

**THE GAZETTE OF INDIA  
EXTRAORDINARY  
PART – III SECTION – 4  
PUBLISHED BY AUTHORITY  
SECURITIES AND EXCHANGE BOARD OF INDIA  
NOTIFICATION  
MUMBAI, THE 3<sup>rd</sup> DAY OF SEPTEMBER 2007**

**1.0 Background**

1.1. SEBI/LE/102396/2007 - Magadh Stock Exchange Limited (hereinafter referred to as “MdhSEL”) is a company limited by shares and was recognized as a stock exchange under Section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as “SCRA”) for a period of 5 years commencing from December 11, 1986. The said recognition was being renewed from time to time under Rule 7 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as “SCRR”) and was last renewed vide gazette notification dated December 7, 2005 for period which was valid up to December 10, 2006 subject to the conditions mentioned below:

- a. The Exchange shall not regulate or control the dealings in securities in any manner whatsoever until further directions as stated in the order no. WTM/GA/35/MIRSD/12/05 dated December 06, 2005.*
- b. The Exchange shall commence trading only after obtaining final approval from SEBI for establishment of the Settlement Guarantee Fund.*

1.2. MdhSEL vide letter dated September 26, 2006 submitted an application for renewal of recognition under Section 3 of SCRA. Subsequently, Securities and Exchange Board of India (hereinafter referred to as “SEBI”) conducted an inspection of MdhSEL on October 30-31, 2006 in order to determine/examine whether MdhSEL has complied with the conditions of renewal of recognition, the instructions, guidelines, etc. issued by SEBI/Government of India from time to time, whether its organization, systems and practices were in accordance with the framework of the SCRA and whether MdhSEL provides a fair, equitable and growing market to the investors.

1.3. During the inspection, it was observed that MdhSEL had several deficiencies in its functioning. Some of the deficiencies observed in this inspection were also pointed out in the previous inspection conducted on November 24-25, 2003. This indicated that MdhSEL failed to rectify certain major deficiencies although 2 years have elapsed from the previous inspection. Some of the deficiencies comprise :

- i. Failure to appoint an Executive Director.
- ii. Shortfall of Base Minimum Capital (BMC).
- iii. Existence of below par scrips in contribution towards BMC.
- iv. Failure to transfer 50% of the interest earned on 1% Security Deposit to the Investor Protection Fund (IPF).

1.4. Apart from the above, some of the major deficiencies that have been observed in the current inspection are :

- i. Failure to create an IPF.
- ii. Failure to inspect the books of accounts of its members.
- iii. Non-payment of annual registration fees by sub-brokers.
- iv. Non-payment of lease rentals by the subsidiary to MdhSEL.
- v. Non-recovery of dues leading to drain of exchange resources.
- vi. Failure to refund the Refundable Financial Support granted by SEBI.
- vii. Provision for subsidy to the members trading through ISE Securities Services Ltd. (ISS).

1.5. In addition to the above irregularities, several instances were observed where functioning of MdhSEL was contrary to the directives/guidelines issued by SEBI from time to time. Some of these are :

- i. Commencement of trading without setting up of Settlement Guarantee Fund/Trade Guarantee Fund as advised by SEBI circular dated June 09, 1997.
- ii. Delay in compliance with the Corporatisation & Demutualization Scheme.

1.6. The above deficiencies were in violation of the provisions of SCRA, SCRR, the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as 'the Act') the Rules and Regulations made there-under, the

circulars/directives issued by SEBI from time to time and the Rules, Regulations and Bye-laws of MdhSEL. Hence, SEBI issued a show cause notice dated November 30, 2006, under Section 4(4) of SCRA read with Section 11 of the Act to the Council of Management (hereinafter referred to as "COM") of MdhSEL, calling upon them to show cause as to why its application for grant/renewal of recognition should not be rejected and as to why SEBI should not refuse to grant/renew the recognition to MdhSEL under Section 4 of SCRA. SEBI advised MdhSEL to reply to the said show notice by December 7, 2006 and also to appear for a personal hearing before the Whole Time Member, SEBI, along with the supporting documents, if any, on December 08, 2006. However due to official exigencies, the personal hearing was rescheduled on December 7, 2006. This was communicated to MdhSEL vide letter dated December 4, 2006. They were also advised that in case they failed to reply/appear for the personal hearing as aforesaid, SEBI would be constrained to presume that MdhSEL had no reply to offer and accepted the charges as alleged and the matter shall be proceeded ex-parte on the basis of the material available on record.

- 1.7. In response to the said show cause notice, the COM made its submissions vide letter dated December 04, 2006 wherein they requested SEBI that the date of appearance be extended by 2 months. Accordingly, SEBI vide letter dated December 18, 2006 informed MdhSEL that the personal hearing has been rescheduled to January 10, 2007.

