WTM/ AB / SEBI / MIRSD/ NRO / 06/ 2019-20

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

UNDER SECTIONS 11(4), 11B AND 11D 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 RESPECT OF

Notice e No.	Entity Name	PAN No.
1	**Allied Financial Services Private Limited**	**AAACA2020K**
2	Mr Rajeev Kumar Asopa	**AASPA3260C**
3	Mr Lalit Agarwal	**AFKPA9024P**
4	Mr Rajendra Prasad Basia	**AAEPB2709B**
5	Mr Awanish Kumar Mishra	**AGOPM7538H**
6	Mr Jitendra Kumar Tiwari	**ALBPT6629A**
7	Money Mishra Financial Services	**AAZFM1357R**
8	Money Mishra Overseas Pvt. Ltd	**AAJCM8612N**
9	M/s Mutual Fund Digilocker LLP	**ABJFM9337L**
10	Mr Pankaj Garg, Partner, M/s Digi locker	**AERPG5388J**
11	Mr Jitender Malhotra, Partner, M/s Digi locker	**ALRPM2119G**

(The aforesaid entities are hereinafter referred to by their respective names / serial numbers or collectively as "the Noticees")

---

1. An interim order was passed in the instant matter on February 27, 2019 (**'interim order'**), wherein, inter alia, the Noticees were debarred from accessing the securities markets, until further directions. The said interim order was in the nature of a show cause notice wherein the Noticees were asked to file objections, if any, within 21 days from the receipt of the interim order and in the event the Noticees failed to file reply or appear for

personal hearing, the findings in the interim order and the directions contained therein would be confirmed against such Noticees.

2. Noticee no. 10 & 11 have filed a joint reply dated 15/03/2019. Noticee no. 2, 3 and 4 have filed their replies dated 18/03/2019, 20/03/2019 and 18/04/2019. Further an opportunity of personal hearing was also granted to all the Noticees on March 25, 2019. Noticee no. 2 to 4 were heard on the said date. Noticee no. 1, 5, 6, 7 and 8 had sought adjournment and further time to file their reply. Noticee no. 10 and 11 were not present for the scheduled hearing on March 25, 2019. Noticee no. 1, 5, 6, 7, 8, 10 & 11 were given another opportunity of personal hearing on April 5, 2019 and were heard on the said date. Noticee no. 1, 5, 6, 7 and 8 have filed their reply dated March 27, 2019. Noticee no. 1 has also filed additional submission dated 22/04/2019. All the Noticees (except Noticee no. 9) have filed 'declaration of assets' as directed in the interim order.

Consideration of Issues and Findings:

3. On the basis of inspection report of NSE, the interim order had alleged that, as on 31st January, 2019, there were client payables of Rs. 138.78 Cr., against which funds of only Rs. 44.42 Crore were available with Allied Financial Services Pvt. Ltd. ('**AFSPL'**) in bank/clearing corporation/clearing member and Exchange. Thus, as on 31/01/2019, there was a shortfall of Rs. 94.42 Cr. payable to the clients by AFSPL and the same was in violation of Clause 1 (d) of SEBI circular no. SMD/SED/CIR/93/23321 dated 18/11/1993, Clauses 2.4.1 and 2.4.2 of SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26/09/2016 However, Noticee no. 1 has contended that the aforesaid observation is based on incorrect figure of 'Creditors Payable' that was taken by NSE inspection team and AFSPL had sufficient funds in hand to meet out its liability. Noticee no. 1 has contended that there were 'Creditor's Payable' to the tune of Rs. 44.14 Cr. as on 31/01/2019, as against a figure of Rs. 138.78 Cr., which was taken by the NSE inspection team to calculate the shortfall. I note that Noticee no. 1 in its reply has

furnished a list of 'creditors payable' as on 31/01/2019. In the said list Noticee no. 1 has excluded the entries of some clients, such as Awanish Kumar Mishra (Noticee No. 5), Primarc Projects Private Limited, Money Mishra Overseas Pvt. Ltd. (Noticee No. 8), Glow Homes Technologies Pvt. Ltd., Money Mishra Financial Services (Noticee No. 7), Dal Chandra Rastogi, Tejswi Impex Pvt. Ltd., as 'creditor's payable'. However, in the trial balance provided to NSE during inspection the said clients were included as 'creditors payable'. I note that Noticee no. 5, 7 and 8 are related and associated entities of Noticee no. 1 and Noticee no. 1, in order to avoid the consequences of this proceeding appears to have excluded Noticee no. 5, 7 and 8 from 'creditors payable', whereas the said Noticees were shown as 'creditors payable' in the trial balance which was submitted to the NSE inspection team. Hence, prima facie the evidence produced by Noticee no. 1 cannot be relied upon and a clear magnitude of the 'creditor's payable' and the resultant shortfall of funds, if any, may be known after the completion of the ongoing forensic audit of AFSPL.

4. The inspection report of NSE had observed and it is alleged in the interim order that on verification of back office Register of Securities (ROS) as on January 31, 2019 vis-a-vis the holding statement of the Beneficiary Account of AFSPL and the securities lying with the Clearing Member, the securities amounting to Rs. 0.34 crores were not available either in DP account or with Clearing Member. Further, NSE inspection also observed that securities amounting to Rs 0.35 crore which were reflected in the DP account of AFSPL were not found to have been recorded in the ROS. Therefore, Noticee no. 1 was alleged to have violated the provisions of SEBI circular no. SMD/SED/CIR/93/23321 dated 18/11/1993, clauses 2.4.1 and 2.4.2 SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26/09/2016. Noticee no. 1 in its reply dated 27/03/2019 has contended that the aforesaid observations of NSE inspection team are on account of calculation error and therefore incorrect. Noticee no. 1 submits that the securities mentioned in ROS duly tally with securities in DP account, for which Noticee no. 1 has furnished a CA certified reconciliation

statement along with its reply. However, I note that Noticee no. 1 has not provided the copies of ROS and the holding statement of its DP account to verify the entries in the reconciliation statement, and even if the copies of ROS and the holding statement of DP account were submitted, the same needs to be verified and determination of facts can be arrived after completion of ongoing forensic audit.

5. The NSE inspection report had observed and the interim order had alleged that as on 30/11/2018, there were funds and securities worth Rs. 37.48 Cr. of 102 inactive clients, which have not been settled. It had further observed, among the said inactive clients, there were 27 inactive clients who have never traded on the Exchange platform. The value of funds and securities of these inactive clients is around Rs. 4.60 crores that have not been settled. Thus, Noticee no. 1 is alleged to have violated Clause 12 (e) of SEBI circular no. MIRSD/SE/Cir-19/2009 dated 03/12/2009, and Clause 8.1.1 of SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26/09/2016, that mandate that a stock broker shall do the actual settlement of funds and securities of its clients on quarterly/monthly basis. In their reply dated 27/03/2019, Noticee no. 1 states that the alleged observation is based on data as on 30/11/2018 and in accordance with the SEBI regulations, AFSPL was required to settle client accounts on 'quarterly basis' and the relevant quarter was Sept-Dec 2018. Noticee no. 1, has furnished a copy of the CA certificate certifying the settlement of funds and securities of active clients as on 31/12/2018. I note that AFSPL in its reply is conveniently not referring to inactive client settlement. It has furnished CA certificates with respect to only active client settlement. I note that the NSE inspection report is drawing adverse observations in respect of non-settlement of inactive client. I note from Exhibit 2, attached to the SCN dated February 7, 2019 issued by NSE (provided by Noticee no. 1 with its reply dated 27/03/2019), that several inactive clients have not been settled by Noticee no. 1. Some of the inactive clients such as Mrs. Jyotika Kapoor and Mr. Suneet Gupta, who have last traded in December 2017,

appears to have not been settled by the Noticee in any of the three quarters till 30/11/2018. The value of funds and securities of these two inactive clients is around Rs. 44.25 lacs and Rs. 3,358 respectively that appears to have not been settled. Further, I also find some clients like Anil Verma & Sons HUF and Mr. Kirpal Singh Virdi which have never traded on the exchange platform, but their accounts appears to have not been settled. The value of funds and securities of these two inactive clients is around Rs. 58.50 lacs and Rs. 27.78 lacs respectively that appears to have not been settled. I note that the aforesaid client names are merely few examples to mention, but there are around 102 such inactive clients which NSE had observed during inspection which were not settled by AFSPL. Hence, I do not find any merit in the contentions raised by Noticee no. 1 in this regard.

6. The inspection report of NSE has observed and the interim order has alleged that AFSPL has misused client's funds on the following grounds:

   i. **Client's funds used for purpose other than specified/non-segregation of transaction between Own and client bank a/c**: NSE inspection report had observed and the interim order had alleged that AFSPL has not segregated transactions between own and client bank a/c. in 44 instances. It was observed that an amount of Rs. 19.72 crores has been transferred from Client to Own Bank a/c. and Rs. 3.89 lacs has been transferred from Own to client bank a/c., resulting in net transfer of Rs. 19.68 crores from client to own bank a/c. Noticee no. 1 is alleged to have violated Clause 1, Clause 1C, Clause 1D of SEBI circular no. SMD/SED/CIR/93/23321 dated 18/11/1993, which inter alia stipulates that the funds of client and Own funds shall be kept in separate bank accounts and transfer from Own to client bank a/c. and vice versa shall be permitted for limited purposes mentioned therein. It is also alleged in the interim order that AFSPL has not maintained a daily reconciliation statement recording the reasons for transfer of funds between own and client bank a/c. Noticee no. 1 in its reply denies having

knowledge of any requirement laid down by SEBI that mandates the maintenance of such reconciliation statement. I note that AFSPL has not maintained a daily reconciliation statement that has been mandated by SEBI in accordance with Clause 2.4.2 of SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26/09/2016.

