BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Date of Hearing : 23.11.2023
Date of Decision : 07.12.2023

Appeal No. 387 of 2022

IIFL Securities Ltd.
701, 7th Floor, Ackruti Center Point,
Central Road, MIDC, Andheri (East),
Mumbai – 400 093. ….. Appellant

Versus

Securities & Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. … Respondent

Mr. Somasekhar Sundaresan, Advocate with Mr. Kunal Katariya, Mr. Sahebrao Wamanrao Buktare, Ms. Ashmita Garodia, Advocate with Mr. Shardul Shah, CA i/b Shah & Ramaiya, Chartered Accountants for the Appellant.

Mr. Gaurav Joshi, Senior Advocate with Mr. Suraj Choudhary, Mr. Ravishekhar Pandey, Mr. Nishit Dhruva, Ms. Shefali Shankar, Ms. Rasika Ghate, Mr. Harsh Sheth, Advocates i/b MDP & Partners for the Respondent.

With
Appeal No. 388 of 2022

IIFL Securities Ltd.
701, 7th Floor, Ackruti Center Point,
Central Road, MIDC, Andheri (East),
Mumbai – 400 093. ….. Appellant

Versus

Securities & Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. … Respondent

Mr. Kunal Katariya, Advocate with Mr. Sahebrao Wamanrao Buktare, Ms. Ashmita Garodia, Advocate with Mr. Shardul Shah, CA i/b Shah & Ramaiya, Chartered Accountants for the Appellant.

Mr. Gaurav Joshi, Senior Advocate with Mr. Suraj Choudhary, Mr. Ravishekhar Pandey, Mr. Nishit Dhruva, Ms. Shefali Shankar, Ms. Rasika Ghate, Mr. Harsh Sheth, Advocates i/b MDP & Partners for the Respondent.

With
Misc. Application No. 776 of 2023
And
Appeal No. 527 of 2023

IIFL Securities Ltd.
701, 7th Floor, Ackruti Center Point,
Central Road, MIDC, Andheri (East),
Mumbai – 400 093. ….. Appellant

Versus

Securities & Exchange Board of India
SEBI Bhavan, Plot No. C-4A, G Block,
Bandra Kurla Complex, Bandra (East),
Mumbai - 400 051. … Respondent

Mr. Darius Khambata, Senior Advocate with Mr. Somasekhar Sundaresan, Mr. Kunal Katariya, Mr. Sahebrao Wamanrao Buktare, Ms. Ashmita Goradia, Advocates and Mr. Shardul Shah, CA i/b Shah & Ramaiya, Chartered Accountants for the Appellant.

Mr. Gaurav Joshi, Senior Advocate with Mr. Suraj Choudhary, Mr. Ravishekhar Pandey, Mr. Nishit Dhruva, Ms. Shefali Shankar, Ms. Rasika Ghate, Mr. Harsh Sheth, Advocates i/b MDP & Partners for the Respondent.

CORAM : Justice Tarun Agarwala, Presiding Officer
Ms. Meera Swarup, Technical Member

Per : Justice Tarun Agarwala, Presiding Officer

1. Three appeals have been filed arising from the same cause of action. Appeal Nos. 387 and 388 of 2022 are against the adjudication orders passed by the Adjudicating Officer (hereinafter referred to as ‘AO’) of Securities and Exchange Board of India

(hereinafter referred to as 'SEBI') imposing a monetary penalty of Rs. 1 crore each under Section 23D of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as 'SCRA').

2. The appellant has filed Appeal No. 527 of 2023 challenging the order of the Whole Time Member (hereinafter referred to as 'WTM') debarring the appellant from taking up new clients for a period of two years. For facility, the facts stated in Appeal No. 527 of 2023 are being taken into consideration.

3. The appellant is a large broking company and is a member of the National Stock Exchange of India Ltd. (hereinafter referred to as 'NSE') and BSE Ltd. (hereinafter referred to as 'BSE') and is in the business of broking, distribution of mutual funds. The appellant is a depository participant with National Depository Services Ltd. (hereinafter referred to as 'NSDL') and Central Depository Services (India) Ltd. (hereinafter referred to as 'CDSL') and portfolio manager. It has various branches spread across the country.

4. SEBI conducted six inspections for the period of April 1, 2011 to January 31, 2017. The details of these inspections are as under :-

Sr. No.	Name of Inspection	Date of Observation Letter	Period of Inspection	No of days covered
1.	*Thematic Inspection*	*4.7.2014*	*1.4.2011 to 31.12.2013*	*NA*
2.	*Comprehensive Inspection*	*19.1.2015*	*1.4.2013 to 30.6.2014*	*NA*
3.	*Supplementary Inspection I*	*6.7.2015*	*1.4.2011 to 30.6.2014*	*10 days*
4.	*Supplementary Inspection II*	*29.12.2015*	*1.4.2011 to 30.6.2014*	*105 days*
5.	*Supplementary Inspection III*	*19.07.2017*	*1.4.2011 to 30.6.2014 (except the days which were inspected during supplementary inspection I & II)*	*695 days*
6.	*Inspection*	*25.7.2017*	*April 1, 2015 to January 31, 2017*	*30 days*

5. The observation letter so issued pursuant to the inspection indicated :-

a) Failure to segregate its own funds from clients' funds;

b) Misuse of credit balances in clients' funds for the benefit of clients having debit balance; and

c) Inappropriate designation of the client bank accounts.

6. The aforesaid findings were based on the thematic inspection and thereafter a comprehensive inspection was made followed by supplementary inspections. The period, thus, covered through the aforesaid inspections were from April 1, 2011 to June 31, 2014 and from April 1, 2015 to January 31, 2017.

7. Based on the aforesaid inspections, two separate enquiry proceedings were initiated against the appellant under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 (hereinafter referred to as 'Intermediaries Regulations'). The first enquiry proceeding covered the thematic inspection, comprehensive inspection and supplementary inspection I and II and the second enquiry proceedings covered the supplementary inspection III and March 2017 inspection.

8. Two show cause notices dated May 2, 2017 and October 28, 2021 were issued by the Designated Authority (hereinafter referred

to as ‘DA’) under the Intermediaries Regulations with respect to enquiry proceedings I and enquiry proceedings II. The DA after considering the reply and the material evidence on record submitted the enquiry report under Regulation 26 of the Intermediaries Regulations recommending cancellation of the certificate of the registration of the appellant.

9. Based on the aforesaid reports, the WTM issued two separate show cause notices on July 18, 2022 and July 4, 2022 under Regulation 27(1) of the Intermediaries Regulations. The show cause notice alleged that during the inspection, out of 45 client bank accounts, 26 client bank accounts were not titled as “client account”. It was also alleged that after the inspection the appellant renamed the account as “client account”, nonetheless, one account with Citi Bank and the other account with South Indian Bank were not renamed and, therefore, the appellant had violated the circular dated November 18, 1993 (hereinafter referred to as ‘1993 circular’) for failure to designate bank accounts used for client transaction as “client account”. The show cause notice also alleged that funds were regularly being transferred from client bank accounts to the pool accounts / control accounts of the appellant which were managed and

controlled by appellant as its own bank account. Further, funds were also transferred from the appellant's own bank accounts to the pool accounts / control accounts and then money was transferred to the settlement account of the stock exchange / clearing house. The show cause notice, thus, alleged that the appellant had violated the 1993 circular for failing to segregate client funds and mixing its own funds with the client funds by transferring its own funds and the client funds to the common pool accounts which were owned by the appellant. The show cause notices further alleged that the funds lying in the pool / control accounts were being used by the appellant for its own purposes such as investments in mutual funds, for insurance, fixed deposits, inter-corporate deposits, transfer of the money to salary account, etc.

10. The show cause notice, thus, alleged that the appellant had violated the 1993 circular by mixing clients' funds with its own funds in the pool account and used the mixed funds for its own purposes. It was also alleged that funds pay out from the stock exchange towards client trades were not transferred to the designated client bank account and that "G Value" of trades on number of days had come out negative and, therefore, it was alleged that the funds of

the credit balance clients were utilized by the appellant for settlement obligations of the debit balance clients.