## **2.0 Personal Hearing and Reply of MdhSEL to the Show Cause Notice**

- 2.1 As authorized by the COM of MdhSEL in its meeting held on January 6, 2007, Wg. Cdr (Retd.) Narendra Kumar, broker member and Shri Abhay Kumar, Manager cum Administrative Officer appeared for a personal hearing before me on January 10, 2007 and made their submissions. Pursuant to the hearing MdhSEL submitted its written submissions vide letter dated January 17, 2007 and e-mail dated April 24, 2007. Further, MdhSEL also informed vide its letters dated March 15, 2007 and May 08, 2007 the steps taken for appointment of Executive Director.

**3.0** A gist of the violations alleged against MdhSEL and its submissions, vide aforesaid letters/e-mail and during the hearing before me, is given below :

**3.1 Failure to appoint the Executive Director.**

MdhSEL failed to appoint a full-time Executive Director (ED) since April 2001. MdhSEL vide letter dated December 06, 2001 made a request wherein it expressed its inability to appoint an ED due to its weak financial condition. Accordingly, SEBI vide letter dated February 22, 2002 granted an extension whereby the appointment of ED was allowed to be deferred for a period of one year. However, despite several reminders to complete the necessary process for appointment of ED, till date no full time ED has been appointed.

MdhSEL submitted that as per the recommendation of the COM of MdhSEL at its meeting held on April 30, 2007, MdhSEL vide letter dated May 8, 2007 recommended the appointment of Shri Narendra Kumar for the post of ED of MdhSEL. It was also submitted that Shri Narendra Kumar voluntarily offered, not to charge any remuneration except a token amount of Re. 1/- p.m. only. He further gave an undertaking that in case of his appointment, he would abide by all the relevant conditions prescribed under Article 25 of the Articles of Association of MdhSEL.

**3.2 Shortfall of Base Minimum Capital (BMC)**

During the previous inspection of 2003, it was observed that:

- ✍ 1 member had less than the minimum prescribed BMC of Rs. 2 lakh,
- ✍ 2 members have not maintained the BMC in the prescribed ratio.

However, during the current inspection of 2006 conducted by SEBI, it was observed that

- ? 10 members had Nil BMC,
- ? 10 members had less than the minimum prescribed BMC of Rs. 1 lac,
- ? 7 members have not maintained the BMC in the prescribed ratio.

In this regard, MdhSEL submitted that the exchange has made specific communication to such members who have deficient BMC, to deposit BMC as

per the prescribed norms. The prescribed norms of eligible shares with 15% haircut and the list of Group - 1 securities has been furnished, to enable them to complete the BMC norms. All such members were given a period of three months (w.e.f. January 1, 2007) to regularize the BMC inadequacies. If such members failed to comply with BMC norms even after this period of three months, the list of such members with inadequate BMC was to be forwarded to the COM for further action. However, the latest compliance status as on April 18, 2007 submitted by MdhSEL indicates that the exchange has issued a circular only on April 10, 2007 to all members regarding regularization of BMC as per the decision of COM meeting dated April 2, 2007.

### **3.3 List of below par scrips contribute towards Base Minimum Capital.**

MdhSEL failed to prescribe the list of shares to be accepted as securities component of BMC of the members and has also failed to periodically value the securities.

MdhSEL submitted that the concerned members whose BMC contribution included below par scrips have been advised and given three months time to comply with the BMC norms and replace these scrips with those listed in Group – 1 or with cash. If such members failed to comply with BMC norms even after this period of three months, the list of such members with inadequate BMC shall be forwarded to the COM for further action. However, the latest compliance status as on April 18, 2007 submitted by MdhSEL indicates that the exchange issued a circular to rectify the position only on April 10, 2007 to all members as per a decision of COM meeting dated April 2, 2007.

### **3.4 Failure to transfer 50% of the interest earned on 1% Security Deposit to the Investor Protection Fund (IPF)**

MdhSEL failed to transfer 50% of the interest accrued on 1% security deposit kept by the issuer company to the IPF, at the time of the offering of securities for subscription to the public.

MdhSEL submitted that 50% of the interest earned on 1% security deposit has been invested in FDRs with ING Vysya Bank Ltd.

### **3.5 Failure to create an Investor Protection Fund (IPF).**

The inspection report observed that MdhSEL failed to create IPF in the form of a Trust. Further, the IPF is being maintained as part of a general fund and not earmarked for the specific purpose of investor protection nor any necessary tax exemptions have been obtained for the fund.

In response to the above, MdhSEL submitted that the required documents and registration fees have been submitted to the Registrar for registration of IPF Trust and are following up at their end.

### **3.6 Failure to inspect the books of accounts of its members.**

MdhSEL failed to inspect the books of accounts of its members. It is noted that 27 members actively traded through ISS and 4 members traded through BOLT terminals but no inspections were undertaken.

In this regard, MdhSEL submitted that the inspection of books of accounts of members who actively traded in other segments such as ISS is under implementation and it is expected to be completed by March 2007. In this regard, specific communications to all such members have also been made to present their audited reports and books of accounts. However, vide latest compliance report MdhSEL has submitted that the inspection is in progress from April 2007.

### **3.7 Failure to refund the Refundable Financial Support granted by SEBI.**

SEBI superceded the COM of MdhSEL w.e.f. December 8, 1997 (extended up to June 07, 2000) and appointed an Administrator to handle the day to day activity of the Exchange. Due to weak financial position of MdhSEL and on its request, SEBI sanctioned a total refundable financial support amounting to Rs

12.32 lakh. MdhSEL has repaid Rs. 7.82 lakh only so far and the balance amount of Rs. 4.50 lakh is still pending.

MdhSEL submitted that due to present financial constraints, on account of suspension of trading as well as drying up of listing fee, the exchange is not able to refund the SEBI dues. In view of the same, MdhSEL has made the request either to part waive the amount of SEBI dues, or, if part waiver is not possible, to dilute the payment terms spread over 5 years.

### **3.8 Non-payment of annual registration fees by sub-brokers.**

SEBI vide its several letters dated August 7, 2003, January 23, 2004 and March 4, 2005 had directed MdhSEL to take up the matter of non-payment of annual registration fees by 3 registered sub-brokers to SEBI. However, it was noted that the Exchange has not pursued the matter with the sub-brokers for payment of registration fees due to SEBI.

MdhSEL submitted that out of the three sub-brokers/brokers –

1. M/s Shivam Securities, sub-broker of Shri Krishna Kumar Rungta has paid the sub-broker fees.
2. The account of the affiliated broker i.e. M/s Rajat Shares & Stock Brokers Pvt. Ltd. is being debited for realization as per final notice dated April 10, 2007. served on him
3. As M/s GSP Financial, the affiliated broker has been declared a defaulter on October 8, 1988; no assets are lying with the exchange, however, while auctioning its membership ticket such dues of SEBI will be realized from the auction amount later.

### **3.9 Non-payment of lease rentals by the subsidiary to MdhSEL.**

MSEA Securities Ltd. (MSL), subsidiary of MdhSEL exists in the same premises as that of the parent Exchange. The subsidiary company was paying Rs. 60,000/- as lease rentals to the parent Exchange for the premises occupied by it till the end of the financial year 2003-04. However, from the subsequent year onwards, the subsidiary company had not paid the lease

rentals nor the parent Exchange has insisted on the same. In reply to the above, MdhSEL submitted that MSEA Securities Ltd. was registered as a wholly owned subsidiary of MdhSEL for the purpose of facilitating trades. However, MSEA Securities Ltd. has not done any business so far and, therefore, it is not considered advisable to charge any rent from the subsidiary as it has no income at all. Hence, it is observed that MdhSEL is conducting its affairs detrimental to the interest of the investors or the public as its actions benefited only its own members.

### 3.10 Non-recovery of dues leading to drain of Exchange resources.

MdhSEL failed to collect the following dues from members as Annual Subscription Fees and from the listed companies as listing fees:-

|                | ANNUAL SUBSCRIPTION FEES |                 | LISTING FEES    |
|----------------|--------------------------|-----------------|-----------------|
|                | No. of members           | Amount          | Amount          |
| <b>2004-05</b> | 75                       | Rs. 2,79,671/-  | Rs. 5,49,425/-  |
| <b>2005-06</b> | 100                      | Rs. 4,53,928/-  | Rs. 5,77,425/-  |
| <b>2006-07</b> | 138                      | Rs. 6,90,000/-  | Rs. 7,71,955/-  |
|                | <b>TOTAL</b>             | Rs. 14,23,599/- | Rs. 18,98,805/- |

MdhSEL submitted that it launched a vigorous campaign for the recovery of arrears of annual subscription, as a result of which it collected a sum of Rs 2.29 lakh in November 2006, Rs 1.61 lakh in December 2006 and Rs 50,000/- in January 2007. A system of imposing penalties/fines for non-payment/delayed payment of Annual Subscription has been adopted as per decision of the exchange and circular dated April 10, 2007 has been issued to members.

Since there is no trading activity in MdhSEL from December 2004, the companies do not find any interest in paying the listing fees to MdhSEL. Eight companies have been de-listed by MdhSEL for non-compliance and non-payment of listing fees. MdhSEL has also filed complaints in regard to recovery of listing fee arrears.

### **3.11 Subsidy provided to the members trading through ISS.**

MdhSEL charged turnover fees @ 0.004% of the total monthly turnover of the members and Rs. 500 per month per terminal on members trading through ISS. However, it was observed that from December 2005 onwards, the members trading through the various segments have stopped making the aforesaid payment to the Exchange and that there was no decision by the COM for waiver of such charges on the members.

MdhSEL submitted that the COM has already decided to recover the turnover charges from the members and is expected that by March 31, 2007 the entire amount will be collected. Further, the members who are availing of trading facility provided by MdhSEL will be requested to bear the expenditure incurred by MdhSEL. MdhSEL has also submitted that the dues arising out of ISS trading facility are being recovered.

**3.12** In addition to the above irregularities, several instances were observed where functioning of MdhSEL was contrary to the directives/guidelines issued by SEBI from time to time. Some of these are mentioned as under:

#### **3.12.1 Commencement of trading without setting up of SGF/TGF**

SEBI vide letter dated June 25, 2002 advised MdhSEL to ensure that it shall not commence trading without establishing the SGF/TGF duly approved by SEBI. However, during the inspection conducted in November 2003 it was observed that MdhSEL continued trading activities till the date of inspection. Further, this has also been an ongoing condition for renewal of recognition since December 11, 2003. However, in the month of August 2005 MdhSEL briefly continued trading, without setting up SGF/TGF, duly approved by SEBI.

In this regard, MdhSEL submitted that there is no trading since last inspection, except the trading between August 01 to 12, 2005, for which Shri CM Pandey the then Executive Director (Officiating) (hereinafter referred to as "OED") has been suspended and is facing enquiry. Further, the proposal for formation of SGF is already with SEBI and on acceptance of such proposal, MdhSEL will

take necessary action to set up SGF. The trading without SGF/TGF formation was primarily a lapse on the part of Shri C M Pandey, OED (under suspension) who commenced trading without bringing the facts to the COM.

### **3.12.2 Delay in Compliance with the Corporatisation & Demutualization Scheme**

SEBI approved and notified the Corporatisation & Demutualization Scheme (hereinafter referred to as "Scheme") of MdhSEL on September 15, 2005. As per the scheme, MdhSEL was required to fix a 'Due Date', not later than 3 months from the date of notification of the Scheme i.e. by December 14, 2005, in order to comply with the various provisions of the Scheme. However, only after continuous follow up by SEBI, MdhSEL complied with its Scheme on June 12, 2006. It is alleged that implementation of the Scheme by MdhSEL after about 9 months of its notification indicated apathy on the part of the COM to take and implement important decisions like Corporatisation and Demutualisation Scheme as required under SCRA.

MdhSEL submitted that the delay in the implementation of the Scheme was caused by the unprecedented and unauthorized act of the then OED and due to the disruption of normal administrative functions and procedural delays at ROC office. However, MdhSEL approached SEBI for grant of extension of time and the scheme was implemented within the extended time given by SEBI.

### **3.12.3 Inadequate Manpower and Infrastructure:**

MdhSEL does not have the basic platform for trading and settlement such as clearing house, a separate bank a/c for pay-in/pay-out, separate demat account for clearing and settlement, licensed and tested trading software, etc. Apart from the above, MdhSEL has very meager manpower (i.e. only 2 officers and 5 staff members) and has no identified staff exclusively to take care of the surveillance functions in MdhSEL, etc.

MdhSEL submitted that its income has not increased due to various reasons including restrictions on trading imposed by SEBI, present national capital market scenario and even the payment of salary to the existing staff and officers was difficult. It assured that the moment there is an adequate income, manpower and other infrastructure will be strengthened and improved.

#### **4.0 Consideration of Issues**

4.1 I have carefully considered the facts and circumstances of the case and the material available on record which includes the show cause notice, replies and the documents submitted by MdhSEL as well as the oral submissions made before me during the personal hearing.

4.2 At the outset, I note that the inspection of MdhSEL was carried out with an objective to ascertain whether the exchange has complied with the conditions /guidelines etc. issued by SEBI / Government of India from to time and whether the exchange provides fair, equitable and growing market to the investors. I also note that the renewal of recognition granted to MdhSEL up to December 10, 2006 was subject to the conditions that the exchange shall not regulate or control the dealings in securities in any manner whatsoever until further directions as stated in the order dated December 06, 2005. It was further directed that the exchange shall commence trading only after obtaining final approval from SEBI for establishment of the Settlement Guarantee Fund. Further, MdhSEL in its oral and written submissions had stated that the deficiencies observed in the inspection report will be complied with either by March 31, 2007 or by mid April 2007. However, I observe that MdhSEL has made a half hearted attempt to comply with the suggestions made by SEBI in the inspection report of 2006. Moreover, some of the suggestions made in the inspection report of 2006 were also part of the suggestions made in the inspection report of 2003. I have examined the reasons assigned for the said non-compliance / delayed compliances and find them grossly inadequate to explain why these conditions have not been complied within the time frame specified by SEBI.

- 4.3 SEBI vide various circulars had directed the stock exchange to appoint an Executive Director for the day-to-day administration of the stock exchange. Further, it shall be the duty of the Executive Director to give effect to the directives, guidelines and orders issued by the Board in order to implement the applicable provisions of law, rules, regulations as also the Rules or the Articles of Association, Regulations and Bye-laws of the stock exchange. However in violation of SEBI circulars as well as the Articles of Association of MdhSEL, I note that MdhSEL did not have a full time Executive Director since April 2001. I further note that MdhSEL, after such an inordinate delay and continuous follow-up by SEBI finally, vide letter dated May 8, 2007, recommended the name of Shri Narendra Kumar for the post of ED, for approval. I observe that Shri Narendra Kumar voluntarily offered his services for a token amount of Re. 1/- p.m. only. It is a preposterous idea to appoint a broker member of the exchange as ED particularly when he represented the COM for the personal hearing.
- 4.4 SEBI vide its circular dated June 18, 2003, stated that the Exchange may reduce the BMC from the existing Rs. 2 lakh to Rs. 1 lakh and refund the excess of BMC to the members on receipt of NOC from SEBI. Further, in terms of SEBI circular dated October 21, 1993, BMC is required to be maintained by the member brokers in the prescribed ratio. However, it is observed that compared to the previous inspection report of 2003 wherein only one member had less than the minimum prescribed BMC, during the current inspection of 2006 that number has substantially increased to 10 members. Moreover, 10 members had Nil BMC which is not acceptable. Further, the number of members not maintaining the BMC in the prescribed ratio has increased from 2 members to 7 members. I note that maintenance of minimum BMC is essential requirement for the member brokers and stock exchange has to monitor the capital adequacy norms prescribed by SEBI on an ongoing basis. Also, MdhSEL is responsible for carrying out appropriate due diligence with regard to its members' compliance under various applicable laws, rules and regulations and ensure compliance with the same. I note that merely issuing a circular to members asking them to regularize the BMC would not suffice and MdhSEL is required to take stern action against

the offending broker members. I find that the exchange has failed in its responsibilities and has shown laxity while recovering the dues from its members. Moreover, there is no denying the fact that even some of the half-hearted measures were taken by MdhSEL only when the deficiencies figured in the inspection report.

- 4.5 Further, SEBI vide circular dated June 11, 2003 provided that the eligible shares for the purposes of securities portion of the BMC shall only be those which are classified as Group I in terms of parameters of volatility and liquidity subject to haircut of 15%. Considering the submission of MdhSEL, I find that MdhSEL has only issued a circular asking its members to regularize the BMC which is grossly inadequate and inconsequential.
- 4.6 During the inspection, it was noticed that MdhSEL had failed to create an Investor Protection Fund in the form of a Trust. From the compliance status report, it appears that the exchange has taken steps to create an IPF Trust. In terms of SEBI Circular dated October 28, 2004, the IPF shall be administered by way of a Trust created specifically for the purpose of protection of investors. The stock exchanges were also advised to ensure that the funds created for IPF are well segregated and that it is protected from any liabilities of the Stock Exchange. Failure to maintain the IPF in the form of a Trust is a serious irregularity and over and above maintaining such fund as a part of a general fund and not assigning it for a specific purpose of investor protection and neither any tax exemptions obtained has to be viewed seriously.
- 4.7 MdhSEL has submitted that the 50% of the interest earned on 1% security deposit has been invested in FDR with ING Vysya Bank Ltd. However, on perusal of the FDR receipts, it is observed that the FDRs have been issued in favor of MdhSEL which is not in accordance with SEBI circular dated October 24, 2004 wherein the Stock Exchanges were advised to ensure that the funds in the IPF are well segregated and that the IPF is protected from any liabilities of the Stock Exchange.

- 4.8 SEBI, in exercise of powers conferred under the Act periodically issues circulars to protect the interests of investors in securities and to promote the development of, and to regulate the securities market. However, I observe that the exchange has failed to comply with the circulars/directives/guidelines issued by SEBI from time to time. One such instance is failure to inspect the books of accounts of its broker members. I note that the Government of India vide circular dated January 29, 1983 required the stock exchanges to inspect the books of accounts of at least 10 % of their active members every year. The exchange has submitted that since no broker member of the exchange has been doing business on the floor of the exchange, it was not considered necessary to inspect the same. Even though, the exchange has informed that steps have been taken to rectify this irregularity till date no report of such compliance has been received from the exchange.
- 4.9 I note that due to breakdown of internal administration and persistent malfunctioning of the COM of MdhSEL, the COM, was superseded by SEBI under section 11 of SCRA for a period of one year w.e.f. December 8, 1997 and was extended up to June 7, 2000. During this period, due to weak financial position of MdhSEL and on its request, SEBI sanctioned a total refundable financial support amounting to Rs 12.32 lakh. MdhSEL till date has repaid only Rs. 7.82 lakh to SEBI and the balance amount of Rs. 4.50 lakh is still due. I note that the payment of the balance amount towards refundable financial support extended by SEBI to MdhSEL has been one of the renewal conditions since December 11, 2003. Further, MdhSEL has been continuously advised / directed to repay the amount due to SEBI. However, MdhSEL has failed to refund the full amount in spite of repeated reminders citing weak financial condition.
- 4.10 One of the irregularities noticed during the inspection was of non payment of annual registration fees by the sub-brokers. SEBI vide numerous letters had directed the exchange to take up the matter of non-payment of annual registration fees by three registered sub brokers to SEBI. However, I observe that the exchange has pursued the matter with the sub-brokers for payment of registration fees due to SEBI and two sub-brokers have paid the fees due.

- 4.11 MdhSEL was advised to ensure the recovery of annual subscription fees from all the member brokers and adopt a system of imposing penalties / fines for non payment / delayed payment of annual subscription fees. The exchange was also advised to initiate suitable action for recovery of the listing fees in arrears from the listed companies. I note that MdhSEL has failed to collect the annual subscription fees from its member brokers and I have noticed that the number of defaulters has been increasing from 75 in the year 2004-05 to 138 in the year 2006-07. Further, I note that it has also failed to recover the listing fees from the companies. It is an admitted fact that in view of the suspension of trading activity at the exchange, the members / companies don't find any interest in paying the annual subscription fees as well as listing fees. Further, I do not find merit in the contention of MdhSEL that once the recognition is granted on permanent basis to it and the trading is started, the financial position of the exchange will improve.
- 4.12 It was observed that MdhSEL had provided subsidy to the members trading through ISS. These members were allowed to trade in the work stations of the Exchange and use the infrastructure facilities of the Exchange. For the year 2006-07, MdhSEL incurred a net expenditure of Rs. 6,32,157/-. It was observed that there is a huge gap between the expenditure incurred by MdhSEL to facilitate trading for few members in other segments and the income received from such members of MdhSEL. It indicated that few members of MdhSEL enjoy huge subsidy from the parent exchange for their trading at the cost of the resource of MdhSEL. I find that MdhSEL is in the process of recovering dues from its members arising out of ISS trading facility; however, the actual amount of dues recovered from members has not been mentioned.
- 4.13 Vide circular dated June 9, 1997, SEBI had advised all Stock Exchanges to set up clearing house/clearing corporation or Settlement Guarantee Fund (SGF) to ensure timely completion of the settlement. Vide the said circular, all the stock exchanges were also advised to submit the relevant information in the prescribed format to SEBI for its examination and approval for setting up of SGF. SEBI vide letter dated June 25, 2002 advised MdhSEL to ensure that

it shall not commence trading without establishing the SGF/TGF duly approved by SEBI. This has been the ongoing condition for renewal of recognition since December 11, 2003. However, on the following occasions, MdhSEL commenced trading without setting up SGF/TGF, duly approved by SEBI:

- (i) **November 2003:** During the inspection conducted in November 2003, it was observed that in addition to trading in illiquid scrips, a number of transactions have been dealt with by the members in illiquid scrips also. As a result the prices of these scrips had gone up substantially ranging from 41% to 2275% within a very short span of time. Further, it was observed that all the scrips traded were in permitted category. The turnover details on MdhSEL are as under :

| Year                | Type of Security | Turnover (Rs.) (approx.) | No. of trading days | Average daily turnover (Rs.) |
|---------------------|------------------|--------------------------|---------------------|------------------------------|
| 2001-02             | Permitted        | 1,10,000                 | 2                   | 56,395/-                     |
| 2002-03             | Permitted        | 39,00,000                | 113                 | 34,600/-                     |
| 01.04.03 – 31.10.03 | Permitted        | 3,00,000                 | 23                  | 12,735/-                     |

- (ii) **August 2005:** I note that MdhSEL, while seeking renewal of recognition vide letter dated December 05, 2003 had given a categorical undertaking to SEBI to be fully compliant with all requirements of SEBI. In spite of the categorical undertaking, it was noted that MdhSEL allowed trading on its trading platform from August 1-12, 2005. On scrutiny of the trading details it was observed that trading volume was to the tune of Rs 90.06 crore, concentrated mainly in the scrip of Bhoruka Financial Services Ltd. (BFSL) which accounted for nearly 99% of the trading volume. It was further noted that BFSL was not listed on MdhSEL and as such it was listed only on Bangalore Stock Exchange Ltd. (hereinafter referred to as 'BgSE'). The last trading in the scrip on BgSE was in year 1988 and the last traded price was Rs.5.00. On enquires it was revealed that the trading of BFSL was allowed by MdhSEL in the permitted category only on August 01, 2005, upon the application made by a broker on

the very same day. It was also observed that the shares were allowed to be traded in the permitted category on the platform of the exchange by Shri CM Pandey Executive Director (Officiating) in contravention of the conditions of renewal of recognition and in complete violation of the undertaking submitted by MdhSEL.

Accordingly, vide ad-interim ex-parte Order dated August 19, 2005 SEBI *inter-alia* directed that:-

- (i) *MdhSEL which acted as unrecognized stock exchange as above shall not assist, regulate or control the dealings in securities in any manner whatsoever until further directions or pending completion of final proceedings, whichever is earlier.*
- (ii) *Shri C M Pandey, Executive Director (Officiating) is hereby suspended from acting as a OED or in any capacity in MSEA or in any other institution related with the securities market, till further orders.*

The above directions were confirmed vide order dated December 6, 2005. In addition to the above, *“MdhSEL was also directed to initiate disciplinary proceedings against Shri C.M. Pandey as per the applicable laws for imposing major penalty. MdhSEL was further directed that till the completion of the disciplinary proceedings of MSEA and pending SEBI investigations, Shri C.M. Pandey shall not be allowed to perform any function which has any bearing on the securities market, or with any institution connected with the securities market.”* Accordingly, MdhSEL had initiated disciplinary proceedings and appointed an enquiry officer. Based on the report of the enquiry officer, the COM has informed that Shri CM Pandey has been dismissed from the services of the exchange.

I note that setting up of SGF was a condition precedent for granting renewal of recognition to MdhSEL. From the chronology of events, it is observed that this pre condition has not been satisfied by MdhSEL even after granting several extensions of renewal. Further I note that MdhSEL has also admitted the lapse on their part and I therefore conclude that even after giving sufficient

time to comply with the conditions of renewal, it has failed to do so and facilitated unauthorized / illegal trading.

4.14 As per the provisions of MdhSEL Corporatisation & Demutualisation (C&D) Scheme notified on September 14, 2005, MdhSEL was required to fix a 'Due Date', not later than 3 months from the date of notification of the Scheme i.e. by December 14, 2005, in order to comply with the various provisions of the Scheme like conversion / re-registration from a company limited by guarantee to a company limited by shares, allotment of shares, reconstitution of the Governing Board, etc. However, MdhSEL submitted its compliance report with regard to the C&D scheme only on June 12, 2006 i.e. after about 6 months from the aforesaid due date, and that too only after rigorous follow up by SEBI and warning of initiating suitable action against the exchange and the COM, including levy of monetary penalty under Section 23G of the SCRA, or suppression of the COM. I observe that C&D is a statutory requirement and above all a progressive move that would bring in structural changes in the Exchange for better governance. By not fulfilling / complying the C&D scheme as per schedule demonstrates that the COM is unable to perform effectively and provide guidance and direction to MdhSEL.

4.15 I note that a Stock Exchange being a "Self Regulatory Organization" is a first level regulator and has a responsibility to oversee the management, administration, trading and settlement of the exchange, regulate its own members, and monitor the functioning of its subsidiary. MdhSEL is a public institution that regulates the dealings in shares and securities, incorporated under the SCRA, guided not only by its own Rules, Bye-laws and Regulations but also by the directives issued by SEBI/Govt. of India from time to time. On perusal of the compliance reports, I find that MdhSEL had substantially not complied with the observations stated in the inspection report. I note that stock exchange being first level regulator; a duty is cast upon them to continuously comply with the various statutory Acts, Rules, Regulations, Bye-laws, etc. of the stock exchange. By their above actions, I find that MdhSEL was lax in complying with the observations stated in the inspection report.

- 4.16 In spite of the fact that there is no trading on MdhSEL since 2004, it is incumbent upon a stock exchange to supervise its trading members comply with the Rules, Bye-laws and Regulations of the exchange at all times during their period of holding of membership of the exchange irrespective of whether they trade or not.
- 4.17 I also note that MdhSEL is facing an acute financial crisis wherein even the payment of salary to the existing staff and officers (read 7 employees) is a big task. Yet, MdhSEL displayed lethargy in recovering outstanding dues from its member brokers as well as the listed companies since 2004-05. MdhSEL has, of-late, launched a vigorous campaign to recover the dues from the members as well as listed companies. However, it is dis-heartening to know that MdhSEL has acted only when told to do so by SEBI and has recovered only a sum of Rs. 4,40,000/- out of the total dues of Rs. 33,22,000/- as per their letter dated January 10, 2007 which is 13% (approx).
- 4.18 It is imperative to mention that MdhSEL can commence trading only after establishment of SGF by the exchange and duly approved by SEBI. I note that the SGF proposal of MdhSEL is pending with SEBI, for approval. Further, MdhSEL indicated in the inspection report of 2006 that a sum of Rs 1,50,000/- has been set up as an initial corpus for the fund. It also informed that the corpus is being built by collection of Rs. 5,000/- per member from all new entrants from the year 2004-05 onwards and the balance in the SGF a/c as on date of inspection was Rs. 1,55,030/-. However, MdhSEL could not produce any FDRs representing the said fund nor the same is reflected in the annual accounts of the exchange for the years 2004-05 and 2005-06. I note that the corpus of SGF should be adequate to meet all the contingencies arising on account of failure of any member/members. Considering that the figure is nominal the corpus of SGF seems to be woefully inadequate.
- 4.19 Further, it is the responsibility of the stock exchanges to detect market manipulations like price rigging, etc. and to monitor abnormal price and volume movements which are not consistent with normal trading pattern. It is also the responsibility of stock exchanges to monitor brokers' position,

margins, trading limits, etc. to ensure that the brokers do not commit defaults adversely affecting the market and the interest of investors. In view of the same, SEBI vide letter dated August 8, 1995 advised all the stock exchanges to have separate surveillance departments entirely devoted to carry out the aforesaid functions. The stock exchanges were also advised that the department shall not be saddled with any other responsibility so that it can concentrate on the aforesaid functions. Further, SEBI vide circular dated February 23, 2005 issued comprehensive risk management framework for the cash market in order to successfully and efficaciously address the market risk. However, the efficacy of the same will be dependent on efficient monitoring, surveillance and timely collection of margins by the Stock Exchange. Apparently, I note that there are only 7 employees in the exchange which includes only two in the officer cadre which according to me is totally inadequate to run a stock exchange which is a Self Regulatory Organization as well as first level regulator to its members / listed companies. Moreover, there is a prolonged vacuum at the top management wherein MdhSEL has failed to appoint a full-time Executive Director since April 2001. Mere existence of a stock exchange without having the basic requirements to function as a stock exchange would not serve any economic purpose towards trading, listing of companies, protection of interest of the investors. Moreover, the continued existence of the exchange is a regulatory burden on SEBI.

- 4.20 Apart from the serious irregularities observed in the inspection report, I find that there are lapses in the basic functioning and administration of the Exchange in terms of the SEBI directives, circulars, SCRA and SCRR. Further there have also been non-compliances by MdhSEL of various circulars / directives/ instructions issued by SEBI time and again which displays an apparent disregard for statutory compliance. I believe that it is imperative that an exchange should not only comply with the directives issued by SEBI and the provisions of law, but also ensure the smooth functioning of the exchange in accordance with law, business ethics, corporate governance etc and in tune with the developments of securities market. However, in the instant case, the deficiencies elaborated above are indicators of a stock exchange functioning in a manner against the interest of the public at large.

- 4.21 Considering the current capital market scenario, where only those institutions, which are capable of adapting to the rapidly changing market structure alone can survive, MdhSEL with the aforesaid inadequacies, would find itself redundant. If MdhSEL is allowed to function in the present manner without any immediate remedial action, it would not only lose its relevance as a public institution but also erode confidence of the investors, which would in turn will adversely affect the orderly development of the securities market.
- 4.22 When the activities of an exchange are carried out contrary to the interest of the investing public and in a manner which is adverse to the interest of the investors, members and the public, the same is bound to damage their interests. Moreover, failure of the COM to ensure proper governance and implementation of the provisions of the SCRA, Bye-Laws of the Exchange and the SEBI directives, circulars etc could erode the confidence of the investors.
- 4.23 The deficiencies and non-compliances brought out supra, prove beyond doubt that MdhSEL has time and again acted contrary and in defiance of SEBI directives/guidelines issued from time to time. Over the years, there were major regulatory lapses that led to supersession of the COM and suspension of trading on the floor of the exchange. Further, the resources available with the exchange in terms of men, material, capital etc. are inadequate to function as a stock exchange. The contention of MdhSEL that the moment there is revival of trading on the exchange and income generated, manpower and other infrastructure will be in place is untenable. Further, as MdhSEL neither provides a trading platform nor serves any public interest in my view, it has ceased to perform the basic economic function for which it was set up.
- 4.24 In view of the above facts and circumstances, and in exercise of the powers conferred upon me under Section 19 read with Section 11 of the Securities and Exchange Board of India Act, 1992 and Section 4(4) of the Securities Contracts (Regulation) Act, 1956, read with the Government of India Notification number F. No. 1/57/SE/93 dated September 13, 1994, I hereby

refuse to renew the recognition granted to MdhSEL. This Order shall come into force after 15 days from the date of the Order.

4.25 In view of this Order, since MdhSEL shall cease to be a recognized stock exchange, it is imperative to pass necessary directions in the interest of investors/shareholders of the listed companies at MdhSEL and in the overall interest of the securities market. I, therefore, in exercise of powers conferred upon me under Section 19 read with section 11 of SEBI Act, 1992 and section 4(4) of SCRA pass the following directions:

4.25.1 The money available in the Investor Protection Fund and Investor Services Fund of MdhSEL lying un-utilized shall be transferred to SEBI Investor Protection and Education Fund within 15 days from the date of notification of this order.

4.25.2 MdhSEL shall set aside sufficient funds in order to provide for settlement of any claims, pertaining to pending arbitration cases, arbitration awards, not implemented, if any, liabilities/claims of contingent nature, if any, and unresolved investors complaints/grievances lying with the exchange, on the date of this Order.

4.25.3 The companies which are exclusively listed on the MdhSEL may consider seeking listing at other stock exchanges or provide for exit option to the shareholders as per SEBI Delisting Guidelines / Regulations.

4.25.4 Consequent upon refusal to renew the recognition granted to MdhSEL, the trading members of MdhSEL shall cease to be trading members of MdhSEL and therefore liable to be de-registered as stock brokers, and their certificate of registration granted by SEBI shall accordingly stand automatically cancelled. However, the said brokers/trading members of MdhSEL shall be liable to pay SEBI registration fees as per Schedule III of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of this Order.

4.25.5 Pursuant to refusal to renew the recognition of MdhSEL, the exchange is directed to refrain from using the expression 'stock exchange' or any variant in its name or in its subsidiary company's name.

4.25.6 MdhSEL is directed to pay the balance amount of Rs 4,50,000/- of the refundable financial support granted by SEBI within 15 days from the date of notification of this order.

4.25.7 MdhSEL is restrained from transferring or alienating any movable or immovable property of the exchange including Bank Accounts in any manner till further directions by SEBI in this regard.

**F. No. SEBI/LE/ 102396 /2007**

**Date : August 30, 2007**

**Place : Mumbai**

**T.C. NAIR  
WHOLE TIME MEMBER  
SECURITIES AND EXCHANGE BOARD OF INDIA**