serving more than 25000 clients through the network of around 4 branches and more than 150 business partners.

b) Inspection was conducted in two tranches. Inspection Report I dated 18.07.2017 pertained to the first tranche dealing with PMLA and Running Account Settlement, and the Noticee submitted its reply to the same vide letter dated 11.09.2017.Inspection Report 2 dated 24.10.2017 was issued in respect of Segregation of Client and Own Funds and Securities and reply thereto was filed on 13.12.2017. Present adjudication proceeding has been initiated only in respect of non-compliance related to violation of general principles of Segregation of Client funds.

c) The Noticee has been abiding by the provisions of the 1993 Circular and Section 23D of the SCRA in the following manner:-

   i. Books of accounts are maintained to distinguish our business as a member in respect of Moneys received from clients and moneys received and paid on own account;
   ii. Client money is received or paid from/ to client designated account only except in case of mistake or error;
   iii. Client accounts belonging to clients are appropriately tagged;
   iv. Maintaining adequate records to ensure proper audit trail of use of client collateral;
   v. Periodic reconciliation of client securities.

d) Noticee has successfully implemented a robust, automatic and effective software Module in its Back-office system for daily monitoring of various parameters related to Monitoring of Client funds. A step-by-step process showing uploading and generation of Enhanced Supervision report is attached herewith as Exhibit-"1". Further, after an initial teething problem, we have quickly adapted with the monitoring and reporting requirement of Enhanced Supervision. Sample data for November and December 2019 is enclosed as Exhibit. The details shows that there is an effective and robust monitoring mechanism and system.

e) Section 23 of SCRA or SEBI circular SMD/SED/CIR/93/23321 dated18th November, 1993 does not provide any methodology, manner, formula or principle for calculation or quantification of mis-utilisation or non-segregation.

f) In case of Noticee, the amount has been computed by applying the concepts, principles, methodology and formulas laid down in Monitoring of Client Assets prescribed in SEBI Circular SEBI/HO/MIRSD/ MIRSD 2/CIR/P/2016/95 on Enhanced supervision dated 26th September, 2016 (herein after referred to as "Enhanced Supervision Circular") .

g) The calculations specified in the Enhanced Supervision Circular are based on certain specific calculations or requirements which did not exist in the past. Some of the major points of differentiation with the introduction of Enhanced Supervision is given below:-

(a) Considering Gross Creditors on standalone basis instead of Net Creditors

(b) Considering only funded portion of Bank Guarantee

(c) Adjustment of Open Bills and uncleared cheques In Debtors/ Creditors

(d) Non-consideration of value of Client Securities

h) Thus, there is mis-utilisation only due to application of formula prescribed in Enhanced Supervision and not otherwise. If Debtors and Creditors are netted then there will be no mis-utilisation.

Retrospective Application of New Circular to Past Period for calculation of Mis-utilisation/ Non- segregation:-

i) Noticee's inspection period is April 2014 to December 2015. The Enhanced Supervision circular has become effective from 1st July, 2017. Application of formulas of recent circular to past period for calculation of mis-utilisation amounts to Retrospective application of law to a past period.

j) Further, such retrospective application of circular to past period is against the established legal principle of "Lex prospicit non respicit", which means that 'The Law looks forward and not backward'. One of the settled and established legal rules is that unless explicitly stated, a piece of legislation is presumed not to be intended to have retrospective operation. Thus, it is not correct to apply the methodology of calculation specified in the circular to past period retrospectively.

k) The issue of retrospective application of circular has been dealt in detail by Hon'ble Supreme Court in many cases. Relevant extracts of some of the relevant judgments are given below:

<u>The Commissioner Of Income Tax Vs M/S Gemini Distilleries (Civil Appeal 16815/2017):</u>

i. While dealing with the issue of retrospective application of circular, Hon'ble Supreme Court held

ii. "…………………………………We are of the considered opinion that the Central Board of Direct Taxes cannot issue any circular having retrospective operations"

<u>The Commissioner Of Income Tax (Central –I) New Delhi Vs Vatika Township Private Limited (Civil Appeal No. 8750 of 2014)</u>

- Para 30 to 37 of the judgment

iii. The legality and the General principles concerning retrospectivity has been dealt with in details by the Hon'ble Supreme Court. Relevant extracts are quoted below:

"…………….

……………..

31. Of the various rules guiding how a legislation has to be interpreted, one established rule is that unless a contrary intention appears, a legislation is presumed not to be intended to have a retrospective operation. The idea behind the rule is that a current law should govern current activities. Law passed today cannot apply to the events of the past. This principle of law is known as lex prospicit non respicit : law looks forward and not backward."

…………………………..

34. ………………………………………………………………….

Thus, the rule against retrospective operation is a fundamental rule of law that no statute shall be construed to have a retrospective operation unless such a construction appears very clearly in the terms of the Act, or arises by necessary and distinct implication. Dogmatically framed, the rule is no more than a presumption, and thus could be displaced by out weighing factors."

iv. Thus, from the above it is clear that retrospective application of circular either in partial or total is unfair, incorrect and unlawful.

l) The System, Processes, Procedures, Books and Records, Risk Management Comply to existing Law and not expected future law.

i. This argument of the Noticee can be best understood with the help of example of GST implementation in India. While GST was discussed for more than a decade it became finally applicable from 01.07.2017 onwards. Obviously an Assessee cannot be compelled to maintain its books and records in a manner which is in tune with the future GST requirement.

ii. Systems, Processes and Due Diligence cannot be built to monitor and check mis-utilisation based on the concept of Enhanced Supervision at the time when even its idea did not exist.

m) Enhanced Supervision was introduced in the backdrop of many investor's complaint received by SEBI due to defaulting Stock Brokers whereby Crores of rupee of Investors funds were siphoned from client account in 2014-2015. SEBI carried out a comprehensive review of rules of stock brokers and a committee on Enhanced Supervision Enhanced was formed in 2015.

n) The committee suggested various measures which were given for suggestion to Broker's Association. Finally after a prolonged discussion and deliberation, circular was issued with a view to implement the recommendations and guidelines of the Committee in September 2016. The implementation was subsequently postponed upto 01.07.2017.

o) Application of particular method of calculation that was an outcome of special circumstances which came into effect from July 2017 to past dates for determining the mis-utilisation is unfair, unlawful and incorrect.

p) Further, in case of Noticee, the application of Enhanced Supervision concept is a complete afterthought of the inspection team. Initial requirement received for inspection did not contain any requirement on Mis-utilization of client funds. Vide email dated 6th January, 2017 further information was sought for verification of mis-utilisation which was after introduction of enhanced supervision circular.

q) SEBI circular SMD/ SED/CIR/93/23321 provides broad guidelines for segregation of Client Funds and Own funds. It provides for permissible and non-permissible transactions in respect of funds and securities that can be deposited or withdrawn to/ from Client Bank and Depository Accounts.

r) In the past Hon'ble Securities Appellate Tribunal (SAT), Whole Time Member (WTM) and Adjudicating Officer have considered different types of transactions as non-segregation citing the reference of this circular. There was no formula based approach in the past until the introduction of Enhanced Supervision. The non-segregation and mis-utilisation was determined on a case to case basis. Mis-utilisation has been determined based on the number and quantum of instances of non-segregations observed.

s) Noticee's general conduct has been satisfactory and there have not been any major client complaint against us. Noticee has installed robust and automated software module for monitoring client assets. There have not been many investor grievances during the relevant period.

t) Further, there has not been any adverse observation in respect of the Enhanced Supervision, indicating that shortcomings if any, have been rectified, in any subsequent internal audit or exchange inspections. In the lights of the fact that necessary corrective actions have been taken and controls have been put in place, Noticee requests to take a lenient view in determining the quantum of penalty.

u) Noticee further craves that the violation be considered as procedural lapse and thereby drop Adjudication Proceedings imposed under Rule 4 of the Rules and not levy any penalty under Section 23D of SCRA and SEBI circular dated November 18, 1993. Noticee places reliance on the following laws and judgments for the same:-

    i. It was held in order dated 25.07.2011 passed by the Hon'ble Securities Appellate Tribunal ("Tribunal") in UPSE Securities Limited V. SEBI (Appeal No. 109 of 2011) that:

    "5*......Every little irregularity / deficiency noticed during the course of the inspection is not culpable and does not call for initiation of penalty* *proceedings. The purpose of inspection in quite a few cases could be better achieved if the inspecting team at the time of the inspection were to advise the erring entity. However, if any serious lapse is discovered, it would always be open to the Board to take penal action in accordance with law. Having said this, we leave the matter at that."*

ii. A copy of Order dated 25.07.2011 passed by Hon'ble Tribunal in the matter of UPSE Securities Limited Vs. SEBI (Appeal No. 109 of 2011) is hereto enclosed and marked as "Exhibit ".

iii. To the same effect Hon'ble Securities Appellate Tribunal in its Order dated 16.06.2011 in the matter of Religare Securities Ltd vs SEBI (Appeal No. 23 of 2011), inter alia observed as follows: "*It must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We also cannot lose sight of the fact that every minor discrepancy / irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved by pointing out the irregularities / deficiencies to the intermediary at the time of inspection and making it compliant....*".

iv. A copy of Order dated 16.06.2011 passed by Hon'ble Securities Appellate Tribunal in the matter of Religare Securities Ltd Vs. SEBI is hereto annexed and marked as Exhibit.

v. In Order dated 11.09.2012 passed by Hon'ble Tribunal in *DSE Financial Services Ltd. V. SEBI* (Appeal No. 153 of 2012). For ready reference, relevant paragraph have been reproduced below:

"3. ...... we have observed that it must be remembered that the purpose of carrying out inspection is not punitive and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. We have also observed that every minor discrepancy/irregularity found during the course of inspection is not

culpable and the object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant. As per the observations made by the adjudicating officer himself, the violations committed by the appellant are mostly technical in nature; some of them are solitary instances and for others the appellant has mostly taken/initiated corrective measures. In view of this, we are of the view that the adjudicating officer was not justified in taking punitive action."

vi. Copy of Order dated 11.09.2012 passed by Hon'ble Tribunal in the matter of DSE Financial Services Vs. SEBI (Appeal No. 153 of 2012) is hereto enclosed and marked as "Exhibit "

10. Vide additional submissions dated March 6, 2020 the Noticee submitted the following:-

i. Application of methodology of calculation of mis-utilisation prescribed in SEBI circular on Enhanced Supervision to the prior period before it came into force is not in accordance with the general principles of law and various landmark judgments of Hon'ble Supreme Court as stated in Para 15 and 16 of Original reply.

ii. Books of Accounts and records are required to be maintained as per the current law and not as per the anticipated or future laws. Infact maintaining the same as per future law may be a non-compliance as per current law. This has been explained in Para 17 to 18 of the Original Reply by drawing a parallel with GST Law in India

iii. SEBI Circular SMD/SED/CIR/93/23321 dated 18th November, 1993 has been always used for identifying non-segregation. Such non-segregation included cases like payment of personal expenses from client account, non-maintenance of separate client accounts etc. The aforesaid circular has never been used for calculation of mis-utilisation as it does not prescribe any specific methodology to calculate the same.

iv. The terms "Non-Segregation" and "Mis-utilisation" are separate and cannot be inter-changeably used for each other. For example, mere incorrect deposit in client account shall correctly be termed as non segregation but the same cannot be mis-utilisation.

v. SEBI circular on Enhanced Supervision dated 26th September, 2016 does not mention that it is in clarification or continuation or addition to SEBI circular dated 18.11.1993 on Segregation of client funds and Securities. Hence, both the circulars are unconnected and independent of each other.

vi. The methodology for calculation of amount of mis-utilisation came into existence only in 2016. It is hard to believe that it took 23 years for SEBI to clarify a methodology for mis-utilisation.

vii. Since 1993 till 2016 until the recent inspections, the methodology has never been used either by Exchange or SEBI for calculation of the amount of mis-utilisation.

viii. The SEBI circular of 1993 was issued at a period when apart from Direct clients, the Client Pay-in and Pay-outs were also managed at Sub-Broker level. At Sub-Broker level, the pay-in/ Pay-out's were released after Netting and Matching of all their client funds and securities. Same client account were used for Vyaj-Badla transactions which were in the nature of financing by Carry forward of transaction. The Settlement cycle followed earlier were T+30/ 15/8/5 day basis and the creditors and Debtors were determined at the end of Settlement cycle. Now, in the above mentioned scenario, it would have been practically impossible to implement the calculation or methodology applied for calculating mis-utilisation.

ix. The term "Each client" in cause (i) of [D] of SEBI circular of 1993 has been incorrectly interpreted to be considering Creditors and Debtors separately. Thus, even by applying the Rules of interpretation, it cannot be constructed to mean that Gross creditors balance shall be less than the balance in Settlement and Client account and Deposits with Exchange.

x. Noticee submitted that in deciding the quantum of Penalty, if any, the following recent Adjudication Orders be taken into consideration:-

    i. In case of GEPL Capital Private Limited (ADJUDICATION ORDER NO. Order/BD/VS/2019-20/6626) dated 29th January, 2020, Penalty of Rs. 1,00,000 considering the fact that out of 15, 11 instances were pertaining to prior to enhanced supervision. The amount of violation are also similar.

    ii. b) Maanibhadra Commodities (ADJUDICATION ORDER NO. MC/VS/2019 -20/4180) dated 29th August, 2019 where a Penalty of Rs. 2,00,000 has been levied when the violation in only for period after the applicability of Enhanced Supervision.

CONSIDERATION OF ISSUES AND FINDINGS

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

Issue No. I Whether the Noticee misutilised funds of the clients for purposes other than those mentioned in the SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 such as for settlement of debit balance client's or proprietary obligations or own purposes, as well as for granting margin exposure to proprietor or debit balance clients, in violation of Section 23D of the SCRA?

Issue No. II If yes, whether the abovesaid failure on the part of the Noticee would attract monetary penalty under Section 23D of the SCRA?

Issue No. III If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 23J of the SCRA read with Rule 5 (2) of the Adjudication Rules?

Issue No. I Whether the Noticee misutilised funds of the clients for purposes other than those mentioned in the SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 such as for settlement of debit balance client's or proprietary obligations or own purposes, as well as for granting margin exposure to proprietor or debit balance clients, in violation of Section 23D of the SCRA?

12. It is noted that Para. 1. D) of the 1993 Circular specifies the following:-

"*No money shall be drawn from clients account other than* -

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

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

iii. money which may by mistake or accident have been paid into such account in contravention of para C above."

13. In the instant case in respect of the Noticee, inspection revealed that in 38 out of 43 instances, total cash and cash equivalents lying in the client and settlement bank accounts and with the stock exchange/ clearing corporation / clearing member at the end of the day were less than gross creditors as per trial balance. On all these 38 days, amount of gross debtors was higher than the difference between gross creditors and aggregate cash/ cash equivalents available with the broker and the exchange. This indicates that the client funds were utilized for

settlement of obligations of debit balance clients. Utilization of client funds towards debtors' obligation observed on these 38 dates was in the range from Rs.11,30,739 to Rs.15,43,44,045 with average improper utilization of Rs.3,09,81,174.

14. Further, it was observed that on 4 days out of 43 days, granting of margin exposure to debit balance clients was also indicated.

15. I note that the possible mis-utilisation calculation has been arrived at using the methodology prescribed in he SEBI Circular of September 26, 2016, which became applicable from 01.07.2017. I take note of the Noticee's submission that all instances mentioned above pertain to the period before this SEBI Circular.

16. However, the requirement that brokers shall not use funds of clients for any purpose other than clients' own use is inherent in the 1993 circular on use of client funds. It is also clearly enunciated in Regulation 26 (xiii) of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 which states as follows:-

"A stock broker shall be liable for monetary penalty in respect of the following violations, namely-
(xiii) Failure to segregate his own funds or securities from the client's funds or securities or using the securities or funds of the client for his own purpose or for purpose of any other client"

17. The 2016 circular prescribed a methodology to estimate the extent of mis-utilisation of client funds in case a broker is using client funds for purposes other than clients own use.

Clause 3.3.1 of the Annexure to the 2016 Circular, refers to the following principle: "*the total available funds i.e. cash and cash equivalents with the stock broker and* *with the clearing corporation/clearing member should always be equal to or greater than Clients' funds as per ledger balance*."

18. I observe that the abovesaid principles are a reiteration of the underlying principle against mis-utilization of the clients' funds, already incorporated in Para. 1. D of the 1993 Circular as well as Regulation 26 (xiii) of the Stock Broker Regulations, and cannot be stated to be an introduction of a new requirement. Thus, I do not find merit in the Noticee's contention that the 2016 Circular introduced an entirely new requirement in this regard which was not applicable in the instant case.

19. Noticee has listed out certain new elements in the 2016 circular, as follows:
    (a) Considering Gross Creditors on standalone basis instead of Net Creditors
    (b) Considering only funded portion of Bank Guarantee
    (c) Adjustment of Open Bills and uncleared cheques In Debtors/ Creditors
    (d) Non-consideration of value of Client Securities

20. On perusal of these elements, I am of the view that these cannot be considered as new elements, as the 1993 circular as well as Regulation 26(xiii) of Broker Regulations make it clear that fund use is prescribed for each client and not for all clients on net basis. Further, the non-funded portion of a bank guarantee cannot be considered as client fund. It is a mechanism used by the broker at his end to meet margin and collateral requirements. Similarly, the lack of specification on treatment of open bills and uncleared cheques was possibly being used to incorrectly treat these items. As far as client securities are concerned, credit balance of funds and securities are not interchangeable.

21. With respect to the 38 instances of alleged misutilisation of client funds to meet debtor obligations, and of 4 instances where client funds were used to grant margin exposure to debtors, the Noticee has not disputed the figures given in the SCN. The computation of 'G' as given in the SCN thus gives an estimate of the extent of

client funds mis-utilised. Even in the absence of calculating G, the fact remains that the data indicates that funds of credit balance clients have been used for meeting obligations of debit clients, i.e. used for other purpose than the clients own obligations.

22. Hence, the contention of the Noticee that at the time of the alleged instances of misutilisation, the formula prescribed in the 2016 Circular did not exist is not acceptable. The Noticee's comparison of the alleged violation with GST regime is not relevant as in this case, no new regime has been introduced in the 2016 circular.

23. In its additional submissions dated March 6, 2020 as well the Noticee has contended that there has been a retrospective application of the methodology for calculating "misutilisation".

24. The Noticee has also argued that the term "segregation" used in the 1993 Circular is different from "misutilisation" used in the 2016 SEBI Circular, and that before the 2016 Circular there has been no adjudication of misutilisation of funds on the basis of the 1993 Circular. I find this contention of the Noticee to be incorrect as, there are several cases where brokers have been penalised for non-segregation as well as misutilisation of client funds under the 1993 Circular – eg. Reliance Shares and Stock Broking Pvt. Ltd. (SEBI WTM Order dated 11.12.2006, paras. 45), Dani Shares and Stocks Pvt. Ltd. (Adjudication Order dated 09.05.2018), Akriti Securities Pvt. Ltd. (SEBI Whole Time Member's Order dated 08.11.2006), Vishal Vijay Shah (Adjudication Order dated 23.02.2018). No new substantive obligation was imposed by virtue of the September 2016 Circular in respect of mis-utilisation of funds. Therefore, the Noticee's submissions that "segregation" and "mis-utilisation" are completely different concepts and misutilisation had never been alleged before the September 2016 Circular cannot be accepted.

25. Further, it needs to be re-emphasised that the methodology adopted in the September 2016 Circular was intended to facilitate enforcement of existing substantive obligations of the broker in respect of maintenance of client accounts by indicating, subject to rebuttal through evidence submitted by the broker, whether the broker has misused client funds. Thus, there is no question of "retrospective application of methodology" as suggested by the Noticee in its additional submissions dated March 6, 2020.

26. In the facts of the instant case, once shortage of funds in clients' bank accounts and settlement accounts as compared to the credit balances which should have been available on the relevant 38 dates, has been indicated, it is sufficient evidence of misutilisation of funds of credit balance clients by the Noticee unless specifically disproved by the Noticee. Further, debit balance clients' obligations ('D') were in excess of the apparent misutilised amount 'G' in all these 38 instances, indicating that 'G' was utilised towards settlement obligations of the debtors. 'G' ranged from Rs. 11.3 lakhs to Rs. 15.3 crores.

27. There are also 4 instances where indication of misutilisation of clients funds towards margin obligations of debit balance clients or the Noticee itself on May 12 2014 (Rs. 8,63,618.89), May 14, 2014 (Rs. 3,20,94,573.74), July 9, 2014 (Rs. 19,11,863.73) and June 12, 2015 (Rs. 1,12,43,320).

28. It is noteworthy that the Notice has not offered any evidence to rebut the misutilisation of client funds and there is no contention that figures have been incorrectly or incompletely recorded at the time of inspection.

29. In view of the above, I find that by using the funds of the clients with credit balance for purposes other than those mentioned in the SEBI Circular dated November 18, 1993, the Noticee has violated SEBI Circular SMD/SED/CIR/93/23321 dated November 18, 1993.

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

and

Issue No. III **If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 23J of the SCRA read with Rule 5 (2) of the SCRA Adjudication Rules?**

30. As it has been established that the Noticee had failed to comply with SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993, the Noticee is liable for imposition of monetary penalty under Section 23D of the SCRA.

31. Text of relevant provision are reproduced as follows:-

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

32. While determining the quantum of penalty under Section 23D of the SCRA, the following factors stipulated in Section 23J of the SCRA have to be given due regard:-

    SCRA

    "23J. Factors to be taken into account by the adjudicating officer

While adjudging quantum of penalty under Section 23-I, the adjudicating officer shall have due regard to the following factors, namely:-

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
(b) the amount of loss caused to an investor or group of investors as a result of the default;
(c) the repetitive nature of the default."

33. I note that inspection did not reveal any specific disproportionate gains or unfair advantage made by the Noticee or specific loss suffered by the investors.

34. In respect of the adjudication orders cited by the Noticee to contend that in cases with similar facts and violations, the quantum of penalty levied on the Noticee was minimum, I note that in all three cases of *GEPL Capital Private Limited* (Adjudication Order No. Order/BD/VS/2019-20/6626) dated 29th January, 2020, *Achintya Commodities Private Limited* (Adjudication Order No. Order/SR/SM/2019-20/6065/139) dated 13th December, 2019 and *Maanibhadra Commodities* (Adjudication Order No. MC/VS/2019 -20/4180) dated 29th August, 2019, the Noticees were held liable for violation of Section 23D of the SCRA. The penalty levied on the Noticees in these cases was determined taking into account mitigating factors such as levy of penalty for the same offence by the stock exchange.

35. I note that no instances of investor complaints have been brought on record, and there are no instances of misutilization pointed out in the Inspection Report after December 2015. I take note of the submission that there has not been any adverse observation in respect of the Enhanced Supervision in any subsequent internal audit or exchange inspections, indicating that shortcomings if any, have been rectified by the Noticee.

36. The Noticee has misutilised credit balance clients funds in 38 instances during the inspection period, for an amount ranging from Rs.11,30,739 to Rs.15,43,44,045 with average improper utilization of Rs.3,09,81,174. Further, misutilisation of clients funds towards margin obligations of debit balance clients or the Noticee itself noted on 4 dates during the inspection period for a total of Rs. 4,61,13,376 and an average of Rs. 1,15,28,344.

37. Therefore, taking into account the aforesaid factors, and considering the facts and circumstances of the case, I am of the view that a penalty of Rs.8,00,000/- will be commensurate with the violations committed by the Noticee.

ORDER

38. After taking into consideration all the facts and circumstances of the case, in exercise of powers conferred upon me under Section 23I of the SCRA read with Rule 5 of the SCRA Adjudication Rules, I hereby impose the following penalty upon the Noticee as shown in the table below:-

Name of the Noticee	Penalty Provisions and Violations	Penalty Amount
Kantilal Chhaganlal Securities Private Limited	Under Section 23D of the SCRA for violation of SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993	Rs. 8,00,000/- (Rupees Eight Lakhs only)

47. The Noticee shall remit / pay the said amount of penalty within 45 days from May 03, 2020 or service of this order, whichever is later, either by way of Demand Draft in favour of “SEBI - Penalties Remittable to Government of India”, payable at Mumbai, OR through online payment facility available on the SEBI website www.sebi.gov.in on the following path, by clicking on the payment link

ENFORCEMENT → Orders → Orders of AO → PAY NOW

48. The Noticees shall forward said Demand Draft or the details / confirmation of penalty so paid to the Enforcement Department – Division of Regulatory Action – II of SEBI. The Noticees shall provide the following details while forwarding DD/ payment information:
    a) Name and PAN of the entity (Noticee)
    b) Name of the case / matter
    c) Purpose of Payment – Payment of penalty under AO proceedings
    d) Bank Name and Account Number
    e) Transaction Number

49. Copies of this Adjudication Order are being sent to the Noticee and also to SEBI in terms of Rule 6 of the Adjudication Rules.

DATE: April 24, 2020
PLACE: MUMBAI

MANINDER CHEEMA
ADJUDICATING OFFICER