11. Thus, the show cause notice alleged that the appellant had violated the provisions of the 1993 circular by the following acts :-

a) By mixing clients' funds with proprietary funds by transferring it to the pool accounts / control accounts;

b) By utilizing funds of the credit balance clients for settlement obligation of the debit balance clients; and

c) By utilizing funds of the credit balance clients for settlement obligation of proprietary trades.

12. The appellant was accordingly called upon to show cause as to why suitable direction should not be issued against the appellant in terms of the recommendation given by the DA or such other directions as deemed fit and proper in the facts of the case should not be issued.

13. On the same inspection, the AO also initiated two proceedings and, on similar lines two show cause notices were

issued. The appellant denied any violation and contended that they have not indulged in any violations of the SEBI laws. The WTM after considering the material evidence on record and after hearing the parties found that the charges levelled against the appellant stood proved. The WTM instead of cancelling the registration as recommended by the DA issued a direction under Section 27 and 28 of the Intermediaries Regulations restraining the appellant from taking up / onboarding any new client for a period of two years in respect of its business as a stockbroker. On the same facts, the AO also found that the charges levelled against the appellant stood proved and, accordingly, imposed a maximum penalty of Rs. 1 crore in each of the adjudication proceedings under Section 23D of the SCRA.

14. We have heard Mr. Darius Khambata, the learned senior counsel with Mr. Somasekhar Sundaresan, Mr. Kunal Katariya, Mr. Sahebrao Wamanrao Buktare, Ms. Ashmita Garodia, the learned counsel with Mr. Shardul Shah, Chartered Accountant for the appellant and Mr. Gaurav Joshi, the learned senior counsel with Mr. Suraj Choudhary, Mr. Ravishekhar Pandey, Mr. Nishit Dhruva, Ms.

Shefali Shankar, Ms. Rasika Ghate, Mr. Harsh Sheth, the learned counsel for the respondent.

15. Before we deal with the issues, we find that the core issue is with regard to the violation of 1993 circular. Our attention was also brought to the notice of a subsequent circular dated September 26, 2016 on the same issue. Before proceeding further, it would be appropriate to consider the circular dated November 18, 1993 issued by SEBI. This circular issued certain guidelines with regard to regulating the transactions between clients and brokers. Under this circular, certain norms were set out which were required to be followed. The circular provided that it shall be compulsory for stock brokers to keep the money of the clients in a separate account and their own money in a separate account. Further, the broker was not permitted to make payments for any transaction which he had made in his own name from the client accounts. However, under certain circumstances, the broker can transfer monies from the client accounts. The circular directed that the word “client” shall appear in the client account as “clients account” and it was obligatory upon the broker to pay / deposit the money of client into the client accounts. The circular also provided as to what monies can be paid into the

client account, namely, that no money shall be paid in the client account other than money held or received on account of client; such money belonging to the member as may be necessary for the purpose of opening or maintaining the account; money for replacement on any sum which may by mistake or accident have been drawn from the account and cheque or draft received by the member receiving in part; and money belonging to the client and in part money due to the member.

16. More importantly the circular of 1993 also stipulated as to what monies can be withdrawn by the broker from the client account. The circular stipulated that no money shall be drawn from the client account other than -

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

ii. Such money belonging to the Member as may have been paid into the client account;

iii. Money which may by mistake or accident have been paid into such account.

17. The circular also issued other directions which we are not concerned with in the present case and it is, therefore, not being stated. On a query raised by the Tribunal, the learned senior counsel for the respondent fairly conceded that a broker can withdraw money from the client account for the purpose of issuing a bank guarantee to the clearing house on behalf of the clients though it is not specifically stated in the 1993 circular. The circular does not provide for any formula to calculate client funds and does not refer to or speak about bank guarantees. It only provides for the creation of separate client bank account and what can be credited or debited from the said account.

18. Over a period of time, the exchanges started monitoring the position of the client bank accounts of brokers to ensure that there was no misuse and that the brokers had the appropriate financial

strength to meet all client obligations at all times. Since 1993, SEBI / exchanges considered the funds lying in the "client bank account" and the cash and cash equivalents "lying with exchange / clearing corporation" as client funds. The formula used is that the sum total of these two items should always be greater than or equal to the sum total of all credit balances of funds payable to clients.

19. In 2015, SEBI constituted a committee on "Enhanced Supervision of The Stock Brokers' which included representatives from stock exchanges, depositories and brokers. The committee made its recommendations in 2015 which eventually led to the issuance of the circular dated September 26, 2016 wherein it provided for a formula to calculate client funds. The basic formula was the same, namely, that the sum total of funds lying in "client bank account" and cash and cash equivalents "lying with the exchange / clearing corporation" being client funds should always be greater than or equal to the sum total of all credit balances of fund payable to clients. The 2016 circular for the first time stated that while calculating client funds, the non-funded portion of the bank guarantee is supposed to be excluded and, therefore, the circular of

2016 which came into effect from July 1, 2017 started calculating the client funds on the basis of non-funded portion of the bank guarantee.

20. SEBI issued a circular dated September 26, 2016 to all the stock exchanges and depositories with regard to enhanced supervision of the stock brokers / depository participants. The said circular does not, in any way, state that it is an addendum or supplement or in continuation of the 1993 circular. However, from a perusal of the 2016 circular one finds that the 1993 circular is reiterated in sum and substance. In ***Arihant Capital Markets Ltd. vs. SEBI Appeal No. 521 of 2019 decided on 21.20.2021***, we have held that the 2016 circular is a crystallization of the earlier circular. The observation made by this Tribunal in its decision in ***Arihant Capital Markets Ltd. (supra),*** was upon a reading of paragraph 2.4 and its sub-paragraphs of the 2016 circular which reiterated the 1993 circular, namely, that stockbroker shall not use clients funds and securities for proprietary purposes including the settlement of the proprietary obligations and that name of stockbroker's clients account and his own account should be different and that the transfer of funds between stockbroker's clients account and clients' own account is only permitted for legitimate purposes. We find that the

2016 circular not only crystalizes the earlier 1993 circular but also irons out the creases of the 1993 circular.

21. We, however, find that the 2016 circular adopted a mechanism for monitoring clients fund lying with the stock broker under Clause 3 of the Annexure to the circular of 2016 in order to find out as to whether a stockbroker was misusing the client funds or not. Paragraph 3.2 of the circular provided a formula for calculation of the value of “G”. The said formula provided that if “G” is negative then it is an indication that the broker has misused the clients’ funds for its own use. While the formula was in use earlier the same was further crystalized by the circular of 2016 to indicate that only the funded portion of the bank guarantee i.e. amount deposited by the broker with the bank to obtain the bank guarantee would be considered as part of the aggregate value of collateral deposit with the clearing corporation or with clearing member. To give an example, if a bank guarantee of Rs. 100/- is to be provided by the client and the bank gives a guarantee for Rs. 100/- by taking a deposit of Rs. 80/- then only the funded portion of Rs. 80/- will be considered and not Rs. 100/- towards collateral deposit with the clearing corporation, meaning thereby that the remaining Rs. 20/-

which was not used by the broker for obtaining a bank guarantee has to be kept in the clients' accounts and cannot be used by the broker for other purposes, otherwise, it would be deemed to be a misuse of clients' funds.

22. We find that the requirement of only the funded portion of the bank guarantee toward the aggregate value of collateral deposit came into existence for the first time through this circular of 2016 circular which became effective from July 1, 2017. Prior to the issuance of the circular dated September 26, 2016 the requirement of only funded portion of the bank guarantee was not existing in the earlier circular issued by SEBI especially the circular of 1993. In fact, SEBI has always considered unconditional bank guarantees equivalent to cash / fixed deposits as provided in SEBI's circular at February 23, 2005 which provided that cash and cash equivalent with the exchange includes funds lying with the stock exchange / clearing corporation in the form of cash, fixed deposits and bank guarantee furnished by a broker.

23. In the light of the aforesaid two circulars, we have to consider the charges levelled against the appellant. The first charge

is failure to change the nomenclature of the bank accounts. Under the 1993 circular stockbrokers were required to designate "client bank account" and report a list of such bank accounts to the stock exchanges for monitoring.

24. In the inspection, it came to light that the appellant had failed to maintain an appropriate nomenclature of client bank accounts with respect of 26 clients bank accounts which were not titled as "client accounts". There is no doubt that pursuant to the inspection the appellant immediately renamed the accounts as "client account" prior to the issuance of the show cause notice. Nonetheless, two of the accounts, namely, one with Citi bank and other with South Indian bank were not renamed. The appellant has tried to justify as to why these accounts could not be renamed. Be that as it may, the facts remains that the 1993 circular clearly mandated that the clients account has to be named as "client accounts". The law is very clear that if something has to be done in a particular manner then the law mandates that the same is required to be done in that manner only. The 1993 circular mandated every stockbroker to ensure that the clients account is renamed as "client account" so that there is clarity

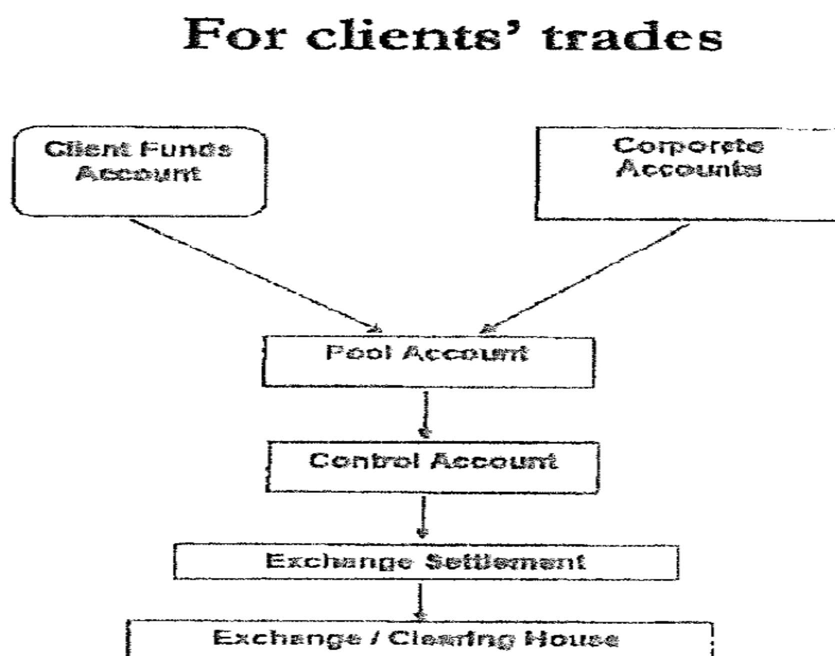
and no confusion to the stock exchange in monitoring the matter with regard to misuse of client funds.

25. Even though, there is no allegation of misuse of client funds by the appellant on account of not properly naming the client accounts, nonetheless, the fact remains that the appellant did not adhere to the mandate given in the 1993 circular and even though the nomenclature “client” was not added to the names of these accounts which was only technical in nature, nonetheless, we are of the opinion that the appellant violated the 1993 circular.

26. The second charge is mixing of funds with client funds by using a pool / control account before transferring the monies to the settlement account. This charge is serious. The 1993 circular clearly mandated that the funds from the clients accounts has to be kept separately from the proprietary funds of the stockbroker and the two funds cannot be mixed together. Clause (1) of the 1993 circular clearly indicated that it shall be compulsory for all brokers to keep the money of the client in the separate account and their own funds in a separate account. There was a clear mandate that clients’ money has to be kept in a separate account and brokers money has to be kept

in a separate account and the nomenclature of the accounts had to be displayed. In this regard, we find that the appellant had used the following process towards administrative convenience which has been depicted in the impugned order as under :-

Diagram 1 : Flow of funds in the records of IIFL



27. Admittedly, from a perusal of the aforesaid chart the appellant had kept the clients fund in separate account and its own money in a separate account. Thereafter, monies from the client accounts and from the own account came into the pool account and

from there it went to the settlement account. The contention of the appellant is, that the pool account was created for administrative convenience as while settling the account, the exchange required only the net amount to be settled with the exchange, namely, that the amount i.e. payable by the clients plus the amount payable by the broker, if any, had to be clubbed together and settled with the exchange. That is to say, if the client had to pay Rs. 80/- and the broker had to pay Rs. 20/-, then the broker was required to pay Rs. 100/- towards settlement in one shot and that the appellant was not required to settle the client account separately and its own proprietary account settled separately with the exchange. For the aforesaid purpose, the pool account was created wherein money towards settlement of the trade was debited from the client account and transferred to the pool account and thereafter transferred to the settlement account.

28. The aforesaid argument appears to be reasonable and plausible. Respondent has not denied the fact that the stock exchange required the broker to pay the entire settlement amount of client as well as his own in one lumpsum amount. The impugned order however takes it otherwise and holds that mixing of client

funds with own money into the pool account amounts to misuse of the client funds.

29. Even though, explanation in this regard, was given by the appellant that the client funds were never touched by the appellant while making the payments from the pool account towards proprietary trades, etc., the WTM disbelieved the said contention on the ground that the money when deposited in the pool account became fungible and cannot be separated.

30. In our view, the approach adopted by the WTM is erroneous. The 1993 circular required the appellant to keep separate accounts, namely, client accounts and own account separately which the appellant had done and which the respondent admits that separate accounts were created by the appellant. The objection of the respondent, is that no pool account could have been created and creation of a pool account in which client money and brokers money were kept was violative of 1993 circular. This approach, in our opinion, is wrong and untenable in as much as Clause (1) of the 1993 circular makes it clear that client accounts and broker's account has to be kept separately which the appellant had created and complied

with the circular. Further, settlement of the client money was debited from the clients account which went into the pool account and from the pool account it went to the settlement account. This fact is also admitted by the respondent. The only objection is that in the pool account the brokers own money was also included and, therefore, there was mixing of funds which was not permissible. As stated above, client funds are maintained in the client account and whenever the client trades, the client obligations towards brokers and stock exchange are debited from the client account which is then transferred to the settlement account. While doing so it goes first into the pool account and then it transferred to the settlement account. In our view, the pool account does not violate the 1993 circular. In our opinion, the 1993 circular does not prohibit the pool account. In fact, the 1993 circular permits the appellant to debit the client account for their obligations and, consequently, while debiting the client obligation from the clients account whether the said amount goes directly to the settlement account or passes through pool account becomes irrelevant.

31. In any case, this procedure was stopped in 2014 itself when it was pointed out in the inspection and the appellant had transferred all

its proprietary trading to a sister concern and, therefore, the question of mixing of client funds with its own funds did not arise thereafter. The AO has admitted in the impugned order that this is a historical issue which stopped in 2014 itself.

32. We are further of the opinion that when any amount is debited from the client account it ceases to be the client's money and, therefore, even if, it does not go directly into the settlement account and goes into the pool account, it does not violate the 1993 circular. The pool account was created for convenience and does not lead to any conclusion that the mixing of client's money with the broker's money amounts to misuse of clients' money.

33. With regard to the misuse of the client funds ("G" negative), we find that the 1993 circular clearly directed the brokers to maintain separate account for clients fund and separate account for brokers' fund. The 1993 circular further provides the circumstances when a broker could be permitted to debit the client account. The circular does not even refer that a bank guarantee has to be provided to the stock exchange by the client / broker nor does it refer as to how it should treat a bank guarantee as directly funded by the client. The

circular only provides for the creation of separate bank accounts for client funds and what can be credited or debited from the said account.

34. To reiterate, the 1993 circular does not talk about bank guarantee to be provided to the stock exchange. The learned senior counsel has admitted that under the 1993 circular, stockbrokers can debit the client account towards issuance of the bank guarantee to the stock exchange.

35. We find that over a period of time the stock exchange started monitoring the position of the client bank account of brokers to ensure that there was no misuse of client amount and that broker had the appropriate financial strength to meet the clients' obligations at all times. Under the 1993 circular, the funds lying in the client account and funds lying with the exchange / clearing corporation were treated as clients funds and the formula used under the 1993 circular was that the sum total of these two items i.e. funds lying in the client account and the funds lying with the stock exchange / clearing corporation should always be greater than or equal to the sum total of all the credit balances of the funds payable to client.

36. As per the circular of SEBI dated February 23, 2005, SEBI considered unconditional bank guarantee equivalent to cash / fixed deposits treating cash, fixed deposits and bank guarantees furnished by the brokers as funds lying with the stock exchange. In 2015, SEBI constituted a committee on “Enhanced Supervision of The Stock Brokers” which included representatives from stock exchanges, depositories and brokers. The committee made its recommendations in 2015 which eventually led to the issuance of the circular dated September 26, 2016 wherein it provided for a formula to calculate client funds. The basic formula was the same, namely, that the sum total of funds lying in “client bank account” and cash and cash equivalents “lying with the exchange / clearing corporation” being client funds should always be greater than or equal to the sum total of all credit balances of fund payable to clients. The 2016 circular for the first time stated that while calculating client funds, the non-funded portion of the bank guarantee is supposed to be excluded and, therefore, the circular of 2016 which came into effect from July 1, 2017 started calculating the client funds on the basis of non-funded portion of the bank guarantee.

37. This method of calculation ("G" negative) which came into effect form July 1, 2017 as per the circular of 2016 is now being applied to the appellant's operations from April 1, 2011 to January 31, 2017 which is the inspection period in question.

38. In our opinion, the circular of 2016 does not state that it is in furtherance of the 1993 circular. The circular of 2016 came into effect from July 1, 2017 and cannot have retrospective operation to be applied for the period April 1, 2011 to January 31, 2017.

39. We find that while calculating the client funds, the AO in the impugned order has excluded the non-funded portion of the bank guarantee which requirement was introduced for the first time with effect from July 1, 2017 onwards. While excluding the non-funded portion, the AO on the basis of the table given in paragraph no. 75 of the impugned order has come to a conclusion that the appellant has misused the client funds which, in our opinion, is based on an erroneous application of the 2016 circular.

40. The contention of the learned senior counsel for the respondent that the calculation has been made on the basis of the

1993 circular and that the 2016 circular has no application cannot be appreciated in as much as the 1993 circular does not state anywhere that the non-funded portion of the bank guarantee has to be excluded. Every broker can obtain bank guarantee on the basis of differential margin depending on the goodwill and credit worthiness of the broker. If the broker enjoys a good relationship with its banks and gets bank guarantee at 50% margin, then SEBI cannot place an impediment and contend that the non-funded portion should remain in the client accounts. As stated earlier, once the money is debited from the clients account for a specified purpose and the specified purpose is valid, then it is not the business of the client or of SEBI to find out as to how the client money is being utilized thereafter so long as the end result is obtained and the monies finds its way into the settlement account, then everything else becomes immaterial.

41. The contention of the learned senior counsel for the respondent is, that even if full bank guarantee value was considered than over a period of six years i.e. during the inspection period from 2011 to 2017, the client funds were negative on 18 days. This contention cannot be considered in as much as we find that the AO has applied the requirement of considering the funded portion of the

bank guarantee with retrospective effect for the period prior to July 1, 2017.

42. In view of the aforesaid, we find that the impugned order holding that "it is the spirit" of 1993 circular which contains the requirement of considering only the funded portion of the bank guarantee is patently erroneous and cannot be sustained. The finding that the non-funded portion of the bank guarantee should be included in the usage of client funds i.e. "G value" is erroneous and cannot form the basis of calculation under the 1993 circular. The finding that the appellant had violated the 1993 circular both in letter and spirit is in complete defiance of the regulatory instructions is patently erroneous. The contention of the learned senior counsel that it is a gross case of repeated defaults is patently erroneous and against the evidence from record.

43. The learned senior counsel for the respondent has heavily placed reliance upon the decision of this Tribunal in ***Arihant Capital Markets Pvt. Ltd. (supra)*** which was followed in ***Asit C. Mehta Investment Interrmediates Ltd. vs. SEBI Appeal No. 92 of 2021 decided on January 3, 2023 and Kantilal Chhaganlal Securities***

Pvt. Ltd. vs. SEBI Appeal No. 391 of 2020 decided on March 24, 2022, wherein this Tribunal held that the formula in the enhanced supervision circular is a crystallization of the earlier formula. Further, the contention that the formula contained in the 2016 circular has been in practice even prior to the issuance of the said circular and is nothing but a numerical iteration of the principles already laid down in the 1993 circular is misplaced and cannot be accepted. At the outset, the 2016 circular was not in furtherance of the 1993 circular. The 2016 circular did include certain directions of the 1993 circular and, therefore, in that respect this Tribunal held in ***Arihant Capital Markets Pvt. Ltd. (supra)*** that the "said formulization is nothing but the crystallization of the earlier circular."

44. This Tribunal in the aforesaid decisions has not held that the 2016 circular reiterates that the 1993 circular. A perusal of the 1993 circular and 2016 circular would show that they are vastly different. In this regard, we find that SEBI issued the circular on September 26, 2016 which was to be implemented from July 1, 2017. SEBI then extended the time for implementation and, in this regard, the stock exchange issued 17 clarificatory circulars to enable its

implementation. We are of the opinion that if the 2016 circular was only a reiteration of 1993 circular, then there was no need for the respondent to issue 17 clarificatory circulars.

45. The 1993 circular nowhere stipulates any formula for computation of deemed misuse of client funds. The 1993 circular only provides the principles of segregation of the client funds from brokers' own fund. We find that this Tribunal in the matter of ***Arihant Capital Markets Pvt. Ltd. (supra)*** was not called upon to decide whether the funded portion of the bank guarantee was to be taken into consideration while calculating the balances with the stock exchange / clearing corporation. The treatment of bank guarantee introduced in the 2016 circular was not existing in the 1993 circular and the treatment of this bank guarantee introduced in 2016 circular was not considered by this Tribunal in ***Arihant Capital Markets Pvt. Ltd. (supra)*** matter and in other cases cited by the respondent. Thus, merely picking up the phrase from the order passed by this Tribunal does not give any right nor can it hold that the 2016 circular was a reiteration of the 1993 circular.

46. We are also of the opinion that the principles of strict interpretation have to apply in the instant case. The participants must know the rules of the game before the game has begun which cannot be changed midway retrospectively to then state that the spirit has always existed. It is not disputed that all the inspections carried out since inception till the inspections in question never raised any observation that only funded portion of the bank guarantee was to be considered. These inspections found no misutilization of the client funds. Admittedly, there has been no misuse of client funds and by wrongly considering the non-funded portion of the bank guarantee as per the 2016 circular, an attempt has been made out to show that there was a misuse of client funds which, in our opinion, is patently erroneous.

47. On account of the aforesaid, the direction of the WTM debarring the appellant under the Intermediaries Regulations from taking new client for a period of two years cannot be sustained.

48. On the same footing, the AO has imposed a penalty of Rs. 1 crore under Section 23D of the SCRA. For facility, the said provision is extracted hereunder :-

> *"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."*

49. Since we have already held that there is no misuse of the clients funds and since there is no failure on the part of the appellant to segregate monies of the client nor monies of the client have been misused by the appellant for its own purposes, no penalty under Section 23D of the SCRA could be imposed. However, we find that the appellant has failed to change the nomenclature of the bank accounts of the client as required to be done under the 1993 circular. Even though, it is a technical breach and there is no misuse of the client funds, nonetheless, if something is required to be done in a particular manner and the same is not done in that fashion, then there is a violation of that circular. Considering the aforesaid that it is only a technical breach, we are of the opinion that in the given circumstances for the two show cause notices, a penalty of Rs. 20 lakh in total would be sufficient for the purpose of this case.

50. Before parting, we fail to understand that when several inspections were made from 2011 to 2017 on the same cause of action and upon an alleged violation being found, the AO should have initiated only one proceeding instead of two proceedings. In our opinion, it does not stand to reason as to why two separate proceedings have been initiated for the same cause of action by bifurcating the period when the whole period could have been taken as one cause of action and proceedings could have been finalized on that basis.

51. In view of the aforesaid, all the appeals are partly allowed. The finding given by the WTM and the AO on the issue of nomenclature of the client accounts being violative of the 1993 circular is affirmed. All other findings are set aside. Consequently, the direction of the WTM restraining the appellant from taking new clients for a period of two years is set aside. The penalty imposed by the AO is reduced to Rs. 20 lakh. Any amount deposited in excess in terms of our order shall be refunded to the appellant within four weeks from today.

52. In the circumstances of the case, parties shall bear their own costs.

Justice Tarun Agarwala
Presiding Officer

Ms. Meera Swarup
Technical Member

07.12.2023
PTM