SHIVAM AUTOTECH LTD

**Date: 9th May, 2023**

**The National Stock Exchange of India Limited**
Exchange Plaza, Bandra Kurla Complex,
Bandra East,
Mumbai – 400051
**(Scrip Code – SHIVAMAUTO)**

**The BSE Limited**
Phiroje Jeejeebhoy Towers
Dalal Street Fort
Mumbai – 400 001
**(Scrip Code – 532776)**

**Ref: Disclosure under Regulation 30 of Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015.**

Dear Sir/Madam,

Pursuant to Regulation 30(2) read with Part A of Schedule III of the of the SEBI (Listing obligations and Disclosure Requirements) Regulations, 2015, ("SEBI Listing Regulations") we wish to inform you that Mr. Bhagwan Dass Narang (Chairman & Independent Director- DIN 00826573) and Ms. Jyothi Prasad (Independent Director-DIN 06947488) ceases to be the Directors from the Board and Committees of the Board of Directors with effect from 28th April, 2023 vide SEBI order no. WTH/SM/MIRSD/MIRSD -SEC-4-26042/2023-24 of the Company. Further Company is in the process of taking actions for applicable regulatory compliances to implement the SEBI orders as applicable in the very next forthcoming meeting of the Board of Directors.

This intimation is being provided to the Exchange pursuant to provisions of Regulation 30 and other applicable regulations, if any, of SEBI (Listing Obligation and Disclosure Requirements) Regulation, 2015 for intimation and record.

We are attaching herewith the SEBI order for your reference.

You are requested to take the same on record.

Thanking you.

Yours truly,

**FOR SHIVAM AUTOTECH LIMITED**

Preeti Sharma
Digitally signed by Preeti Sharma
Date: 2023.05.09 20:58:29 +05'30'

**PREETI SHARMA**
**COMPANY SECRETARY**

SHIVAM AUTOTECH LTD

**Annexure-1**
**Cessation of Independent Directors of the Company:**

| Details of events that need to be provided | Information of such event(s) | |
|---|---|---|
| **Name of the Director** | Mr. Bhagwan Dass Narang | Ms. Jyothi Prasad |
| **DIN** | 00826573 | 06947488 |
| **Designation** | Chairman & Independent Director | Independent Director |
| **Reasons For change** | Cessation vide SEBI order no. WTH/SM/MIRSD/MIRSD - SEC-4-26042/2023-24 dated 28th April, 2023 | Cessation vide SEBI order no. WTH/SM/MIRSD/MIRSD - SEC-4-26042/2023-24 dated 28th April, 2023 |
| **Brief Profile** | Not Applicable | Not Applicable |
| **Disclosure of Relationship between Directors (in case of appointment of a director)** | Not Applicable | Not Applicable |

**FOR SHIVAM AUTOTECH LIMITED**

Preeti Sharma
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Date: 2023.05.09 20:59:20 +05'30'

**PREETI SHARMA**
**COMPANY SECRETARY**

SHIVAM AUTOTECH LTD

## LIST OF DIRECTORS AS ON DATE

| S.NO. | Name of Director | Designation |
|---|---|---|
| 1. | Mr. Neeraj Munjal | Managing Director |
| 2. | Mrs. Charu Munjal | Whole Time Director |
| 3. | Mr. Anil Kumar Gupta | Non-Independent Director |
| 4. | Mr. Sunil Chinubahi Vakil | Independent Director |

**FOR SHIVAM AUTOTECH LIMITED**

Preeti Sharma
Digitally signed by Preeti Sharma
Date: 2023.05.09 21:00:07 +05'30'

**PREETI SHARMA**
**COMPANY SECRETARY**

# SECURITIES AND EXCHANGE BOARD OF INDIA

## ORDER

**UNDER SECTIONS 11(1), 11(4), 11B(1) AND 11B(2) OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 AND SECTION 12A(2) OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 IN THE MATTER OF KARVY STOCK BROKING LIMITED**

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**In respect of:**

| Noticee No. | Name of the Noticees | PAN |
|---|---|---|
| 1. | Karvy Stock Broking Limited | AABCK5190K |
| 2. | Comandur Parthasarathy | AAFPC7617L |
| 3. | Yugandhar Meka | ADKPM7260M |
| 4. | Bhagwan Das Narang | AAEPN3092R |
| 5. | Jyothi Prasad | AAEPP6028P |
| 6. | Ashish Agarwal | ABVPA4409P |
| 7. | Rajiv Ranjan Singh | ASHPS8610D |
| 8. | Karvy Realty (India) Limited | AAECM0358C |
| 9. | Karvy Capital Limited | AAACG4544N |

(The above-mentioned entities are individually referred to by their corresponding names/numbers and collectively referred to as "*Noticees*")

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**<u>Background in brief</u>**

1. Karvy Stock Broking Limited (hereinafter referred to as '**KSBL**'/'***Noticee no. 1***'/'***Company***') is registered with Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') as a stock broker with registration number

INZ000172733. KSBL was a member registered with National Stock Exchange of India Ltd. (hereinafter referred to as "**NSE**") and the BSE Ltd. (hereinafter referred to as "**BSE**") for its stock broking activities. KSBL is also registered as a Depository Participant (in short "**DP**") with SEBI registration number IN-DP-CDSL-175-2015 and was a member of National Securities Depository Limited (hereinafter referred to as '**NSDL**') and Central Depository Services Limited (hereinafter referred to as '**CDSL**').

2. NSE forwarded a preliminary report dated November 22, 2019 to SEBI which was prepared based on a limited purpose inspection of KSBL conducted on August 19, 2019 wherein the records of KSBL from January 01, 2019 onwards were inspected. In the said report, NSE had *inter-alia* observed that KSBL was raising funds by pledging clients' securities and by misusing the Power of Attorney (in short '**PoA**') granted to it by its clients and the funds so raised were being diverted to the group entities of KSBL, thereby violating various provisions of law with respect to pledging/misuse of clients' securities by KSBL. It was also alleged in the said preliminary report that KSBL had sold excess securities (securities not available in DP account) to the tune of INR 485 Crore through 9 related entities, which were also its clients, till May 31, 2019. Further, KSBL had also transferred excess securities to 6 out of these 9 related entities.

3. In order to prevent further misuse of clients' securities, SEBI had passed an ex-parte ad-interim order dated November 22, 2019 (hereinafter referred to as '***Interim Order***') against KSBL on the basis of facts and material presented by NSE in its preliminary report. In the said *Interim Order*, KSBL was prohibited from taking new clients in respect of its stock broking activities and NSDL and CDSL were directed not to act upon any instruction given by KSBL in pursuance of Power of Attorney given to it by its clients. At the same time, NSDL and CDSL were also directed to monitor the movement of securities into and from

the DP account of clients of KSBL as DP, to ensure that its clients' operations are not affected. NSDL and CDSL were also directed to allow transfer of securities from DP account no. IN300394-11458979, named KARVY STOCK BROKING LTD (BSE) only to the respective beneficial owner who has paid in full against these securities, under supervision of NSE.

4. Subsequently, a clarificatory order dated November 29, 2019 was passed by SEBI wherein it rejected the request of KSBL to permit KSBL to use the Power of Attorney granted by its clients, only for the limited purpose of transfer of securities to the pool account solely for settling the clients' pay-in obligations to the Stock Exchanges.

5. Aggrieved by this aforementioned clarificatory order, KSBL filed an appeal before the Securities Appellate Tribunal (hereinafter referred to as '**SAT**'), which was dismissed by the Hon'ble SAT vide order dated February 11, 2020 on the ground of 'Appeal not pressed'.

6. In the meanwhile, NSDL issued a press release on December 02, 2019 *inter alia* stating that pursuant to the aforementioned SEBI Orders, NSDL had transferred securities from the demat account IN300394-11458979 of KSBL to the demat accounts of respective clients who have paid in full against these securities.

7. At the same time, vide its order dated December 02, 2019, NSE suspended KSBL from its membership. Against the said decision of NSE, KSBL had filed an Appeal before Hon'ble SAT which also got disposed of by Hon'ble SAT vide its order dated December 03, 2019 with a liberty to KSBL to file an appeal before Member and Core Settlement Guarantee Fund Committee of NSE (hereinafter referred to as '**MCSGFC**'). Vide its order dated December 06, 2019, MCSGFC dismissed the appeal of KSBL and upheld the decision of NSE temporarily suspending the membership of KSBL. Subsequently, vide order dated November 23, 2020, the MCSGFC decided to expel KSBL from the membership of NSE.

8. During this whole period since the passing of the *Interim Order* till November 2020, KSBL had not submitted its reply to SEBI with respect to the allegations and *prima-facie* observations made in the said *Interim Order* and only sought adjournments after adjournments on the ground that it was making efforts to arrange funds in order to settle the claim of its clients or by citing other reasons/excuses viz: COVID pandemic or heavy rains in Telangana or sickness of its Chairman or negotiation being done with a buyer (who was supposedly interested in buying the stake in one of the group companies of KSBL from which it expected to received funds to settle claims of its clients) etc. It is observed that, despite numerous adjournment granted to it, KSBL didn't submit its reply to the allegations and also failed to appear for personal hearing on one or the other pretext. Finally, the directions issued vide *Interim Order* were confirmed by SEBI vide Order dated November 24, 2020 (hereinafter referred to as '***Confirmatory Order***'). It is pertinent to record that no appeal has been preferred by KSBL against the said *Confirmatory Order* and consequently, the directions issued against it vide the *Interim Order* are continuing to be in force till date.

9. In the meantime, NSE had appointed Ernst and Young LLP (hereinafter referred to as '***EY***'/'***Forensic Auditor***') to conduct forensic audit into the shortfall of funds and securities noticed during joint inspection conducted by SEBI, NSE, BSE, NSDL and CDSL, in order to identify the extent of misuse of funds and securities as well as other violations committed by it and also to identify the role of management and directors of KSBL in the said wrongdoings. Consequently, EY conducted forensic audit of the records of KSBL for starting from the period of April 01, 2016 to October 19, 2019 (hereinafter referred to as '**Examination Period**") and submitted its report to NSE on January 09, 2020. On the basis of

findings of the aforementioned joint inspection and Forensic Audit Report of EY, NSE also submitted its observations to SEBI on November 23, 2020.

10. On the basis of all the material available on record, SEBI conducted its own examination and noticed the following;

10.1. KSBL was raising loans from financial institutions by pledging shares of its clients as collateral. In September 2016, KSBL's outstanding borrowing under loan against securities (in short "**LAS**") facility offered by banks stood at INR 789.41 crore, with the overall borrowing standing at INR 1,051.36 crore. The said overall borrowing of KSBL increased to INR 2,032.67 crore by September 30, 2019.

10.2. At the same time, there was a substantial increase seen in the pledging of securities by KSBL. The value of securities pledged increased from INR 202 crore on June 30, 2017 to INR 1,855 crore by March 2018 and had further increased to INR 2,700 crore by September 2019.

10.3. It was also noted that as on September 05, 2019, at least 75 percent of the total shares in all its clients' holding were pledged by KSBL to borrow funds for its own use, which included cases where the clients' holding were pledged despite such clients having credit balances in their accounts maintained with KSBL as on that date. Further, out of all the clients whose securities were pledged by KSBL with various financial institutions, a total of 58% of these clients, who were holding at least 52% value of all the pledged securities, hadn't even traded for more than one month prior to September 05, 2019.

10.4. It was found that clients' securities were pledged regularly even in case of clients who had no negative balance (i.e. who had zero or credit balances). Securities of these clients were transferred to KSBL's margin/beneficiary

account and were pledged to financial institutions from the said account. Upon enquiry, KSBL failed to provide any evidence of consent being taken from any of these clients to pledge their securities. At the same time, it was seen that stocks were borrowed/taken from clients' demat accounts without following Stock Lending and Borrowing Mechanism of the Stock Exchanges.

10.5. The loans undertaken by KSBL from banks/NBFCs increased sharply from INR 500.77 crore as on 31 March 2019 to INR 2,032.67 crore on 30 September 2019. Out of this, an amount of INR 786.93 Crores was raised by pledging securities worth of INR 2700 Crores with the financial institutions.

10.6. This also shows that KSBL borrowed an additional INR 1,531.90 Crores during the six months' period from April 01 to September 30, 2019. Out of this additional borrowing of INR 1,531.90 Crore, an amount of INR 1,228.36 Crore was noticed to have been transferred to the group companies of KSBL. Out of this 1,228 Crores so transferred, INR 428.36 Crore have been shown as advances for investment in subsidiaries and INR 800 Crore have been shown as Loans to/receivables from the subsidiaries in the books of accounts of KSBL.

10.7. It was noticed by EY from the analysis of total inflow/outflow between KSBL and its group entities that a net amount of approximately INR 1,120 Crore was transferred from KSBL to its various group companies over the period of time till October 19, 2019. Out of this amount, largest beneficiaries of these transfer of funds over the course of Examination Period were two wholly owned subsidiaries of KSBL viz. M/s Karvy Realty India Limited (hereinafter referred to as '***Noticee no. 8***'/'***Karvy Realty***') and M/s Karvy Capital Limited (hereinafter referred to as '***Noticee no.***

***9*** /'***Karvy Capital***') which received INR 1094.19 Crores and INR 348.76 Crores respectively form KSBL. As already mentioned earlier, the said funds were raised by KSBL by pledging securities which were not owned by it but were owned by its clients and the said amounts have not been returned by the respective companies to KSBL.

10.8. In addition to this, NSE also identified that KSBL had shortfall of funds to the tune of INR 402 crore and there was also shortfall in securities (valuation) to the tune of INR 157 crore as on November 17, 2020.

10.9. Supplanting the above, MCSGFC of NSE has observed certain other violations by KSBL in its order dated November 23, 2020, which are in short stated as under:

10.9.1. Misappropriation of securities of other clients amounting to INR 484.56 crore and these securities were used for meeting the obligation of 9 connected clients or entities.

10.9.2. Non-availability of client funds to the tune of INR 67.58 crore as on September 24, 2019. The given shortfall had deemed to have increased further to INR 319 Crore in the light of the letter dated November 29, 2019 from Union Bank of India informing that certain funds claimed to be available with KSBL earlier in form of FDs were not free from encumbrances.

10.9.3. NSE reported that KSBL has not settled funds to the extent of INR 527.18 crore and securities worth of INR 2862.05 crore, that were outstanding to its clients as on November 22, 2019. Out of this, settlement of funds amounting to INR 78.86 crore belonging to 1,17,318 clients and securities amounting to INR 827.93 Crore

belonging to 81,119 clients had not taken place despite no trading done by these clients for more than 3 months prior to that date.

10.9.4. Incorrect submission of data under Enhanced Supervision.

10.9.5. As on September 30, 2019, there was a shortfall of Net worth of KSBL and the same was calculated as INR (-)1,388.08 Crore after considering loans and advances to group companies/associates.

11. On the basis of the aforementioned findings, an SCN dated January 29, 2021 was issued to a total number of 9 entities namely KSBL, its promoter cum Managing Director C Parthasarathy (hereinafter referred to as '***Noticee no. 2***') and its other directors viz. Mr. Yugandhar Meka, Mr. Bhagwan Das Narang, Ms. Jyothi Prasad and Mr. Ashish Agarwal (who had resigned from the *Company* on July 14, 2019), its CEO Mr. Rajiv Ranjan Singh and two wholly owned subsidiaries of KSBL viz. *Karvy Realty* and *Karvy Capital*, both of which were the alleged beneficiaries of the aforementioned wrongdoings. In the said SCN, it was alleged that KSBL and its aforementioned management have failed to perform their respective role and further have displayed glaring lack of vigilance on their part which was the reason for the unauthorized pledging/misutilisation of clients' securities & funds as cited above. The aforesaid acts were observed to be not in compliance with the Rules, Regulations, and Circulars issued by SEBI from time to time. It is also alleged that the two group companies of KSBL namely *Karvy Realty* and *Karvy Capital* were the two major beneficiaries of the funds diverted by KSBL by mis-utilizing funds and securities of the clients, held by KSBL in a fiduciary capacity. The SCN has alleged that afore-stated acts and omissions on the part of KSBL, have resulted into violation of the following provisions of law:

11.1 Section 23D of Securities Contracts (Regulations) Act, 1956 (hereinafter referred to as '**SCR Act, 1956**') read with SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993;

11.2 Regulation 4(1) and 4(2)(m) of Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), Regulations, 2003 (hereinafter referred to as '**PFUTP Regulations**')

11.3 Clauses A(1), A(2), A(3), A(4) & A(5) of Code of Conduct as provided under Schedule II read with Regulation 9 of the Securities and Exchange Board of India (Stock Brokers) Regulations, 1992 (hereinafter referred to as '**Stock Broker Regulations**');

11.4 SEBI Circulars No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016. and SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/201764 dated June 22, 2017;

11.5 SEBI Circular CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 read with SEBI/HO/MIRSD/DOP/CIR/P/2019/95 dated August 29, 2019;

11.6 SEBI Circular SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009;

Further, the Designated Directors of KSBL, and CEO (*Noticees no. 2 to 7*) are deemed to be responsible for conducting the business of the *Company* or managing the affairs of the *Company* related to its business activities and therefore, they have been made liable in terms of provisions given under Sections 27(1) and (2) of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as '**SEBI Act**') for the afore listed alleged violations committed by and on behalf of the *Company* i.e. KSBL.

12. In view of the aforesaid allegations that have been brought out in the SCN, the *Noticees* were called upon to show cause as to why suitable directions should not be issued against them and appropriate penalty be not imposed upon them under

the provisions of Sections 11(1), 11(4), 11B(1), 11B(2) of SEBI Act as well as Section 12A(2) of SCR Act, 1956 for the alleged violations of the provisions of law mentioned in the SCN.

13. The SCN was initially delivered to all the *Noticees* at the registered address of *Noticee no. 1,* as it was the last available workplace address of *Noticees*. However, no reply was forthcoming from any of the *Noticees*. Therefore, a reminder letter dated September 03, 2021 was issued. However, no reply was submitted by any of the *Noticees* even after delivery of the said reminder letter. Subsequently, a personal hearing of all the *Noticees* was scheduled in the matter on March 22, 2022 so as to honour and ensure due compliance with the principles of nature justice. None of the *Noticees* appeared in the personal hearing on the scheduled date however, a letter dated March 21, 2022 was received on the letterhead of KSBL wherein a request for adjournment of personal hearing was made on the ground that the *Noticee no. 2* being in judicial custody, was unable to appear and make the submissions on behalf of himself as well as on behalf of the *Company*. Considering the above and in the interest of justice, the scheduled personal hearing in the matter was adjourned to May 05, 2022. On the said date Mr. Prashant Kumar and Mr. Javed Lateef, advocates, appeared for *Noticees no. 1, 2* and *8* and sought adjournment on the ground that the *Noticee no. 2* was still in judicial custody and they were in process of collecting documents and information so as to make a suitable representation defending the interest of these noticees viz. *Noticees no. 1, 2* and *8* effectively. Considering the facts associated with the matter, the personal hearing was adjourned to May 20, 2022 and the *Noticees* were asked to ensure their presence on the said pre-scheduled date. On the said date, the aforementioned two Authorized Representatives appeared for *Noticees no. 1, 2, 4, 5, 8* and *9* and made their common submissions vide a common letter dated May 20, 2022, which they also reiterated in their oral submissions.

14. Meanwhile, vide letter dated May 09, 2022, *Noticee no. 3* claimed that he hadn't received the SCN and provided his personal address and email ID requesting to be provided with sufficient documents to enable him to defend the allegations made in the SCN. To ensure that a fair and transparent process is followed and *Noticee no. 3* is given sufficient opportunity, a copy of the SCN along with necessary annexures was served upon *Noticee no. 3* vide email dated May 17, 2022. Further, as no appearance was made by *Noticees no. 6* and *7*, another attempt was made to deliver the SCN at the alternate address of these two noticees. It is seen that the SCN was delivered to the *Noticees no. 6* and *7* at their respective alternative addresses vide Speed Post on July 06, 2022 and July 08, 2022 respectively.

15. Subsequently, *Noticees no. 3* and *6* sought inspection of documents which was granted to them and the said inspection was carried out by *Noticees no. 3* and *6* on July 06 and 14, 2022 respectively. Subsequently, replies to the SCNs were received from *Noticees no. 3, 6* and *7*. After that, personal hearing in the matter was scheduled again on September 14, 2022 which was attended by the respective Authorized Representatives(ARs) of *Noticees no. 3 & 6* and in their oral presentations, these two ARs reiterated their individual submissions already made by them vide letters dated September 13, 2022 and September 12, 2022 respectively. The submissions of *Noticee no. 3* were supplanted by his post-hearing submissions dated March 30, 2023.

16. *Noticee no. 7* had also appeared along with his Authorized Representative in the said hearing conducted on September 14, 2022 but he requested for an adjournment of the hearing so as to be able to submit his reply in the light of his recent release from judicial custody. He also sought certain additional documents. While his request for adjournment was accepted, he was intimated that all the relied upon and relevant documents available with SEBI have already been provided to him and the additional documents desired by him are neither part of

the present proceedings nor are available with SEBI, hence, his request was not acceded to. Subsequently, he submitted his reply to the SCN vide letter dated October 05, 2022 and the said submissions were also reiterated by his Authorized Representative in his arguments before me during the personal hearing conducted on November 10, 2022. The said submissions were supplanted by his post hearing submission dated February 17, 2023.

17. In the end, I find that the *Noticees* by way of different letters have submitted their respective written replies to the SCN, the details of which can be listed out at one place in the following table:

**Table 1: List of replies of the respective Noticees**

| **Noticee no.** | **Letter date** |
|---|---|
| Noticee no. 1 | May 20, 2022 |
| Noticee no. 2 | May 20, 2022 |
| Noticee no. 3 | September 14 & 15, 2022, March 30, 2023 |
| Noticee no. 4 | May 20, 2022 |
| Noticee no. 5 | May 20, 2022 |
| Noticee no. 6 | September 12, 2022 |
| Noticee no. 7 | September 04, 08, & October 05, 2022 and February 17, 2023 |
| Noticee no. 8 | May 20, 2022 |
| Noticee no. 9 | May 20, 2022 |

18. In the meanwhile, vide an application dated August 10, 2022, *Noticee no. 6* had sought the instant proceedings qua him to be settled under the Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018, however, the said settlement application was rejected by SEBI and the said rejection of his application was intimated to him vide letter dated December 05, 2022.

**Replies of the *Noticees*:**

19. *Noticees no. 1, 2, 4, 5, 8* and *9*, by way of a common letter dated May 20, 2022, made their submissions which were more or less common in nature. The main contentions of these 6 noticees articulated in their submissions that are relevant for the purpose of instant proceedings are captured in brief hereunder:

    19.1. KSBL was incorporated in 1995 and it was originally promoted by a few chartered accounts. Of the original promoters/shareholders, *Noticees no. 2, 3* and one M. S. Ramakrishna continued to be the shareholders, and *Noticee no. 2* along with his family was having the largest shareholding in the *Company*.

    19.2. *Noticees no. 4 & 5* were independent directors of the *Company*. *Noticee no. 6* was the nominee director from Baring Asia, a foreign private equity firm which had invested to the extent of about 10% of the share capital of KSBL. *Noticee no. 6* had resigned from KSBL in August 2019 and *Noticees no. 2 & 3* were mentioned as the designated directors in the records of NSE and other exchanges during the period relevant for the present proceedings.

    19.3. *Noticees no. 1, 2, 4, 5, 8* and *9* have contended that it was *Noticee no. 7*, being the CEO of the *Company*, was overall in charge of retail broking which includes back office operations, reporting to the exchanges about various compliances etc.

    19.4. KSBL had over 400 branches and over 1200 franchisee outlets apart from having online facility provided to its clients. The business development team taking care of the franchisee was separate (and they were not reporting to the *Noticee no. 7*) however, the operations team providing support to the back office team of the franchisee was common. There was a back office operations head who was reporting to the *Noticee no. 7*.

19.5. The 6 noticees have further submitted that the treasury team of KSBL was managing the pay in and pay out of funds and the collection of funds was handled by a separate team, whose head was reporting to the VP (Finance) and a KMP of KSBL, while they also had a dotted line reporting to the operations head and CEO of broking i.e. *Noticee no. 7*.

19.6. While explaining the connection with 9 allegedly related clients to whom funding was allegedly provided by KSBL using other clients' funds, these 6 noticees have submitted that Karvy group had incorporated 8 companies for the purpose of canvasing insurance policies of various insurance companies. However, due to certain regulations of IRDAI, Karvy group was not allowed to directly or indirectly procure insurance policies. Hence, the business of canvasing of insurance policies in the said companies was stopped but these companies were not closed.

19.7. They have also submitted that *Noticee no. 7*, in connivance with the VP (Finance), undertook large trading activities in these companies and in order to meet the pay in obligations, had pledged the shares so purchased in these companies and availed loans. Apart from this, in connivance with the VP (Finance), he had also transferred funds from KSBL to *Karvy Realty* and in turn to these 9 related entities, for meeting the exchange obligations. The value of positions/stocks, that were procured in these companies, had fallen very low on account of the fall in the market and there were huge losses incurred.

19.8. With respect to the allegation of misusing of clients' securities, the aforementioned 6 noticees have submitted that KSBL was in the process of providing T+5 facilities to its clients and the clients were providing the securities towards margin requirements. The securities had to be transferred to the account of KSBL for availing the credit facilities towards working

capital from the banks for the purpose of funding of these clients. These 6 noticees have categorically submitted that the banks were aware that the securities were those of the clients and KSBL used to provide a periodic statement to the banks with details of ultimate beneficiaries of these securities. A few of the bank sanction letters clearly mentioned that the collateral would be client securities (sanction letters of Axis Bank and HDFC Bank clearly specifies this). KSBL was providing a statement to the bankers wherein the details of the securities being held in the beneficiary account of KSBL as collateral on behalf of the clients, were clearly mentioned. Such statement provided the client code, the clients name and the details of the securities held by them. The accusation that the clients' securities were wrongly pledged from the beginning is totally false, erroneous and the banks appear to have used 'pledging of clients' shares' as an unfair accusation against KSBL.

19.9. The 6 noticees have contended that the securities so pledged were used only for the purpose of meeting the clients' obligations, barring the exception in 2019, when, without the knowledge of MD and Board of Directors, *Noticee no. 7* had unilaterally taken some positions in some clients' accounts connected with KSBL. In order to fulfil the obligations, *Noticee no. 7* had pledged additional securities of clients, where the securities were borrowed at a cost, by paying interest on the value of the securities to these clients.

19.10. The aforementioned 6 noticees have attempted to explain fund transactions with *Karvy Realty* by stating that KSBL, apart from being a broker member with NSE and other stock exchanges, was also into other business activities. As a holding company, KSBL was investing into the capital of a number of its subsidiary companies and was also providing short term liquidity to these

subsidiary companies in the form of ICDs through *Karvy Realty*, which itself was a 100% subsidiary of KSBL.

19.11. An attempt has been made by these 6 noticees to explain the shortfall in net worth by stating that the net worth of KSBL was calculated based on L C Gupta Committee formula. As per this formula, any investment in an unlisted subsidiary company was required to be deducted from calculation to arrive at the net worth. However, any short term advances to subsidiary companies was earlier not required to be deducted. To overcome this difference in calculation of net worth on the basis of inclusion and exclusion of various instruments, KSBL was providing short term funds to *Karvy Realty*, which was in turn subscribing to the capital of the subsidiary companies and was also providing short term funds. Due to amendment in the process of calculation of net worth since August 2021 wherein it was decided to deduct short term advances from gross calculations, there was a sudden shortfall in net-worth.

19.12. It has been submitted by the aforementioned 6 noticees that the facilities that were being provided by KSBL to the subsidiaries were out of its own funds (surplus of the brokerage earned and other earnings), and from term loans borrowed from the banks. The LAS facility was being availed only for the purpose of meeting the client obligations. This is visible clearly in light of the fact that the total outstanding funds against LAS facility as on September 30, 2019 was only 785.93 crores, whereas the investment and advances in/to the subsidiaries were INR 1120 crores.

19.13. They have further submitted that, pursuant to SEBI circular dated June 20, 2019, stating that client securities should not be pledged by the stock broker, KSBL had negotiated with its Bankers to replace the clients' shares earlier provided by it as collateral with its own shares. Accordingly,

unencumbered shares of Karvy Data Management Services Limited and K Fin Technologies Limited, held by *Noticee no. 2* in his personal capacity and that of his son were offered. Additionally, *Noticee no. 2* also provided all his Immovable properties as security, apart from providing personal guarantee in order to release clients' shares. ICICI Bank Limited and HDFC Bank Limited had taken the shares of Karvy Data Management Services Limited and K Fin Technologies Ltd., as replacement collaterals to the clients' securities but they failed to release the clients' securities in return.

19.14. In the end, it has been submitted by KSBL and *Noticee no. 2* that they are in the process of settlement of clients' funds and securities as well as one-time settlement of banks' dues. In this regard, the funds to the extent of INR 311 Crores have been settled by virtue of sale of certain businesses of KSBL and other Karvy Group entities by NSE.

20. *Noticee no. 3*, by way of letters dated September 13 & 15, 2022 and March 30, 2023, made his submissions. The submissions so advanced are as follows:

20.1. *Noticee no. 3* has submitted that he has been a Non-Executive Director of KSBL since March 30, 1995 and as such had neither any knowledge nor any kind of control over the day-to-day affairs of the KSBL including the decisions taken on pledging of clients' securities for borrowings or transfer of funds to group companies of KSBL.

20.2. *Noticee no. 3* has further submitted that the issue of borrowings by pledging clients' shares and transfer of funds to group companies was never raised before the Board.

20.3. He has further contended that, despite all these facts, he has exercised due diligence and, as early as in January 2017, he had questioned the then CFO of KSBL, Mr. G Krishna Hari, about the borrowings of KSBL and if

clients' shares were pledged for obtaining loans. However, in his reply email dated January 21, 2017, Mr. G Krishna Hari had categorically denied pledging of clients' shares.

20.4. He has further contended with support of necessary evidence that he had again written to the CFO of KSBL (Mr. G Krishna Hari) in May, 2019, and sought more details about the securities pledged by KSBL for borrowings and the end use of the loans obtained. He had also requested *Noticee no. 2* to order a forensic audit of the *Company* in September, 2019. However, *Noticee no. 2* refused to order a forensic audit on the pretext that it would aggravate the situation and also cited personal difficulties for not acting upon the requests to provide the aforementioned information.

20.5. Even attempts made by *Noticee no. 3* subsequent to the *Interim Order* to access any kind of document related to KSBL was denied. In support of this, *Noticee no. 3* has submitted copies of emails dated February 19, 2020 and May 25, 2020, wherein he had sought information and documents of the alleged loans taken by the *Company* or about the purpose or compliances with respect to the same loans. However, the said requests were not entertained by *Noticee no. 2*. In fact, his requests for forensic audit of KSBL and audit of various financial transactions prior to sale of Karvy Data Management Services Ltd. had also fallen to deaf ears.

20.6. *Noticee no. 3* has further submitted that over the period of last two years, he has also written multiple letters to the regulators flagging the lapses at KSBL and requesting appropriate regulatory action as the Board of Directors and *Noticee no. 2*, being the Chairman and Managing Director of KSBL, had refused to act on the issues flagged by SEBI order.

20.7. *Noticee no. 3* also submitted evidence in support of his claim that he had reported several statutory non-compliances by the *Company* to the Registrar

of Companies which pertinently highlighted that no board meetings of the *Company* had taken place for 6 (six) quarters and there was a failure on part of the Key Managerial Personnel to disclose the information to the Members of Board of Directors.

20.8. *Noticee no. 3* has contended that the material available on record doesn't implicate him as he was not a key employee and KSBL itself has admitted that only the CMD was in position to explain the business rationale for transfer of funds made by KSBL to group companies. In addition to the CMD, only the CFO, Compliance Officer, Finance head and some other persons were updated on the dealings with banks for borrowings.

20.9. In support of this submission, *Noticee no. 3* has intimated that the Hyderabad Police, in its investigation into the loan defaults committed by KSBL to the Banks and other financial institutions, has already come to the conclusion that he had no knowledge of the fraud perpetrated in KSBL.

20.10. The Enforcement Directorate ('ED') had also initiated a money laundering investigation against KSBL. Its fund trail investigation found that the CMD i.e. *Noticee no. 2* and the CFO of KSBL, Mr. G Krishna Hari, were the main conspirators in transferring the borrowed funds to other group companies of KSBL as well as to certain shell companies.

20.11. In the end, *Noticee no. 3* has pointed towards certain specific points in the EY report wherein it has been mentioned that the employees of KSBL have stated that only *Noticee no. 2*, being the CMD, would be able to explain the business rationale for transfer of the funds raised by KSBL, to its group companies.

21. Similar to the aforementioned submissions of *Noticee no. 3*, *Noticee no. 6* has also submitted that he was on the Board of KSBL as the Nominee Director on behalf

of a Foreign based private equity firm which had invested to the extent of more than 10% of total share capital of KSBL. He had no role in the day to day functioning of KSBL and was not aware of any wrongdoings of KSBL as none of these wrongdoings was ever brought before the Board of Directors of the *Company*.

22. Moving on to the *Noticee no. 7*, I find that by way of letters dated September 04, 2022, September 08, 2022, October 05, 2022 and February 17, 2023, he has made his submissions as summarized below:

    22.1. *Noticee no. 7* had requested for certain documents which mainly related to the documents relied upon by MCSGFC while passing its order dated November 23, 2020. *Noticee no. 7* has also requested for cross examination of some of the present/former employees of KSBL.

    22.2. He has stated that he had left KSBL in January, 2020. Presently, he doesn't have any access to information and documents related to KSBL. The Management of KSBL is trying to make him a scapegoat by shifting all possible blames on him and by projecting him as the person who was handling the affairs of the *Company*.

    22.3. *Noticee no. 7* has contended that there has been an inordinate delay of three years in initiation of the present proceedings in the light of the fact that the inspection was conducted from June to August 2019 and the hearings have taken place in the year 2022. He has also submitted that the delay has caused him great prejudice as he has no access to the records of KSBL and is unable to make his submissions.

    22.4. While submitting that the SCN was issued to him only on the basis of his designation and there is no finding or adverse observation against him either in the SCN or its Annexures, *Noticee no. 7* has attempted to explain

that his job profile was client acquisition, client servicing and Branch co-ordination for equity retail broking business of KSBL. The designation assigned to him as "CEO-Stock Broking" was given to him only from October 2017 without any change in job profile. The said designation was a 'market facing' designation and no power was vested in him as a consequence of assigning this designation.

22.5. While attempting to explain the corporate structure of KSBL, *Noticee no. 7* submitted that the *Company* consisted of various divisions like Retail arm of Stock Broking, Private Wealth Management, Distribution of Financial Products, Currency Broking, Franchisee Business, Institutional Broking, etc. and other business with other group companies. Furthermore, at no point of time, he was heading this big conglomerate of KSBL or all the Stock Broking businesses of KSBL. The businesses related to Franchisee Broking, Institutional Broking & Currency Broking had their own separate Business Heads reporting directly to the CMD. The finance, operations, human resources and administration teams commonly catered to all the business divisions of KSBL and were not under his control.

22.6. *Noticee no. 7* has further contended that broadly his role and involvement was too petty/miniscule to be portrayed as a CEO of the *Company* since he was looking after only a very small functional activity in KSBL. He has submitted that he had never done any back-office, compliance or inspection related work in his career at KSBL and for the first time in 2019, he was asked by KSBL management to coordinate with the NSE inspection team.

22.7. *Noticee no. 7* has submitted that he has been implicated on the basis of his misleading designation as the CEO of the *Company*, though in reality he was not the CEO of the whole *Company* KSBL but was only heading a

small part of the business vertical of the *Company* related to stock broking and consequently, he was not the person responsible for the overall business or day to day management of the KSBL. He was only an employee of the *Company* looking after Client acquisition, Client servicing and Branch co-ordination for retail broking business of KSBL. The designation granted to him was not a statutory designation in terms of Companies Act, 2013 but was an in-house or internal departmental designation. The same can be understood from the fact that two other persons viz. Mr. Abhijit Bhave and Mr. Ramapriyan P.B. were also designated as CEOs by KSBL.

22.8. The prescribed procedure for appointment of CEO or Key Managerial Person under the provisions of the Companies Act, 2013 and the rules thereof *inter-alia* includes passing of a Board Resolution, obtaining consent letter, issuing appointment letter and filing statutory forms with Registrar of Companies (in short '**RoC**'). However, no part of the said procedure was carried out by KSBL in case of his appointment as a CEO so as to statutorily designate him as CEO of KSBL under Companies Act, 2013. Conversely speaking, in 2020, the required statutory process was in actuality carried out by KSBL while making appointment of Mr. Amitabh Chaturvedi as a CEO. In fact, KSBL never considered him as a KMP. As an evidence, *Noticee no. 7* has submitted copies of Form MGT-7 for F.Y 2017-2018 and 2018-2019 wherein his name is not appearing in the list of KMPs for the *Company*. Similarly, Form DIR-12 for F.Y 2017-2018 and 2018-2019 have also not been filed at the time of appointing him as CEO, which are necessary to file for intimation of appointment of Key Managerial Persons to the RoC. At the same time, Form MR-1 for F.Y 2017-2018 for intimation to RoC about appointment of Managerial

Person was also not filed for him. Highlighting all these evidences, *Noticee no. 7* has contended that he was never a KMP of KSBL during any period of his employment at KSBL.

22.9. *Noticee no. 7* has also submitted that he had time and again raised concerns before the management of KSBL that the designation should not lead to misrepresentation about him as CEO. This was also communicated by him in an email dated September 14, 2019 to the then Company Secretary of KSBL.

22.10. Referring to all these submissions and evidences, *Noticee no. 7* has submitted that he had no role or involvement in raising funds from the Banks. Further, he had no powers or authority to instruct transfer of funds to group companies. He is not a signatory to any document with the financial institutions such as Sanction Letter, Loan Agreements, Hypothecation agreements etc.

22.11. *Noticee no. 7* has further claimed that he was not even aware of the facts that the funds were being raised by way of unauthorized pledging of clients' securities and the same were being transferred to group companies as the said activity was being looked after by the Operations and Treasury team. He was looking after only client acquisition, Client servicing, Branch co-ordination and had no say or involvement of whatsoever nature in operations, compliance and finance.

22.12. With respect to the asset collection drive conducted by KSBL under which clients were lured by it to lend their securities to KSBL against return of interest, *Noticee no. 7* has submitted that the said program was not designed by him and no objection regarding the said product was raised by the Compliance Department of KSBL. As the same program was prepared by the management and cleared by the Compliance

Department, he had no reasons to doubt on the legal validity of the said program.

22.13. He has submitted that the lists of Employees and the reporting authorities specified in Forensic Audit Report are based on the information provided by KSBL, hence are not reliable, and he has denied that the General Manager-Back Office Operations and VP-RMS were reporting to him on their departmental responsibilities.

22.14. In the end, in support of his case, *Noticee no. 7* has submitted that he himself has been a victim of illegal acts of KSBL. His investments in SIP and Equity, have also been stuck and KSBL has failed to release the sales proceed of his investments of around INR 72 lakhs. In support of this, he has submitted a copy of the claim form submitted to NSE wherein he has claimed an amount of INR 99,41,280 as due from KSBL.

**Background of the matter and Preliminary Objections**

23. After having summarized the submissions of *Noticees*, before proceeding further in the matter, it is important to narrate the background facts which have ensued the matter to reach the stage of the extant proceedings. To begin with, it may be recalled that NSE inspected the records of KSBL for the FY 2018-19 during which KSBL had declared that it had pledged securities worth of around INR 65 crore as on August 31, 2018 with Banks/NBFCs against which an Over-draft facility was raised. NSE inspection team also found that KSBL had raised excess funds to the tune of INR 90,385 for 9 clients by pledging the securities of other clients of KSBL and those other clients did not have any obligation which warranted such funds to be raised by KSBL.

24. Subsequently, NSE, vide circular ref. No. NSE/INSP/39393 dated November 13, 2018, directed all its Trading Members (i.e. Stock Brokers registered with

NSE) to report DP account wise, client-wise and ISIN wise securities balances to it from January 2019 onwards. The Trading Members were also directed to report the details of the securities pledged by them.

25. In the month of April 2019, SEBI conducted reconciliation of the client-wise, ISIN-wise weekly reporting done by all stock brokers (including KSBL) to the Exchanges, with the securities balance as per DP records. Wherever SEBI noticed a mismatch in stock broker reporting and corresponding DP records, such mismatch in both these records were shared with the Exchanges.

26. Along with the aforementioned weekly submissions of securities, the Trading Members were also required to report client-wise funds and securities balances on a monthly basis as per SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

27. NSE reconciled the clients' securities balances, as reported by KSBL for the month of June 2019, with the actual securities holding available in its DP accounts; wherein it was found that, as against reported balance, securities amounting to INR 957 crores were not available in demat accounts of KSBL. Further, NSE also matched and compared the monthly reports submitted by KSBL for the months of May and June 2019 with the weekly report submitted by KSBL for the last week of these months and observed that KSBL reported excess holdings to the tune of INR l196 crores and INR 965 crores in the months of May and June 2019 respectively in monthly reporting as compared to corresponding weekly reporting submitted by it.

28. Upon receipt of no satisfactory reply from KSBL on this issue, NSE conducted a limited purpose inspection of the operations, books, records etc. of KSBL on August 19, 2019 covering a period from January 01, 2019 onwards. At this stage, for the first time, it was found out during the inspection that KSBL never reported to NSE, one of its DP accounts, viz: DP Account no. IN300394-

11458979 opened in its own name viz. KARVY STOCK BROKING LTD.-BSE. The said DP account was opened by KSBL on December 20, 2000 and it was categorized by KSBL as 'Client Beneficiary Account'.

29. From further in-depth examination of this account, it was observed that KSBL, in aggregate, had pledged clients' securities worth INR 2873 crores with Banks/NBFCs to raise funds against all the DP accounts under its control, of which, client securities worth INR 2650.51 crores were observed to be pledged from aforesaid DP account, with 944 unique ISINs pledged from the said DP account with financial institutions. As stated above, no information regarding this DP account was ever reported by it to NSE. NSE then approached the Depositories to find out the first date on which pledge was created in the said DP account and found that the first such pledge in the said DP account was created with financial institutions against loans availed by KSBL, long back from 2013 onwards.

30. It was further noted by NSE that KSBL had credited the funds so raised, by it by pledging the clients' securities, into 6 of its own bank accounts ("Stock Broker-own Account") instead of "Stock Broker-Client Account". In order to hide these fund transfers, these 6 bank accounts were also not reported to Exchanges.

31. It was observed by NSE that the funds so raised were not used for meeting the trading obligations of the respective clients, whose securities were pledged by KSBL from the aforementioned demat account, but were used by KSBL for its own purpose.

32. While KSBL gave assurances to un-pledge the securities and release the same back to the respective clients by September 30, 2019, it failed to do so. Subsequently, it defaulted in settling the clients' funds and securities. The said default continued till November 22, 2019 on which date SEBI passed *Interim Order* and restrained KSBL from taking new clients. Keeping in view the misuse

of Power of Attorney provided by its clients to KSBL, SEBI also directed the depositories not to act upon any instructions of KSBL in pursuance of such Power of Attorneys provided by various clients of KSBL. Subsequently, vide order dated December 02, 2019, NSE disabled the trading terminal of KSBL.

33. The failure of KSBL in settlement of clients funds and securities continued for over a period of more than one year despite multiple follow up by SEBI and NSE. However, KSBL failed to settle its obligations towards refund of funds and securities to its clients to whom the same were due. Therefore, in order to protect the interest of the investors and securities market, vide MCSGFC Order dated November 23, 2020, KSBL was declared by NSE as a defaulter and the membership of KSBL with NSE was cancelled.

34. Meantime, NSE, after discussions with SEBI, appointed EY to conduct a forensic audit of the books of accounts of KSBL. The scope of the Forensic Audit, as mandated to EY, was *inter alia* to perform a detail examination into the shortfall in clients' securities held in the custody of KSBL in order to ascertain if there was any misappropriation of clients' securities and the extent of such misappropriation (if any), as well as to understand the end utilization of the clients' funds/securities that were allegedly misused/misappropriated by KSBL. The scope of Forensic Audit also included identification of the role played by the Management and Directors of the *Company* in such shortfall/misappropriation of clients' securities as well as clients' funds.

35. The said Forensic Audit was completed by EY and it submitted its report to NSE on January 09, 2020. On the basis of findings of the Forensic Audit Report and documents submitted by EY with it, NSE conducted its own examination/review and submitted its own report to SEBI on November 09, 2020. On the basis of findings of these examination and the material collected by EY and NSE, SEBI conducted further examination of those findings and materials and later on issued

the SCN dated January 29, 2021 on the basis of conclusion reached in its own examination.

36. I have carefully considered the allegations made against the *Noticees* in the SCN, their replies and submissions made before me during personal hearing and all the material available on record. However, before proceeding to deal with the allegations of violations of the provisions of SEBI Act, PFUTP Regulations, Stock Broker Regulations, SCR Act, 1956 and various SEBI Circulars as enumerated in the SCN, I find it relevant to deal with certain preliminary objections raised by some of the *Noticees*.

37. I note that *Noticee no. 7* has sought certain documents, a list of which has been submitted by him as part of his preliminary submissions. I note from the said list that most of the documents sought by *Noticee no. 7* are those which have been used by MCSGFC while passing its order dated November 23, 2020. However, none of the said documents is available with SEBI. As a corollary, I can hold that none of these materials has been relied upon or is found relevant for the purpose of adjudication of the present proceedings. All the relevant materials used for the purpose of present proceedings, as available with SEBI, have already been provided to all the *Noticees* in the course of the present proceedings. Under the circumstances, when a document is not available with SEBI, nor the same has been collected in the course of examination, nor the same is relied upon while making an allegation in the present proceedings, the *Noticee* cannot be allowed to use the present proceedings as a tool to collect evidences as per its wish which is not even available with SEBI. Therefore, the submission of the *Noticee no. 7* in this regard including his request regarding supply of certain evidences, not relied upon in the SCN, is not tenable.

38. Further, *Noticee no. 7* has also sought cross examination of a number of persons, all of which were employed by KSBL and by its connected entities at the relevant

point of time. I find that statement of none of these persons has been recorded by SEBI nor any such statement, if recorded by any other agency, has been relied upon for the purpose of the present proceedings. Therefore, cross examination of such persons who have not deposed before SEBI becomes redundant and irrelevant for the purpose of present proceedings. I, therefore, find that the request for cross-examination of these persons by *Noticee no. 7* is not justified and hence deserves rejection.

39. *Noticee no. 7* has also contended that there has been inordinate delay in initiation of the present proceedings and the same has caused prejudice to him as he has no access to the records of KSBL. In this regard, I find that the inspection of KSBL was conducted by NSE during June to August, 2019. Subsequently, EY was appointed as Forensic Auditor by NSE and on the basis of its preliminary report, NSE conducted its own examination and forwarded its report to SEBI on the basis of which, an *Interim Order* was passed immediately on November 22, 2019. Subsequently, time was granted to KSBL to submit its replies to the observations made in the *Interim Order*. However, KSBL kept on seeking extension on one or other grounds, all of which have been dealt with elaborately in the *Confirmatory Order*. On account of these delaying tactics employed by KSBL combined with COVID pandemic, the *Confirmatory Order* could be passed only on November 24, 2020. Subsequently, an SCN was issued to all the *Noticees* including KSBL on January 29, 2021. However, the SCN could not be delivered to some of the noticees, including *Noticee no. 7* due to lack of availability of their correct address and non-cooperation on the part of KSBL in providing the latest addresses of these entities. Therefore, I am of the view that no delay in the present matter has been caused by SEBI. Further, I note that, by his own submissions, *Noticee no. 7* was an employee of KSBL till January 2020, by which time already two months had passed after the issuance of *Interim Order*. Therefore, during this

period, he had access to all the documents, that he wanted to use for his case. However, subsequent termination of *Noticee no. 7* by KSBL cannot be attributed upon SEBI as a defense for not having access to information/documents of KSBL. In any case, all the documents relevant for the present proceedings that have been in possession of SEBI, have already been provided to all the *Noticees* including *Noticee no. 7*. Therefore, I find the submissions of *Noticee no. 7* to be untenable in the facts of the present matter.

40. Before proceeding to deal with the allegations as recorded above against the *Noticees*, I find it appropriate that for the purposes of easy reference, relevant provisions of law which have allegedly been contravened as per the SCN are reproduced hereunder:

**SCR Act, 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 not exceeding one crore rupees.*

**PFUTP Regulations, 2003**

**4. Prohibition of manipulative, fraudulent and unfair trade practices**

(1) *Without prejudice to the provisions of regulation 3, no person shall indulge in a manipulative, fraudulent or an unfair trade practice in securities markets.*

(2) *Dealing in securities shall be deemed to be a manipulative fraudulent or an unfair trade practice if it involves any of the following, namely: —*

*(m) a market participant entering into transactions on behalf of client without the knowledge of or instructions from client or misutilizing or diverting the funds or securities of the client held in fiduciary capacity.*

**Stock Broker Regulations**

**Regulation 9**

**Conditions of registration.**

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

(b) *he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him;*

(e) *he shall take adequate steps for redressal of grievances, of the investors within one month of the date of receipt of the complaint and inform the Board as and when required by the Board;*

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

(g) *he shall at all times maintain the minimum networth as specified in Schedule VI.*

**Schedule II**

**Code of Conduct for Stock Brokers**

**A. General.**

(1) *Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.*

(2) *Exercise of due skill and care: A stock-broker shall act with due skill, care and diligence in the conduct of all his business.*

(3) *Manipulation: A stock-broker shall not indulge in manipulative, fraudulent or deceptive transactions or schemes or spread rumours with a view to distorting market equilibrium or making personal gains.*

(4) *Malpractices: A stock-broker shall not create false market either singly or in concert with others or indulge in any act detrimental to the investors interest or which leads to interference with the fair and smooth functioning of the market. A stockbroker shall not involve himself in excessive speculative business in the market beyond reasonable levels not commensurate with his financial soundness.*

(5) *Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.*

**Consideration and findings:**

41. Before going into the specifics of the issues for consideration, I find it relevant to provide a brief introduction to the process involved in buy/sale of securities, clearing of those buy/sell trades, settlement of the trades effected and the role of stock brokers in the entire process of trading in securities.

42. As it is well known, persons desirous of transacting in securities on the stock exchange platform cannot approach it directly and have to do it through a stock broker. So, in a transaction of securities, the stock brokers act on behalf of their respective clients to give effect to the transaction, for which they charge a fee. Thus, stock brokers (also called Trading Member of the Stock Exchange which they are affiliated with) facilitate the carrying out of transactions on stock market by bringing buyers and sellers to the platform of stock exchanges. At the same time, every stock broker is mandatorily required to connect with a member of clearing corporation (called Clearing Member) who settles the trades of the clients of such broker.

43. The usual process of transacting on the stock exchange involves three steps –

a) trading,
b) clearing, and
c) settlement.

A trade happens once an order to buy/sell a particular security placed by one entity matches with an order for sale/buy of the same security, placed by another entity. Consequent to such trade, the clearing process takes place. This process is essentially the identification of what security is owed to the buyer from the seller

and how much money is owed to the seller from the buyer. Upon confirmation of this, the obligations of both the parties to a trade are determined. This process of identification of the corresponding obligations is undertaken by clearing corporations/clearing houses. However, since both the parties trade through their respective stock brokers, the clearing takes place on two levels. At the level of clearing corporation, the clearing takes place by determining the net funds and securities liability of each broker/clearing member. Subsequently, at the clearing member level, the obligation of individual clients gets identified. Once this process is completed, settlement takes places wherein the security travels from seller to buyer and funds travel in the opposite direction i.e. from buyer to seller. For example, in case two clients of a broker buy and sell 100 securities of a specific scrip, the settlement takes place at the level of clearing member only since, as far as the clearing corporation is concerned, there is a net 'zero' fund and scrip liability at that stock broker's end. However, in the same case, if the two clients belong to two different brokers, the same settlement takes place at clearing corporation level as there will be a net liability at each of the two stock brokers' ends (i.e. security will travel from selling broker and funds will travel from buying broker to the Clearing Corporation).

44. To be able to transact, a client has to essentially maintain three accounts:

a) trading account - to place orders for buying and selling securities;
b) bank account- to transfer funds to buy securities and to receive payment from the stock broker against sale of securities; and
c) demat account- to store/keep/hold the securities owned in electronic form.

45. A client, while availing the services of a stock broker and to ensure that his trades should get executed successfully, may also use the Margin Trading Facility provided by stock brokers. The said facility is essentially a mode of borrowing funds or availing leverage from the stock broker in which the stock broker allows

the client to take a bigger position in the market than what is permissible/allowed based on the funds available in his bank account. For using this facility, the client may pay only a small percentage of the trade value, called the Margin and borrow the additional amount from the stock broker. Such margin by the client is allowed to be given in the form of cash or as securities.

46. While a stock broker cannot transfer funds and securities from clients' accounts without the permission of the clients, however, for the purpose of smooth operation of trading systems and management of clients' trading, clients generally provide a running Power of Attorney to their broker(s), using which the stock broker can transfer funds and securities from clients' accounts to settle the trades of such client or to provide margin facility to such clients.

47. In the past, it was noticed that there were a number of instances wherein clients' funds and securities were misused by the brokers using this power of attorney given to them by their clients. Soon after it was entrusted with statutory authority by an act of the parliament, I find that SEBI had issued a Circular no. SMD/SED/CIR/93/23321 on November 18, 1993 wherein the stock brokers were prohibited from using clients' funds and securities for purposes other than what were permitted under the said circular. The said circular laid down in specific terms that under what circumstances money can be withdrawn from clients' account and when money can be deposited in clients' account. Similarly, it also laid down circumstances wherein securities could be deposited in or withdrawn from clients' accounts and with the advent of Depositories system, the possibility of misuse of clients' securities had reduced to a large extent. Subsequently, SEBI vide its Circular ref. SEBI/MIRSD/SE/Cir-19/2009 dated December 03, 2009 and SEBI Circular ref. CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 reiterated its earlier directions regarding stock brokers not being allowed to use clients' funds and securities for their own purposes. The aforementioned

SEBI Circular dated June 20, 2019 clearly laid down that a client's securities can be pledged only to the extent to meet the dues owed by the said client's account. Further, vide the above mentioned circular of 2019, in order to streamline the position, stock brokers were given time till October 01, 2019 to un-pledge clients' securities in cases wherein, the clients' securities had been pledged by stock brokers for purposes other than to meet the dues on behalf of the client's trading account or where clients' securities had been pledged even though there was no debit balance in the client's accounts.

48. This circular of June 20, 2019 was issued as a culmination of data collected by SEBI through two circulars dated September 26, 2016 and June 22, 2017 wherein the stock brokers were mandatorily required to disclose data as mandated to be submitted in the aforesaid circulars to the stock exchanges in the format prescribed therein. The said data, as mandated to be submitted by the stock brokers, was required as a matter of formulization of the instructions already contained in the circular issued by SEBI on November 18, 1993. Accordingly, the data so collected was used by SEBI and Stock Exchanges to keep track of stock brokers' activities so that no stock broker could misuse clients' funds and securities for the benefit of another client or for the proprietary trades of the stock broker itself or for purposes other than what were permissible under the relevant laws/circulars. For the purpose of better supervision, the said circulars listed out different categories under which all the bank and demat accounts maintained by a stock broker are required to be classified. The said circulars also clearly laid down the circumstances under which funds or securities can be moved from one bank/demat account to another. It may be noted here that the afore stated circulars issued by SEBI essentially contained nothing new but were issued as extension of the crucial directions that were already issued vide the first SEBI Circular dated November 18, 1993 and rather were issued with much more details

and requisitions of data in prescribed formats so as to provide the stock brokers with fresh opportunity to relook/review their records, clients' accounts, bank accounts, demat accounts etc., so as to ensure that the directions issued by SEBI vide its Circular dated November 18, 1993 are being complied with both in letter and spirit and to elicit necessary declarations from the stock brokers backed by proper supporting records/data, to assure that they are using the funds and securities of their clients only for the specific permitted purpose i.e. to meet the trading obligations of the respective clients and that there was no anomaly in the declaration/disclosure made by them to the regulators viz. to the stock exchanges or to the SEBI.

49. In the background of the aforesaid regulatory directions issued by SEBI and the legal position emerging therefrom, it is seen that the allegations against KSBL have been spelt out in the SCN on the following four aspects:

a) raising of funds for self-use by pledging clients' securities;

b) transfer of such funds to its own group companies;

c) non-settlement of clients' funds and securities; and

d) observations with respect to certain other violations in the order passed by MCSGFC of NSE on November 23, 2020.

50. Now, coming to the first issue of raising of funds by pledging clients' securities, I find that KSBL had arranged for a LAS (Loans against Shares) facility with financial institutions which allowed it to borrow funds from them by pledging securities. I also observe from the Forensic Audit Report that the borrowings made by KSBL through the pledging of clients' securities formed a sizeable portion of its overall borrowings. This is demonstrated by the fact that, in September 2016, the total outstanding amount of loans availed by KSBL by virtue of the LAS facility was INR 789.41 crore out of a total borrowing of INR 1,051.36

made by it. Subsequently, there was a substantial increase in the value of securities pledged by KSBL, after witnessing an initial decline in such values for a short period during 2017. It is noticed from the Forensic Audit report that the total value of the securities pledged, as on June 30, 2017, was INR 202 crore, which increased to approximately INR 2,700 crore by September, 2019. In fact, the borrowed funds through LAS facility have seen exponential increase in between March and September 2019. The same is visible from the information furnished in below table which has been reproduced from the findings of the Forensic Audit conducted by EY:

**Table 2: Change in borrowings of KSBL in first half of FY 2019-20**

(Figures in INR Crores)

| **Particulars** | **31 March 2019** | **30 September 2019** |
|---|---|---|
| Loan Against Securities | 26.11 | 786.93 |
| Other borrowings | 474.66 | 1245.74 |
| **Total** | **500.77** | **2032.67** |

51. In this regard, I find that, as per the extant circulars, the stock brokers are allowed to pledge clients' securities. However, in order to prevent misuse of clients' securities, the said authority in the hands of stock brokers has been subjected to a number of restrictions/conditions imposed by SEBI through a number of circulars including SEBI Circulars dated June 20, 2019 and August 29, 2019. The restrictions *inter alia*, which are relevant for the purpose of present proceedings, are as following:

a. Securities of clients can be pledged only in case the same is consented by clients through separate consent letter or in case where a running Power of Attorney has been signed by clients to pledge their securities; and

b. The funds raised through such pledging cannot be used for any purpose other than to fund clients' trading obligations under margin trading facility or to recover debit client balance; and

c. Funds raised from such pledging of securities cannot be more than the debit balance reflected in the said client's account.

52. It has been found out from the NSE examination that a large part of securities pledged by KSBL for borrowing funds through LAS facility belonged to/owned by the clients of KSBL. The said findings were also confirmed by EY in the Forensic Audit conducted by it. In this regard, it has been found during the course of joint inspection of KSBL, carried out by SEBI, NSE, BSE and the Depositories, that KSBL used to transfer shares of clients into its own demat account bearing A/c Number IN300394-11458979 named as KARVY STOCK BROKING LTD-BSE by using the Power of Attorney given to it by the clients and then was continuously raising funds by pledging those securities from the said demat account. It was also noticed that the said demat account was deliberately kept hidden from the eyes of SEBI and Stock Exchanges and was never reported even under enhanced supervision mechanism implemented by the Stock Exchanges in pursuance to SEBI Circular dated September 26, 2016.

53. In this regard, it has been observed that the securities belonging to the clients were being pledged by KSBL also included the securities of those clients who had no negative balance against their names in the ledger of KSBL i.e. who were having zero balance or some credit balances against their names in the ledger of KSBL. In this respect, the Forensic Audit Report has recorded a sample of cases which reveals that even the securities of the clients having credit balances had been pledged by KSBL; and the said finding by the forensic auditor is being reproduced hereunder:

**Table 3- Details of clients' having credit balances in their accounts whose securities were pledged by KSBL**

| No. of days passed since last trade | Number of clients having credit balance as on September 05, 2019 | Value of securities pledged (INR in crores) |
|---|---|---|
| <=30 | 35,532 | 480 |
| 31 to <=90 | 24, 138 | 248 |
| 91 to <= 180 | 13,113 | 94 |
| 181 to <=360 | 10, 254 | 102 |
| 361 to <= 720 | 3,001 | 60 |
| >720 | 294 | 30 |
| **Total** | **86,332** | **1,014** |

54. The data presented in the aforementioned Table No. 3 has not been disputed by any of the *Noticees*. In this regard, I refer to Clause 2.5 of SEBI circular ref. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 on 'Enhanced Supervision of Stock Brokers/Depository Participants' read with Clause 2(c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017, which reads, "*a stock broker is entitled to have a lien on client's securities to the extent of the client's indebtedness to the stock broker and the stock broker may pledge those securities.*" It further reads, " …*the stock brokers shall ensure the following:*

*2.5.1 Securities of only those clients can be pledged who have a debit balance in their ledger.*

*2.5.2. Funds raised against such pledged securities for a client shall not exceed the debit balance in the ledger of that particular client.*

*2.5.3. Funds raised against such pledged securities shall be credited only to the bank account named as "Name of the Stock Broker-Client Account".*

*2.5.4. The securities to be pledged shall be pledged from BO account tagged as "Name of the Stock Broker-Client Account".*"

55. It is quite evident from a plain reading of the above provision that a stock broker could pledge securities only of those clients who had debit balances in their ledgers, and that too only to the extent of such client's indebtedness. In the present case, as has been narrated above, KSBL was found to have pledged securities of clients who had no negative balances corresponding to their names. In such a circumstance, it can't be said that KSBL had any authority whatsoever, to pledge such clients' securities in terms of the instructions contained in the afore quoted SEBI Circular. It has been noted above that none of the *Noticees* has furnished explanation of any sort justifying the above act of pledging of securities of those clients who had neither defaulted to KSBL nor there was any debit balance in their ledger accounts warranting pledging of their securities. Therefore, the pledging of clients' securities having no negative balance in KSBL's ledger can't be held legal and justified by any stretch of imagination. Hence, the above act by KSBL of pledging securities of clients having no debit balances in their accounts was apparently in clear violation of the norms mandated through the above-mentioned circulars issued by SEBI.

56. It has also been observed that for the purpose of the aforesaid raising of funds, KSBL was organizing special asset collection drives amongst its clients under which it used to induce the clients to park their securities with it by promising to pay them interest on the value of stocks so lent by them to KSBL. It was also being promised to the clients that the securities so lent by them will be deposited in their demat accounts and that they will face no problem in settlement of their trading in those scrips (lent by them) which can be done by them any time by giving a single phone call. Securities so collected by inducing and enticing clients through these special asset collection campaigns were transferred to demat Account No. IN300394-11458979 of KSBL, the account which was deliberately not shared and disclosed to the Exchanges, and the securities so transferred to

the above said undisclosed/unreported demat account were kept on lien under LAS facility through which it was raising funds from financial institutions. Thus, by deploying such a device and scheme, KSBL was fraudulently avoiding reporting of such borrowing of stocks from its clients by way of offering inducements to the clients and was also thereby avoiding the attendant regulatory compliances at two levels. Firstly, it was bypassing stocks lending and borrowing mechanism already available on Stock Exchange platforms. Secondly, by not disclosing the aforementioned demat Account under the Enhanced supervision mechanism of Exchanges, and by transferring clients' shares to this undisclosed demat account for onward pledging to the lending financial institutions, KSBL has kept the details of such pledged shares hidden from Regulatory oversight. It was noticed that the funds so raised through the pledging of securities, that were lawfully not owned by KSBL but by its clients, were further kept deposited in 6 separate bank accounts, details of which were also not disclosed to the Stock Exchanges. Further, in its attempt to evade regulatory oversight, it is seen that KSBL used to deposit the funds so raised by way of unauthorized pledging of clients' securities, in the bank accounts of its connected entities.

57. I note that the aforesaid factual position has not been contested by any of the *Noticees* hence, it leaves no shred of doubt in holding that the KSBL was raising money by keeping clients' securities on pledge in complete disregard of the regulatory directions of SEBI and in violation of the established provisions of law. The said act was deliberately being done on a continuous basis and was kept hidden from Regulatory oversight of both the Stock Exchanges and SEBI.

58. In this respect, it has been recorded in the Forensic Audit Report that KSBL, as an explanation to its above-mentioned actions, stated to the Forensic Auditor that the securities were pledged after the receipt of consent from such clients. However, when enquired about the proof of the said consent, KSBL was not able

to provide any evidence of any such consent having been taken by it from the clients. This shows that KSBL could not provide any sustainable justification to EY to defend its act of pledging of the securities belonging to its clients nor even any such evidence has been produced before or during the present proceedings before me to substantiate the aforementioned unfounded claim, made by it.

59. On the contrary, EY has noticed various concrete instances wherein KSBL was seen to have transferred clients' securities to its own demat account without taking any consent from such clients. For instance, EY has found that the branch official of Allahabad branch of KSBL had sent an email dated October 12, 2019 to KSBL head office in Hyderabad requesting that certain securities, taken from a client's account, be transferred back to the said client as the client's chartered accountant had called up complaining how these shares got transferred to 'KSBL Beneficiary Account' from 'client's demat account'. This is an evidence enough to show that the acts of KSBL of transferring securities from the demat accounts of a number of clients were executed surreptitiously while keeping those clients in dark and without obtaining the necessary consent from such clients in any form or in any manner, before transferring their shares to its own demat account. In many other cases, it is noted that KSBL had transferred securities from clients' accounts by misusing running Power of Attorney, provided by such clients for smooth functioning of their accounts.

60. Furthermore, as already stated above, SEBI Circular CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 read with SEBI Circular bearing no. SEBI/HG/MIRSD/DOP/CIR/P/2019/95 dated August 29, 2019 stated as under:

"*4.7 With effect from September 01, 2019, clients' securities lying with the TM/CM in "client collateral account", "Client Margin Trading Securities account" and "client unpaid securities account" cannot be pledged to the Banks/NBFCs for raising funds, even with*

*authorization by client as the same would amount to fund based activity by TM/CM which is in contravention of Rule 8(1)(f) & 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.*

*4.8 Further, the client's securities already pledged in terms of clause 2.5 of SEBI Circular SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 and clause 2 (c) of SEBI circular CIR/HO/MIRSD/MIRSD2/CIR/P/2017/64 dated June 22, 2017 shall, by August 31, 2019, either be unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed off after giving notice of 5 days to the client.*"

So, affirming the earlier mentioned direction issued as long back as in the year 1993, SEBI had clarified by issuing further instructions to the stock brokers that, effectively after September 01, 2019, a stock broker was not allowed to pledge the shares of clients lying with it in any event including on the basis of the so called authorization obtained from the respective clients. It has further been clarified with respect to the securities of clients which were already pledged by the stock brokers even for any legitimate purposes such as for providing margin funding, that with respect to such pledged securities a stock broker was required to either un-pledge those securities and return them to the clients upon fulfilment of their pay-in obligation, or in the case of failure of such clients in meeting their pay in obligation, the stock broker may dispose of the securities of the said defaulting clients after giving notice of 5 days to such clients. Further, the said circular provided an opportunity to the TM/CM as a one-time measure, to make good the deficit, if any, in the securities belonging to their clients, by ensuring strict enforcement of the Circular dated June 20, 2019 on or before October 01, 2019, so that all the stock brokers who had already pledged their clients' shares to raise funds (prior to the issuance of the afore-stated circulars) would arrange to get those shares unpledged so as to become compliant with the provisions of

the aforementioned circular. I find from MCSGFC Order dated November 23, 2020 that KSBL had given an undertaking to NSE that it would comply with the provision of the aforementioned circular by September 30, 2019. However, it has been noted in the Forensic Audit Report that shares of clients' of KSBL to the tune of INR 2,700 crore were still found pledged even beyond the September 30, 2019 deadline.

61. Thus, KSBL, by pledging the securities of the clients in the manner described above and continuing to do it even after specific direction of SEBI thereby prohibiting such pledging of securities of clients, has clearly violated SEBI Circular CIR/HO/MIRSD/DOP/CIR/P/2019/75 dated June 20, 2019 read with Circular bearing no. SEBI/HG/MIRSD/DOP/CIR/P/2019/95 dated August 29, 2019.

62. Moving on to the next allegation, it has been noted in the SCN that as on November 22, 2019, KSBL had not settled funds to the extent of INR 527.18 crore and securities worth INR 2,862.05 crore with its clients which were refundable to them. The details of such unsettled funds and securities are as following:

**Table 4: Details of clients' funds and securities not settled till November 22, 2019**

| Particulars | Number of Clients | Value of Funds (In crore) | Value of Securities (In crore) |
|---|---|---|---|
| Clients with Only Securities | 47,502.00 | - | 317.81 |
| Clients with Only Funds | 1,37,232.00 | 217.16 | - |
| Clients with both Funds and Securities | 1,34,099.00 | 310.02 | 2,644.24 |
| **Total** | **3,18,833.00** | **527.18** | **2,862.05** |

63. As explained earlier, the last step involved in effecting a trade on the stock exchange platform is settlement of funds and securities to the clients. So, in the process of clearing of a trade, once the mutual obligation of the buyer and seller

is determined, settlement happens whereunder, the securities are transferred from the account of selling client and funds are transferred from the account of buying client to the clearing corporation on T+1 day. On T+2 day, the respective funds and securities get transferred to the account of brokers of seller and buyer respectively who in turn are obligated to settle the same in the bank/demat account of respective seller/buyer within a period of 24 hours.

64. In the present case, as can be seen from the Table 4 above, it has been unearthed that, while the clearing corporation settled the funds and securities with KSBL on time, the settlement of such securities and funds of a large number of clients remained incomplete at the end of KSBL to its clients.

65. In this regard, specific reference is made to Clause 12 of the SEBI Circular bearing no. MIRSD/SE/Cir-19/2009 dated December 03, 2009. The said provision states,

"*12. Unless otherwise specifically agreed to by a Client, the settlement of funds/securities shall be done within 24 hours of the payout. However, a client may specifically authorize the stock broker to maintain a running account subject to the following conditions…*"

66. Thus, except for when a client specifically agrees for a longer time for settling his trades from broker's end, it is mandatory for a stock broker to settle the funds/securities of the clients within 24 hours of receipt of the payout from clearing corporation. The aforementioned Table 4 clearly establishes that the said settlement of funds and securities of the clients had not been done in true compliance by KSBL within the timeline stipulated in the circulars issued by SEBI. At the same time, it is noticed that KSBL has failed to provide any evidence to establish that its clients had agreed for their funds/securities to be settled beyond the 24-hour period. In fact, upon perusal of the reply of KSBL during the present proceedings, it transpired that it is still in the process of settlement of clients' funds and securities and till now there are large number of clients whose

funds/securities still remain to be paid/returned to them even after three years have elapsed since the passing of *Interim Order* and KSBL is still seeking time to complete the settlement of funds and securities of its clients, which it has unlawfully misappropriated for its own purposes/advantages. Such prayer of extension of time is itself evident of the fact that KSBL has acted in violations of the aforementioned circulars issued by SEBI and related provisions of law. Under the circumstances, I find it established beyond any scope of doubt that KSBL, by not settling the securities/funds of the clients within the period prescribed for the same, has clearly violated the provisions of SEBI Circular bearing no. MIRSD/SE/Cir-19/2009 dated December 03, 2009.

67. The SCN has further alleged that the loans raised by KSBL were transferred to its group companies and were also used for funding the trading of certain other clients of KSBL.

68. In this regard, specific reference must be made to Section 23D of the SCR Act, which prescribes that a stock broker who fails to segregate the securities or moneys of its clients or uses the securities or moneys of one client or more than one clients for the benefit of self/proprietary uses or for the benefit of another client, he shall be liable for penalty. At the same time, reference is made to SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993, which provides that it shall be compulsory for all stock brokers to keep the money of their clients separate from their own proprietary money. The said circular further provides that no money shall be drawn from clients' accounts other than in the following circumstances –

a. money required for payment to or on behalf of clients or for or towards payment of a debt payable to the Member/Broker from clients or money drawn on client's authority, or money in respect of which there is a specific liability of clients to the Member/Broker, 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;

b. such money belonging to the Member/Broker as may have been paid into the client account for the purpose of opening or maintaining the account or a cheque or draft received by the Member/Broker representing in part money belonging to the client and in part money due to the Member/Broker.; and

c. money which may by mistake or accident have been paid into such account other than such amounts that are required to be paid into clients account.

69. In this regard, I find it relevant to refer to the provisions of SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016 which states as following: -

"*2.4. In line with the prevalent regulatory requirement, it is reiterated that;*

*2.4.1.* ***Stock Broker shall not use client funds and securities for proprietary purposes including settlement of proprietary obligations***.

*2.4.2. Transfer of funds between "Name of Stock Broker - Client Account" and "Name of Stock Broker - Settlement Account" and client's own bank accounts is permitted. Transfer of funds from "Name of Stock Broker - Client Account" to "Name of Stock Broker - Proprietary Account" is permitted only for legitimate purposes, such as, recovery of brokerage, statutory dues, funds shortfall of debit balance clients which has been met by the stock broker, etc. For such transfer of funds, stock broker shall maintain daily reconciliation statement clearly indicating the amount of funds transferred.*

*2.4.3. Transfer of securities between "Name of the Stock Broker - Client Account" and individual client's BO account, "Name of the Stock Broker – Pool Account" and "Name of the Stock Broker – Collateral Account" is permitted. Transfer of securities between "Name of the Stock Broker - Client Account" to "Name of the Stock*

*Broker - Proprietary Account" is permitted only for legitimate purposes such as, implementation of any Government/Regulatory directions or orders, in case of erroneous transfers pertaining to client's securities, for meeting legitimate dues of the stock broker, etc. For such transfer of securities, stock broker shall maintain a stock transfer register clearly indicating the day-wise details of securities transferred.*" (emphasis supplied)

70. It has already been brought out in the preceding paragraphs that a sizeable portion of the borrowings of KSBL was raised by pledging the securities of its clients. To find out the end usage of such funds, an examination was carried out under which an analysis of the 'bank books' was performed by EY for the period of April 01, 2016 to October 19, 2019 to identify the transfers made from the books of accounts of KSBL to its connected entities. It is observed from the examination of the books of accounts of KSBL by EY that funds were continuously being transferred to *Karvy Realty* and *Karvy Capital* from the accounts of KSBL to the tune of a total of INR 1442.95 Crores as per the following details:

**Table 5- Funds transferred to KRIL and KCL from KSBL**

INR in Crores

| | ***Figures in INR Crore - Inflow /(Outflows)*** | | | | |
|---|---|---|---|---|---|
| **Company Name** | **FY 2016-17** | **FY 2017-18** | **FY 2018-19** | **FY 2019-20** | **Total** |
| Karvy Realty India Limited | (86.63) | (235.49) | (109.74) | (662.33) | (1,094.19) |
| Karvy Capital Limited | (164.80) | (70.82) | (144.69) | 31.55 | (348.76) |
| **Total** | (251.43) | (306.31) | (254.43) | (630.78) | **(1442.95)** |

The aforementioned funds inflow/outflow as calculated by EY during the course of Forensic Audit clearly shows that a net amount of INR 1442.95 Crores was transferred from KSBL to the two of its group companies viz. *Karvy Realty* and *Karvy Capital* between FY 2016-17 and FY 2019-20. Out of this, a net transfer of INR 1,094.19 crore was made to *Karvy Realty* and a net transfer of INR 348.76 crore was made to *Karvy Capital.*

71. In this regard, I find from the Forensic Audit Report that, with respect to the period between March 31, 2019 and September 30, 2019, the total borrowings of KSBL witnessed a sharp rise from INR 500.77 Crores as on March 31, 2019 to INR 2,032.67 Crore by September 30, 2019. This was an increase of INR 1,531.90 crore in borrowing of KSBL which amounted to an increase of more than 400 per cent in total borrowing of KSBL within a short period of six months. Such an unusual rise in the borrowing by KSBL created suspicion in the mind of Forensic Auditors who specifically examined the end-application of the aforesaid borrowed funds. It has been brought out in the Forensic Audit Report that out of the aforesaid borrowed amount of INR 1,531.90 crore, a total amount of INR 1228.36 Crores had been transferred to the group companies of KSBL during the said six months' time period.

72. The Forensic Audit Report also records that the borrowed funds raised by KSBL by using the LAS facility were transferred to bank accounts shown as 'own' accounts of KSBL and therefrom the said funds were again transferred to different related parties of KSBL. A sample of such transactions is presented hereunder:

**Table 6: Transfer of funds raised through LAS facility to connected entities of KSBL**

| From | | | | | To | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Type** | **Account Number** | **Transaction date** | **Amount Transferred** | **Balance** | **Type** | **Account Number** | **Transaction date** | **Amount Received** | **Balance** |
| LAS | BAJAJ FINANCE - 21877416 | 29-07-2016 | 3.99 | | Own | 00210140000014 | 29-07-2016 | 3.99 | 4.06 |
| Own | 00210140000014 | 29-07-2016 | 1.50 | 2.56 | KRIL | 210340003682 | 29-07-2016 | 1.50 | |
| | | | | | | | | | |
| LAS | BAJAJ FINANCE - 39825410- | 01-12-2017 | 25.00 | | Own | 00210140000014 | 01-12-2017 | 25.00 | 33.43 |
| Own | 00210140000014 | 01-12-2017 | 23.00 | 10.43 | KRIL | 210340003682 | 01-12-2017 | 23.00 | |
| | | | | | | | | | |
| LAS | 000805005109 | 03-04-2019 | 25.00 | | Own | 000405034104 | 03-04-2019 | 25.00 | -251.46 |
| Own | 000405034104 | 03-04-2019 | 5.18 | -256.64 | Own | 000805005109 | 03-04-2019 | 5.18 | 40.18 |

| | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| Own | 000805005109 | 03-04-2019 | 25.00 | 15.18 | Own | 00210140000014 | 03-04-2019 | 25.00 | 30.15 |
| Own | 00210140000014 | 03-04-2019 | 23.00 | 7.15 | KRIL | 210340003682 | 03-04-2019 | 23.00 | |
| | | | | | | | | | |
| LAS | 210130000134 | 02-04-2019 | 40.00 | | Own | 210140000014 | 02-04-2019 | 40.00 | 49.56 |
| Own | 210140000014 | 02-04-2019 | 15.60 | 33.96 | KRIL | 210340003682 | 02-04-2019 | 15.60 | |
| Own | 210140000014 | 02-04-2019 | 16.00 | 17.96 | KRIL | 210340003682 | 02-04-2019 | 16.00 | |
| Own | 210140000014 | 02-04-2019 | 14.00 | 3.96 | KRIL | 210340003682 | 02-04-2019 | 14.00 | |
| | | | | | | | | | |
| LAS | BAJAJ FINANCE - 57197261 | 16-10-2018 | 10.00 | | Own | 00210140000014 | 16-10-2018 | 10.00 | 10.04 |
| Own | 00210140000014 | 16-10-2018 | 4.00 | 6.04 | KRIL | 210340003682 | 16-10-2018 | 4.00 | |
| | | | | | | | | | |
| LAS | BAJAJ FINANCE - 48395828 | 23-05-2018 | 13.00 | | Own | 00210140000014 | 23-05-2018 | 13.00 | 13.06 |
| Own | 00210140000014 | 23-05-2018 | 5.75 | 7.31 | KRIL | 210340003682 | 23-05-2018 | 5.75 | |
| | | | | | | | | | |
| LAS | 210130000134 | 02-04-2016 | 15.00 | | Own | 210140000014 | 02-04-2016 | 15.00 | 15.12 |
| Own | 210140000014 | 02-04-2016 | 15.00 | 0.12 | KRIL | 00210340003682- | 02-04-2016 | 15.00 | |
| | | | | | | | | | |
| LAS | 210130000134 | 02-04-2016 | 13.50 | | Own | 210140000014 | 02-04-2016 | 13.50 | 13.58 |
| Own | 210140000014 | 02-04-2016 | 10.00 | 3.58 | KRIL | 00210340003682- | 02-04-2016 | 10.00 | |
| | | | | | | | | | |
| LAS | 210130000134 | 02-04-2016 | 15.00 | | Own | 210140000014 | 02-04-2016 | 15.00 | 30.78 |
| Own | 210140000014 | 02-04-2016 | 10.00 | 20.78 | KRIL | 00210340003682- | 02-04-2016 | 10.00 | |
| Own | 210140000014 | 02-04-2016 | 10.00 | 10.78 | KRIL | 00210340003682- | 02-04-2016 | 10.00 | |
| Own | 210140000014 | 02-04-2016 | 10.00 | 0.78 | KRIL | 00210340003682- | 02-04-2016 | 10.00 | |
| | | | | | | | | | |
| LAS | 210130000134 | 03-04-2018 | 37.25 | | Own | 210140000014 | 03-04-2018 | 37.25 | 79.73 |
| Own | 210140000014 | 03-04-2018 | 27.50 | 52.23 | KRIL | 00210340003682- | 03-04-2018 | 27.50 | |
| | | | | | | | | | |

*KRIL-Karvy Realty (India) Limited (*Noticee no. 8*)

73. Similar to the aforementioned fund transactions, the Forensic Audit Report also notes that there were transactions where funds were transferred from bank accounts earmarked as 'Client bank accounts' to 'Own bank accounts' of KSBL, and such funds were in turn shifted to group companies of KSBL. A sample of such transactions is shown as follows:

## Table 7: Transfer of funds from client's account to connected entities to KSBL

| From | | | | | To | | | | |
|---|---|---|---|---|---|---|---|---|---|
| **Type** | **Account Number** | **Transaction date** | **Amount Transferred** | **Balance** | **Type** | **Account Number** | **Transaction date** | **Amount Received** | **Balance** |
| Client | 210340000107 | 11-07-2018 | 12.00 | | Own | 210140000014 | 11-07-2018 | 12.00 | 12.05 |
| Own | 210140000014 | 11-07-2018 | 12.00 | 0.06 | KCAP | KARVY CAPITAL LTD | 11-07-2018 | 12.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 27-10-2017 | 100.00 | | Own | 210140000014 | 27-10-2017 | 100.00 | 101.09 |
| Own | 210140000014 | 27-10-2017 | 10.00 | 91.09 | KRIL | 210340003682 | 27-10-2017 | 10.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 24-01-2018 | 50.00 | | Own | 210140000014 | 24-01-2018 | 50.00 | 57.06 |
| Own | 210140000014 | 24-01-2018 | 45.00 | 12.06 | KRIL | 210340003682 | 24-01-2018 | 45.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 24-01-2018 | 50.00 | | Own | 210140000014 | 24-01-2018 | 50.00 | 114.26 |
| Own | 210140000014 | 24-01-2018 | 13.00 | 101.26 | KRIL | 210340003682 | 24-01-2018 | 13.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 27-03-2018 | 50.00 | | Own | 210140000014 | 27-03-2018 | 50.00 | 50.21 |
| Own | 210140000014 | 27-03-2018 | 13.50 | 36.71 | KRIL | 210340003682 | 27-03-2018 | 13.50 | |
| Own | 210140000014 | 27-03-2018 | 12.00 | 24.71 | KRIL | 210340003682 | 27-03-2018 | 12.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 28-12-2017 | 48.00 | | Own | 210140000014 | 28-12-2017 | 48.00 | 48.69 |
| Own | 210140000014 | 28-12-2017 | 13.50 | 35.19 | KRIL | 210340003682 | 28-12-2017 | 13.50 | |
| | | | | | | | | | |
| Client | 210340000107 | 31-03-2018 | 45.00 | | Own | 210140000014 | 31-03-2018 | 45.00 | 45.18 |
| Own | 210140000014 | 31-03-2018 | 13.00 | 32.18 | KRIL | 210340003682 | 31-03-2018 | 13.00 | |
| Own | 210140000014 | 31-03-2018 | 15.00 | 17.18 | KRIL | 210340003682 | 31-03-2018 | 15.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 28-02-2019 | 45.00 | | Own | 210140000014 | 28-02-2019 | 45.00 | 51.92 |
| Own | 210140000014 | 28-02-2019 | 50.00 | 1.92 | KRIL | 210340003682 | 28-02-2019 | 50.00 | |
| | | | | | | | | | |
| Client | 210340000107 | 22-03-2019 | 44.00 | | Own | 210140000014 | 22-03-2019 | 44.00 | 44.03 |
| Own | 210140000014 | 22-03-2019 | 6.25 | 37.78 | KRIL | 210340003682 | 22-03-2019 | 6.25 | |
| Own | 210140000014 | 22-03-2019 | 5.75 | 32.03 | KRIL | 210340003682 | 22-03-2019 | 5.75 | |
| | | | | | | | | | |
| Client | 210340000107 | 28-03-2018 | 41.65 | | Own | 210140000014 | 28-03-2018 | 41.65 | 41.75 |
| Own | 210140000014 | 28-03-2018 | 40.00 | 1.75 | KRIL | 210340003682 | 28-03-2018 | 40.00 | |
| | | | | | | | | | |

*KRIL-Karvy Realty (India) Limited (*Noticee no. 8*)

74. The aforementioned two tables together, clearly establish that KSBL was continuously raising funds from various financial institutions through LAS facility by pledging of its clients' securities. The provisions of SEBI Circular dated June 22, 2017, as quoted earlier in this Order, clearly stipulate that funds raised by using clients' securities shall belong to the clients and clients only. However, despite being fully aware of the aforementioned provisions of law, KSBL was continuously transferring these funds first to its 'own' bank accounts, and thereafter the said funds were being transferred to the group companies of KSBL including *Karvy Realty* and *Karvy Capital*.

75. In fact, looking at the structure of the device employed by KSBL for effecting these fund transfers, it will not be an exaggeration to say that the above device was deceitfully used by KSBL whereby the funds raised from financial institutions by using its clients' securities were 'routed' by it to its related and connected entities viz; *Karvy Realty* and *Karvy Capital*, after passing them through its own accounts. Similarly routing of funds was also noticed in case of funds withdrawn from 'clients' bank accounts' maintained by KSBL, which were subsequently transferred to *Karvy Realty* and *Karvy Capital*, numerous examples of which have been enumerated in Tables 6 and 7 above. The said routing of funds appears to have been shrewdly done through the accounts of KSBL to avoid detection of transfer of funds to connected entities of KSBL, which, otherwise, would have been noticed by both the first level Regulators as well as by the clients had these funds were directly transferred from clients' accounts to group entities of KSBL. As the funds were being transferred to KSBL bank accounts, the clients presumed the same to be for the purpose of meeting settlement/margin obligations on behalf of them and never raised objection against such transactions. Similarly, the Stock Exchanges never raised any objection on the first leg of such transfer of funds due to it being a transfer from clients' accounts

to the stock broker's account, which was a normal activity to take place in the ordinary course of stock broking business and is permitted under a number of circumstances, most importantly for settlement of clients' accounts and for margin trading purposes. Thus, by using this fraudulent and deceptive structure, KSBL was blowing dust in the eyes of its clients, SEBI and Stock Exchanges in a devious manner.

76. However, due to issuance of SEBI Circulars dated June 20, 2019 and August 29, 2019, KSBL had to un-pledge all the clients' securities that it had pledged without being in compliance with the aforementioned circular dated June 22, 2017. By that time, the scheme employed by KSBL to raise funds by way of unauthorized pledging of clients' securities for transferring the said funds to its group entities had come to light during the limited purpose inspection conducted by NSE on August 19, 2019. During the said inspection, NSE found out that KSBL was deliberately not disclosing demat account No. IN300394-11458979 (named as KARVY STOCK BROKING LIMITED-BSE), through which it had pledged clients' securities. Therefore, KSBL had to give undertaking that it would un-pledge all the clients' securities by September 30, 2019.

77. As the funds so raised by pledging clients' securities had already been transferred by KSBL to *Karvy Realty* and *Karvy Capital*, which had misappropriated these funds for one or the other purposes, it became impossible for these entities to return the funds back to KSBL on such a short notice so as to enable KSBL to repay the loans and get the clients' shares unpledged. Under these circumstances, the whole burden of arranging funds to un-pledge its clients' securities fell upon KSBL which it failed to discharge. Due to such failure, it failed to settle clients' funds and securities on or before September 30, 2019 as per its undertaking given to NSE which ultimately led to default in settlement of clients' funds and

securities. Alarmed by this, the Forensic Audit was ordered by NSE wherein the whole deceitful scheme of KSBL was uncovered.

78. It is seen from the above discussions that, by raising funds through the pledge of clients' securities and by placing the funds so raised in its own account (proprietary account) and then by diverting such funds to its group entities, KSBL has clearly violated the requirement under the extant legal regime to keep the moneys and securities of clients separate and segregated from its own funds & securities apart from violating the restrictions/conditions stipulated by SEBI with respect to the usage of clients' funds and securities only for the purpose of meeting obligation of the clients' trades and other consequential requirements only as per the instructions contained in the aforesaid SEBI circulars. Further, KSBL, by moving funds from the clients' accounts to its own accounts for its extraneous reasons, has clearly violated the grounds specified under the extant legal regime for transfer of funds from clients' accounts to its own. By doing so, KSBL has clearly violated the provisions of SEBI Circulars dated November 18, 1993 and September 26, 2016.

79. At the same time, by its failure to settle clients' funds and securities within the prescribed timeline, KSBL has also become liable for penalty under the provisions of Section 23D of the SCR Act, 1956 read with SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 and SEBI Circular No. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016.

80. Lastly, considering the observations made in MCSGFC Order dated November 23, 2020, certain allegations have been made in the SCN on the basis of findings given in the aforementioned Order.

81. It has been alleged that KSBL had not only misappropriated the funds of its clients and other funds raised by it by keeping its clients' securities pledged with the lender financial institutions in an unlawful manner and also by transferring

the funds so raised unlawfully to its subsidiary companies, but has also misappropriated clients' securities for meeting the obligation of its nine (09) clients, which were the entities closely connected to it.

82. In this regard, it is observed from the data provided in the MCSGFC Order dated November 23, 2020 that till May 31, 2019, KSBL had sold securities to the tune of INR 484.56 Crores in the accounts of 9 clients however, the shares so sold from the accounts of the 9 clients were in excess of their respective holdings. Further, securities worth of INR 257.08 Crores, pledged on behalf of 4 out of the aforementioned 9 clients, were unpledged during the period of June 01, 2019 to August 22, 2019 and securities worth INR 217.85 Crores were recovered by KSBL from 4 out of the said 9 clients. It was also submitted by KSBL during the aforementioned MCSGFC proceedings that the securities balances were incorrectly shown (in excess) in the back office records for 8 of the aforesaid 9 clients amounting to INR 528.79 Crores as compared to the actual balances of securities outstanding qua these clients. Further examination of Depository Participant record suggests that KSBL had transferred securities worth INR 27.80 Crores to its connected entities from the Beneficiary account of its 156 clients who had not executed a single trade with KSBL. Similarly, securities worth INR 116.30 Crores were transferred off market to the aforementioned 9 clients from 291 accounts of its other clients who had not traded with KSBL since June 01, 2019. The same was admittedly done to give more than permitted exposure to these 9 clients. I find it important to mention here that the following 9 entities had received the aforementioned preferential treatment:

**Table 8: Entities connected to KSBL which had used clients' securities for trading**

| S. No. | Client Name | Relation with KSBL |
|---|---|---|
| 1 | Karvy Consultants Limited | Direct Subsidiary |
| 2 | Wizard Insurance Services Pvt. Ltd. | Having common email IDs under the domain name of karvy.com and having common addresses in the UCC records. |
| 3 | Zenith Insurance Services Pvt. Ltd. | |
| 4 | Buoyant Insurance Services Pvt. Ltd. | |
| 5 | Nova Wealth Management Services Pvt. Ltd. | |
| 6 | Vitalink Wealth Advisory Services Pvt. Ltd. | |
| 7 | Classic Wealth Management Services Pvt. Ltd. | |
| 8 | Champion Insurance Services Pvt. Ltd. | |
| 9 | Pelicon Wealth Advisory Services Pvt. Ltd. | |

Along with this, I find from the submission dated May 20, 2022 of *Noticees no. 1, 2, 4, 5, 8* and *9* during the course of present proceedings wherein they have admitted that, except for the company at S. No. 1 in the aforementioned Table, the remaining 8 companies were incorporated by KSBL in order to offer insurance products of different companies, as a part of its strategy to enter into insurance business.

83. In this regard, I note from the findings given in the MCSGFC Order dated November 23, 2020 that other clients' securities were used to settle the trades of 9 connected entities of KSBL. I further find from the Forensic Audit Report that, out of these 9 entities, Karvy Consultants Limited was a promoter entity of KSBL. It has also been recorded in the MCSGFC Order dated November 23, 2020 that, till May 31, 2019, KSBL had accepted that the securities balances in respect of 8 of the aforesaid 9 clients had been shown to be more than the actual available securities balance in its back office records. Thus, it is quite clear that there has been misuse of the securities belonging to the other clients of KSBL.

84. It has also been observed in the MCSGFC Order dated November 23, 2020 that as on September 24, 2019, total amount payables to all the clients of KSBL stood at INR 430.67 crore while KSBL had misrepresented by claiming that it was holding free funds to the extent of INR 363.09 crore including a Fixed Deposit of INR 251.42 crore with Union Bank of India. Thus, it was shown that KSBL was having a fund shortfall of barely INR 67.58 crore only. However, it was subsequently informed by Union Bank of India to NSE that KSBL had availed overdraft facility by pledging the said Fixed Deposit. Therefore, the said Fixed Deposit was not unencumbered. In the light of this revelation, the shortfall of funds by November 22, 2019 was recalculated by NSE in the light of the aforementioned letter of Union Bank of India and the shortfall in clients' funds accordingly got increased to INR 434.19 crore. The details regarding the non-availability of clients' funds, as captured in the MCSGFC Order dated November 23, 2020, are provided hereunder:

**Table 9: Funds shortage at KSBL**

*Amount (INR Crore)*

| **Particulars** | **Sept 24, 2019** | **Nov 22, 2019** |
|---|---|---|
| Amount Payable to clients of KSBL– A | 430.27 | 527.18 |
| Total cash/bank balances with KSBL - B | 259.5 | 257.09 |
| Funds with Exchange, Clearing Member/Clearing Corporation – C | 103.59 | 91.32 |
| Value of FDRs forming part of cash/bank Balance, observed to be not free and unencumbered based on letter from Union Bank of India dated Nov 29, 2019- D | 251.42 | 255.42 |
| **Net-availability of Funds [E= (B+C-D)-A]** | **-319** | **-434.19** |

85. It is noted from the MCSGFC Order dated November 23, 2020 that KSBL had accepted the observation regarding non-availability of clients' funds as brought out above. In view of the above facts, I find that KSBL had clearly failed to show that it had adequate funds to pay off to its clients, and such non-availability of funds to settle its obligation towards its clients can lead to singular conclusion that the funds of its clients were misused by KSBL. This observation gets further strengthened in the light of the fact that even till now the funds of all the clients of KSBL have not been settled and a majority of clients are waiting to receive their dues from KSBL. Had KSBL been flushed with funds, it would have settled all the clients' accounts within a short period of time, arguably before September 30, 2019, in line with the undertaking given by KSBL to NSE. Given the fact that clients' funds have not been settled even after more than three years have wheeled away since passing of the *Interim Order*, it conclusively establishes a glaring shortage of funds at KSBL's end, which resulted into default in payment of funds to its clients.

86. Further, observations had been made in the MCSGFC Order dated November 23, 2020 regarding KSBL's net worth. The MCSGFC Order records that the net-worth of KSBL was in the negative, considering the loans and advances to group companies/associates. The details with respect to the shortfall in net-worth of KSBL are as under:

**Table 10: Detail of shortfall in net-worth of KSBL**

(*Amount in INR crore*)

| **Particulars** | **Amount** | **Amount** |
|---|---|---|
| Capital and Reserves | | 428.57 |
| Less: Non Allowable Assets | | 1,816.65 |
| Fixed Assets | 358 | |
| Non Allowable Securities /Investments | 225 | |
| Doubtful Debts and Advances | 1228 | |

| | | |
|---|---|---|
| Prepaid Expenses | 4.80 | |
| 30% of Marketable Securities | 0.10 | |
| **Net worth** | | **(1,388.08)** |

In this regard, an attempt has been made by KSBL to explain the shortfall in its net worth by stating that the net worth of KSBL was calculated based on L C Gupta Committee formula. Earlier, in the said calculation, any investment in an unlisted subsidiary company was required to be deducted to arrive at the net worth. At the same time, any short term advances to subsidiary companies was earlier not required to be deducted to arrive at net worth of a stock broker. However, the method of calculation was changed from August 2021 wherein it was decided that short term advances would also be deducted in calculation of net worth. Due to this, there is a sudden shortfall in its net worth.

87. It is however observed that the aforementioned reasoning offered by KSBL in its defense to justify its negative net worth has no factual support, hence, is sans any credibility. In this regard, I find that the MCSGFC Order was passed on November 23, 2020 i.e. the calculation of net worth of KSBL was made prior to the new method of calculation of net worth was implemented. However, in the said calculation, the net worth has been detected to be negative, as indicated in the Table 10 above. In this regard, it is stated that Regulation 9(g) read with Schedule VI of Stock Brokers Regulations mandate a stock broker to maintain a minimum net worth as prescribed by SEBI from time to time. A negative net-worth is a clear violation of the obligation to maintain a prescribed level of positive net-worth. Thus, by its failure to maintain a positive net worth, KSBL has violated the provisions of Regulation 9(g) of Stock Broker Regulations.

88. In the end, the SCN has alleged that KSBL has violated Regulation 4(1) and 4(2)(m) of the PFUTP Regulations. In this regard, Regulation 4(1) of PFUTP Regulations *inter alia* prohibits every person from indulging in manipulative,

fraudulent or unfair trade practices in the securities markets. Similarly, Regulation 4(2)(m) *inter alia* provides that a market participant entering into transactions on behalf of its client without the knowledge of or instructions from client or misutilising or diverting the funds or securities of the client, held in fiduciary capacity, would be deemed to be a manipulative, fraudulent or unfair trade practice.

89. It is well established fact that the relationship between a stock broker and its client is of fiduciary nature. It is based on an implicit trust that the stock broker will act in the best economic interest of its client. For the same purpose, a running power of attorney is generally signed by the clients trusting that the stock broker will act in his best interest and will use his funds and securities only against his trading and for his benefit only. In the same magnitude, when a stock broker takes securities from a client's account to its own account, it is presumed that the same is done under a trust that the said securities will be used for the purpose and benefit of the said client only.

90. However, considering that KSBL has pledged the securities of its clients without taking authorization from them; misused the securities of its clients; misused the funds of its clients, even misused the funds that were raised by pledging its clients' securities in an unauthorized manner and has been recklessly deficient in its services as a stock broker by failing to timely settle the trades of its clients, it leaves me with no hesitation in holding that the aforesaid actions of KSBL have been fraudulent in nature and have been committed against the trust reposed upon it by its clients, apart from the fact that such devious acts are in the nature of unfair trade practices whereby KSBL unabashedly benefitted its own connected entities at the expense of its general clients by misappropriating their securities and funds. I, accordingly, find that KSBL has clearly violated the provisions of Regulation 4(1) and 4 (2)(m) of the PFUTP Regulations.

91. Lastly, it has been alleged in the SCN that KSBL has also breached Clauses A(1), (2), (3), (4) & (5) of the Code of Conduct provided under Schedule II read with Regulation 9 of the Stock Broker Regulations, which every registered stock broker is obligated to adhere to.

92. Clause A(1) of the aforementioned Code mandates a stock broker to maintain high standards of integrity, promptitude and fairness in conduct of its business. However, the facts of the present matter clearly show that KSBL had acted in complete disregard of the legitimate interests of its clients and has provided benefits to its own subsidiaries and other connected entities at the cost of such clients. The lack of promptitude or rather intentional belatedness on the part of KSBL in disclosing the fact to its clients that their shares have been pledged by it against their will and authority and that the funds so raised by it by pledging their securities were solely and conveniently utilized for its own benefit; smacks of glaring indulgence in fraudulent misappropriation of clients' securities and funds, by which KSBL has not only made a mockery of its fiduciary duty towards its clients as a market intermediary but also even put the integrity of the securities market at risk. The said fact of unauthorized pledging of clients' securities and misuse of the funds so raised by pledging of clients' securities came to light when KSBL started defaulting on its obligations towards its clients. In the light of all the facts narrated in the present Order, lack of integrity, promptitude and fairness in the acts of KSBL are self-evident and writ large from the very acts of KSBL as have been elucidated elaborately in the foregoing paragraphs. Under the circumstances, in my above observation, it is not difficult to hold in the facts of the present matter that KSBL has violated the provisions of Clause A(1) of Code of Conduct given under Schedule II of Stock Broker Regulations.

93. Clause A(2) of Code of Conduct for Stock Brokers mandates a stock broker to act with due skill, care and diligence in conduct of its business. In this regard, it

is now well established that KSBL has acted in a manner which, by no stretch of moderation, can be called careful and diligent. In fact, it has acted in flagrant disregard of basic due diligence expected from a stock broker registered with SEBI. It has been adequately exposed by EY in its Forensic Audit that every day the treasury team of KSBL used to calculate the requirement of funds for its operations in the light of the quantum of trades undertaken during the day. The said calculation used to be forwarded to operation team, which further used to randomly select securities lying in different clients' accounts for placing them under pledge with financial institutions to raise funds through LAS facility so as to meet the funds requirement. Once such securities were identified, they were transferred to the demat accounts of KSBL including A/c No. IN300394-11458979 (named as KARVY STOCK BROKING LTD-BSE) wherein the securities were pledged and funds were raised by KSBL for its operations. This entire operation was being done in complete disregard to various laws and circulars issued by SEBI and Stock Exchanges. This fact itself speaks volumes that KSBL was not acting with due care and diligence while conducting its business and therefore, has undoubtedly violated the provisions of Clause A(2) of Code of Conduct for Stock Brokers.

94. Clause A(3) of Code of Conduct for Stock Brokers mandates a stock broker not to indulge in manipulative, fraudulent and deceptive transactions or schemes. In this regard, it has already been established above that the misdeeds of KSBL resulting in misappropriation of clients' securities and funds, as discussed in preceding paragraphs, fall squarely within the definition of a fraudulent scheme. Further, KSBL has deceived its clients into believing that their shares and funds were safe and that the scheme under which KSBL was mobilizing securities by way of borrowing securities from the clients with a promise to pay them interest on the value of their securities so lent to KSBL was a legal scheme under which

they were legally receiving interest from KSBL. Such deception and misrepresentation made by KSBL before its clients has lured large number of clients to lend their securities to KSBL which ultimately resulted into those clients losing their funds and securities, and the same have not been recovered by them from KSBL till date. Therefore, it requires no major effort at this stage to hold that KSBL has violated the provisions of Clause A(3) of Code of Conduct for Stock Brokers.

95. Clause A(4) of Code of Conduct for Stock Brokers mandates a stock broker not to indulge in any act that is detrimental to the investors' interest or any act which may lead to interference with the fair and smooth functioning of the market. A stock broker is also mandated not to involve in excessive speculative business beyond reasonable levels not commensurate with his financial soundness. All these mandates were completely disregarded by KSBL in its operation wherein it has not only traded in excess of its financial capacity by allowing its related entities to trade in securities market by using the securities belonging to its other clients; it has also raised funds of huge amounts, as highlighted earlier, by keeping its clients' securities worth of hundreds of crores of rupees under pledge with various lending financial institutions. Needless to emphasize here that if SEBI had allowed the lending financial institutions to recover their loans advanced to KSBL against those pledged shares of clients by invoking those pledges, it would have triggered simultaneous sale of those pledged securities by all these financial institutions on the exchange platforms thereby creating acute selling pressure in different scrips and posing a systemic risk to the entire stock market. This further amplifies the fact that by its misconduct KSBL has not only acted in a manner detrimental to the interest of its own clients but also detrimental to the interest of investors at large. Therefore, I have no qualms in holding that KSBL has violated the provisions of Clause A(4) of Code of Conduct for Stock Brokers.

96. Clause A(5) of Code of Conduct for Stock Brokers mandates a stock broker to abide by all the provisions of SEBI Act and rules, regulations issued by the Government, SEBI and the Stock Exchange. In this regard, it has now been well established above that KSBL has violated numerous provisions of law in furtherance of the scheme deployed by it to fulfill its ulterior motive as elaborately discussed in the present order, hence, as a corollary to the same, it can be confidently concluded that KSBL has also violated the provision of Clause A(5) of Code of Conduct for Stock Brokers.

97. In view of all the aforesaid, I find no hesitation in holding that KSBL has acted in complete disregard to the provisions of Regulation 9(f) read with Clauses A(1), A(2), A(3), A(4) and A(5) of Code of Conduct for Stock Brokers prescribed under Schedule II of Stock Broker Regulations.

98. Before moving ahead to examine the role played by the management of KSBL, if any, in the entire saga of above discussed wrongdoings committed by KSBL, I find it necessary to refer to the provisions of Section 27(1) and 27(2) of SEBI Act which read as below:

**SEBI Act**

**Contravention by companies.**

**27.** (1) *Where a contravention of any of the provisions of this Act or any rule, regulation, direction or order made thereunder has been committed by a company, every person who at the time the contravention was committed was* ***in charge of, and was responsible to, the company for the conduct of the business of the company,*** *as well as the company, shall be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly:*

*Provided that nothing contained in this sub-section shall render any such person liable to any punishment provided in this Act, if he proves that the contravention was*

*committed without his knowledge or that he had exercised all due diligence to prevent the commission of such contravention.*

(2) *Notwithstanding anything contained in sub-section (1), where an contravention under this Act has been committed by a company and it is proved that the* ***contravention has been committed with the consent or connivance of, or is attributable to any neglect*** *on the part of, any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the contravention and shall be liable to be proceeded against and punished accordingly.*

*Explanation : For the purposes of this section,—*

(a) *"company" means any body corporate and includes a firm or other association of individuals;* and

(b) *"director", in relation to a firm, means a partner in the firm.*

One can appreciate that the above quoted provisions of SEBI Act have introduced the concept of vicarious liability in the realm of securities law. The said provisions hold every person, who was/is in charge of, and responsible to the company for the conduct of the business of the company when the contraventions of securities law happened, as liable for the contravention of provisions of SEBI Act or rules, regulations, directions, for which the said company has been held liable. At the same time, if it is proved that the said contravention has been committed with the consent or connivance of, or is attributable to any negligence on the part of any director, manager, secretary or other officer of the company, such director, manager, secretary or other officer shall also be deemed to be guilty of the said contravention committed by the company.

99. Therefore, a person may be held to be vicariously liable for the contravention committed by the company if:

99.1. He was in charge of, and responsible to, the company for the conduct of the business of the company at the relevant point of time; or

99.2. Being the director, manager, secretary or other officer of the company, the contravention was committed with the consent or connivance of, or is attributable to any negligence on his/her part.

100. In this regard, I have gone through and considered the submissions of all the *Noticees*. I find that *Noticees no. 1, 2, 4, 5, 8* and *9*, in their combined reply, have made a meek attempt to defend themselves against the allegations levelled against them in the SCN. I note that, except for the *Noticees no. 1, 8* and *9*, all other *Noticees* have tried to distance themselves from the responsibilities of the whole KSBL default saga and have sought exoneration from the allegations made against them in the SCN.

101. In this regard, *Noticees no. 2, 4,* and *5* have submitted that they were not aware of anything pertaining to the wrongdoings that were happening in the *Company* and have further tried to shift the whole blame upon *Noticee no. 7* (Rajiv Ranjan Singh), who was stated to be working in KSBL as CEO-Stock Broking at the relevant point of time. They have contended that it was the *Noticee no. 7*, who was running the whole fraudulent scheme, as discussed in detail in the preceding sections of the present order, without having authorization of anyone in the *Company* and he is the only person to be held responsible in the matter along with the Vice President (Finance) of the *Company*. While these *Noticees* have admitted to the act of pledging of clients' shares & misutilisation of clients' securities by KSBL, raising of funds through pledging of securities not owned by KSBL etc., the argument they are holding onto is that only the shares of those clients were pledged who were provided with margin trading facility by KSBL. According to

their claim, the pledging of shares of other clients was done by *Noticee no. 7* without any information to Board of Directors of KSBL.

102. At the same time, *Noticee no. 3* has submitted that he was a Non-Executive Director of the *Company* and was not involved in day to day operation of the *Company*. Further, all the aforementioned wrongdoings were never discussed in the meetings of Board of Directors and no permission to pledge the securities of clients or to divert funds so raised by KSBL to the accounts of KSBL's connected entities was ever taken from Board of Directors.

103. He has further submitted that he had raised the issue of misuse of clients' funds as early as in January 2017 but the CFO, Mr. G Krishna Hari, replied to him vide an email dated January 21, 2017 stating that no client security had been pledged by KSBL, which ultimately turned out to be a false assurance. He also submitted that as soon he found out about misuse of clients' funds and securities, he requested for forensic audit of the Books of Accounts of the *Company*, but the same was refused by *Noticee no. 2* on one pretext or the other. He has also submitted numerous evidence showing that he had raised issues discussed in present matter at various forums including the meetings of Board of Directors of KSBL but his request for fixing accountability was rejected by the Board of Directors of the *Company*. He has also submitted that he has been submitting representations to SEBI, SFIO, RBI, NSE and Registrar of Companies to investigate into the wrongdoings in the affairs of KSBL. Therefore, his role is rather more of a whistle-blower than a perpetrator in the matter.

104. Similarly, *Noticee no. 6* has submitted that he was a nominee director of a private equity firm which had invested in KSBL and he has stopped being associated with KSBL with effect from July 14, 2019. He has further submitted that he was essentially a non-executive director, having no role to play in day to day functions of KSBL. He has also submitted that his only role was to see governance aspects

of KSBL by way of attending Board of Directors meetings, in order to protect the financial interest of the investor he was representing. Further, he has submitted that the transactions involving raising of funds through pledging of clients' securities as well as the other wrongdoings alleged in the SCN were never discussed in the meetings of Board of Directors, therefore, he was not aware of any such wrongdoings.

105. In the end, *Noticee no. 7*, who has been blamed by some of the other *Noticees*, as cited above, for all the fraudulent acts leading up to the default on the part of KSBL to settle the dues with its clients, has during his personal hearing, submitted that his job profile was limited to only client acquisition, client servicing and Branch co-ordination for equity retail broking business of KSBL. The designation assigned to him that of "CEO-Stock Broking" from October 2017 was merely a paper designation without any change in job profile and with no authority given to him of a CEO as per law befitting to such a designation.

106. He has further submitted that he was never in control of such a big conglomerate like KSBL nor even was in charge of the whole Stock Broking businesses of KSBL. The business verticals of KSBL related to Franchisee Broking, Institutional Broking & Currency Broking had their own separate Business Heads reporting to the CMD. The finance, operations, human resources and administration teams commonly catered to all the business divisions/verticals of KSBL and were also not under his control.

107. *Noticee no. 7* has further submitted that the designation of CEO granted to him was not a statutory CEO designation in terms of Companies Act, 2013 but an in-house or internal departmental designation just to create a perceptional value before others. Consequently, the prescribed procedure for appointment of CEO or Key Managerial Person under the provisions of the Companies Act, 2013 and the rules thereof which *inter-alia* included passing a Board Resolution, obtaining

consent letter, issuing appointment letter and filing statutory forms with Registrar of Companies (ROC) etc. were never followed nor were expected to be followed in the case of his appointment as CEO as the said appointment was merely a change in designation without any change in his job profile. In fact, KSBL never considered him as a Key Managerial Person and he was never disclosed so by the *Company* as well.

108. He has submitted that he had no role or involvement in raising of funds from Banks by pledging the clients' securities. Further, he had no powers or authority to instruct any transfer of funds to group companies of KSBL. He was not a signatory to any document signed by KSBL with the financial institutions such as Sanction Letter, Loan Agreements, Hypothecation agreements etc. In fact, he was not aware of any funds being raised by way of unauthorized pledging of clients' securities as the said activities were being looked after by the Operations and Treasury team. He has denied that the General Manager-Back Office Operations and VP-RMS were reporting to him on their departmental responsibilities.

109. I have carefully considered the submissions and pleadings made by all the afore-stated *Noticees* including *Noticee no. 7*. First of all, I find that *Noticee no. 2* has been holding the majority stake of KSBL through shares held by himself, his family members, his HUF and his connected entities. He is the promoter of the *Company* along with *Noticee no. 3*. He has always been Managing Director of the *Company* and thus was exercising complete control over the day-to-day affairs of the *Company* and that is very much evident from the designation of the post he was holding in the *Company*.

110. In continuation of the aforesaid, I find that he has been representing KSBL before all the forums in respect of all the proceedings that have resulted out of the fraudulent acts of KSBL as borne out of the facts already narrated earlier in the present order. He was directly interacting with NSE to resolve the issues

relating to pledging of securities. He represented KSBL in MCSGFC proceedings and proceedings before SEBI as well, which resulted into passing of *Interim Order* and *Confirmatory Order*. In fact, when the queries were raised by EY to find out the object behind fund transfers to *Karvy Realty* and *Karvy Capital*, it was intimated to them by the employees of KSBL that only *Noticee no. 2* would be in position to answer them. I also note that during the course of present proceedings also, the personal hearings granted to KSBL were adjourned twice on the ground that *Noticee no. 2* was in judicial custody and only he has the knowledge of all the funds and securities transactions and only he was in a position to explain the matter properly. Subsequently, when the authorized representatives of *Noticee no. 2* was asked during the personal hearing dated May 20, 2022 to ensure the physical presence of *Noticee no. 2* on the next hearing date in order to find out from him the steps so far taken by KSBL to settle clients' funds and securities as well as about the future course of action that he intends to take in this regard, he failed to appear on the given date.

111. I find that the submissions of *Noticees no. 3* and *6* corroborate the above position that *Noticee no. 2* was in complete command and control over the *Company*. Prior to appointment of EY by NSE to carry out forensic audit, when *Noticee no. 3* requested the board of KSBL for conducting a forensic audit of the *Company* so that accountability of persons responsible for the alleged wrongdoing may be fixed, the same was rejected by the *Noticee no. 2* by stating that any Forensic Audit would be damaging for the *Company*.

112. All the aforesaid factual observations clearly establish that the *Noticee no. 2* was in fact the master brain behind all the wrongdoings that have been discovered during the course of SEBI's and NSE's examinations and also unearthed by the Forensic Audit conducted by EY. I also find that almost all the emails attached as evidence with Forensic Audit Report were either originated from *Noticee no. 2*

or were sent to him or at least he was marked a copy in those emails meaning thereby, the *Noticee no. 2* was always in complete control and was informed about all the transactions and events that were happening in the affairs of the *Company*. The fact that he refused to conduct Forensic Audit as a reaction to the suggestion made by *Noticee no. 3*, clearly creates a presumption against him that he didn't want his role in the entire fraudulent game played by KSBL to be exposed, which has ultimately come out by way of Forensic Audit Report of EY. At this stage, the fact can't be ignored that the funds so raised by pledging the securities of clients of KSBL had ultimately landed in companies that were substantially connected with the *Noticee no. 2* only. It is very uncanny and difficult to believe that the *Noticee no. 2* was not aware of and never bothered to make any inquiry from any other person including the *Noticee no. 7* to even know about the source and reasons behind the funds being received in the accounts of *Karvy Realty* and *Karvy Capital* as well as 9 connected companies of KSBL.

113. Before moving on to the other noticees, I find it important to note here that the role of Non-Executive Director (including an Independent Director) in a company is confined to the issues raised in the meetings of its Board of Directors. If an issue has not been raised or a matter has not been discussed in the Board of Directors, such Non-Executive Director may not be normally held liable with respect to the said matter. At the same time, a Director acts in fiduciary responsibility to the shareholders of the company. His position is one of trust, wherein the shareholders appoint him as director to protect their interest. For that object, he is expected to act diligently in order to safeguard the interest of the shareholders of the company. Therefore, it is expected of him that he should raise issue, which comes to his notice from any other source, before the Board of Directors in order to seek clarity on those issues from the persons in control of the day to day affairs of the company.

114. With respect to *Noticee no. 3*, I do not find any evidence that he was involved in the day to day operations of the *Company*. He was also not named as a Key Managerial Person by KSBL. He has also submitted a plethora of evidence to establish that it was he who had raised red flags about all the issues discussed in the present order before the Board of Directors as well as through his individual emails sent to other directors but to no avail.

115. I have gone through the evidence submitted by *Noticee no. 3* in support of his submissions. I find that the evidences produced by him in his defense prove that *Noticee no. 3* had raised the issues of diversion of funds that were raised by pledging of clients' shares before other directors on numerous occasions. The evidences placed on record also show that he had also sought Forensic Audit to be carried out of the books of accounts of the *Company* to find out the extent of wrongdoings and also to fix the responsibility of persons involved in such wrongdoings. However, such requests were stonewalled by *Noticee no. 2* on flimsy grounds.

116. In this regard, one can appreciate that any decision taken by the Board of Directors, is taken by way of majority voting. Therefore, failure of the Board of Directors to take any action on the issues raised by *Noticee no. 3*, cannot be attributed to him. Under the circumstances, upon appreciation of evidence on record, it is observed that the same is not sufficient to establish fault or wrongdoing on the part of *Noticee no. 3* in respect of the wrongdoings of KSBL discussed in this order.

117. With respect to *Noticees no. 4* and *5*, I find from the material available on record that they were appointed as Independent Directors on the Board of Directors of the *Company*. They have submitted a combined response along with *Noticees no. 1, 2, 8* and *9* wherein they have taken the same stand as that of *Noticee no. 2*.

118. In respect of these two noticees, I find that *Noticee no. 3* had again and again raised concerns about the wrongdoings inside KSBL. I have also found that *Noticee no. 3* had sought forensic audit of the *Company*. The said fact has been noted and as pointed out above, the communications of *Noticee no. 3* seeking forensic audit and fixing responsibility of wrongdoers were also marked to *Noticees no. 4* and *5*. However, there is no evidence available showing any action whatsoever taken by these independent directors either to make the *Company* to conduct a forensic audit or to fix the accountability of the perpetrators of the wrongdoings and fraudulent acts committed by the management of KSBL or even to ensure that justice to the clients is meted out by settling their funds and securities expeditiously, even after the issue was raised by SEBI, NSE or even by their own colleague director, *Noticee no. 3*. It is observed that these two noticees, along with *Noticee no. 3*, were enjoying a majority in the Board of Directors of the *Company* and were certainly in a position to force *Noticee no. 2* to conduct forensic audit of books of KSBL. Upon conduct of the said audit exercise and based on the outcome of the same, the future course of action could have been decided including fixing responsibility in the matter. However, the materials available on record clearly show that the *Noticee no. 4* and *5* rather stood on the side of *Noticee no. 2* and remained oblivious to their responsibility to act fairly and thereby failed in performing their acts diligently and in a transparent manner. Under the circumstances, I am of the view that these two noticees have failed to bring sufficient material on record to show that they have performed their duties as independent directors and kept an arm's length distance from the management of the *Company*. Rather, the materials on record coupled with the conduct of these two noticees compel me to record that *Noticees no. 4* and *5* were, if not hand in glove with *Noticee no. 2*, but had certainly preferred to remain knowingly negligent in their duties and thereby permitted the wrongdoings of misutilisation of securities and funds of the clients of KSBL to happen right under their nose as

there is no other reason as to why they would remain oblivious even to the findings of SEBI, NSE as well as to their own colleague Director's concerns which were founded on credible facts and evidences apart from media reports. Therefore, I find them guilty of the contraventions as alleged in the SCN. I observe that the silence and inaction shown by the two independent directors, viz: *Noticees no. 4* and *5* are glaringly unbecoming of the sacrosanct statutory role assigned to the Independent Directors in a company and also points towards their indirect complicity with the main perpetrator of the wrongdoings viz. *Noticee no. 2*. By being complicit with *Noticee no. 2*, they have not only failed to act in the best interest of the investor clients of KSBL but have also shied away to even bring out such deceitful and illicit acts of the *Company* to the knowledge of public at the earliest. In fact, their complicity with *Noticee no. 2* has allowed him to continue with his fraudulent scheme of misutilization of the funds and securities of the clients of KSBL unabatedly as well as diversion of the funds raised from pledging the clients' securities of KSBL.

119. With respect to *Noticee no. 6*, I find that he was a nominee director of an investor in the *Company*. Therefore, he was appointed as a Non-Executive Director of the *Company*. As already held above, there is no evidence to suggest that the matters related to pledging clients' securities in a fraudulent manner and diversion of huge amounts of funds raised from lending institutions by pledging those securities were ever raised or discussed in the meetings of Board of Directors of KSBL till the said illicit acts were taken up for examination and review by SEBI and NSE. I also note that *Noticee no. 6* had resigned from the position of Director of KSBL on July 14, 2019. Therefore, the emails sent by *Noticee no. 3* seeking clarification from the management of KSBL about the afore-narrated fraudulent acts and also seeking forensic audit of books of accounts of KSBL were not addressed/marked to *Noticee no. 6*. In light of all these facts, I don't find any wrongdoing or

negligence on the part of *Noticee no. 6* as no evidence is available on record to suggest that he was aware of such wrongdoings committed by KSBL during his tenure as a nominee director on the Board of KSBL.

120. Lastly, I find that *Noticees no. 1, 2, 4, 5, 8* and *9* have attempted to shift the entire blame for all the aforesaid wrongdoings of KSBL onto the *Noticee no. 7*. I also note from submissions of *Noticee no. 3* that *Noticee no. 7* had purportedly confessed to the Board of Directors of KSBL that he was the person behind all the fraudulent transactions committed by KSBL.

121. However, after analyzing all the facts and attendant circumstances dispassionately, I find that the above named noticees are apparently trying to make a scapegoat out of *Noticee no. 7*. From the continuous exchange of communications made by KSBL with SEBI, NSE and EY, one can easily understand that KSBL was always presenting *Noticee no. 2* as the person who was in complete control of the affairs of the *Company*. Even though *Noticee no. 7* had resigned in January 2020, and the Forensic Audit report was not submitted by EY till January 09, 2020, the confession purportedly made by *Noticee no. 7* to the Board of Directors of KSBL stating that he was the person behind all the wrongdoings of KSBL, was not made available by KSBL to EY. In fact, the existence of any such confession given by *Noticee no. 7* was never disclosed before any forum prior to the present proceedings i.e. after more than 30 months post the said confession supposedly made by *Noticee no. 7* before the Board of Directors of the *Company*, as is being claimed by the above noted noticees during the present proceedings before me. Further, had *Noticee no. 7* been the only person behind the entire fraudulent scheme through which the clients' funds and securities were misappropriated by KSBL and if *Noticee no. 7* indeed wanted to make such a confession, then I do not see any reason as to why *Noticee no. 2* resisted so much to the proposal made by *Noticee no. 3* for conducting an internal

forensic audit so as to fix responsibility. In the facts asserted by these noticees, *Noticee no. 2* would have rather been happy to conduct a forensic audit so as to book *Noticee no. 7* with all evidences in hand.

122. It is a common knowledge that for committing any wrongdoing, there has to be a certain motive behind it. While the Hon'ble Supreme Court of India has held in the matter of *Securities and Exchange Board of India vs. Kanaiyalal Baldevbhai Patel (2016)6 SCC 368* that proving of *mens rea* is not indispensable to establish fraud, it is a fact that an investigation into the motive gives a complete picture behind the whole scheme of things that led to commission of an offense or violation.

123. In the present matter, one most important undisputed fact remains that the funds raised by pledging clients' securities were diverted to wholly owned subsidiaries of KSBL, which were again controlled by *Noticee no. 2* by virtue of his control over KSBL. As regards to the *Noticee no. 7*, I find that no evidence of any kind of profit having been made by him has been found in the matter. In such a scenario, it doesn't make any sense for *Noticee no. 7* to involve himself into such an elaborate design without having any skin in the entire scheme. I also note that *Noticee no. 7* was made CEO-Retail Broking in October 2017, however, the materials on record show that pledging of clients' securities was taking place much prior to that. This shows that the scheme was in operation much before *Noticee no. 7* came into picture with a new designation of CEO-Retail Broking which again was an apparently ornamental designation having no statutory backing under the provisions of Companies law.

124. I also find from the submissions of *Noticee no. 2* that the funds transfers to the tune of thousands of crores were allegedly made by *Noticee no. 7* along with the VP (Finance) of the *Company*, however, such an allegation doesn't appear to be either plausible or reliable as there is no evidence to suggest that *Noticee no. 7* had ever dealt with the bank accounts of KSBL. Further, except for one or two emails,

nowhere *Noticee no. 7* was found to be mentioned in any of those emails that have been attached as evidence to the Forensic Audit Report submitted by EY. In fact, in the submissions made by KSBL to EY, it is shown that VP (Finance and Accounts), Mr. Sachin Agarwal was reporting to G Krishna Hari who himself was reporting to *Noticee no. 2* directly.

125. I also find from the Forensic Audit Report that NSE had intimated *Noticee no. 2* vide a phone call on November 09, 2019 stating that EY would visit KSBL office on the next day, to get access to the laptops/desktops as part of their forensic audit to collect evidences in the matter. However, it is observed by EY during the course of Forensic Audit that the laptop of *Noticee no. 2* was completely cleaned off by using an anti-forensic tools prior to the visit of EY team to KSBL's office premises after the aforementioned phone call made from the end of NSE. Emails of certain other employees from their laptops were also deleted in this regard. In this regard, *Noticee no. 7* has also submitted during the course of his personal hearing that his emails were forcefully deleted to remove evidence of any culpability of anyone inside KSBL.

126. In the end, I find that KSBL merrily chose not to take any action against *Noticee no. 7* even after he purportedly confessed to such a wrongdoing involving fraudulent misappropriation of clients funds and securities worth of thousands of crores of rupees. This very lackadaisical act or rather no action on the part of KSBL clearly shows that there was no evidence whatsoever to implicate *Noticee no. 7* for all the wrongdoings that have been committed by KSBL in the matter, hence there was no cause of action against *Noticee no. 7*. It, therefore, appears that the claim being put forth before me during the present proceedings to suggest that *Noticee no. 7* has already confessed to have committed all the wrongdoings in the name of the *Company* is a concocted & imaginary allegation against *Noticee no. 7* with an attempt, albeit an unsuccessful one, to sacrifice *Noticee no. 7* to all the

regulatory and enforcement actions in order to save *Noticee no. 2*. It is also pertinent to note that the VP (Finance) of KSBL, Mr. Sachin Agarwal, passed away after the fraudulent scam of KSBL got exposed to the public. It appears that taking the advantage of the absence of late Mr. Sachin Agarwal who is not there anymore to defend himself, KSBL has also chosen to implicate him (Mr. Sachin Agarwal) for committing the afore stated wrongdoings along with *Noticee no. 7*. However, such allegations against these two employees would not hold water when adequate compelling evidences are already available in the records to establish that it was *Noticee no. 2* who was running the day-to-day affairs of KSBL with complete control and command and it is he who has always been in the forefront in the matter of representing KSBL in all forums and before all authorities and it is he who was responsible for committing all the wrongdoings on a regular basis that ultimately led to huge losses of funds and securities of thousands of clients of KSBL which still remain unsettled till date.

127. While I hold that the attempt to shift the blame for the entire wrongdoings committed on *Noticee no. 7* is misplaced on facts and is untenable, at the same time, I find from the evidences available on record that as an employee of KSBL, *Noticee no. 7* had actively participated in the 'asset collection drive', launched by KSBL, through which securities were collected by KSBL from its clients' by luring them with a promise of giving them good amounts of interest *in lieu of* their securities being lent by them to KSBL. From the discussions on the fraudulent acts committed by KSBL in the preceding paragraphs, one can easily point out that the 'asset collection drive' launched by KSBL to indulge in largescale mobilization of securities from its clients, *albeit* on a loan basis, was one of the root causes of all the evils that have been committed by KSBL. Given the fact that *Noticee no. 7* was admittedly a professional in securities market for more than 20 years, he was expected to be aware of the securities lending and borrowing

mechanism already available in the stock exchanges as a recognized platform for carrying out borrowing and lending of securities. In such a scenario, *Noticee no. 7* should have been alarmed himself after seeing such a large scale borrowing of securities being indulged in by KSBL and, in turn, should have alarmed the management about the regulatory repercussions of such activities being engaged in by a stock broker. Further, he was holding a pretty senior position in the *Company* and ought to have raised queries before the management regarding the purpose of such large scale borrowing of securities. However, no effort has seemingly been made by *Noticee no. 7* to find out the end use of such borrowed securities. This shows his lack of diligence that was expected from a senior official of a large size corporate brokerage firm like KSBL.

128. Lastly, it has been established that funds to the tune of INR 1442.95 Crore were transferred to the accounts of *Karvy Realty* and *Karvy Capital*, details of which have been provided in Table 5 above. The same has not been denied either by *Noticees no. 1* or *2* or by these two aforementioned subsidiaries of KSBL. Therefore, while no direct role has been attributed to *Karvy Realty* and *Karvy Capital* in the wrongdoings of KSBL, it cannot be overlooked that the ultimate beneficiary of the whole wrongdoing turned out to be *Karvy Realty* and *Karvy Capital*. At the same time, no evidence has been produced to suggest that the funds have been returned back by these two entities to KSBL since then. In fact, no plan of returning of such funds has been placed on record either by *Karvy Realty* or *Karvy Capital*. Therefore, as the regulator of securities market, it is the primary duty of SEBI to protect the interest of investors and no such interest could be protected unless the funds so diverted by KSBL are brought back to the books of KSBL for onward settlement of dues with the aggrieved clients who have lost their money and securities.

129. In light of all the discussions in the foregoing paragraphs, there cannot be two opinions that the clients' of KSBL have grossly suffered from losses of their securities and funds that have caused huge agony for no fault on their part. Their shares and funds have been used by KSBL as collaterals to raise funds only for siphoning off these funds to connected entities. It has been brought to my notice that funds and securities of some of the investors have been settled owing to efforts made by NSE in selling the assets of KSBL and also by using the securities that were available in the demat Accounts of KSBL. However, till date many investors have been left behind waiting for settlement of their funds and securities. Given the sacrosanct statutory duty of protecting the investors and safeguarding the integrity of the securities market that have been entrusted upon SEBI as a regulator, it is now an avowed duty of SEBI to exercise its powers firmly and effectively to protect the securities market and the investors from all forms of fraudulent acts. A basic premise that underlies the integrity of securities market is that the intermediaries will act in good faith for the benefits of investors, as they have a fiduciary duty towards their clients on whose behalf they operate in securities market. In fact, it is not exaggeration to suggest that stock brokers are expected to act as first line of regulators and they are expected to keep an eye on the activities of their clients and intimate the stock exchanges as soon as they suspect some wrongdoing in the securities market. However, in this case, the stock broker itself is found to be perpetrating fraud behind the back of its gullible clients by misappropriating their assets.

130. In such cases where stock brokers themselves act *mala fide* towards their clients, and fail to conform to the standards of good governance and ethical behavior as prescribed in securities laws and resort to fraudulent activities, the very edifice of securities market becomes susceptible and vulnerable to a collapse if not stopped in time. In this case, the conduct of *Noticees no. 1, 2, 4, 5, 7, 8* and *9*, at one point

of time or other, as brought out quite succinctly in the foregoing discussions, has been in derogation to the basic duties required to be performed by them under law. The massive asset mobilization drive followed by raising of huge sums of funds from financial institutions by using the securities mobilized from the clients with a promise to pay them interest and misappropriating those funds by diverting them to KSBL's connected entities thereby defaulting in its obligations to settle the securities and funds with the clients as per regulatory instructions, speak a tell-tale story of fraud driven by greed of KSBL and its management to amass thousands of crore of rupees at the cost of its innocent clients, making it a fit case where SEBI needs to send out a firm message to deter the stock brokers and their managements from indulging in such acts of unethical, unfair and fraudulent behavior as observed in this case. In my view, in the facts and circumstances of this case, strong deterrent action is warranted to be taken through the present order.

131. I further note that the SCN calls upon the *Noticees* to show cause *inter alia* as to why penalties under Sections 15HA and 15HB read with Sections 11(4A) and 11B(2) of the SEBI Act and under Section 23D read with Section 12A(2) of SCR Act, 1956 should not be imposed for the violations of various provisions of SEBI Act, SCR Act, 1956, PFUTP Regulations, Stock Broker Regulations and various circulars issued by SEBI, as alleged in the SCN. I note that the powers vested under Section 11B(2) of SEBI Act and Section 12A(2) of SCR Act, 1956 are without prejudice to the powers to issue directions under Sections 11(1), 11(4A) and 11B(1) of the SEBI Act and Section 12A(1) of SCR Act, 1956. In this regard, I note that Sections 15HA and 15HB of the SEBI Act and Section 23D of SCR Act, 1956 provide as under:

**SEBI Act**

**Penalty for fraudulent and unfair trade practices.**

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

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

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

**SCR Act, 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.*

132. The aforesaid findings discussed in the present order clearly establish that the *Noticees no. 1* and *2* have acted in violation of provisions of the SEBI Act, PFUTP Regulations, Stock Broker Regulations as well as provisions of SCR Act, 1956 read with Section 27(1) and 27(2) of SEBI Act. Additionally, it has also been brought out in the present order that the *Noticees no. 4* and *5* have acted in violation of provisions of the PFUTP Regulations read with Section 27(1) and 27(2) of SEBI Act.

133. In view of the detailed factual analysis and deliberations as well as my observations recorded in the foregoing paragraphs of this order with regard to wrongdoings committed by KSBL as well as by *Noticee no. 2* as alleged in the SCN, I find that the aforesaid two noticees are liable for issuance of appropriate directions for debarment from accessing the securities market and dealing in securities under Section 11B(1) of SEBI Act, as well as for imposition of appropriate penalty under Section 11B(2) read with Sections 15HA and 15HB of SEBI Act as well as under Section 12A(2) read with Section 23D of SCR Act, 1956.

134. In this regard, I find that Section 15J of SEBI Act and Section 23J of SCR Act. 1956 provide factors to be considered while imposing the penalties. The said factors are common under both these provisions and have been reproduced below:

(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.

At the same time, it is well settled position of law that these three factors are not exhaustive in nature and the adjudicating authority, while deciding penalty in a matter, may take into account any other factor beyond the aforementioned factors.

135. In this regard, I find that while funds to the tune of INR 1442.95 Crores have been transferred to *Noticee no. 8 & 9*, there is no allegation of any direct gain made by either *Noticees no. 1, 2, 4* or *5* in the present matter. However, it is a matter of fact that, more than 3 lakh clients, whose funds and securities were not settled by

KSBL in line with the process and timelines prescribed by SEBI in various circulars, have suffered great mental agony due to fear of losing their money. Such mental agony of large number of the clients is still persisting even though more than 3 years have elapsed since passing of *Interim Order,* as their funds and securities have still not been settled. At the same time, I find that securities of the clients were being regularly pledged by KSBL since 2016. Therefore, such wrongdoing was not a one-time exercise but was being committed repeatedly on a continuous basis till the *Interim Order* restricted KSBL from acting on the basis of power of attorney provided to it by its clients. Therefore, I have considered all these factors in deciding penalty in the present matter.

## Directions

136. Having carefully considered the materials available on record and the submissions advanced by the *Noticees* and following the principles of preponderance of probabilities, I hold that the charges relating to violation of the provisions of the SEBI Act, SCR Act, 1956, the PFUTP Regulations, the Stock Broker Regulations and various circulars issued by SEBI as brought out in detail in this order are found to have been substantially established against *Noticees no. 1* and *2*. At the same time, the charge of violation of the provisions of the PFUTP Regulations has also been established against *Noticees no. 4* and *5*. I also note that *Noticee no. 7* has been found to have acted negligently and has failed to exercise due diligence. Further, *Noticees no. 8* and *9* have been found to be the major beneficiary of the whole scheme in the present matter. At this stage, I am also cognisant about the directions issued against KSBL vide *Interim Order* dated November 22, 2019 which were confirmed by *Confirmatory Order* dated November 24, 2020. I also note that KSBL has been expelled from the membership of NSE in terms of MCSGFC Order dated November 23, 2020. At the same time, no direction, whatsoever, has been passed against the rest of the noticees. Hence, considering the gravity of the

violations found established on the *Noticees no. 1*, *2*, *4* and *5* and failure of due diligence found in case of *Noticee no. 7*, I am of the view that to meet the ends of justice, it will be sufficient to pass the following directions, while exercising the powers conferred upon me under Section 11(1), 11(4), and 11B(1) read with Section 19 of the SEBI Act:

136.1. *Noticees no. 8* and *9* are directed to return the funds transferred to them, as elaborated in Table 5 of this Order. The said funds shall be transferred to KSBL within a period of three months, failing which NSE is directed to take control of assets of *Karvy Realty* and *Karvy Capital* to recover the said money.

136.2. *Noticees no. 1* and *2* are restrained from accessing the securities market and further prohibited from buying, selling or otherwise dealing in securities (including units of mutual funds), directly or indirectly, or being associated with the securities market in any manner, whatsoever, for a period of 7 years.

136.3. *Noticee no. 2* is hereby restrained from holding the post of director, or any key managerial position or associating himself in any capacity with any listed public company and any public company which intends to raise money from the public, or any intermediary registered with SEBI for a period of 10 years.

136.4. *Noticees no. 4* and *5* are hereby restrained from holding the post of director, or any key managerial position or associating themselves in any capacity with any listed public company and any public company which intends to raise money from the public, or any intermediary registered with SEBI for a period of 2 years.

136.5. Further, *Noticee no. 7* is cautioned and directed to be careful before associating himself as a Director or any key managerial position in any intermediary of the securities market or any listed public company and any public company which intends to raise money from the public.

136.6. The proceedings in respect to *Noticees no. 3* and *6* are disposed off in terms of observations mentioned in para 116 and 119 respectively of the present Order.

136.7. The *Noticees no. 1, 2, 8* and *9* are directed to cooperate with NSE in refund of funds and securities of the clients of KSBL.

137. In addition to the aforementioned directions, the following penalties have also been imposed upon the *Noticees no. 1* and *2* in terms of Section 11B(2) read with Section 19 of the SEBI Act and Section 12A(2) of the SCR Act, 1956, due to their violation of relevant provisions of law, as mentioned below:

| **Provisions of law violated** | **Penal Provision** | **Quantum of penalty** | |
|---|---|---|---|
| | | **Karvy Stock Broking Limited** | **C Parthasarathy** |
| Section 23D of SCR Act, 1956 read with SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 further read with SEBI Circular dated December 03, 2009 | Section 23D of SEBI Act | INR 1,00,00,000 | INR 1,00,00,000 |
| Regulation 4(1) and 4(2)(m) of PFUTP Regulations | Section 15HA of SEBI Act | INR 10,00,00,000 | INR 5,00,00,000 |
| Clauses A(1), A(2), A(3), A(4) & A(5) of Code of Conduct as provided under | Section 15HB of SEBI Act | INR 1,00,00,000 | INR 1,00,00,000 |

| | | | |
|---|---|---|---|
| Schedule II read with Regulation 9 of the Stock Broker Regulations | | | |
| SEBI Circulars dated September 26, 2016 and SEBI circular dated June 22, 2017 | Section 15HB of SEBI Act | INR 1,00,00,000 | INR 1,00,00,000 |

138. In addition to the aforementioned penalties imposed upon *Noticees no. 1* and *2*, I also impose a penalty of INR 5,00,000 on each of *Noticee no. 4* (Bhagwan Das Narang) and *Noticee no. 5* (Ms. Jyothi Prasad) in terms of Section 11B(2) read with Section 19 of the SEBI Act for their violation of Regulations 4(1) and 4(2)(m) of PFUTP Regulations.

139. The *Noticees no. 1*, *2*, *4* and *5* are directed to pay the penalty as detailed above within 45 (forty-five) days from the date of service of this order by way of online payment through following path on the SEBI website: www.sebi.gov.in/ENFORCEMENT → Orders → Orders of Chairman/ Members → Click on PAY NOW or at the linkhttps://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html. The *Noticees no. 1, 2, 4* and *5* shall forward the details/confirmation of penalty so paid through e-payment to "The Division Chief, Division of Post Inspection Enforcement Action, Market Intermediaries Regulation and Supervision Department (MIRSD), Securities and Exchange Board of India, SEBI Bhavan II, Plot no. C -7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai- 400051" in the format given in the Table below:

| | |
|---|---|
| Case name | |
| Name of payee | |
| Date of payment | |
| Amount paid | |
| Transaction no | |
| Bank details in which payment is made | |
| Payment is made for | Penalty |

140. The Order shall come into force with the immediate effect.

141. A copy of this order shall be served upon the *Noticees*, Stock Exchanges, Depositories and Registrar and Share Transfer Agents of all Mutual Funds for ensuring compliance with the above direction.

**Sd/-**

**DATE: APRIL 28, 2023** **S. K. MOHANTY**

**PLACE: MUMBAI** **WHOLE TIME MEMBER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**

**B.D. NARANG**
Chairman & Managing Director (Retd.)
ORIENTAL BANK OF COMMERCE

Resi-cum-Office
'64', Ground Floor
'B' Block, Gulmohar Park,
New Delhi - 110049
Tel : 011-41037812, 46542290
Tele fax : 011-41037812
E-mail : bd_narang@yahoo.com

Date 8/05/2023

Board of Directors
Shivam Autotech Limited
Emaar Digital Greens – Tower A
Sector 61, Gurugram – 122 102
Haryana

Dear Sir,

**SEBI Order # WTH/SM/MIRSD/MIRSD -SEC-4-26042/2023-24 dated 28 April 2023 & Cessation of My Directorship in SHIVAM Autotechltc.**

This is with reference to theSEBI order that was shared with the Company Secretary of Shivam Autotech by me earlier.

By virtue of this order, I have ceased to hold the office of Chairman and Independent Director of your company. Kindly consider this communication as my resignationfor your recordsand follow the required process.

I take this opportunity to thank my fellow members of the Board for the support and participative interactions during my tenure. I wish Shivam Autotech continuous and steady growth in times to come.

Thanking You

BHAGWANDAS NARANG
DIN 00826573