BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/PM/NK/2019-20/6988]

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

In respect of **M/s Motilal Oswal Financial Services Limited (Formerly known as Motilal Oswal Securities Limited)**

In the matter of Inspection of Books of Motilal Oswal Financial Services Limited (Formerly known as Motilal Oswal Securities Limited)

(**PAN: AAECM2876P**)

FACTS OF THE CASE

1. SEBI conducted an inspection of Motilal Oswal Financial Services Limited (Formerly known as Motilal Oswal Securities Limited) (hereinafter referred to as **'Stock Broker/MOFSL/**Noticee/MOSL') to examine whether MOFSL has complied with the requirements of SEBI circular dated November 18, 1993. The period of inspection was from April 1, 2012 to March 31, 2014 (hereinafter referred to as '**Inspection period**'). The inspection findings were communicated to MOFSL vide letter dated December 29, 2014 and supplementary inspection findings were communicated vide letter dated and July 18, 2017. MOFSL is registered with SEBI as Stock Broker of National Stock Exchange of India Limited (hereinafter referred to as NSE), BSE Limited (hereinafter referred to as BSE) and Metropolitan Stock Exchange of India (hereinafter referred to as MSEI).

2. Inspection alleged that the Noticee has misutilised funds of the clients. The Noticee utilised the credit balance lying in the clients' bank account towards meeting its own/other clients' obligations. In view of the aforesaid, it was alleged that Noticee failed to segregate the funds and securities of the clients. Hence, it has violated the provisions of SEBI circular no. SMD/SED/CIR/93/23321, dated November 18, 1993. SEBI, therefore, initiated Adjudication proceedings against the Noticee for violating the provisions of SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993 (hereinafter referred to as the 'SEBI circular dated November 18, 1993').

Appointment of Adjudicating Officer

3. The undersigned was appointed as the Adjudicating Officer under Section 23 I of the Securities Contracts (Regulation) Act 1956 (hereinafter referred to as 'SCRA, 1956') read with Rule 3 of the Securities Contracts (Regulations) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as the 'said Rules') to inquire into and adjudge under the provisions of Section 23D of Securities Contracts (Regulation) Act-1956 for the alleged violation of the provisions of law by the Noticee.

Show Cause Notice, Reply and Personal Hearing

4. The Noticee was issued a show cause notice (hereinafter referred to as 'SCN') EAD/AO-PM/NK/MOSL/11714/1/2019 dated May 9, 2019 under Rule 4(1) of the said Rules as to why an inquiry should not be held and penalty not be imposed under Section 23D and of Securities Contracts (Regulation) Act, 1956 for the alleged violation of the provisions of law.

5. In the SCN it was alleged that on 11 days out of 20 sample days (approximately 55% of the total selected sample days), the Noticee has misutilised the funds of credit balance clients lying with the Noticee and the value of misutilised credit balance clients' funds ranged from Rs. 5.01 crore (3% approx) to 102.06 crore (46% approx) for the sample dates. On the basis of abovementioned, inspection alleged that there were instances where MOFSL had indulged into intermingling/misuse of clients' funds. The details are as per the table below:

Date	Funds Available in client bank accounts and cash/cash equivalent deposits with clearing corporation/ clearing member - across all Stock Exchanges		Clients' Funds as per the client ledger- across all Stock Exchanges	Difference		
	Total of end of the day balance in all Client Bank Accounts	Collateral deposited with clearing corporation/ clearing member in form of Cash and Cash Equivalents (Bank Guarantee, Fixed Deposit etc.) FD+BG/2+Cash)	Aggregate Value of Credit balances of all clients as obtained from trial balance across stock exchanges (after adjusting for open bills for clients, un-cleared cheques deposited by clients and un-cleared cheques issued to Clients)	Calculate if G is negative G = (A+B) - C	Aggregate Value of debit balances of all clients as obtained from trial balance across stock exchanges (after adjusting for open bills for clients, un-cleared cheques deposited by clients , un-cleared cheques issued to Clients)	If G is Less than (<) D ; there is misuse of clients Funds by the Stock Broker (Either for Own Purpose of for Other clients Obligations) Negative G = ( )
	A	B	C	G= (A+B)-C	D	G, if G<D
28-Aug-13	264,249,479	905,584,920	1,627,264,845	(457,430,447)	1,177,510,157	(457,430,447)
06-Dec-13	1,160,975,605	969,062,720	1,969,850,164	160,188,161	1,548,746,393	160,188,161
24-Dec-13	1,394,070,481	989,062,720	2,334,268,348	48,864,853	1,010,632,026	48,864,853
29-Jan-14	521,853,350	919,947,384	1,512,067,051	(70,266,317)	1,367,169,422	(70,266,317)
31-Jan-14	914,648,011	926,537,798	1,477,941,131	363,244,678	1,480,670,167	363,244,678
26-Feb-14	1,707,229,816	999,702,030	1,694,214,624	1,012,717,221	1,065,969,982	1,012,717,221
27-Mar-14	164,215,925	1,042,297,953	2,227,141,126	(1,020,627,249)	1,691,561,124	(1,020,627,249)
03-Apr-12	81,899,120	1,534,461,412	1,521,831,974	94,528,557	1,331,437,337	94,528,557
30-May-12	1,147,369,794	1,337,208,554	1,411,154,519	1,073,423,829	950,457,450	1,073,423,829
18-Jun-12	661,788,050	1,169,098,267	1,501,861,225	329,025,092	1,085,609,087	329,025,092
09-Jul-12	2,258,998,278	468,173,852	1,782,587,658	944,584,472	951,909,055	944,584,472
21-Sep-12	2,253,076,083	433,997,852	2,266,505,534	420,568,401	1,139,089,167	420,568,401
03-Oct-12	1,105,875,876	465,356,984	2,076,457,389	(505224529)	1,790,039,508	(505224529)
04-Oct-12	1,200,223,936	625,405,079	2,196,579,377	(370950362)	1,578,351,725	(370950362)
05-Oct-12	1,106,574,806	625,429,127	2,235,904,081	(503900147)	1,139,634,719	(503900147)
10-Oct-12	722,809,570	403,669,118	2,014,200,157	(887721469)	1,307,431,832	(887721469)
30-Nov-12	1,333,892,658	495,497,851	1,879,539,529	(50149020)	1,361,323,057	(50149020)
21-Feb-13	92,130,776	1,095,547,852	1,699,154,470	(511475842)	1,250,460,786	(511475842)
22-Feb-13	49,071,672	1,053,047,852	1,600,205,612	(498086088)	1,394,976,843	(498086088)
28-Mar-13	216,567,714	695,347,852	1,299,731,939	(387816372)	1,503,789,090	(387816372)

6. The Noticee vide letter dated May 30, 2019 sought inspection of documents relied upon in issuing the SCN which was acceded to. It is observed from the material available on record that the inspection of documents were completed on July 5, 2019. The Noticee vide letter dated July 8, 2019 submitted that during the above inspection they were provided with documents which were part of the SCN. Further, it submitted that it should be provided with all documents/inspection report collected/prepared during the inspection by SEBI whether relied upon or not. The Noticee was explained vide Hearing Notice dated August 16, 2019 as *"It is understood that inspection of an intermediary is an interactive process wherein the inspection team visits the intermediaries, collects data, analyses and prepares report. The findings of the said report after approval of the competent authority is shared with the concerned intermediary for comments on the inspection findings. The inspection team then either accepts the explanation provided and recommends no action or rejects the explanation and recommends action depending on the gravity of the misconduct. Therefore, I find that at all time during the process, the intermediary is kept in loop. Further, I also find that all the material relied upon in issuing the SCN was provided along with the SCN. Therefore, I do not find merit in your submissions vide letter dated July 8, 2019".*

   It is pertinent here to note that Hon'ble SAT in the matter of Shruti Vora Vs SEBI [Appeal (L) No. 28 of 2020) decided;

   "18. In the light of the aforesaid, we are of the opinion that concept of fairness and principles of natural justice are in-built in Rule 4 of the Rules of 1995 and that the AO is required to supply the documents relied upon while serving the show cause notice. This is essential for the person to file an efficacious reply in his defence.

   19. A bare reading of the provisions of the Act and the Rules as referred to above do not provide supply of documents upon which no reliance has been placed by the AO, nor even the principles of natural justice require supply of such documents which has not been relied upon by the AO. We are of the opinion that we cannot compel the AO to deviate from the prescribed procedure and supply of such documents which is not *warranted in law. In our view, on a reading of the Act and the Rules we find that there is no duty cast upon the AO to disclose or provide all the documents in his possession especially when such documents are not being relied upon.*

25. In view of the aforesaid, the request of the appellant for supply of the documents in possession of the authority is misconceived and cannot be accepted. Prima facie, the only object in making such demand is to obstruct the proceedings. We accordingly do not find any merit in the appeal and is dismissed with no order as to costs."

7. The Noticee replied to the SCN vide letter dated October 3, 2019, relevant portion of which is reproduced as below:

- *At the outset, we deny the allegations and adverse observations against us in the Show Cause Notice and nothing contained in the Show Cause Notice shall be deemed to be admitted by us for the lack of traverse. Pursuant to an Order dated July 30, 2018 passed by Hon'ble National Company Law Tribunal, Mumbai Bench, Motilal Oswal Securities Limited (MOSL) has been amalgamated with Motilal Oswal Financial Services Limited ("**MOFSL**") with effect from August 21, 2018.*

- *It is respectfully submitted before the learned Adjudicating Officer that the allegations of SEBI are generic and vague in nature in respect of violation of the 1993 Circular. Although the Show Cause Notice which is based on the Inspection Report, reproduces the entire 1993 Circular, the specific provision of the 1993 Circular is not mentioned in the Show Cause Notice. Further, MOFSL is unable to understand the specific instance which according to SEBI showed that mis-utilization of the credit balance of a particular client. It is a settled position of law that the allegations must be specific and clear to enable the Noticee to deal with such specific allegation. The Noticee must be put to notice of such violations to enable the Noticee to deal with such specific allegation and provide his explanation. The allegations, in the present case, rather provides a broad spectrum and expects the Noticee to identify and understand on its own the exact nature of violation and the breach.*

- *The allegations and observations which are presented to the learned Officer, based on which the Show Cause Notice is issued, is therefore incomplete and is not in consonance with the* *principles laid down by the Hon'ble Supreme Court in the case of* **Gorkha Security Services v. Govt. of NCT Of Delhi &Ors**. *The Hon'ble Supreme Court has held that **"t**he fundamental purpose behind serving of a show cause notice is to make the Noticee understand the precise case set up against him which he has to meet. This would require statement of imputations dealing with the alleged breaches and defaults he has committed, so he gets an opportunity to rebut the same.**"***

- *In the present case, it is not clarified as to how and which part of the 1993 Circular is allegedly violated by MOFSL nor the exact instance where MOFSL has withdrawn funds from clients account for purposes other than those permitted is highlighted. This aspect must be taken note of by the learned Adjudicating Officer while deciding the issue between SEBI and the Noticee.*

- *The 1993 Circular requires a stock broker to withdraw money from clients' accounts only when money is required for payment to or on behalf of clients or towards payment of debt due to the broker from the clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the member, provided that the money so drawn shall not in any case exceed the total of the money so held for the time being for such each client. The 1993 Circular further mandates the broker to have separate and distinct accounts for fund and securities of the clients. It is respectfully submitted that MOSL has complied with all these requirements and this issue was also explained to the inspection team. MOSL has never withdrawn any funds from the client balances and have always kept separate client accounts for funds & securities from its own account. The two accounts were never mixed nor were there any transactions between the two accounts. We crave leave to refer to and rely upon the Certificate from a Chartered Accountant certifying this position.*

- *In any case, MOFSL humbly submits that it has not violated 1993 Circular and was in compliance with the same as far as the segregation of funds & securities are concerned which is supposed to be the case against the Noticee. The rest of the provisions under the 1993 Circular which deals with the lien of broker, securities of clients, payment within 2 days, margin collection, contract notes, square off for client's failure to make payment or deliver securities* *etc. are not even applicable in the present case and the Noticee hereby responds to the assumed allegations of SEBI.*

- *The 1993 Circular requires a stock broker to withdraw money from clients' accounts only when money is required for payment to or on behalf of clients or towards payment of debt due to the broker from the clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the member, provided that the money so drawn shall not in any case exceed the total of the money so held for the time being for such each client. The 1993 Circular further mandates the broker to have separate and distinct accounts for fund and securities of the clients. It is respectfully submitted that MOFSL has complied with the said requirements by keeping separate client accounts for funds & securities from its own account. MOSL has never withdrawn any funds from the client balances and have always kept separate client accounts for funds & securities from its own account. The two accounts were never mixed nor were there any transactions between the two accounts. Towards this end, MOFSL can even provide a certificate of confirmation in this regard from any SEBI appointed Chartered Accountant.*
- *MOFSL has never withdrawn any funds from the client account which belongs to the client and utilized the same at any point of time. MOFSL maintains separate ledgers and accounts for each client. Money received on account of each client is always reflected correctly in their ledgers. The Show Cause Notice does not highlight a single instance where it has withdrawn funds from clients account for purposes other than those permitted other than making a bald allegations. It is a matter of fact that till date not a single complaint is filed by any client*
- *As regards to the allegation of using one clients' money for another client, it submitted that the correct facts have not been considered by SEBI or the inspection team although MOFSL did provide the required clarification during the inspection and also vide its letter dated October 5, 2017. MOFSL clarified that on the 11 days, the total fund lying in all the client bank accounts and cash collaterals lying with the exchange was less than gross creditors. The credit balance as mentioned in the computation (Annexure 1 of Show Cause Notice) does not include the margin requirement of the client and hence the same is on higher side. If the margin requirement is considered, there would be a considerable decrease in the figures. The inspection team was*

requested to consider this and to deduct the margin position from the creditor balance where trading and exchange obligation are met by MOSL. This position has erroneously been interpreted by the inspection team (Ref: paragraph 5 of the Show Cause Notice). MOSL had, in fact, clarified that whenever the client expressed difficulties in meeting their obligations, MOSL had arranged to meet with the shortfall and ensured that the exchange obligation was met. Secondly, the margin requirement being a debt owed from the client, is a receivable at the hands of the broker & the exchange. This is an important factor while considering the exact computation.

- *MOSL has always given funds to all its clients within 24 hours of their demand majorly through bank transfers (NEFT/RTGS). Further, it is an admitted position that each and every client was aware of their respective position and the same can be verified from the records. Each and every client was permitted and allowed to trade and take positions based on the margin available with the exchange across each client. We are at a loss to understand how the inspection team could arrive at such an incorrect finding against MOSL*
- *Annexure 1 of the Show Cause Notice provides a table allegedly containing instances of 11 sample dates where a working of alleged difference between available funds and credit balance of clients is mentioned. This is apparently based on what is presented by the inspection team. This is also understood to be based on the working prescribed by SEBI circular no. SEBI/HO/MIRSD/MIRSD2/ CIR/P/2016/95 dated September 26, 2016 ("**2016 Circular**").*
- *The 2016 Circular relating to "Enhanced Supervision of Stock Brokers / Depository Participants" inter alia requires that, "The total available funds i.e. cash and cash equivalents with the stock broker and with the clearing corporation / clearing member (A+B) should always be equal to or greater than Clients' funds as per ledger balance." This Circular was issued on September 26, 2016 and was followed by SEBI Circular No SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/138 dated December 22, 2016, making it applicable and effective from July 01, 2017. However, the inspection is of a prior period and therefore said 2016 Circular is not applicable.*

- *Prior to implementation of the 2016 Circular there was no necessity or requirement of carrying out such a working. The period covered under the inspection conducted by SEBI was for the period between April 1, 2012 to March 31, 2014 and during this period the working annexed to the Show Cause Notice was never required to be carried out and maintained by the brokers. The Show Cause Notice should, therefore, find no fault with it even if the calculation of "G" column gives a 'negative' figure as the 2016 Circular was implemented prospectively and not retrospectively.*

- *In any case, the total credit balance as arrived by SEBI in its report excludes the margin applicable to the clients / available across the client. Column 'G' allegedly contains a shortage of balance, but the margin requirement of the clients against the same is ignored and is not taken into account. The margin requirement of clients having credit balance is in excess of the alleged shortage which singularly demolishes the allegations of SEBI.*

- *Without prejudice to foregoing it is also pertinent to mention here that before 2016 Circular, there was no prescribed method for computation of Bank Guarantee (BG). It was only in 2016 Circular it was provided that only 50% of BG will be considered for the calculation of G. Prior to 2016 Circular, we were considering 100% of BG value for the calculation of G. This practice of 100% consideration of BG value was followed by the market and was never denied by the Exchanges. In fact, Exchanges were only accepting BG as margins against which clients were provided exposure. Further, Exchanges in the past have carried similar analysis of various brokers and have been considering BG and never pointed out that BG's 50% value should be considered for calculation of G. Thus, if we consider BG on 100% basis then total shortfall comes to 5 days, aggregating to Rs. 166 Crores approximately.*

- *2016 Circular introduced a different method of working which was applicable from July 1, 2017. It is pertinent to note that MOSL has followed the working of enhanced supervision in letter and spirit from the date of its applicability and therefore there has never been a single instance when the calculation of "G" has been negative. MOSL has robust systems in place to ensure all the compliance requirements implemented by SEBI and Exchanges as on date. A certificate from a*

Chartered Accountant elucidating the calculation of "G" since July – 2017 can be provided by the noticee should the learned Adjudicating Officer so directs.

- *Without prejudice to the above submissions, assuming for a moment, but not accepting that the infractions and instances seen by SEBI does trigger any violation, the same is purely unintentional and technical in nature. While there is absolutely no case made out against MOFSL, the proceedings could be concluded with a warning to the Noticee and disposing of the proceedings without any direction.*
- *The Courts and SEBI has itself, in a number of cases opined that the purpose of carrying out inspection is not punitive but to point out the deficiencies, if any, to the intermediary at the time of inspection and making it compliant. Further, the references to the following cases:*

Parties	***Ratio***
UPSE Securities Limited vs. SEBI ***[2011 SCC OnLine SAT 86]***	*The object of carrying out inspection of the books of accounts and records of any intermediary including a stock exchange, or its subsidiaries is to ensure compliance with the provisions of the Act, Rules, Regulations, By-laws and circulars issued from time to time which are meant to regulate the securities market. Every little irregularity/deficiency noticed during the course of the inspection is not culpable and does not call for initiation of penalty proceedings. The purpose of inspection in quite a few cases could be better achieved if the inspecting team at the time of the inspection were to advise the erring entity.*
Religare Securities Limited vs. Securities and Exchange Board of India	*The purpose of carrying out inspection is not punitive, and the object is to make the intermediary comply with the procedural requirements in regard to the maintenance of records. Every minor discrepancy/ irregularity found during the course of inspection is not culpable and the object of the inspection could well be achieved*

Parties	***Ratio***
[SAT Appeal No. 23 of 2011]	*by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and making it compliant.*
M/s. Mansukh Securities and Finance Ltd. Vs. SEBI ***[2011 SCC OnLine SAT 91]***	*When seeking clarifications from a Noticee and pointing out the irregularities would be sufficient for ensuring compliance, then inspection need not necessarily lead to imposing any penalty.*
DSE Financial Services Ltd. vs. SEBI ***[2012 SCC OnLine SAT 159]***	*Every minor discrepancy/irregularity found during the course of inspection is not culpable and object of the inspection could well be achieved by pointing out the irregularities/deficiencies to the intermediary at the time of inspection and make it compliant.*

- *In our humble submissions, there has not been even a single incidence of client's complaint against it for denial of limits of fund & securities withdrawal. Had it resorted to use one client's money for other then at least on few days, clients with credit balance would have not been allowed to take position as the same would have been already consumed by other clients as wrongly alleged. The fact that there has never been any single instance where clients with credit balance have been restricted in using their balance.*
- *It is respectively submitted that upon the review of the findings in the inspection report, MOFSL placed the observations before the Board of Directors. It was decided that despite there being no violation, the advice of the regulator and the concerns expressed must be taken note of and therefore the compliance issues were yet again reviewed by the Board. In any event, the issue has become infructuous considering the developments in the regulatory scope and absence any violation in this regard.*
- *Based on our aforesaid submissions, we humbly pray that there is enough material to suggest that no further enquiry under Rule 4 (3) of the Adjudication Rules is required in the matter. It is, therefore, humbly requested that the Show Cause Notice be dropped without imposing any*

monetary penalty on us. In any event, we humbly request the learned Adjudicating Officer to consider the entire issues, the compliances and the approach of the Noticee as regards the SEBI compliances.

- *We request the learned Officer to consider the totality of the case and dispose of the proceedings. Should the Officer decide to hold a further inquiry, it is requested that a personal hearing be given to the Noticee to enable the Noticee to explain the issues again in detail and in perspective.*

8. Thereafter, an opportunity of personal hearing was granted to the Noticee on February 3, 2020 vide hearing notice dated January 8, 2020. The Compliance Officer of the Noticee confirmed their attendance for the said personal hearing. The personal hearing was attended by the Noticee's Authorised Representatives (hereinafter referred to as ARs) including its Compliance Officer and Vice President, Legal. The ARs submitted that a detailed reply to the SCN dated May 9, 2019 was submitted vide letter dated October 3, 2019 and no additional submission is required.

9. In view of the above, I am convinced that the Noticee was given sufficient opportunity to present its case before me and that the principle of natural justice have been complied with respect to the Noticee's matter.

Consideration of Issues and Findings

10. I have carefully perused the charges leveled against the Noticee in the SCN, written and oral submissions of the Noticee along with other documents/material available on record. In the instant matter, the following issues arise for consideration and determination:

    a. ***Whether the Noticee has violated the provisions of SEBI circular SMD/SED/CIR/93/23321 dated November 18, 1993?***

    b. ***Whether the Noticee is liable for monetary penalty as prescribed under Section 23D of Securities Contracts (Regulation) Act-1956 for the aforesaid violation?***

    c. ***If so, what should be the quantum of monetary penalty?***

11. Before proceeding further, I would like to refer to the relevant provisions of the SEBI (Stock Broker) Regulations and SEBI circular dated November 18, 1993 which read as under:

SEBI circular No. SMD/SED/CIR/93/23321 dated November 18, 1993:

1. *It shall be compulsory for all Member brokers to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the Member broker is taking a position as a principal will be allowed to be made from the client's account. The above principles and the circumstances under which transfer from client's account to Member broker's account would be allowed are enumerated below.*

A] Member Broker to keep Accounts: Every member broker shall keep such books of accounts, as will be necessary, to show and distinguish in connection with his business as a member -

i. Moneys received from or on account of each of his clients and,

ii. the moneys received and the moneys paid on Member's own account.

B] Obligation to pay money into "clients' accounts". Every member broker who holds or receives money on account of a client shall forthwith pay such money to current or deposit account at Bank to be kept in the name of the member in the title of which the word "clients" shall appear (hereinafter referred to as "clients account"). Member broker may keep one consolidated clients account for all the clients or accounts in the name of each client, as he thinks fit: Provided that when a Member broker receives a cheque or draft representing in part money belonging to the client and in part money due to the Member, he shall pay the whole of such cheque or draft into the clients account and effect subsequent transfer as laid down below in para D (ii).

C] What moneys to be paid into "clients account". No money shall be paid into clients account other than –

i. money held or received on account of clients;

ii. such money belonging to the Member as may be necessary for the purpose of opening or maintaining the account;

iii. money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of para D given below;

iv. a cheque or draft received by the Member representing in part money belonging to the client and in part money due to the Member.

D] What moneys to be withdrawn from "clients account". No money shall be drawn from clients account other than -

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

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

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

12. I note that Inspection findings are based on analysis of samples and test checking of various books and other records maintained by the Noticee, as well as written/oral submissions of the Noticee & its officials to the inspection team. Consequently, the instances of irregularities/observations pointed out in inspection report are illustrative in nature and are not all-inclusive.

13. I note from the SCN that the inspection team had selected 20 sample dates for analysis and observed that on 11 sample dates the Noticee had utilised the funds belonging to its creditor clients (clients which are to receive money from the Noticee or are having credit balance with the Noticee) for funding / allowing exposure to its debtor clients (clients which are to pay money to the Noticee or are having debit balance with the Noticee). In other

words, the obligation of debtor clients were met with the funds of the creditor clients and therefore, the Noticee had misutilised the funds of the credit balance clients which amounts to intermingling of funds contrary to the provisions of the SEBI circular No. SMD/SED/CIR/93/23321 dated November 18, 1993. The above instances of misutilisation of funds of the clients on 11 sample days out of the 20 sample days represent approximately 55% of the sample dates selected by the inspection team. I also note that the amount of misutilisation was in the range of Rs. 5.01 crore to Rs. 102.06 crore (approx.).

14. I have carefully considered the charges against the Noticee, its replies/submissions and the relevant material available on record. I note from records that the details of the shortage of balance for the 11 sample days as referred to in the table at paragraph 5, based on which the allegation of violation of relevant Clauses of the 1993 Circular has been made, was calculated as per the Table 1, provided in the SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016. For dealing with the charge, I deem it appropriate to examine the scope of the requirements laid down in paragraph 1(D)(i) of the SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993. It is noted that the principal obligations as stipulated in circulars are;-

    a. That the stock brokers shall keep the money of the clients in a separate account and their own money in a separate account; and

    b. No payment for transactions in which the Member broker is taking a position as a principal will be allowed to be made from the client's account.

15. The aforesaid paragraph 1(D)(i) of the SEBI Circular No. SMD/SED/CIR/93/23321 further provides, that moneys can be withdrawn from clients' account in following circumstances-

    a. money properly required for payment to or on behalf of clients or

    b. for or towards payment of a debt due to the Member from clients or

    c. money drawn on client's authority, or

    d. money in respect of which there is a liability of clients to the Member, However, the above withdrawal of moneys from clients' account should not, in any case, exceed the total of the money so held for the time being for such each client

16. I note from the reply of the Noticee that one of its main contention is that the SCN has not specified the specific breach and in particular exact violation by the Noticee. I find that SEBI Circular SMD/SED/CIR/93/23321 dated November 18, 1993 in clear and unambiguous term clarifies the nature of transactions to be undertaken in the clients' bank account. I note that rationale behind the SEBI circular is that funds which the clients give to stock brokers should be available with stock brokers either in the clients' Bank account or with the exchange as margin. I have perused the Hon'ble Supreme Court's Order in the matter of Gorkha Security Services v. Govt. of NCT Of Delhi & Ors. and find that the reference to the same is not relevant to the present matter as the SCN in the present matter specifically provides details of the allegations/violations and also the consequent penal provisions and the penalty to be imposed in respect of the said default/violation.

17. I note that the Noticee has submitted that funds received from the clients are maintained separately and has used the same only on their behalf and has paid the dues of all clients within 24 hours of their request. I understand that the funds of credit balance clients (column "C" of the table in paragraph 5; i.e. Balance as per the client ledger in the books of stock broker) shall be available with the stock broker in the client and settlement accounts (column "A" of the table in paragraph 5) and cash and cash equivalent collaterals (column "B" of the table in paragraph 5). I understand that A+B should be equal to C in respect of clients having credit balance or excess funds as mentioned above. I understand that if A+B (as mentioned above) is less than C, it translates into the funds being used either for own purpose or for other clients who have insufficient funds and if A+B is more than C, it means that the funds received from the clients have not been accounted for to the extent of the excess. I understand that if the credit balance clients' funds were not utilised then the Noticee would have had to use its own funds to fund the clients with insufficient balance in their account. Therefore, in either of the circumstances, it amounts to misutilisation as the Noticee /Stock Broker is substituting its own funds with the funds

of the clients. Therefore, the Noticee's contention that it did not use the clients' funds for its own purpose holds no sanctity.

18. I note that the inspection team had brought out 11 instances (sample dates) out of 20 instances (sample dates) of shortage of available balance indicating misuse of clients' fund by the stock broker for own purposes or for other clients having debit balances or both. In this regard, I am of the view that once the shortage in the available balance vis-à-vis the total credit balance of clients (as appearing in the books of accounts of the stock broker) has been established, the same per se is sufficient proof of misuse of clients' money. Therefore, in such circumstances, the onus is on the Stock Broker/Noticee to prove that there was no misuse of clients' funds. In the instant case, the Inspection Team has clearly established the shortfall in available balances vis-à-vis-the total credit balance in the client ledger (as appearing in the books of accounts of the stock broker) on various days.

19. I note that one of the primary and preliminary contention of the Noticee was that the misutilisation of funds calculated by the inspection team is apparently based on the working prescribed by SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/138 dated December 22, 2016, making it applicable and effective from July 01, 2017. Therefore, since the inspection is of a prior period, the said 2016 Circular is not applicable. I have perused the material /documents available on record and other materials available in public domain and I am of the considered view that the aforesaid calculation have always been part of the working during inspections of Stock Brokers relating to Segregation of funds and securities in accordance with SEBI circular dated November 18, 1993. It is only that the 2016 SEBI circular has explicitly prescribed the computation.

I note that a similar view has been taken by SEBI Whole Time Member (WTM) in the matter of AC Agarwal Share Brokers Private Limited wherein the WTM observed *"The Noticee, as a preliminary objection, has contended that since the 2016 circular was made applicable after the period of inspection, the same has no application in the instant matter. In this regard, I note that the 2016 Circular has been issued inter alia for monitoring of clients' fund through a sophisticated alerting and reconciliation mechanism, to detect* *any misutilisation of clients' funds, which was already prohibited under the 1993 Circular. I note that the Clause 3.3.1 of the Annexure to the 2016 Circular, under which the said Table 1 has been prescribed, refers to the following principle:*

"the total available funds i.e. cash and cash equivalents with the stock broker and with the clearing corporation/clearing member should always be equal to or greater than Clients' funds as per ledger balance."

I observe that the said principle is a reiteration of the underlying principle against misutilisation of the clients' funds, already incorporated in Clause D of the 1993 Circular, and cannot be stated to be an introduction of a new requirement. Thus, I do not find merit in the Noticee's contention that the 2016 Circular is not applicable in the instant case."

20. I note that Noticee has submitted that the margin utilised by the credit balance clients were not debited to their account. Therefore, had the margin utilised been debited their balance would have been lower than what was reported. I understand it is not appropriate to adjust the margin requirements of clients against their funds (credit balance) with the stock broker. As understood, the margin requirement is not a settlement obligation but debt owed by the client to the stock broker. I understand that the funds of clients lying with stock broker are part of margin deposited by clients and does not involve any fund movement. I understand that funds of clients can only be deposited in the client bank accounts or with the exchange. While comparing credit balance of clients, it is assumed that all collateral deposits with the clearing corporation belong to the clients and not to the stock broker. However, it is very unlikely that stock broker do not use their own fund for depositing with the clearing corporation. Therefore, by assuming the aforesaid, a conservative approach beneficial to the stock broker is already adopted. I understand that by taking into account the total exchange deposits adjusted for non-funded part, subtracting margin requirement from credit balance would amount to double counting/benefit to the stock broker.

21. I note that the above argument of MOFSL with respect to the margin requirement is not acceptable, since the margins collected from the clients are in the form of funds and/ or securities. I understand that the fund portion of the margin collected from the client has

already been considered while calculating the client deposits with the stock broker. Further, the stock broker has deposited the margins with the exchanges/ clearing corporations in the form of funds and/ or securities. The fund portion of the margin deposited with the exchanges/ clearing corporations has already been considered in the calculation while calculating the total collaterals deposited by the stock broker with the exchanges/ clearing corporations. Hence, the client margin cannot be considered again to reduce the client credit balances as that would amount to double benefit to the stock broker. Further, the margins collected/ deposited in the form of securities cannot be considered for the purpose of accessing the misuse of the clients' funds. In view of the above, the aforesaid argument of the stock broker is without merit and cannot be accepted. I understand that the total funds of the credit balance clients as on any date should be available with the stock broker either in the designated client bank account(s) or as collateral deposited with the exchanges/ clearing corporations in the form of Cash, Fixed Deposits & Bank Guarantees *(Funded Portion)"*.

22. I also note that the aforesaid contention regarding margin is not verifiable and the Noticee has not explained how it arrives at the amount of margin utilised by the clients which were not debited to the clients account. Further, the Noticee has not provided with any verifiable amount of margin that was not accounted for. I note that the Noticee has itself accepted that margin requirement is a debt owed from the client. Therefore the same should be accounted for as soon as it accrues and debited to the respective clients instead of keeping it open for days and if it is not accounted then, it has not accrued and what has not accrued cannot be considered. I understand that in the capital market segments there is no requirement of margin exposure. The stock broker collects the margin (value of trades intended to be executed) upfront or certain percentage of the value as a general practice of risk management. I understand that if the margin collected from the clients is accounted for then the same will further increase the credit balance instead of reducing. I understand that if a client executes a buy trade then the value of his trades is entered into the books of accounts at the end of the day upon final confirmation of trades rather than keeping it pending for days. I also note that in case a client has executed buy trades then

corresponding to the value of trades the stock broker is in possession of the securities. Therefore, I do not understand the contention of the Noticee that margin utilised by the clients were not debited into their accounts.

23. I note that the Noticee in its reply had submitted that Inspection had considered only 50% of the Bank Guarantee (BG) instead of 100% as followed by market prior to the 2016 SEBI circular. It is to be noted that the value of Bank Guarantee has been considered to be 50% (half), since the funded portion (i.e. funds deposited for availing the Bank Guarantee) of a Bank Guarantee is 50% of the Bank Guarantee extended to a stock broker. The leveraged portion (i.e. extra 50% extended by the Bank in lieu of the 50% deposit) of the BG is over and above money held for clients. In view of the above, I understand that the leveraged part of the BG does not involve fund and therefore the same is not to be considered while computing funds of the clients. Further, Client's funds, even if lying idle with the broker, is not to be used by the broker as working capital. I note that the measure (provisions of the circular) is intended to increase transparency in fund / client management by the brokers.

24. In view of the aforesaid discussions, I am of the considered view that the Noticee has misutilised the funds of credit balance clients for own/debit balance clients in 11 sample dates out of 20 sample dates as brought out in paragraph 5 above.

25. I also note that the Noticee has referred to observations made by Hon'ble Supreme Court and Hon'ble SAT in several matters where in it has been observed that the purpose of inspection is not punitive and the same has been considered.

26. In view of the discussions in paragraphs 11 to 25 above, I conclude that the Noticee has failed to maintain segregation of client's funds, and further misused the clients' funds, thereby violating the provisions of the SEBI circular No. SMD/SED/CIR/93/23321 dated November 18, 1993, which warrants penalty under Section 23D of the SCRA 1956. The relevant provisions of the SCRA 1956 read as under:

Securities Contracts (Regulation) Act, 1956 (SCRA, 1956)

[Penalty for failure to segregate securities or moneys of client or clients.]

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

27. At this juncture it is pertinent to note the observation of the Hon'ble Supreme Court of India in the matter of *SEBI Vs. Shri Ram Mutual Fund* [2006] 68 SCL 216(SC) held that *"In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant…".*

28. While determining the quantum of monetary penalty under Section 23D, I have considered the factors stipulated in Section 23-J of the SCR Act, which reads as under:

"23J - Factors to be taken into account while adjudging quantum of penalty

While adjudging the quantum of penalty under section 12A or section 23-I, the Securities and Exchange Board of India or the adjudicating officer shall have due regard to the following factors, namely:

(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

(b) the amount of loss caused to an investor or group of investors as a result of the default;

(c) the repetitive nature of the default."

29. In the present matter, it is noted that no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of such default by the Noticee. Further from the material available on record, it may not be possible to ascertain the exact monetary loss to the investors /clients on account of default by the Noticee.

30. I note here that SEBI circular dated November 18, 1993 *inter alia* strictly laid down what moneys to be paid into "clients account" and what moneys to be withdrawn from "clients account", so as to reduce the opportunity for systemic risk that may arise from investors who are active in more than one market. The intent was, thus, to promote securities market stability and in this endeavour of the regulator, it was in the interest of the Noticee to comply with the same and not put itself at risk by transferring of its clients moneys. I find it necessary to point out here that a system which is put in place by the Regulator is with a clear focus on investor protection. Intermediaries have to adapt themselves and put such mechanisms in place that complement the compliance standards set by the Regulator, rather than finding means to get around such systems.

ORDER

31. After taking into consideration the nature and gravity of charges established, the facts and circumstances of the case as enumerated above, I, in exercise of the powers conferred upon me under Section 23I (2) of the SCR Act, 1956 read with Rule 5 of the Adjudication Rules, hereby impose a impose a monetary penalty of Rs. 17,00,000/- (Rupees Seventeen Lakh only) on the Noticee i.e. Motilal Oswal Financial Services Limited under section 23D of the SCR Act, 1956 for the violation of the provisions of SEBI Circular SMD/SED/CIR/93/23321 dated November 18, 1993.

I am of the considered view that in the facts and circumstances of the case, the said penalty is commensurate with the default/violations committed by the Noticee.

32. The Noticee shall remit / pay the said total amount of penalty within 45 days of receipt of this order in either of the following way:

a. By using the web link https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html; OR
b. By way of Demand Draft in favour of *"SEBI - Penalties Remittable to Government of India",* payable at Mumbai; OR

33. The Noticee shall forward the said Demand Draft in the format as given in table below shall be sent to "The Division Chief, Enforcement Department -DRA-II, Securities and Exchange Board of India, SEBI Bhavan, Plot no. C- 4 A, "G" Block, Bandra Kurla Complex, Bandra (East), Mumbai - 400 051." and also to e-mail id :- tad@sebi.gov.in

Case Name	
Name of Payee	
Date of payment	
Amount Paid	
Transaction No	
Bank Details in which payment is made	
Payment is made for (like penalties/ disgorgement/ recovery/Settlement amount and legal charges along with order details)	
Penalty	

34. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, recovery proceedings may be initiated under Section 28A of the SEBI Act, 1992 for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties.

35. In terms of rule 6 of the Adjudication Rules, copies of this order are sent to the Noticee and also to SEBI.

Date: February 28, 2020 **Prasanta Mahapatra**
Place: Mumbai **Adjudicating Officer**