BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO.: VSS/AO- 66/2009]

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

In respect of

M/S Anand Rathi Share and Stock Brokers Limited

(formerly known as M/S Navratan Capital and Securities Pvt. Ltd.)

SEBI Registration No.: INB230676935 and INB010676931

DP Reg. No. - IN-DP-NSDL-149-2000

(PAN No.: AAACN3405F)

FACTS OF THE CASE IN BRIEF

1. Securities and Exchange Board of India (hereinafter referred to as **"SEBI"**) conducted an inspection of books and records of M/S Anand Rathi Share and Stock Brokers Ltd. (formerly known as M/s. Navratan Capital and Securities Pvt. Ltd.) (hereinafter referred to as **'ARSBL/NCSPL/Noticee'**) Member, Bombay Stock Exchange (hereinafter referred to as 'BSE'), National Stock Exchange (hereinafter referred to as 'NSE') and National Securities Depositories Ltd. (hereinafter referred to as 'NSDL') during March 21-22 and 26-30, 2007 covering the period from April 2006 till the date of inspection.

2. On sample and random checking of the books of accounts and records of NCSPL, certain deficiencies were observed in the functioning of NCSPL. The findings of inspection included (a) discrepancies in fund based activities, (b) discrepancies in Know Your Client Forms, (c) failure to enter Unique Client Code, (d) Non collection of PAN Details, (e) Lack of due skill and care in the course of its broking business, (f) Director acting as sub broker, (g) Lack of due skill and care in the conduct of DP business and (h) Levying of custody charges. Therefore, it was alleged that NCSPL had violated the provisions of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as **'Brokers Regulations'**), SEBI (Depositories and Participants) Regulation, 1996 (hereinafter referred to as 'DP Regulations') and certain SEBI Circulars and consequently, liable for monetary penalty under section 15HB of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the '**SEBI Act'**) and sections 19A and 19G of Depositories Act, 1996 (hereinafter referred to as 'Depositories Act').

APPOINTMENT OF ADJUDICATING OFFICER

3. The undersigned was appointed as the Adjudicating Officer, vide orders dated January 15, 2008 and July 8, 2008, under section 15 I of the SEBI Act read with rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalty by Adjudicating Officer) Rules, 1995 (hereinafter referred to as the **'Rules'**) to inquire into and adjudge under section 15HB of SEBI Act and sections 19A and 19G of Depositories Act, for the aforesaid alleged violation committed by NCSPL.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

4. Show Cause Notice No. EAD-5/VSS/RS/ 142436 /2008 dated October 24, 2008 (hereinafter referred to as **'SCN'**) was issued to NCSPL under rule 4 of the Rules to show cause as to why an inquiry should not be initiated against it and penalty be not imposed under section 15HB of SEBI Act and section 19A and 19G of Depositories Act for the alleged violations committed by NCSPL.

5. The Noticee vide letter dated November 17, 2008 replied to the Show Cause Notice, which was incomplete in many respects. The submissions were, therefore, found to be unsatisfactory.

6. In the interest of natural justice and in order to conduct an inquiry in terms of rule 4(3) of the Rules, the Noticee was granted an opportunity of personal hearing on December 24, 2008, vide notice dated December 5, 2008. Mr. Jugal Mantri, Authorised Representative of the Noticee, appeared and requested time till January 16, 2009 to submit a point-wise (complete and detailed) reply to the said SCN, which was accepted. The Noticee vide letter dated January 14, 2009 submitted a detailed reply to the SCN.

7. In order to conduct an inquiry in terms of rule 4(3) of the Rules, another opportunity of hearing was granted to the Noticee on February 12, 2009, vide notice dated January 30, 2009. Mr. Jugal Mantri, Authorized Representative of the Noticee, appeared and reiterated the submissions made in the reply dated January 14, 2009 and made further written submissions vide letter dated February 18, 2009 and March 13, 2009.

CONSIDERATION OF ISSUES AND FINDINGS

8. I have carefully perused the written and oral submissions of the Noticee and the documents available on record. The charges leveled against the Noticee and my findings thereon are as under :

9. **Discrepancies with regard to Fund Based Activities**

(a) – (i) It was alleged that the Noticee had not only allowed its clients who had debit balances in their accounts to trade but also funded such clients.

(a) – (ii) The Noticee had bid in IPO/Rights Issue on behalf of its clients in spite of debit balance in their ledger accounts.

(a) – (iii) The Noticee through its Group Company and client RGFL carried out funding activities for its clients, who had debit balances in their accounts, by pledging their shares with RGFL. Further, the Noticee failed to furnish the bank account number from where the amount was transferred. Thus, in the absence of the bank account number, it was inherent that the Noticee was accepting third party funds on behalf of its clients.

(b) – (i) With regard to the allegation regarding allowing as well as funding the clients to trade in spite of having debit balance in their respective accounts, the Noticee has submitted that it aggregates the balance in all the ledger accounts of a particular client across the segments in an exchange i.e. cash and F & O, across the stock exchanges i.e. BSE and NSE and across the markets i.e. BSE, NSE and Commodities Exchanges and creates a consolidated position (debit/credit) of the client. Based on the said

aggregation/consolidation, the Noticee arrives at the net debit/credit position of the client. Thereafter, if the net position of the client is credit, then only the client is allowed to take further positions. Based on the aforesaid practice, the Noticee has submitted that all the clients referred to in the inspection report/SCN, except one, had credit balance in their combined ledger. Only one client had a debit balance of less than 10% of the required margin in F & O. The Noticee has submitted copy of the authorization letters taken from the clients permitting the Noticee to adopt the practice of consolidating the position of the client across the segments, across the exchanges and across the markets.

(b) – (ii) With regard to allegation of bidding on behalf of clients for IPO/Rights Issue, the Noticee has submitted that in most of the cases, the clients had credit balance in their combined ledger account. Moreover, it had initiated an on-line IPO bidding facility to its online customers. It was in the process of testing, streamlining and smoothening its online IPO process and acted upon all the requests flowed to it without transferring credit balance in other segments. Thereafter, it does not have any such instance of financing the clients for IPOs without ensuring credit balance.

(b) – (iii) With regard to the allegation of indirect financing to the clients through its group company, the Noticee has submitted that it had received all the instructions directly from its clients and it had merely followed and acted upon them in good faith. It does not have any control over their holdings/funds or imposed any restriction on any of its clients to carry on their business. It had not dealt with the group

company directly on behalf of the clients and did not indulge in any intermediation. In all the cases, the clients had dealt with the funding company directly and transfers had taken place between them. The Noticee has also submitted the HDFC Bank Account Details which was not submitted to the inspection team.

(c)– (i) I have perused the material available on record and the documents submitted by the Noticee in support of its contentions. I find that the Noticee maintains a separate ledger account for its clients for different segments in a stock exchange, for different stock exchanges and for securities and commodities market separately. However, it takes into consideration the balance lying in the different accounts of its client to arrive at whether the client is having debit or credit balance. Upon perusal of the documents submitted by the Noticee presenting the consolidated net position of the clients and the authorization obtained from the clients for the same, I find that the submission of the Noticee is in order in this regard. However, in order to verify whether the practice of consolidating the client's position across the segments, across the exchanges and across the markets being followed by the Noticee is in order, clarification was sought from BSE and NSE. BSE vide letter dated March 06, 2009 has stated, inter-alia, that '*Byelaws of BSE don't have any provision authorizing or prohibiting adjustment of a client's account across different Segments of an Exchange or across different Exchanges or between different Markets'*. NSE, vide its letter dated March 05, 2009 has submitted as under:-

A) <u>Adjustment of dues of clients across different segments i.e Cash, F&O etc</u>

Regulation 6.1.5 (e) of Part A of the Capital Market Regulations of the Exchange stipulates that the Trading Members shall keep a separate ledger account for each client in respect of the transactions on the Exchange and shall not mingle such account with the account of the client in respect of transactions of any other stock exchange or any other transaction which the trading member may enter into with such client.

B) <u>Adjustment of dues of clients across different Exchanges i.e between BSE and NSE</u>

In addition to the point no. A) which stipulates that the trading member shall not mingle account of client in respect of transactions of any other stock exchange, additionally Regulation 6.1.3 of the F&O Regulations of the Exchange stipulates that Where a Trading Member holds membership of any other recognised stock exchange(s), then such a Trading Member shall maintain a separate books of accounts, records and documents for trades executed on each recognised stock exchange.

C) <u>Adjustment of dues of clients between different markets i.e Stock Market and Commodities Market</u>

As regards adjustment of dues of clients between different markets i.e Stock Market and Commodities Market, there is no provision in the Bye-laws, Rules and Regulations of the Exchange.