NSE inspection report on the basis of the transfer from client bank a/c. to own bank a/c. has observed and interim order had alleged that in one instance client funds were used for investment in own property and donation in own name. Noticee no. 1 submits that the transfer from client bank a/c. to Own bank a/c. was done since, AFSPL was eligible to transfer the said balance from the client on account of brokerage, delayed payment charges and NSE transaction charges. Hence, there is no misutilisation of client's funds, according to Noticee no. 1. However, I note that in the absence of the daily reconciliation statement, it would be difficult to rely on any account ledgers being provided by Noticee no. 1 to prove that the transfer of funds from client bank a/c. to Own bank a/c. was on account of brokerage, delayed payment, NSE transaction charges etc. as claimed by Noticee no. 1. Nonetheless, despite the absence of daily reconciliation statement, even if I proceed to examine the contention raised by Noticee no. 1, I find that, the findings in the NSE inspection report on this issue, is based on the inspection of client bank a/c, Own Bank A/c and client ledgers, for the period from Nov 2017 to July 2018. However, the Annexures (copies of ledgers) submitted by Noticee no. 1 in support of their claims for alleged brokerage, delayed payment charges and NSE transaction charges are for the period from 1/04/2017 to 31/03/2019. Further, I find that the account 'Delayed Payment Charges' is not reflected in the trial balance as on January 31, 2019, that was submitted to NSE during inspection by Noticee no. 1. Furthermore, it is also pertinent to note that all the entries reflected in the 'Delayed Payment Charges'

ledger account as furnished by Noticee no. 1 with its reply, are dated 31/01/2019 .i.e. Noticee no. 1 had levied the delayed payment charges to its client's account on one single day, out of an entire period of 22 months and that too post NSE inspection. Hence, in the absence of the daily reconciliation statement, I find the reasoning given by Noticee no. 1 that the client owed brokerage, delayed payment charges and NSE transaction charges to AFSPL and there is no misutilisation of funds cannot be accepted at this stage.

ii. **Use of client funds to meet proprietary obligations:** NSE inspection had observed that on all five sample dates, client funds were used to meet proprietary obligation amounting to Rs. 88.29 crores. The following table illustrates the alleged violation;

Date	**Pro Loss (A)**	**Client Loss (B)**	**Net (C=A-B)**	**Pro ledger balance (D)**	**Funds of clients used for pro obligation (E=D-A) if D is Positive or value of A**
28-12-2017	-75434384	-142594879	-218029263	-146315552.6	75434384
31-01-2018	-515173563	515192238	18,674.75	122464385.4	392709178
8/2/2018	-334749368	364614943	29865575.25	-98028619.47	334749368
16-10-2017	-91941240	87247715	-4693525.5	54856871.55	37084368
24-11-2017	-79889035	43000491	-36888544	-79372846.04	43000491
				Total	**88,29,77,788.85**

Noticee no. 1 is alleged to have violated Clause 1 (d) of SEBI circular no. SMD/SED/CIR/93/23321 dated 18/11/1993, clauses 2.4.1 and 2.4.2 SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated 26/09/2016 that inter alia stipulate that client's funds shall not be used for any other purpose except for those specified therein**.** Noticee no. 1 submits that NSE inspection team omitted/skipped to consider ABC margin available with clearing member of AFSPL and if the same was taken into consideration, alleged observation would not exist. I note

that 'Pro Ledger' balance as maintained by AFSPL ought to have incorporated ABC margin as well. The following Table is produced by Noticee no. 1 in its reply dated 27/03/2019 to support its argument:

DATE	PRO OBLIGATION	ABC MARGIN BALANCE	PRO LEDGER BALANCE	Money Mishra Financial Services	Money Mishra Overseas Pvt Ltd	Awanish Kumar Mishra	TOTAL OWN FUND	NET SURPLUS FUND AFTER PRO OBLIGATION
	A	B	C	D	E	F	G=C+D+E+F	H=G-A
28.12.17	-75434384	935000000	-146315552.6	686398268.5	0	143124947	683207662.8	607773278.8
31.01.18	-515173563	948800000	122464385	222990292.2	0	251115113.9	596569791.1	81396228.08
08.02.18	-334749388	907800000	-98028619	329049137.4	0	392585501.3	623606019.7	288856651.7
16.10.17	-91941240	977225000	54856871	635142429.4	0	6081257.05	696080557.4	604139317.4
24.11.17	-79889035	633825000	-79372846	450155708.1	0	-27728518.43	343054343.6	263165308.6

It is pertinent to note that in its reply dated 27/03/2019, Noticee no. 1, in the Table provided as above, has included the ledger balances of Noticee no. 5, 7 and 8, as its own funds and thus, shown that if the ledger balances of Noticee no. 1, 5, 7 and 8 were taken together, then there was a net surplus fund available after meeting the 'Pro Obligations' for the relevant dates. However, I note that Noticee no. 5, 7 and 8 are the clients of Noticee no. 1 and hence, their ledger balances cannot be clubbed with the 'Pro Ledger' balance of Noticee no. 1, even if the Notice no.5, 7 and 8 are related/associated with Noticee no.1. Therefore, there is no merit in the contentions raised by Noticee no. 1.

iii. **Payment made to client's without having sufficient balance in their ledger:** NSE inspection team has observed that payment to the following five clients amounting to Rs. 26.42 crores were made in excess of balances available in their ledgers:

Client Code	Client Name	Payment made (Rs.)
C4546	Cointribe Technologies Pvt.Ltd.	25,31,93,713
C4559	J J Tradelinks Pvt.Ltd.	1,00,00,000
C4560	Orchha Vikas Pvt.Ltd.	10,23,000
C4622	Rkz Financial Consultancy LLP	9,100
C4590	Citizen Medicare Pvt.Ltd.	24,000
		26,42,49,813

a. I note that NSE inspection team has observed that payment to Cointribe Technologies Pvt. Ltd. were made in excess of its ledger balance. To this, Noticee no. 1 submits that the accounts of Cointribe Technologies Pvt. Ltd. must be seen alongwith the account of Antorday Commercial and Holdings Pvt. Ltd., since Noticee no. 1 has treated both these accounts as 'Group Accounts' as they were run and operated by Dalmia/OCL Group, the authorised signatories for both these accounts are the same and both the accounts have common shareholders. I note that Cointribe Technologies Pvt. Ltd. and Antorday Commercial and Holdings Pvt. Ltd. are two separate corporate entities and they ought to have been treated separately for accounting purposes, margin obligation and settlement purposes. I note that NSE vide Circular no. 38154 dated June 27, 2018 and Circular no. 25612 dated June 20, 2014, allows for treating of two accounts as 'related' but only for collecting and reporting margin obligation. One of the instance when two accounts are treated as 'related' in accordance with the aforesaid circular is when one corporate entity is the promoter and controlling shareholder of the other corporate entity. In the instant case, it is not the case of Noticee

no. 1 that Cointribe Technologies Pvt. Ltd is the promoter and controlling shareholder of Antorday Commercial and Holdings Pvt. Ltd. or vice versa. Further, I note that inter-client settlement is prohibited by virtue of Clause 12 (i) of Annexure of SEBI Circular MIRSD/ SE /Cir-19/2009 dated December 03, 2009. Hence, in any case, Noticee no. 1 cannot treat the said account as a Group Account with other clients.

b. NSE inspection team has observed that payout to JJ Tradelinks Pvt Ltd. were in excess of their ledger balance. Noticee no. 1 submits that payout of Rs. 1 Cr. to the said client was released in good faith as an interim measure against an undated cheque which was given as security for the said amount. I note that without having any underlying transaction related to securities market, the said payout of 1 Cr. appears to be in the nature of a lending transaction, which stock-brokers are otherwise forbidden from carrying out under Rule 8 (1)(f) and Rule 8 (3)(f) of Securities Contract (Regulation) Rules, 1957 which mandate that a stock broker should not undertake any activity involving any personal financial liability.

c. NSE inspection team has observed that Noticee no. 1 has made payouts to RKZ Financial Consultancy LLP, Citizen Medicare Pvt. Ltd. and Orchha Vikas Pvt. Ltd. in excess of their ledger balances. Noticee no. 1 submits that payouts to aforesaid accounts were made on account of reversal of brokerage. Additionally, Noticee no. 1 has stated that, in case of Orchha Vikas Pvt. Ltd, a partial amount was paid to the said client on account of a trade dispute resolution, but I note that, Noticee no. 1 has merely made a plain submission without any evidence in support thereof. Noticee no. 1 has failed to provide any details in respect of the nature of the dispute, the forum before which the dispute was pending or even the copy of the complaint filed by Orchha Vikas Pvt. Ltd .etc.

Therefore, I am not convinced with the contentions raised by Noticee no. 1 in respect of any of their averments in relation to the aforesaid allegations of misuse of client funds.

7. I note that SEBI had received a complaint dated February 8, 2019 (received on 11/02/2019) from Dalmia Cement East Ltd. and OCL India Ltd. alleging that Mutual Funds securities worth Rs. 344.07 Cr were fraudulently transferred from their demat account to the demat account of Noticee no. 5, 7 and 8. The said complainant stated that Noticee no. 1 was their Depository Participant and that they suspect the role of Noticee no. 1 in the alleged fraudulent transfer. Further, NSE inspection report had also observed transfer of Mutual Fund securities from Dalmia Cement East Ltd., OCL India Ltd. and Dalmia Cement (Bharat) Ltd. to Noticee no. 5, 7 and 8. Further, on 31/12/2018, SEBI had also received a complaint on SCORES platform from Novjoy Emporium Pvt. Ltd. (client of AFSPL) that Mutual Fund securities worth Rs. 21.70 Cr., were fraudulently transferred from their demat account to the demat account of Noticee no. 9, in which Noticee no. 10 and 11 are partners. I note that NSE inspection report observes that Mutual Fund securities were transferred from Novjoy Emporium Pvt. Ltd. to Noticee no. 5, 7 and 8, through Noticee no. 9. NSE inspection report also observes that Noticee no. 5, 7 and 8 had used the mutual fund securities as collateral to meet their margin obligation with clearing member of AFSPL i.e. IL&FS Securities Services Ltd. (**'ISSL'**). I note that an independent investigation is being conducted by SEBI to look into both the aforesaid complaints of alleged transfers of mutual fund securities (hereinafter referred to for each complaint and both the complaints collectively as '**Alleged Transfer'**).

