**MEMBER AND CORE SETTLEMENT GUARANTEE FUND COMMITTEE**

**Of**

**NSE Clearing Limited**

**Exchange Plaza, Bandra Kurla Complex, Bandra East, Mumbai – 400051**

**In the matter of Professional Clearing Member**

**M/s IL&FS Securities Services Ltd.**

**CORAM:**

| | | |
|---|---|---|
| Mrs. Bhagyam Ramani | - | Chairperson of the Committee |
| Mr. N.K.Maini | - | Committee Member |
| Mr. Harun R Khan | - | Committee Member |
| Mr. Vikram Kothari, (MD) | - | Committee Member |

**Also Present:**

Mr. Dhawal Shah - Head - Compliance

Ms. Jinal Shah - Chief Manager

Ms. Shivani Dalvi – Chief Manager

Ms. Divya Potdar- Manager

Mr. Amit Kadam - Manager

**Invitee:**

Mr. Ravindra Bathula – General Counsel, NCL

Ms. Hima Bindu Vakkalanka – Vice President

Mr. Amit Amlani – Vice President, Finance & Accounts

Meetings of the Committee were held through Video Conferencing due to the COVID Pandemic.

## I. BACKGROUND

1) IL&FS Securities Services Ltd. ("**Noticee**"), having its registered office at IL&FS House, 14 Raheja Vihar, Chandivali, Andheri East, Mumbai- 400072, is registered as a Professional Clearing Member (PCM) with NSE Clearing Limited ("**NCL**") (SEBI Registration No. INZ000163538).

2) NCL conducted a regular inspection of the Noticee's books, registers, records and other relevant documents in the Futures & Options (F&O) and Currency Derivatives (CD) segment covering the period from October 01, 2017 to September 30, 2018. Pursuant to the inspection, a Preliminary Observation Sheet (POS) was issued wherein NCL drew Noticee's attention to certain observations and the violation of NCL Rules/Bye-laws/Regulations. In response to the said POS, the Noticee has submitted its reply vide its email dated July 01, 2019 and a hard copy of the signed POS was sent by the Noticee on July 26, 2019.

## II. INSPECTION FINDINGS

**3)** The following is a summary of the findings and details of violations by the Noticee as observed in the inspection report dated July 03, 2019**.**

### A. Findings

#### I. Discrepancy in computation of networth and shortfall in networth

a. For the half year ended March 31, 2018 and half year ended September 30, 2018, discrepancy in the computation of networth by the Noticee was observed.

b. As on March 31, 2018, the Noticee had submitted a networth certificate to NCL of Rs. 176.99 Crores. However, Noticee had failed to deduct Inter Corporate Deposits ("ICDs") amounting to Rs.750 Crores. After deducting the ICDs amounting to Rs.750 Crores, the networth of the Noticee as on March 31, 2018 works out to Rs. (-)573.01 Crores. This has resulted in shortfall of networth of the Noticee.

c. Similarly, for the period ended September 30, 2018, it is observed that the Noticee had submitted networth certificate to NCL of Rs.207.07 Crores. However, the networth after deducting the ICDs, interest on ICDs, loan to IL&FS Employee Welfare Trust, Interest on loan, Impact of IND AS and Sundry Debtors aggregating to Rs.154.06 Crores, works out to Rs.53.01Crores.

**II. Issuance of ICDs to group/associated entities**

(i) The Noticee issued ICDs to group/associated companies. The source of ICDs was Commercial Papers and internal accruals.

(ii) As on March 31, 2018, ICDs worth Rs.750 Crores and as on September 30, 2018, ICDs worth Rs.121 Crores were given.

**III. Failure to collect margin from its trading member**

The Noticee has failed to collect margin from its trading member Allied Financial Services Ltd. (Allied) in four instances amounting to Rs.617.94 Crores. It was observed that on 2 days which were Saturdays ; i.e.; December 30, 2017 and March 31, 2018, the Noticee released mutual fund units to Allied which were part of collateral used for earlier day's margin requirement. The same were returned by Allied to the Noticee on

Monday i.e. January 01, 2018 and April 02, 2018 respectively. Accordingly there was shortfall of margin observed for four days as mentioned in Annexure 1 to the SCN as per the details in the below table:-

| Date | Days | TM Name | Total Margin (Rs.) | Total Collaterals (Rs.) | Shortfall (Rs.) | MF released Amount (Rs.) |
|---|---|---|---|---|---|---|
| 30-Dec-17 | Saturday | Allied Financial Services Ltd. | 1,81,27,20,261.54 | 82,26,69,705.44 | 99,00,50,556.10 | 3,29,62,41,561.48 |
| 31-Dec-17 | Sunday | Allied Financial Services Ltd. | 1,81,27,20,261.54 | 82,26,69,705.44 | 99,00,50,556.10 | 3,29,62,41,561.48 |
| 31-Mar-18 | Saturday | Allied Financial Services Ltd. | 3,25,99,58,458.67 | 1,16,03,17,911.85 | 2,09,96,40,546.82 | 3,35,05,98,756.50 |
| 01-Apr-18 | Sunday | Allied Financial Services Ltd. | 3,25,99,58,458.67 | 1,16,03,17,911.85 | 2,09,96,40,546.82 | 3,35,05,98,756.50 |
| | | **TOTAL** | | | **6,17,93,82,205.84** | |

## B. Violations observed

The following violations were observed in the inspection report :

i. Discrepancy in computation of Networth (not in accordance with recommendations of L.C. Gupta Committee) and Shortfall in Networth (not in accordance with Rule 12 of Chapter IV of the Rules of NCL F&O segment);

ii. ICDs given to group/associated companies and the source of which are Commercial Papers and internal accruals (not in accordance with Rule 8(3)(f) of Securities Contracts (Regulation), Rules 1957 (“SCRR”)

iii. Failure to collect margin from the member (not in accordance with Regulation 4.5.1 of Chapter 4 of NCL Regulations (F&O) segment) (“NCL Regulations”)

## III. CHRONOLOGY OF EVENTS PURSUANT TO ISSUANCE OF SCN BY NCL

4) A Show Cause Notice dated January 17, 2020 ("SCN") was issued to the Noticee calling upon it to show cause before the Member And Core Settlement Guarantee Fund Committee of NCL ("**Committee**") as to why appropriate disciplinary action in terms of Rule 1 and Rule 2 of Chapter V of Rules of NCL (F&O) segment should not be initiated against the Noticee for the said non-compliances as mentioned in the SCN. The said SCN referred to the details of the observations in the inspection report.

5) In terms of the SCN, the Noticee was provided an opportunity of personal hearing before the Committee on January 29, 2020. The Noticee, vide its letter dated January 21, 2020, sought additional time of 15 days up to February 10, 2020, to submit its response to the SCN. Vide email dated January 23, 2020, the Noticee was informed that based on the request of the Noticee, extension was granted and the next date of personal hearing would be communicated to the Noticee.

6) The Noticee furnished its written submissions in response to the SCN vide its letter dated February 10, 2020 ("February 2020 Submissions").

7) NCL vide its letter dated July 13, 2020 informed the Noticee to appear before the Committee on July 22, 2020.

8) At the personal hearing before the Committee in its meeting held on July 22, 2020, the Noticee appeared before the Committee and on the same day, in addition to the oral submissions during the hearing, the Noticee through its advocates, also made submissions vide three emails dated July 22, 2020 ("July 2020 submissions"). Vide one of the three

aforesaid emails, the Noticee had submitted a note titled "Submission on the moratorium orders for the IL&FS group" with respect to the order dated October 15, 2018 ("Stay Order") as confirmed by the order dated March 12, 2020 passed by Hon'ble National Company Law Appellate Tribunal ("NCLAT") in the IL&FS group matter. During the hearing, Noticee had submitted that the proceedings before this Committee, are proceedings before a "tribunal" and are squarely prohibited from being instituted or continued by virtue of the Stay Order passed by the Hon'ble NCLAT.

9) The Committee considered the objections raised by the Noticee in its February 2020 submissions and the submissions made in the hearing held on July 22, 2020 and came to the conclusion that it should proceed with the matter as per the Rules/Byelaws/Regulations of NCL. In this regard, the Committee also sought a legal opinion of a former judge of Supreme Court of India. Accordingly, NCL vide its letter dated September 28, 2020, informed the Noticee to appear before the Committee on October 6, 2020.

10) The Noticee vide its letter dated October 03, 2020 requested to adjourn the hearing to any date after October 26, 2020 and requested to provide a copy of the legal opinion obtained by NCL pertaining to applicability of the said Stay Order of the Hon'ble NCLAT to the proceedings before the Committee.

11) NCL vide its letter dated October 14, 2020, responded to the Noticee stating that NCL has obtained the legal opinion for the guidance of the Committee and stated the reasons which were considered by the Committee for resuming the proceedings and called upon the Noticee to appear before the Committee on October 29, 2020.

12) The Noticee vide its letter dated October 27, 2020 referred to a decision of the Hon'ble

Securities Appellate Tribunal **("Hon'ble SAT")** in Dewan Housing Finance Corporation Ltd. Vs SEBI wherein the Hon'ble SAT had set aside the Show Cause Notice issued by SEBI. The Noticee stated that since this ruling by the Hon'ble SAT in Dewan Housing case squarely applies to the SCN issued in respect of the Noticee (owing to the operation of moratorium order in the Noticee as well), NCL/ the Committee will have no jurisdiction to proceed in the matter. The Noticee further, *inter alia*, requested that the Committee should first hear the Noticee on preliminary objections and reiterated its request for a copy of the legal opinion.

13) NCL vide its letter dated February 12, 2021, responded to the Noticee's letter dated October 27, 2020 and also provided the Noticee with a copy of the said legal opinion and called upon the Noticee to appear before the Committee on February 24, 2021.

14) In response to the above letter of NCL, the Noticee vide its email dated February 19, 2021, stated that the Hon'ble SAT was considering an appeal filed by the Noticee which raises a question on whether proceedings pursuant to a show cause notice can continue during the subsistence of a moratorium order. The Noticee further stated that the said pending appeal is also pertinent to the proceedings sought to be instituted under the SCN and requested to adjourn the hearing pursuant to the SCN fixed for February 24, 2021 to a later date.

15) In response to the above email of the Noticee, NCL informed the Noticee to provide the details of the appeal filed by the Noticee and informed the Noticee to appear before the Committee on March 15, 2021.

16) The Noticee vide its email dated March 5, 2021, provided the details of the appeal, being Appeal No.76 of 2021, filed by the Noticee (without annexures). NCL vide its email dated March 8, 2021, informed the Noticee to provide all the Annexures to the appeal pursuant to which the Noticee vide its email dated March 10, 2021, provided the same to NCL.

17) NCL vide its email dated March 19, 2021, informed the Noticee to appear before the Committee on March 26, 2021 since the hearings scheduled to be held on March 15, 2021 and March 20, 2021 were postponed on the requests of the Noticee.

18) The Noticee appeared before the Committee on March 26, 2021 and made its submissions. The Noticee restricted its submissions to the preliminary objections raised by it. After hearing the matter and submissions at length, the Committee directed the Noticee to provide its written submissions by April 1, 2021. The Noticee submitted its written submissions dated April 4, 2021 ("April 2021 submissions").

19) The Committee reviewed the said preliminary objection raised by the Noticee and concluded that the preliminary objection raised by the Noticee is untenable and accordingly the conclusion of the Committee giving detailed reasons was communicated to the Noticee vide letter dated May 03, 2021. The Committee also relied upon the order dated April 06, 2021 passed by the Hon'ble SAT in the said Appeal No.76 of 2021 filed by the Noticee against SEBI, wherein the Hon'ble SAT has decided on the question of applicability of Stay Order to regulatory authorities after considering the full import of the Stay Order and had clearly held that the Stay Order cannot be extended to cover the regulatory authorities. Accordingly, vide letter dated May 03, 2021, NCL informed the Noticee to appear before the Committee on May 10, 2021 to make its further submissions, if any, on the merits of the matter.

20) The Noticee sought postponement of the personal hearing scheduled on May 10, 2021, due to non-availability of the Senior Counsel appearing on behalf of the Noticee. Accordingly, the Noticee was informed that the hearing was rescheduled to May 24, 2021 vide NCL's email dated May 7, 2021. Subsequently the Noticee vide its email dated May 21, 2021 requested NCL to adjourn the hearing scheduled on May 24, 2021 stating that the Senior Counsel representing the Noticee had tested positive for COVID and hence would not be

able to attend the hearing. The Committee considered the request of the Noticee and adjourned the hearing. Vide NCL letter dated June 17, 2021, the Noticee was called upon to attend the hearing before the Committee on June 25, 2021.

21) At the personal hearing before the Committee in its meeting held on June 25, 2021, the Noticee appeared before the Committee. During the personal hearing, the Noticee made its oral submissions on the merits and requested the Committee to give additional time to make written submissions in the matter. The written submissions which compile and contain all the Noticee's submissions on the merits of the matter in the SCN were submitted by the Noticee to NCL vide its email dated July 01, 2021 **("July 2021 Submission**s"),

## IV. CONSIDERATION OF SUBMISSIONS OF THE NOTICEE AND FINDINGS OF THE COMMITTEE: -

The Committee has considered both the preliminary objections as well as the submissions of the Noticee on the merits of the matter as submitted by the Noticee and the Committee is herein below summarizing the submissions of the Noticee and the Committee's findings thereon.

22) **Noticee's Preliminary Objections/Submissions**: -

22.1) The Noticee has submitted that, the Hon'ble NCLAT has, by an order dated October 15, 2018 (as confirmed by the order dated March 12, 2020) (together, "NCLAT Orders"), stayed ,*inter alia*, the institution and continuation of suits or any other proceedings by any party or person before any court or tribunal ,*inter alia*, against the Noticee and the proceedings pursuant to the SCN are covered by the NCLAT Orders and, therefore, could not have been instituted and cannot be continued. The Noticee had submitted that it had also raised the above preliminary objection on similar grounds in separate proceedings initiated by the SEBI pursuant to a SEBI show cause notice

(SEBI SCN) dated December 9, 2019. SEBI has passed an order dated January 8, 2021 and held that it has jurisdiction to continue the proceedings pursuant to the SEBI SCN despite the NCLAT Orders. The Noticee had preferred an appeal before the Hon'ble SAT. While the Hon'ble SAT has dismissed the appeal and upheld SEBI's order dated January 8, 2021, the Noticee has preferred Civil Appeal before the Hon'ble Supreme Court and the said Civil Appeal is pending. Noticee has preferred an appeal before the Hon'ble SAT challenging the order relating to preliminary objections dated May 3, 2021 passed by NCL. The Noticee has submitted that the submissions on merits of the matter are without prejudice to the stand taken by the Noticee in the said appeal.

22.2) The Noticee has submitted that proceedings under the SCN of NCL ought not to proceed as SEBI has initiated proceedings pursuant to SEBI SCN and has, *inter alia*, alleged transgressions similar to the alleged transgressions/violations contained in the SCN of NCL.

22.3) The Noticee has submitted that the allegations contained in the SCN pertain to a period prior to October 1, 2018, during which time the Noticee was being managed by its erstwhile board of directors. The Hon'ble NCLAT by its orders: (a) superseded the then existing board of directors of IL&FS and appointed the New Board with effect from October 2018 with a mandate to resolve the IL&FS Group (which includes the Noticee); and (b) permitted the New Board to appoint directors on the board of directors of the group companies of IL&FS, including but not limited to the Noticee. The persons/ directors who were at the helm of affairs of the Noticee during the relevant period are no longer at the helm of affairs of the Noticee. Therefore, given that the New Board and their nominees have assumed charge of IL&FS and its group companies such as the Noticee (as applicable) and are working with the Ministry of Corporate Affairs (MCA) to correct the debt contagion of the IL&FS Group, initiating and continuing these

disciplinary proceedings and taking action, punitive or otherwise, against the Noticee which is under the charge of the nominees of the New Board and undergoing a resolution process to remedy the ill-effects of its erstwhile mis-governance (which does not pertain to, and reflect upon its management by the present board of directors), would adversely affect the efforts being made by the MCA and the New Board to resolve the IL&FS Group including the Noticee.

**23) Findings of the Committee on the Preliminary Objections/Submissions of the Noticee**

23.1) The Committee considered the preliminary objection with respect to the Stay Order raised by the Notice under Para 22.1 and concluded that the preliminary objection raised by the Noticee is untenable. The Committee notes that its elaborate and reasoned findings on the preliminary objections raised by the Noticee have been communicated to the Noticee vide NCL's letter dated May 03, 2021. Therefore, the Committee is not herein dealing with the said preliminary objection again. The Committee further notes that the Noticee has preferred an appeal against the same before the Hon'ble SAT and the same is pending.

23.2) With respect to the submission of the Noticee in Para 22.2 above, the Committee observes that though some of the causes for initiation of action by SEBI and initiation of action by NCL may be common, the initiation of action by SEBI is for violation of its Regulations, whereas the initiation of disciplinary action by NCL is for violation of its Rules, Regulations and Bye-Laws. Further, while NCL has initiated disciplinary proceedings for taking action against the Noticee, as a clearing member in respect of violations noticed during inspection relating to the period October 01, 2017 to September 30, 2018, SEBI has initiated action for imposing monetary penalty on the Noticee under the provisions of SEBI Act, 1992. The nature and purpose of the notice

dated December 09, 2019 by SEBI and the nature and purpose of the notice dated January 17, 2020 by NCL are different, even though they may be based on some common violations. Therefore, initiation of any action by SEBI by issuing notice dated December 09, 2019 as aforesaid, will not come in the way of NCL proceeding with the disciplinary action initiated by it against the Noticee.

23.3) With reference to the Noticee's submission in Para 22.3 above, the Committee has considered the submissions that the SCN pertains to a period prior to October 1, 2018, during which time Noticee was being managed by its erstwhile board of directors and that the Noticee which is now under the charge of the nominees of the New Board and is undergoing a resolution process and considerable efforts are being made by the MCA and the New Board to resolve the IL&FS Group. While the Committee recognises that resolution of the IL&FS Group has been undertaken, the same does not mean that the previous violations can be ignored or extinguished on account of change in management. The violations need to be dealt with by this Committee in order to discharge its mandate in accordance with the applicable Rules, Bye-laws, Regulations and circulars.

**24) Noticee's submissions that the SCN is vague**

The Noticee has submitted that the charges/ allegations in the SCN are baseless, devoid of merit and ought to be dismissed on the following grounds:-

24.1) The Noticee has submitted that it is a settled position of law that proceedings based on vague and non-specific allegations are in contravention of the principles of natural justice and any order passed thereon is wholly vitiated. The Noticee has referred to certain case laws in this regard and has contended that the said position of law has been affirmed by the Hon'ble Supreme Court in *Canara Bank & Ors.*

*vs. Debashish Das & Anr.,* reported in (2003) 4 SCC 557, *Commissioner of Central Excise vs. Brindavan Beverages* reported in (2007) 5 SCC 388 and *Nasir Ahmed vs. Assistant Custodian General* (1980) 3 SCC 1.

24.2) The Noticee has submitted that the allegations in the SCN are vague, not specific and lacking in material particulars as below :-

**a)** The first allegation in the SCN merely states that the Noticee has failed to deduct ICDs while computing its net worth and that the same is not in accordance with recommendations of the L. C. Gupta Committee, without disclosing any detail/ specific reasons therefor.

**b)** As per the L. C. Gupta Committee recommendations, which are set out in Circular No. 559 bearing Ref. NSE/MEM/8166 dated December 4, 2006 ("Circular"), the net worth of a clearing member is to be computed in the following manner :-

*"Capital + Free Reserves*
*Less: Non-allowable assets viz.,*
*(a) Fixed Assets*
*(b) Pledged Securities*
*(c) Member's Card*
*(d) Non-allowable securities (unlisted securities)*
*(e) Bad deliveries*
*(f) Doubtful Debts and Advances **
*(g) Prepaid expenses, losses*
*(h) Intangible Assets*
*(i) 30% of Marketable securities*

**Explanation: Includes debts/advances overdue for more than three months or given to associates."*

**c)** The Circular (including the L. C. Gupta Committee recommendations contained therein) makes no reference to ICDs. The SCN does not indicate as to why the ICDs in question should have been reduced in the computation of

net worth as per the L. C. Gupta Committee recommendations and/or the Circular. In order to enable the Noticee to respond to this allegation, the SCN ought to have specifically explained how ICDs would come under any of the "Non-Allowable Assets" as per the recommendations of L. C. Gupta Committee. The absence of such explanation renders this allegation in the SCN vague, not specific and contrary to the principles of natural justice.

**d)** The second allegation (pertaining to alleged violation of Rule 8(3)(f) of SCRR), merely states that:

> *"It is observed that ICDs were given to group/ associated companies As on March 31, 2018, ICDs worth Rs. 750 Crs and as on September 30, 2018, ICDs worth INR 121 Crs were given by the Noticee. These ICDs were given by the Noticee to its group/ associated companies out of internal accruals and Commercial Papers"*

**e)** The SCN does not make any specific allegation or particularize the details of the alleged violation. The only indication as to the alleged violation of the SCRR is a singular reference to Rule 8(3)(f) of the SCRR, without specifying the nature of the alleged lapses on part of the Noticee or the manner in which its actions are in violation of Rule 8(3)(f). No particulars of the ICDs are mentioned nor any explanation as to how the entities with which the Noticee has placed them are "group/ associated companies". The absence of these details and explanations renders this allegation in the SCN vague, not specific and contrary to the principles of natural justice.

**f)** The Noticee submitted in case of a violation of these provisions, the SCN *inter alia*, threatens suspension / expulsion of membership. In such circumstances, it is settled law that a show cause notice must specify the particular grounds on the basis of which an action is proposed to be taken so as to enable the Noticee

to answer the case against it. If these conditions are not satisfied, the Noticee cannot be said to have been granted any reasonable opportunity of being heard. Particularly in cases which result in expulsion from membership the requirement of a valid, particularized, and unambiguous show cause notice is particularly crucial due to the severe consequences of expulsion from membership including loss of trading license.

24.3) The Noticee has submitted that the SCN is vague, unsubstantiated, and lacking in any particulars whatsoever and no adverse action can or ought to be taken on the basis of the same. Therefore, any order holding the Noticee in violation of any of the acts mentioned therein will be vitiated.

**25) Findings of the Committee on the Noticee's Submission that the SCN is vague**

25.1) The Committee is of the view that the submission made by the Noticee that the SCN is vague is incorrect and untenable. The Noticee had filed its reply to the POS without any such allegation. The Noticee has also orally and in writing made its submissions on the merits of the case and each allegation in the SCN which proves that the Noticee fully and correctly understood each allegation in the SCN. The said allegation, therefore , appears to be, a mere afterthought.

25.2) The Noticee has been admitted as clearing member since 2000 and has been regularly submitting net-worth certificates in compliance with the regulatory requirements. The Noticee is required to submit the certificate of a chartered accountant who has to review and confirm that the computation of net-worth is in accordance with the method of computation prescribed by Schedule VI of

SEBI (Stock Brokers and Sub & Brokers) (Second Amendment) Regulations, 2013 and the method of computation prescribed by Dr. L.C. Gupta Committee Report. After being a member for so many years, the Noticee cannot allege that it is unaware how ICDs' could be covered under "Non Allowable Assets" or why the said ICDs' should be reduced from the computation of net worth.

25.3) The Committee is of the view that the Noticee's contention that the SCN is vague is a mere after thought and without basis.

**26) Noticee's Submission that there is no discrepancy in computation of Networth and consequently no shortfall in networth**

26.1) The Noticee has submitted that for computation of networth, ICDs do not fall under 'Non-Allowable Assets'. The ICDs have not been deducted as they do not constitute "Non-Allowable Assets" which are to be deducted for the purposes of calculating the networth of the Noticee as per the above L.C. Gupta Committee formula. The Noticee also submitted that there was no reason to believe that counter party/associates may default in repayment of the ICDs in the future. Hence, the Noticee confirmed that it was on this basis that the Noticee had no reason to declare these ICDs as doubtful or to classify them under "Doubtful Debts and advances" in its financial statements for the year ended March 31, 2018. It would be incorrect to presume that ICDs given to group companies ipso facto become doubtful debts and advances.

26.2) The Noticee has submitted that the ICDs have not been deducted as they do not constitute "Non-Allowable Assets" which are to be deducted for the purposes of calculating the net-worth of the Noticee. The Noticee further submitted that in fact, in the past, NCL had by its letter dated September 24, 2018, sought to allege that the ICDs

ought to have been deducted from the networth of the Noticee for the submission of net-worth in March 2017 as the ICDs allegedly constitute "doubtful debts and advances" (which is a deductible sub-category under the head of 'Non- Allowable Assets"). Even at that juncture, the Noticee has clarified, *inter alia*, that;

a) The ICDs appearing in the balance sheet of the Company were not in the nature of "Doubtful Debts and Advances" and were in fact classified under the category of "Unsecured, considered good unless stated otherwise" in audited financial statements for March 31, 2017.

b) There was no reason to believe that counter party/associates may default in repayment of the ICDs in the future as the ICDs were not due in March 2017.

c) The ICDs were repaid in full in the course of 2018 and ,therefore, the ICDs could not be considered as "Doubtful debts and advances".

26.3) The Noticee submitted that no action was taken thereafter and NCL is deemed to have accepted the Noticee's submissions in response.

26.4) With regard to the year ended March 31, 2018, the Noticee has submitted that the ICDs do not constitute "Doubtful Debts and Advances" in light of the following facts and circumstances:-

a) The ICDs appearing in the balance sheet of the Company were not in the nature of "Doubtful Debts and Advances" and were in fact classified under the category of "Unsecured, considered good unless stated otherwise" in audited financial statements for March 31, 2018.

b) As per the IL&FS group treasury framework, group companies were requested to deposit the available funds in a liquidity management pool. The Noticee has been placing the ICDs in the ordinary course of business and withdrawing the same as per the requirement. Moreover, the Noticee, has been following net worth computation format as provided by NCL since the clearing business was domiciled in the Noticee and has also been submitting its audited financial statements regularly.

c) In terms of the net-worth computation format, an asset is required to be declared as "doubtful" when there is reasonable doubt about recovery of the asset as per management estimate. In the present instance, ICDs outstanding were not due as of March 31, 2018. Further, there was no reason to believe that counter party/associates may default in repayment of the ICDs in the future. Hence, the Noticee has submitted that it was on this basis that the Noticee had not declared these ICDs as doubtful and had not classified them under "Doubtful Debts and Advances" in its financial statements for the year ended March 31,2018. The ICDs given to the group companies were not falling in the category of doubtful debts and advances. It would be plainly incorrect to presume that ICDs given to group companies ipso facto become doubtful debts and advances. All these ICDs were subsequently repaid in the months of April - June, 2018.

26.5) With regard to the networth for the period ended September 30, 2018, the Noticee has submitted that the ICDs do not constitute Doubtful debts and advances in light of the following facts and circumstances :-

a) These ICDs were advanced only in the months of June-August, 2018. Further, they were repayable on demand (i.e., not overdue)

b) The ICDs were not considered as doubtful in September 2018 and hence ICDs along with interest were not reduced from net worth while computing the net worth. In March 2019, the company has written off 50% of ICDs outstanding amount and balance 50% has been considered as doubtful and equivalent amount has been provided for.

c) Similarly, loan given to IL&FS Employees Welfare Trust ("EWT") was not classified as doubtful and hence loan given to EWT along with interest was not reduced from net worth while computing the net-worth.

d) In relation to other Ind AS adjustments which were-not considered while computing net worth, the Noticee states that till financial year ending March 31, 2018, the Noticee used to prepare accounts under Generally Accepted Accounting Principles ("IGAAP"). The financial year ending March 31,2019 was first year where accounts were prepared under Ind AS. Pending adoption of Ind AS Financial Statements, for September, 2018, net worth was computed based unaudited IGAAP financial statements and the same was submitted on November l7, 2018. Ind AS financial statements for September,2018 was adopted by the Board on January 24,2019.

e) Even if the two ICDs placed in June 2018 (i.e. more than three months prior to September 30, 2018), although not due for repayment, are deducted while computing the net worth, the aggregate amount of the said ICDs was only INR 17 crores and the revised net worth is INR 1,90,07,48,261 (i.e., INR 207.07 Crores (approx.) less INR 17 crores)

f) The calculation of the net-worth was based on a bona fide understanding of the relevant provisions. This was also discussed in detail with National Stock Exchange of India Ltd. ("NSE"). The fact that the advances with respect to the financial statements dated March 31,2018 in question are fully repaid further vindicates the stance adopted by the Noticee.

g) Advances (ICDs and Loan to EWT, including interest accrued) with respect to the financial statements dated September 30, 2018 were not in the nature of doubtful and pending adoption of Ind AS for the financial statements for period ending September 30, 2018, the submission on November 17, 2018 was based on unaudited IGAAP financial statements and the Company had not made adjustments in computation of networth.

h) The Noticee has also referred to Schedule III to the Companies Act, 2013 and made submissions as regards the treatment of ICDs in the Balance Sheet of a Company.

26.6) The recommendations of the Dr. L. C. Gupta Committee and/or the Circular (Circular No. 559 bearing Ref. NSE/MEM/8166 dated December 4, 2006) make no reference whatsoever to ICDs and the SCN does not explain how the said recommendations require ICDs to be deducted while computing net worth. Therefore, the Noticee has been left with no option but to proceed on the assumption that the ICDs are being considered as "Doubtful Debts and Advances" and make its submissions accordingly.

26.7) None of the IL&FS Group companies with whom the Noticee had placed the ICDs are "**associate companies**" of the Noticee. An 'associate company' is defined under Section 2(6) of the Companies Act, 2013 as follows:-

> *"(6) "associate company", in relation to another company, means a company in which that other company has a significant influence, but which is not a subsidiary company of the company having such influence and includes a joint venture company.*
> *Explanation.—For the purpose of this clause,*
> *(a) the expression "significant influence" means control of at least twenty per cent. of total voting power, or control of or participation in business decisions under an agreement;*
> *(b) the expression "joint venture" means a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the arrangement;"*

The Noticee does not control any voting power in any of the said companies. The SCN does not even allege that the Noticee controls or participates in the business decisions of any of the said companies or that the said companies are joint venture companies of the Noticee.

## 27) Findings of the Committee in respect of the computation of networth and consequently shortfall in net-worth

27.1) At the outset, the Committee notes that the Noticee itself has submitted to the Committee that the ICDs were given to associates. In this regard, the Committee refers to Para II 7 (A) (vi)(c) of the Noticee's February 2020 submissions wherein the Noticee has submitted that "*In the present instance, ICDs outstanding were not due as of March 31, 2018. Further, there was no reason to believe that* ***counter party/associates*** *may default in repayment of the ICDs in the future*" (emphasis supplied). Therefore it is clear that even the Noticee had considered the entities to whom ICDs were given as being associate companies. Therefore, the subsequent

allegation in the Noticee's July 2021 submissions that none of the IL&FS Group companies with whom the Noticee had placed the ICDs are "associate companies", is obviously a belated afterthought.

27.2) The treatment of ICDs is required to be done in accordance with regulatory framework applicable. Every clearing member is required to maintain the minimum stipulated net-worth on an ongoing basis and accordingly required to submit the net-worth certificate on half yearly basis in accordance with the regulatory requirement. NSE, vide circular dated October 26, 2017 bearing circular number NSE/COMP/36179 stipulated the method of calculation of net-worth based on the recommendation of the L. C. Gupta committee. As per this method, net-worth is calculated on the basis of capital and free reserves less non allowable assets which include doubtful debts and advances. By way of an explanation, it was clarified that doubtful debts and advances shall include debts and advances overdue for more than three months or given to associates. Therefore, the explanation clearly covers two categories of debts and advances ; viz ; (a) Debts and advances overdue for more than 3 months and (b) Debts and advances given to associates. Thus the said explanation clearly excludes debts and advances given to associates from the net-worth computation. The Committee observes that in the present case, the ICDs have been given to associate companies and ,therefore, had to be excluded from the computation of the net worth as clearly specified in the Explanation to the said formula. In fact, as aforesaid, the Noticee's initial submission dated February 10, 2020 itself also referred to the parties to whom the ICDs were given as being "counter party / associates" and as "group companies".

27.3) In the present case, the Noticee has itself submitted the following particulars of the ICDs given to its associate/ group companies as on March 31, 2018 and as on

September 30, 2018.

**Details of ICDs as on March 31, 2018**

| **Company Name** | **Relationship** | **Amount Placed (Rs.)** |
|---|---|---|
| ISSL Settlement & Transaction Services Ltd | Subsidiary | 6,00,00,000 |
| IL&FS Energy Development Company Limited | Fellow Subsidiary | 1,00,00,00,000 |
| IL&FS Energy Development Company Limited | Fellow Subsidiary | 2,50,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 2,50,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 18,50,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 15,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 35,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 23,00,00,000 |
| IL&FS Energy Development Company Limited | Fellow Subsidiary | 3,00,00,00,000 |
| **Total** | | **7,50,00,00,000** |

**Details of ICDs as on September 30, 2018**

| **Company Name** | **Relationship** | **Amount Placed (Rs.)** |
|---|---|---|
| IL&FS Financial Services Limited | Fellow Subsidiary | 10,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 7,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 57,00,00,000 |
| IL&FS Financial Services Limited | Fellow Subsidiary | 17,00,00,000 |
| Infrastructure Leasing & Financial Services Ltd | Holding Company | 30,00,00,000 |
| **Total** | | **1,21,00,00,000** |

27.4) The Committee notes that the above details of ICDs have been furnished by the

Noticee itself during the course of the inspection. As may be seen from the above table, the nature of relationship of the said entities with the Noticee as represented by the Noticee is either "subsidiary" or "fellow subsidiary". It is also noted that the Noticee itself has disclosed the above entities as 'related parties' in Note No. 30 in the financial statements for the year ended March 2018 submitted by the Noticee during the course of inspection.

27.5) The Noticee's reference to the definition of "associate company" under the Companies Act is misconceived, since for the purposes of securities laws and securities regulatory issues, **"associate"** has been defined by the SEBI circular dated September 17, 2001 which is applicable to the Noticee in its capacity as a clearing member. The definition of "associate" as stipulated in the said Circular is as follows:-

> *"Associate' in relation to a stock broker, individual, body corporate or firm, shall include a person:*
> *(i) who, directly or indirectly, by himself, or in combination with other persons, exercises control over the stock broker, whether individual, body corporate or firm or holds substantial share of not less than 15% in the capital of such entities, or*
> *(ii) in respect of whom the stock broker, individual or body corporate or firm, directly or indirectly, by itself or in combination with other persons, exercises control or*
> *(iii) whose director or partner is also a director or partner of the stock broker, body corporate or the firm, as the case may be.*
>
> *The expression 'control' shall have the same meaning as defined under clause (c) of Regulation 2 of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997".*

Further the term "associate" has also been defined under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 ("**SEBI Intermediaries Regulations**"), which is reproduced as below:

> " *"associate" means any person controlled, directly or indirectly, by the intermediary, or any person who controls, directly or indirectly, the intermediary, or any entity or person under common control with such intermediary, and where such intermediary is a natural person will include any relative of such intermediary and where such intermediary is a body corporate will include its group companies (as defined in the Monopolies and Restrictive Trade Practices Act, 1969 (Act No. 54 of 1969) or any re-enactment thereof) or companies under the same management."*

The definition of "control" under the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 is reproduced as below:-

> *""control", in relation to an intermediary shall include the power to, directly or indirectly, control the management or policy decisions of such intermediary by person or persons acting individually or in concert"*

27.6) It is observed that the aforesaid definitions of "associate" become applicable to the Noticee as an intermediary in its capacity as a clearing member of a clearing corporation. It is observed that in terms of the definition of "associate" under the aforesaid SEBI circular, the term "associate" in relation to a stock broker, individual, body corporate or firm, shall include a person in respect of whom the stock broker, individual or body corporate or firm, directly or indirectly, by itself or in combination with other persons, exercises control. Similarly, under the SEBI Intermediaries Regulations, the term "associate" means any person controlled, directly or indirectly, by the intermediary". This criterion is satisfied in the present case by the ICDs given by the Noticee to ISSL Settlement & Transaction Services Ltd., since the Noticee has categorized the aforesaid entity as a subsidiary and disclosed it in the Noticee's annual report as a "related party".

27.7) It is observed that in terms of the definition of "associate" under the aforesaid SEBI circular, the term "associate" , also includes a person who, directly or indirectly, by himself, or in combination with other persons, exercises control over the stock broker,

whether individual, body corporate or firm or holds substantial share of not less than 15% in the capital of such entities. Similarly, under the SEBI Intermediaries Regulations, the term "associate" means any person who controls, directly or indirectly, the intermediary, or any entity or person under common control with such intermediary". This criterion is also satisfied in the present case. It is observed that Infrastructure Leasing & Financial Services Ltd. (IL&FS) is admittedly the holding company of the Noticee. The ICDs given by the Noticee to IL&FS Energy Development Company Limited and IL&FS Financial Services Limited satisfy the aforesaid criterion since the Noticee has categorized the aforesaid entities as 'fellow subsidiaries' and included them in the annual report as "related parties". The criterion under the aforesaid SEBI Circular that a person who, indirectly, by himself, or in combination with other persons, exercises control over the stock broker is satisfied on account of the indirect control over the Noticee as well as the fellow subsidiaries by virtue of them having a common holding company ; viz ; Infrastructure Leasing and Financial Services Ltd. ("IL&FS"). Similarly, the criterion under the SEBI Intermediary Regulations that any person who controls, directly or indirectly, the intermediary, or any entity or person under common control with such intermediary is also satisfied on account of the aforesaid facts since IL&FS as a holding company exercises control over the Noticee and also over the fellow subsidiaries. Further, the fellow subsidiaries to whom the ICDs were given by the Noticee are under the common control of the holding company along with the Noticee. In this regard, the Committee notes that IL&FS is holding 81.24% of the shareholding of the Noticee as disclosed by the Noticee in Note No. 3 in the financial statements for the year ended March 2018. Further, IL&FS exercises control over the Noticee as is also evident from the Noticee's own submission that as per the IL&FS group treasury framework, group companies were asked to deposit the available funds in a liquidity management pool.

27.8) The Committee has also noted that it is the Noticee's own submission that as per the IL&FS group treasury framework, group companies were asked to deposit the available funds in a liquidity management pool. The Noticee has submitted that it has been placing the ICDs in the ordinary course of business and withdrawing the same as per the requirement. Therefore it is untenable to contend that the borrower entities, which are group/associate companies and are all pooling funds for liquidity management, are not to be treated as "associate" entities for the purposes of the said L.C. Gupta Committee recommendation for networth calculation.

27.9) The Committee, therefore, observes that the ICDs given to associate companies as on March 31, 2018 to (i) ISSL Settlement & Transaction Services Ltd, (ii) IL&FS Energy Development Company Limited, (iii) IL&FS Financial Services Limited and as on September 30, 2018 to (i) IL&FS Financial Services Limited and (ii) Infrastructure Leasing & Financial Services Ltd. were required to be excluded from the networth calculation.

27.10) The Noticee's contention that only an amount Rs.17 Crores in respect of ICDs overdue for more than 3 months could be deducted from the net worth computation in accordance with L C Gupta Committee methodology, is untenable as all ICDs given to associates, irrespective of the tenure, have to be excluded while computing net worth as per L C Gupta Committee recommendations.

27.11) The Committee further notes that SEBI in its order dated July 02, 2021 with regard to the Noticee, has ,*inter alia,* held that *" I note that for calculation of net-worth of ISSL in its capacity as a Clearing Member, the Noticee has to follow the procedure laid down in the Broker Regulations. As per the annual report of the Noticee, these ICDs were given to its associates and hence, as per the explanation given in the*

*Broker Regulations, these ICDs came under the category of "doubtful debts and advances" and were required to be excluded for calculation of net-worth of ISSL as a clearing member".*

27.12) Further, the classification or representations in the financial statements of the Noticee is not relevant for the purpose of calculation of net-worth as the methodology for computation has been prescribed. The same requires the inclusion of capital and free reserves and the exclusion of the "Non-allowable assets" as stated in the L.C. Gupta Committee Recommendation.

27.13) The Committee observes that in view of the aforesaid findings, the Noticee's contentions that the ICDs are not doubtful or that the ICDs are not due for more than 3 months is not relevant in the facts of the present case where ICDs have been given to associate companies and ,therefore, the contention of the Noticee in its February 2020 submission that as on March 2019, the Noticee had . *"...written off 50% of ICD outstanding amount and balance 50% has been considered doubtful..."* is of no significance.

27.14) The Noticee also contended that the Circular dated December 4, 2006 issued by NSE (including the L. C. Gupta Committee recommendations contained therein) makes no reference to "ICDs". In this regard, the Committee observes that the same are also "debts" or "advances". In any case, the Noticee was well aware that ICDs were also "debts / advances" as contemplated by the L.C. Gupta Committee recommendations as is evident from the Noticee's own February 2020 submissions.

27.15) In the light of the aforesaid findings, the Committee is satisfied that upon the exclusion of ICDs worth Rs. 750 Crores given to ISSL Settlement & Transaction Services Ltd, IL&FS Energy Development Company Limited and IL&FS Financial

Services Limited as on March 31, 2018, there is shortfall in the net-worth to the extent of Rs. (-) 573.01 Crores as against the required networth of Rs. 3 Crores for Futures & Options segment and accordingly the contention of the Noticee that there was no discrepancy in the computation of net-worth as of March 31, 2018 is untenable.

27.16) It is also noted that the Noticee itself in its July 2021 submission has ,*inter alia*, extracted a passage from SEBI's Order in the case of Geojit BNP Paribas Financial services Ltd., wherein it was held that

> *" I note that as per law, there is no restriction on the inter corporate loan given by the SEBI registered intermediary. An inter corporate loan given by a stock broker out of the surplus funds* ***which exceed the minimum net worth requirement applicable to stock broker as well as the working capital requirement for its business, as a temporary financial accommodation would not pose the risk to the business of the stock broker …."***

Therefore, even as per the said Order relied on by the Noticee itself, SEBI also has clarified that ICD's or loans can be given by intermediaries like the Noticee only from funds in excess of the minimum net worth requirement. Further, the Committee notes that ICDs which are permitted to be given are considered under the category of "loans and advances" in the L C Gupta Committee recommendation. The intention is that even a permitted and valid ICD is required to be excluded if it is given to an associate or if it is overdue for more than 3 months. Therefore, the deduction of such ICDs is a mandatory requirement to arrive at the net worth in terms of the LC Gupta Committee recommendations.

27.17) The Committee observes that on the account of the aforesaid findings with regard to the calculation of net-worth by excluding advances given to associate companies, the findings in the SCN that there was a discrepancy in computation of networth as on September 30, 2018 is also substantiated and established.

27.18) Further, the loan given to IL&FS Employee Welfare Trust ought to have been excluded from the net-worth calculation on account of the said loan being a doubtful loan as mentioned by the Noticee itself in its Unaudited financial statements for half year ended September 30, 2018 submitted by the Noticee to NCL during the course of inspection. The Committee notes that the inspection findings as communicated to the Noticee by way of the POS were arrived at on the basis of the information submitted by the Noticee to NCL during the course of inspection. Such information included the unaudited financial statements for half year ended September 30, 2018. The Noticee has stated in the notes to the unaudited financial statements that the ICDs (including accrued interest) given to IL&FS Financial Services Limited (Rs. 93.05 crores approx.) and Infrastructure Leasing & Financial Services Ltd. (Rs. 30.61 crores approx.) had defaulted in their debt obligations and their then current credit rating was 'D' (Default) respectively as on September 30, 2018. Further, with respect to the loan given to IL&FS Employees Welfare Trust along with the interest accrued on it (Rs. 13.05 crores. approx.), the Noticee had stated that in view of the then current adverse situation of IL&FS, being the entity on whose behalf the Employees Welfare Trust administers its schemes, there was significant uncertainty with regard to the extent and timing of recovery of the aforesaid loan amount. Therefore the Noticee itself was well aware that the ICDs as on September 30, 2018 as well as the Loan to IL&FS Employee Welfare Trust were Doubtful Debts And Advances as is evident from the statements made by the Noticee in the Notes to the unaudited financial statements for the half year ended September 30, 2018.The Committee, therefore, observes that the aforesaid loans were in fact doubtful debts and advances on account of the aforesaid statements by the Noticee itself in the Notes to the unaudited financial statements for the half year ended September 30, 2018 and hence ought to have been excluded from the calculation of the net-worth.

27.19) The Committee also observes that while it was mandatory for the Noticee to adopt IND AS (Indian accounting standards) w.e.f. April 01, 2018, the Noticee had failed to do so and had submitted the unaudited financial statements by adopting IGAAP (Indian Generally Accepted Accounting Principle) standards. Had the Noticee adopted IND AS, the net-worth would have been reduced by a further amount of Rs. 6.46 Crores as submitted by the Noticee during inspection. In view of the above findings, the Committee observes that the net worth of the Noticee as on September 30, 2018 stands reduced to Rs.53.01 Crores after deducting the ICDs, interest on ICDs, loan to IL&FS Employee Welfare Trust, Interest on loan, Impact of IND AS and Sundry Debtors. The Committee observes that the computation of net worth by the Noticee is not in accordance with the L.C. Gupta Committee recommendation and the networth of Rs.207.07 Crores arrived at by the Noticee is incorrect. Therefore, the Committee observes that there is a discrepancy in computation of networth by the Noticee as on September 30, 2018.

**28) Noticee's submission with respect to violation of Rule 8(3)(f) of the SCRR**

28.1) Rule 8 (3)(f) of SCRR prohibits/restricts a member of a stock exchange from engaging (either as a principal or employee) in any business other than that of securities or commodity derivatives, except as a broker or agent not involving any personal financial liability.

28.2) The Noticee has referred to an appeal and stated that currently pending before the Hon'ble Supreme Court is SEBI's appeal (Appeal) from an order dated July 3, 2019 passed by the Securities Appellate Tribunal wherein SEBI has, *inter alia*, has effectively contended that clearing corporations are not recognized stock exchange.

The Noticee further submitted that it is the stand of SEBI that a clearing corporation like NCL does not constitute a recognized stock exchange and the same is pending consideration before the Hon'ble Supreme Court. Following the aforesaid contention of SEBI if it were to be held by the Hon'ble Supreme Court that NCL does not constitute a 'recognised stock exchange' then Rule 8(3)(f) of SCRR will have no application at all as regards the conduct of members of the NCL is concerned. More so, since one of the possible outcomes in case of an adverse decision, would be suspension/ expulsion of membership. Due to this reason, the present proceedings ought to be adjourned until such time that the Hon'ble Supreme Court returns a final judgement on the Appeal pending before it.

28.3) As per the IL&FS group treasury framework, group companies were asked to deposit the available funds in a liquidity management pool. The Noticee has submitted that it has been placing the ICDs in the ordinary course of business and withdrawing the same as per the requirement. Therefore, the Noticee has contended that ICDs do not constitute a "business activity" and there is no violation of Rule 8(3) (f) of the SCRR.

28.4) The Noticee in its submissions has referred to various case laws in support of its contention as to what constitutes a "business" activity and that the said ICDs given by the Noticee, do not amount to any "business".

28.5) The Noticee has stated that the term "business" is usually used in the context of making a profit and referred to the definition of the term "business" in P. Ramanatha Aiyar's Advanced Law Lexicon (5th Edition Volume l) as a term *"of wide import and it means an activity carried on continuously and systematically by a person by the application of his labour or skill with a view to earning an income"*. Thus, only when a person does something with the intention of earning an income, can it be said

that the person is carrying on a 'business'. In the present case, ICDs were deposited as a part of group treasury framework and was not a separate line of business carried out by the Noticee. Therefore, the ICDs do not constitute a "business activity" and there is no violation of Rule 8(3)(f) of SCRR.

28.6) The Noticee has submitted that it is common knowledge that any business/ enterprise, when it has surplus funds, it would invest the same in fixed deposits/ ICDs/ bonds etc. This by itself is not to be considered as a separate business activity. Only when an act is carried out with the intention of earning an income, does that act amount to 'business'. Black's Law Dictionary, 10th Edition, defines 'business' as *"a commercial enterprise carried on for profit; a particular occupation or employment habitually engaged in for livelihood or gain."*

28.7) The ICDs were created by the Noticee in its holding company IL&FS and the subsidiary companies of IL&FS namely IL&FS Financial Services Limited (IFIN) and IL&FS Energy Development Corporation Limited (IEDCL) from the surplus funds available with the Noticee as a part of the group treasury framework and was not a separate line of business. Thus, the creation of ICDs with IFIN, IEDCL and IL&FS is not in the nature of a systematic business activity which is being continued by application of labour or skill with a view to earn income.

28.8) The Noticee submits that in the case of Geojit BNP Paribas Financial Services Limited (Geojit), SEBI, during the course of inspection of Geojit had observed that Geojit had given loans and fund transfers to its subsidiary and had alleged the same to be in violation of the provisions of ,*inter alia*, Rule 8(3)(f) of the Rules. SEBI, during the adjudication proceedings, examined the record and found that Geojit had used its surplus funds invested and excess fund in the current account to one of its

subsidiaries and that SEBI held as follows :-

> *"I note as per law there is no restriction on the inter corporate loans given by a SEBI registered intermediary. An inter-corporate loan given by a stock broker out of the surplus funds, which exceed the minimum networth requirement applicable to stock broker as well as the working capital requirement for its business, as a temporary financial accommodation would not pose the risk to the business of the stock broker and affect the clients dealing with them. The main purpose of rule 8(3)(f) of SCRR was to prohibit the brokers to invest the clients' money in other businesses. However, in the present case, there is a clear demarcation of the clients' fund and its own fund."*

The Noticee ,therefore, contends that it was held in the Geojit case that placing ICD's with group companies does not constitute a violation of 8(3)(f) of the Rules, and that specially when the ICD's were created out of Noticee's own/proprietary funds and not client funds, there was no violation of Rule 8(3)(f) of the Rules by the Noticee.

28.9) The Noticee has stated that the question of the nature of ICDs has also been considered in taxation matters in the context of whether income from ICDs is taxable as "business income" (arising directly out of business activity of a concern) or "income from other sources". In Commissioner of Income Tax vs. Swani Spice Mills P. Ltd. {available at 2010 SCC OnLine Bom 2023}, a Division Bench of the Hon'ble Bombay High Court considered ICDs specifically that :-

> *"where the business of the Assessee does not consist of the investment of funds, the activity of the Assessee of parking its surplus funds with a view to earn interest cannot be regarded as partaking of the character of a business activity that would generate business income".*

28.10) The Noticee has submitted that in the present case, the ICDs were created by the Noticee from the surplus funds available with it, but not as a separate line of business. The Noticee further submitted that, in fact, the SCN itself states that the source of funds for the ICDs are commercial papers and internal accruals. Thus, as per established law, the creation of ICDs by the Noticee is not in the nature of a

systematic "business" activity which is being continued by application of labour or skill with a view to earn income. Further, as per SEBI's order in Geojit, the investment of surplus/ excess funds by the Noticee is not a violation of Rule 8(3)(f) of the SCRR especially when the ICDs were created out of the Noticee's own/proprietary funds and not client funds.

28.11) The Noticee has submitted that vide its letter dated July 24, 2018, NSE had raised a similar issue regarding why extending of ICDs was not a violation of Rule 8(3)(f) of the SCRR. In response, the Noticee had, vide its letter dated August 3, 2018, clarified why the extending of ICDs did not constitute a business activity and were in compliance with the extant regulatory framework. Thereafter, no further communication was addressed by NSE on the subject, thereby indicating that Noticee's submissions in this regard had been accepted.

**29) Findings of the Committee regarding violation of Rule 8(3)(f) of the SCRR**

29.1) The Committee observes that every clearing member is registered with SEBI under the SEBI (Stock Brokers) Regulations, 1992 **("SEBI Stock Broker Regulations")**. The Committee notes that the provisions of the SEBI Stock Broker Regulations which are applicable to a stock broker are also made mutatis mutandis applicable to a clearing member as stipulated in Regulation 10 F of the SEBI Stock Broker Regulations. The said Regulation 10 F stipulates that Chapters IV – General Obligations and Responsibilities; Chapter V – Procedure for Inspection and Chapter VI – Procedure for Action in case of Default, which are applicable to a stock broker are also mutatis mutandis, applicable to a clearing member. The Committee observes that the Noticee being a Clearing

Member is required to abide by the Code of Conduct, which has been prescribed in Schedule II of the SEBI Stock Broker Regulations. Any registration granted by SEBI under Regulation 6 of the Stock Broking Regulations is subject to one of the conditions that the stock broker shall at all times abide by the Code of Conduct as specified in Schedule II. Under clause A (5) of the said Code of Conduct, for Stock Brokers, a stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him. In view of the aforesaid regulatory provisions, it is not open for the Noticee to contend that the regulatory provisions of Rule 8 (3) (f) are not applicable to it.

29.2) The Committee further observes that the question of law pending before the Hon'ble Supreme Court in the appeal referred to by the Noticee in Para 28.2 above has no bearing with respect to the regulatory requirements which are required to be complied with by the Noticee as a clearing member under the provisions of SCRR with respect to Rule 8(3)(f).The Committee observes that the said appeal relates to, *inter alia*, the issue of the jurisdiction of the Hon'ble SAT and not to the issue of the applicability of SCRR to members of the NCL.

29.3) The Committee notes that the Noticee had endeavored to define what constitutes "business" in its submissions and also referred to various judgements in this regard. The Committee notes that Rule 8(3)(f) of SCRR provides as follows :-

> *No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if :-*
>
> ……
>
> *(f) he engages either as principal or employee in any business other than that of securities 14[or commodity derivatives] except as a broker or agent not involving any personal financial*

*liability, provided that-*

*(i) the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on business on the stock exchange either as an individual or as a partner in a firm*

*,*

*(ii) in the case of those members who were under the rules in force at the time of such application permitted to engage in any such business and were actually so engaged on the date of such application, a period of three years from the date of the grant of recognition shall be allowed for severing their connection with any such business,*

*(iii) nothing herein shall affect members of a recognised stock exchange which are corporations, bodies corporate, companies or institutions referred to in items [(a) to (n) of sub-rule (8)].*

The Committee observes that it is ,therefore, clearly stipulated that there is a prohibition on a member to engage either as principal or employee in any business other than that of securities except as a broker or agent not involving any personal financial liability. In this regard, the Committee also notes the circular dated May 07, 1997 issued by SEBI wherein it was clarified that borrowing and lending of funds by a trading member in connection with or incidental to or consequential upon securities business was not disqualified under Rule 8(1)(f) and Rule 8(3)(f).

29.4) The Committee notes that the purpose for which the ICD has been given is of significance in determining whether it is in connection with or incidental or consequential to the securities business. In this regard, the Committee notes that in the case of ***Sugal and Damani Share Brokers Ltd*** decided by SEBI on May 09, 2017 in Para 17, SEBI observed that :-

*"....from the aforesaid Circular, it is noted that if the member broker borrows or lends the fund for the purpose of meeting pay-in obligation of its clients in connection with or incidental to or consequential upon the securities business, then, prohibition*

*under Rule 8(3)(f) would not apply. However, if such loan is taken or given which is not in connection with or incidental to or consequential upon the securities business, then certainly, such activity is not permitted in terms of said Rule 8(3)(f).”*

Accordingly, the Committee observes that a permitted activity of issuance of ICDs would be an activity which should be undertaken in connection with, incidental or consequential to the securities business.

29.5) The Committee further observes that the Noticee has referred to the case of Geojit Securities wherein SEBI dealt with the provisions of Rule 8(3)(f) of SCRR. The Committee notes that the Noticee has relied on Para 18 of the said case which is reproduced as below:-

> “18. *There is no restriction on the inter corporate loans given by a SEBI registered intermediary. An inter-corporate loan given by a stock broker out of the surplus funds, which exceed the minimum networth requirement applicable to stock broker as well as the working capital requirement for its business, as a temporary financial accommodation would not pose the risk to the business of the stock broker and affect the clients dealing with them. The main purpose of rule 8(3)(f) of SCRR was to prohibit the brokers to invest the clients’ money in other businesses. However, in the present case, there is a clear demarcation of the clients fund and its own fund.”* (Emphasis supplied)

The Committee notes that :-

a) As aforesaid, even in the Geojit case, SEBI had clarified that any such ICDs can only be given out of the surplus funds, which exceed the minimum networth requirement applicable to stock broker and which exceeds the working capital requirement of the broker.

b) The Committee further observes that in Para No. 14 of the aforesaid case, SEBI had observed that for an activity to be considered as a business activity there should be several activities with several clients and SEBI also observed in Para

No. 16 that the ICDs should be placed out of broker's own funds. The Committee, therefore, while recognizing that there is no restriction on the inter corporate loans, given by a SEBI registered intermediary, however observes that whether the activity of issuance of ICDs constitutes business or not has to be determined on a case to case basis and that it has to be ,*inter alia*, considered (a) whether own funds or surplus funds of the member were used for giving ICDs; (b) whether the activity was repetitive ; i.e. ; several activities of the same kind were being undertaken with several parties or not.

c) The Committee finds that the facts of the present case indicate that the Noticee had given ICDs worth Rs.750 Crores to its associate/ group companies. The source of funds for the ICDs given was Commercial Papers (CPs) and internal accruals. A substantial amount of the source of funds was arranged through the borrowings raised by the Noticee through issuance of CPs of Rs. 788 Crores. It is observed that out of the total amount of Rs.750 Crores of ICDs given to associates, Rs.656 Crores were sourced out of CPs and Rs. 94 Crores was sourced out of internal accruals as on March 31, 2018.

d) It can, therefore, be seen that internal accruals were a very minimal source of the funds given as ICDs and the same were mostly from CPs. The Committee, therefore, finds that a substantial amount of funding for the ICDs is not generated out of the Noticee's own funds and ,therefore, the Noticee's said ICDs did not satisfy the aforesaid criteria as held by SEBI in the Geojit order, since the ICDs were not given by the Noticee out of its surplus own funds.

e) The Committee observes that in the present case, a substantial amount of funds given as ICDs to the said associate companies were raised through borrowings by way of CPs and the same were not surplus own funds as in the Geojit case.

Therefore, the Committee observes that contention of the Noticee that the ICDs were created by the Noticee from the surplus funds available with it, or that ICDs were created out of Noticee's own/proprietary funds does not hold good and stands controverted by the facts in the present case and hence the said contention of the Noticee is untenable.

f) Further, the said activity of giving ICDs was carried out by the Noticee several times involving several entities and, therefore, it is not an isolated activity for investment purpose and it is observed that the Noticee had given ICDs not only in the financial year 2018 but also in the previous year 2017. The Committee further observes that the CPs were borrowed at interest rates of 8.5 % to 9.5% per annum and ICDs of Rs.650 Crores were given to associate companies at a higher interest rate of 18 % per annum. Therefore, the Noticee was making a profit by way of interest differential between its borrowing and lending. This has also been disclosed by the Noticee in the financial statements for the half year ended September 30, 2018 under the head "other operating revenues" amounting to Rs.145.90 crores, read with footnote where the Noticee has mentioned that an amount of Rs.143.43 crores out of the other operating revenues includes interest earned on inter corporate deposits and fixed deposits with banks. Therefore, the Noticee itself had shown the interest earned on ICDs as revenue income in its unaudited financial statements for the half year ended September 30, 2018. The Committee further notes that vide email dated March 05, 2019 submitted by the Noticee to NCL during the course of inspection, the Noticee has given the bifurcation of other operating revenues as under:

| Table 1- Break up of other operating revenues | | | |
|---|---|---|---|
| Rs. in Crores | | | |
| **Particulars** | **Half year ended Sep 30, 2018.** | **FY 2017-18** | **FY 2016-17** |
| Interest earned on Inter corporate Deposits | 36.74 | 44.4 | 129.39 |
| Interest earned on Fixed deposits with bank | 106.68 | 175.33 | 120.26 |
| Other | 2.47 | 5.21 | 8.29 |
| **Total** | **145.89** | **224.94** | **257.94** |

The Committee further notes that as per financial statements for the half year ended September 30, 2018, the total income was Rs.197.81 Crores and the profit before tax was of Rs.47.20 Crores. It is thus observed that the interest earned from ICDs contributes considerably to the revenue of the Noticee.

g) The Noticee has submitted that in terms of the IL&FS group treasury framework, group companies were requested to deposit the available funds in a liquidity management pool, and the Noticee has been placing the ICDs in the ordinary course of business and withdrawing the same as per its requirement. This activity of borrowing funds and then placing the same in liquidity management pool not only poses a risk to the business of the Noticee but it is also an activity which is not relevant for the purpose of undertaking securities business and hence is not an activity which is connected with, incidental or consequential to securities business to qualify for the exemption permitted under the SEBI Circular dated May 7, 1997. It appears that the funds were being placed at a group level which involved the participation of many businesses which are undertaken by the IL&FS group companies in various fields and, therefore, such activity could not have been undertaken with respect to securities business alone and is a group practice which is not relevant to the securities business neither could it be taken to mean it is connected with,

incidental or consequential to the securities business. The Committee further observes that the liquidity management was not even undertaken from own funds or surplus funds but substantially through borrowed funds by way of CPs. Such liquidity management and the policy of the IL&FS group in this regard is not relevant if such policy is not in accordance with securities laws and such internal policies cannot override the regulatory framework prescribed under SCRR including SEBI circulars issued in that regard.

h) The Committee also notes that the Noticee in its submission has stated that the Noticee has placed the ICDs "*in the ordinary course of business".* This also amounts to an admission that the borrowing and then lending of money to earn higher income / interest was in fact a 'business'.

29.6) Therefore, after considering all the facts and circumstances of the case, the Committee concludes that the placing of ICDs was more than a mere investment of surplus funds and amounts to a business activity done on a regular basis for earning profit in the form of interest.

29.7) The Committee notes that the Noticee has contended that vide its letter dated August 3, 2018 addressed to NSE, the Noticee has submitted that it had clarified why the extending of ICDs did not constitute a business activity and why the Noticee was in compliance with the extant regulatory framework. The Noticee further submitted that thereafter no further communication was addressed by NSE on the subject, thereby indicating that the Noticee's submissions in this regard have been accepted. The Committee observes that upon a perusal of the said correspondence with NSE, that the Noticee had represented that *"ISSL as the largest clearing member in the equity derivatives segment is required to meet*

*pay-in and margin obligation with clearing corporation as part of its day to day operations. The placement of ICDs is part of the liquidity management by ISSL towards meeting such obligations and were not disbursed as a business activity."*

The same purpose for undertaking the activity was also mentioned in its letter dated October 19, 2018 to NSE. The Committee, however, observes that the Noticee has now represented before the Committee that the Noticee has placed the ICDs as per the IL&FS group treasury framework wherein group companies were requested to deposit the available funds in a liquidity management pool and that the Noticee has been placing the ICDs in the ordinary course of business and withdrawing the same as per the requirement. The Committee, observes that contrary to the submissions made in its letter addressed to NSE, the purpose for placement of ICDs was not incidental or consequential to the securities business as required under the above mentioned SEBI circular dated May 07, 1997 but for liquidity management as a part of IL&FS group treasury framework and ,therefore, the explanation given to NSE is contradicted by the submissions with respect to the ICDs being done as an activity as per the IL&FS group treasury framework requirement.

29.8) Further, during the inspection, the Noticee was requested vide email dated January 29, 2019 to elaborate the details as to whether the borrowed funds; viz; the CPs which were the source of funds for giving ICDs, were used to meet the margin obligation of trading members since the Noticee stated in its letter to NSE that the placement of ICDs is a part of the liquidity management by the Noticee towards meeting payin and margin obligations. The Noticee, however, while responding to the aforesaid email vide its email dated February 1, 2019 reiterated that there is a requirement for usage of borrowed fund towards meeting its margin and settlement obligations but failed to confirm that the same were used towards

meeting the payin/margin obligations. This indicates that the purpose was to provide liquidity management for the ILFS Group rather than to meet payin and margin obligations as stated in the letter dated August 3, 2018 to NSE.

29.9) The Committee, therefore, concludes that the Noticee violated the provisions of Rule 8(3)(f) of the SCRR as stated in the SCN.

**30) Noticee's submissions with regard to the violation of Regulation 4.5.1 of the NCL Regulations.**

30.1) As a clearing member, the Noticee obtained the relevant collateral from Allied, from time to time. In all the four instances the Noticee had ensured availability of sufficient collaterals against applicable margins through the period as per established process.

30.2) With respect to movement of the mutual fund units over the weekend, the same was enabled based on the written request of Allied as the client. The withdrawal of securities was considered by the Noticee upon receipt of specific withdrawal request from Allied. In the two instances wherein collateral was released to Allied on the weekend, securities collateral was received by the Noticee on the next trading day in the morning prior to commencement of trading, thereby ensuring sufficiency of collateral towards margin requirement.

30.3) It is not even the case/ allegation in the SCN that the Noticee had not 'demanded' the margin from the constituent. On the contrary it is a tacit admission in the SCN that such margin was in fact demanded and made available to the Noticee. The allegation is only that the Noticee failed to 'collect' margin, which is not covered

by Regulation 4.5.1 at all. Maintaining of margin as also the discretion to increase/ decrease the trading activity/ open positions etc. is that of the constituent, and as per the instructions of the constituent, the trading member carries out the transactions.

30.4) The Noticee has submitted the following details to explain the position at the relevant time :-

a) As of the closing hours on December 29, 2017 and March 28, 2018, there was no shortfall in collateral, as the Noticee had sufficient funds to cover the same.

b) The constituent, i.e., Allied, made a specific request to the Noticee for the release of collateral vide letters dated December 29, 2017 and March 28, 2018. Furthermore, these letters also specifically set out that in the event Allied is unable to return the collateral within time then the Noticee, *inter alia*, had the authority to initiate any action necessary to protect its interests which could, amongst others, include restrictions on further trading or close out of open positions of Allied, in accordance with the process set out in the CM-TM Agreement [See, Clause 2 (4), (8) and (9) of the CM TM Agreement].

c) On the very next trading day, i.e., January 1, 2018 and April 2, 2018, prior to commencement of trading, the collateral was returned to the Noticee, and hence the Noticee was not necessitated to reduce Allied's trading limits and/ or take any other action.

d) Therefore, in light of the above, it is clear that there was no shortfall in collateral, and hence such allegations are without merit.

e) It was further submitted that the SCN raises a presumptive allegation in so far as it alleges that the release of collateral from the Noticee to Allied on the abovementioned instances caused a shortfall in collateral. It cannot be said ipso facto that release of collateral by a clearing member causes a shortfall. Illustratively, on December 30, 2017, the collateral with the Noticee was INR 4,11,89,11,266.92, of which INR 3,29,62,41,561.48 was released to Allied. After such release, Noticee was still in possession of INR 23,36,72,779.44 in excess collateral over uncrystallized loss.

30.5) The Noticee has submitted that a perusal of the details provided in Annexure 1 of the SCN reveals that the four instances of alleged failure to collect margin are actually two instances where collateral was permitted to be withdrawn by Allied (based on written requests received by the Noticee) on non-trading days (i.e., on a Friday in respect of the instance in December 2017 and Wednesday in respect of the instance in March 2018 where Thursday and Friday were non-trading days). On both those instances, collateral was permitted to be withdrawn by Allied after trading hours on the last trading day and collateral was again placed by Allied with the Noticee prior to trading hours on the immediately following trading day. That is why the alleged shortfall is shown only on non-trading days but not on the following trading day.

30.6) The Noticee has submitted that the fact that no shortfall in margin is shown in Annexure 1 to the SCN on any day other than non-trading days is a tacit admission that such margin was not only demanded but actually collected by the

Noticee from Allied.

30.7) The relationship between Allied and the Noticee was governed by a Clearing Member – Trading Member Agreement' dated November 14, 2017 ("CMTM Agreement") and an addendum of even date ("Addendum"). For convenience, the CMTM Agreement and the Addendum were referred to collectively as the "Agreement". Withdrawal of securities was considered by the Noticee upon receipt of specific withdrawal request from Allied vide letters dated December 29, 2017 and March 28, 2018 (collectively "Letters"). Furthermore, the Letters also specifically set out that in the event Allied is unable to return the collateral within time then Noticee ,*inter alia*, had the authority to initiate any action necessary to protect its interests which could, amongst others, include restrictions on further trading or close out of open positions of Allied, in accordance with the process set out in the Agreement. In the two instances wherein collateral was released to Allied on the weekend, securities collateral was received on the next trading day in the morning, prior to commencement of trading, thereby ensuring sufficiency of collateral towards margin requirement.

**31) Findings of the Committee regarding the violation of Regulation 4.5.1 of the NCL Regulations**

31.1) As may be observed from the record, an analysis of the release of collateral by the Noticee to Allied and whether there was corresponding reduction in margin requirements was scrutinized. It was observed that on 2 days which were Saturdays i.e. December 30, 2017 and March 31, 2018, the Noticee released mutual funds to Allied which were part of collateral used for earlier day's margin requirement. The same were returned by Allied to the Noticee on Monday i.e.

January 01, 2018 and April 02, 2018 respectively. Therefore, there was a failure to collect margin from the member in accordance with Regulation 4.5.1 of Chapter 4 of NCL Regulations on 4 instances as per the details mentioned in the Annexure 1 to the SCN.

31.2) The Noticee's submission regarding excess collateral over uncrystallized loss is untenable as the collaterals are required to be maintained as per the margin requirement and not to be compared with the uncrystallized loss.

31.3) The contention of the Noticee that the release was done on the basis of a request by the client Allied is untenable since the collateral posted was constituting the margins towards an outstanding position. As long as the outstanding position remains, the underlying collateral cannot be released even at the request of the client. The same would also be contrary to prudent risk management practices.

31.4) In the present case, it is observed that upon release of the collateral to Allied, there was a shortfall in the margin cover on December 30, 2017 and December 31, 2017 for an amount of Rs. 99 Crores (approx.) and on March 31, 2018 and April 01, 2018 for an amount of Rs.209 Crores. (approx.), resulting in a violation of Regulation 4.5.1 of Chapter 4 of NCL Regulations.

31.5) The contention of the Noticee that Regulation 4.5.1 only required the Noticee to demand margin from its constituents (including Allied) and that there is no allegation in the SCN to the effect that the Noticee failed to 'demand' margin, is untenable. A clearing member cannot intentionally release the required margins when the positions are still open and have to be covered by the applicable minimum margins at all times. The requirement to demand margins from its constituents under Regulation 4.5.1 includes collection and retention of the

margins collected as long as the outstanding position remains and margin obligations continue. Otherwise it would lead to an anomalous position that margins have to be demanded but need not be collected or retained. No Clearing Member can be permitted to state that they have demanded the margin but need not collect and retain the margin under Regulation 4.5.1. Margins once collected for an outstanding position, must be retained as long as the position is open and outstanding, irrespective of whether the intervening days are trading days or non-trading days.

31.6) The Committee also notes that SEBI also has considered the said Regulation 4.5.1 in its order dated July 02, 2021 passed with respect to the Noticee and SEBI ,*inter alia* , observed that :-

> "*Regulation 4.5.1 of the NCL F&O Regulations requires a CM to demand collateral/ margin money from its trading members. While the regulation does not state that such weekend release of collateral is not permissible, I note that such a statement is not required in the first place. By the very nature of the principle of margin collection, it is clear that such release of collateral, which has been obtained for positions taken by the TMs, is not permissible. The entire concept of collection of margins is to minimize risk and in no way can it be construed that release of collateral over a weekend, when positions are open, is permissible."*

The Committee observes that the Noticee's submission that it cannot be said ipso facto that release of collateral by a clearing member causes a shortfall is untenable since the clearing member is required to maintain adequate margins at all points in time till the positions are open. The Committee notes that as per Clause 9.1 of Item 9 of NCL's Consolidated circular dated April 17, 2017, initial margin shall be payable on all open positions of Clearing Members, up to client level, and shall be payable upfront by Clearing Members in accordance with the margin computation mechanism and/ or system as may be adopted by the Clearing

Corporation from time to time. Therefore, members are required to collect initial margins from their client/constituents on an upfront basis. Non collection of adequate margins amounts to failure to adhere to prudent risk management practices. There would be a huge risk of inadequate margin coverage towards any losses which may accrue on account of failure of Allied to return the collateral to the Noticee. It would make a mockery of the risk management system and the margin system, to permit any clearing member to release the margin on any day, irrespective of trading or non trading day, as long as the outstanding position continues. The Committee observes that the Noticee had no justification for releasing the collateral which resulted in the shortfall in margin and the contention of the Noticee that it has demanded the margin from the client and satisfied the requirement of Regulation 4.5.1 deserves to be rejected as being frivolous, fallacious and as a mere after thought to justify its erroneous conduct.

31.7) The Committee views the conduct of the Noticee with seriousness since the release of margin supporting an outstanding position without any basis poses a serious risk and could have a cascading effect on the securities market considering the quantum of margin shortfall which has arisen in the present case, i.e., of an amount of Rs.99 Crores and Rs. 209 Crores on the respective dates as mentioned above. The Committee observes that the voluntary release of margin without any justification as seen in the present case requires to be dealt with stringently and, therefore, it is a fit case for imposition of penalty.

## DECISION

32) The Committee observes that on account of the findings mentioned above, the Noticee has failed to compute the networth in accordance with recommendations of the L.C. Gupta Committee. Accordingly, the Committee notes that for the period ended March 31, 2018, there was a shortfall in networth and for the periods ended March 31, 2018 and September 30, 2018, there was a discrepancy in computation of networth. Therefore, the Noticee has failed to comply with the requirements for continued admittance to clearing membership ; viz. ; maintenance of the prescribed networth in accordance with Rule 12 of Chapter IV of the Rules of NCL F&O segment. While the networth was recouped to required minimum levels as on September 30, 2018, none the less as on March 31, 2018, there was a failure to maintain the minimum networth as prescribed and there was a shortfall in networth by a substantial amount of Rs.(-)573.01 Crores as against the required networth of Rs. 3 Crores for Futures & Options segment.

33) The Committee observes that in terms of the provisions of Rule 8(3)(f) of SCRR, a member is prohibited from engaging in any business other than the business of securities, subject to the exceptions as stated herein above. The Committee notes that ICDs were given by the Noticee to associate/group companies and the Committee observes that as stated above, the placement of ICDs was undertaken primarily with borrowed funds by way of CPs and not out of own surplus funds. It was also a repetitive activity undertaken with various entities which resulted in a profit that was earned by lending the borrowed funds at a higher rate and the spread between the rate of borrowing and the rate of lending was shown in the financial statements of the Noticee as revenue. The purpose of placing these ICDs for liquidity management at group level was as per the internal policy of the IL&FS group and, therefore, was not an activity being undertaken in connection with, incidental or consequential to securities business. The said ICDs were in violation of Rule 8(3)(f) of SCRR for the reasons

as set out herein above in detail.

34) With respect to the above two violations, the Committee notes that the quantum of the ICDs placed is substantial. The quantum of discrepancy in networth calculation too is substantial. The quantum of shortfall in networth as stated above is also of a substantial amount of Rs. (-)573.01 crores. The purpose of placing the ICDs is for liquidity management as per the internal policy of the IL&FS group which is not an activity being undertaken in connection with, incidental or consequential to securities business. These violations warrant a stringent action. The Committee observes that under Rules 1 and 2 of Chapter V of NCL Rules (F&O) segment, the Committee is empowered to impose commensurate penalty of an appropriate amount to demonstrate not only the seriousness with which such violations are considered but also to act as a sufficient deterrent to ensure strict compliance with the Rules, Bye-laws and Regulations by the Clearing Members. The Committee is therefore satisfied that after considering all the facts and circumstances as stated above, it is a fit case to levy a penalty of an amount of Rs. 25,00,000/- for each of the aforesaid violations.

35) The Committee observes that there was a failure to collect margin by the Noticee from the trading member, Allied on account of release of margins supporting an outstanding position of Allied without any justification resulting in a margin shortfall amounting to about Rs.99 Crores and Rs. 209 Crores on the respective dates as mentioned above. For the reasons as set out herein above in detail, it is clearly established that there was violation of Regulation 4.5.1 of NCL Regulations by the Noticee. This violation posed a serious risk and could have had a cascading effect on the securities market considering the quantum of margin shortfall. The Committee observes that a penalty is leviable at the rate of 1% of the short-collection/non-collection of margins per client per segment per day in terms of SEBI circular CIR/DNPD/7/2011, dated August 10, 2011. The Committee is of the view that it is a fit case for imposition of such a penalty and that such a penalty is proportionate and commensurate

with the nature and quantum of violation by the Noticee considering the fact that such shortfall was occasioned by the inexplicable, deliberate and voluntary action of the Noticee to release the margin without any justification as stated in the findings of the Committee herein above. The Committee notes that in the present case there was shortfall of margin observed for four days as mentioned in Annexure 1 to the SCN of an amount of Rs. 6,17,93,82,205.84 and 1% of the same works out to Rs. 6,17,93,822.05. Accordingly, an amount of Rs. 6,17,93,822.05 (Rs. six crore seventeen lakh ninety three thousand eight hundred twenty two and five paise) is levied as penalty upon the Noticee for this violation.

36) The aforesaid penalties of Rs. 25,00,000, Rs.25,00,000 and Rs. 6,17,93,822.05 respectively for each of the aforesaid violations will be payable by the Noticee within a period of 30 days from the date of this order. In case the Noticee fails to pay the aforesaid penalty, the said amount shall be recovered from the available collateral of the Noticee with NCL from the date of expiry of the aforesaid period of 30 days.

| **Sd/-** | **Sd/-** | **Sd/-** | **Sd/-** |
|---|---|---|---|
| **Bhagyam Ramani** | **Harun R Khan** | **N K Maini** | **Vikram Kothari** |
| **(Chairperson)** | **(Committee Member)** | **(Committee Member)** | **(Committee Member)** |

**Due to COVID situation, the Committee has given confirmation on email instead of physical signatures**

**Date:- August 16, 2021**