BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. BM/AO- 147/2011]

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

Adroit Financial Services Pvt Ltd.

SEBI Registration No. INB230853830 (NSE) & INB011228336 (BSE)

(PAN. No. AABCA1156D)

FACTS OF THE CASE IN BRIEF

1. Securities and Exchange Board of India (hereinafter referred to as '**SEBI**') conducted an inspection into the books of accounts and other records maintained by Adroit Financial Services Pvt Ltd (hereinafter referred to as the '**Noticee**'**)** Broker, Bombay Stock Exchange Ltd **(BSE)** and National Stock Exchange India Ltd **(NSE)** during the period January 27, 2009 to February 05, 2009 (hereinafter referred to as the '**Inspection Period**'). The inspection covered financial years 2006 – 2007, 2007 – 2008 and 2008 – 2009.

2. The inspection was carried out to examine whether the books of accounts, records, documents and various other records maintained by the Noticee were in the manner specified by the Securities Contract (Regulations) Rules, 1957, Securities & Exchange Board of India (Stock Brokers & Sub-Brokers) Regulations, 1992 and the provisions of SEBI Act and rules and regulations of Securities Contract (Regulations) Act, 1956 were being complied with.

3. On inspection of the books of accounts, documents and records of the Noticee on sample random checking basis, the following irregularities/deficiencies were observed:

   i. The cash book of the Noticee reflected number of cash inflows and outflows which did not appear to be related to the imprest account of the Noticee. The source/destination and cash flows from the corresponding narration of entries in the cash book were also not clear. The cash book further revealed that there had been some payments in cash to some individual entities.

   ii. The bank book of the Noticee revealed that the Noticee had been transferring funds from its bank accounts earmarked for client's trading transactions to the bank accounts earmarked for its business operations. It was further observed that the clients dividend was being used for the business purpose of the Noticee indicating no proper segregation between own funds and clients funds.

   iii. On scrutinizing the client data base, it was observed that the Noticee allotted common client codes to its clients.

   iv. It was observed that the Noticee was dealing with few unregistered sub-brokers.

   v. From the client ledgers of the Noticee it was observed that its clients were adjusting their debit/ credit balances with each other in the name and style of *"Group Transfers".* It was observed that the group transfers were taking place without proper authorization.

   vi. An examination of the client ledgers of the Noticee further revealed various instances of issue of cheques/ group transfers or adjustments made by the Noticee despite debit balance in the client's account.

   vii. Further, the Noticee's Member- Client agreement revealed that there were few clauses that were undesirable and unsuitable for the clients.

4. In view of the above, it was alleged that the Noticee violated Clauses A (1), A (2) and A (5) of Code of Conduct specified under Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as "**Brokers Regulations**"), SEBI circular no. SMD-1/23341 dated November 18, 1993 , SEBI/MRD/SE/ Cir-33/2003/27/08 dated August 27, 2003, SEBI circular no SMD/SED/ Cir/93/23321

dated November 18, 1993 , SEBI circular no SMDRP/Policy /CIR-39/2001 dated July 18, 2001, Regulation 18B of Brokers Regulation, SEBI circular no SMD-I/3118 dated December 27, 1993, SMD/POLICY/Circular/3-97 dated March 31, 1997 , Sub-bro/Cir/02/2001 dated January 15, 2001, SEBI circular no SMD-I/23341 dated November 18, 1993, SEBI circular no SEBI/MRD/SE/Cir-12/2005 dated May 13, 2005 and SEBI Act, 1992. Consequently, the above violations make the Noticee liable for monetary penalty under section 15 HB of the SEBI Act.

APPOINTMENT OF ADJUDICATING OFFICER

5. I was appointed as the Adjudicating Officer, vide order dated June 23, 2010 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 15 HB of the SEBI Act for the alleged violation committed by the Noticee.

SHOW CAUSE NOTICE, HEARING AND REPLY

6. Show Cause Notice No. EAD-6/BM/20743/2010 dated September 23, 2010 (hereinafter referred to as **'SCN'**) was issued to the Noticee under rule 4 of the Rules to show cause as to why an inquiry should not be held against the Noticee and penalty be not imposed under section 15 HB of the SEBI Act for the alleged violations specified in the SCN.

7. The Noticee vide emails dated October 7, 2010 and October 21, 2010 sought extension of time to reply to the SCN. The Noticee vide letter dated October 29, 2010 replied to the SCN and the same has been dealt in later part of the order.

8. In the interest of natural justice and in order to conduct an inquiry as per rule 4(3) of the Rules, an opportunity of personal hearing was granted to the Noticee on November 23, 2010 vide hearing notice dated November 04, 2010 at SEBI- Head Office, Mumbai. The Noticee vide email dated November 19, 2010 sought adjournment of the personal hearing as the Noticee's consultant was unable to attend the same.

9. Accordingly, another hearing notice dated December 03, 2010, was issued to the Noticee for a hearing to be held on December 15, 2010 at SEBI- Head Office, Mumbai. Mr. Mohit Sharma and Mr. Vinod Jain, Authorized Representatives (hereinafter referred to as the '**AR**') appeared on behalf of the Noticee. During the personal hearing further information/documents were sought such as summary of expenses incurred date wise and voucher wise by the Noticee in the cash withdrawals, list of the Noticee's offices, sample copy of the dividend account, Unique Client Identification Code for six of Noticee's clients and sample vouchers and copies of bill. The Noticee agreed to submit the information/documents by January 06, 2011.

10. The Noticee vide email dated January 06, 2011 sought further extension of time of 10 days to submit their reply. The Noticee vide letter dated January 17, 2011 submitted the above required documents.

11. On perusal of the documents submitted by the Noticee, the Noticee vide letter dated February 28, 2011 asked to explain in detail how the dividends were duly transferred to the clients account from the Noticees account and evidences/documents regarding the general market activities, advertisements, branding shows undertaken by the alleged unregistered sub-brokers.

12. The Noticee vide letter dated 14 March, 2011 sought 4 weeks time to furnish the documents and the same was done by the Noticee vide letter dated May 16, 2011.

13. On perusal of the above submission dated May 16, 2011 it was observed that further clarifications were required in the matter, hence another opportunity of personal hearing was granted to the Noticee vide hearing notice dated September 06, 2011 for a hearing to be held on September 23, 2011 at SEBI- Northern Regional Office (NRO), Delhi. Mr. Vinod Jain, Mr. Mohit Sharma and Mr. Nikhil Raj Gupta appeared on behalf of the Noticee. During the personal hearing the Noticee was required to submit details of the business promotion practiced by it and also the details of the prudent risk management system followed by the Noticee.

14. The Noticee vide letter dated October 3, 2011 submitted the information / documents sought during the hearing which is dealt in the later part of the order.

CONSIDERATION OF ISSUES AND FINDINGS:

15. I have carefully perused the written submissions of the Noticee, the copy of the documents submitted by the Noticee and the materials available on record. The allegations against the Noticee, reply of the Noticee and my findings thereon are discussed as under:

16. **Cash Books:**

Allegation:

i. On inspection of the Noticee's cash book it was observed that that there were a number of transactions involving receipt and payment of cash by the Noticee. The source/ destination of such cash flows from the corresponding narration of entries in the cash book were not clear.

ii. It was alleged that the Noticee could not justify large amount of frequent cash withdrawals and cash deposits. It was alleged that the Noticee failed to clarify the purpose of regular self withdrawal to the extent of ₹. 20,00,000/- and the source of cash deposit of ₹.9,90,000/-, ₹. 15,00,000/- and ₹. 20,00,000/- in the period of two financial years i.e. 2006 – 07 and 2007 - 08.

iii. It was further alleged that the Noticee was undertaking cash transactions relating to the trading in securities market which is prohibited by SEBI.

iv. SEBI vide circular ref. SMD-1/23341 dated November 18, 1993 has directed that "*(vi) Member-brokers should not accept cash for purchases of securities and / or give cash against sales of securities. All payments received / made should be strictly by "Crossed - Payee A/c" cheques.*" Further, vide circular no. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003 it has been stipulated that "*brokers and sub-brokers should not accept cash from the client whether against obligations or as margin for purchase of securities and / or give cash against sale of securities to the clients.*" Hence, it is alleged that the Noticee violated SEBI circular no. SMD-1/23341 dated November 18,

1993 and SEBI circular no. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003 and clause A (2) of Code of Conduct prescribed for the brokers under Regulation 7 of Brokers Regulations.

Reply:

i. Not undertaken any kind of cash dealings with any of the clients or customers and there have not been a single case where cash received from the customer or cash was paid to the customer.

ii. All transactions listed in the inspection relates to cash withdrawn from business account for routine cash office expenses, cash deposited into business account from cash balance in hand, cash transferred from one branch to another, cash paid towards salary, cash paid/ received to/ from employees advance.

iii. With respect to withdrawal of ₹. 20 lakh the same was spent for the purchase of stamps for execution and registration of purchase agreement for our new office at Shopprix Mall, Uttar Pradesh.

Findings:

i. The Noticee submitted details of cash withdrawn and correspondingly utilization of the cash withdrawn by the Noticee for two financial years 2006 – 2007 and 2007 - 2008 identifying the nature of each transaction. I find that the details of certain expenses date wise, voucher wise have also been provided as few sample expenses.

ii. I note from the submission of the Noticee that the payments in cash to some individual entities were by way of salary to such individuals.

iii. I further find from the vouchers/ receipts for daily expenses submitted by the Noticee and also the summary of cash transactions made by the Noticee during the financial year 2006-2007 and 2007-2008 that the same was not for purchase/ sale of securities but was for meeting routine expenses that are incurred in various offices for conference, staff welfare, stationery and various other expenses besides payment of salary to some selected staffs.

iv. The Noticee explained the withdrawal of ₹. 20,00,000 was correspondingly spent for the purchase of stamps for execution and registration of purchase agreement for their new office at the Shopprix Mall, Ghaziabad, U.P. I find that the Noticee submitted a copy of the cash voucher dated January 03,

2008 of ₹.17.14 lakh (voucher no – CVP19-0301) towards payment of stamp duty on the date of withdrawal of ₹. 20 lakh.

v. As per SEBI circular no. SMD-1/23341 dated November 18, 1993 and SEBI circular no. SEBI/MRD/SE/Cir- 33/2003/27/08 dated August 27, 2003 the alleged violation comes to play once a broker accepts cash for purchases of securities and / or give cash against sales of securities. In the present matter I am convinced that the cash transactions were not in any way related to the broking operations, hence the alleged violation of the SEBI circulars dated November 18, 1993 and August 27, 2003 and clause A (2) of Code of Conduct prescribed for the brokers under Regulation 7 of Brokers Regulations does not stand against the Noticee.

17. **Bank Book:**

Allegation:

i. It was alleged from the Noticee's bank books from the financial years 2006-07, 2007-08 and 2008-09 that the Noticee had been transferring funds from its bank accounts earmarked for client's trading transactions to the bank accounts earmarked for its business operations.

ii. The Noticee's business operation further revealed that there were no corresponding entries of payment of dividends to the clients. It was alleged that client's dividend were used for the Noticee's business purposes indicating that there was no proper segregation between own funds and client's funds. Further with respect to the vouchers produced by the Noticee in support of its reply that there was no misuse of clients' dividend, it is alleged that the vouchers were not genuine and were prepared manually without bearing any receiving voucher number generated serial numbers.

iii. It was further observed that the Noticee admittedly was using the client's funds for meeting its proprietary obligations and thus allegedly used clients' money to pay its business expenditure.

iv. SEBI vide its circular SMD/SED/CIR/93/23321 dated November 18, 1993 states that there should be a line of segregation between own funds & client funds. The circular distinguishes very clearly what money to be paid into and drawn from *"clients account".* It is thereby alleged that by not creating a clear segregation between the Noticee's own funds and that of its client's, the

Noticee thus allegedly violated the provisions of SEBI Circular SMD/SED/CIR/93/23321 dated November 18, 1993. The Noticee has also violated the provisions of clause A (5) of Schedule II specified under Regulation 7 of Brokers Regulations, 1992 which states that "A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him."

Reply:

i. The Noticee submitted a copy of the sample ledger account for the year 2006 and 2007 showing dividends credited into the account of the concerned clients stating all dividends received during the period of inspection were duly paid to the clients by transferring the dividend amount received to the credit of the clients concerned within 24 hours of the receipt of the same by the Noticee.

ii. With regard to the issue of segregation of the Noticee's own funds and that of the fund of its client's, the Noticee submitted that the various transfers from the client account to business account and from business account to clients account have undertaken duly in accordance to SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 2003. The circular observes that the client money account is credited with 'money representing in part money belonging to the client and in part money due to the member.' The Noticee submitted that the aforesaid expression refers to the brokerage amount and other amounts chargeable by the broker to the client for various services being provided to the client, which are included in the money credited to the client money account.

iii. The Noticee further submitted that the total amount of brokerage earned by it from April 1, 2006 till November 30, 2006 was ₹. 6,26,70,813.41 crore, and the various transfers made by the Noticee was very low as compared to the aforesaid brokerage earned and credited to client money account. Hence the money transferred by the Noticee from the client money account to the exchange dues account, is fully covered by the money belonging to the Noticee (broker) deposited in the clients account.

Findings:

i. I find that the Noticee vide submission dated May 16, 2011 submitted a sample copy of its dividend ledger from FY 2006-2007 to establish that all dividends received by the Noticee have been duly transferred to the credit of the respective clients on daily basis .i.e, on the same day on which the same amount is received by the Noticee in its bank account. I observe from the sample ledger account of the Noticee that there are credit entries which reflect the actual dividends received as credit in the Noticee's bank account and on the debit side of the dividend account the various entries reflect journal vouchers by which the dividends so received were transferred by way of credit to the account of respective clients. I am therefore convinced that the dividends were duly credited into the account of the Noticee's clients.

ii. With regard to the use of clients fund for proprietary trading of Noticee, the Noticee in its reply dated January 25, 2010 at Para. 11.3 admitted that the Noticee was also doing proprietary trading in addition to the trading for the clients and the fund transfers from the client to business and vice versa have taken place against the Noticee's proprietary trading settlement obligations. A sample of comparative sheet of pay in and pay out and settlement wise net obligation for proprietary trading submitted by the Noticee is as given below:

No.	**Sett. No.**	**Trade Date**	**Pay in/ Pay out date**	**Proprietary net pay in/ pay out**	**Cumulative balance**	**Amt transfer from client to business**	**Amt transfer from business to client**
Brokerage from April 01, 2006 – 10th April				3119216.92	3119216.92		
1.	NN6064	5-Apr-06	10-Apr-06	-2001794.60	1117122.32		
2.	NW6064	5-Apr-06	10-Apr-06	64648.20	1182070.52		
3.	NN6065	7-Apr-06	12-Apr-06	7330436.90	8512507.42		
4.	NW6065	7-Apr-06	12-Apr-06	390.00	8512897.42		
5.	NN6066	10-Apr-06	13-Apr-06	-3691016.75	4821880.67		
6.	NW6066	10-Apr-06	13-Apr-06	-59261.55	4762619.12	850000	
7.	NN6067	12-Apr-06	17-Apr-06	3190405.55	7953024.67	150000	
8.	NW6067	12-Apr-06	17-Apr-06	-182092.20	7770932.47		
9.	NN6068	13-Apr-06	18-Apr-06	12499479.45	20270422.92		500000
10.	NW6068	13-Apr-06	18-Apr-06	71871.45	20342283.37		
11.	NN6069	17-Apr-06	19-Apr-06	-3876334.25	16465949.12		
12.	NW6069	17-Apr-06	19-Apr-06	-29763.05	16436186.07	400000	

13.	NN6070	18-Apr-06	20-Apr-06	-13748996.05	2687190.02		
14.	NW6070	18-Apr-06	20-Apr-06	-619268.10	2067921.92		

iii. It is evident from above and the reply given by the Noticee that it was using the client money for its own business, hence I find that the Noticee's subsequent reply that the amount was used for exchange dues and brokerage is not satisfactory. I find that there is lack of consistency in the Noticees reply and observe that the same to be an after-thought and hence, do not accept the submission of the Noticee. As per SEBI circular the fund towards the proprietary settlements needs to be met from the Noticee's own business account and not from its clients account. The Noticee has therefore violated SEBI circular SMD/SED/CIR/93/23321 dated November 18, 2003 and clause A (5) of Schedule II specified under Regulation 7 of Brokers Regulations, 1992.

18. **Common Client Codes:**

Allegations:

i. It was alleged from the Noticees client data base that the Noticee allotted common client codes to its clients.

ii. The alleged common client codes allotted to the clients were as follows:

CLIENT NAME	CLIENT CODE	ADDRESS	DP-ID	NAME OF THE DP
K.L.SETHI	6	A -3/103, SHUBHAM ARCADE, RAMPRASTHA COLONY , GHAZIABAD		N/A
MOHD ASHIM ISLAM	6	2458,RANG MAHAL TILAK BAZAR DELHI-110006	IN300206	ABHIPRA CAPITAL LIMITED
KASISH GURNANI	136	HOUSE NO. 55 SHAKTI NAGAR INDORE MADHYA PRADESH	12034500	ASHIKA STOCK BROKING LIMITED
LAXMAN DASS CHHABRA	136	H. NO-F-111 KAMLA NAGAR AGRA UTTAR PRADESH	IN302822	ADROIT FIN SER PVT LTD
DIPTI JAIN	600	HOUSE NO. 59 MUSSADDI PURA UJJAIN MADHYA PRADESH	IN302822	ADROIT FIN SER PVT LTD
SAVITRI PATHAK	600	H.NO. 11/4 PARDESI PURA INDORE MADHYA PRADESH	IN302822	ADROIT FIN SER PVT LTD

iii. SEBI vide circular no. SMDRP/Policy/CIR-39/2001 dated July 18, 2001, directed that *"every investor should have a unique ID. In this regard, it will be mandatory for all brokers to use unique client codes."* In view of the above it was alleged that the Noticee failed to comply with SEBI circular dated July 18, 2001 and the provisions of clause A (2) and A (5) of Schedule II specified under Regulation 7 of Brokers Regulations, 1992 .

Reply:

i. The Noticee vide submission dated January 25, 2010 stated that during inspection the client code were appearing as same due to clerical mistake in preparing the MS Excel file which were given to the Inspecting Officials as MS Excel displays client code 06 as 6, whereas both the client codes are entirely different.

ii. A summarized list of six client codes and the corresponding client name and their addresses and also the date of their registration with Stock Exchange as unique client identification code is given as below:

No.	CLIENT NAME & ADDRESS	CLIENT CODE	DATE OF REGISTRATIONWITH STOCK EXCHANGE ALONG WITH NAME OF EXCHANGE
1.	K.L.SETHI A -3/103, SHUBHAM ARCADE, RAMPRASTHA COLONY , GHAZIABAD	6	08-JUN-2005 NATIONAL STOCK EXCHANGE
2.	MOHD ASHIM ISLAM 2458,RANG MAHAL TILAK BAZAR DELHI-110006	06	03-March-2007 NATIONAL STOCK EXCHANGE
3.	KASISH GURNANI HOUSE NO. 55 SHAKTI NAGAR INDORE MADHYA PRADESH	0136	12-Jul-2007 NATIONAL STOCK EXCHANGE
4.	LAXMAN DASS CHHABRA H. NO-F-111 KAMLA NAGAR AGRA UTTAR PRADESH	136	19-FEB-2008 NATIONAL STOCK EXCHANGE
5.	DIPTI JAIN HOUSE NO. 59 MUSSADDI PURA UJJAIN MADHYA PRADESH	600	BOMBAY STOCK EXCHANGE
6.	SAVITRI PATHAK H.NO. 11/4 PARDESI PURA INDORE MADHYA PRADESH	0600	26-FEB-2005 NATIONAL STOCK EXCHANGE

Findings:

i. The Notice submitted with its reply copy of the download from NSE website showing the allotment of the client codes. I find from the copy of the download from NSE website of the above six clients that the Unique Client Codes (6, 06, 136, 0136, 600, 0600) were duly approved by NSE against the six clients. The Noticee thus allotted different client codes to its clients. Hence the allegation of violation of SEBI circular no. SMDRP/Policy/CIR-39/2001 dated July 18, 2001 and clause A (2) and A (5) of Schedule II specified under Regulation 7 of Brokers Regulations, 1992 does not stand established.

19. **Group Transfers/adjustments among the clients:**

Allegation:

i. It was alleged from the Noticees client ledgers that its clients were adjusting their debit/ credit balances with each other in the name and style of *"Group Transfers"* as per details below:

Statement	**From 01/04/2008 to 30/11/2008**			
Date	**Particulars**	**Debit**	**Credit**	**Balance Amount**
Client	**Hotel Library Club P Ltd**	**0**		**0**
7/7/2008	**BEING GROUP ADJUSTED**		**4500000**	**22273500.41**
9/26/2008	**BEING GROUP ADJUSTED**	**4500000**		**26039452.49**

Date	**Particulars**	**Debit**	**Credit**	**Balance Amount**
Client	**Consolidated Securities Ltd**			
4/1/2008	**Group Transfer (N)**	**40000000**		**-197181.48**
6/5/2008	**Cheque Paid (N)**	**5000000**		**-1056448.08**
8/14/2008	**Cheque Paid (N)**	**7489769.9**		**-4780633.4**
10/22/2008	**Group Transfer (N)**		**40000000**	**45209703.04**

Date	**Particulars**	**Debit**	**Credit**	**Balance Amount**
Client	**AKG Securities and Consultancies**			
4/1/2008	**Group Transfer (N)**		**40000000**	**-2702903.7**

4/2/2008	**Group Transfer**		**3000000**	**-26587620.3**
6/30/2008	**Begin Group ADJ**	**3000000**		**-18355975.5**
10/22/2008	**Group Transfer (N)**	**40000000**		**22351775.81**

ii. It was alleged that the above group transfers were taking place without the proper authorization as per SEBI vide circular no. SMD-1/23341 dated November 18, 1993. The circular regulates the transactions with the clients wherein it is stated: *"No adjustment between one client account to another should be made unless express authority has been obtained from the clients. Such authority should be preserved by the broker"* In view of the above, it was alleged that the Noticee violated provisions of SEBI circular no. SMD-1/23341 dated November 18, 1993 and clause A (2) of the Code of Conduct specified under Regulation 7 of Brokers Regulations, 1992.

Reply:

i. The transfers have been made on the basis of written authorization from the concerned entities. Copies of the authority letter were provided by the Noticee.

Findings:

i. I find from the authority letter dated 1/4/2008 issued by Consolidated Securities Ltd that the same authorized debit of ₹. 4 crore to their account for the purpose of utilizing as group transfer to AKG Securities and Consultancy Services. The said letter is duly signed and stamped by Consolidated Securities Ltd.

ii. In respect to transaction on 2/04/2008, 30/6/2008 and 22/10/2008, I find that the respective authorization was duly obtained by the Noticee to undertake adjustment between one client to another. The same has been signed by the above clients.

iii. With respect to M/s Hotel Library Club Ltd, I find that the client had given written authorization to the Noticee for the transfer of funds between the equity and commodity trading accounts. The fund transfer on 7/07/2008 of ₹. 45,00,000/- represents the fund transfer from its commodity trading account which was transferred back on 26/09/2008. The copy of the relevant authorization of M/s Hotel Library Club Ltd was duly provided by the Noticee.

iv. I conclude that a proper authorization was indeed taken by the Noticee for the group transfers between AKG Securities, Consolidated Securities Ltd and M/s Hotel Library Club Ltd. Hence, I do not hold the Noticee violation of the SEBI

circular dated November 18, 1993 and clause A (2) of the Code of Conduct specified under Regulation 7 of Brokers Regulations, 1992. The Noticee has further confirmed that as per SEBI circular dated December 03, 2009, the practice of permitting group adjustments and transfer is stopped.

20. **Unregistered sub-brokers:**

Allegation:

i. Inspection alleged that a few entities were receiving *commission* well before the period of their registration as sub-brokers indicating that the Noticee was allegedly dealing with the entities given below.

- Narayan Mishra- BSE regn. on 03.03.2008, NSE regn. On 31.05.2007 and AP regn. on 26.12.2008.
- V3 Securities Pvt. Ltd.- NSE regn. on 28.11.2008
- Vipin Bajaj- BSE regn. on 21.07.2008, NSE regn. on 10.03.2008 and AP regn. on 23.12.2008.
- Yash Anand- NSE regn. on 06.01.2009, AP regn on 06.01.2009.
- APN Impex- NSE regn no. 14.01.2009.

ii. Section 12 of SEBI Act, 1992 states that - *"No stock-broker, sub- broker, share transfer agent, banker to an issue, trustee of trust deed, registrar to an issue, merchant banker, underwriter, portfolio manager, investment adviser and such other intermediary who may be associated with securities market shall buy, sell or deal in securities except under, and in accordance with, the conditions of a certificate of registration obtained from the Board."*

iii. Regulation 18 B of the Brokers Regulation states that *stock broker shall not deal with any person as a sub-broker unless such person has been granted certificate of registration by the Board under sub-regulation (1) of Regulation 12.*

iv. SEBI vide circular no. SMD-I/3118 dated December 27, 1993 directs that the stock brokers are not to deal with those sub-brokers who are not registered with SEBI. Hence it was alleged that the Noticee violated the provisions of Regulation 18 B of the Brokers Regulation and circular no. SMD-I/3118 dated December 27, 1993 read with the provisions of section 12 of SEBI Act, 1992 and SEBI circular SMD/POLICY/CIRCULAR/3-97 dated March 31, 1997 and Sub-Brok/Cir-I/2001 dated January 15, 2001 .

Reply:

i. The Noticee submitted that the dealings with the above mentioned parties were not in the nature of dealings between a broker and sub-broker. The aforesaid parties were retained by the Noticee for undertaking general market activities including advertisements, branding, shows, investor relation management and attending various problem faced by investors registered with them.

ii. During the above period the various sub contractors to whom such services were outsourced by them were technically qualified to undertake various tasks and the word *'commission'* actually indicated that they were authorized and appointed for a particular assignment i.e, commission on a job.

iii. We submit copies of our ledger account indicating the manner in which the aforesaid services from the said professionals are now being accounted in our books of account as 'professional charges' and charges toward 'business promotion'.

iv. The stamp charges was towards the cost of stamp papers, provided by the Company to these professionals to complete various duties and to utilize the stamp papers whenever so required.

Findings:

i. The Noticee vide reply dated May 16, 2011and January 17, 2011 elaborated on the stamp paper charges and commission charges as shown on the bills and vouchers of the entities. I observe that the bills enclosed a fixed monthly commission paid to the entities for the services rendered to the Noticee. The Noticee further clarified that during the aforesaid period, the various sub contractors to whom such services were outsourced by the Noticee were technically qualified to undertake various tasks and the work "*commission*" actually indicate that they were authorized and appointed for a particular assignment i.e, commission on the job. The Noticee also enclosed appointment letters of the above entities. I find from the appointment letters of the above entities that they were appointed as Business Promotion Consultant for a monthly "*commission*" for undertaking various business promotional activities on behalf of the Noticee.

ii. Hence, I observe that the "commission" as found to be appearing on the ledgers against the above entities were actually commission for various day to day business promotional activities which the entities were appointed for and not

commission as sub-broker. I further observe that the entities were not acting as an unregistered sub-broker of the Noticee. Further there are no evidences/ documents available on record to prove that the entities functioned or carried on duty as a sub-broker of the Noticee.

iii. Hence, I am satisfied with the submission made by the Noticee and the alleged violation of Regulation 18 B of the Brokers Regulation, section 12 of SEBI Act and SEBI circulars dated December 27, 1993, March 31, 1997 and January 15, 2001 does not stand against the Noticee.

21. **Payments made to clients despite debit balance:**

Allegations:

i. It was alleged from the client ledgers of the Noticee that various instances of issue of cheques/ group transfers or adjustments made by the Noticee despite debit balance in the client's account.

ii. It was alleged that such instances of payment to some of the clients when they do not have credit balance are indicative of favoritism being done to some clients at the cost of the other clients.

iii. SEBI vide circular no. SEBI/MRD/SE/Cir-12/2005 dated May 13, 2005 laid down comprehensive risk management framework for the cash market, wherein it was stipulated that "*Members should have a prudent system of risk management to protect themselves from client default. Margins are likely to be an important element of such a system.*"Hence, it was alleged that the Noticee have not followed a prudent system of risk management framework, and thereby violated SEBI circular dated May 13, 2005 and the provisions of Clause A (1) & A (2) of Code of Conduct prescribed for the brokers under Regulation 7 of Brokers Regulations, 1992.

Reply:

i. SEBI inspection has primarily identified 2 clients where payments had been made to the clients despite debit balance in their account. It is submitted that these clients have sufficient securities and balances lying in their accounts at the time of making the payments. The following table shows summary statement of combined net position of the two clients at the time of making the payments:

Date	Actual CR/DR after payment of cheque & margin (Consolidated Securities)	Actual CR/DR after payment of cheque & margin (AKG Consultancy)	NET CR/DR after group adjustment
8/9/2007	8681733.62	26208446.93	34890180.55
8/10/2007	1945618.64	26270159.43	28215778.07
9/13/2007	13928720.45	28950435.23	42879155.68
9/28/2007	16065723.21	35497850.13	51563573.34
10/1/2007	13033975.16	37610117.47	50644092.62
10/4/2007	9108504.62	34324019.17	43432595.79
10/5/2007	9791624.31	36171607.16	45963231.47
10/6/2007	3791624.31	36171607.16	39963231.47
10/15/2007	(876423.75)	40880550.66	40004126.91
10/30/2007	16299763.76	28217001.59	44446765.35
11/7/2007	16635172.99	29761086.03	46396259.02
12/10/2007	(43499.27)	47589216.89	47545717.62
12/14/2007	1195958.82	45729069.54	46925028.36
2/15/2007	32435468.80	18457805.71	13977663.09
3/7/2008	46276858.63	(36512562.55)	9764296.08

ii. It is submitted that on all days there was a surplus amount available which is more than the requirement of the margin except on 2 days i.e, 15 February, 2008 and 7 March, 2008 where there is a negative balance. The said shortage in margin in respect of AKG was adequately covered by the excess margin provided by another client i.e, Consolidated Securities on both the aforesaid dates. Authority letter for the adjustment was accordingly provided for the same.

Findings:

i. The Noticee stated that certain criteria are kept into consideration before making payments to its clients with debit balance e.g, financial balance in the ledger, margin available, balance available with the Noticee, cheques issued from time to time, financial ledger net balance (normally positive) and shares of clients available with the Noticee in the beneficiary account as well as the margin account.

ii. I find that the Noticee's risk management as a broker is covered at all times. On perusal of the documents like financial ledger, margin ledger as well as proof of shares and securities valuation which were available with the Noticee as margin from the clients, I find that the Noticee indeed followed a prudent system of risk management. Hence, I am satisfied with the submissions of the Noticee and the alleged violation of SEBI circular dated May 13, 2005 and the provisions of

Clause A (1) & A (2) of Code of Conduct prescribed for the brokers under Regulation 7 of Brokers Regulations, 1992 does not stand against the Noticee.

22. **Member-Client Agreement:**

Allegations:

i. Inspection observed that the following clauses contained in the Noticee's Member- Client agreement were undesirable or unsuitable for the clients:

Clause 34. b states; *"The client shall ensure that he/ she/ it shall not deal through the stock broker on the stock exchange of which he/ she/ it is registered as a broker or subbroker"*

Clause 45 states; *"The client agrees that any amounts which are overdue from the client towards trading or on account of any other reason to the stock broker will be charged with delayed payment charges at such rates as may be determined by the stock broker."*

Clause 49 states; " *The client hereby agrees that the stock broker may communicate/ send information to the client like contract notes, transaction statements, order confirmations, order modifications, order executions, trade confirmations, trade modifications, bills, account statements, trading/ settlement cycles, delivery/ payment schedules, policies, procedures, notices, FAQs and any other documents / reports, using any or more of the following means or methods such as post I speed post I courier I registered post I registered AD I facsimile Itelegram I cable I e-mail I voice mails I telephone (telephone includes such devices as mobile phones ete.) including SMS on the mobile phone or any other similar device; by messaging on the computer screen of the client's computer; by informing the client through employees I agents of the stock broker; by publishing I displaying it on the website of the stock broker / making it available as a download from the website of the stock broker; by displaying it on the notice board of the branch I office through which the client trades or if the circumstances, so require, by radio broadcast/television broadcast /newspapers advertisements etc; or any other suitable or applicable, mode or manner. The client agrees that the postal department /the courier company /newspaper company and the e-mail /voicemail service provider and such other service providers shall be the agent of the client and the delivery shall be complete when communication is given to the postal department I the courier company / the e-mail / voicemail service provider, ete. by the stock broker and the client agrees never to challenge the same on any grounds including delayed receipt/ non receipt or any other reasons whatsoever."*

Reply:

i. In respect to clause 34.b the Noticee submitted that in those cases where prior permission of the exchange is brought on record by the concerned client, from the date of permission of the stock exchange, the clause 34.b will stand suitable modified/deleted. The Noticee further submitted that there is a possibility that some time the transaction may be undertaken without prior permission on the record hence the clause is just a prohibitory clause in the agreement to monitor SEBI directions.

ii. In respect to Clause 45 the Noticee submitted that the payment of the client becomes due and payable to them on the basis of pay in and pay out requirement of the stock exchange. The Noticee further submitted that it has not charged interest on all its clients and the interest has been charged only after the concerned client failed to pay after repeated reminders. The Noticee also submitted that they have not charged interest to the accounts of the clients, except in those cases where the matter has been referred by them to the arbitration of the stock exchange and the client is a persistent defaulter and also in all cases such amount of interest charged has been duly disclosed to the NSE Arbitration Department.

iii. Regarding clause 49 the Noticee stated that digitally duly signed electronic contract notes are sent only to that client who specifically opts for it. Besides sending the various contract notes electronically (when opted), it also sends it physically in all cases. Further the contract notes are also available at the Noticee's website to all its clients at any point of time.

Findings:

i. SEBI vide its Circular no. SEBI/MIRSD/Cir-6/2004 dated January 13, 2004 states that;*"A stock broker/ sub broker of an exchange cannot deal with brokers/sub brokers of the same exchange either for proprietary trading or for trading on behalf of clients, except with the prior permission of the exchange."*

ii. It was observed from the above that trading by the stock broker/ sub broker of an exchange with the brokers/ sub-brokers of the same exchange either for proprietary trading or for trading on behalf of clients is allowed if the stock broker/ sub broker has obtained a prior permission of the exchange. Therefore I find that the clause 34.b of the Noticee's Member- Client agreement was not framed in line with the above circular and may not be suitable/ desirable for the

clients who are registered as stock broker/ sub-broker in the current form. Noticee has also admitted to the deviation made in the aforesaid clause.

iii. With regard to Clause 45 of the Noticee's Member Client Agreement, I find that the aforesaid clause tends to charge the delayed payment charges on the payments that become overdue on the part of the client. However, the same has not been defined in the clause and/ or in Member- Client Agreement as to when the payment shall become overdue. Definition of the period for payment to become overdue by the Noticee becomes more important as the member is not in the business of providing the Margin Trading Facility to its clients. Further, it was observed that the agreement is silent on the rate at which these delayed payment charges shall be levied. Not mentioning of rate of interest may not be desirable as a broker may charge any rate to the clients without the knowledge of the client. Further the Noticee may charge different rates for different clients by not adopting a uniform policy with regard to the delayed payment charges.

iv. I further find that by inserting clause 49, the Noticee has kept the discretion entirely with itself of communicating/ sending the information relating to the trading of the client including but not limited to contract notes via physical or electronic modes. SEBI vide its circular no. MRD/DoP/SE/Cir-20/2005 dated September 8, 2005 has directed to the Members of the Stock Exchanges:

"The digitally signed ECNs may be sent only to those clients who have opted to receive the contract notes in an electronic form, either in the Member – Client agreement / tripartite agreement or by a separate letter. The mode of confirmation shall be as per the agreement entered into with the clients……"

v. I find that the aforesaid clause of the Member- Client agreement does not provide the option to the clients for receiving the contract notes in electronic form. It gives the full discretion to the Member to communicate/ send the contract notes or any other information in any form be it a physical form or electronic form.

vi. In view of the above it is observed that the Noticee has not taken due care and diligence in framing of the member-client agreement. Hence, the Noticee has not complied with Clause A (2) of Code of Conduct specified under Regulation 7 of Broker Regulation by inclusion of undesirable clauses in the member client agreement.

23. In light of the above, following allegations of the violations stands established:

i. Bank Books - Segregation between the Noticee's own funds and that of its client's:

Violation of SEBI Circular SMD/SED/CIR/93/23321 dated November 18, 1993 and clause A (5) of Schedule II specified under Regulation 7 of Brokers Regulations, 1992.

ii. Inclusion of undesirable clauses in Member-Client Agreement:

Violation of Clause A (2) of Code of Conduct specified under Regulation 7 of Broker Regulation.

24. 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."*.

25. 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, 1992 of the SEBI Act, which reads as under :

15HB:- Penalty for contravention where no separate penalty has been provided.

"Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board there under for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees."

26. While determining the quantum of monetary penalty under section 15HB, I have considered 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."

27. In the instant case, it is noted that no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of such default by the Noticee. Further from the material available on record, it may not be possible to ascertain the exact monetary loss to the investors on account of default by the Noticee. I find from the records that the default of the Noticee is not repetitive in nature.

ORDER

28. After taking into consideration all the facts and circumstances of the case, I impose a penalty of ₹.1,00,000 (Rupees One lakh only) under section 15HB of the SEBI Act on the Noticee which will be commensurate with the violations committed by it.

29. The Noticee shall pay the said amount of penalty 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 Regional Manager, SEBI – Northern Regional Office, Bank of Baroda Building, 5th Floor, 16, Sansad Marg, New Delhi 110001.

30. 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: **December 16, 2011**
Place: **Mumbai**

BARNALI MUKHERJEE
ADJUDICATING OFFICER