8. I note that Noticee no. 1, 5, 7 and 8 have contended that the mutual fund securities in question have been procured by them by way of loan from the transferors, on the basis of duly executed DIS slips, and that they have not fraudulently obtained any of these securities. Noticee nos. 1, 5, 7 and 8

further contend that there is no embargo in law that prohibits transfer of mutual fund securities as loan. I note that Noticee no. 1, 5, 7 and 8, alongwith their reply dated 27/03/2019, have provided copies of some DIS slips that were used for some of the transfers in question and have also furnished a Forensic Examination Report obtained by them that purportedly confirms that the DIS slips used for transfer of mutual fund units bear the signature of authorized signatories of transferors i.e. certifying that the signature on DIS slips are genuine. I also note that Noticee no. 1, 5, 7 and 8 have not provided any evidence to show that the mutual fund securities were given to them on loan such as copy of subsisting Loan Agreement, details of the Loan arrangement such as period of loan, rate of interest, purpose of loan, terms of repayment, parties to the arrangement, security/collateral arrangement for the said loans, etc. I note that Noticee no. 1, 5, 7 and 8 have made plain statement that the securities in question were procured by way of loan without any evidence and supporting details. I also note that Dalmia Cement East Ltd. and OCL India Ltd. have filed complaints with Economic Offences Wing (EOW) Delhi Police in respect of the alleged unauthorised transfer of mutual funds units by Noticee no. 1, 5, 7 and 8. Further, on the directions of EOW, Delhi a freeze has been ordered on the further movement of these securities. I also note that ISSL (clearing member of Noticee no. 1) has moved a Writ Petition before the Hon'ble High Court at Delhi challenging the directions of EOW, Delhi Police directing a freeze on the said securities.

9. The NSE inspection report had observed and it is alleged in the interim order that AFSPL has not maintained the requisite net-worth and thereby violated Regulation 9 (g) of SEBI (Stock Brokers & Sub Brokers) Regulations, 1992, which states that a stock broker shall at all times maintain the minimum net worth as prescribed in the regulations. However, I note that while making this observation, the date on which the net-worth was found to be insufficient was not mentioned in the interim order. Hence, in its reply, Noticee no. 1 has assumed the date of such observation to be 30/07/2018 and showed that the calculation of net-

worth by NSE inspection team was incorrect. I note that the date of observation of insufficient net-worth in the interim order was 30/09/2018. I also note that this date of observation of insufficient net-worth was known to Noticee no. 1, through NSE SCN dated February 7, 2019 which was issued to it by NSE, which clearly indicated the date of observation of insufficient net-worth as on 30/09/2018 and the copy of the NSE SCN has been enclosed by Noticee no. 1 with its reply dated 27/03/2019, in the present proceeding. Hence, I note that Noticee no. 1 has conveniently ignored the date of observation and chosen to rely on its own assumed date of observation and has attempted to prove that there was sufficient net-worth on the assumed date. The Noticee no. 1 has also not contended anything in respect of insufficient net-worth as on 30/09/2018.

10. The interim order has alleged that AFSPL had done incorrect margin reporting on 7 instances pertaining to 7 clients amounting to Rs. 328.34 Crore in F & O segment. I note that while calculating the incorrect margin reported to the Exchange, value of mutual funds securities have not been considered as collateral. It is alleged that by incorrect margin reporting Noticee no. 1 has violated Clauses 6 and 7 of SEBI Circular CIR/DNPD/7/2011 dated August 10, 2011, Clause A (5) of the code of conduct as specified in Schedule II of Regulation 9 (f) of SEBI (Stock Brokers & Sub Brokers) Regulations, 1992. However, it is contended by Noticee no. 1 that if the value of mutual fund securities are included then there is no incorrect margin reporting by AFSPL. However, I note that despite inclusion of mutual fund securities, the margin reporting in case of two clients viz. Ennar Portfolio LLP and Awal Portfolio LLP are still incorrect. I observe that in its reply dated 27/03/2019, Noticee no. 1 has only taken the value of initial margin and not included the 'exposure margin' and 'MTM margin' which is required to be collected and reported with effect from July 2, 2018 in terms of the SEBI circular no: SEBI/HO/MRD/DRMNP/CIR/P/2018/75 dated May 02, 2018. Hence, I find that there is incorrect margin reporting by AFSPL on at least two

instances pertaining two clients i.e. in case of margin of Ennar Portfolio LLP on 10/09/2018 and Awal Portfolio LLP on 11/09/2018.

11. The NSE inspection team has observed and it is alleged in the interim order that AFSPL has been running an 'assured return scheme', since an analysis of the client bank account and client ledger reveals that payments to 27 clients have been made at regular intervals in co-relation to their credit balance of funds/securities that are available with AFSPL. The inspection report points out that the payouts to these 27 clients are not in accordance with funds payout arising out of transaction associated in securities. It is alleged that Noticee no. 1 has Clause A (1), (2), (3), (4) and (5) and Cause B (4), (6), (7) and (8) of the code of conduct as specified in Schedule II of Regulation 9 (f) of SEBI (Stock Brokers & Sub Brokers) Regulations, 1992. Noticee no. 1 has contended that the payout in question were given out of credit balance available in the respective accounts of the clients and that no interest at any rate was credited to the said accounts. Noticee no. 1 has stated that, after making payments, the credit balances in the respective accounts have gone down which clearly indicates that there was no payment towards assured returns or any other returns whatsoever. I note that Exhibit 6 to the NSE SCN (which is annexed as Annexure 1 to the reply of Noticee no. 1), gives a list of payouts to 27 clients. This list indicates that several payouts were made to these clients at regular intervals with almost intra-client consistent amounts. I note that the NSE inspection report also states that these payouts are not supported by corresponding transactions in securities. Hence, I find that these payouts made at regular intervals and reflecting almost intra- client consistent amounts, raise prima facie suspicion of an 'assured returns scheme' being run by AFSPL, which further needs to be examined in the Forensic Audit. In the meantime, after the passing of the interim order in the instant matter, SEBI has received complaints from eighteen clients of AFSPL alleging that Noticee No. 1 has taken their money assuring them to pay it back with interest. I note that the said complaints have also been

forwarded to the stock exchange so that the Forensic Auditor may examine these claims.

12. The NSE Inspection report has observed and it is alleged in the interim order that AFSPL had done the following wrong reporting under the monthly enhanced supervision framework as laid down by SEBI circular no. SEBI/HO/MIRSD/MIRSD2/CIR/P/2016/95 dated September 26, 2016:

i. **Wrong reporting of client's securities**: The NSE inspection report observes that as on July 27, 2018, AFSPL has wrongly reported details of client's securities in case of 32 instances pertaining to 31 clients in involving an amount an amount of Rs. 65.59 lacs and further it has also not reported securities details of 7 clients amounting to Rs. 102.96 lacs. As regards the said allegation, Noticee no. 1 has contended that there was an error in the Enhanced supervision software which was later rectified by the NSE approved vendor, which resulted in the aforesaid mismatch. Noticee no. 1 further states that the error was earlier reported to NSE and their executives have also confirmed that was an error in the enhanced supervision software.

ii. **Wrong reporting of Pledging Client Securities:** It has been alleged that AFSPL has misreported of having pledged client securities in case of 2 clients as on July 27, 2018. I note that Noticee no. 1, admits that on account of back-office software error the wrong reporting has happened and further submits that AFSPL has never pledged any shres of its clients.

iii. **Wrong reported details of financial balance of all clients:** It is alleged that AFSPL has reported NIL balance of all clients as on July 27, 2018. However, NSE inspection found that it has 251 clients as debtors amounting to ₹ 281.45 Crores and creditors amounting to

₹45.11 Crore as on July 27, 2018. I note that Noticee no. 1 submits that it was a case of back office software error.

It is the case of Noticee no. 1 that the aforesaid errors took place because of an error in the Enhanced Supervision Reporting software as well as technical glitch in the back-off software of AFSPL. However, it is pertinent to mention that, though it is claimed by Noticee no. 1 in its reply that the error in respect of Enhanced Supervision software was reported to the Exchange, but Noticee no. 1 has not provided any evidence of communication with the exchange in this regard. Noticee no. 1 has also not provided any evidence of confirmation as claimed to have been received from the executive of the exchange acknowledging the software error in the Enhanced Supervision Reporting software of Noticee no. 1. I further note that Noticee no. 1 has stated in its reply that the aforesaid back-office errors were duly corrected and reported to NSE. However, NSE has confirmed vide its email dated 07/05/2019 that no corrections/resubmissions were reported by AFSPL for its monthly client funds and securities balance that is reported as on July 27, 2018, and the corrections in the data as claimed by AFSPL may have been done in the succeeding month's Enhanced Supervision Report. Hence, the contention of Noticee no. 1 does not have any merit.

13. Noticee no. 2 to 4 have contended that they have ceased to be the directors of AFSPL from November 29, 2016, August 30, 2017 and November 18, 2016 respectively i.e., prior to the change of management of AFSPL. The Noticee no. 2 to 4, have contended that AFSPL had entered into an SPA with Money Mishra Securities Pvt. Ltd. (**'MMSPL'**) and other shareholders of AFSPL on July 9, 2016, pursuant to which there was a change of shareholding, resulting into change of control, at AFSPL. The said Noticees also submit that, it was specifically agreed in the SPA that after the transfer of shares of AFSPL was completed, AFSPL shall pass all necessary resolutions to effect the resignation of Noticee no. 2 to 4 and do the requisite compliance with RoC. It is the case of the said Noticees that

the change of control-cum-management at AFSPL took several months to materialize which involved the seeking of permission for 'change in control/management' from NSE, NSDL and SEBI. The said Noticees further submit that during the course of this exercise, the new management of AFSPL failed to file FORM DIR-12 with MCA for cessation of directorship of Noticee no. 2 to 4. Hence, the Noticee no. 2 to 4 should not be jeopardized for the failure of AFSPL to file the requisite e-Forms with RoC.

14. I find that AFSPL in its Board meeting held on November 5, 2017, accepted the resignation of Noticee no. 2 to 4 and had authorised Noticee no. 5 to file e-form DIR-12 with the RoC. However, the said eform was not filed with the RoC by AFSPL, until March 2019. I note the effective date of resignation as being mentioned in the relevant eform DIR- 12, being 18/11/2016 for Noticee no. 4, 29/11/2016 for Noticee no. 2 and 30/08/2017 for Noticee no. 3. I also note that Noticee no. 1, 5 and 6 have not raised any objections/ allegations/ adverse remarks against the role of Noticee no. 2 to 4, either in their reply or at the time of personal hearing. The violations alleged in the interim order are for the period from 01/05/2017 to 31/01/2019. I also note that Noticee no. 2 to 4 have filed undertakings in respect of any liability that falls upon them in the present proceedings. On the basis of the said undertakings, the restrictions imposed in the interim order on the operation of the bank accounts of the said Noticees were revoked after the personal hearing held on 25/03/2019. Therefore, in view of the above, I find that continuation of interim directions in force, against Noticee no. 2 to 4 may not be warranted at this stage. However, if the involvement of Noticee nos. 2 to 4 is found in the Forensic Audit or the investigation/inquiry by SEBI, they shall also be liable in accordance with law.

15. Noticee no. 10 and 11 have submitted that they were working with Noticee no. 7 as a Dealer and thereafter from July 2017, they were appointed as Dealer by Noticee no. 1. They have contended that Noticee

no. 1 was their employer and it was Noticee no. 1 who had set up the firm 'Mutual Fund Digi Locker LLP' (Noticee no. 9). Noticee no. 10 and 11 claim that after setting up Noticee no. 9, the Noticee no. 1 opened a demat account in the name of Noticee no. 9, as the Noticee no. 1 itself was the DP. They also claim that Noticee no. 1 has executed a PoA in its favour for operating the said demat account of Noticee no. 9. The Noticee no. 10 and 11 have denied having knowledge of any transfer of mutual funds units being made into the demat account of Noticee no. 9 from Novjoy Emporium Pvt. Ltd. and further transfer of the said securities from demat account of Noticee no. 9 to the demat account of Noticee no. 5, 6 and 7.

16. I note that Noticee no. 10 and 11 have admitted being employed with Noticee no. 1. I also note that, it is not the case of Noticee nos. 10 and 11 that they have fraudulently been made the partners of Noticee no. 9. Neither is the case of Noticee no. 10 and 11 that the said demat account of Noticee no. 9 has been fraudulently opened by Noticee no. 1. Rather Noticee no. 10 and 11 claim to have acted under employer-employee relationship on the directions of Noticee no. 1 and its incumbent directors. The Noticee no. 10 and 11 further contended that without their knowledge/consent, the alleged mutual funds securities were credited and debited from the demat account of Noticee no. 9 and they came to knew about the Alleged Transfer only vide the SEBI interim order. I note that Noticee no. 10 and 11 are the only partners of Noticee no. 9. I note that despite the purported knowledge (vide interim order) of the Alleged Transfer of mutual funds units through Noticee no. 9, the Noticee no. 10 and 11 have not lodged any complaint with any authority including SEBI, to complain about the alleged fraudulent transfer. They have merely denied having knowledge of the Alleged Transfer in the reply to this proceeding and have failed to show any other steps being taken by them to remedy the anomaly. I note that Noticee no. 10 and 11 were employees of Noticee no. 1 and they are partners of Noticee no. 9 (which is an LLP). It is alleged in the complaint dated 31/12/2018 from Navjoy Emporium Pvt. Ltd. to SEBI, that certain mutual funds amounting to Rs. 21.70 Cr., were transferred

from their demat account into the demat account of Noticee no. 5, 6 and 7, through the demat account of Noticee no. 9. Therefore, Noticee no. 10 and 11 appear to be conveniently denying knowledge about the Alleged Transfer of mutual fund securities, only to escape the consequences of the present proceedings. Hence, I am of the view that the interim directions must be confirmed against Noticee no. 9, 10 and 11.

17. Noticee no. 1, 5, 6, 7 and 8 contend that the present case does not call for an ex-parte ad-interim order with such wide ramifications since there exist no element of urgency. The said Noticees further contended that the violations referred in the NSE inspection report are for the period from 01/05/2017 to 31/01/2019 i.e. for a period of two years and 7 months and most of the alleged violations are such which arise during the normal course of working and which could have been addressed by having resort to other mechanism available with the Exchange such as by issuing advice, caution, imposing penalty, suspension, termination etc. According to the said Noticees such violations do not call for passing of ex-parte ad-interim order as was done in the present case. The said Noticees have placed reliance on the order of Hon'ble SAT dated 13/03/2019 in the matter of *North End Foods Marketing Pvt. Ltd v. SEBI*. Noticee no. 1, 5, 6, 7 and 8 further contend that the complaints made by Dalmia Cement East Ltd., and OCL India Ltd should have been lodged with SCORES platform and the routine dispute resolution method of forwarding complaint to the depository and seeking their reply should have been followed. According to the said Noticees no such mechanism of dispute resolution was adopted in the present case.

18. In respect to the aforesaid contention of Noticee no. 1, I note that the first complaint in respect of Alleged Transfer of mutual fund units was received by SEBI on 31/12/2018 from Novjoy Emporium Pvt. Ltd. for securities worth Rs. 21.70 Cr. The next complaint was received on February 11, 2019 by Dalmia Cement East Ltd. and OCL India Ltd alleging similar modus operandi in respect of the same Depository Participant i.e.

