

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: Dr. T. C. Nair, WHOLE TIME MEMBER
IN THE MATTER OF IPO INVESTIGATIONS –
KHANDWALA INTEGRATED FINANCIAL SERVICES PVT. LTD.

Date of hearing: August 2, 2006

Appearance:

For Noticee: Shri Somasekhar Sundaresan, Advocate
Shri Vimal P. Khandwala, Director
Shri Anand Dapki, Manager
Shri Hormuz Mehta, Associate

For SEBI : Shri Sanjeev Dutt, Chief General Manager
Shri V. R. Prasad, Deputy Legal Adviser
Ms. Kshama Chavan, Legal Officer

ORDER

(UNDER SECTIONS 11 AND 11B OF SEBI ACT, 1992)

1.0 Background

1.1 By an ad interim *ex-parte* Order dated April 27, 2006 (hereinafter referred to as the 'Order') under section 19 read with sections 11, 11B and 11(4) of the Securities and Exchange Board of India Act, 1992 and section 19 of the Depositories Act, 1996 pending enquiry and passing final Order, certain interim directions were issued against various market participants including Khandwala Integrated Financial Services Pvt. Ltd. (hereinafter referred to as 'KIFSPL').

1.2 The ad interim *ex-parte* Order dated April 27, 2006 states that KIFSPL, Depository Participant (DP) of National Securities Depository Ltd (NSDL) prima facie appeared to have failed in adhering to the Know

Your Client (KYC) norms laid down by SEBI thereby facilitating opening of demat accounts in fictitious / benami names and cornering the retail portion of shares in Initial Public Offering (IPO). In view of the above preliminary finding, KIFSPL was directed not to open fresh demat accounts till further directions.

- 1.3 Para 17.18 of the Order dated April 27, 2006, stated that the said Order shall be treated as show cause notice against the concerned entities named therein including KIFSPL. These entities were given opportunity to file their objections, if any, to the Order within 15 days from the date of the Order and if they so desire, avail of an opportunity of personal hearing at the SEBI Head Office, Mumbai within 15 days from the date of the Order. They were also given an opportunity to avail of the facility to inspect the relevant documents relied upon by SEBI against them, prior to hearing.

2.0 Findings regarding KIFSPL in SEBI's ad interim ex-parte Order

- 2.1 The focus of the SEBI investigations in the matter of IPOs has been on entities indulging in off-market transactions after the allotment of shares but prior to listing and commencement of trading on the stock exchanges thereby cornering IPO shares in retail segment through benami/fictitious demat accounts. In the Order dated April 27, 2006, SEBI, prima facie found in respect of KIFSPL as under:
- 2.2 At para 8.3 of the *ex-parte* Order, based on the information submitted by NSDL, out of 37,420 NSDL afferent accounts, 1153 afferent accounts were opened with KIFSPL.
- 2.3 At table 9.11 of the *ex-parte* Order, the verification by NSDL regarding genuineness of dematerialized account-holders revealed that out of

56216 demat account holders held with 105 DPs, KIFSPL had 1399 number of demat account holders sharing common addresses.

- 2.4 At table 5.7 of the *ex-parte* Order, it is stated that in the IPO of Infrastructure Development Finance Company (IDFC), Shri Dhaval A. Mehta, a Key Operator received 1,75,560 shares from 660 demat accounts while in the IPO of M/s Suzlon Energy Ltd., he received 61,808 shares from 3,863 demat accounts. Further another Key Operator, Shri Chandrakant Amratlal Parekh in the IPO of M/s Suzlon Energy Ltd. has received 12,883 shares from 803 demat accounts.
- 2.5 As stated at table 10.2 of the Order, inter alia it is observed that M/s Welvet Financial Advisors Pvt. Ltd and Bhanuprasad Dipakkumar Trivedi have received large number of shares from Roopalben Panchal, a Key Operator in various IPOs.
- 2.6 At para 11.24 of the Order, it is stated that Hasmukh HUF has received Rs. 2475.36 lakh from various sets of entities viz. Dhiren Vora, Rajesh Patel, Hasmukh Vora, Sujal Leasing, Zealous Trading, Taurus Infor, Sonal Vora, Girdhari Bhatia-Inani Commodities Pvt. Ltd. and redemption of funds in the HDFC Cash Management Fund. The original sources of the funds in most of the instances were Parklight (BSE broker) or Nyalchand (NSE broker) or Sputnik Steels Pvt. Ltd. or Lokprakashan or H. S. Shah, N. S. Shah and Mittal Shah or Khandwala Integrated Financial Services Pvt. Ltd. or Inani Securities Ltd. or Inani Commodities.
- 2.7 In view of the above findings in the Order, directions as mentioned in Para 1.2 above were issued to KIFSPL.

3.0 Oral hearing and submissions of KIFSPL

3.1 KIFSPL filed its preliminary submissions to the Order on May 10, 2006. Thereafter, it availed itself of the opportunity to inspect the documents relied upon by SEBI on June 8, 2006. The submissions made by KIFSPL in the aforesaid letter are as under:

- i. *In respect of opening of 1153 afferent accounts stated in para 8.3 of the Order it was submitted that the accounts opened by KIFSPL are of genuine nature and have been opened by its clients for regular day to day trading and many of these accounts are still operational. Further all the Know Your Client (KYC) documentation of these 1153 accounts is upto date and complete. The KYC documentation may be inspected by SEBI at any time.*
- ii. *With regard to table 9.11 of the Order highlighting 1399 demat account holders sharing common addresses, it was submitted that KYC documentation for all the account holders are complete. The KYC documentation for all the 1399 account holders has been taken. Further regular audits have been conducted by NSDL in the last five years, to verify the authenticity of the accounts held by it, including 1399 accounts. In all the audits carried out by NSDL, nothing adverse or wrong was pointed out against KIFSPL.*
- iii. *KIFSPL does not have bulk opening of accounts which is deviant from ordinary or normal conduct. Further the staff of KIFSPL has not erred in securing KYC documentation on any account.*
- iv. *With regard to the existence of common address, under the applicable law, there is no restriction on opening more than one demat account by a single investor. The software utilised for opening any demat account deployed by any DP in India has never had any facility to alert or restrict the opening of accounts entailing the address used in any account already existing with the same DP. Further at the time of opening these accounts, there has never been any laws that restricted or regulated the existence of an identical address across demat accounts. Had such law existed, the software provided by the Depositories would have definitely entailed this feature, namely restricting the ability of any demat account holder to provide an address already utilised by demat account holder.*
- v. *It is well established principle of law that before passing any punitive order against anybody, reasonable opportunity should be offered to the aggrieved party and the principles of natural justice be followed. Further it cannot be the intention of SEBI to hurt the interests of large number of innocent retail investors. On the contrary, the Order conveys a sense of urgency to pass an interim order to protect the interest of the genuine*

retail investors. Hence this order negatively affects the interest on the genuine retail customers of ours on one hand and subsequently tries to protect the interest of the retail customers on the other hand.

- vi. *The provisions of Section 11 and 11B have to be invoked only in the case of acute emergencies where grave and irreparable harm is likely to be occasioned to the interest of securities market. No such event or circumstance in relation to actions of KIFSPL is evident in the Order and there is no reasonable justification for the continuation of the restrictions imposed in the Order.*

3.2 KIFSPL appeared before me on August 2, 2006 for personal hearing through its officials represented by Advocates as recorded on the first page of this Order and made oral submissions.

4.0 Consideration of the issues

4.1 I have carefully considered the prima facie findings as recorded in the Order and the submissions made by KIFSPL and I have dealt them separately as under:

4.2 I find that the ex-parte Order, was passed in exercise of powers under section 11 (4) and 11B of SEBI Act, 1992. Section 11(4) empowers SEBI to pass such orders both before pending investigation or enquiry and also after completion of investigation or enquiry. As the Order itself records that the Order has been passed pursuant to a detailed investigation and further the proviso to section 11 (4) provides for passing of such Order, pending post decisional hearing, I do not find any legal infirmity in passing such Order. With regard to the contention of passing punitive Order earlier, the prohibition of not opening fresh demat accounts was issued upon a serious suspicion on the genuineness of the afferent accounts subject to verification by the Depositories. It was not a punitive measure but a preventive step taken by SEBI in view of urgency, pending inquiry in the interest of investors and the securities market.

- 4.3 As regards 1153 afferent accounts, I have noted that these accounts have been identified in the Order as fictitious/benami accounts which prima facie were observed to have been used for the purpose of cornering the shares in various IPOs. In view of the large scale afferent accounts maintained with the DPs having more than 500 such accounts, SEBI as a precautionary measure and in the interest of securities market directed them not to open fresh demat accounts pending verification and enquiry. KIFSPL contended that all the alleged 1153 afferent accounts are genuine and many of these accounts are operational. To ascertain the genuineness of these afferent accounts and the compliance of KYC norms by the DPs, SEBI directed both the Depositories to verify the same.
- 4.4 With regard to opening of 1399 accounts sharing common addresses, KIFSPL submitted that there is no restriction on opening of more than one demat account by a single investor. While I agree that there is no such bar, it appears that KIFSPL prima facie failed to comply with the KYC norms laid down by SEBI in terms of exercising due diligence to establish the identify of the clients as prescribed in SEBI Circulars dated August 4, 2000 and August 24, 2004 and opened the afferent accounts. I am of the view that KIFSPL should have exhibited high standards of professionalism and integrity in its dealings with the clients.
- 4.5 Further, I have noted that at para 17.10 of the Order dated April 27, 2006, SEBI had directed Depositories to conduct inspection of DPs identified in Order to verify whether all the account holders of the DPs referred at para 17.9 of the Order are genuine and KYC norms laid down by SEBI have been complied with. In this connection, NSDL vide its letter dated June 12, 2006 and July 27, 2006 submitted their 'in person' verification report of demat account holders maintained with

KIFSPL wherein it was observed that in total 1570 demat account holders were called for 'in person' verification of which 1042 account holders appeared for verification. In continuation with the above verification NSDL vide its letter dated September 18, 2006 has submitted additional information regarding the afferent accounts which is under examination by the Enquiry Officer. In this regard, I have also noted that an Enquiry Officer has been appointed and a show cause notice dated November 22, 2006 was also issued to KIFSPL by the Enquiry Officer. I am of the view that issues, if any, shall be taken up by him and necessary action may be taken against KIFSPL, if found guilty of violating any regulations of SEBI.

- 4.6 I have also noted that another ex-parte interim Order ("*Disgorgement Order*") dated November 21, 2006 was issued in continuation of ex-parte Order dated April 27, 2006. Depositories and certain DPs including KIFSPL were directed to disgorge jointly and severally the ill-gotten gains and an amount of Rs.28,72,971.90/- has been mentioned against KIFSPL. The findings of the 'Disgorgement Order' are co-terminus with the findings of enquiry. I further note that the Hon'ble Securities Appellate Tribunal vide Order dated January 11, 2007 admitted the appeal filed by KIFSPL and stayed the operation of the 'Disgorgement Order'. Further, in a similar case where final Order was passed by SEBI, the Hon'ble Securities Appellate Tribunal has allowed SEBI to initiate proceedings against that entity for disgorgement in accordance with law. Therefore, in my view, the enquiry proceedings are to be concluded before further action with regard to the penalty and disgorgement is taken. Based on the above findings, it prima facie appears that KIFSPL was lax in following KYC and other norms which it was obliged to follow. In view of the fact that almost 9 months have elapsed, the entity being restrained from opening new accounts, I am of

the view that the interim Order against KIFSPL barring them from opening new accounts may not be required.

5.0 Order

5.1 In view of the above, I, in exercise of the powers conferred upon me in terms of Section 19 read with Section 11 and 11B of the SEBI Act, 1992, hereby direct that there is no need to continue with the directions issued to Khandwala Integrated Financial Services Pvt. Ltd. not to open fresh accounts.

5.2 It is clarified that the present order gives only a prima-facie finding as to the necessity of passing the interim directions at this stage and accordingly all issues and contentions are left open to be considered by the Enquiry Officer and to be decided in subsequent proceedings pursuant to his report.

5.3 This order shall come into force with immediate effect.

PLACE: MUMBAI

T. C. NAIR

DATE: January 22, 2007

WHOLE-TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA