Member and Core Settlement Guarantee Fund Committee
("MCSGFC"/ "Committee")
of
National Stock Exchange of India Limited
Exchange Plaza, Bandra-Kurla Complex, Bandra East, Mumbai – 400 051
held on October 11, 2022

In the matter of the Trading Member M/s LKP Securities Limited

CORAM

Ms Mona Bhide	-	Chairperson
Mr K Narasimha Murthy	-	Committee Member
Ms Anuradha Rao	-	Committee Member
Mr Ranganayakulu Jagarlamudi	-	Committee Member

ALSO PRESENT

Dr. Dinesh Kumar Soni	-	Senior Vice President – Regulatory

BACKGROUND

1. M/s LKP Securities Limited ("**Noticee**") is a Trading Member registered with the National Stock Exchange of India Limited ("**Exchange**"/"**NSEIL**") and enabled for trading in the Capital Market ("**CM**") segment since July 1995, Futures and Options ("**F&O**") segment since August 2003 and Currency Derivatives ("**CD**") segment since August 2008.

2. The Exchange conducted a limited-purpose inspection of the Noticee's books of accounts and records from October 2021 to December 2021 to verify the availability of clients' funds as of June 14, 2021, June 15, 2021, and June 17, 2021. Post-inspection, the Exchange issued a show-cause notice dated April 1, 2022. The Noticee, vide its emails dated April 19, 2022, and October 12, 2022, replied to the said show-cause notice.

INSPECTION OBSERVATION/VIOLATION

3. The observation/violation alleged in the show cause notice is summarized hereunder:

   3.1. Misuse of clients' funds to the extent of Rs.3.93 crores, Rs.2.32 crores, and Rs.1.43 crores as of June 14, 2021, June 15, 2021, and June 17, 2021, respectively, thereby violating Principle 1 of the Enhanced Supervision of Stockbrokers.

PRESENT PROCEEDINGS BEFORE MCSGFC

4. The Exchange, vide its email dated October 8, 2022, granted the Noticee with an opportunity for a personal hearing before the Committee. On behalf of the Noticee, Mr. Alpesh Dangodra (Chief Financial Officer), and Ms. Sunita Ambavkar (Compliance Officer), appeared before the Committee and made the following oral submissions:

   a. The Noticee had sufficient funds in its own/proprietary account, but due to an operational issue in the back end, the said funds were not transferred to the client account on the reported dates.

   b. The credit balances include funds owed to its promoter group, viz. LKP Finance, having common directors and shareholders. The Noticee owed Rs.1.42 crores, Rs.11 crores, and Rs.10 crores, to LKP Finance Limited as of June 14, 2021, June 15, 2021, and June 17, 2021, respectively. If the sum owed to LKP Finance is excluded from the value of creditors, the value of 'G', i.e. availability of funds, will be positive on all the reported dates.

REGULATORY PROVISIONS

5. At the outset, it is appropriate to refer to the relevant regulatory provisions violated by the Noticee, extracts whereof are as reproduced below:

   a. Regulation 4.5 3 (e) of Exchange Regulations

      No Trading Member or person associated with a Trading Member shall make improper use of the constituent's securities or funds.

b. Exchange Circular No. NSE/INSP/33276 dated September 27, 2016

3.3. Based on the aforesaid information submitted by the stockbroker, Stock Exchanges shall put in place a mechanism for monitoring clients' funds lying with the stockbrokers on the principles enumerated below:

3.3.1. Funds of credit balance clients used for settlement obligation of debit balance clients or own purpose:

Principle

The total available funds i.e. cash and cash equivalents with the stock broker and with the clearing corporation/clearing member (A+B) should always be equal to or greater than clients' funds as per ledger balance (C)

$$G=(A+B)-C$$

CONSIDERATION & FINDINGS

6. The observation/violation, the replies of the Noticee and the findings of the Committee are as under:

6.1. **Misuse of clients' funds**

6.1.1 The Exchange verified the collaterals/deposits available with the Clearing Corporation/Clearing Member, bank balances lying in the client bank and settlement accounts of the Noticee, and client payables reported in the client-level cash and cash equivalent submission by the Noticee as of June 14, 2021, June 15, 2021, and June 17, 2021.

Upon verification, the Exchange observed that the Noticee used the funds of credit balance clients to meet the settlement obligations of debit balance clients and/or own purpose to the extent of Rs.3.93 crores, Rs.2.32 crores, and Rs.1.43 crores as of June 14, 2021, June 15, 2021, and June 17, 2021, respectively, thereby violating Principle 1 of the Enhanced Supervision of Stockbrokers.

6.1.2 In reply to the SCN, the Noticee submitted as under:

a. The Noticee did not do proprietary trading during the inspection period.

b. There are no instances of client complaints for denial of limits of funds or securities withdrawal.

c. The clients' funds are kept in a separate bank account maintained by it. On payment/receipt of funds to/from the client, such debit/credit of funds is reflected in the respective ledger account of the client. The funds of clients are not used to meet the obligations of any other clients or own purposes. If the funds are misused as alleged, the credit balance clients would be unable to trade.

d. The observed violation occurred at the peak of Covid-19 pandemic. The back-office staff failed to transfer funds from own account to client account and furthermore failed to consider the balance in own account. Thus, the value of "G" was incorrectly calculated.

e. The lapses were merely technical/operational caused due to lack of adequate checks during the inspection period. The Noticee identified the lapses and resolved the issues. No clients' funds were used in a manner detrimental to the clients' interests.

f. Its promoter company, i.e. LKP Finance Limited, having common directors and shareholders, had a credit balance amounting to Rs.1.42 crores, Rs.11 crores, and Rs.10 crores as of June 14, 2021, June 15, 2021, and June 17, 2021, respectively. This can be verified from the cash and cash equivalent report dated June 14, 2021, June 15, 2021, and June 17, 2021. If the credit balances owed to the family members and promoter group are excluded from the value of creditors, and fund balances in own account are included, the value of 'G', i.e. availability of funds, will be positive on all the reported dates.

6.1.3 The Committee finds as under:

a. The Noticee attributed the inspection observation/violation to procedural/technical lapses. It claimed that (i) the clients' funds are not used for own purposes as it did not do proprietary trading during the inspection period. (ii) there are no client complaints. (iii) the credit balances of promoter group should be excluded from the value of total creditors. (iv) the funds lying in own/proprietary account should be considered in the total end of the day balance.

b. As per Exchange Circular No. NSE/INSP/33276 dated September 27, 2016, only fund balances available in all client bank accounts, including the settlement account maintained by the Trading Member, shall be considered. Hence, the Noticee's claim that the Exchange failed to consider the funds lying in the own/proprietary account in the total end of the day balance on the observed dates is not tenable.

c. The Noticee claimed that its promoter company, i.e. LKP Finance Limited, having common directors and shareholders, had a credit balance amounting to Rs.1.42 crores, Rs.11 crores, and Rs.10 crores as of June 14, 2021, June 15, 2021, and June 17, 2021, respectively.

Upon verification of the cash and cash equivalent balances, the Noticee's claim is acceptable. After excluding the credit balances payable to LKP Finance Limited from the total credit balances, the revised value of 'G', i.e. availability of funds, is as under:

Particulars	14-06-2021	15-06-2021	17-06-2021
Value of 'G'	-3,92,80,000.00	-2,32,10,000.00	-1,42,50,000.00
Credit balance of Promoter Company	1,42,53,972.88	11,08,88,543.70	10,72,20,605.00
Revised value of 'G'	-2,50,26,027.12	8,76,78,543.70	9,29,70,605.00

In view of the above, the misuse of clients' funds persists on one day, i.e. June 14, 2021, and the extent of misuse is reduced from Rs.3.93 crores to Rs.2.50 crores.

d. As per Regulation 4.5.3 (e) of the Exchange Regulations (CM and F&O Segments), no Trading Member or person associated with a Trading Member shall make improper use of the constituent's securities or funds. Further, as per clause 3.3.1 of Exchange Circular No. NSE/INSP/33276 dated September 27, 2016, the total available funds, i.e., cash and cash equivalents with the Trading Member/Clearing Corporation/Clearing Member, should always be equal to or greater than the clients' funds as per ledger balance. Thus, the Noticee violated the above regulatory provisions mentioned above.

e. As per Exchange Circular No. NSE/INSP/47457 dated February 25, 2021, if the misuse is above Rs.2 crores and below Rs.10 crores, and up to 50% of the net worth, the prescribed monetary penalty is up to 3% of the misuse. The misuse is Rs.2.50 crores as of June 14, 2021. The net worth of the Noticee is Rs.24.25 crores as of March 31, 2021.

6.1.4 Considering there is no shortfall of clients' funds on the next day, i.e. June 15, 2021, the Committee decided to levy a monetary penalty of Rs.2.50 lakhs (1% of the Rs.2.50 crores) for the observed violation.

DECISION

7. Given the above, the Committee levies the following penalty for the violation mentioned below:

Sr. No.	Committee's Findings	Prescribed Penalty as per Exchange Circular No. NSE/INSP/47457 dated February 25, 2021	Penalty
a.	The Noticee misused the clients' funds to the extent of Rs.2.50 crores as of June 14, 2021.	Monetary penalty of up to 3% of the misuse	Rs.2.50 lakhs (Reasons enumerated above)
TOTAL			Rs.2.50 lakhs

8. The Noticee shall pay a monetary penalty of Rs.2.50 lakhs (Rupees Two Lakhs Fifty Thousand only).

Sd/-
Mona Bhide
(Chairperson)

Sd/-
K Narsimha Murthy
(Committee Member)

Sd/-
Ranganayakulu Jagarlamundi
(Committee Member)

Date: January 2, 2023