AFSLP, referring to Alleged Transfer of mutual fund securities worth Rs. 344.07 Cr. Hence, prima facie there was an allegation of unauthorised transfer of mutual fund securities worth 365 Crores (approx.) against the same depository participant using the same modus operandi and it was also alleged and later found that the said securities were used as collateral by Noticee no. 5, 7 and 8 to meet their margin obligations with ISSL (clearing member). Further, though the NSE inspection report pertains to the inspection period from 01/05/2017 to 31/01/2019, but SEBI was intimated about the findings of the inspection report from NSE on February 12, 2019. Therefore, in view of the large value of alleged mutual fund securities involved, coupled with the findings of the NSE inspection report in respect of non-availability of client's funds, non-availability of client's securities, misuse of client's funds, use of client's funds to meet proprietary obligations, running an 'assured return scheme' for clients .etc., it was felt appropriate to pass the ex-parte ad-interim order to curb further mischief and in the larger interest of the functioning of the securities market to immediately restrain the Noticees from accessing the securities market. Therefore, the case law cited by Noticee no. 1 has no relevance and the said contention has no merit.

19. Noticee no. 1, 5, 6, 7 and 8 have contended that SEBI has ordered freeze on all bank accounts and all moveable and immovable properties without being able to show whether such accounts or such properties were purchased out of the proceeds of the alleged violations. The said Noticees have referred to section 11(4)(e) of the SEBI Act, 1992 wherein the second proviso provides that only the assets so far as it relates to the proceeds actually involved in violation, can be attached. I note that a restraint has been ordered from debits to the bank accounts of the Noticees under section 11(4)(d) of the SEBI Act, 1992 and not under section 11(4)(e) of the said Act as assumed by Noticee no. 1, 5, 6, 7 and 8. Further, the said prohibitory direction has been issued only with the view to prevent the said Noticees from diverting the available resources in the backdrop of the magnitude of the alleged violations.

20. In its additional submissions dated 22/04/2019, the Noticee no. 1 has requested SEBI, to annul the contract relating to open position on NIFTY 5000 CE 27th June 2019 expiry, on the ground that the said contract has become naked and cannot be hedged due to the directions contained in the interim order. I note that requests for annulment of trades are dealt by stock exchanges/ clearing corporations in accordance with their bye-laws. It would not be out of place to state that in any Option Contract multiple parties are involved including the investors in such contracts. All the concerned are required to be heard before taking any steps for annulment. It is pertinent to note the observation of SAT in the following matters:

a. **Ibrahim Ahmed vs. SEBI (Appeal No. 40 of 2009)** – *"This dispute between the parties cannot be gone into by the Board which is a statutory regulator meant to protect the interest of the investors and to regulate the securities market.*

b. **MCS Ltd vs. SEBI (Appeal No. 107 of 2008) -** "*The Board rightly directed the appellant to return all the data/records and the same has been complied with by the appellant. As regards the dues which the appellant is claiming, it would be open to it to resort to proceedings before an appropriate forum for recovering the same. The Board cannot take upon itself to adjudicate such contractual issues."*

c. **Hameed Ullah Lalji alias Tony Ullah vs. SEBI (Appeal No. 123 of 2008):-** *. These disputes are obviously of a civil nature and can appropriately be decided by a Civil Court. The Board cannot adjudicate such disputes. It can only regulate the market"*

21. I note that this order deals with only the confirmation/ revocation of directions issued vide interim order- cum- SCN dated 27/02/2019, and such request for annulment of contract cannot be entertained in the present proceeding. I also note that Hon'ble SAT vide its order dated 15/05/2019 in the matter of *IL&FS Securities Services Ltd. v. SEBI & Ors.*

(Appeal no. 198 of 2019), had recommended ISSL to move an appropriation application under Clause 5 of Chapter VII of the bye-laws of National Securities Clearing Corporation Limited, if ISSL were to seek the annulment of the aforesaid contract.

DIRECTIONS:

22. Under the above circumstances, I find that, no case is made out by Noticee no. 1, 5, 6, 7, 8, 9, 10 and 11 for revocation of interim directions issued by SEBI vide the interim order dated February 27, 2019. In view of the above, I, in exercise of powers conferred upon me by virtue of section 19 read with sections 11(1), 11(4), 11B and 11D of the SEBI Act, 1992, Regulation 35 of Securities And Exchange Board Of India (Intermediaries) Regulations, 2008, by way of this confirmatory order, pending completion of forensic audit by NSE and investigation by SEBI, hereby issue the following directions:

a. The directions mentioned at para 8(a), 8(b), 8(c), 8(e), 8(f), 8(g) and 8(i) of the interim order dated February 27, 2019, stand confirmed against Noticee no. 1, 5, 6, 7, 8, 9, 10 and 11
b. The directions mentioned at para 8 of the interim order against Noticee no. 2, 3 and 4, shall be discontinued.
c. Further proceedings, if any, initiated based on findings of Forensic Audit by NSE/SEBI investigation shall take place before the competent Whole Time Member.

23. This order shall come into force with immediate effect. A copy of this order shall be forwarded to all the Stock Exchanges, the relevant banks, all Depositories and Registrar and Transfer Agents of Mutual Funds to ensure that the directions given above are strictly complied with.

Sd/-

Place: Mumbai

ANANTA BARUA

Date: May 17, 2019

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA