BEFORE THE SECURITIES APPELLATE TRIBUNAL MUMBAI

Appeal No. 48 of 2012

Date of Decision: 13.06.2012

Adroit Financial Services Pvt. Ltd.
401-402, 4th Floor, Angel Mega Mall,
Plot No.CK-1, Kaushambi,
Ghaziabad, U.P. 201010 …Appellant

Versus

Securities and Exchange Board of India
SEBI Bhavan, Plot No.C4A, G Block,
Bandra Kurla Complex,
Bandra (East), Mumbai – 400 051. …Respondent

Mr. Vinod Jain, Chartered Accountant with Mr. Mohit Sharma, Advocate for the Appellant.

Mr. Prateek Seksaria, Advocate with Mr. Mihir Mody and Mr. Mobin Shaikh, Advocates for the Respondent.

CORAM : P. K. Malhotra, Member & Presiding Officer (*Offg*.)
S.S.N. Moorthy, Member

Per : S.S.N. Moorthy

The appellant is a stock broker registered with the Bombay Stock Exchange Ltd. and National Stock Exchange of India Ltd. In the present appeal, the appellant challenges imposition of a penalty of ` 1 lac by the adjudicating officer of Securities and Exchange Board of India (for short the Board). The penalty was imposed under section 15HB of the Securities and Exchange Board of India Act, 1992 for violating clauses A(1), A(2) and A(5) of the Code of Conduct specified under regulation 7 of Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Regulations, 1992 and a few circulars issued by the Board in connection with the conduct of stock brokers (referred to hereinafter as Broker's Regulations and Circulars). The Board conducted an inspection of the books of accounts and other records maintained by the appellant during the period January 27, 2009 to February 5, 2009 covering financial years 2006-2007, 2007-2008 and 2008-2009. As a result of the inspection several irregularities were noticed by the Board. A show cause notice was issued to the appellant on September 23, 2010 listing out the various

irregularities and calling for its explanation thereto. The irregularities mentioned in the show cause notice fell in to various categories as relating to (1) maintenance of cash book (2) maintenance of bank book (3) allotment of common client codes to different clients (4) dealing with unregistered sub-brokers (5) group transfers and adjustment among clients in client ledgers (6) payment made to clients and (7) Know Your Client forms and agreements. The appellant furnished detailed replies to the alleged irregularities denying the charges levelled against it. A personal hearing was also afforded to the representatives of the appellant. After considering the explanations offered by the appellant, most of the charges contained in the show cause notice were dropped. Two charges, namely, discrepancies in maintenance of bank book and Member-Client agreement were not found to have been explained satisfactorily. The adjudicating officer concluded that the maintenance of bank book and the clauses in the Member-Client agreement are not in keeping with the provisions governing the Code of Conduct prescribed for the brokers. Accordingly, a penalty of ` 1 lac was imposed on the appellant.

2. Shri Vinod Jain, Chartered Accountant appearing on behalf of the appellant, stoutly opposed the imposition of penalty on the ground that the appellant has maintained all registers and documents in conformity with the Broker's Regulations and the adjudicating officer has failed to appreciate the explanations offered and the clarifications given. According to him, there is no instance of misuse of client's funds or appropriation of client's funds for proprietary obligations and hence the allegation regarding transfer of funds relating to the client to the proprietary account of the appellant is baseless. Similarly, with reference to the document governing Member-Client agreement, which is part of the records, it is argued that the norms laid down by the Board have been complied with and no case of irregularity has been noticed during the inspection.

3. Shri Prateek Seksaria, learned counsel appearing for the Board, defended the orders of the adjudicating officer.

4. On a careful consideration of the arguments put forward by both the sides we are of the view that no serious irregularity has been identified and established by the adjudicating officer in the present case warranting imposition of a penalty of ` 1 lac.

5. The first allegation relates to transfer of funds in the bank account of the appellant. It is alleged that the appellant has transferred funds from its bank account earmarked in clients trading transactions to the bank account earmarked for its own business operations. In other words, there was no proper segregation of the funds relating to the broker and the client. According to the adjudicating officer, the client's funds have been used to meet the proprietary obligations of the appellant which is contrary to the guidelines. On a perusal of the account copies furnished by the appellant it is noticed that there has been no instance of such misuse of funds resulting in a disadvantage to the client. The appellant has furnished detailed month wise pay-in and pay-out particulars which show that the cumulative balance always was a credit balance. The account statements furnished by the appellant show that dividends due to the clients were credited to their respective accounts immediately as per the guidelines. As regards brokerage and other charges, it is noticed that the brokerage amount earned by the appellant was substantially high as compared to other charges due to the client and the appellant did not misuse the client's funds in any manner. The appellant has furnished date wise details of transfers to the account of the client and the adjudicating officer has not found any fault with the details especially with reference to the alleged misuse of client's funds. With reference to the circular governing credit and withdrawal of monies from the client's account it is seen that the appellant had transferred only the consideration and brokerage or extra monies due to the members and not any item other than that mentioned in the circular. The analysis of deposits and withdrawals shows that there was no instance of a negative balance in the relevant account at any point of time. This shows that the appellant had the benefit of its funds and there was no case of transfer/misuse of funds belonging to the client. After analysing the account statements the adjudicating officer found that there is a lack of consistency in the reply furnished by the appellant and this appears to be an afterthought and so not acceptable. Apart from this, there is no finding to the effect as to how the client's funds got merged with that of the appellant and used by him for proprietary obligations.

6. With respect to Know Your Client norms, the adjudicating officer has taken objection against clauses 34(b), 45 and 49 of the Member-Client agreement form. The adjudicating officer took the stand that the clauses mentioned hereinabove were 'undesirable or unsuitable for the clients'. It is the case of the adjudicating officer that clause 34(b) is not

framed in line with the relevant circular of the Board. 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." Clause 34(b) of the Member-Client agreement states thus: "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 a registered as a broker of sub-broker". The spirit and intention of the guidelines contained in the circular have been conveyed through the relevant clause and there is no violation of the circular of the Board. Clause 45 of the member-client agreement states thus: "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 brokers". The adjudicating officer concluded that the rate at which delayed payment charges would be levied is silent and it is not desirable to leave the rate of such charges without a uniform policy regarding delayed payment. The adjudicating officer has not taken into account the additional clauses in the declaration form which deal with areas where discretion is available to the member and the client. This is one area where no mandatory prescription is available and so clause 45 deals with delayed payment charges at such rates as may be determined by the stock brokers. The only observation of the adjudicating officer is that it is not desirable to leave the rate of interest in the area of discretion. He has not cited any case of charging of interest which is arbitrary or unjust. In the absence of any statutory requirements, the Inspecting team could have counselled the appellant to specify the rate of interest. This, in any event, does not call for a penal action. Infact, the explanation offered by the appellant would show that no interest has been charged on a unilateral basis since interest has always been decided by arbitration award. The facts would show that the adjudicating officer has proceeded only from a presumption and no instance of irregularity has been identified.

7. Clause 49 of the Member-Client agreement deals with a number of options for communication between the client and the stock broker. A reading of the said clause would show that all possible modes of communication have been exhaustively dealt with. The adjudicating officer has concluded that it does not provide for an option to the clients for receiving the contract notes in electronic form and it gives full discretion to the appellant to

select any mode at its discretion. We fail to appreciate the findings of the adjudicating officer. A reading of clause 49 would show that all possible modes of communication including physical form and electronic form are mentioned therein. Additionally, in the letter of authority given by the client there is a specific clause authorising the appellant to send the contract notes or other documents through electronic mode if it is so desired by the client. Infact, the option is given to the clients to specify the modes of communication and there is a clear provision for digital communication as well. It is also noticed that the appellant has taken care to modify some of the areas as suggested by the inspection team.

The above discussion would show that the adjudicating officer has not identified any irregularity or violation of statutory provision calling for imposition of penalty in this case. The order of the adjudicating officer imposing penalty is set aside. The appeal is allowed. No costs.

Sd/-
P.K. Malhotra
Member &
Presiding Officer (*Offg.*)

Sd/-
S.S.N. Moorthy
Member

13.6.2012
Prepared and compared by
RHN