WTM/AB/SEBI/MIRSD/HO/36/2019

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 READ WITH REGULATION 35 OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008.

In the matter of *ex parte ad interim* order dated November 22, 2019 passed in respect of Karvy Stock Broking Limited (PAN: AABCK5190K)

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1. Securities and Exchange Board of India (hereinafter referred to as "**SEBI**") passed an *ex parte ad interim* order dated November 22, 2019 (hereinafter referred to as "interim order") against Karvy Stock Broking Limited (hereinafter referred to as "**KSBL**"/"**Stock Broker**"/"**Noticee**") 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. KSBL sent letters dated November 24, 2019, November 25, 2019 and November 26, 2019 primarily requesting SEBI to permit the continuation of KSBL using the power of attorney (PoA) 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.

3. On November 28, 2019, KSBL filed an Appeal no. 579 of 2019 before Hon'ble Securities Appellate Tribunal, Mumbai (hereinafter referred to as "**Hon'ble SAT**") *inter alia* praying as follows:

"

(a) the Hon'ble Tribunal be pleased to direct the Respondent to allow the Appellant to use the Power of Attorney given by clients for limited purpose of transfer of securities to the pool account from demat accounts for settling clients' pay-in obligations to the exchanges;

(b) pending the hearing and final disposal of this Appeal, this Hon'ble Tribunal be pleased to stay the operation and effect of relevant direction in the para no. 21 of the Impugned Order passed by the Respondent;

(c) in the alternative direct the Respondent to consider the request made by the Appellant through its letters dated 24.11.2019, 25.11.2019 & 26.11.2019

(d) ……."

4. Hon'ble SAT vide order dated November 29, 2019 disposed of the appeal *inter alia* directing as under:

> *"……..7. We accordingly dispose of this appeal at this stage with a direction to the WTM to consider the request of the appellant which has been made vide letters dated November 24, 25 and 26, 2019 and pass an appropriate order after giving an opportunity of hearing by December 02, 2019……..*"

5. Accordingly, vide an email dated November 29, 2019, KSBL was called for hearing on the same day at 2:00 pm. During hearing, KSBL was represented by its advocates and Mr. C. H. Vishwanath, VP- Compliance of KSBL and following submissions were made on behalf of KSBL:

(i) KSBL has 12 lacs clients, out of which 3 lacs clients are active clients. On an average 20,000-25,000 clients transact on daily basis, out of which 15,000-18,000 clients are doing transactions through online trading platform. Out of this, 2000 to 2500 client transactions result into delivery. KSBL has 900 offices (including franchise) across India.

(ii) The interim order only prohibits KSBL from taking new clients meaning thereby that it has been allowed to service its existing clients.

(iii) On one hand, vide directions in para 21(ii) of the interim order directs the Depositories not to act upon the instructions given by KSBL in pursuance of the PoA of the clients which has resulted into KSBL's inability to execute the instructions of the client on the basis of PoA and not able to transfer the securities in the pool account for settlement of the clients obligations. However, on the other hand in para 21(iii) of the interim order, the directions are given to the Depositories to monitor the movement of securities to ensure that the client operations are not affected.

(iv) KSBL in accordance with the direction at para 21 (i) of the interim order has only been restricted from accepting new clients, however, it is still obliged to service its existing clients. The direction at para 21 (ii) of the interim order is a qualified direction and not a

blanket restriction, as is being interpreted by the Depositories. Thus, if the directions at para 21(i), 21 (ii) and 21 (iii) of the interim order are to be read in harmony, the Depositories have been directed not to act upon any instructions in pursuance of the PoA, only to the extent of preventing further misuse of client securities. The direction at para 21 (ii) is not meant to restrict the use of PoA by KSBL to meet the daily pay-in obligations of those clients whose securities have not been alleged misused. By imposing a complete embargo on use of PoA, the Depositories have misinterpreted the spirit of the directions contained in the interim order and which in turn has resulted into tremendous hardship and losses for the clients of KSBL.

(v) Since, none of the PoA's of clients' are being acted upon by the Depositories, KSBL is unable to transfer the clients' securities from clients' demat account to KSBL's pool demat account, which is resulting in delivery failure and consequent delivery of securities through auction mechanism, thus incurring huge loss for the clients.

(vi) KSBL is ready to furnish suitable undertaking so as to ensure that the permitting use of PoA will not be misused by it.

(vii) Accordingly, KSBL has prayed for permitting it to use PoA for its existing clients.

6. I have considered the representations and aforesaid submissions made during the hearing. The interim order in the matter was passed by SEBI when it was *prima facie* found that the KSBL has misused the clients' securities by misusing the PoA given to it by its clients. Thus, direction given in para 21(ii) of the interim order restricts the use of PoA by KSBL.

7. The KSBL is now praying for removal of restriction on the use of PoA. I note that the clients of stock brokers are free to avail various modes for giving instructions to the brokers including through PoA. Giving instructions through PoA is not mandatory, in terms of SEBI Circular no. CIR/MRD/DMS/13/2010 dated April 23, 2010. Master Circular on Delivery Instruction Slip (DIS) of NSDL-Depository, provide detailed framework for instructions for delivery of securities such as instruction received from illiterate persons/from blind persons/though fax,

SPEED-e facility, etc. As per the Business Rules of depositories, the mode of affecting transfer by book entry based on electronic instruction received from the client such as through Speed e facility eliminating the need to deliver the DIS in physical form. If any client seeks to give instruction in physical form, he may also do so by sending the DIS through fax to depository participant and original DIS may be sent within three days of the fax. The client who seeks to send physical DIS, in addition to sending it by fax has option to deliver the same at the offices of the broker of depository participant (DP).

8. As noted in detail in the interim order, SEBI Circular No. CIR/HO/MIRSD/DOP/CIR/P/2019 dated June 20, 2019 provides that the client's securities already pledged shall, by August 31, 2019 (later extended to September 30, 2019), be either unpledged and returned to the clients upon fulfilment of pay-in obligation or disposed of after giving notice of 5 days to the client. The said circular also provided that clients' securities lying with a stock broker shall not be permitted to be pledged/transferred for raising funds by the stock broker. Also in terms of the said circular, all TM and/or CM are required to transfer the clients' securities received in pay-out to clients demat account within one working day. In case the client does not pay for such securities received in pay-out, then the TM/CM shall be entitled to retain those securities up to five trading days after pay-out. Further, where the client fails to meet its funds pay-in obligation within five trading days from payout day, the TM/CM shall liquidate the securities in the market to recover its dues. Under no circumstances, the securities of the clients received in pay-out, can be retained by the TM/CM beyond five trading days and/or can be used for any other purpose.

9. Thus, from October 01, 2019, TM/CM were obliged to unpledge all the securities pledged by them and were prohibited from creating any new pledge on clients' securities. Any pledge created or continued on clients' securities after October 01, 2019 is in violation of the said circular. The interim order refers to the interim report given by NSE wherein it has been mentioned that in one demat account no. 11458979, named KARVY STOCK BROKING LTD (BSE) which was never disclosed by KSBL in its filing with stock exchanges, the securities worth Rs. 2300 crore (approx.) of more than 95,000 clients, were unauthorizedly transferred into this account by KSBL, by misusing the PoA given by its clients. The securities of fully

paid clients were also pledged by KSBL to generate funds for its own/group entities use. The outstanding pledge, if any, was to be unpledged by September 30, 2019 as required under Circular dated June 20, 2019 which was not complied with by KSBL. Forensic audit of the KSBL, institiated by NSE, is in progress and the full magnitude of the mis-utilisation of the clients' securities will be known after completion of the forensic audit. Therefore, taking into consideration, the facts and circumstances of the case including enormity of the *prima facie* violations observed against the KSBL in the interim order, it would not be prudent to allow the use of PoA by KSBL given to it by its clients, as prayed by KSBL. Thus, the clients of KSBL who seek to sell securities through KSBL may do so by using electronic or physical DIS only. Accordingly, representations dated November 24, 25 and 26, 2019 made by KSBL stands disposed of, on the aforesaid lines.

10. This order shall come into force with immediate effect. A copy of this order shall be forwarded to KSBL, Stock Exchanges and Depositories to ensure that the directions given above are strictly complied with.

Sd/-

Place: Mumbai **ANANTA BARUA**

Date: November 29, 2019 **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA