

BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. Order/MC/DS/2019-20/6201]

UNDER SECTION 15-I (2) OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 AND RULE 5 OF SEBI (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 1995.

In respect of –

1. **M/s Karvy Financial Services Limited** (PAN – AACCK6354L) having address at – 705/706, 7TH Floor, Hallmark Business Plaza, Sant Dnyaneshwar Marg, Opp. Guru Nanak Hospital, Bandra (East), Mumbai - 400051.

In the matter of M/s Regaliaa Realty Limited.

BACKGROUND

1. Securities and Exchange Board of India (hereinafter be referred to as, “**SEBI**”) initiated adjudication proceedings under Section 15A(b) of SEBI Act, 1992 (hereinafter be referred to as, the “**SEBI Act**”) against M/s Karvy Financial Services Limited (hereinafter be referred to as, “**the Noticee**”) for the alleged violations of Regulation 7(1) read with 7(2) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 1997 (hereinafter be referred to as, the “**SAST Regulations, 1997**”), Regulation 29(1) read with 29(3) of the SEBI (Substantial Acquisition of Shares and Takeovers) Regulations, 2011 (hereinafter be referred to as, the “**SAST Regulations, 2011**”) and Regulation 13(1) of the SEBI (Prohibition of Insider Trading) Regulations, 1992 (hereinafter be referred to as, the “**PIT Regulations**”).

APPOINTMENT OF ADJUDICATING OFFICER

2. SEBI initiated adjudication proceedings and appointed Mr. Suresh Gupta, Chief General Manager as Adjudicating Officer under Section 15I of the Securities

and Exchange Board of India Act, 1992 (hereinafter be referred to as, the “**SEBI Act**”) read with Rule 3 of the SEBI (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter be referred to as, the “**Adjudication Rules**”) *vide* order dated February 07, 2017 to inquire into and adjudge under Section 15A(b) of the SEBI Act against the Noticee for the aforesaid alleged violations. Subsequently, the undersigned was appointed as the Adjudicating Officer on May 29, 2018 which was communicated *vide* order dated November 05, 2018.

SHOW CAUSE NOTICE, REPLY AND HEARING

3. Show Cause Notice No. EAD/EAD5/MC/CB/905/2019 dated January 08, 2019 (hereinafter be referred to as, the “**SCN**”) was served upon the Noticee under Rule 4(1) of the Adjudication Rules to show cause as to why an inquiry should not be held and penalty be not imposed against it under Section 15A(b) of SEBI Act, 1992, for the alleged violations of Regulation 7(1) read with 7(2) of SAST Regulations, 1997, Regulation 29(1) read with 29(3) of SAST Regulations, 2011 and Regulation 13(1) of PIT Regulations.
4. The allegations levelled against the Noticee in the SCN are summarized as below:
 - a) Ms. D Deeptha Reddy, Mr. D Sudhakara Reddy and Ms. D Usha Reddy were promoters of the M/s Regaliaa Realty Limited (Company).
 - b) Examination revealed that the aforementioned promoters, in order to obtain a project loan for the company, created encumbrance on the shares held by them by way of a pledge in favour of the Noticee to secure repayment of the aforesaid loan. The details of the shares encumbered by the aforementioned promoters of the company are as follows:

Name	Category	Pledged Shares	Percentage of total share capital	Date of Creation of Pledge
Sudhakar Reddy	Promoter – cum – Director	976340	27.12%	February 24, 2011

Name	Category	Pledged Shares	Percentage of total share capital	Date of Creation of Pledge
D Deeptha	Promoter – cum – Director	739300	20.54%	February 24, 2011
D Usha Reddy	Promoter	284460	7.90%	February 24, 2011
Total		2000100	55.56%	

- c) Creation of pledge in the manner mentioned in the paragraph hereinabove required the Noticee to disclose creation of pledge to the Company as well as BSE in terms of Regulation 7(1) read with 7(2) of the SAST Regulations, 1997.
- d) Thereafter, pledge created over the shares of the promoters / directors of the Company was invoked by the Noticee on February 16, 2012 and subsequently, 20,00,100 shares of the Company amounting to 55.56% of its total share capital were transferred in favour of the Noticee.
- e) As a result of such invocation, the Noticee was required to disclose the details of the shareholding in the Company acquired by it to the Company as well as BSE under Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and to the Company under Regulation 13(1) of the PIT Regulations.
- f) BSE vide email dated June 16, 2015 and Company vide letter dated August 29, 2018 confirmed that no disclosures were received from the Noticee in relation to creation and subsequent invocation of pledge over the shares of the Company.
- g) In view of the aforesaid, it was alleged that the Noticee did not disclose the creation and subsequent invocation of pledge over the shares of the Company and thereby, violated Regulation 7(1) read with 7(2) of the SAST Regulations, 1997, Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations.

- h) Noticee was informed that alleged violation, if established, would make the Noticee liable for monetary penalty under Section 15A(b) of the SEBI Act, 1992, text of which is reproduced as under:-

SEBI Act

*“15A. **Penalty for failure to furnish information, return, etc-** If any person, who is required under this Act or any rules or regulations made thereunder, -*

(b) to file any return or furnish any information, books or other documents within the time specified therefor in the regulations, fails to file return or furnish the same within the time specified therefor in the regulations, he shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less.”

5. In respect of the SCN, Noticee vide emails dated March 8, 12 and April 24, 2019 informed that they will be filing application for settlement. An opportunity of hearing was provided to the Noticee on October 24, 2019 vide notice dated October 07, 2019. Vide email dated October 15, 2019, Noticee requested to keep the present matter on abeyance till the conclusion of its settlement application. Vide email dated October 22, 2019, Noticee informed that it is not proceeding ahead with the settlement process and requested for adjournment of hearing scheduled on October 24, 2019.
6. Accordingly another opportunity of hearing was provided to the Noticee on November 19, 2019 vide notice dated October 22, 2019 through email. Noticee submitted its reply vide letter dated November 18, 2019. Hearing on November 19, 2019 was attended by the Authorised Representative of the Noticee (AR) – Mr. Yogesh Gaat, Mr. Jimit B Shethwala, Mr. Muthuswamy Iyer and Ms. Sabeena Mahadik. AR of the Noticee reiterated the submissions made in its reply dated November 18, 2019 and stated that it will be filing additional submissions. Accordingly Noticee vide email dated November 26, 2019 filed its additional submissions.

7. The key submissions of the Noticee are summarized as below:

- a) Noticee informed that it falls within the definition of 'financial institution' as per RBI and since the amended Regulations 7(1) read with 7(2) of the SAST Regulations, 1997 allows an exemption for financial institution to make disclosures to the Target company and the Stock exchange, Noticee should be exempted from the applicability of the SAST Regulations.
- b) Noticee submitted that the creation of pledge was clearly reflected in the Shareholding Pattern of Target Company as on March 31, 2011. In the shareholding pattern, the said shares were mentioned as 'encumbered shares' as available on the stock exchange website.
- c) Noticee submitted that in respect to alleged violation of Regulation 29(1) read with 29(3) of SAST Regulations, 2011, Noticee had disbursed a loan facility of Rs.7,00,00,000/- (Rupees Seven Crore Only) to M/s. Regaliaa Realty Limited (as a Principal Borrower) along with its directors, viz., Mr. D. Sudhakara Reddy, Ms. D. Usha Reddy, Ms. D. Deeptha Reddy (being Co-borrowers) against equitable mortgage of their property and also pledge of shares. For the said purposes, the Borrowers along with the Co-Borrowers had executed the various loan documents such as Loan Agreement, Demand Promissory Note, Undertaking, Memorandum of Entry, Letter of Guarantee, Power of Attorney, Declaration, Authorization and Declaration, Memorandum of Deposits of Title Deeds etc., in favour of Noticee.
- d) In February 2012, M/s. Regaliaa Realty Limited and its co-borrowers defaulted in fulfilment of the loan obligation pursuant to which on February 16, 2012, Noticee was constrained to invoke the pledge on 20,00,100 equity shares into its own Demat Account with the sole intention of eradicating the risk associated with the pledged security. By virtue of the pledge being invoked, Noticee shareholding in Regalia Realty Limited increased from 0% to 55.56%.
- e) For lending financial institution, it is in normal course of business to obtain security inter-alia including but not limited to equity shares and create

pledge in its favour to protect its risk. Also, in the event of non-fulfillment of loan obligations by the borrower, the lender invokes the security to realise its dues. In our case the client registration documents clearly capture such details and also contain relevant clauses empowering us as a lending institution to invoke the pledge on the equity shares in the event of default and disposing such shares through sale.

- f) Noticee submitted that it never had intention of acquiring control over the Target Company. Further, it is submitted that neither there was any member of Noticee on the board of the Target Company nor was Noticee involved in handling the day to day affairs of the Target Company. Its action of invocation of pledged shares was only a risk mitigating measure.
- g) Noticee submitted that after the invocation of the pledged shares on February 16, 2012, Noticee was classified under public shareholding as 'bodies corporate' in the shareholding pattern filed by the Target Company as on March 31, 2012 as available on the stock exchange. Therefore the fact of invocation of pledge was in the knowledge of the public.
- h) Noticee also informed that on August 31, 2018, Noticee complied with the direction issued vide SEBI order no. WTM/RKA/EFD/165/2016 dated October 27, 2016 and in compliance with and pursuant to Regulations 3(1), Regulation 4 read with Regulation 14, Regulation 15(1) and 32(1)(f) and other applicable provisions of the SEBI Takeover Regulations.
- i) Disclosure under Regulation 29(1) of SAST Regulations, 2011 were made on December 26, 2018 to company and stock exchange.
- j) Noticee submitted that, as per the SEBI (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulation, 2018 applicable w.e.f December 31, 2018, exemptions are granted to housing finance companies and Systematically Important Non-Banking Finance Company under Regulation 29 of SEBI SAST regulation. Clearly such amendment was done with a view to deal with the situation as faced in the instant case. It is SEBI's view itself that such invocation of pledge should not be construed as a breach of SAST guidelines or PIT Regulations.

- k) Noticee requested that since it is Systematically Important Non-Banking Finance Company, the above exemption should be applied in letter and spirit in the instant case.
- l) Noticee submitted that in respect to Regulation 13(1) of PIT Regulations, disclosures were made on December 26, 2018.
- m) In view of the foregoing submissions, it submitted that, Noticee has not violated provisions of Regulation 7(1) read along Regulation 7(2) of SEBI SAST Regulation, 1997.
- n) The disclosure required under the Regulation 29(1) read with Regulation 29(3) of SAST Regulation, 2011 were made to the Target Company and the Stock Exchange as mentioned above.
- o) The disclosure required under the Regulation 13(1) of SEBI PIT Regulation, 1992 were made to the Target Company as mentioned above.
- p) Noticee submitted that in the light of the aforesaid facts the present SCN against the Noticee may be dropped and Noticee may be exonerated from all the charges and no penalty be imposed against it under section 15A(b) of SEBI Act, 1992, as mentioned in the captioned show cause notice.

CONSIDERATION OF ISSUES AND FINDINGS

8. The issues that arise for consideration in the instant matter are:

Issue No. I Whether Noticee had failed to make mandated disclosures under the Regulation 7(1) read with 7(2) of the SAST Regulations, 1997, Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations as alleged in the SCN?

Issue No. II If yes, whether the failure, on the part of the Noticee would attract monetary penalty under Section 15A(b) of the SEBI Act?

Issue No. III If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 15J of the SEBI Act read with Rule 5(2) of the Adjudication Rules?

Issue No. I Whether Noticee had failed to make mandated disclosures under the Regulation 7(1) read with 7(2) of the SAST Regulations, 1997, Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations as alleged in the SCN?

9. In the explanation to Regulation 7(1) read with 7(2) of the SAST Regulations, 1997, it is stated that, *“For the purposes of sub-regulations (1) and (1A), the term ‘acquirer’ shall include a pledgee, other than a bank or a financial institution and such pledgee shall make disclosure to the target company and the stock exchange within two days of creation of pledge”*
10. Noticee in its reply informed that it falls within the definition of ‘financial institution’ as per RBI and the SAST Regulations, 1997 allow an exemption for financial institution to make disclosures to the Target company and the Stock exchange.
11. I note that the Noticee is an NBFC registered with RBI and is hence a non-banking financial institution in terms of the RBI Act. I note that financial institutions are exempted from disclosure in terms of the explanation to Regulations 7(1) and 7(2) of the SAST Regulations, 1997. Hence, I am of the view, that the Noticee is not in violation of Regulations 7(1) read with 7(2) of the SAST Regulations, 1997, in respect of transaction of creation of pledge carried out on February 24, 2011.
12. The proviso to Regulation 29 of the SAST Regulations, 2011, states that, *“**Provided** that such requirement shall not apply to a scheduled commercial bank or public financial institution as pledgee in connection with a pledge of shares for securing indebtedness in the ordinary course of business.”* While the SAST Regulations 2011 do not define public financial institution (PFI), the SAST Regulations 1997 state that public financial institution means a public financial institution as defined in section 4A of the Companies Act, 1956. The Noticee is not a PFI in terms of section 4A of the Companies Act, 1956.

13. Regulation 29(1) read with 29(3) of the SAST Regulations requires the acquirer who acquires 5% of shares or more shares of the company to disclose *within two working days of the receipt of intimation of allotment of shares, or the acquisition of shares or voting rights in the target company to,— (a) every stock exchange where the shares of the target company are listed; and (b) the target company at its registered office.* As the Noticee is not a PFI, it was required to make disclosures under Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 in respect of transaction of invocation of pledge of 20,00,100 shares carried out on February 16, 2012.
14. In terms of Regulation 13(1) of PIT Regulations, “*Any person who holds more than 5% shares or voting rights in any listed company shall disclose to the company in Form A, the number of shares or voting rights held by such person, on becoming such holder, within 2 working days of :— (a) the receipt of intimation of allotment of shares; or (b) the acquisition of shares or voting rights, as the case may be.*”
15. On account of invocation of pledge by the Noticee on February 16, 2012, it acquired 20,00,100 shares of the Company amounting to 55.56% of its total share capital. Hence the Noticee was required to make disclosure under Regulation 13(1) of PIT Regulations
16. BSE vide email dated June 16, 2015 and Company vide letter dated August 29, 2018 confirmed that no disclosures were received from the Noticee in relation to invocation of pledge over the shares of the Company. Noticee in its reply admitted the fact that the pledge created over the shares was invoked by the Noticee on February 16, 2012, since the borrowers have defaulted in fulfilment of the loan obligation. By virtue of the pledge being invoked, Noticee shareholding in Regalia Realty Limited increased from 0% to 55.56% and the said disclosure under Regulation 29(1) of SAST Regulation and Regulation 13(1) of PIT Regulation was made on December 26, 2018 to company and stock exchange i.e. after a delay of 6 years and 11 months.

17. In view of the aforesaid, it is established that the Noticee failed to make disclosures as required under Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations.

18. Noticee has also submitted that, exemptions are granted to housing finance companies and Systematically Important Non-Banking Finance Company under Regulation 29 of SEBI SAST regulation, as per the SEBI (Substantial Acquisition of Shares and Takeovers) (Third Amendment) Regulation, 2018 applicable w.e.f December 31, 2018 and requested that Noticee may be exempted from such Regulations. The said contention of the Noticee is not acceptable as the said amendment cannot be applied retrospectively to transactions which took place in 2012.

Issue No. II If yes, whether the failure, on the part of the Noticee would attract monetary penalty under Section 15A (b) of the SEBI Act?

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Issue No. III If yes, what would be the monetary penalty that can be imposed upon the Noticee taking into consideration the factors stipulated in Section 15J of the SEBI Act read with Rule 5 (2) of the Adjudication Rules?

19. Since failure of the Noticee in making disclosures to Company and BSE under Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations is established, I am of the view that it warrants imposition of monetary penalty under Section 15A(b) of the SEBI Act on the Noticee, text of which is reproduced as under:

SEBI Act

“15A. If any person, who is required under this Act or any rules or regulations made thereunder—

.....

(b) to file any return or furnish any information, books or other documents within the time specified therefore in the regulations, fails to file return or furnish the same within the time specified therefore in the regulations, he shall be liable to a penalty of one lakh rupees for

each day during which such failure continues or one crore rupees, whichever is less.”

20. While determining the quantum of penalty under Section 15A(b) of the SEBI Act, the following factors stipulated in Section 15J of the SEBI Act, have to be given due regard:

- a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- (b) the amount of loss caused to an investor or group of investors as a result of the default;
- (c) the repetitive nature of the default.

21. I note that no quantifiable figures are available on record to assess disproportionate gain made or loss caused to investors by the aforesaid violation. While it is established that the Noticee made delayed disclosure to Companya and BSE under under Regulation 29(1) of SAST Regulation and Regulation 13(1) of PIT Regulation was made on December 26, 2018 to company and stock exchange i.e. after a delay of 6 years and 11 months. Further, I also note from reply of the Noticee and statement of shareholding pattern of the Company, available on the website of the BSE for the financial quarter ending March 2012 – Shareholding of Noticee was correctly reflected as 20,00,100 shares (55.56% of holding) as on quarter ending March 2012, which was in public domain by March 31, 2012. I note that being a registered financial institution, the Noticee was required to be aware of the applicable laws and should have been mindful of making requisite disclosures when invoking pledge of shares against default in loans.

22. Therefore, taking into account the facts and circumstances of this matter, and the mitigating factors, I am of the view that a penalty of ₹5,00,000 will be commensurate with the violations committed.

ORDER

23. After taking into consideration all the facts and circumstances of the case, in exercise of powers conferred upon me under Section 15I (2) of the SEBI Act

read with Rule 5 of the Adjudication Rules, I hereby impose a penalty of ₹5,00,000/- (Rupees Five Lakh only) upon the Noticee, i.e. M/s Karvy Financial Services Limited under Section 15A(b) of the SEBI Act for violation of Regulation 29(1) read with 29(3) of the SAST Regulations, 2011 and Regulation 13(1) of the PIT Regulations.

24. The Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of Demand Draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, OR through online payment facility available on the SEBI website www.sebi.gov.in on the following path, by clicking on the payment link

ENFORCEMENT → Orders → Orders of AO → PAY NOW

25. The Noticee shall forward said Demand Draft or the details / confirmation of penalty so paid to the Enforcement Department – Division of Regulatory Action – I of SEBI. The Noticee shall provide the following details while forwarding DD/ payment information:

- a) Name and PAN of the entity (Noticee)
- b) Name of the case / matter
- c) Purpose of Payment – Payment of penalty under AO proceedings
- d) Bank Name and Account Number
- e) Transaction Number

26. Copy of this Adjudication Order is being sent to the Noticee and also to SEBI in terms of Rule 6 of the Adjudication Rules.

DATE: DECEMBER 23, 2019

PLACE: MUMBAI

MANINDER CHEEMA

ADJUDICATING OFFICER