WTM/AB/SEBI/MIRSD/HO/37/2019

SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: ANANTA BARUA, WHOLE TIME MEMBER
ORDER

UNDER SECTIONS 11(1), 11(4) AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 - IN THE MATTER OF KARVY STOCK BROKING LIMITED

In respect of representations made pursuant to orders of Hon'ble SAT, by:-

Representor No.	**Name of the Representor**	
1.	Bajaj Finance Ltd.	Representation made pursuant to Hon'ble SAT Order dated 03.12.2019
2.	ICICI Bank Ltd.	Representation made pursuant to Hon'ble SAT Order dated 04.12.2019
3.	HDFC Bank Ltd.	Representation made pursuant to Hon'ble SAT Order dated 04.12.2019
4.	IndusInd Bank Ltd.	Representation made pursuant to Hon'ble SAT Order dated 04.12.2019

Aforesaid entities are hereinafter individually referred by their respective names/Representor numbers and collectively referred to as "Representors".

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1. Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") passed an *ex parte ad interim* order cum show cause notice dated November 22, 2019 (hereinafter referred to as "**interim order**") against Karvy Stock Broking Limited (hereinafter referred to as "**KSBL**"/"**Stock Broker**") wherein *inter alia* following directions were issued:

"……..

(i) KSBL is prohibited from taking new clients in respect of its stock broking activities;

(ii) The Depositories i.e. NSDL and CDSL, in order to prevent further misuse of clients' securities by KSBL, are hereby directed not to act upon any instruction given by KSBL in pursuance of power of attorney given to KSBL by its clients, with immediate effect;

(iii) The Depositories shall monitor the movement of securities into and from the DP account of clients of KSBL as DP to ensure that clients' operations are not affected;

(iv) The Depositories shall not allow transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) with immediate effect. The transfer of securities from DP account no. 11458979, named KARVY STOCK BROKING LTD (BSE) shall be permitted only to the respective beneficial owner who has paid in full against these securities, under supervision of NSE; and

(v) The Depositories and Stock Exchanges shall initiate appropriate disciplinary regulatory proceedings against the Noticee for misuse of clients' funds and securities as per their respective bye laws, rules and regulations;……."

2. On December 01, 2019, Representor No. 1 filed an Appeal (L) No. 585 of 2019 before Hon'ble Securities Appellate Tribunal, Mumbai (hereinafter referred to as "**Hon'ble SAT**") impugning the interim order and *inter alia* seeking setting aside of the interim order to the extent that the shares pledged to Representor No. 1 should not be transferred to the beneficial owners.

3. Hon'ble SAT vide order dated December 03, 2019 while disposing of the aforesaid appeal filed by Representor No. 1, *inter alia,* directed as under:

"……..9. Accordingly, without commenting on the merit of the case, we direct the WTM of SEBI to hear the appellant on the basis of their representation dated November 23, 2019 and / or any other additional representation which they may like to make. If the appellant is desirous to make any additional representation it shall be made latest by December 4, 2019. Thereafter, the WTM of SEBI shall consider the representation(s) of the appellant and, after giving an opportunity for personal hearing, pass an order as per law latest by December 10, 2019. In the interim further transfer of securities shall remain suspended from DP account no. 11458979, named KARVY STOCK BROKING LTD. (BSE) in terms of direction no. (iv) of the

impugned order (supra)……."

4. Subsequently, Representor No. 2, 3 and 4 filed separate Appeals before Hon'ble SAT, impugning the interim order. The details of the appeals filed by Representor No. 2, 3 and 4 are as under:

Representor Number	**Name of Representor**	**Number of Appeal**
Representor No. 2	ICICI Bank Ltd.	Appeal (L) No. 589 of 2019
Representor No. 3	HDFC Bank Ltd.	Appeal (L) No. 588 of 2019
Representor No. 4	IndusInd Bank Ltd.	Appeal (L) No. 590 of 2019

5. Appeals filed by Representor No. 2, 3 and 4 were disposed of by the Hon'ble SAT vide its common order dated December 04, 2019, with the following observations and directions:

"…… 7. Having heard the learned Senior Counsel and Counsel for the parties, without going into the merit of the case, we are of the considered view that beyond the directions passed in our order of Bajaj Finance Ltd. (supra) no further relief can be granted at this stage. We have no dispute with the interpretations of the provisions of the Depositories Act and Regulations thereunder. However, while dealing with a case of alleged fraud the implications of the same have to be factored in. The very purpose of an ex parte ad interim order is to deal with the eventualities arising from such alleged fraud or similar major violations. This ex parte ad interim order was issued on November 22, 2019. Even an oral mentioning was made by the Appellants before this Tribunal only on December 2, 2019 by which time a lot of water has flown under the bridge. Now it is on record before us that after a due diligence by NSE and NSDL securities have been transferred to the account of the clients. Therefore, further rights have been created / restored involving more than 80,000 investors. In this context, a prayer to recall the same or to retain the same as frozen accounts of those clients becomes untenable. As ordered in the matter of Bajaj Finance Ltd. (supra), Appellants are at liberty to approach SEBI. If any representations from the Appellants are pending or filed on or before December 6, 2019 before SEBI, the WTM of SEBI, after providing an opportunity of hearing to the Appellants, shall pass an order in accordance with law latest by December 12, 2019.

8. All these three appeals are disposed of on above terms with no order on costs……"

6. A Praecipe was filed by Representor No. 3 in the disposed of Appeal (L) No. 588 of 2019, seeking extension of time to file representation before SEBI. The said Praecipe was taken up for hearing by Hon'ble SAT on December 06, 2019 when Hon'ble SAT passed the following directions:

> *"1. Not on board. Mentioned by the learned counsel for the appellant. Upon hearing both the sides time to file representation is hereby extended in the case of the present appellant to December9, 2019. Consequently, respondent SEBI also shall pass an order in accordance with law latest by December 16, 2019."*

7. In view of the direction given in the Hon'ble SAT order dated December 03, 2019, December 04, 2019 and December 06, 2019, SEBI filed three separate Praecipe in the disposed of appeals bearing Appeal (L) No. 585 of 2019, Appeal (L) No. 589 of 2019 and Appeal (L) No. 590 of 2019, seeking modifications of the orders dated December 03, 2019 and December 04, 2019 (in respect of ICICI Bank Ltd. and IndusInd Bank Ltd.) to allow SEBI to pass orders with respect to the respective appellants therein, on or before December 16, 2019, in accordance with law. On these Praecipes, Hon'ble SAT passed the three separate but identical orders on December 09, 2019 which provide as under:

> *"Not on Board. Based on the request of the respondent let the order be passed by the Whole Time Member by 16th December, 2019 positively."*

8. Representors filed their respective representations in term of the aforesaid orders passed by the Hon'ble SAT, the details of which are as follows:

Representor Number	**Name of Representor**	**Date of Representation made pursuant to order of Hon'ble SAT**
Representor No. 1	Bajaj Finance Ltd.	December 04, 2019
Representor No. 2	ICICI Bank Ltd.	December 06, 2019
Representor No. 3	HDFC Bank Ltd.	December 09, 2019
Representor No. 4	IndusInd Bank Ltd.	December 06, 2019

9. In view of the aforesaid directions by the Hon'ble SAT, Representors were given an opportunity of hearing and accordingly, Representor No. 1, 2 and 4, as represented by their respective advocates and authorized representatives, were heard on December 06, 2019. Representor No. 3,

as represented by its respective advocates and authorized representatives, was heard on December 09, 2019.

10. Representors also undertook inspection of documents, the details of which are as follows:

S. No.	Name of Bank / NBFC	Date of Inspection
1.	Representor No. 1	December 09, 2019
2.	Representor No. 2	December 09, 2019
3.	Representor No. 3	December 09, 2019
4.	Representor No. 4	December 09, 2019 December 10, 2019

11. After hearing Representors also filed written submissions, the details of which are as under:

Representor Number	Name of Representor	Written Submissions filed on
Representor No. 1	Bajaj Finance Ltd.	Dated December 11, 2019 received on December 11, 2019
Representor No. 2	ICICI Bank Ltd.	Dated December 11, 2019 received on December 11, 2019
Representor No. 3	HDFC Bank Ltd.	No WS filed.
Representor No. 4	IndusInd Bank Ltd.	Dated December 09, 2019 received on December 10, 2019

12. Brief of the submissions made by the respective Representors is as under:

A. Submissions of Representor No. 1:

(i) During the period between December, 2014 and August, 2019, Applicant No. 1 had issued various loan against shares facilities in favour of KSBL ("LAS Agreement", whereby the loan amounts were secured against certain shares held in KSBL's Account. Total amount of Rs. 345 crores was sanctioned by Applicant No. 1 in favour of KSBL.

(ii) One of the terms of issuance of loan under the LAS Agreement was that securities offered by KSBL under the said arrangement will be that of KSBL's and that KSBL must have an absolute title over the said securities. Subsequent to execution of the first LAS Agreement in December 2014, KSBL provided a written undertaking dated January 07, 2015 stating that the securities lying in KSBL 's Account were owned by KSBL and not by its broking clients.

(iii) In around, October-November, 2019, the margin amount maintained by KSBL in its account reduced below the prescribed thresholds. On failure to fulfil their obligations, on November 20, 2019, Applicant No. 1 issued a loan recall notice to KSBL calling upon KSBL to make payment of an outstanding balance amount of Rs. 3,44,49,81,608/- giving 3 working days' time KSBL to repay the loan amount, failing which Applicant No. 1 would enforce the security under the LAS Agreement. Because of interim order, Applicant No. 1 could not invoke the pledge.

(iv) In the legal framework provided by the Depositories Act, 1996 (i.e. Sections 2(1)(a), 9 and 10) a pledge can be created only with the previous approval of the depository, i.e. upon the satisfaction of the depository that the pledger is the beneficial owner to such securities on which a pledge is proposed to be created. The Depositories Act further states that any entry in the records of a depository is an evidence of a valid pledge created in favour of the pledgee. Further, Regulation 58 of the SEBI (Depositories and Participants) Regulations, 2018 ("DP Regulations") lays down the manner of creating pledge or hypothecation.

(v) In view of provisions of Regulation 58 of DP Regulations, 2018 and Clause 9.9 of the Bye-Laws of NSDL read with 12.9 of the Business Rules of NSDL, it is the duty of the depository participant and the depository to ensure that the pledger is a beneficial owner of such securities over which the pledge is being created in favour of the pledgee. This is also due to the fact that securities being fungible in nature, it is not possible to distinguish between each security.

(vi) The securities were never marked as client or client pooled account as is mandatory under multiple SEBI circulars. SEBI circular on 'Enhanced Supervision of Stock Brokers/Depository Participants' dated September 26, 2016 required the stock brokers to use specific nomenclatures with respect to various broking accounts. Under the said circular,

the stock brokers and depository participants are subject to annual inspection by the stock exchanges and depositories. As per the Interim Order, it seems that KSBL's Account which contains the disputed securities, existed since 2000. However, neither NSE nor NSDL to which KSBL is a member, were aware of the existence of KSBL's Account, as per the Interim Order. It is impossible to expect that an NBFC like Applicant No. 1, with very limited resources available in public domain, will be able to identify the same, in disregard of the explicit representations made to it by NSDL and KSBL.

(vii) Therefore, Applicant No. 1 is a bonafide pledgee in law and it held a valid pledge over the securities lying under KSBL's Account. Hon'ble SAT Order dated December 03, 2019 also highlighted the said fact.

(viii) With regards to cancellation of pledge, Regulation 58 of the DP Regulations and Clause 9.9.9 of the NSDL Bye Laws shall be applicable and the applicable laws do not permit release/ transfer of a pledge without approval or consent from the pledgee.

(ix) Under Section 176 of the Indian Contract Act, 1872, Applicant No. 1 is well within its rights as a pledgee to exercise its own discretion with regard to sale of the pledged shares which it cannot exercise now, as a result of the interim order.

(x) Acting as a quasi-judicial body while issuing the interim order, SEBI is itself bound by the provisions of the Depositories Act and the DP Regulations. Furthermore, the interim order does not permit NSDL to violate the applicable laws for complying with the said directions. Therefore, the action of NSDL of unilaterally revoking the Pledge on KSBL's Account was invalid and illegal and has deprived Applicant No. 1 of its legal rights as a pledgee.

(xi) The interim order has been passed on the basis of preliminary investigation by NSE, and an appropriate forensic audit is still undergoing. An interim order cannot be the basis for creating permanent and irreversible third-party rights.

(xii) SEBI circular dated June 20, 2019 was issued to recognized stock exchanges, recognized clearing corporations, depositories, trading members / clearing members and depository participants. It was not issued to banks/ NBFCs. Therefore, it was the responsibility of such

stock exchanges, trading and clearing members, etc. to ensure compliance with the said circular. From operative part of the SEBI circular, it is clear that the circular was to be made prospectively effective and not retrospectively, i.e. it did not provide that all the existing pledges would also be considered in contravention of Rule 8(1)(f)& 8(3)(f) of Securities Contracts (Regulation) Rules, 1957.

(xiii) The directions issued in the interim order cannot itself invalidate the Pledge created in favour of Applicant No. 1 under the LAS Agreement. The Hon'ble Supreme Court in B.O.L Finance Limited v. The Custodian and Ors., has held that an agreement entered into between parties cannot ipso facto be invalidated pursuant to instructions issued post execution of such agreement.

(xiv) The Depositories Act itself guarantees safety to the beneficial owners of securities. Section 16 of the Depositories Act states that any loss caused to a beneficial owner due to the negligence of a depository participant or the depository is required to be made good by the depository. Upon completion of the ongoing forensic investigation, in the event it is determined that the beneficial owners were defrauded by KSBL, then they can be duly compensated under Section 16.

(xv) Representor No. 1 has *inter alia* prayed that, -

a. no further orders or modification to existing orders under the Interim Order be issued;

b. direct NSE and NSDL to freeze and suspend any further transfer of securities, including removal of pledge, from KSBL's Account;

c. restore the pledge in favour of Applicant No. 1 which was removed from KSBL's Account pursuant to the interim order. In the alternate, provide Applicant No. 1 with the amounts owed by KSBL to it or direct NSDL to indemnify BFL with the said amounts;

d. prohibit any further transaction on securities which were transferred from KSBL's Account to other beneficial accounts;

e. Set aside the interim order in so far it relates to KSBL's Account.

B. Submissions of Representor No. 2:

(i) During the period between March 13, 2009 and October 01, 2019 ("Relevant Period"), Applicant No. 2 had given various monies in the form of loan credit facilities under various facility agreements ("Facility Agreement"), whereby the amounts sanctioned were secured against certain shares ("Pledge") held by KSBL in KSBL's Account. During the Relevant Period, a total amount of Rs. 700 crores was sanctioned by Applicant No. 2 in favour of KSBL and as on December 01, 2019, the balance outstanding through such Facility Agreement is Rs. 642.25 crore.

(ii) One of the terms of issuance of loan/ credit facilities under the Facility Agreement was that KSBL was compliant with the relevant legal provisions and that KSBL had good title over the securities held in KSBL's Account.

(iii) KSBL failed to fulfil its repayment obligations under the Facility Agreement. Therefore, on November 05, 2019 Applicant No. 2 issued a notice to KSBL inter alia calling upon KSBL to repay all the outstanding amounts availed by KSBL under the Facility Agreement ("Loan Repayment Notice"). Pursuant to the issuance of the Loan Repayment Notice, Applicant No. 2 was entitled to invoke the pledge for receipt of amounts due to them under the Facility Agreements. However, in the meanwhile, on November 22, 2019, SEBI issued the Interim Order.

(iv) Applicant No. 2, reiterated all the submissions on law made by Applicant No. 1 and further submitted that with regards to creation of pledge by mercantile agents, Section 178 of the Indian Contract Act, 1872 provides that where a mercantile agent is, with the consent of the owner, in possession of goods or the document of title to goods, any pledge made by him, when acting in the ordinary course of business of a mercantile agent, shall be as valid as if he were

expressly authorised by the owner of the goods to make the pledge provided that the pawnee acts in good faith and has not at the time of the pledge notice that the pawnor had no authority to pledge. As per these provisions, a pledge by a mercantile agent is valid if such agent acts with the consent of the owner of such securities and has title over/possession of such securities. Applying the said principle in the facts and circumstances of the present matter, it is stated that the pledge created in favour of ICICI under the Facility Agreement was valid and ICICI is entitled to enjoy and exercise all its statutory rights as a pledgee.

(v) Representor No. 2 has *inter alia* made the following prayer:

(a) no further orders or modification to existing orders under the interim order be issued;

(b) direct NSE and NSDL to freeze and suspend any further transfer of securities, including removal of pledge, from KSBL's Account;

(c) restore the pledge in its favour which was removed from KSBL's Account pursuant to the interim order. In the alternate, compensate Applicant No. 2 with the value of the underlying securities pledged in favour of Applicant No. 2 or direct NSDL to indemnify Applicant No. 2 with the said amounts;

(d) Prohibit any further transaction on securities which were transferred from KSBL's Account to other beneficial accounts;

(e) Set aside the interim order in so far it relates to KSBL's Account.

C. Submissions of Representor No. 3:

(i) As part of its regular business, HDFC Bank has extended various loan facilities to Karvy Stock Broking Limited ('KSBL') since 2003. Among other loan facilities, HDFC Bank has also extended loans against shares/securities to KSBL. Such loans are standard secured lending product, commonly known as LAS facilities. The LAS facility extended by HDFC Bank to KSBL ("LAS Facility") has been renewed from time to time. As on date, the aggregate LAS Facility extended by

HDFC Bank to KSBL is to the tune of Rs.350 crores out of which INR 208,50,28,778.12 remains due and payable by KSBL to HDFC Bank. The LAS Facility extended to KSBL is inter alia secured by way of a pledge of securities created by KSBL in favour of the Appellant.

(ii) Pertinently, the 'Specific Covenants' contained in the Sanction Letter specifically provides that the shares pledged by KSBL to HDFC Bank "-pertains to the borrower/group companies/ promoters". This covenant was given effect to and as of November 21, 2019, all of the shares pledged by KSBL to HDFC Bank in respect of the LAS Facility stood in the name of KSBL. It is worth stressing that not a single share standing in the name of any of KSBL's clients or from any of KSBL's client accounts was pledged in favour of HDFC Bank as of November 22,2019.

(iii) Since the shares to be pledged were in dematerialised form the pledge was created in accordance with the provisions of the Depositories Act, 1996 and regulations made thereunder. NSDL after having the opportunity to carry out necessary inquiries as mandated under law, has recorded the pledge in the name of HDFC Bank from time to time without objection. NSDL's records admittedly reflected KSBL as the "Pledger Client". The client ID of the pledger i.e .11458979" as reflected in NSDL's records also belonged to KSBL and not to any of KSBL's clients.

(iv) In fact, even after June 20, 2019, SEBI, NSE and NSDL who are the authorities closely monitoring brokers under the extant circulars, permitted KSBL to create pledges over securities available in DP account no. 11458979. This naturally gave lenders such as HDFC Bank the comfort and assurance that the pledges created by KSBL were in accordance with applicable law and with the knowledge of SEBI, NSE or NSDL.

(v) After the interim order was passed, on November 23, 2019, NSDL issued a letter to HDFC Bank informing HDFC Bank that pursuant to the Interim Order and based on information provided by NSE, certain "securities appear to be pledge are therefore under a state of abeyance." This letter cleared indicated that the shares pledged in favour of HDFC Bank had been frozen/kept in abeyance as a matter of caution and would therefore not be transferred or dealt with by any party. NSDL also assured HDFC Bank that this meant that a status quo would be maintained on the shares and the pledge would not be removed until and unless Karvy cleared its dues to HDFC Bank.

(vi) Section 59(4) of the Companies Act, 2013 deals with rectification of the register of members of a company in case the name of the beneficial owner of the shares is not correctly recorded. In .such a situation, the remedy of the an grieved person is to file an application before the National Company Law Tribunal to seek rectification of the records of the depository and the NCLT is empowered to direct a depository to rectify its records. In the instant case, there is no order of the NCLT directing NSDL to rectify its records in respect of any of the shares pledged in favour of HDFC Bank.

(vii) Even otherwise, it is an admitted position that KSBL's clients had executed power of attomeys ("POAs") in favour of KSBL. Thus, KSBL was undoubtedly acting as an agent of its clients. Assuming without conceding that KSBL had dealt with any client securities, the same was done in pursuance of the ostensible authority conferred to it under the POAs. In such situations, the settled position of law is that when an agent has 'ostensible authority' and deals with third parties, all such acts bind the principal even if the agent did not have 'actual' authority. This is recognised by the Hon'ble Supreme Court in Chairman, LIC vs. Rajiv Kumar Bhasker.

(viii) A pledge of dematerialised shares, once created, can only be released in the manner set out in the Depositories Act, DP Regulations and the Byelaws and Business Rules of NSDL. Once the law lays down the manner of release of a pledge, it must mandatorily be done in that manner and no other manner.

(ix) In the instant case, the shares in question admittedly stood in the name of KSBL. Such record is evidence of the beneficial ownership of the shares and lenders such as HDFC Bank are entitled to treat such record as a true and correct reflection of the beneficial ownership of the shares. Further, a pledge was validly created by the beneficial owner in favour of HDFC Bank. This pledge was duly recognised and recorded by NSDL in accordance with the Depositories Act and DP Regulations. Thus, the validity of the pledge is unimpeachable and HDFC Bank was entitled to all the benefits of the pledge without interference or hindrance.

(x) The directions contained in paragraph 21(iv) of the Interim Order are ultra vires the powers of SEBI and are without any legal authority whatsoever.

(xi) Despite recording the aforesaid observation, SEBI and NSDL have chosen to act unilaterally 7 days after the Interim Order and have released the pledge created in favour of HDFC Bank. Immediately thereafter, these securities were transferred to unknown accounts without taking action under byelaws of the exchanges/depositories as contemplated in the Interim Order itself.

(xii) In the absence of any legal authority, the Interim Order and actions taken pursuant thereto are nothing short of expropriatory, arbitrary and unreasonable actions that deprive HDFC Bank of its legitimate constitutional rights under Articles 14, 19, 21 and 300-A and its vested contractual and legal rights. The manner in which these actions were taken, i.e. without giving HDFC Bank a right of hearing or taking into consideration HDFC Bank's written representation to SEBI, also amount to a gross violation of natural justice and the rule of law.

(xiii) In the instant case, the Interim Order effectively amounts to a mandatory injunction at the ex-parte ad-interim stage which is impermissible in law. Moreover, the directions contained in the Interim Order and actions subsequent thereto, i.e. release of pledge and transfer of shares to third parties unknown to HDFC Bank at the ad- interim stage are nothing short of a final determination of right of the parties pending inquiry and even before giving HDFC bank a right of hearing. Such actions are clearly in excess of SEBI's powers under Sections 11/ 11B of the SEBI Act and are therefore unsustainable.

(xiv) The Interim Order wholly omits to consider and circumvents the legal provisions that already exist to protect the rights of KSBL's clients without interfering with the rights of a third party such as HDFC Bank. The byelaws of NSE provide that all disputes between a broker and its client shall mandatorily be referred to arbitration under the byelaws and Regulations of NSE. In addition to obtaining and enforcing an arbitration award against the broker under the byelaws, the client also has recourse to the Investor Protection Fund ("IPF") set up by the NSE. Similar arbitration provisions are also available in the byelaws of NSDL.Once arbitration has been incorporated into the byelaws of NSE and the same have been accepted by the clients of a broker, Section 8 of the Arbitration and Conciliation Act, 1996 mandates that all disputes covered by the arbitration agreement are mandatorily required to be determined by arbitration and no other judicial authority has any jurisdiction to determine such matters.

(xv) The Interim Order also ignores Section 16 of the Depositories Act which deals with situations when a beneficial owner suffers a loss due to the negligence of the depository or the participant. Accordingly, to the extent the actions taken pursuant to the Interim Order cannot be reversed, SEBI either individually and/or jointly and severally with NSE and NSDL is bound to indemnify/compensate HDFC Bank to the tune of Rs.208,50,28,778.12 (plus accrued interest) which would otherwise have been immediately recoverable from the pledged shares. So far as NSE and NSDL are concerned, SEBI may also consider passing necessary directions to compensate HDFC Bank out of the IPF available with NSE and NSDL which would have otherwise been applied to satisfy the claims of KSBL's clients.

(xvi) That SEBI be pleased to immediately vacate and withdraw paragraph 21(iv) of the Interim Order with retrospective effect and reverse all actions taken pursuant thereto, including but not limited to the actions recorded by NSDL in its letters dated November 23, 2019 and December 2, 2019 to HDFC Bank Ltd.

(xvii) Representor No. 3 has *inter alia* made the following prayers:

(a) SEBI to vacate and withdraw paragraph 21(iv) of the Interim Order with retrospective effect and reverse all actions taken pursuant thereto, including but not limited to the actions recorded by NSDL in its letters dated November 23, 2019 and December 2, 2019 to HDFC Bank Ltd.;

(b) To extent the actions taken pursuant to the Interim Order cannot be reversed, SEBI be pleased to either individually, or jointly and severally with NSE, NSDL and their respective IPFs, indemnify/compensate HDFC to the tune of Rs.208,50,28,778.12 (plus accrued interest) being the outstanding portion of the LAS Facility that is due from Karvy to HDFC

(c) That pending hearing and final determination of the captioned matter, SEBI either individually or jointly and severally with NSE and/or NSDL, restore the pledges standing in favour of HDFC Bank Ltd. as on November 22, 2019 by procuring identical shares

from the open market and/or placing cash security with HDFC Bank of an amount equal to the market value of the shares at the close of market hours on November 22, 2019;

(d) That pending hearing and final determination of the captioned matter, SEBI be pleased to pass an order and direction immediately restraining, freezing and/or putting a hold on any further transfer, dealing, or encumbrances of the shares that were pledged in favour of HDFC Bank Ltd. from DP account no. 11458979, named KARVY STOCKBROKING LTD (BSE) and were transferred out of such DP account on or after November 22, 2019.

D. **Submissions of Representor No. 4**:

(i) In May, 2013 Applicant No. 4 had agreed to advance these credit facilities as and by way of Loan Against Securities ("LAS") to KSBL. Accordingly, Applicant No. 4 and KSBL entered into a "Master General Terms Agreement" and "Deed of Pledge of Securities" both dated May 17, 2013 ("Facility Agreements"). Under clause 3 (b) of the Deed of Pledge of Securities, KSBL had specifically represented to Applicant No. 4 that the securities being tendered by it towards the LAS facilities are the absolute property of the pledger and at the sole disposal of the pledger and are free from any charge or encumbrance or any lien or security interest of any nature whatsoever.

(ii) KSBL further represented that it has all the requisite powers and authority to pledge and grant a security interest in the securities being tendered by it in the manner and for the purposes contemplated under the Facility Agreements.

(iii) In light of the aforesaid, Induslnd was offered securities by KSBL by creating pledge in favour of Induslnd Bank's DP ID. The pledge in favour of Induslnd Bank was marked by KSBL from its demat account held under the name of Karvy Stock Braking Limited, being the DP Account. As against such security, Induslnd Bank sanctioned a total amount of Rs. 185 crores, and the total outstanding as on date is Rs. 159.16 crores.

(iv) The pledge in favour of Induslnd Bank was created in compliance with applicable provisions of Section 12 of the Depositories Act, 1996 ("Depositories Act") read with

Bye-Law No. 9.9 of the NSDL Bye Laws, Rule No. 12.9 of the NSDL Rules and Bye- Law No. 14 of the Central Depositories Services Limited ("CDSL") Bye Laws.

(v) On December 2, 2019, without following the mandate of Regulation 79 (6) of the Securities and Exchange Board oflndia (Depositories and Participants) Regulations, 2018 ("Depositories Regulations"), which mandates that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee, and without even giving any prior intimation/order/communication to such effect, such securities were de-pledged by NSDL.

(vi) Thus, in spite of lndusInd being a pledgee, and thereby directly being interested in certain securities lying in the DP Account, such securities were transferred by NSDL in tandem with and in connivance with NSE and perhaps with SEBI to third parties without any prior concurrence being taken by it in terms of applicable law from Induslnd or providing it with an opportunity of being heard.

(vii) Such transfer, is grossly illegal, arbitrary and an example of administrative overreach by NSDL, NSE and SEBI, and has the effect of enervating Induslnd's status as a secured creditor of KSBL.

(viii) NSDL, admittedly as per directions of SEBI and instruction/supervision from NSE, unilaterally de-pledged the securities and effected the transfer thereof to the demat accounts of clients who have allegedly paid in full against such securities in spite of the fact that the observations in the Interim Order itself clarify that the only way for a client of KSBL to claim their funds, stocks and securities from KSBL is to approach the concerned stock exchanges/depositories under their respective bye-laws. Thus, such action is contrary to the Interim Order in as much as it does not follow the process prescribed therein for the purposes of claiming of securities by a client of KSBL, and thus, is bad in law.

(ix) The SEBI Order, as well as concomitant and consequent actions have been passed/undertaken in gross violation of the principles of natural justice in as much as

IndusInd was not even given an opportunity of being heard prior to such actions being effected in spite of such directions having the serious ramification of altering the status of Indusind Bank from a secured creditor to an unsecured creditor.

(x) SEBI in passing the Interim Order has acted in gross overreach of its powers contained in Sections 11, 11B and 11(4) of the Securities and Exchange Board of India Act, 1992 by virtue of having used such powers to defeat the provisions of the Depositories Act, and by creating third party rights at an interim stage Similarly, the effect of de-pledging of the said securities by NSDL and subsequent transfer thereof to third parties is thus creating permanent rights pending a forensic audit of KSBL is grossly abusive of the powers, role and duties of a depository.

(xi) Representor No. 4 has *inter alia* prayed for following reliefs:

(a) Direct all depositories/depository participants to restore shares that have been transferred out of the DP Account bearing Number-11458979 held in the name of KARVY STOCKBROKING LTD (BSE) from November 23,2019 onwards and freeze any transfer thereof till the time final determination of rights and liabilities including ownership of such securities is determined by a final order.

(b) In the alternative, direct all depositories/depository participants to transfer all shares that have been transferred out of the DP Account bearing Number -11458979 held in the name of KARVY STOCKBROKING LTD (BSE) from November 23,2019 onwards to an escrow account under the custody of SEBI till final determination of rights and liabilities including ownership of the securities is determined by a final order.

(c) Pending completion of prayers in i) and ii), direct all depositories /depository participants not to allow transfer/dealing of securities from any account wherein securities have been transferred from the DP Account bearing Number-11458979 held in the name of KARVY STOCK BROKING LTD (BSE) from November 23, 2019 onwards.

13. I have considered the submissions made in the representations filed by the Representors, arguments advanced during the hearing on behalf of the Representors and the written submissions filed by the Representors.

14. Before dealing with the submissions made by the Representor, it would be appropriate to discuss the broad conspectus of the matter.

(a) KSBL is a member of NSE and is a stock broker registered with SEBI. KSBL is also the Depository Participant (DP) of NSDL and CDSL and is registered as such with SEBI. Stock broker provides the services of execution of trades on the platform of the stock exchange on the instructions of client. For availing services of a stock broker, the client enters into an agreement and may also execute a special power of attorney on the lines of format prescribed by SEBI. The PoA can be acted upon by a broker only if there is any order/instruction/transaction for trade on the exchange. After the order is matched or confirmed or executed, the extent of shares to be delivered or extent of amount to be paid is crystallized, and then the PoA can be activated/acted upon, for fulfilling delivery or settlement obligation. After matching/confirmation/execution of trade, securities move from the beneficial owner account of the client to the pool account of the stock broker using valid PoA, as stock broker settles the trade on net basis for the purpose of his pay in obligations. Thereafter, the securities move from pool account (transit account) of the broker to the settlement account of clearing corporation for settling the net pay-in obligations, on behalf of the clients. Even though the securities have moved from the clients BO account to pool account or settlement account, the client continues to remain the beneficial owner under section 10(3) of the Depositories Act, 1996 and securities lying with stock broker remain in trust for the client. If any benefit like dividend/bonus/rights shares, etc. is received in respect of shares even lying in pool or settlement account, the client is entitled to same under Section 10(3) of the Depositories Act, 1996 and the broker is obligated to remit the same to the clients.

(b) In this case, it has been observed that there was neither any instructions from the clients to KSBL and nor any corresponding trade on the stock exchange. Thus, there was no occasion to use/activate the PoA by KSBL. It has been observed that KSBL had 12 lacs clients, out of which 3 lacs clients were active clients. The interim report given by NSE in the matter revealed

that in one demat account no. 11458979, named KARVY STOCK BROKING LTD (BSE) which was not disclosed by KSBL in its filings with stock exchanges, the securities worth Rs. 2300 crore (approx.) of more than 95,000 clients, were unauthorizedly transferred into this account by KSBL to generate funds for its own/group entities use. KSBL in its letter dated November 19, 2019, addressed to NSE, had stated that the value of clients' securities pledged, as computed on September 16, 2019 was Rs. 2873 crores which reduced to Rs. 2319 crores as on November 19, 2019. Taking into consideration the interim report of NSE and the facts and circumstances of the case, the interim order was passed against the KSBL under Sections 11(1), 11(4) and 11B of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as "**SEBI Act, 1992**") to protect the interest of investors and securities market.

15. I note that all the Representors have mainly claimed that they are bonafide lenders and have sought the relief of *status quo ante* in the matter, in addition to praying for many other reliefs. The Representors have submitted that the pledge of dematerialized shares held with a depository, is created in accordance with the provisions of the Depositories Act, 1996, DP Regulations and bye laws of the Depositories, and once the pledge is so created, it is a valid pledge and the depositories had no right to unilaterally release the pledge without the consent of the Representors and also to transfer the securities to purported investors/clients of KSBL. It is further argued by the Representors that the interim order did not authorize the depositories to release the pledge and transfer the securities (hereinafter referred to as "**impugned securities**") from the demat account no. 11458979, to the purported investors' account. It is further submitted, without prejudice, even if it is said that the depositories acted on the directions contained in the interim order, then the interim order of SEBI was arbitrary and illegal to the extent that, it allowed depositories to transfer securities from the demat account no. 11458979 to the respective clients account, without having regard to the validly created pledges and creating third party rights that will be irreversible, at the stage of ex-parte ad-interim order itself.

16. Before dealing with the submissions of the Representors, for the sake of convenience, relevant extract of the applicable legal provisions, is reproduced below:

Relevant Extract of the provisions of the Depositories Act, 1996:

"Definitions.

2.(1) In this Act, unless the context otherwise requires, —
(a)"beneficial owner" means a person whose name is recorded as such with a depository;
(j)"registered owner" means a depository whose name is entered as such in the register of the issuer;

Section 10. Rights of depositories and beneficial owner. -

(1) Notwithstanding anything contained in any other law for the time being in force, a depository shall be deemed to be the registered owner for the purposes of effecting transfer of ownership of security on behalf of a beneficial owner.

(2) Save as otherwise provided in sub-section (1), the depository as a registered owner shall not have any voting rights or any other rights in respect of securities held by it.

(3) The beneficial owner shall be entitled to all the rights and benefits and be subjected to all the liabilities in respect of his securities held by a depository.

Pledge or hypothecation of securities held in a depository.

12.(1) Subject to such regulations and bye-laws, as may be made in this behalf, a beneficial owner may with the previous approval of the depository create a pledge or hypothecation in respect of a security owned by him through a depository.

(2) Every beneficial owner shall give intimation of such pledge or hypothecation to the depository and such depository shall thereupon make entries in its records accordingly.

(3) Any entry in the records of a depository under sub-section (2) shall be evidence of a pledge or hypothecation."

Relevant Extract of the provisions of the DP Regulations, 2018:

*"**Manner of creating pledge or hypothecation***

79.(1) If a beneficial owner intends to create a pledge on a security owned by him he shall make an application to the depository through the participant who has his account in respect of such securities.

(2) The participant after satisfaction that the securities are available for pledge shall make a note in its records of the notice of pledge and forward the application to the depository.

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

(4) On receiptof the intimation under sub-regulation (3) the participants of both the pledger and the pledgee shall inform the pledger and the pledgee respectively of the entry of creation of the pledge.

(5) If the depository does not create the pledge, it shall send along with the reasons an intimation to the participants ofthe pledger and the pledgee.
(6) The entry of pledge made under sub-regulation (3) may be cancelled by the depository if pledger or the pledgee makes an application to the depository through its participant:
Provided that no entry of pledge shall be cancelled by the depository without prior concurrence of the pledgee.
(7) The depository on the cancellation of the entry of pledge shall inform the participant of the pledger.
(8) Subject to the provisions of the pledge document, the pledgee may invoke the pledge and on such invocation, the depository shall register the pledgee as beneficial owner of such securities and amend its records accordingly.
(9) After amending its records under sub-regulation (8) the depository shall immediately inform the participants of the pledger and pledgee of the change who in turn shall make the necessary changes in their records and inform the pledger and pledgee respectively.
(10) If a beneficial owner intends to create a hypothecation on a security owned by him he may do so in accordance with the provisions of sub-regulations (1) to (9).
(11) The provisions of sub-regulations (1) to (9) shall mutatis mutandis apply in such cases of hypothecation: Provided that the depository before registering the hypothecatee as a beneficial owner shall obtain the prior concurrence of the hypothecator.(12) No transfer of security in respect of which a notice or entry of pledge or hypothecation is in force shall be effected by a participant without the concurrence of the pledgee or the hypothecatee, as the case may be."

Relevant Extract of the SEBI's Circular dated April 23, 2010:

"PoA favouring Stock Brokers

PoA executed in favour of a Stock Broker by the client should be limited to the following:

1. Securities

i. Transfer of securities held in the beneficial owner account(s) of the client(s) towards stock exchange related margin / delivery obligations arising out of trades executed by the Client(s) on the stock exchange through the same Stock Broker.

ii. Pledge the securities in favour of Stock Broker for the limited purpose of meeting the margin requirements of the client(s) in connection with the trades executed by the clients on the stock exchange through the same Stock Broker. Necessary audit trail should be available with the Stock Broker for such transactions.

iii. To apply for various products like Mutual Funds, Public Issues (shares as well as debentures), rights, offer of shares, tendering shares in open offers etc. pursuant to the instructions of the Client(s). However, a

proper audit trail should be maintained by the Stock Broker to prove that the necessary application/act was made/done pursuant to receipt of instruction from Client."

17. In the present case, interim report given by the NSE disclosed that KSBL unauthorisedly transferred securities in the demat account no. 11458979 by misusing the Power of Attorney (PoA) given to KSBL by its clients. I note that the scope and ambit of the PoA is laid down in the SEBI's Circular dated April 23, 2010 which standardized the requirements pertaining to PoA. The first thing which Circular says is that standardizing of the norms pertaining to PoA must not be construed as making the PoA a condition precedent or mandatory for availing broking or DP services. PoA is merely an option available to the client for instructing his broker or DP to facilitate the delivery of shares and pay-in/pay-out of funds etc. Said Circular further provides that no stock broker or depository participant shall deny services to the client if the client refuses to execute a PoA in their favour. The said Circular, makes it clear that the PoA given by the client to the broker is not general PoA but is a specific PoA which can be exercised by the broker contingent upon execution of trade on the stock exchange, on instruction of client.

18. In the present case, in respect of impugned securities which have been unauthorisedly removed/transferred by KSBL to the demat account no. 11458979, were belonging to the clients who had paid in full against these securities and there was no further instructions to act upon them (hereinafter referred to as "**fully paid clients**"). Therefore, KSBL was not at all authorized to pledge securities owned by its fully paid clients. The unauthorized transfer of securities of fully paid clients by KSBL, is misappropriation of clients' securities by KSBL. These securities were subsequently unauthorisedly pledged by KSBL to the Representors for availing the loans. Thus, the pledge created by KSBL of the securities owned by its clients, was unauthorized and in law, not treated as a valid pledge.

19. As can be noted from Section 12(1) of the Depositories Act, 1996, a beneficial owner can create pledge on the securities "owned" by him. Similarly, Regulation 58 of DP Regulations, 1996 and Regulation 79 of DP Regulations, 2018, further reiterates that a beneficial owner can create pledge of securities "owned" by him. As noted above, in the present case, securities lying in the demat account no. 11458979 which were unauthorisedly pledged by KSBL with the Representors, were owned by the clients of KSBL and the clients continued to be entitled to all the benefits attached

to such securities in terms of Section 10(3) of the Depositories Act, 1996. These securities were not at all owned by KSBL. Therefore, in terms of the provisions of the Depositories Act, 1996 and DP Regulations, KSBL could not have pledged these securities. Accordingly, such unauthorized pledge was not in accordance with law and hence, did not create any right in favour of the Representors.

20. Some of the Representors by referring to the provisions of Sections 176 and 178 of the Indian Contract Act, 1872 and Section 27 of the Sales of Goods Act, 1930 have submitted that they have acted in good faith and hence, they are protected as pledgees from any wrongdoing of the pledger. I note that Section 176 of the Indian Contract Act applies in case of a valid pledge/pawn. Whereas in the present case, as noted above KSBL was not the owner of the securities and thus, not at all authorized to pledge the securities, therefore, these Sections would not apply. The Representors have claimed that KSBL was acting as mercantile agent. Section 178 of Indian Contract Act, 1872, deals with pledge by mercantile agent. "Mercantile agent" is defined under Section 2(9) of the Sales of Goods Act, 1930 to mean a mercantile agent having in the customary course of business as such agent authority either to sell goods, or to consign goods for the purposes of sale, or to buy goods, or to raise money on the security of goods. I note that KSBL, as a stock broker was only a facilitator for placing of buy and sell orders, as instructed by its clients, with the stock exchange. In this case, even there was no instruction from the clients to buy/sell securities nor there was any trade executed warranting any movement of securities from the accounts of the clients, and thus, the analogy drawn with mercantile agent is wholly misplaced. Thus, misappropriation of clients' securities by KSBL cannot be equated with sale made by a mercantile agent.

21. The analogy with mercantile agent is further misplaced, as there was the absence of good faith and notice to the Representors that the KSBL had no authority to pledge, as demonstrated in the following paras:

(a) In terms of SEBI Circular dated September 26, 2016, a stock brokers own demat account should be suffixed with the words "Proprietary Account". The demat account no. 11458979 of KSBL was not suffixed with the words "Proprietary Account" which should have alerted the Representors. Further, the name of the demat account no. 11458979 i.e. KARVY STOCK BROKING LTD (BSE), from where the securities have been pledged,

because of the use of the word "(BSE)" and categorization of said account as "non-house", on the face of it, gives an indication that securities lying in this account may not be belonging to KSBL and thus, requiring further inquiry. The use of the word "(BSE)", categorization of account as "non-house" and absence of the word "proprietary" in the account name should have alerted the Representors for taking further precautions.

(b) The Representors have contended that they are not aware of any such categorization of the demat accounts as "house" and "non-house" beneficiary account. In this regard, it is noted that except Representor No. 1, all other Representors are also registered as DPs. Representor No. 2, 3 and 4 also have their demat accounts which are categorized as "house"/ "non-house", the details of which are as under:

BANK NAME	**HOUSE CLIENT ACCOUNT**	**BENEFICIARY CLIENT ACCOUNT (NON HOUSE)**
HDFC BANK LTD	35	12
ICICI BANK LIMITED	10	21
INDUSIND BANK LTD	11	12
Total	**56**	**45**

Thus, the contention of the Representors that they were not aware of the categorization of "house" and "non-house" accounts, is not acceptable. Further, even if it is assumed that they are not aware of the categorization, as argued by the Representors, the categorization of the account as "non-house" beneficiary itself could have alerted Representors for making further inquiries.

(c) Also, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 which came into force on October 01, 2019, specifically provided as under:

"4.6……

…….

Referencing the above stated provisions, TMs/CMs are pledging collateral/securities of the clients with the Banks/NBFCs to borrow funds to meet the margin requirement of the clients/proprietary obligation which is not contemplated in the provisions of the aforesaid SEBI circular. In this regard, it is reiterated that the client securities received as collateral shall be

used only for meeting the respective client's margin requirement by way of depositing the same with Stock Exchange/ Clearing Corporation/ Clearing House.

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……..."

Representors are the Banks and NBFC, who are in the business of giving loans against securities to the stock brokers, therefore, as the Circular was having bearing on their business activity, they must be aware of it. In this regard, Representors have contended that the said Circular is not addressed to them. As stated above, Representors who are banks are also registered DPs and the Circular is addressed to DPs also. Further, I note that when this Circular was issued on June 20, 2019, same was widely reported in the newspapers and newsportals on June 21, 2019 and thereafter also. Therefore, ignorance of the Circular by such Representors is incomprehensible.

(d) It is further noted that the securities which were lying in the demat account no. 11458979 i.e. KARVY STOCK BROKING LTD (BSE) is not reflected in the balance sheet of KSBL as its investment or holding in securities. The current investments mentioned at para 2.35 of the balance sheet of KSBL for the FY 2018-19 shows that KSBL was showing securities valuing Rs. 27.79 Lakhs only. Similarly, KSBL was holding securities worth Rs. 28.01. lacs, as on March 31, 2018 and securities worth Rs. 35,143/- as on March 31, 2017, whereas the lenders including the Representors together have extended loans, against shares having value to the extent of Rs. 2873 crores as on September 16, 2019 which later reduced to Rs. 2319 crores as on November 19, 2019. Representors have submitted that balance sheet shows financial affairs of the company as on a particular date only. However, it is observed that the Representor No. 1 since 2014, Representor No. 2 since, 2009, Representor No. 3 since, 2003 and Representor No. 4 since 2013, have been extending loans to KSBL. In this regard, it is noted a prudent lender always refer to balance sheet

for ascertaining the financial position and solvency of the borrower and also the purpose of loan, before lending.

(e) SEBI Circular dated June 20, 2019 *inter-alia* provided that clients' securities lying with the stock broker 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. The Circular further provided that clients' securities already pledged either be unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed of after giving notice of 5 days to the client. These requirements of the Circular were directly concerning the business activity of the Representors and therefore, all pledgees were required to take appropriate action to comply with the Circular.

22. Thus, from the above para 21 (a) to (e), it cannot be said that Representors acted in good faith as required under Section 178 of the Indian Contract Act, 1872. It further demonstrates that the Representors did not verify the title of KSBL over the pledged securities and merely relied on the representation of KSBL. The forensic audit ordered by NSE is for allegation of violation of securities laws by KSBL. The issue whether lenders have exercised proper due diligence or has complied with applicable laws pertaining to loans against shares, can be looked into by the concerned regulator, if so deemed fit.

23. With reference to Section 27 of the Sales of Goods Act, 1930, I note that the said Section applies in case of sale of the goods. I note that the latin maxim *'Nemo dat quad non habet'* which is the principle underlying the Section 27, is applicable in the present case which means that 'No one can transfer a better title than he himself possesses'. KSBL was not authorized to pledge securities. Such pledge did not pass any title as KSBL was not the owner of the securities. Thus, KSBL did not pass any title or interest in these securities to the Representors as KSBL itself was not having any title to such securities. I note, the principle that holder in due course gets good title applies in case of negotiable instruments like cheques, bills of exchange, promissory notes, etc. where the holder is for consideration and without notice of the defect in the title of transferor. The said principle is not applicable in respect of goods/shares i.e. other than negotiable instruments and reliance placed on the same for unauthorized pledge is wholly misplaced.

24. Some of the Representors have contended that section 10 read with section 2(1)(a) of the Depositories Act, 1996, creates an irrefutable presumption on which the whole depository system rests i.e. a person whose name is recorded as 'beneficial owner' by the depository as BO, of such securities. It is the case of these Representors that since the demat account no. 11458979 reflected the name "Karvy Stock Broking Ltd. (BSE)", they relied upon the irrefutable presumption created in law and had no reason to believe that the securities lying in that account would not belong to KSBL.

25. In regard to contention raised in para 24 above, I note that Depositories Act, 1996 does not create any irrefutable presumption merely because a security is in a demat account, as argued by the Representors. I note that 'beneficial owner' recorded by the depository may not always have the 'beneficial interest' in such shares or may not always be real owner of such shares. For example, the name of the nominee may appear as the beneficial owner' in the records of the depository, after the death of the owner making nomination. However, the nominee is merely a 'holder in trust', of such securities, on behalf of the legal heirs who are entitled to inherit such securities under the law of succession. Similar, is the case of a trustee whose name may be reflected as the 'beneficial owner' in the records of the depository, however, such shares are held by the trustee on behalf of the beneficiaries of the Trust. The client remains beneficial owner even if the securities are transferred to pool account or settlement account after execution of valid trade and is entitled to all the benefits attached to such securities, in terms of Section 10(3) of the Depositories Act, 1996. In such case, broker merely acts as trustee of securities for clients. Opening of such accounts and putting clients'/investors' securities in them does not make opener of such account *de facto* or *de jure* owners of such securities. Actual beneficial owner of the securities held in demat is the one who has paid consideration or owns them and who is entitled to the rights and benefits attached to such securities, under Section 10(3) of the Depositories Act, 1996. The above observations are without prejudice to the discussions in para 21 (a) (b) & (c), above, where it has been noted that "Karvy Stock Broking Ltd. (BSE)" could not have been treated as "beneficial owner" as claimed by Representors, in the facts and circumstances of the case. The consequences of accepting of contention similar to the one raised by the Representors has been explained in ABN Amro Bank Vs. Indian Railway Finance 1996 85 CompCas 689 CLB, as follows:

"……..52. If wrongful pledging of a third party's securities is recognised as valid for the purpose of conveying title, the investors will be in for a raw deal. The securities market being a wide network, it is essential to rely on the services of intermediaries who take upon themselves the responsibility of delivering the scrips or receiving the price. Every such transaction has to be as per the rules of the stock exchange and should be evidenced by a contract note as the brokers being members of the stock exchange are governed by the rules and regulations of the exchange. If such wrongful pledging is recognised, there will be total chaos in the securities market. As such the stock exchange regulations do not permit this in the ordinary course. Thus, we come to the inevitable conclusion that the delivery of the IRFC bonds does not convey a good title to the petitioner-bank, and they cannot appropriate the same to themselves……..."

26. Representors have also cited some case laws explaining the power of courts to direct restitution, at the interim order stage. I find that these judgments are in relation to the power of Civil Courts and are not applicable to the present proceedings which are under Sections 11 and 11B of the SEBI Act, 1992 and to the facts and circumstances of the present case.

27. With respect to securities other than the impugned securities, it is noted that direction contained in para no. 21 (iv) of the interim order does not affect the position with respect to unpaid clients, if any, of KSBL. Even unpaid clients continue to be owner of securities, even when the securities are in pool account or settlement account. In terms of SEBI Circular dated June 20, 2019, KSBL ought to have unpledged the existing pledges on unpaid clients, securities and was supposed to sell the securities to the extent of outstanding obligation of the client. KSBL has failed to comply with the said Circular. It is not clear whether any trade instructions were given by such clients or they were unpaid clients. In any case, even if such clients are considered unpaid clients, the stock broker can exercise lien only to the extent of unpaid amount/brokerage and the balance is required to be remitted to the client. In no case, such securities can be pledged even with the consent of the client, as per SEBI's Circular dated June 20, 2019, from October 01, 2019 onwards. In case the client does not pay for securities purchased by him then stock broker is entitled to retain those securities up to five trading days only. If client fails to meet its funds pay-in obligation within five trading days, the stock broker has to liquidate the securities in the market to recover its dues and remit the balance to the client's account. Under no circumstances, the securities of the clients received in pay-out, can be retained by the stock broker beyond five trading days and/or can be

used for any other purpose. In the absence of corresponding trade instruction, pledging of securities of such clients is also unauthorized and hence, in law not treated as valid pledge.

28. Further, Hon'ble SAT in its order dated December 04, 2019 has rightly observed as under:

> *"7……..Now it is on record before us that after a due diligence by NSE and NSDL securities have been transferred to the account of the clients. Therefore, further rights have been created / restored involving more than 80,000 investors. In this context, a prayer to recall the same or to retain the same as frozen accounts of those clients becomes untenable……..".*

29. In view of the discussions in paras 17-28 above, reliefs sought by the Representors are not tenable and the remedy for the Representors lies against KSBL before civil court of competent jurisdiction.

30. Representations made by the Representors are disposed of, on the aforesaid lines.

Sd/-

Place: Mumbai **ANANTA BARUA**

Date: December 13, 2019 **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA