**BEFORE THE ADJUDICATING OFFICER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**

**ADJUDICATION ORDER NO. Order/AK/AS/2023-24/28288**

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**UNDER SECTION 19H OF THE DEPOSITORIES ACT, 1996 READ WITH RULE 5 OF THE DEPOSITORIES (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 2005 AND SECTION 15-I OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF THE SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995 IN RESPECT OF:**

**Central Depository Services (India) Ltd**
**(PAN – AAACC6233A)**
Address - Marathon Futurex, A-Wing, 25th floor,
NM Joshi Marg, Lower Parel, Mumbai – 400013
Email ID - nehal.vora@cdslindia.com; nayana@cdslindia.com

**In the matter of BRH Wealth Kreators Ltd**

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**BACKGROUND OF THE CASE**

1. Securities and Exchange Board of India (hereinafter referred to as **"SEBI"**) conducted an examination in the matter of BRH Wealth Kreators Ltd. (hereinafter referred to as **"BRH"**). BRH is registered with SEBI as a Stock Broker and a Depository Participant, and also, as a Depository Participant with Central Depository Services (India) Ltd (hereinafter referred to as "**CDSL/Noticee"**).

2. SEBI observed from the findings of the aforementioned examination that CDSL, as a Depository, had allegedly violated provisions of Regulation 79(5) read with Regulation 79(3) and Regulation 17 read with Clause 2, 5 and 10 of Code of Conduct for Depositories as specified in Part D of the Third Schedule of SEBI (Depositories and Participants) Regulations, 2018 (hereinafter referred to as **"DP Regulations"**), Clause 13.4.2, 14.2 and 14.4 of Bye Laws of CDSL, Clause 2.3.1 read with Clause 1.2 of Annexure of SEBI Circular

SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 (hereinafter referred to as **"Circular dated September 26, 2016"**) and the directions contained in the SEBI Interim Order ref no WTM/AB/SEBI/ERO/25/2019 dated October 07, 2019 (hereinafter referred to as **"Interim Order"**).

**APPOINTMENT OF ADJUDICATING OFFICER**

3. On being satisfied that there are sufficient grounds to inquire and adjudicate upon the aforesaid alleged violations, SEBI in exercise of powers under Section 19H of the Depositories Act, 1996 and Rule 3 of the Depositories (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as the **"Adjudication Rules, 2005"**), and Section 19 r/w Section 15-I of the SEBI Act, 1992 and Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as the **"Adjudication Rules, 1995"**), appointed the undersigned as the Adjudicating Officer, vide communique dated March 09, 2023, to inquire into and adjudge under Section 19H r/w Section 19G of the Depositories Act, 1996 and under Section 15-I r/w Section 15HB of the SEBI Act, 1992, the alleged violations by the Noticee.

**SHOW CAUSE NOTICE AND PERSONAL HEARING**

4. Show Cause Notice ref no EAD-6/AK/VV/15461/1/2023 dated April 20, 2023 (hereinafter referred to as **"SCN"**) was issued to the Noticee to show cause as to why an inquiry should not be initiated against it, and why penalty, if any, should not be imposed against it under Section 19G of the Depositories Act, 1996 and Section 15HB of the SEBI Act, 1992 for the alleged violations. Vide response dated May 03, 2023, Noticee sought additional time for submitting reply to the SCN. Vide response dated May 19, 2023, Noticee submitted its reply to the SCN on merits. The personal hearing in the matter was held on June 19, 2023. During the course of hearing, Senior Counsel Sharan Jagtiani appeared on behalf of the Noticee and made submissions relying upon the response dated May 19, 2023. Vide email dated June 20, 2023, Noticee submitted a copy of order of the Hon'ble Securities Appellate Tribunal (hereinafter referred to as **"SAT"**) dated August 07,

2014 (Appeal No. 204 of 2014) in the matter of R.M. Shares Trading Pvt Ltd vs SEBI.

**CONSIDERATION OF ISSUES AND FINDINGS**

5. The issues that arise for consideration are as under:

5.1. Whether Noticee failed to monitor pledge of securities by BRH from ineligible demat account, resulting in violation of provisions of Regulation 79(5) read with Regulation 79(3) and Regulation 17 read with Clause 2, 5 and 10 of Code of Conduct for Depositories as specified in Part D of the Third Schedule of the DP Regulations, and Clause 14.2 and 14.4 of Bye Laws of CDSL?

5.2. Whether Noticee failed to assign appropriate nomenclature to the demat account maintained by BRH, resulting in violation of provisions of Clause 2.3.1 read with Clause 1.2 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016?

5.3. Whether Noticee failed to record the freeze on the demat accounts of BRH, resulting in violation of provisions of Clause 13.4.2 of CDSL Bye Laws and the directions contained in the SEBI Interim Order? Further, whether Noticee, by allowing invocation of pledge from such demat accounts by HDFC Bank Ltd (hereinafter referred to as **"HDFC"**), violated the directions contained in the SEBI Interim Order?

5.4. If yes, whether the violations, if any, attract monetary penalty under the provisions of Section 19G of the Depositories Act, 1996 and Section 15HB of the SEBI Act, 1992, as applicable? If so, what quantum of monetary penalty should be imposed on the Noticees after taking into consideration the factors mentioned in Section 19-I of the Depositories Act, 1996 and Section 15J of the SEBI Act, 1992?

6. Before I proceed with the matter, it is pertinent to mention the relevant legal provisions alleged to have been violated by the Noticees, as applicable during the Investigation Period, and the same are reproduced below:

***DP Regulations***

***Depository to abide by the Code of Conduct***

*17. The depository holding a certificate of commencement of business shall, at all times, abide by the Code of Conduct as specified in the Part D of the Third Schedule.*

***Manner of creating pledge or hypothecation.***

*79. ……….*

*(3) Within fifteen days of receipt of the application, the depository shall after concurrence of the pledgee through its participant, create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.*

*…………..*

*(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.*

***THIRD SCHEDULE***

***Part –D***

***CODE OF CONDUCT FOR DEPOSITORIES***

*……..*

*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.*

***CDSL Bye Laws***

*13.4 ACCOUNT FREEZING*

*………*

*13.4.2 CDSL or the participant shall freeze the account of a Beneficial Owner maintained with it in the manner specified in the orders or directions of any court or tribunal or any Government or SEBI or any other authority made or given under any law for the time being in force.*

*14. PLEDGE AND HYPOTHECATION*

*………*

*14.2. For the purpose of creation of any pledge or hypothecation of securities, CDSL or a participant shall, on an application by any Beneficial Owner, issue a certificate of holdings to the Beneficial Owner, certifying that the Beneficial Owner is entitled in its name to such number of securities of such Issuer as are proposed to be pledged or hypothecated.*

*14.4. CDSL or a participant shall not refuse permission to the pledgor or hypothecator to create a pledge or hypothecation in respect of securities available for pledge or hypothecation unless operations in respect of those securities are restrained or frozen by virtue of any order or direction of any court, tribunal, Central Government, SEBI, RBI or the Central or State Government in case of Securities issued by RBI or the Central or State Government or other competent authority or by CDSL itself and if the CDSL or a participant does not create such pledge or hypothecation as the case may be, it shall intimate the intending pledgor and pledgee of its decisions setting out its reasons for such refusal.*

*14.6. Subject to the provisions of the pledge/hypothecation documents, the pledgee/ hypothecate may invoke the pledge or hypothecation, as the case may be through his participant and on such invocation, CDSL shall register the pledgee/ hypothecatee as Beneficial Owner of such securities and shall amend its records accordingly. Thereafter, CDSL shall immediately inform the participants of the pledgor and the pledgee of the change and who in turn shall make necessary changes in their records and inform the pledgor and pledgee respectively.*

***SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016***

*Enhanced Supervision of Stock Brokers/Depository Participants*

*Clause 1.2 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016*

*1.2 The nomenclature for bank accounts and demat accounts to be followed is given as under:*

*1.2.1 Bank account(s) which hold clients funds shall be named as "Name of Stock Broker - Client Account".*

*1.2.3. Demat account(s) which hold clients' securities shall be named as "Name of Stock Broker- Client Account".*

*1.2.5. Demat account(s), maintained by the stock broker for depositing securities collateral with the clearing corporation, shall be named as "Name of Stock Broker- Collateral Account".*

*1.2.6. Demat account(s) held for the purpose of settlement would be named as " Name of Stock Broker - Pool account".*

*1.2.7. Bank account(s) held for the purpose of settlement would be named as " Name of Stock Broker - Settlement Account""*

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

*2.3.1. 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.*

***SEBI Interim Order WTM/AB/SEBI/ERO/25/2019 dated October 07, 2019***

*9. Under the above circumstances, I, in exercise of powers conferred upon me under Sections 11(1), 11(4), 11B and 11D read with Section 19 of the SEBI Act, 1992 and Regulation 35 of SEBI(Intermediaries) Regulations, 2008, by way of this ex parte ad interim order, hereby issue the following directions:*

*(iii) ……Noticees are directed not to dispose of or alienate any assets, whether movable or immovable, or to create or invoke or release any interest or charge in any of such assets except with the prior permission of NSE and BSE;*

*……….*

*(v) Till further directions in this regard, the assets of the Noticees shall be utilized only for the purpose of payment of money and / or delivery of securities, as the case may be, to the clients / investors under the supervision of the concerned exchanges/depositories;*

*(vi) The depositories are directed to ensure that no debits are made in the demat accounts, held jointly or severally, of the aforesaid Noticees and persons except for the purpose mentioned in sub-para (v) above, after confirmation from NSE/BSE;*
*(vii) The banks are directed to ensure that no debits are made in the bank accounts held jointly or severally by the Noticees except for the purpose of payment of money to the clients/investors under the written confirmation of NSE/BSE.*

7. The findings of the examination and allegations against the Noticee in the SCN are summarized below:

7.1 <u>Failure to reject request for creation of pledge of client securities by BRH</u>

7.1.1. It was observed that BRH availed of 'loan against shares' facility, by pledging securities of its clients with, interalia, HDFC. Further, the securities had been pledged from two demat accounts maintained by BRH with the Noticee as depository. The total quantity of shares pledged was 2,00,70,640 for Rs 158.68 Crores. It was observed that the aforesaid pledge had been invoked by HDFC on October 14, 2019 and December 05, 2019. Further, as per the financial ledger balances of clients in the books of BRH, securities worth Rs. 116.62 crores of clients having credit/nil balance were invoked, while the securities worth Rs. 42.27 crores were invoked for clients having debit balances of Rs. 5.22 crores. It was also observed that the clients, who were having debit balance more than their security holding, had a total debit balance of Rs. 3.43 crores, however the value of securities invoked for these clients was Rs. 1.28 Crores.

7.1.2. It was alleged that the Noticee could have ascertained that the securities in demat account of BRH belonged to the clients of BRH and refused the creation of pledge in the demat account. DP Regulations specifically recognize the power of depository not to create a pledge. The Noticee was under an obligation to exercise due diligence while dealing with a request for creation of pledge, which included satisfaction that the BRH was entitled for pledging the shares. Exercise of due diligence required the Noticee to ascertain existing debit balance of clients and the authorization from the clients before creation of the pledge.

7.1.3. Therefore, by allowing creation of pledge in the 'TM/CM Client Account', Noticee allegedly failed to monitor pledging of securities by BRH from ineligible demat account, resulting in violation of provisions of Regulation 79(5) read with Regulation 79(3) of DP Regulations and Clause 14.2 and 14.4 of Bye Laws of CDSL.

7.2 Failure to assign appropriate nomenclature to the demat account of BRH

7.2.1. It was observed that the Noticee was under an obligation to assign appropriate nomenclature to the demat account of BRH as provided under the SEBI Circular ref no. SEBI/HO/MIRSD/MIRSD2/ CIR/P/2016/95 dated September 26, 2016, within three months from the date of the said Circular i.e. December 26, 2016. However, the Noticee failed to assign appropriate nomenclature, i.e. "Name of Stock Broker-Client account", to the demat account of BRH from which the shares were pledged. Therefore, Noticee allegedly violated the provisions of Clause 2.3.1 read with Clause 1.2 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/ 2016/95 dated September 26, 2016.

7.3 Failure to freeze the demat accounts of BRH by allowing invocation of pledge

7.3.1. It was observed that the Interim Order dated October 07, 2019 had directed, interalia, that,

*9. Under the above circumstances, I, in exercise of powers conferred upon me under Sections 11(1), 11(4), 11B and 11D read with Section 19 of the SEBI Act, 1992 and Regulation 35 of SEBI(Intermediaries) Regulations, 2008, by way of this ex parte ad interim order, hereby issue the following directions:*

*……….*

*(v) Till further directions in this regard, the assets of the Noticees shall be utilized only for the purpose of payment of money and / or delivery of securities, as the case may be, to the clients / investors under the supervision of the concerned exchanges/depositories;*

*(vi) The depositories are directed to ensure that no debits are made in the demat accounts, held jointly or severally, of the aforesaid Noticees and persons except for the purpose mentioned in sub-para (v) above, after confirmation from NSE/BSE;*

7.3.2. Further, CDSL Bye Laws mandate that depositories are under an obligation to give effect to any restraint or attachment orders issued by SEBI and/or any competent authority by marking a freeze on the demat accounts in the manner specified in such orders. Therefore, the Noticee was under an obligation to mark “freeze” on the pledged securities since the securities lying therein were owned by the Beneficial Owners and even after the pledge, continued to be the property of the Beneficial Owners.

7.3.3. However, it was observed that Noticee did not act in accordance with the directions contained in the SEBI Interim Order, particularly since the Interim Order had categorically observed that BRH did not have the title over the securities pledged by it, which is a prerequisite for creation of the pledge. Therefore, the Noticee failed to record the freeze on the demat accounts of BRH, resulting in violation of provisions of Clause 13.4.2 of CDSL Bye Laws and the directions contained in the SEBI Interim Order.

7.3.4. Further, it was observed that the Noticee allowed invocation of pledge from such accounts on October 14, 2019 and December 05, 2019, resulting in violation of the directions contained in the SEBI interim order.

8. The submissions made by the Noticee as regards allegations levelled against it are summarized below.

8.1. <u>Failure to reject request for creation of pledge of client securities by BRH</u>

8.1.1. The instant proceedings have been initiated after an inordinate delay leading to violation of principles of natural justice. This is evidence from the fact that SEBI was aware of invocation of shares of BRH by HDFC at least by 19th March 2020, when a Show Cause Notice was issued to HDFC by SEBI alleging that such invocation was illegal. Further, only after two years of issuance of the said Show Cause Notice, that SEBI addressed a letter dated May 25, 2022 to the Noticee making certain observations and seeking explanation on the same, and subsequently, after another year, issued the SCN on April 21, 2023.

8.1.2. Since at least March 2014, SEBI had sought clarifications and had been repeatedly informed that in CDSL's system, pledges existing prior to any freezing order are permitted to be invoked even after such freezing order, through system validations without any manual intervention by CDSL. It is a matter of record that SEBI did not, in any of its correspondence exchanged since March 2014, object to the aforementioned practice followed by CDSL or pass any directions to not permit such invocation. Further, the SCN relies upon a purported stand taken by SEBI on this issue in its correspondence addressed on December 20, 2021 i.e. two (2) years after the invocation of pledge by HDFC. In the event SEBI did not agree with the practice followed by CDSL permitting invocation of pre-existing pledges, SEBI ought to have, soon after it became aware of the same, communicated its objections and/or directed CDSL to stop such practice and modify its system. Instead, SEBI did not object to such practice for over nine years.

8.1.3. In terms of applicable provisions of the DP Regulations, that CDSL or its Depository Participant's obligations upon receiving a request for creation of pledge is limited to the extent of determining whether the securities upon which pledge is sought to be created is available with the Beneficial Owner making the request and obtaining the concurrence of the pledgee (through its Depository Participant) in relation to the creation of pledge in its favour. Further, the DP Regulations and CDSL's Bye-Laws state that in case the pledge is not created pursuant to a request made for the same, reasons therefor must be recorded. Bye-Law No. 14.4 of CDSL's Bye-Laws further clarifies that the only circumstance in which CDSL could refuse permission to a pledger to pledge any securities is if the operations in respect of such securities are restrained or frozen by any order or direction of a Court, Tribunal, SEBI, Central Government, RBI or CDSL itself.

8.1.4. It is not possible for the Noticee to have visibility over operations of a stock broker and exercise due diligence to the extent of (i) ascertaining the debit balances of clients in such *Stock Broker-Client Account* of BRH; and (ii) obtaining authorization from the clients before creation of a pledge.

8.1.5. The applicable provisions require the Stock Exchanges to ensure enhanced and better supervision of Stock Brokers while the Depositories are merely intended to take certain steps to aid such enhanced supervision by the Stock Exchanges. As a Depository, CDSL is neither able nor required to monitor the activities of Stock Brokers and such responsibility is solely that of the Stock Exchanges. The limited role of CDSL, which doesn't extend to ascertaining the details of the debit balances of the clients of a Stock Broker, is also apparent from Clause 7 of the Annexure to the Circular ref no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016. The said provision requires Stock Brokers to upload clients' fund balance and securities balance on the system of the Stock Exchange and not the Depository. Further, at the time of becoming a Depository Participant, a Depository Participant is required to adopt a 'Chinese Wall policy' between its function as a Depository Participant and a Stock Broker. Therefore, the suggestion made in the SCN that the Noticee ought to have ensured that client securities are not misused by Stock Brokers is wholly incorrect and without any basis.

8.1.6. Noticee has relied upon the Adjudication Order bearing No. Order/MC/RM/2022-23/21420 dated November 25, 2022 passed by SEBI, wherein the limited scope of Depository's obligations with respect to the operations of a Stock Broker had been accepted and acknowledged, and CDSL was held to be not liable for any of the allegations made in such regard. Noticee has also relied upon the Order of the Hon'ble SAT in the matter of R.M. Shares Trading Pvt Ltd vs SEBI dated August 07, 2014 (Appeal No. 204 of 2014) and contended that the aforesaid Order must be considered, and either followed or distinguished by recording reasons in the instant matter.

8.1.7. In CDSL's system, upon receipt of a request for creation of pledge over certain demat shares, the DP Id and the Client Id of the pledgor are put by the Pledgor DP, pursuant to which the system checks the requisite information as to whether the securities are held in the demat account of the pledgor, if there is any freeze operating on such shares/ demat account and if there is any existing encumbrance on such shares, before executing the pledge without any manual intervention at CDSL's end.

8.1.8. The pledge created over the shares held in BRH's demat accounts was from June 2007 to September 2019 and it was only through the Interim Order dated October 07, 2019 that SEBI directed freezing of the demat accounts of BRH. Accordingly, at the time of receipt of request for creation of pledge, the shares sought to be pledged were available to be pledged and CDSL was, therefore, obligated under law to create such pledge.

8.1.9. Therefore, at the time of creation of pledge on the securities held by BRH, CDSL complied with all the applicable legal provisions and directions of SEBI. Accordingly, CDSL also acted in compliance with its obligations under the Code of Conduct to act in a manner safeguarding the interests of investors and integrity of the depository system and the securities market.

8.2. Failure to assign appropriate nomenclature to the demat account of BRH

8.2.1. While the SEBI Circular dated September 26, 2016 required the assignment of nomenclature to be carried out within 3 months of the issuance of the said Circular, SEBI issued another Circular ref no SEBI/HO/MIRSD/MIRSD2/ CIR/P/2016/138 dated December 20, 2016 extending the timeline for compliance with Clause 2.3.1 of the Circular dated September 26, 2016 till July 01, 2017. Therefore, the allegation made by SEBI that the period of CDSL's alleged non-compliance with the Circular dated September 26, 2016 was from December 26, 2016 is erroneous.

8.2.2. On the day of issuance of the Circular dated September 26, 2016, CDSL's system had a provision for Stock Broker's demat accounts with sub-status codes such as Pool Account, Client Margin Account and Client Beneficiary Account.

8.2.3. Pursuant to the issuance of the Circular dated September 26, 2016, with effect from December 5, 2016, CDSL introduced/ modified the sub-status codes for demat accounts and thereby provided for the facility of tagging the demat account of a Stock Broker through specific sub-status codes. Pertinently, the Circular dated September 26, 2016 specifically provided for the naming or 'tagging' of the demat accounts as per the nomenclature prescribed in the Circular.

8.2.4. CDSL also issued Communiques dated September 29, 2016 and November 22, 2016 to all Depository Participants, interalia, informing them about the Circular dated September 26, 2016, providing details of the facility which would be provided by CDSL in compliance with the said Circular, whereby the demat accounts of Stock Brokers could be appropriately tagged by using separate sub-status codes, and issuing requisite directions to the Depository Participants in this regard.

8.2.5. For the Stock-Broker's demat accounts opened till December 3, 2016, in cases where the Stock Brokers did not change the sub-status codes as required in the Circular dated September 26, 2016 by the deadline of June 30, 2017, CDSL carried out such changes and ensured that all the demat accounts opened by Stock-Brokers were categorized as 1) Pool Account 2) Client Account 3) Proprietary Account / Deemed Proprietary and 4) Collateral Account.

8.2.6. SEBI vide Adjudication Order ref no Order/MC/RM/2022-23/21420 dated November 25, 2022 had examined the assignment of nomenclature by CDSL and had acknowledged the same to be in compliance with the directions in the Circular dated September 26, 2016.

8.2.7. The allegation that nomenclature of the demat account of BRH was not in accordance with CDSL's own communique dated May 29, 2007 is made without any details and is baseless.

8.2.8. CDSL had not relied upon email dated June 23, 2017 by SEBI to support its responses pertaining to assigning of appropriate nomenclature as per the 2016 Circular, and instead, had relied upon the said email in the context of creation of pledges.

8.3. <u>Allegations with respect to failing to freeze the demat accounts of BRH by allowing invocation of pledge from such accounts</u>

8.3.1. The SCN does not refer to any provision of law which mandates freezing of demat accounts pertaining to pre-existing pledges.

8.3.2. Since at least March 2014, SEBI has raised queries whether CDSL permitted the invocation of pledges on shares which existed prior to any freezing order being passed and CDSL had repeatedly clarified that CDSL's system does permit such pledges to be invoked. In fact, CDSL had explained to SEBI that in CDSL's system, upon the creation of a pledge on the securities, the control of such securities vests with the pledgee and the pledgee is permitted to invoke such pledge through system validations without any manual intervention by CDSL. Such system invocation is not impacted by a subsequent freezing of the pledgor's demat accounts. However, despite the clarifications provided by CDSL, SEBI did not raise any objection to such practice followed by CDSL and/or direct CDSL to modify such system to prevent invocation of such pledges post a freezing order.

8.3.3. CDSL addressed an email dated March 21, 2014 to SEBI informing that if securities had already been pledged prior to the demat account being frozen, the pledge can still be invoked by the pledgee. Further, it was clarified that no fresh pledge is permitted after the account has been frozen. Thereafter, no further correspondence was received from SEBI making any objection or providing any advice/ direction on such practice followed by CDSL.

8.3.4. Soon after the issuance of the Interim Order in the present matter and before the invocation of pledge on the securities held in BRH's demat account on October 14, 2019, correspondence were exchanged between SEBI and CDSL on October 9, 2019 and October 11, 2019, wherein SEBI was again informed that pledges created prior to freezing of demat accounts are permitted to be invoked by CDSL. It is submitted that no response was received from SEBI objecting to such practice or passing any directions in relation thereto, even at such time. It was only on 20th December 2021, i.e. more than two years after the invocation of pledge on shares held in BRH's demat account, that a response was received from SEBI.

8.3.5. In the SCN, SEBI has sought to place reliance on the response dated December 20, 2021 to allege that the rejection by SEBI of CDSL's proposal for amendment of its Bye-Laws substantiates the stand that a Depository has to record freeze on all the shares in the demat accounts of the Stock Broker, without giving differential treatment to the pledged securities. In this regard, it is submitted such response was addressed by SEBI more than two years after the invocation of pledge on shares held in BRH's demat account. SEBI was well aware of the practice followed by CDSL since 2014 itself. SEBI called upon CDSL to provide clarifications in relation to the procedure followed by CDSL in relation to pre-existing pledges on multiple occasions, however, at no point in time did SEBI communicate any concerns to CDSL regarding such practice not being acceptable.

8.3.6. The amendment to Bye-Laws suggested by CDSL was to explicitly define the right of pledgees over shares which were pledged prior to any freezing order on the relevant demat accounts. This demonstrates the efforts and initiatives taken by CDSL to ensure that such aspects are explicitly provided for in its Bye-Laws and there is no misunderstanding or lack of clarity on such aspects between SEBI and CDSL.

8.3.7. In addition to the fact that SEBI communicated its rejection of CDSL's proposed amendment to its Bye-Laws only in December 2021, even at such time, SEBI did not direct CDSL to stop/ change the practice followed by it and merely stated that the procedure for invocation of pledged or hypothecated securities depends on the terms of the contract between the lender and borrower and the directions of the restraining order. Thus, it could not be gainsaid that the rejection of the amendment to the CDSL Bye-Laws in any manner implied that CDSL ought to discontinue the practice being followed by it.

8.3.8. In fact, in response to SEBI's aforesaid rejection, CDSL had addressed a letter to SEBI on January 22, 2022, interalia, clarifying that the arrangement or agreement entered into between the parties (pledgee-pledger) is outside the purview of CDSL as a Depository and invocation of pledge is permitted by CDSL directly through its system without any manual intervention. It was, therefore, stated that it is more prudent to put a system in place that will be followed in every case since determining the procedure or action to be taken on a case-to-case basis will result in a delay in taking such action and will also result in the pledgee being aggrieved. SEBI was, accordingly, once again informed that CDSL would be continuing with its existing system of permitting invocation of pledges.

8.3.9. There is no SEBI Circular or Directive stating the parameters for a system driven check to restrict pledge creation or invocation in the Depository system. This is particularly relevant since CDSL's Bye-Laws would require that any such restriction imposed by CDSL should be supported by regulatory directions.

8.3.10. The Hon'ble SAT, vide its Order dated February 18, 2022 in the matter of HDFC Bank vs SEBI (Appeal No. 83 of 2021) held that the invocation of pledge by HDFC Bank over the shares held in BRH's demat accounts was valid and not in violation of the Interim Order.

**Issue No. I: Whether Noticee failed to monitor pledge of securities by BRH from ineligible demat account, resulting in violation of provisions of Regulation 79(5) read with Regulation 79(3) and Regulation 17 read with Clause 2, 5 and 10 of Code of Conduct for Depositories as specified in Part D of the Third Schedule of the DP Regulations and Clause 14.2 and 14.4 of Bye Laws of CDSL?**

9. I note that BRH had availed of the facility of 'loan against shares' by pledging securities of its clients with the entities viz. JM Financial Products Limited, Bajaj Finance Limited and HDFC as per the following details:

| Pledgee Name | Quantity | Value (Rs) |
|---|---|---|
| Bajaj Finance Limited | 6,94,629 | 4,85,17,834.20 |
| JM Financial Products Limited | 20,26,412 | 14,61,35,823.81 |
| HDFC | 2,45,50,164 | 2,06,75,68,594.16 |
| **Total** | **2,72,71,205** | **2,26,22,22,252.17** |

10. I further note that BRH had availed of the said 'loan against shares' facility from HDFC by pledging shares from two demat accounts maintained with the Noticee as the Depository, as per the following details (as on September 30, 2019):

| BO ID | Pledged Quantity | Pledged Amt (Rs. in cr.) |
|---|---|---|
| 1204630000021137 | 1,73,53,289 | 144.38 |
| 1204630000155615 | 27,17,351 | 14.30 |
| **Total** | **2,00,70,640** | **158.68** |

11. I note that the aforesaid pledge amounting to Rs 158.68 Crores had been invoked by HDFC on October 14, 2019 and December 05, 2019. Further, as per the financial ledger balances of clients in the books of BRH, securities worth Rs. 116.62 crores of clients having credit or nil balance were invoked. Also, securities worth Rs. 42.27 crores were invoked for clients who had debit balances of Rs. 5.22 crores. For the clients who had debit balance more than their security holding, securities amounting to Rs 1.28 Crores were invoked for a total debit balance of Rs. 3.43 crores.

12. I note that as per the provisions of Circular dated September 26, 2016, BRH could have pledged securities of only the clients who had a debit balance in their ledger. Further, funds raised against such pledged securities could not have exceeded the debit balance in ledgers of the said debit balance clients. However, the securities which had been pledged by BRH for raising funds amounting to Rs 158.89, were of clients who either had credit or nil balance, or who had debit balances lesser than the funds raised by pledging their securities. I note that CDSL, in its capacity as the Depository, allowed pledging of aforesaid securities by BRH, which forms the ground of the alleged instant violation.

13. I firstly note that the securities were pledged with BRH with HDFC from June 2007 to September 2019, during which no freeze was operational on the said securities by any court order/ SEBI order etc. Further, I note that as per the applicable provisions of the DP Regulations and the DP Bye Laws, the obligation upon receiving request for creation of pledge is limited to the extent of determining whether the securities upon which pledge is sought to be created is available with the Beneficial Owner making the request and obtaining the concurrence of the pledgee, through its Depository Participant.

14. I also note for reference the provisions alleged to have been violated by the Noticee below:

***DP Regulations***

***Manner of creating pledge or hypothecation.***

*79. ……….*

*(3) Within fifteen days of receipt of the application, the depository shall after concurrence of the pledgee through its participant, create and record the pledge and send an intimation of the same to the participants of the pledger and the pledgee.*

*…………..*

*(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants of the pledger and the pledgee.*

15. I note that the Noticee was obligated to process the request for creation of pledge within 15 days of the application, after obtaining concurrence of the pledgee, and give reasons to the participants of pledger and pledgee if it fails to do so. I note from the above that Noticee had a limited scope with respect to determining legality of the hypothecation operation, and extending the said scope to include analysis of debit balance of clients whose shares are being pledged seems farfetched.

16. Further, I note the relevant provisions of CDSL bye laws below:

***14. Pledge and hypothecation.***

***14.2.*** *For the purpose of creation of any pledge or hypothecation of securities, CDSL or a participant shall, on an application by any Beneficial Owner, issue a certificate of holdings to the Beneficial Owner, certifying that the Beneficial Owner is entitled in its name to such number of securities of such Issuer as are proposed to be pledged or hypothecated.*

*……….*

***14.4.*** *CDSL or a participant shall not refuse permission to the pledgor or hypothecator to create a pledge or hypothecation in respect of securities available for pledge or hypothecation unless operations in respect of those securities are restrained or frozen by virtue of any order or direction of any court, tribunal, Central Government, SEBI, RBI or the Central or State Government in case of Securities issued by RBI or the Central or State Government or other competent authority or by CDSL itself and if the CDSL or a* *participant does not create such pledge or hypothecation as the case may be, it shall intimate the intending pledgor and pledgee of its decisions setting out its reasons for such refusal.*

17. I note that Bye Law 14.4 stated above places restriction on the creation of pledge in case '*operations in respect of those securities are restrained or frozen by virtue of any order or direction of any court, tribunal, Central Government, SEBI, RBI or the Central or State Government in case of Securities issued by RBI or the Central or State Government or other competent authority or by CDSL itself'*. I note that in the instant matter, the restrictions on trades in the demat account of BRH were imposed only vide Interim Order dated October 07, 2019, while the pledges had been created by BRH at different times starting from June 2007 to September 2019. Therefore, I note that at the time of pledge creation by BRH, no 'freezing order' was operational with respect to the demat account pertaining to the pledged securities.

18. Further, I note that the capability of determining debit balances of clients, or obtaining the authorization of the clients before creation of the pledge etc, lies within the purview of Stock Exchanges, and not the Depositories. The extant provisions do not mandate submission of details of clients' funds and securities balance with the depository by the broker. Therefore, the Noticees in its capacity as the depository, could not be expected to have visibility in the operation of BRH to the extent of inferring the illegality of the hypothecation of the shares based on the debit balance of the clients.

19. Therefore, I note that the Noticee, by allowing creation of pledge by BRH from demat accounts of its clients, had not violated the provisions of Regulation 79(5) read with Regulation 79(3) of DP Regulations, Clause 14.2 and 14.4 of Bye Laws of CDSL and Regulation 17 read with Clause 2, 5 and 10 of Code of Conduct for Depositories as specified in Part D of the Third Schedule of DP Regulations.

**Issue No. II: Whether Noticee failed to assign appropriate nomenclature to the demat account maintained by BRH, resulting in violation of provisions**

**of Clause 2.3.1 read with Clause 1.2 of Annexure of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016?**

20. I note that in terms of clause 2.3.1 read with clause 1.2 of the SEBI Circular dated September 26, 2016, Noticee was mandated to implement new nomenclature for bank and demat accounts, within three months of the date of circular. Further, vide SEBI Circular ref no SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/138 dated December 20, 2016, the timeline for compliance with Clause 2.3.1 of the SEBI Circular dated September 26, 2016 was extended to July 01, 2017.

21. I note that the demat account number viz. 1204630000021137 belonging to BRH, from which the shares had been pledged with HDFC, had 'First Holder Name' as *'BRH Wealth Kreators Ltd'*, and had been tagged with the sub status as *'Corporate CM/TM-Client account'* with the Noticee, which indicated that the account was maintained for safekeeping of securities received from clients of BRH. I note that the said nomenclature was allegedly not in compliance with the provisions pertaining to nomenclature in terms of SEBI Circular dated September 26, 2016.

22. In this regard, Noticee submitted that pursuant to the Circular dated September 26, 2016, with effect from December 5, 2016, it had introduced/ modified the sub-status codes for demat accounts and provided for the facility of tagging the demat account of a Stock Broker through specific sub-status codes. The details of changes brought by the Noticee, as per its submissions, were as below:
    22.1. CDSL introduced sub-status codes for stock-broker's Proprietary and Collateral Accounts;
    22.2. Description of sub-status code 'Client Margin Account' was changed to 'Client Account';
    22.3. Sub-status code of stock-broker's 'Client Beneficiary' accounts was changed to 'Client Account';
    22.4. New account opening with sub-status code 'Client Beneficiary' was discontinued;

22.5. For the stock-broker's accounts opened till December 3, 2016, a one-time modification window was provided to stock-brokers to change sub-status code to either 'Client' or 'Proprietary' or 'Collateral' through their Depository Participants till December 25, 2016 which was further extended till June 30, 2017.

23. I further note that the Noticee had issued Communiques dated September 29, 2016 and November 22, 2016 to all Depository Participants, interalia, informing them about the Circular dated September 26, 2016 and providing details of the facility which would be provided by Noticee in compliance with the said Circular. Further, I note from the Noticee's submission that for stock broker's demat accounts opened till December 3, 2016, wherein the stock brokers had not changed the sub status codes as mandated in the Circular dated September 26, 2016, Noticee had itself carried out the required changes and ensured that the demat accounts opened by Stock-Brokers were categorized as 1) Pool Account 2) Client Account 3) Proprietary Account / Deemed Proprietary and 4) Collateral Account.

24. I note that vide Communique dated September 29, 2016, Noticee had stated that the operational modalities with respect to guidelines regarding uniform nomenclatures for naming/ tagging demat accounts would be informed separately. Thereafter, vide Communique dated November 22, 2016, Noticee had provided facility of tagging the demat account with specific sub status codes, instead of change in nomenclature of the demat account. In this regard, point 3 of CDSL communique dated November 22, 2016 provides as follows:

*"..................It may please be noted that as the appropriate nomenclature as mentioned in the above mentioned SEBI circular can be tagged with the help of separate sub-status, DPs are not required to do any change in name of the demat account to give effect to the aforementioned SEBI circular.............."*

I note from the above that Noticee implemented the provisions pertaining to nomenclature in terms of SEBI Circular dated September 26, 2016 by tagging demat accounts through sub-status codes, which reflected the purpose of the demat accounts. However, Noticee did not change the name of the account itself. The aforesaid communique, which mandated the sub status codes in terms of its interpretation of SEBI Circular dated September 26, 2016, was issued to all the Depository Participants and was available in the public domain. I note that SEBI had not contradicted the aforesaid interpretation and implementation of the Circular dated September 26, 2016 by Noticee.

25. Further, I note that the Noticee served the purpose and spirit of the provisions pertaining to nomenclature provided in the Circular dated September 26, 2016, by providing for the tagging of demat accounts in sub-status categories, even though it did not ensure strict compliance with letter of the provisions by changing the name of account itself.

26. Upon consideration of the facts pertaining to the method of nomenclature adopted by the Noticee *in toto*, I am inclined to accept the Noticee's submissions as regards allegations levelled against it, and therefore, I note that the Noticee had not violated the provisions of Clause 2.3.1 read with Clause 1.2 of Annexure of SEBI Circular dated September 26, 2016.

**Issue No. III: Whether Noticee failed to record the freeze on the demat accounts of BRH, resulting in violation of provisions of Clause 13.4.2 of CDSL Bye Laws and the directions contained in the SEBI Interim Order. Further, whether Noticee, by allowing invocation of pledge from such demat accounts by HDFC, violated the directions contained in the SEBI Interim Order?**

27. I note that the SEBI Interim Order dated October 07, 2019 directed, interalia, the depositories that they should ensure no debits were made in the demat accounts of the Noticees including BRH, except for the specified purposes. Further, CDSL Bye Law 13.4.2 mandates that the CDSL or the Depository participants are under an obligation to give effect to any restraint/ attachment orders issued by SEBI by marking a freeze on the demat accounts in the manner specified in such orders.

However, the Noticee allegedly did not mark freeze on the demat account of BRH which was used for pledging clients' securities, and further, allowed invocation of the pledges by HDFC, resulting in violation of the directions contained in the SEBI Interim Order read with CDSL Bye Law 13.4.2.

28. In this regard, I note that the Noticee, as a practice, allowed invocation of pledges pertaining to demat accounts on which freezing orders had been passed vide SEBI orders, provided the pledge had been created prior to passing of such freezing order. I further note from the Noticee's submissions that it had repeatedly conveyed to SEBI regarding its position on allowing invocation of such pledges subjected to aforesaid conditions. The first such communication sent by the Noticee to SEBI was vide email dated March 21, 2014, wherein it was stated that,

*"We wish to clarify that if the pledgor's account is frozen for debit and credit pursuant to SEBI Order and –*

*a. <u>If securities are already pledged in favour of pledgee prior to the freeze, the pledge can be invoked by the pledgee</u>.*

*b. No fresh pledge is permitted after the freeze."*

29. I also note that Noticee, vide letter dated April 18, 2019, had sought SEBI's approval for the amendment of its Bye Laws to the effect that where a pledge or hypothecation had already been created on securities prior to the date on which the operations in respect of such securities had been frozen, the pledgee could invoke the pledge/hypothecation through the Depository Participant and the Noticee should register the pledgee as the Beneficial Owner of such securities. I note that further correspondences dated October 09, 2019, October 11, 2019 and January 10, 2020 were exchanged between the Noticee and SEBI, that is, after the passing of Interim Order dated October 07, 2019. However, SEBI had not raised any objection to the aforesaid practice of CDSL or prohibited the same either, in the aforesaid correspondences.

30. Further, SEBI had replied to the Noticee's request regarding amendment to the Bye Law, vide letter dated December 20, 2021, and stated, interalia, that

*"2……It is noted that the procedure for invocation of pledged/ hypothecated securities subsequently restrained or frozen by virtue of any regulatory order depends on several factors such as the terms of the legal-commercial contract between borrower and lender, and the directions of the restraining order. The transfer of ownership in such cases are governed by the circumstances of the specific case, which is taken into account by the depository.*

*3. there could be legal and procedural nuances in specific cases which could be subject to legal interpretations and moreover these may or may not be adequately reflected in the proposed bye laws, thus the proposed bye laws have not been approved by the Competent Authority".*

Therefore, to paraphrase, the aforesaid letter stated that the invocation of shares, after passing of freezing orders, must be done on a case to case basis depending on the terms of the contract between the lender and borrower and the directions of the restraining order. However, the aforesaid letter did not contain any direction to stop the practice by the Noticee completely.

31. I further note that the Hon'ble SAT in the matter of HDFC bank vs SEBI (Appeal no. 83 of 2021) had held that HDFC's invocation of pledge over the shares held in BRH's demat accounts after the passing of Interim Order was valid, and that the 'assets' of BRH referred to in Para 9(v) of the Interim Order did not include securities which were earlier pledged to HDFC.

32. I also note the provisions of CDSL Bye Law 13.4.2 as below:

*13.4.2. CDSL or the participant shall freeze the account of a Beneficial Owner maintained with it in the manner specified in the orders or directions of any court or tribunal or any Government or SEBI or any other authority made or given under any law for the time being in force.*

I note that the aforesaid provisions mandated the Noticee to freeze the account of a Beneficial Owner in the manner specified in the Order in that regard, however, it is not explicitly stated that the freeze extends to the securities which had been pledged before the date of the Interim Order.

33. I note that from the material on record, including the extant provisions and the correspondence exchanged between SEBI and the Noticee since 2014, that it could not be construed that the Noticee was mandated to ensure prohibition on invocation on securities pertaining to which freezing order had been issued. Therefore, the Noticee, by allowing HDFC to invoke the pledge over securities as detailed in foregoing paragraphs, had not violated the directions contained in SEBI Interim Order dated October 07, 2019 read with CDSL Bye Law 13.4.2.

## ORDER

34. Considering the facts and circumstances of the case as stated above, I am of the view that the Noticee has not violated the provisions as alleged in the SCN. The Show Cause Notice ref no EAD-6/AK/VV/15461/1/2023 dated April 20, 2023 issued against the Noticee is accordingly disposed of.

35. In terms of Rule 6 of the Adjudication Rules, 2005 and Rule 6 of the Adjudication Rules, 1995, a copy of this order is being sent to the Noticee and also to the SEBI.

**Place: Mumbai** **AMIT KAPOOR**

**Date: July 24, 2023** **ADJUDICATING OFFICER**