D) <u>Consideration of ledger accounts across different segments, exchange and markets by arbitrators</u>

For the purpose of this query, we have examined sample of arbitral awards passed by arbitrators. Based on the same, it is observed that wherever specific consent for specific transfers/adjustments has been obtained from the parties, arbitrators have taken cognizance of the same in the award passed.

A copy of the letter dated February 20, 2009 seeking clarification from NSE and NSE's aforesaid reply was forwarded to the Noticee vide letter dated March 09, 2009. I have perused the reply dated March 13, 2009 of the Noticee in this regard. I find that the Noticee has been maintaining a

separate ledger for each client in each segment. It also maintains separate set of books of accounts, records and documents for cash and F & O segments separately. I have noted the submission of the Noticee that purely for operational convenience and in order to ensure proper fund management with an objective to meet the statutory obligations towards the exchanges, and with the consent of the clients, it transfers fund from one group company to another having common holding/shareholders in both the companies who are members of different exchanges. I have also noted its categorical submission that it does not adjust any dues at any exchange by available credit in any other exchange and in fact, makes actual fund transfers from its account/exchange ledger account to another exchange/ledger account. In view of the foregoing, I find merit in the submissions of the Noticee in this regard.

(c)– (ii) With regard to bidding on behalf of its clients for IPOs/rights issues, I have noted the submissions of the Noticee. In the light of my findings at (c) – (i) above, I find merit in the submissions of the Noticee in this regard.

(c)-(iii) With regard to indulging in fund based activities through the group company, I have noted the submissions of the Noticee and perused the documents submitted in support of the same. Upon perusal, I find that the Noticee had not played any role of intermediation between its clients and the group company in regard to transfer of securities or funds. Thus, the allegation against the Noticee does not stand established.

10. **Discrepancies in Know Your Client Forms**

(a) On the basis of scrutiny of client agreements and registration forms, it was alleged that the said documents were not having complete details. The discrepancies observed in some of the cases include opening of accounts without receiving a copy of board resolution, opening of account prior to the date of board resolution and with different name of sub-brokers on the tripartite agreement, etc.

(b) The Noticee has submitted that it had opened the accounts after collecting the certified copy of the board resolutions from the entities concerned. As regards opening the account prior to the date of board resolution, the Noticee has submitted that the actual date of activation of the account was June 5, 2006 and not January 2006 as was mentioned in the Inspection Report. As regards non-collection of the certified copy of the board resolution, the Noticee has submitted that it had collected the same but erroneously filed elsewhere. It had since corrected the mistake. With regard to entering different names of sub-brokers on tripartite agreement, it had admitted the mistake but submitted that it was a typographical error.

(c) I have perused the submissions of the Noticee and the documents submitted by it. I find merit in the submissions of the Noticee with regard to opening of account except in the process of mentioning of different name of sub brokers in the tripartite agreement. Since the Noticee had admitted his fault with regard to mentioning of different name of sub brokers in the tripartite agreement, I hold that the allegation against the Noticee stands established and consequently, it had violated *SEBI Circular No SEBI/MIRSD/DPS-*

1/Cir-31/2004 dated August 26, 2004 and Regulation 26(xii) of Brokers Regulation.

11. **Failure to enter Unique Client Code**

(a) It was alleged that in certain instances the Noticee had allotted multiple client codes to the same client.

(b) The Noticee has submitted that in most of the instances cited by SEBI, new UCC was generated because of transfer of account/s from one branch to another or due to creation of employee trading account. However, the Noticee had confirmed that the earlier account was blocked but not deactivated before activating the other account and as a result, both the UCCs were visible. The difference between blocking and deactivation is that when an account is blocked, the client cannot trade but his client code exists and debit and credit can take place in his account till the account is deactivated from the ledger. A client code can be deactivated only if the balance in its account becomes "NIL".

(c) Based on the above mentioned submissions, clarifications were sought regarding four instances, where both the clients' codes were active. The Noticee vide its letter dated February 18, 2009 clarified that in two instances the codes were active because as per exchange regulations open positions cannot be transferred to another client code and, hence, due to the open position in the respective codes in F & O segment, the trades were carried out in both UCC for cash segment purely on a temporary basis and subsequently resolved. In the third instance, both the accounts had different PAN and, hence, there was no violation. As regards the fourth instance, the Noticee had admitted the violation and replied that while transferring backend-date, the entry

was missed out in previous code which was subsequently resolved. I have noted the submissions of the Noticee and perused the documents submitted by the Noticee. I find merit in the submissions of the Noticee and, therefore, hold that the violation does not stand established.

12. **Non Collection of PAN Details**

(a) On the basis of the analysis of Client Master, it was alleged that the Noticee had entered wrong/same PAN details for different clients. Further, it had also allowed its clients to trade without PAN. The details of such cases were furnished to the Noticee vide para 3(d) of the SCN.

(b) The Noticee has admitted its fault with regard to entry of wrong PAN details but submitted that the same was due to inadvertence. It has also submitted that upon re-verification, it had deactivated the accounts of those who had not submitted the PAN details. With regard to the allegation of allowing trading without PAN, the Noticee has submitted that it had blocked all the accounts of the clients which do not have PAN details and such clients were not allowed to trade. It has also submitted that only when the clients provide the relevant PAN proof, the accounts would be activated after scrutiny.

(c) I find that in order to strengthen the Know Your Client (KYC) norms and identify every participant in the securities market thereby ensuring sound audit trail of all the transactions, SEBI vide its circular MRD/DoP/Cir- 05/2007 dated April 27, 2007 made PAN as the sole identification number for all participants transacting in the securities market with effect from July 2, 2007.

Whereas, I find that the inspection was conducted in March 2007 covering the period from April 2006 to March 2007, during which period, quoting of PAN was not mandatory. Thus, the need to comply with the provisions of Circular dated April 27, 2007 during April 2006 and March 2007, does not arise. Since, the provisions of the circular were not attracted, the question of compliance or otherwise with the same also does not arise. Therefore, the allegation of violation does not stand established.

13. **Lack of due skill and care in the course of broking business**

(a) – (i) Based on the perusal of client ledger and Client Master, it was alleged that the Noticee had entered into transactions before entering into agreement with its clients.

(a) – (ii) It failed to capture bank account details in respect of 5,000 clients and other details in respect of more than 2,900 accounts.

(a) – (iii) The Noticee without proper authorization made adjustments/transfers between various clients and between the securities and commodities market for its clients.

(a) – (iv) The Noticee had also pledged the securities to the clearing corporation for additional capital whose beneficial ownership was not with it.

(a) – (v) With regard to trade modification, it was alleged that the Noticee had not only modified the codes upto three calendar days but it had also modified the same trade more than once.

(b) – (i) The Noticee has admitted the fault with regard to the deficiencies pointed out in the execution of the agreement with the clients and transaction date mismatch in some

cases. It has submitted that the same was due to clerical/typographical error. Moreover, in few cases a new client-member agreement was executed due to loss/misplacement of the original agreement.

(b) – (ii) With regard to the allegation of failure in capturing bank and other details, the Noticee had admitted the fault and replied that it stands rectified now.

(b) – (iii) With regard to allegation of improper authorization, the Noticee replied that it had taken proper authorization/undertaking from its clients before making various adjustments/transfers and also submitted the authorization letters taken from the clients.

(b) – (iv) With regard to the allegation of pledging of shares whose beneficiary ownership was not with the Noticee, the Noticee replied that it receive shares from its clients and transfer the same to the Clearing Corporation for additional capital in NSE F&O segment. Neither the Noticee had pledged clients' shares nor had it transferred clients' shares to Rathi Global Finance Limited account as alleged.

(b) – (v) The Noticee had admitted its fault with regard to trade modification and replied that it was due to either technical glitches or punching errors. Further, the Noticee had now centralized the job of trade modification and hence, took time to adjust with the new system.

(c) – (i) With regard to the deficiencies pointed out regarding broker client agreement, since the Noticee has admitted the same, the allegation stands established.

(c) - (ii) With regard to the deficiencies pointed out regarding failure to capture bank account and other details, since the Noticee has admitted the same, the allegation stands established.

(c) - (iii) As regards adjustments/transfers between clients, I have perused the authorization letters submitted by the Noticee and find merit in his submissions. I hold that the allegation does not stand established.

(c) - (iv) As regards pledge of securities to the clearing corporation, I find merit in the submissions of the Noticee.

(c) - (v) As regards modification of trades, since the Noticee has admitted the same, the allegation stands established.

In view of (c-i), c(ii) and (c-v) above, I hold that the Noticee had violated clause A (1) of Code of Conduct for brokers specified under regulations 7 and 26 (xvi) of Brokers Regulations.

14. **Director acting as a Sub Broker**

(a) It was alleged that one of the directors, Shri Pradeep Gupta, whose corporate entity PKG Finstock Private Limited (hereinafter referred to as “PKG”), member of Jaipur stock exchange, was a sub-broker of NCSPL.

(b) The Noticee has admitted the violation but submitted that PKG has submitted application to surrender its sub-broker registration. Moreover, the sub broker was passive and all its clients were transferred to some other sub brokers.

(c) In order to ascertain the veracity of the submissions, clarifications were sought from the Noticee vide letter dated April 6, 2009. The Noticee vide letter dated April 14, 2009 replied to the queries.

(d) Upon perusal of the material available on record including the clarification sought and the reply of the Noticee, my findings are as under:-

(i) Mr. Pradeep Kumar Gupta was the director on the board of PKG since the inception of the company. Thus, during the period covered under inspection, i.e. from April 2006 to March 2007, Mr. Pradeep Kumar Gupta was a director on the board of PKG.

(ii) During the period covered under inspection, Pradeep Kumar Gupta individually held 46.31% in PKG. Along with his wife (Mrs. Preeti Gupta) and daughter (Ms. Aishwariya Gupta), the collective shareholding of the family was 72.09% in PKG.

(iii) During May/June 2008, certain transfers were made amongst the shareholders of PKG. Prior to this transfer, the details of their shareholding were as under:-

Name	No. of shares	%
Pradeep Kumar Gupta	1,21,020	46.31
Preeti Gupta	11,840	4.49
Aishwariya Gupta	56,100	21.29
Total	**1,88,960**	**72.09**

(iv) On June 07, 2008, Pradeep Kumar Gupta transferred 71000 shares (26.95%) to Raj Kumar Jain. After the said transfer, the details of the shareholding of Pradeep Kumar Gupta and his family were as under:-

Name	No. of shares	%
Pradeep Kumar Gupta	51,020	19.36
Preeti Gupta	11,840	4.49
Aishwariya Gupta	56,100	21.29
Total	**1,18,960**	**45.14**

(v) PKG was an active sub broker of the Noticee during the period covered under inspection.

(vi) During this period, the client base of PKG increased by 4,736 clients and reached to 14,380 clients as on March 31, 2007.

(vii) PKG was made inactive in the month of July 2007 i.e. 4 months after the SEBI inspection.

(viii) Mr. Pradeep Kumar Gupta has been the director on board of NCSPL since November 22, 1991.

(ix) NCSPL vide its letter/s dated March 06, 2009 addressed to BSE and NSE had sought cancellation of registration of PKG as its sub broker. Thus, the Noticee did not take any necessary action with regard to cancellation of registration of PKG when the violation was first pointed out by the SEBI Inspection team. The necessary action was initiated only after two years of inspection, that too, after the SCN was issued to the Noticee on October 24, 2008 and after the specific queries were raised during the hearing held on February 12, 2009.

(x) A specific query was raised with regard to the quantum of business carried out by PKG during the period covered under Inspection. The same was not furnished by the Noticee, for the reasons best known to it and consequently, hindered the adjudication proceedings.

In order to avoid any conflict of interest, SEBI has prohibited a director of a broking firm to be a sub broker of the same firm. Despite this, the Noticee had allowed the entity, PKG Finstock, controlled by one of its directors, Mr. Pradeep Kumar Gupta, to act as its sub broker. It took action for cancellation of the sub broker only when the violation was pointed out by the Inspection Team and during the conduct of the present proceedings. In view of the above and since the Noticee had admitted the fault, I hold that the allegation against the Noticee stands established and consequently, it violated *Regulation 15A and Regulation 26(xx) of Brokers Regulation.*

15. **Lack of due skill and care in the conduct of DP business**

(a) On the basis of the scrutiny of Client Registration Form, it was alleged that the Noticee had not only entered wrong Bank Details but also failed to sign the Agreement and did not collect the list of co-parceners. The Noticee had taken the proof of correspondence address (M/S Everest Flavors Ltd.) without taking any other document which shows that the correspondence address captured for the client is same as that of M/s. Everest Flavors Ltd. Moreover, the Noticee had entered wrong PAN details for its clients. It was also alleged that the Noticee failed to capture the signature of one of its clients.

(b) The Noticee has admitted its fault with regard to wrong entry of Bank Details but submitted that it was a typographical error. The Noticee has also admitted its fault with regard to the allegation of signing the agreement and capturing the signature of its client, but submitted that the same have been rectified now. With regard to the allegation of non collection of list of co-parceners, the Noticee has submitted that it is not necessary to collect the same while opening the account in NSDL. With regard to the allegation of correspondence address, the Noticee has submitted that the client (Sudha Ramesh Modi), who is also a director of M/S Everest Flavors Ltd. desired to receive all correspondence at her office address and hence, requested the Noticee for the same. As a matter of policy, the Noticee had collected all necessary documents, viz. proof of permanent address and correspondence address, before opening the account. With regard to the allegation of wrong entry of PAN Details, the Noticee has contented that it had captured correct PAN Details in all cases except in one instance, which has been rectified now.

(c) I have perused the documents submitted by the Noticee and find merit in the submissions of the Noticee with regard to the collection of list of co-parceners, correspondence address and collection of PAN details. Since the Noticee had admitted its mistake with regard to entry of wrong bank details, failure to capture client's signature and failure to sign the agreement, I hold that the allegation made against the Noticee stands established and consequently, it violated *clause 3 of code of conduct for depository participants specified under Regulation 20A of DP Regulation.*

16. **Levying of Custody Charges**

(a) It was alleged that the Noticee had charged to its clients approximately Rs.11,000/- during the period April 2005 till November 2006 as custody charges.

(b) The Noticee has submitted that the charges were levied to one of its sub broker account and the same has since been refunded.

(c) *In order to rationalize the charge structure, SEBI vide its Circular No. MRD/DoP/SE/DEP/CIR-4/2005 dated January 28, 2005* prohibited levying of custody charges by DPs with effect from April 1, 2005. In spite of this, the Noticee had levied custody charges on its client for one and a half years. Thus, the allegation made against the Noticee stands established and consequently, it violated clause 6 of code of conduct for depository participants specified under Regulation 20A of DP Regulations and SEBI Circular No. MRD/DoP/SE/DEP/CIR-4/2005 dated January 28, 2005.

17. In view of the foregoing, the following allegations made against the Noticee stand established resulting in violation:

(a) Mentioned different name/s of sub brokers in the tripartite agreement resulted in violation of SEBI Circular No SEBI/MIRSD/DPS-1/Cir-31/2004 dated August 26, 2004 and Regulation 26(xii) of Brokers Regulation.

(b) Deficiencies in execution of broker client agreements, failure to capture bank account and other details and modification of trades resulted in violation of clause A (1) of Code of Conduct for brokers specified under regulations 7 and 26 (xvi) of Brokers Regulations.

(c) Allowed an entity controlled by one of its directors and his family, to act as its sub-broker resulted in violation of Regulation 15A and Regulation 26(xx) of Brokers Regulation.

(d) Entered wrong bank details, failed to sign the agreement and failed to capture the signature of the client resulted in violation of clause 3 of code of conduct for depository participants specified under Regulation 20A of DP Regulation.

(e) Levy of custody charges resulted in violation of clause 6 of code of conduct for depository participants specified under Regulation 20A of DP Regulations read with SEBI Circular No. MRD/DoP/SE/DEP/CIR-4/2005 dated January 28, 2005 .

18. As far as the aforesaid 5 violations, my further findings are as under:

a. With regard to violation of deficiencies observed in Know Your Client forms, I find that Broker is required to exercise utmost care and caution while opening an account. This obligation has been cast upon him to ensure safety and integrity of the security market. I find from the reply of the Noticee that it had admitted the lapses pointed out with regard to different names of sub-

brokers on tri-partite agreements. The Noticee's submission that such lapses had occurred due to a typographical error while opening the account cannot be accepted as commercial interest should not overshadow the compliance with the due diligence requirements. I have noted the submissions of the Noticee that it had rectified the error. It is, thus, established that the Noticee was not diligent in opening the Account and it has, thus, violated SEBI Circular No SEBI/MIRSD/DPS-1/Cir-31/2004 dated August 26, 2004 and Regulation 26(xii) of Brokers Regulation.]

b. With regard to deficiencies in execution of broker client agreements, failure to capture bank account and other details and modification of trades I have examined the contentions advanced by Noticee. As discussed earlier, it is imperative that all documentation relevant to the client should be maintained properly at the broker's end. A client registration form is devised to obtain certain useful information about the client to enable the stock broker to know about the credibility of the client before dealing with him. Client identification and details are also important since it makes it easier for the audit trail to identify the clients with the assistance of details like bank account details, etc. These provide inputs as regards the credentials of the clients. Thus, a properly maintained member-client agreement imparts transparency to the functioning of the broker/sub broker as an intermediary and ensures that all professional dealings that are carried out, are effected in a prompt, efficient and cost effective manner, which ultimately has a bearing on the interests of the investors. Further, with regard to the trade modification, I find that, trade modification facility for modifying trades done during the day is available on the request of the client. It is the obligation of the broker to execute the clients request for the

modification of the trade on the same day. However, I find that the Noticee has not only modified the trades upto three days but has also modified the same trades more than once. Hence, failure on the part of the Noticee to allow the client for the transactions before entering into the agreement, obtaining the bank account details and modification of the trades calls for a penalty.

c. With regard to director acting as sub-broker, I find that Mr. Pradeep Kumar Gupta who is director on the Board of Noticee since the year 1991 has controlling stake in PKG (along with his family), which has acted as sub-broker with the Noticee. The Noticee contended that PKG was made inactive and all its clients were transferred to some other sub-brokers, but I find that PKG was active during the period covered under inspection. The clients base of PKG increased by 4,736 clients during the same period. PKG was made inactive only after 4 months of the inspection. The Noticee failed to take necessary actions neither by removing Mr. Pradeep Kumar Gupta from its board nor applied for the cancellation of registration of PKG as sub broker. The Noticee did not take any action even when the SCN was served to it. The necessary action was initiated only when subsequent queries were raised during the hearing, which was held on February 12, 2009. Further, the Noticee did not furnish the information with regard to the quantum of business carried out by PKG in the period covered under inspection. Therefore, the Noticee is liable for penalty for the violation of Regulation 15A and Regulation 26(xx) of Brokers Regulation.

d. As regards the deficiencies observed in the functioning of the Noticee as DP {pointed out in para 17(d) and 17(e)}, I find that

the Noticee had taken necessary corrective steps not only to rectify the deficiencies but also to ensue that such errors do not recur in future. I am, therefore, of the view that the same does not warrant any penalty.

19. The Hon'ble Supreme Court of India in the matter of *SEBI Vs. Shri Ram Mutual Fund* [2006] 68 SCL 216(SC) held that *"In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant…".*

20. In view of the foregoing, I am convinced that it is a fit case to impose monetary penalty under section 15HB of the SEBI Act {for the violations committed in its broking business as detailed in paras 17 and 18 (a, b and c)}. The provisions of section 15HB of SEBI Act is mentioned hereunder:-

"Penalty for contravention where no separate penalty has been provided
Section 15HB: *Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.".*

21. While imposing monetary penalty under section 15HB of SEBI Act, it is important to consider the factors stipulated in section 15J of SEBI Act, which reads as under:

"15J - Factors to be taken into account by the adjudicating officer
While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:-
(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."

22. It is difficult, in cases of this nature, to quantify exactly disproportionate gain or unfair advantage enjoyed by an entity and the consequent losses suffered by the investors. The functioning of the Noticee with total disregard to the requirements of statutory obligations leads to the conclusion that it has definitely taken unfair advantage and gained at the cost of investors. Further, the Noticee had not furnished the details of the quantum of business carried out by its subbroker, which has hampered the adjudication process. The records indicate that NCSPL has been a fairly active broker.

ORDER

23. After taking into consideration all the facts and circumstances of the case and material available on record, I hereby impose a monetary penalty of Rs.1,00,000/- (Rupees one lakh only) on the Noticee which will be commensurate with the default committed by it.

24. The Noticee shall pay the total penalty of Rs.1,00,000/- (Rupees one lakh only) under section 15HB of SEBI Act by way of demand draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, within 45 days of receipt of this order. The said demand draft should be forwarded to Mr. Piyoosh Gupta, General Manager, MIRSD, SEBI, SEBI Bhavan, and Plot No. C – 4 A, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051.

25. In terms of rule 6 of the Rules, copies of this order are sent to the Noticee and also to the Securities and Exchange Board of India.

Date: **May 04, 2009** **V.S.SUNDARESAN**

Place: **Mumbai** **ADJUDICATING OFFICER**