BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/MC/RM/2022-23/21419]

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

In respect of –

1. **National Securities Depository Limited (NSDL) (PAN No. : AADCN9802F**) having address at Trade World A Wing, 4th Floor, Kamala Mills Compound, Senapati Bapat Marg, Lower Parel (West), Mumbai -400013

In the matter of Karvy Stock Broking Limited

BACKGROUND

1. Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') initiated adjudication proceedings under Section 19G of the Depositories Act, 1996, against National Securities Depository Limited (hereinafter referred as "**Noticee/NSDL**"), for alleged violation of the following:
   a) intent of the SEBI letter dated February 21, 2006 and the provisions of regulation 17 read with regulation 98 of the SEBI (Depositories and Participants) Regulations, 2018, (hereinafter referred to as the D&P Regulations, 2018) read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the SEBI (Depositories and Participants) Regulations, 1996 (hereinafter referred to as the D&P Regulations, 1996) read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.
   b) Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 and Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to SEBI Circular dated September 26, 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with

regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

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

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

APPOINTMENT OF ADJUDICATING OFFICER

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

SHOW CAUSE NOTICE, REPLY AND HEARING

3. Show Cause Notice No. EAD-2/AP/VS/10130/2021 dated May 10, 2021 (hereinafter be referred to as, the "**SCN**") was served upon the Noticees under Rule 4 of the Adjudication Rules read with Section 19H of the Depositories Act to show cause as to why an inquiry should not be held and penalty not be imposed upon the Noticee under Section 19G of the Depositories Act for the aforesaid alleged violations.

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

5. SEBI along with National Stock Exchange of India Limited (hereinafter referred to as "NSE") and Bombay Stock Exchange Limited (hereinafter referred to as "BSE") conducted a joint inspection of Karvy Stock Broking Limited (hereinafter referred

to as “KSBL”) from June 2019. Subsequently, a forensic auditor was appointed by NSE and preliminary report was forwarded by NSE to SEBI on November 2019, based on which SEBI passed an ex-parte ad-interim order dated November 22, 2019 and a confirmatory order dated November 29, 2019 (‘Orders’) on the non-compliances observed with respect to the pledging/ misuse of client securities by KSBL.

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

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

d) Inspection observations and complaints in respect of misuse of clients' assets by KSBL.

8. NSDL submitted its reply vide emails dated November 17, 2020, January 27, 2021, February 17, 2021, February 24, 2021, February 27, 2021, March 02, 2021,March 03, 2021 and March 31, 2021 and letter dated August 12, 2020. Based on the NSDL response, SEBI examined the matter and made certain preliminary findings. The preliminary findings, SEBI's observations based on NSDL response are summarized as under:

9. **Preliminary Finding No. 1:** NSE vide email dated January 02, 2017 sought pledge details with respect to all demat accounts of KSBL from NSDL. NSDL, vide email dated January 10, 2017, denied providing the information to NSE citing the SEBI letter ISD/RR/DS/60960/06 dated February 21, 2006. On September 22, 2017, NSE sought details of securities pledged in the client account of KSBL from NSDL. NSDL vide email dated October 05, 2017 refused to provide the information by citing SEBI letter dated February 21, 2006. NSDL did not approach SEBI for any clarification on the SEBI letter dated February 21, 2006.

10. Based on NSDL response to the finding, SEBI observed as under:

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

b) Para 2 of the said letter, which directs NSDL to share data with Exchange, mentions that Depositories are required to provide the 'requisite information' to the Stock Exchanges as and when sought by them. The direction here does not limit or specifically refer to the information mentioned at Para 1 of the letter. Further, as per letter, "…it could be inferred that upon stock exchanges seeking relevant information on a case to case basis for their investigation cases or analysis, the depositories were required to provide the requisite information to BSE and NSE". As such, both the Depositories were under an obligation to provide the pledge related information of KSBL/its clients to NSE when the same was sought by NSE. However, by not providing the pledge related information to NSE, when specifically sought, NSDL has not complied with letter and intent of SEBI letter dated February 21, 2006.

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

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

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

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

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

12. **Preliminary Finding No. 2:** NSDL failed to notice that demat accounts were not tagged as per the prescribed nomenclature as laid down in para 2.3 to the annexure of the SEBI circular dated September 26, 2016. KSBL had not assigned the nomenclature to the demat account no. 11458979, named Karvy Stock Broking Ltd (BSE), which was in violation of SEBI Circular dated September 26, 2016 but NSDL had not taken any action against KSBL in this regard.

13. Based on NSDL response to the finding, SEBI observed as under:

a) As per Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016, all demat accounts held by the stock brokers were required to be assigned the appropriate nomenclature as the following "Name of Stock Broker- Pool Account / Client Account / Proprietary Account / Collateral Account", reflecting the purpose of those demat accounts. As per Clause 2.3.1 of Annexure to this circular, Stock Exchanges and/or Depositories are required to ensure that all existing demat accounts of stock brokers are assigned appropriate nomenclature. Further, as per Clause 2(a) of SEBI circular dated June 22, 2017, nomenclature of proprietary demat accounts was made voluntary and, all those demat accounts which did not meet the nomenclature, as prescribed under Clause 1 of SEBI Circular dated September 26, 2016, would be deemed to be proprietary.

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

c) Further, as per Clause 2(a) of SEBI Circular dated June 22, 2017, all those demat accounts which did not meet the nomenclature, as prescribed under Clause 1 of Annexure to SEBI Circular dated September 26, 2016, would be deemed to be proprietary. In this regard, KSBL accounts in NSDL that were not tagged in terms of SEBI circular dated December 16, 2016 circular, did not reflect that those accounts are 'deemed to be proprietary' in the nomenclature of the concerned account, account category or its sub-type, in the account details shared with Stock Exchanges. In respect of demat a/c 11458979, the nomenclature was ‘Karvy Stock Broking Limited (BSE)’, similar to nomenclature of other demat accounts irrespective whether they were tagged/ untagged. The earlier category of this demat a/c was ‘beneficiary client’, and sub-type as ‘Body Corporate- Domestic’ continued, not reflecting that they are deemed to be proprietary account.

d) As per Clauses 2.4.3, 2.4.4, 2.5.1 and 2.5.4 of Annexure to SEBI circular dated September 16, 2016, transfer of securities from individual clients’ accounts & ‘Stock Broker- client account’ to ‘Stock Broker- proprietary account’ is for legitimate purpose and the same shall be monitored by Exchanges. Further, securities of only those clients can be pledged who have a debit balance in their ledger and such pledge shall be from BO account with nomenclature as "Name of the Stock Broker - Client Account” alone. In this regard, towards appropriately monitoring compliance with such requirement, it is important that nomenclature of demat account is appropriately reflected. However, in the instant case of KSBL related account details shared by NSDL with exchanges, nomenclature of all the demat accounts of KSBL were not changed, and the account category/sub-type of untagged reflected earlier details. It thus makes difficult for Stock exchanges to differentiate the deemed to be proprietary accounts from other tagged/untagged stock brokers’ accounts. If nomenclature of tagged accounts were correctly reflecting that they are pool/collateral/client account, and/or if the untagged account in the nomenclature / account sub-type were reflecting that it is ‘deemed to be proprietary’ account or blank data in place of continuing to provide earlier type-subtype, Stock Exchanges would have been in better position to identify that securities from client account are being transferred to brokers’ deemed to be proprietary account, and the same is subsequently being pledged. Thus, the modus operandi adopted by KSBL would have surfaced earlier and would have given an opportunity to taking timely corrective action. Failure on the part of NSDL to appropriately reflect nomenclature of the tagged account as pool/collateral/client/proprietary account, and by continuing the sub-status of untagged account as earlier status (i.e. ‘Domestic’ in case of impugned demat account a/c), has thus resulted in dilution of appropriate implementation of SEBI circular dated September 16, 2016 read with circular dated June 22, 2017 on enhanced supervision of Stock Broker/DPs.

e) Further, post implementation of SEBI circular dated December 17, 2018 (i.e. since February 2019) NSDL was considering all untagged accounts of KSBL (including impugned demat no. 11458979) as 'Stock Broker - Proprietary Account' for the purpose of generation of alerts. However, while providing these alerts to Stock Exchanges inter alia in respect of transfer of large value of shares through off-market transfers other than for settlement purposes, details of source and target demat account no., and name, among others, details were provided, however account type-subtype of such accounts was not provided therein. In absence of the same, given that nomenclature of the demat accounts were not as per Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016, it becomes difficult to differentiate the pool/collateral/client from proprietary account, while processing these alerts. As such, absence of proper nomenclature of accounts while providing alerts related to large value off-market transfers to Stock Exchanges, diluted appropriate implementation of SEBI circular dated December 17, 2018.

f) In addition to the above, with regard to demat a/c 11458979, having nomenclature ‘Karvy Stock Broking Limited (BSE)’, category as ‘beneficiary client’ and sub-type as ‘Body Corporate- Domestic’, was supposed to have securities that pertain to the account holder i.e. KSBL, as per NSDL’s bye-law. Further, as submitted by NSDL, this account was considered as deemed to be proprietary account for purpose of alert generation as per SEBI circular dated December 17, 2018 implemented from February 01, 2019. As per the interim order dated November 22, 2019, covering period since January 2019, KSBL was noted to be consistently transferring the securities from clients’ demat account to this proprietary demat account, and those securities were subsequently being pledged. In terms of Clause 2.5.4 of Annexure to SEBI Circular dated September 26, 2016, the client’s securities can be pledged by

Stock Broker from BO account tagged as "Name of the Stock Broker - Client Account" alone. However, prior to generation and sharing of alerts since February 2019 towards implementation of SEBI circular dated December 17, 2018, NSDL has failed to be vigilant and take necessary action for such transfer of client securities to Stock brokers' deemed proprietary demat account and subsequent pledge of such securities in the depository system. This highlights lack of due diligence on the part of NSDL along-with lack of proactive and responsible attitude towards safeguarding interests of investors, integrity of the depository system and the securities market.

14. **Therefore, it was alleged that NSDL is not in compliance with Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016. Further, NSDL was noted to be not in compliance with Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to SEBI Circular dated September 26, 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.**

15. **<u>Preliminary Finding No. 3:</u>** In terms of SEBI Circular No. SEBI/HO/MIRSD/DOP/CIR/P/2018/153 dated December 17, 2018, Depositories are *inter alia* required to put in place an Early Warning Mechanism and sharing of information between Stock Exchanges, Depositories and Clearing Corporations to detect the diversion of clients' securities by the stock broker at an early stage so as to take appropriate preventive measures, as mentioned below:
As per Clause 8 of the circular, *"Based on the analysis of the early warning data, if it is established that the stock broker's financial health has deteriorated and/ or he has made unauthorized transfer of funds / securities of the client, in such cases Stock Exchanges / Depositories shall jointly take preventive actions on the stock broker which may include one or more of, but not limited, to the following:*
8.1 Actions to be initiated by the Stock Exchanges:
…

8.2 Actions to be taken by the Depositories:

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

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

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

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

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

17. Based on the NSDL response to the finding, SEBI observed as under:

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

19. It is, however, observed that even though various alerts were generated at the depositories end since February 2019, the only action noted to be taken by Depositories is sharing the same with Stock Exchanges / Clearing Corporations for further necessary action. Pursuant to receipt of investor complaints related to unauthorized transfer of securities, with effect from September 2019, NSDL deployed its staff at Karvy DP office to monitor its activities, thereafter they appointed an auditor to verify the transactions and sent statement of transactions to the clients of KSBL. However, while KSBL was consistently transferring clients' securities in its proprietary demat account and then subsequently pledging them, the depository merely shared the numerous and serious alerts signaling the same with the Stock Exchanges / Clearing Corporations. It did not take any proactive measures to stop such a misuse of its depository system by KSBL and safeguard the interest of investors in the securities market, and thereby efficiently discharging its regulatory functions. Further, based on the early warning signals/ alerts received at their end, if the Depository had promptly acted upon the alerts, they could have protected assets of several investors.

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

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

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

to be carried out by Depositories, highlighting the casual approach in processing alerts of such serious nature.

23. In view of the above it was observed that NSDL adopted casual approach and failed to conduct proper due diligence while processing investor complaints as well as while conducting inspection of KSBL as a DP, and ensuring that conduct of its DP is in a manner that will safeguard the interest of investors and the securities market. If Depositories had effectively conducted inspections of KSBL as a DP and examined complaints received in respect of KSBL as a DP seriously, the issue of misuse of client's securities would have surfaced earlier, thereby enabling SEBI and/or Exchanges to take timely action towards safeguarding interest of investors. However, failure to take such appropriate measures in respect of KSBL as a DP highlights lack of proactive and responsible attitude towards ensuring that conduct of its DPs is in a manner that safeguards the interests of investors, integrity of the depository system and the securities market.

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

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

26. In response to SCN dated May 10, 2021 Noticee requested additional time for filing of reply to SCN and sought inspection of all the records and documents relevant to the proceedings including the investigation report. Vide email dated December 09, 2021, Noticee was provided with relevant excerpts of the Examination report. Noticee again sought extension to file the reply, and filed reply to SCN vide letter dated February 01, 2021.

27. Opportunity of Hearing before undersigned was provided to the Noticee through video conferencing on January 07, 2022. Upon request of Noticee for rescheduling of the personal hearing, the hearing was rescheduled to February 02, 2022 and then subsequently to February 03, 2022. The Personal hearing on February 03, 2022 was attended by Authorised Representative of the Noticee, viz. Mr. Somasekhar Sundaresan, Advocate, Ms. Yugandhara Khanwilkar, Advocate, Mr. Joby Mathews, Advocate, Mr. Anshuman Sugla, Advocate, Mr. Samar Banwat, Executive Director, NSDL, Mr. Malav Shah, Vice President, NSDL, Mr. Harish Kumar, Senior Manager, NSDL. The Authorised representative of the Noticee reiterated the submissions made by the Noticee in its reply and submitted post hearing submissions dated March 02, 2022.

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

29. National Securities Depository Limited ("NSDL") is a depository as defined in the Depositories Act, 1996 and is regulated by the Securities and Exchange Board of India (SEBI) as per Section 11 of the Securities and Exchange Board of India Act, 1992. The functions of a depository are to act as a record-keeping institution, which represents the infrastructure to record issuance, holding and transfer of securities in dematerialized form in the Indian capital market.

30. NSDL provides services to investors, and issuer companies through more than 250 depository participants. NSDL undertakes inspection and audit of the operations of Depository Participants to verify their compliance with the bye-laws, business rules, and circulars issued by NSDL from time to time regarding the abovementioned activities. It is further pertinent to note here that NSDL does not have any quasi-judicial or executive policy role unlike SEBI and stock exchanges.

31. As a depository, NSDL is also required to strictly follow the regulatory framework and maintain confidentiality and sanctity of its record – wherever the law stipulates a disclosure, such disclosure should be made, and where no disclosure is stipulated, the record must be protected. The default position is to maintain

confidentiality and not the other way around. It is also noteworthy that the role of a depository is to be a record-keeper and in doing so, the depository does not adjudicate title or determine disputes between owners of securities – which is a significant departure from other market infrastructure institutions such as stock exchanges. This context needs to be kept in mind when assessing this matter.

32. With reference to paragraph 2(a) and 2(b) of the SCN and to the preliminary examination regarding the role of stock exchanges and NSDL, Noticee submit as follows: -

33. At the relevant time, there was no provision for sharing of sensitive information by the depositories with third parties. Market infrastructure institutions are expected to be very specific and cautious in parting with information and if there is no framework for providing information sought, far-reaching repercussions could follow – as was seen in the case of Anand Rathi, who as the president of a stock exchange had sought information about brokers' positions on the market.

34. As all the surveillance information provided to the Exchanges was being routed through SEBI and as information related to off-market transactions in demat accounts of beneficial owners was sought by the said Exchanges, SEBI issued the Letter dated February 26, 2006, in relation to off-market transactions in demat accounts of beneficial owners. The relevant extract of the text of the said Letter is reproduced hereunder:

    Para 1: *"… As you may be aware, currently data regarding off-market transactions above 100,000 shares and information on beneficial owners whose holding crosses 5% or beneficial owners who hold more than 5% and transferred 2% or more is being furnished to SEBI by the depositories on a monthly basis and the same is forwarded to BSE and NSE by SEBI. The issue was reviewed in the weekly surveillance meeting held on February 6, 2006"*

    and at para 2, it is mentioned that*: "As the data is required only in course of investigation, the stock exchanges have suggested that they would prefer seeking* *relevant information from the depositories on a case-to-case basis for their investigation cases or analysis."*

35. Therefore, the intention of the said letter was clearly in the context of the data mentioned in paragraph 1 of the said Letter i.e. those relating to off-market transactions in demat accounts of beneficial owners, that "the data" considered for sharing did not include blanket provision of data on pledge transactions in demat account of Trading Members/Stock Brokers (including KSBL).

36. Therefore, it cannot be interpreted that the scope of the term "relevant information" is beyond what is required of a Depository as set out in the said letter. It is clear from a plain reading of the letter that the term "relevant information" refers to subsets of "the data" as explained in paragraph 1 and paragraph 2 of the letter and as demonstrated above.

37. This letter was specific as to the nature of information covered by it, and NSDL provided information pertaining to off-market transactions to the Exchanges as and when requested, which is admittedly the case. No objection was received from the Exchanges or SEBI regarding the same.

38. In NSDL's replies to emails dated January 2, 2017 and September 22, 2017 sent by the National Stock Exchange of India Limited ("NSE"), Noticee has given valid reasons for not sharing the details of pledges done by a trading member with the NSE. Such reasons were presumably found to be satisfactory by NSE since the matter was not taken to SEBI for an intervention similar to the letter dated February 26, 2006.

39. However, it is now being alleged that NSDL did not seek clarification from SEBI regarding the letter dated February 21, 2006 as should be applied to the requests about pledges in 2017 – such an allegation is vague and incoherent. Had this been perceived an issue for SEBI, it was always open to SEBI to issue a similar letter to depositories. From NSDL's perspective, it is submitted with the greatest respect,

that being a record-keeping agency, no other agency including any stock exchange or SEBI took any initiative to create a framework akin to the framework of the letter dated February 21, 2006 in connection with pledges. To blame NSDL for not seeking clarification is therefore, untenable – particularly when there was no ambiguity for a clarification to be warranted.

40. In regard to Paragraph 2(b) of SCN, it may be noted that vide SEBI's Circular dated June 22, 2017, the requirement to tag proprietary demat accounts of a stock broker/trading member has been made voluntary by SEBI; furthermore, the onus and responsibility of ensuring that trading members tagged their demat accounts in an appropriate manner was delegated to the stock exchanges and not to the depositories including NSDL. The role of the Depositories in this regard was strictly restricted to facilitating the same.

41. On not providing pledge related information when sought by NSE in the year 2017 In this regard Noticee contends that suggestions of notions such as "proactive" and "attitude" are vague in the context of penal proceedings. NSDL has been adherent to requirements to be met by it, and as a record-keeping institution, discharged its stipulated duties. To make ambiguous allegations such as alleged failure to be "proactive" or having a "responsible attitude" is a very vague and conjectural allegation.

42. At the relevant time, there was no provision for sharing of confidential or sensitive information by the depositories to stock exchanges including information on pledges. Market infrastructure institutions are expected to be very specific and cautious in parting with information and if there is no framework for providing information sought, far-reaching repercussions could follow.

43. It is pertinent to note that prior to the letter of February 21, 2006, such off market transaction data was made available by NSDL to SEBI, which was then forwarded by SEBI to the stock exchanges. Thus, data relating to off market transactions in

demat account of beneficial owners was provided by Depositories to Stock Exchanges only at the direction of and authorization from SEBI.

44. With reference to the same, we draw your attention to Section 18 of the Depositories Act reproduced herein below:

"Power of Board to call for information and enquiry.

18(1) The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing, -

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

45. As per Section 2(b), "Board" means the Securities and Exchange Board of India. Thus, Section 18 specifically confers wide powers to SEBI to seek any information from the Depositories related to the securities held by them, on a request made in writing, and therefore it is only on their written request that any Depository could provide such information to any other person to the extent the same is authorized. In exercise of such power, there was no direction from SEBI to part with information – the only exercise of the same being the letter dated February 21, 2006.

46. In view of the above, Noticee submit that any communication, order, circular or instructions issued by SEBI is to be construed purposively. On a plain reading of the contents, it was clear that the extraordinary measure of sharing information by depositories with exchanges was relating to off market transfers. Such data did not bring within its ambit information about pledges. Hence, NSDL in a bona fide manner, read and understood the said Letter dated February 21, 2006 in the context, in which it was issued, i.e. information related to off-market transactions in the demat accounts of beneficial owners only.

47. Pledge transactions in a demat account are not off-market transactions and hence, in the bona fide view of NSDL, it was not authorized by SEBI to provide the same to exchanges within the scope of the letter dated February 21, 2006. No invocation

of Section 18 of the Act as stated above had been made by SEBI either in connection with information about pledges. Therefore, NSDL cannot be faulted for adhering with the sacred legal requirement of not sharing information beyond what is permitted by the regulatory framework.

48. Furthermore, with reference to the paragraph 5.a.iii.3. of the said SCN, Noticee submit that, NSDL, having believed the said understanding of the Letter to be true and correct, could not have gone beyond the scope of the same, merely because the said Letter did not explicitly restrict NSDL from providing any other information outside the scope of the said Letter. Therefore, the allegation that the said Letter did not prevent NSDL from providing information cannot be sustained.

49. Without prejudice to the above submissions, even assuming without admitting that the interpretation drawn by SEBI is correct, it cannot be said that the understanding and inference drawn by NSDL from the Letter dated February 21, 2006 is absurd or a contrary interpretation to the said letter. In view of the same, considering that the understanding drawn by NSDL, absent any specific clarification from SEBI, is within the confines of law and legal interpretation and that there was no blanket authority granted to Exchange(s) to seek any required information from depository for investigation purposes. It is denied that NSDL has violated any provisions of law.

50. Furthermore, with regard to the allegation that NSDL ought to have sought clarification from SEBI regarding the interpretation of the letter dated February 21, 2006, it is pertinent to note that even after NSDL expressed its inability to provide the pledge related information in the demat Accounts of Stock Brokers including KSBL (“Broker Demat Accounts”) due to the said letter on two occasions (first on January 10, 2017 and second on October 5, 2017), NSE had never challenged or questioned or raised any objection regarding NSDL’s interpretation of the letter ; rather NSE accepted the reason provided by NSDL for not providing the requested information and did not seek any clarification from SEBI. If NSE had not accepted the response of NSDL and also since the information regarding the concerned

Broker Demat Accounts was, in fact crucial for NSE to detect misuse of client securities by KSBL and protect investors' interest, we humbly submit that the onus was on NSE to proactively seek authorization/clarifications from SEBI regarding the same or at the very least, object to the reply of NSDL and in turn intimate SEBI, failing which, the onus on seeking clarification from SEBI regarding the interpretation of the said Letter cannot be said to fall on NSDL.

51. It is also pertinent to note that the aforesaid understanding was not that of NSDL alone – CDSL had also denied to provide the pledge transaction data of Broker Demat Accounts to NSE citing the same reason as provided by NSDL. Hence, at the relevant point in time, when two different depositories had the same understanding about the scope of data that can be provided to exchanges under the said Letter, it cannot be alleged that everyone was wrong about their understanding of the law and should face penal proceedings. Instead, a more reasonable approach would be to see that the depositories were scrupulously adhering to the apparent framework of information provision pursuant to SEBI's intervention.

52. It is further pertinent to note that the Depositories Act and the Depositories Regulations do not attribute or confer a regulatory role in respect of the pledge or transfer of securities by clients on Depositories or Participants; Depositories and Participants are only required to ensure that the pledge or transfer is carried out in the manner specified in the Bye Laws, Business Rules and Circulars issued from time to time.

53. It is only vide SEBI circular dated December 17, 2018 that SEBI directed depositories to provide pledge transaction data of trading members with exchanges. Based on express directions of SEBI, depositories started providing required information to exchanges. It is submitted that the fact that SEBI had to issue specific directions vide a specific circular, and not merely any clarification, to direct Depositories to provide pledge related data itself demonstrates that the previous regulatory framework did not provide for the same.

54. Therefore, the allegation that NSDL failed to take a proactive and responsible attitude towards safeguarding the interests of investors and the integrity of the Depository System and the Securities Market is unsustainable.

55. In view of the above, it is denied that NSDL violated the intent of the SEBI letter dated February 21, 2006 and the provisions of Regulation 17 read with Regulation 98 of the Depository Regulations r/w Clauses 1, 2 & 5 of the Code of Conduct for Depositories along with Regulation 14A of the SEBI (D&P) Regulations 1996 read with Clauses 1, 2, and 5 of the Code of Conduct for Depositories.

56. In regard to assigning nomenclature to Broker Demat Accounts in terms of SEBI circular dated September 26, 2016 read with Circular dated December 20, 2016 and June 22, 2017 on enhanced supervision of Stock Brokers/Depository Participants following may be noted:

57. At the outset it is submitted that Clause 1 of the Annexure to the Circular dated September 26, 2016 ("September Circular") laid down the nomenclature to be followed by stock brokers for naming/tagging of the bank accounts and Broker Demat Accounts maintained by all stock brokers. Existing Broker Demat Accounts maintained by stock brokers were required to be assigned nomenclature/ tags as specified therein within three months from the date of the said SEBI circular. Subsequently, SEBI vide circular dated December 20, 2016 decided that the September Circular would be made effective from April 1, 2017 and laid down the revised timelines for implementing the various provisions of the said circular. As per the revised timelines, the date of implementation of Clause 2.3.1 was July 1, 2017. Thereafter, SEBI issued a Circular dated June 22, 2017 ("June Circular") providing certain clarifications to September Circular. In terms of the said clarifications, Clause 1 of Annexure to September Circular was amended and clauses 1.2.2 and 1.2.4 were deleted, accordingly the mandatory requirement of tagging proprietary demat accounts by stock brokers as 'Stock Broker – Proprietary Account' was made voluntary and the untagged demat accounts of

stock brokers were to be deemed to be proprietary. As such, Clause 1 of Annexure, in its amended form, came into effect from July 1, 2017.

58. Pursuant to the aforesaid SEBI circulars, both the depositories, NSDL and CDSL issued Circular dated December 16, 2016 and November 22, 2016 respectively (collectively referred to as "Depository Circulars") informing the depository participants about the facility provided to appropriately tag various demat accounts of stock brokers opened for different purposes by using separate sub-types and the process to be followed. In accordance with the Depository Circulars, stock brokers were required to submit a modification request to tag the account with sub-type Stock Broker-Client', 'Stock Broker – Proprietary' and 'Stock Broker-Collateral'.

59. In para 5.b.iii.2 of the SCN, SEBI has observed that NSDL merely facilitated change in type/sub-type account category instead of a change in nomenclature of the demat account of stock brokers. The nomenclature/ name of the BO account holder was left unchanged even where the concerned demat accounts were tagged by the stock brokers as per Clause 1.2 of Annexure to SEBI Circular dated September 26, 2016. The said observation is contrary to the mechanism of change in nomenclature/ tagging of demat accounts prescribed under the said circular. Para 2.2 of the September Circular has prescribed the following format in which the stock brokers were required to report the demat accounts:

Name of DP	Account number/ Client ID	DP ID	Name of Account Holder	PAN	Sub-type/ tag of demat account (Proprietary/ Client/ Pool/ Collateral)	Date of Opening

60. It can be seen from the above format that it was sub-type/ tags that were required to be created by the depositories so that the stock brokers can assign the applicable sub-type/ tag to the demat accounts in the depository system. There was no requirement to change name of account holder to add words 'Client

Account', 'Proprietary Account', 'Collateral Account' or 'Pool Account' after the name of account holder.

61. The September Circular required all the stock brokers registered with SEBI to approach the respective depositories and identify all the demat accounts which they were holding and tag each of the demat account as per the applicable nomenclature/tags. A Stock broker, who is holding securities in a demat account, may be holding securities either its own securities or securities of its clients. In case the securities in the demat account are owned by the broker itself, then the stock broker is required to tag such demat account as a 'proprietary' account. In case the securities in the demat account are owned by its clients, then the demat account may be tagged 'Client', 'Pool' or 'Collateral' account.

62. The main purpose of tagging such demat accounts by types/subtypes is to clearly identify whether such demat accounts are holding securities which are owned by the stock broker or are holding securities which are owned by its clients. In the computerized depository system, when such an identification is made by clearly introducing a new tag i.e. sub-type, it becomes extremely easy to identify such demat accounts, either with the naked-eye or using any computer tool. Therefore, regardless of whether it is a nomenclature of the BO account or a type/ subtype/ category of the BO account, it would simply be possible to identify the nature and character of the accounts for stock exchanges or for SEBI, whichever be the body conducting inspections or investigation of stock broker. Therefore, an allegation about change in category of type/subtype "instead of" change in "nomenclature" is a distinction without a difference and does not at all compromise the effectiveness of categorization.

63. In terms of the September Circular, all stock brokers had an obligation to tag their every single demat account held with a depository either as a 'proprietary' account holding its own securities or as a 'client', 'pool' or 'collateral' account holding client's securities. If the September Circular would have been fully implemented and enforced, all the demat accounts which are held by the stock broker would have

been reported by the stock brokers to the stock exchanges. In case any stock broker would not have reported any demat account, the depositories were already providing the list of all accounts held by every stock broker to the stock exchanges, so that the stock exchanges can easily identify the stock brokers, who are noncompliant with the requirements of the September Circular. However, in the June Circular, it was decided that in respect of those demat accounts, which are not tagged by the stock broker either as a ‘proprietary’ or ‘client’, or ‘pool’ or ‘collateral’, it will be deemed to be proprietary. Thus, the June Circular relaxed the strict requirements of the September Circular and did not require the stock brokers to approach the Depository Participant, in case of demat accounts which were ‘proprietary’ demat accounts. However, the June Circular did not relax the reporting requirements of the stock broker, and the stock brokers were still required to report all accounts held by them to the stock exchanges. NSDL also continued to provide information of all accounts of stock brokers to the stock exchanges, to enable stock exchanges to clearly identify such demat accounts, which were not meeting with the requirements of the September Circular.

64. The show-cause notice mentions that in respect of demat account number 1145879, the nomenclature was ‘Karvy Stock Broking Limited (BSE), similar to nomenclature of other demat accounts irrespective of whether they were tagged/untagged. The earlier category of this demat account was ‘beneficiary client’, and sub-type as ‘Body Corporate – Domestic’ continued, not reflecting that they are deemed to be proprietary. This statement that the type/sub-type “body corporate/domestic account” held by KSBL was not reflective that they are ‘deemed to be proprietary’ is a fallacious argument. As explained above, a stock broker can essentially hold securities in it’s demat account, which either belong to itself or its clients. There cannot be third type of holdings in the demat account. Thus, irrespective of the legal status of KSBL i.e. body corporate/domestic, it is quite evident since the issue of June Circular, that all demat accounts of the stock broker, if they are not tagged as ‘client’ or ‘collateral’ will be ‘deemed to be proprietary’ account.

65. Upon receiving request from NSE for providing details of demat accounts of stock brokers (including Karvy) as per PAN provided by NSE, NSDL generated a list of 5096 demat accounts of stock brokers existing in the NSDL depository system as on October 30, 2017. It is observed that as on October 30, 2017, Karvy held 65 demat accounts with NSDL; these accounts were identified on the basis of PAN as provided by the stock exchange. Of the 65 demat accounts, it was observed that nomenclature/ tags of 16 demat accounts was modified as per the tags specified in the aforesaid SEBI circulars and Depository Circulars, while there was no change in the nomenclature/ tags of the remaining 49 accounts, which included the demat account DP ID: IN300394; Client ID: 11458979 held in the name of 'KARVY STOCK BROKING LTD (BSE)'.

Sr. no.	**Account description/ type-sub type**	**No. of accounts**	**Details of SEBI circular as per which account is tagged**
1	Client Margin Trading Securities account	1	Maintained by TM to hold securities that are bought under Margin Trading facility.
2	Client collateral account	3	Maintained by TM for holding client securities for margin purpose and onward transfer to collateral account for Pledging with Clearing Corporation
3	Stock Broker – Collateral	4	Maintained by TM for Pledging own and clients securities with Clearing Corporation
4	Clearing Member (CM) Pool Account	6	Maintained by Clearing Members for settlement purpose.
5	Stock Broker-Client	16	Maintained by TM to hold clients' securities
6	Body Corporate-Domestic	45	Deemed to be 'Stock Broker - Proprietary Account'.
	Total accounts	**75**	

66. It may be noted that September Circular as amended by June Circular did not mandatorily require the Broker Demat Accounts to be tagged with new tags. Hence, the subtype of the untagged demat accounts continued to remain as 'domestic'. The stock brokers were mandatorily required to tag only those demat

accounts used by stock brokers for client related transactions and tagging of proprietary demat accounts was voluntary.

67. Further, the untagged demat accounts of KSBL with subtype as ‘domestic’ can be easily identified and understood to be ‘deemed to be proprietary’ demat accounts (without any tagging as ‘proprietary’) as per the June Circular. Hence, there was no requirement of changing the nomenclature, or their types or subtypes for untagged such accounts.

68. It is pertinent to mention that pursuant to the September Circular, the tagging of proprietary Broker Demat Accounts was mandatory until the issuance of the June Circular. After June Circular, the tagging of Broker Demat Accounts was made voluntary with respect to proprietary accounts. Therefore, the option to change the nomenclature/type of such accounts still existed albeit voluntarily. NSDL had already provided the facility for tagging the Broker Demat Accounts as per type/sub-types prescribed under the September Circular and the June Circular merely relaxed the requirement of tagging proprietary Broker Demat Accounts as sub-type ‘Stock Broker – Proprietary’. In terms of the June Circular, there was no requirement to create another sub-type as ‘deemed to be proprietary’ because the untagged demat accounts were simply required to be deemed to be proprietary without requiring to tag any type/sub-type. Therefore, the untagged demat accounts of KSBL continued to reflect their existing types/subtypes, such as ‘beneficiary client’ and sub-type as ‘Body Corporate – Domestic’ for demat a/c number 11458979.

69. Further, if at all, NSDL had created another sub-type as ‘deemed to be proprietary’ then it would lead to situation of creating a new sub-type which would be same as an already existing sub-type (i.e. Stock Broker – Proprietary). It was also observed that few other stock brokers have voluntarily tagged their accounts as ‘Proprietary’ in NSDL system prior to June Circular. Secondly, while KSBL would have reported the demat account details to Exchanges, they would have provided this information

to Exchanges as per the format prescribed under the September Circular, whether account is client or proprietary.

70. Noticee submitted that that NSDL provided appropriate types/sub-types of the demat accounts of KSBL, wherein the tagged demat accounts were having types/ subtypes as ‘Client’, ‘Pool’ or ‘Collateral’ and untagged demat accounts continued to have their existing types/ subtypes. As per the June Circular, the untagged demat accounts were to be understood as deemed to be proprietary demat accounts by the stock exchanges and depositories. Hence, the details of demat accounts of KSBL as provided by NSDL to stock exchanges was sufficient enough to differentiate the deemed to be proprietary accounts from other tagged/untagged accounts of KSBL. Therefore, the allegation in paragraph 5.b.iii.4 of the SCN that “it makes for stock exchanges to differentiate the deemed to be proprietary accounts from other tagged/untagged stock broker’s accounts” is not maintainable.

71. Further, NSDL while providing details of Broker demat account, had clearly mentioned in the body of emails about the number of untagged demat accounts of stock brokers and the same can be found in the annexures attached to the emails. The June Circular does not require the depositories to create a separate sub-type as ‘deemed to be proprietary’ for untagged demat accounts. The said circular clearly stated that the demat accounts, which do not fall under Clauses 1.2.1, 1.2.3, 1.2.5, 1.2.6 and 1.2.7 (which means accounts which are not tagged) shall be deemed to be proprietary. Hence, the stock exchanges should have deemed such untagged accounts as proprietary accounts and should not have confused with pool/collateral/client account.

72. With regard to demat account No.11458979, DP ID IN300394, as observed in paragraph 5.b.iii.5 of the Show Cause Notice, the same was a demat account owned by Karvy and correctly deemed to be the Trading Member’s Proprietary Account by NSDL for the purpose of generating alerts as required under SEBI’s Circular dated December 17, 2018 (which came into effect on February 1, 2019) (“December Circular”). Therefore, even if KSBL had not voluntarily tagged the

nomenclature/ sub-type of the demat account No.11458979 having account holder name as "Karvy Stock Broking Limited (BSE)", the same was considered as a Proprietary Account of KSBL by NSDL because it was untagged.

73. The same is made clear by various correspondence with the stock exchanges; the tabulated format attached to the emails, clearly shows the sub-type of the account as 'client' and in any other case was to be deemed as a proprietary as per the December Circular. Furthermore, the body of the emails sent to the stock exchanges also contained a breakup of the accounts that are tagged or untagged by the stock broker, to ensure clear communication of the same. Whenever NSE had queries or required clarifications on the details of the demat accounts of stock brokers provided by NSDL, NSE has communicated the same with the respective NSDL Officials and NSE's queries were appropriately replied. Further, the formats of alerts to be generated under December Circular were agreed between NSDL and the exchanges. Accordingly, all alerts in respect of the off market transfers, other than settlement purposes, were provided by NSDL to the exchanges in the agreed format. It is also noteworthy that the details of Broker Demat Accounts with their types/ sub-types were already provided by NSDL to the Exchanges, as and when requested, under the September Circular. Hence, the allegation that 'it becomes difficult to differentiate the pool/collateral/client account from proprietary account, while processing these alerts' is not sustainable. If at all, the Stock Exchanges were finding it difficult to differentiate the demat accounts for processing the alerts, then the Stock Exchanges could have proactive sought necessary clarification from NSDL.

74. In furtherance of the same and in order in ensure complete and uniform compliance with the circulars issued in this regard, more particularly the circular dated June 22, 2017, NSDL had sent a Letter dated July 19, 2017 to SEBI (MIRSD-2) highlighting the implications of the relaxation granted to the stock brokers regarding the validations put in place for restricting transfers from demat accounts tagged as Stock Broker – Client to Stock Broker – Proprietary. NSDL requested SEBI to intervene in order to adopt a uniform approach to the implementation of

the said Circular to ensure stock brokers are not permitted to violate the requirements of the SEBI circular. A copy of the said Letter dated July 19, 2017 is placed on records. Such action of NSDL demonstrates its pro-activeness in bringing the implications to the notice of SEBI for taking cognizance of the same.

75. A perusal of the Circulars dated September 26, 2016, December 20, 2016 and June 22, 2017 show that the onus of ensuring that Broker Demat Accounts were appropriately tagged by Trading Members was on the Stock Exchange and not on the Depositories. Depositories were only required to provide facilities for appropriately changing the nomenclature/ tags of demat accounts; which was admittedly, done. The relevant extracts of the Circular dated September 26, 2016 is re-produced below:

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

2.3.6. Depositories shall ensure that once the nomenclature for a particular demat account has been assigned by the stock broker, then the same shall not be modified.

………

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

76. Pursuant to the aforesaid SEBI's Circulars, the following steps have been taken by NSDL in compliance with the role assigned to depositories under the said circular:

i. A facility has been enabled in NSDL system to appropriately tag various accounts of stock brokers opened for different purposes in accordance with the sub-type/ tag prescribed under the SEBI Circular.

ii. Once carried out, no further modifications are allowed in the nomenclature/ type or sub-type (tags) of a Broker Demat Account.

iii. NSDL provided stock broker-wise details of all the demat accounts held by a Stock Broker based on the PAN as and when provided by the concerned

Stock Exchanges as stipulated under point no. 2.3.8 of the SEBI circular to facilitate the exchanges to reconcile the details of demat accounts provided by stock brokers. Tabulated list of various dates on which said information is provided by NSDL to NSE is placed on records. For example, as may be seen from the information provided by NSDL to NSE vide email dated November 14, 2017, based on PANs of 1207 stock brokers provided by NSE, 5396 BO accounts were found to be held with NSDL Depository Participants by 1116 stock brokers. The remaining 92 stock brokers were not found to hold any demat account with any DP of NSDL. Of the 5396 BO accounts found, 3223 BO accounts were tagged by the concerned stockbrokers, while the remaining BO accounts were not tagged. Details of stock broker wise tagged and not tagged accounts were provided to NSE. Similarly, as may be seen from the information provided by NSDL to BSE vide email dated August 21, 2018, based on PANs of 1407 stock brokers provided by BSE, 10687 BO accounts were found to be held with NSDL Depository Participants by 1280 stock brokers. The remaining 127 stock brokers were not found to hold any demat account with any DP of NSDL of the 10687 BO accounts found, 3003 BO accounts were tagged by the concerned stockbrokers, while the remaining BO accounts were not tagged. Details of stock broker wise tagged and not tagged accounts were provided to BSE.

iv. All the monitoring criteria as specified in the September Circular were implemented.

v. Necessary amendments have also been made in Chapter 18 of Business Rules of NSDL with respect to penalty on the Participants and the same were notified to Depository Participants vide NSDL Policy Circular dated March 29, 2017.

vi. NSDL has issued the circular related to Enhanced Supervision of Stock Brokers/Depository Participants to its Depository Participants vide policy circular dated October 4, 2016.

vii. Additional reason codes for off-market transfers were introduced for transfer of securities from 'Stock Broker-Client' account to 'Stock

viii. Broker-Proprietary' account, permitted only for legitimate purpose such as implementation of any Government / Regulatory directions or orders, in case of reversal of erroneous transfers pertaining to Client's securities, for meeting legitimate dues of the stock broker.

ix. In addition to above, in order to facilitate Stock Exchanges to identify possible misuse of client securities by Trading Members and taking appropriate steps to protect client interest, monthly alerts (in the form of transaction data) are shared with exchanges with respect to month on month variation in the value of holding in stock broker - client accounts, where difference in the value of securities between two periods is more than 50% (only reduction in value from the previous month) and where the difference in the value is more than Rs. 1 crore.

77. Without prejudice to the above, it is once again repeated, reiterated and submitted that the onus on ensuring compliance with the tagging of the demat accounts of stock brokers lies not with the Depositories but with stock exchanges. NSDL act only as facilitators for the same and can provide the details of demat accounts of stock brokers to the Exchanges for reconciliation purposes and verifying compliance by the stock brokers.

78. Admittedly, NSDL had sent periodic alerts to the Exchanges in compliance with the December Circular; the stock exchanges including NSE did not point out any discrepancy or "confusion" in the alerts sent by NSDL and therefore, it cannot be said that NSDL failed to act in accordance with SEBI circulars or that the alerts provided was confusing or lacked clarity.

79. It is reiterated that a Depository is not empowered to restrict the transfer of a security by a stock broker; such restrictions are imposed and enforced by the stock exchange of which the Stock Broker is a Trading Member. In fact, as set out in paragraph 5.b.iii.4 and in clauses 2.4.3, 2.4.4, 2.5.1 and 2.5.4 of the Circular dated September 16, 2016, the transfer of securities from client's accounts to the proprietary accounts of stock brokers is to be monitored by the stock exchanges

and the Depository only acts as a facilitator to the same. Further clauses 2.3.7 specifically empower only the Stock Exchanges to penalize Stock Brokers for non-compliance as per the provisions of the Bye-Laws, Rules and Regulations of the Stock Exchanges.

80. Without prejudice to the above submissions, it is pertinent to note that no debits were made in the beneficiary accounts of the clients. Based on analysis of the transactions undertaken in KSBL's demat account no. 11458979, it was noted that the securities, which were being pledged by KSBL from the demat account no. 11458979, were credited from KSBL's demat account no. 12691085 (categorized as Stock Broker – Client Account). Further, it was observed that the majority of securities credited in KSBL's demat account no. 12691085 were received from market transfers (Pay-out) from Clearing Corporation. Therefore, even assuming without admitting that NSDL had the power to monitor unauthorized transfers, it would not have been possible for NSDL to identify an irregular transaction since there was no unauthorized debits from the client's demat account, rather a redirection of securities to proprietary account of KSBL took place.

81. In any event, admittedly, NSDL included this account while providing alerts regarding transfer of large value of shares through off-market transfers other than for settlement purposes and even if the account type/sub type were not included in the alerts, the stock exchanges were provided with requested information to undertake necessary analysis and investigation for verifying the compliance with the stock brokers.

82. Without prejudice to the above, it is repeated and reiterated that it was the responsibility of stock exchanges and not of the Depositories to ensure that stock brokers/trading members made appropriate tagging of the demat accounts as per the prescribed nomenclature/sub-types.

83. In view of the above, Noticee denies that there was any lack of due diligence on its part or that there was a lack of proactive and responsible attitude on its part

towards safeguarding interests of investors and the integrity of the Depository System and the Securities Market. Further, it is denied that NSDL failed to comply with Clause 2.2.1 r/w Clauses 1.1, 1.2 and 2.5.4 of the Annexure to SEBI's Circular dated September 26, 2016 and clause 2 (a) of SEBI's circular dated June 22, 2017. It is also denied that NSDL failed to comply with Regulation 17 r/w Regulation 98 of the Depositories Regulations 2018 and/or Regulations 14A of the Depositories Regulations, 1996 r/w Clauses 1, 2 and 5 of the Code of Conduct for Depositories.

84. On Early Warning Mechanism to prevent diversion of client securities (SEBI Circular dated December 17, 2018) Noticee placed on the record the following contentions:

85. At the outset, it is submitted that as per December Circular, Market Infrastructure Institutions such as the stock exchanges, clearing corporations and depositories ("collectively referred to as "MIIs") were directed to implement early warning mechanisms set out in the circular with effect from February 1, 2019. Accordingly, pursuant to meeting held on January 24, 2019, the Standard Operating Procedure ("SOP") was framed amongst the MIIs, which was duly approved by SEBI on January 24, 2019. The SOP clearly defined the trigger (parameter) of each early warning alert as set out in the December Circular. A copy of the SOP and minutes of meeting held on January 24, 2019 is placed on records.

86. It is submitted that in terms of Clause 3.2 of the December Circular pertaining to Early Warning Mechanism, NSDL has provided the following alerts/ details with respect to accounts of various stock brokers (including Karvy) under the below mentioned criteria to NSE, BSE and MCX on monthly basis from February 2019 onwards:

a) Movement of shares to / from a large number of Clients' demat accounts or large value shares to stock broker proprietary accounts and vice- versa.
b) Alerts in respect of stock brokers maintaining multiple proprietary demat accounts and opening any new demat account in their name for client purposes.

c) Details of demat account where transfer of large value of shares through off-market transfers (other than for settlement purposes) were undertaken.

87. A perusal of Clause 8 of the said Circular states that ‘based on the analysis of the early warning data, if it is established that the stock broker’s financial health has deteriorated and/or he has made unauthorized transfer of funds/ securities of the client, in such cases, stock exchanges/ Depositories shall jointly take preventive action on the stock broker’. The said provisions stipulates that first the early warning data should be analyzed. While NSDL has provided various alerts on various stock brokers (including Karvy) to NSE since February 2019, the said alerts were required to be analyzed against the backdrop of the transactions undertaken by the stock brokers.

88. Only thereafter, and based on analysis of data generated from the alerts, can it be established that the stock broker had made unauthorized transfer of securities of the client. Therefore, till the time NSDL started receiving investor complaints related to unauthorized transfer of securities i.e. from July 2019 (this trend repeated during August and September 2019), NSDL was not in a position to establish that there were unauthorized transfer of securities for taking the preventive actions as set out in Clause 8.2 of the said Circular.

89. As per the SOP, with respect to alert set out in Clause 3.3 of the said Circular (increase in investor complaints alleging unauthorized delivery instructions), the depositories were required to generate alerts in case of more than 5 investor complaints of unauthorized transactions against the stock broker during a month is received and share the details with other MIIs. Further, with respect to alerts set out in Clause 3.2 (stock broker maintaining multiple demat accounts, movement of share to/ from a large number of client’s demat accounts, transfer of large value of shares through off-market transfers), NSDL had provided the necessary data on these alerts to the exchanges so that they could seek explanation from the brokers and undertake further enquiry/ investigation. Therefore, as per the obligations set out in the SOP, NSDL had discharged the same by providing the alerts and taking

other actions against KSBL (as a DP) after receiving complaints from investors beyond the threshold agreed in the SOP.

90. The SEBI Circular dated July 1, 2020 (“SOP Circular”) wherein the Standard Operating Procedure of actions to be taken by Stock Exchanges, Clearing Corporations and Depositories in the cases of default by Trading Member (TM)/ Clearing Member (CM) in para 4 clearly states that on analysis of early warning signals or any of the prescribed triggers, if the Stock Exchanges / Clearing Member is of the view that the TM / CM is likely to default in the repayment of funds / securities to its clients and / or fail to meet the settlement obligations to CM / CC, then the specified actions shall be taken by Stock Exchanges/ Clearing Corporations and Depositories as per the prescribed timeline. As per the SOP Circular, it is the Stock Exchanges, who are required to analyze and assess whether the TM is in default and then issue a notice/circular informing about disablement of the TM in all segments.

91. After receipt of information about disablement from the Stock Exchange, the depositories are required to take the actions allocated to it. Though the SOP Circular was issued subsequently, it does recognize the limited role of depositories in taking any action against a TM as specifically set out at sr. no. 4.16 to 4.20 of the SOP Circular. The relevant extracts of the SOP Circular are reproduced below:
“4. On analysis of early warning signals or any of the following triggers, if the SE / CC is of the view that the TM / CM is likely to default in the repayment of funds / securities to its clients and / or fail to meet the settlement obligations to CM / CC:
……….
the following actions shall be taken by Initiating Stock Exchange (ISE) / SEs / CCs and Depositories as per the timeline given below:
4.6 ISE shall inform the Depositories about the disablement immediately and advice Depositories to freeze the demat accounts of the TM (including TM Pool Accounts). (ISE shall give specific instructions along with PAN to the Depositories). Any debit in the demat account of TM shall be made under supervision of ISE.”

After receipt of information on disablement from SE, Depositories can take action specified at sr. no. 4.16 to 4.20.

92. Without prejudice to the above, NSDL also took the following preventive actions with regards to the alerts generated:

a) NSDL shared the details of investor complaints for unauthorized debits against KSBL from period starting from July 2019 with other MIIs in accordance with clause 7 of the December Circular;

b) NSDL staff was deputed at Karvy office for close monitoring of activities of KSBL as a Depository Participant w.e.f. September 2019;

c) An auditor was appointed by NSDL to verify the transactions of KSBL thereby imposing 100% special concurrent audit.

d) NSDL had stopped opening of new demat account by Karvy w.e.f. November 11, 2019.

e) As a proactive step, the Statement of Transactions was sent to the Clients of Karvy where debit transactions had taken place for period from August 1, 2018 to August 31, 2019.

f) NSDL participated in the consultation meeting and supported NSE in the appointment of a Forensic Auditor in October 2019.

93. It is alleged in the Show Cause Notice that although various alerts were generated regarding deterioration of a stock broker's financial health or unauthorized transfer of funds/securities of clients, NSDL failed to take action against Karvy. In this regard, as per the December Circular, the determination of the financial health of a stock broker and the nature of transfer of funds and securities of clients by a stock broker can be done only by the stock exchange. NSDL, as a depository, can provide transaction data as per the pre-decided parameters and information regarding increase in number of investor complaints for unauthorized transactions on the client's demat accounts to stock exchanges for their analysis and further inquiry/ investigation.

94. Admittedly, after receiving complaints of unauthorized debits on client's demat accounts from clients, from July 2019, NSDL proactively shared information with other MIIs including stock exchanges, deputed its staff to monitor operations at Karvy in September 2019 and also appointed an auditor to verify transactions. Further, proactively, transaction statements were sent to clients in respect of transactions that took place from August 1, 2018 to August 31, 2019. SEBI in their examination report have mentioned that NSE did not examine the demat account no. 11458979, reported by NSDL on November 14, 2017 for any possible misuse of client's securities, which it is submitted only could have done by NSE after considering their own records. Therefore, the allegation that NSDL did not take any action other than sharing information with the stock exchanges is not maintainable. Further, at the relevant point in time, there was no evidence of misuse of any client securities with NSDL.

95. It is submitted that even prior to receiving complaints, periodic inspections of depository operations of Karvy were conducted, including a joint inspection with SEBI. During such inspections, including the joint inspection with SEBI, NSDL did not observe instances of unauthorized debits of clients' assets. Therefore, the allegation that NSDL did not foresee the deterioration of the stock broker's financial health or unauthorized transfer of funds/securities of clients is not maintainable.

96. It is reiterated that Karvy did not misuse the Depository System as erroneously alleged or otherwise. The transfer of securities and pledges on securities done by Karvy from its demat account no. 11458979 were in accordance with the process prescribed under the Byelaws and Business Rules of NSDL; in fact, in relation to the investor complaints for unauthorized debits, it was found that shares were transferred from client's demat account to Karvy's accounts by Karvy (as a stock broker) using the Power of Attorney executed in their favour by clients. Hence, NSDL, at the relevant point of time, did not have any material evidence to demonstrate the misuse of client securities and take steps to stop the transfer of securities. Further, as explained in paragraph 8(B)(p) above, the majority of securities credited in KSBL's demat account no. 12691085 were received from

market transfers (Pay-out) from Clearing Corporation and therefore, it would not have been possible for NSDL to identify an irregular transaction since there was no unauthorized debits from the client’s demat account, rather a redirection of securities to proprietary account of KSBL took place.

97. In furtherance to the above, it is also submitted that the alerts which were generated with respect to KSBL were not sufficient for NSDL to solely make any judgment or inference with regards to any of violations which eventually came to light. The alerts in question are in fact information on specified types of transactions which was periodically sent to the stock exchanges for analysis and not a determinant of violations by themselves. It is further submitted that there was no difference in alerts generated for other stock brokers and Karvy, therefore the violations of Karvy could not have been adjudged at that time without due investigation by the Stock Exchanges.

98. Therefore, it is submitted that even if, alerts were generated since February 2019, NSDL could not have taken action on the same, until the same was analyzed in the back drop of information available with the exchanges and after they have ascertained the occurrence of any misuse of funds or securities action could be taken.

99. Further, the paragraph 8 of the December Circular had mandated that the stock exchanges and depository shall jointly take preventive actions on the stock broker. Depository, as a market infrastructure institution can only take actions against a depository participant for violation of its byelaws and not against a stock broker. Within the four corners of the regulatory structure of a depository, whatever steps that could have taken by a depository, NSDL has taken those steps as mentioned above. NSDL was first MII to share alerts on unauthorized debit complaints with other MIIs.

100. In view of the above, it is denied that NSDL did not take any proactive measures to stop misuse of the Depository System by Karvy and safeguard the interests of

investors in the securities market. It is further denied that NSDL did not act on the early warning alerts/signals. It is also denied that NSDL has not complied with the requirements of Regulation 17 of the Depositories Regulations 2018 and clauses 2 & 5 of the Code of Conduct for Depositories.

101. On inspection observations and complaints in respect of misuse of clients' assets by KSBL, Noticee place on the record the following submissions:

102. With regards to the actions set out in Clauses 8.1, 8.2 and 8.3 of the December Circular, it is repeated and reiterated that the same is "based on the analysis of the early warning data, if it is established that the stock broker's financial health as deteriorated and/ or he has made unauthorized transfer of funds / securities of the client, in such cases Stock Exchanges / Depositories shall jointly take preventive actions on the stock broker". In case of Karvy, NSDL started to receive complaints from clients related to unauthorized transfer of securities from June 2019 mentioned herein below:

Date	**No. of Complaints**
June, 2019	3
July, 2019	9
August, 2019	13
September, 2019	9
October, 2019	10

103. On receipt of the complaints, NSDL took the following action:

a) On initial receipt of 3 complaints in June, 2019, NSDL, after analysis of the same, forwarded these complaints to Depository Participant, KSBL ("DP-KSBL") seeking clarifications. DP-KSBL sought clarifications from KSBL (as a stock broker) and responded that the said unauthorized transfers were based on the instructions of the Power of Attorney Holder (i.e. KSBL in the capacity as stock broker) and provided copies of the agreement and POA. The said information was forwarded to the concerned client for confirmation. No reply was received thereafter from the client.

b) Thereafter, in July 2019, since the number of complaints was more than 5, the information about investor complaints was shared by NSDL with other MIIs. Amongst all MIIs, it was NSDL who first highlighted about the investor complaints. Further, it was due to vigilance of NSDL that once the number of complaints aroused to more than 5, NSDL informed exchanges to take cognizance of the same and examine the matter.

c) During this time, DP-KSBL continued to provide case specific replies for the complaints and informed that the securities were debited on the basis of Power of Attorney and that there was some error at the Stock-Broker KSBL's end. It was further informed that the securities were transferred back to the respective client's accounts by Stock Broker KSBL.

d) On receipt of the said information, NSDL sought copies of the delivery instructions slips ("DIS") from DP-KSBL. Thereafter, DPKSBL provided instruction files received from the Power of Attorney Holders and instruction reports downloaded from DPM software to verify the same, which was verified by NSDL.

e) Thereafter NSDL sent warning letter of disciplinary action to DP- KSBL in September 2019, to which DP-KSBL replied stating that no action of unauthorized transfers was taking place. It was also observed that these investor complaints received from June 2019 till October 2019 were resolved by DP-KSBL and thereafter, no further escalations were received by NSDL regarding the same investor complaints.

104. Over and above the aforesaid actions, the following activities were undertaken by NSDL:

   a) Deputed its staff at Karvy's office for monitoring of activities as a Depository Participant w.e.f. September 2019
   b) Thereafter, an auditor was appointed by NSDL to verify the transactions.
   c) NSDL also sent statements of transactions to the clients of KSBL where debit transactions have taken place for the period from August 1, 2018 to August 31, 2019 to enable clients to verify and raise complaints, if there is any discrepancy in the statement.

d) Supported NSE in appointing a Forensic auditor in October 2019 in consultation with other MIIs.

105. Admittedly, after receiving complaints from clients, NSDL not only brought the same to the notice of stock exchanges, but deputed its own employees to monitor the transactions done in Karvy's accounts and ensure the complaints were adequately dealt with.

106. Furthermore, it is pertinent to note that NSDL can monitor and inspect the depository operations of KSBL and not the Stock Broker operations of KSBL and therefore could not have taken any further action against them as monitoring of the use of client funds and securities by a stock broker/trading member is the responsibility of the stock exchange; NSDL cannot be liable for such failure.

107. In view of the above, it is denied that appropriate measures were not taken by NSDL against Karvy as a DP and it is further denied that there was a lack of proactive and responsible attitude on the part of NSDL to ensure protection of the interests of investors and the integrity of the Depository System and the Securities Market.

108. It is further denied that NSDL has failed to comply with the requirements of Regulation 17 of the Depositories Regulations 2018, Regulations 14A of the Depositories Regulations 1996 and clauses 2, 5 & 10 of the Code of Conduct for Depositories.

109. It is submitted that NSDL as a depository, had oversight over only the activities of KSBL as a Depository Participant and not as a Stock Broker. Furthermore, the information available at that time was not sufficient to establish the activities that took place in KSBL until the said information was analyzed by the Stock Exchanges. As demonstrated hereinabove, aside from the regulatory compliances, as enumerated in various rules, regulations and circulars that NSDL have admittedly complied with, NSDL have further undertaken take several proactive

steps to ensure protection of the investors; some of the proactive steps taken in recent past for reducing risk of misuse of client securities by stock brokers are:

a) NSDL voluntarily introduced the requirement of concurrent audit of the DPs by an independent auditor on half yearly basis and submission of audit report with NSDL
b) Submitted concept paper on Margin Collateral through Pledge to SEBI.
c) Submitted proposal on validations/checks in off-market transfers to SEBI.
d) Upon recommendations of NSDL, payment details were made mandatory for off-market transfers with reason code 'Off-Market Sale'.
e) A joint proposal on rationalization of off-market transfer reason code and eliminating reason code 'Others' was submitted to SEBI.
f) Since implementation of the Margin Pledge, NSDL is providing the list of all active/suspended 'Client Collateral Accounts' of Stock Brokers held with Depository Participants (DPs) of NSDL to all Stock Exchanges on fortnight basis.

Therefore, the underlining allegation in the SCN that NSDL have taken a casual approach is not maintainable.

110. In view of the above, NSDL submitted that there are no sufficient grounds to conduct an enquiry in terms of Rule 4(1) of the Depositories (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 and no penalty is liable to be imposed under Section 19G of the Depositories Act, 1996. Therefore, NSDL may be discharged from the Show Cause Notice and the present proceedings and an order may be passed accordingly.

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

CONSIDERATION OF ISSUES AND FINDINGS

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

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

(b) Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (**Circular 2016),** Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to Circular 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

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

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

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

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

Issue No. I **(a) Whether Noticee violated intent of the SEBI letter dated February 21, 2006 and the provisions of regulation 17 read with**

regulation 98 of D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

113. NSE vide email dated January 02, 2017 sought from Noticee, the details of pledge done by KSBL from all KSBL's DP accounts during January 2016 to December 2016 in order to undertake an internal analysis of KSBL. However, Noticee vide email dated January 10, 2017 denied the information sought by NSE, and informed that SEBI vide letter No. ISD/RR/DS/60960/06 dated February 21, 2006 (hereinafter referred as '**SEBI 2006 letter'**) had advised depositories to share with stock exchanges, data pertaining to off-market transfers of beneficial owner account holders only and not related to Trading Member.

114. Further, NSE vide its email dated September 22, 2017 informed Noticee about the half year Risk Based Supervision(RBS) assessment for the FY 2016-17 being conducted by it then for the top 25 members with highest scores. The aforesaid NSE email highlighted that in light of recent instances (then) involving misuse of client assets by members, the details of the securities pledged from the client accounts of the members was required by NSE in order to verify the availability of client securities with the members. KSBL was one of the aforesaid 25 members for whom NSE was carrying out RBS assessment and had sought the details of the securities pledged from its client accounts. In response, Noticee vide email dated October 05, 2017 again informed NSE that SEBI vide SEBI 2006 letter had advised depositories to share with stock exchanges data pertaining to off-market transfers of beneficial owner account holders only and not related to Trading Member.

115. It is alleged in the SCN that despite NSE highlighting the purpose while seeking the pledge data with respect to KSBL from Noticee, Noticee on two occasions refused to provide the details sought by NSE and cited the SEBI 2006 letter in its refusal. KSBL misutilised client securities worth Rs. 2300 Crores belonging to more

than 95,000 client, by unauthorizedly pledging them from just one demat account i.e. KSBL Demat account no. 11458979. The funds raised against the pledge were used by KSBL for itself and its group entities, as established in SEBI order dated November 29, 2019. As per forensic audit report of KSBL, total value of securities pledged by KSBL was Rs.2873 Crores against which funds of Rs.851.43 Crores were raised from 8 banks/ NBFCs. It is alleged in the SCN that if the information regarding pledge was provided by Noticee to NSE, the misuse of client securities by KSBL would have come to light much earlier.

116. SCN further states that para 2 of the SEBI 2006 letter did not limit the scope of NSDL on what to share, and if there was any doubt or confusion in this regard, Noticee could have proactively approached SEBI for clarification of doubts or guidance, however Noticee did not approach SEBI in regard to the NSE requests. Hence, Noticee allegedly did not comply with letter and intent of SEBI 2006 letter, and thereby violated provisions of regulation 17 read with regulation 98 of D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

117. The allegation against the Noticee thus rests on the authority provided in the SEBI letter of February 21, 2006 to share information with the exchanges directly rather than through SEBI. The letter refers to the practice at that time of depositories providing to SEBI data regarding ‘off market transactions above 100,000 shares and information on beneficial owners whose holding crosses 5% or beneficial owners who hold more than 5% and transferred 2% or more’ on monthly basis, which was forwarded to BSE and NSE by SEBI. The letter goes on state that as per stock exchanges’ suggestion, the aforesaid data was required only in the course of investigation, and they would prefer seeking relevant information from the depositories on a case to case basis for their investigation and analysis. Therefore, through the said 2006 letter, SEBI directed depositories, including Noticee, to provide the requisite information to BSE and NSE as and when required by them without routing through SEBI.

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

119. From the reading of SEBI 2006 letter, in the context, it is evident that the Noticee was already sharing market wide data regarding off market transactions to exchanges through SEBI, and SEBI directed Noticee to directly provide this data to exchanges i.e. data for off market transaction data with the information for specific beneficial owners when they receive such requests from exchanges for their investigation and analysis. The reading of the SEBI 2006 letter, does not indicate that its 2nd para gave omnibus approval to exchange for seeking and obtaining any information for any purpose from the depositories. The letter is a mere acceptance of the suggestion of exchanges that rather than sharing 'market wide off market transaction data basis certain parameters' through SEBI, 'specific off market transaction data' for certain entities as required by exchanges may be provided, when sought.

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

   a) In place of market wide off market transaction data (basis certain parameters), specific data for off market transactions of entities required by exchanges on case to case basis may be provided
   b) Exchanges to raise requests directly with depositories, and depositories to share information directly with exchanges.

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

122. Noticee has submitted that as per Section 18 of Depositories Act, only on written request from SEBI, depository could provide such information to any other person to the extent the same is authorized, and there was no direction from SEBI to provide pledge information to exchanges. Chapter IV of the Depositories Act on 'Enquiry and Inspection' gives power to SEBI to "call for information and enquiry". The relevant part of Section 18 under Chapter IV is reproduced below:

> ***18. Power of Board to call for information and enquiry***
>
> *(1) The Board, on being satisfied that it is necessary in the public interest or in the interest of investors so to do, may, by order in writing,—*
>
> *(a) call upon any issuer, depository, participant or beneficial owner to furnish in writing such information relating to the securities held in a depository as it may require;*
>
> *(b) authorise any person to make an enquiry or inspection in relation to the affairs of the issuer, beneficial owner, depository or participant, who shall submit a report of such enquiry or inspection to it within such period as may be specified in the order.*

123. It is clear from the NSE email dated January 02, 2017 referring to carrying out internal analysis of KSBL that the information was required for the purpose of

making an enquiry into the pledging of shares by KSBL during January 2016 to December 2016.

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

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

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

127. The stand taken by depositories (including Noticee) that the directions given by SEBI in past (SEBI 2006 letter) for sharing the information directly with exchanges was not in regard to sharing pledge transactions of members, was clearly communicated to NSE. Noticee has contended that it did not have any doubt regarding the interpretation of the SEBI 2006 letter. It was open to NSE to contest the stand of the Noticee before SEBI or to escalate the matter to SEBI. I note that there is nothing on record to indicate, that post refusal of sharing of information by Noticee on both occasions, there was any follow-up on these requests by NSE with depositories or that the matter was taken up NSE with or through SEBI. I also note that it was in December 17, 2018 when SEBI specifically directed Noticee to provide pledge transaction data pertaining to members, that the Noticee complied with the direction and provided the relevant information to the exchanges.

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

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

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

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

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

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

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

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

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

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

132. In this regard, I note that without doubt, if SEBI had been alerted earlier about exchanges requiring Depositories data, the default may have come to light earlier. The issue to be decided is whether it was the responsibility of the Noticee to inform SEBI that the request made by NSE was declined by it. It has been established in the preceding paras that the SEBI 2006 letter did not authorize Noticee to provide information beyond that specified in the letter i.e. information on off-market transactions. It was thus incumbent on the party seeking information, i.e. NSE to raise the issue before SEBI. It is not the case that merely because the Noticee was the repository of data on pledge of shares, it was required to be aware of potential wrong doing involving pledge of shares. I take note of the contention by

the Noticee that as per Depository Act and regulations, the depositories have not been conferred or attributed with the regulatory role in respect of pledge transactions of securities by clients, but are supposed to check only if it is carried in the manner specified in the Bye Laws, Business Rules and Circulars issued from time to time.

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

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

(b) Whether Noticee violated provisions Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (Circular 2016), Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to Circular 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.

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

Further, the clause 2.3 of the annexure to the 2016 circular mandates that the Stock exchanges and/or Depositories as the case maybe, shall *inter alia* ensure that as per clause 2.3.1 all existing demat accounts maintained by stock brokers are assigned proper nomenclature, within three months from the date of the circular (the timelines were revised through subsequent circulars to be effective from April 01, 2017 and again through clarification on June 22, 2017).

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

137. Towards compliance of 2016 circular by Noticee, NSDL facilitated change in subtype/account category to reflect the specified nomenclature rather than change in the name of the BO account itself. This was alleged in the SCN to be not in accordance with the 2016 circular.

138. Noticee in its reply has contended that a facility to appropriately tag demat accounts opened by stock brokers using separate sub-types was put in place. Stock Brokers were required to submit a modification request to tag account as “Stock Broker-Client”, “Stock Broker-Proprietary” and Stock Broker-Collateral”. Para 1.2 read with format for reporting of demat accounts by Stock Brokers given in para 2.2 of the 2016 circular showcase that it was subtypes/tags that were required to be created by Depositories. There was no requirement to change name of account holder to add words, ‘Client account’, ‘Proprietary account’, ‘Collateral account’ or ‘Pool account’ after the name of the account holder. Stock Brokers accordingly had to approach the respective depository and tag accounts, wherein accounts with own securities were tagged ‘Proprietary’ and accounts with client securities were tagged ‘client/pool/collateral’. Such tagging of sub-type categorization helped identification of the nature and character of the accounts for stock exchanges or for SEBI.

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

140. Further, clause 2.3 of the 2016 circular mandates that the Stock Exchanges and/or Depositories, as the case may be shall ensure that the nomenclature guidelines are adhered by the stock brokers within the timelines specified. Clause 2.3.1 states that "*All existing demat accounts maintained by stock brokers are assigned the appropriate nomenclature as mentioned above, within three months from the date of this circular*". The 3 month deadline was subsequently extended as mentioned in preceding paras. Clause 2.3.4 stated that "*All new bank and demat accounts opened by the stock brokers shall be named as per the above given nomenclature and the details shall be communicated to the Stock Exchanges within one week of the opening of the account.*" The circular thus refers to 'assigning of nomenclature' for old accounts and 'named as per give nomenclature' for new accounts. This seems to indicate possible difference in method of assigning nomenclature to existing accounts vis-a-vis naming of new accounts.

141. In this regard, I note that Noticee put in place a facility to appropriately tag demat accounts opened by stock brokers using separate sub-types. Further the clause 8 of NSDL Circular No. NSDL/POLICY/2016/0101 dated December 16, 2016 provides as follows:

"8. Participant should note that the appropriate nomenclature as mentioned in the aforesaid SEBI Circular dated September 26, 2016 are facilitated by separate type and sub-type of account to implement the guidelines mentioned in SEBI Circular. <u>Therefore, there is no need to do any change in the name of account holder.</u>"(emphasis supplied)

142. From the above, it is evident that Noticee clearly stated in its circular that it was implementing the SEBI guidelines on nomenclature by assigning types and sub-type to accounts to reflect the purpose of the demat accounts, and not changing the name of the account itself. Accordingly, basis such tagging of accounts by type sub type, Noticee put validations in place in the depository system to restrict transfers from demat account tagged as Stock Broker-Client to Stock Broker-Proprietary for the permitted reasons only in compliance of 2016 Circular. Thus, clause 8 of NSDL Circular No. NSDL/POLICY/2016/0101 dated December 16, 2016, clearly illustrated the method of implementation of the SEBI 2016 circular adopted by the Noticee. Further, this circular was issued to all its DPs and was available in the public domain and in knowledge of SEBI. I note that there is nothing on records to indicate that SEBI contradicted the interpretation or implementation of SEBI 2016 circular by Noticee or made any observations on the method adopted to assign the required nomenclature by the Noticee. Further, I note that the tagging of accounts by Noticee in type and sub type categories served the purpose of the identification of the account as per specified nomenclature and the placing of validations in the depository system for legitimate transfers, in order to achieve the intent of the 2016 circular. In view of the above, I find that Noticee did not dilute the compliance of SEBI 2016 circular.

143. The SCN alleged that KSBL's DP Account No. 11458979 with name "Karvy Stock Broking Limited (BSE)", was not in accordance with the nomenclature prescribed

in 2016 circular. This account was not tagged, and hence was 'deemed to be proprietary'. However, the name did not reflect so. The demat a/c no. 11458979 had its category as 'beneficiary client' and sub-type as 'Body corporate-domestic'. Hence, KSBL demat account was not in compliance of appropriate nomenclature and tagging guidelines, whereas appropriate nomenclature and tagging would have made it possible for exchanges to detect the modus operandi of KSBL of transferring securities from client accounts to deemed proprietary account and then pledging it. Further, post implementation of SEBI Circular dated December 17, 2018 (**2018 Circular**) the alerts shared by the Noticee in respect of transfer of large value of shares through off market transfers other than settlement lacked details in respect of sub type of the demat accounts involved.

144. In this regard Noticee has contended that since KSBL demat account no. 11458979 was an untagged account, as per June 2017 circular it was deemed to be a proprietary account. Further as per June 2017 circular there was no requirement of changing the nomenclature or creating a tag 'deemed to be proprietary' (this would have led to creation of a new subtype). Further, the details of broker demat accounts with their types and sub-types were already provided to the exchanges, under the 2016 circular. All untagged accounts were to be considered deemed to be proprietary as per June 2017 circular, hence there was sufficient details to differentiate the deemed proprietary account from other tagged/untagged accounts. The detailed breakup of demat accounts of stock brokers were also provided to the exchanges by the Noticee. The formats of alerts generated under December Circular were agreed between Noticee and the exchanges. If stock exchanges found it difficult to differentiate the demat accounts, they could have sought clarification, whereas none was sought.

145. In this regard, I note that based on aforesaid information provided by Noticee to exchanges, account no.11458979, was deemed to be proprietary account. In case the exchanges found the activity in the account to be other than of proprietary nature, or in case there was any other reason to believe that the account contained client share, or where the category or sub type of such untagged accounts

indicated any difference in purpose then being proprietary, it should have been taken up by the exchange with the depository. I also note that Exchanges and depositaries had agreed on the format for alerts and if the alerts were not serving purpose for detection of misuse of client securities, exchanges, being assigned with duty to analyze and identify misuse of securities by its stock brokers, should have proactively taken it up with the Noticee. There is no evidence on record to indicate that any such issue was raised by the exchanges with the Noticee. In view of the same, I accept the contention of the Noticee.

146. As per Noticee's byelaws securities in the KSBL demat account 8979 being categorized as 'beneficiary client' was supposed to have securities pertaining to KSBL, and the account was considered as deemed to be proprietary by Noticee (for generation of alerts). Since KSBL was regularly transferring client's securities to this deemed proprietary account and then pledging the same in depository system, it was alleged in the SCN that Noticee failed to be vigilant in regard to such securities transfer and failed to take action, thereby lacking in due diligence, reactiveness and responsible attitude towards safeguarding the interests of investors, integrity of the depository system and the securities market. These alerts included all KSBL untagged account including demat account no. 11458979. The aforesaid actions of Noticee allegedly diluted implementation of 2016 circular and December 2018 circular.

147. In response, Noticee has contended that no unauthorized debits were made in the beneficiary accounts of the clients, securities were received from Clearing Corporation as market transfers (Pay-out) in KSBL's demat account no. 12691085 (categorized as Stock Broker-Client account) which comprised majority of securities in the said account. Further, securities were transferred from account no. 12691085 to account no. 11458979 from where they were being pledged. These would not have been identified as unauthorized debits from the client's demat account rather a redirection of securities to proprietary account of KSBL.

148. In this regard I find that the transfers between the two aforementioned accounts were between KSBL account tagged as 'Stock Broker- Client Account to a KSBL proprietary account. I note that NSDL shared the information of transfer of securities between these two KSBL accounts with the exchanges. Since the stock exchange is the frontline regulator for supervision of brokers and monitoring of misuse of client securities by stock brokers, it was the responsibility of the stock exchanges to note and question the off-market transfer of securities from a KSBL clients account to a KSBL proprietary account.

149. In order prevent misuse of client securities by pledging, the 2016 circular prohibits pledging of client securities beyond the debit balance of the client as per client ledger. Further, Clause 2.5.4 of the 2016 Circular states that *The securities to be pledged shall be pledged from BO account tagged as "Name of the Stock Broker -Client Account".* This clause applies to pledging of client securities and requires that client securities shall be held in and pledged only from a demat account clearly tagged as a client account. KSBL pledged client securities from a proprietary account. However, the clause does not state that securities held in a proprietary account cannot be pledged. Hence, while KSBL was clearly in default by holding client securities in its proprietary account and pledging them, the framework of monitoring and supervision under the 2016 circular did not place the onus of identifying that the securities in the KSBL proprietary account no. 11458979 belonged to clients on the depositories. That responsibility lay with the exchanges and depositories were required to share necessary information of off-market transfers with exchanges, which the Noticee did. Hence, I accept the contention of the Noticee that I note that the identification of misuse of client securities by the stock brokers is to be carried out by stock exchanges by monitoring activities of its member stock brokers, and that it is depository participants which are under the regulatory purview of Noticee.

150. I take note of the Noticee's submissions that to comply with 2016 circular it did what all was required, like putting in place the system enabling tagging, prevented change in nomenclature/tagging once made by broker, provided details of

untagged/tagged demat account details of stock brokers to stock exchanges, and made necessary amendments in the NSDL rules, issued NSDL policy circular, introduced additional reason codes for legitimate off-market transfers, and monthly alerts aimed at identifying misuse of client securities by stock brokers.

151. In view of the above, I find that violation of provisions Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (Circular 2016), Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to Circular 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories by Noticee is not established.

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

152. It is alleged in the SCN that despite various alerts which signaled diversion of securities generated pursuant to Early Warning Mechanism (EWM), at NSDL end post implementation of SEBI circular dated Dec 17, 2018 (December Circular) since February 2019, Noticee did not take proactive steps to prevent misuse of depository system by KSBL, in violation of Regulation 17 of the D&P Regulations, 2018 read-with Clauses 2 and 5 of the Code of Conduct for Depositories

153. In response, Noticee has submitted that Market Infrastructure Institutions such as the stock exchanges, clearing corporations and depositories ("collectively referred to as "MIIs") were directed to implement early warning mechanisms set out in the circular with effect from February 1, 2019. Accordingly, pursuant to meeting held on January 24, 2019, the Standard Operating Procedure ("SOP") was framed amongst the MIIs, which was duly approved by SEBI on January 24, 2019. The

SOP clearly defined the trigger (parameter) of each early warning alert as set out in the December Circular.

154. The December Circular required the Noticee to share alerts with stock exchange as specified in clause 3.2 of the Circular. Noticee provided alerts to exchanges on monthly basis from February 2019 onwards, and it is not the case that Noticee failed to provide such alerts. Stock exchanges were required to analyze alerts to determine if these indicated unauthorized transfers and share the same with other stock exchanges and depositories and take joint preventive action as para 8 of the December circular. Further, as per SOP, stock exchanges were mandated to analyze and assess whether the trading members are in default and if yes, issue disablement notice. It is only thereafter that depositories could initiate action as per para 4.16 to 4.20 of SOP. I note that it is not the case that exchanges shared their analysis and suggested joint preventive action which the Noticee failed to take or that the Noticee failed to follow comply with the SOP.

155. With regard to Clauses 8 stating that “based on the analysis of the early warning data, if it is established that the stock broker’s financial health as deteriorated and/ or he has made unauthorized transfer of funds / securities of the client, in such cases Stock Exchanges / Depositories shall jointly take preventive actions on the stock broker”, Noticee submitted that in case of KSBL, it started to receive complaints from clients related to unauthorized transfer of securities from June 2019 mentioned herein below:

Date	**No. of Complaints**
June, 2019	3
July, 2019	9
August, 2019	13
September, 2019	9
October, 2019	10

156. I take note of submissions by the Noticee that it undertook necessary steps post receipt of investor complaints against KSBL like sharing details of investor complaints for unauthorized debits against KSBL, deputed NSDL staff to KSBL

DP, appointed auditor for 100% special concurrent audit, sent statement of transactions to clients of KSBL etc. Further, Noticee submitted that when these complaints were taken up with KSBL DP, they were found to be backed up the POA and there was no material evidence to demonstrate misuse of client securities. Further, the Noticee has contended that Noticee as depository could take action against KSBL DP only, not KSBL Stock Broker and it took all the steps within its regulatory ambit.

157. I note that as per SOP prepared pursuant to the December Circular, the alerts generated and shared by the Noticee, required no action in terms of investigation/surveillance/analysis at depository's end. It was exchanges who were supposed to take cognizance of such alerts and take action as per the SOP. Therefore, I find that while Noticee shared the alerts it was required to share under the SOP, it cannot be said to have failed to take proactive steps, as further steps were required to be taken by exchanges.

158. With regard to KSBL-DP, I note that Noticee took steps post receipt of investor complaints like sharing details of investor complaints for unauthorized debits against KSBL, deputed NSDL staff to KSBL DP, appointed auditor for 100% special concurrent audit, sent statement of transactions to clients of KSBL etc.

159. In view of the above, I find that based on material on record, it is not established that Noticee is in violation of <u>provisions Clause 2.3.1 read with Clauses 1.1 and 1.2 of Annexure to SEBI Circular dated September 26, 2016 (Circular 2016), Clause 2 (a) of SEBI Circular dated June 22, 2017, Clause 2.5.4. of Annexure to Circular 2016 and regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 1, 2 and 5 of the Code of Conduct for Depositories, along-with regulation 14A of the D&P Regulations, 1996 read-with Clauses 1, 2 and 5 of Code of Conduct for Depositories.</u>

(d) Whether Noticee violated provisions of Regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 2, 5 and 10

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

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

161. In response, Noticee has submitted that upon receipt of the complaints, Noticee in addition to other steps taken, took up the complaints with KSBL-DP, verified the clarification and shared the clarification received with the complainants for confirmation. These clarifications were supported by documents or were resolved at the KSBL-Broker end, and required no further escalation. Further, once number of complaints crossed 5, it shared the information with other MIIs. Noticee also issued warning letter to KSBL–DP. Noticee has contended that it could only monitor and inspect Depository participant’s operations and not of the Stock Broker, which is the responsibility of the Stock Exchange. Further, at given time no further action could be done or anticipated in respect of the KSBL DP.

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

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

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

10. A depository shall monitor the compliance of the rules and regulations by the participants and shall further ensure that their conduct is in a manner that will safeguard the interest of investors and the securities market.

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

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

165. With regard to handling of complaints, I note that Noticee received the first set of complaints in June 2019. Noticee has documented how it handled the complaints. I note that by then, the misutilisation of securities by KSBL had come to light subsequent to a joint inspection of KSBL by SEBI and exchanges was carried out in June 2019. Therefore, given the period when investor complaints were received and actions taken by Noticee, it cannot be held that Noticee adopted casual approach in examining complaints of investors.

166. In view of the above, I find that the material on record does not establish that Noticee is in violation of Regulation 17 read with regulation 98 of the D&P Regulations, 2018 read-with Clauses 2, 5 and 10 of the Code of Conduct for

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

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

ORDER

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

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

DATE: November 25, 2022 **MANINDER CHEEMA**
PLACE: MUMBAI **ADJUDICATING OFFICER**