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Investors fret as India bars brokerage Karvy over alleged misuse of client funds

MUMBAI, Nov 26 (Reuters) - A ban by India's market regulator on Karvy Stock Broking from taking on new clients and executing trades for allegedly misusing client securities has unnerved the country's retail investors.

The Securities and Exchange Board of India (SEBI) barred Karvy on Friday after a preliminary investigation by the National Stock Exchange (NSE) showed the brokerage pledged and sold some of its client securities to raise funds for its own use, without client authorisation and in violation of new rules.

Karvy said in a statement over the weekend that there was no "mis-utilisation" of client securities. Some investors are considering a move to big, bank-owned brokerages even if they cost more, according to three financial advisers, bucking a recent trend towards discount brokers.

"Worried clients have been calling me and I've told them they may shift if they are more comfortable with a bigger brokerage," said SR Srinivasan of financial planning firm SriNivesh Advisors, although he said that out of the handful that have called none had yet shifted.

NSE had been investigating trades at Karvy following several complaints by investors who said the brokerage was not granting fund transfer requests.

SEBI in June announced a ban on brokers pledging their clients' securities to banks or non-banking financial companies to raise funds.

A total of close to 20 billion rupees (\$278.67 million) is at stake, according to SEBI, including about 10.96 billion rupees transferred by Karvy to its group company Karvy Realty Pvt Ltd.

The Karvy Group serves 70 million individual investors and provides investment advice to more than 600 companies, according to its website.

"A lot of people are also worried about their associations with other businesses of Karvy," Vishal Dhawan, founder of Plan Ahead Wealth Advisors said. "Investors may consider temporarily shifting from low-cost brokerages to bank-owned ones."

In its statement, Karvy said that SEBI's order only prevents it from adding new clients and that it had yet stated its position to the regulator.

Karvy did, however, say that while it had started unwinding pledged shares following SEBI's June directive it had not finished the process.

"The whole issue is of outstanding payment to around 150-180 clients of the brokerage," Karvy Group's Chairman C Parthasarathy told the Hindu BusinessLine daily, adding that about 250-300 million rupees due to clients would be cleared in less than a fortnight.