BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO.: PJ/AO - 10/2015]

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

In respect of

M/S Anand Rathi Share and Stock Brokers Limited

SEBI Registration No.:

Bombay Stock Exchange (INB 011371557 & INF/INE 010676931)

National Stock Exchange(INB/F/E 230676935) and

MCX Stock Exchange(INB/F 260676938 & INE 260676935)

(PAN No.: AAACN3405F)

FACTS OF THE CASE IN BRIEF

1. Securities and Exchange Board of India (hereinafter referred to as **"SEBI"**) conducted a special purpose inspection of books and records of M/S Anand Rathi Share and Stock Brokers Ltd. (hereinafter referred to as **'ARSBL/Noticee'**) Member, Bombay Stock Exchange (hereinafter referred to as 'BSE'), National Stock Exchange (hereinafter referred to as 'NSE') and MCX Stock Exchange(hereinafter referred to as 'MCX-SX') during January 23 and 24, 2014 covering the period from April 2012 till the date of inspection. The scope of the said inspection was to examine whether the noticee has complied with the provisions of SEBI Circulars dated November 18, 1993 and August 27, 2003 with respect to segregation of funds and securities of clients.

2. On sample and random checking of the books of accounts and records of the noticee, certain deficiencies were observed in the functioning of noticee. Based on the findings it was noted that (a) the noticee has utilized/withdrawn funds from the designated client bank account for the purpose of making payments to a person other than its client, (b) the noticee has made payments of it's clients to its group company

which is commodities broker and (c) the noticee has failed to exercise due skill and care in conduct of its business and has failed to comply with statutory requirements. Therefore, it was alleged that noticee had violated certain provisions of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as **'Brokers Regulations'**) and certain SEBI Circulars and consequently, liable for monetary penalty under section 15HB of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the '**SEBI Act'**).

APPOINTMENT OF ADJUDICATING OFFICER

3. The undersigned was appointed as the Adjudicating Officer, vide order dated December 02, 2014, under section 19 of the SEBI Act read with section 15-I of the SEBI Act and rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalty by Adjudicating Officer) Rules, 1995 (hereinafter referred to as the **'Rules'**) to inquire into and adjudge under section 15HB of SEBI Act, for the aforesaid alleged violation committed by the Noticee.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

4. Show Cause Notice No. EAD/PJ/JAK/OW/29950/2015 dated October 31, 2015 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 initiated against it and penalty be not imposed under section 15HB of SEBI Act for the alleged violations committed by the Noticee.

5. The Noticee vide letter dated November 20, 2015 replied to the Show Cause Notice.

6. In the interest of natural justice and in order to conduct an inquiry in terms of rule 4(3) of the Rules, the Noticee was granted an opportunity of personal hearing on December 10, 2015, vide notice dated November 30, 2015.

7. Mr. Jugal Mantri,(Executive Director and Group CFO) and Mr. Deepak Kedia(Vice President - Compliance Head), authorised representatives of the Noticee, appeared and

reiterated the submissions made vide letter dated November 20, 2015. They had also made oral submissions and explained that they had streamlined their systems, details of which will be provided by written submissions, latest by December 14, 2015, which was accepted. The Noticee vide e-mail dated December 14, 2015 submitted details.

CONSIDERATION OF ISSUES

8. I have carefully perused the written and oral submissions of the Noticee and the documents available on record. The issues that therefore arise for consideration in the present case are:

a. Whether the Noticee has violated the provisions of SEBI Circulars No. SMD/SED/CIR/93/23321 dated November 18, 1993 and SEBI Circular No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003?

b. Whether further the Noticee has violated the provisions of Clause A(2) and A(5) of the Code of Conduct specified under Schedule II read with Regulation 9(f) of the Brokers Regulations?

c. Does the violations, if any, attract monetary penalty under Section 15HB of SEBI Act?

d. If so, what would be the monetary penalty that can be imposed taking into consideration the factors mentioned in Section 15J of SEBI Act?

FINDINGS

9. Before moving forward, it is pertinent to refer to the relevant provisions of the SEBI Circulars No. SMD/SED/CIR/93/23321 dated November 18, 1993, SEBI Circular No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 and Clause A(2) and A(5) as specified in Schedule II read with regulation 9(f) of the Brokers Regulations, which read as under:

The relevant portion of the SEBI circular No. SMD/SED/CIR/93/23321 dated November 18, 1993 is provided below:

Regulation Of Transactions Between Clients And Brokers

.....

C] What moneys to be paid into "clients account". No money shall be paid into clients account other than - i. money held or received on account of clients; ii. such money belonging to the Member as may be necessary for the purpose of opening or maintaining the account; iii. money for replacement of any sum which may by mistake or accident have been drawn from the account in contravention of para D given below; iv. a cheque or draft received by the Member representing in part money belonging to the client and in part money due to the Member.

D] What moneys to be withdrawn from "clients account". No money shall be drawn from clients account other than - i. money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the Member from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the Member, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client; ii. such money belonging to the Member as may have been paid into the client account under para 1 C [ii] or 1 C [iv] given above; iii. money which may by mistake or accident have been paid into such account in contravention of para C above.

.....

The relevant portion of the SEBI circular No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 is provided below:

Sub:- Mode of payment and delivery

1. Please refer to SEBI circular No.SMD/SED/CIR/93/23321 and letter No. SMD-1/23341 dated November 18, 1993 regarding regulation of transactions between clients and brokers.

2. It is reiterated 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.

3. All payments shall be received / made by the brokers from / to the clients strictly by account payee crossed cheques / demand drafts or by way of direct credit into the bank account through EFT, or any other mode allowed by RBI. The brokers shall accept cheques drawn only by the clients and also issue cheques in favour of the clients only, for their transactions. However, in exceptional circumstances the broker or sub-broker may receive the amount in cash, to the extent not in violation of the Income Tax requirement as may be in force from time to time.

.....

Conditions of registration.

9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely,-

(a) ....;

(b) ....;

(c) ....;

(d) ....;

(e) ...;

(f) he shall at all times abide by the Code of Conduct as specified in Schedule II; and

SCHEDULE II SECURITIES AND EXCHANGE BOARD OF INDIA (STOCK BROKERS AND SUB-BROKERS) REGULATIONS, 1992 CODE OF CONDUCT FOR STOCK BROKERS

A. GENERAL

(1).....

(2) EXERCISE OF DUE SKILL AND CARE: A stock-broker, shall act with due skill, care and diligence in the conduct of all his business.

(3)....

(4).....

(5) COMPLIANCE WITH STATUTORY REQUIREMENTS: 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.

10 .The charges leveled against the Noticee and my findings thereon are as under :

11. It was alleged that the noticee has utilised/withdrawn funds from the designated client bank account for the purpose of making payments to a person other than its client resulting in violation of SEBI circular dated November 18, 1993. The circular inter alia requires that that the broker shall withdraw funds from the clients account towards payment of a debt due to the broker from clients or money drawn on client's authority or money in respect of which there is liability of clients to broker.

12. Noticee has stated in its reply that:

The said transfer of funds from own account to client account is done only for meeting out the exchange pay in/client payout as per requirement, whenever we feel that the balance available in client account is falling short to meet such requirements we transfer the funds from our own account to client account, so that the necessary pay in can be met without fail due to delay in receipt of funds from clients. Generally after receipt of due funds from clients in client account, we again transfer the amount given earlier by us in client account to our own account but at no time total amount of funds transferred by us from client account to own account exceeds the total of funds transferred by our own account to client account for meeting exchange / client payout requirements.

We have never used client's money for meeting any single obligation and in fact our net worth is in surplus over Rs. 50 Crores as reflected in our balance sheet.

We have deposited our funds in to the client account only to meet pay in obligation of the client as the funds from the client are actually received/ cleared after the pay in date.

We have not mixed up our funds with clients fund and have even never ever used clients fund for taking our proprietary position, in fact we don't have any transaction in our pro account in cash market.

RTGS (Real Time Gross Settlement) is yet a farfetched dream and is yet not 100% operational across Pan India. Furthermore we are borrowing crores of rupees as working capital from Banks carrying interest to meet client's pay in obligation before the actual cheque received from clients being credited in our bank. In practicality the clients cheque gets cleared on the third day and thus funds are transferred from own account to client account to meet their temporary settlement obligations.

We have not made any amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the such adjustments of clients across different segments.

Moreover, as advised by your SEBI Inspection team to our company to stop direct transactions of fund transfer from own account to client account and vice versa. We would like to state that, we have already implemented adherence and streamlined our system as per your direction i.e. Funds transfer via settlement account.

We are now routing the transfer of funds from our own bank account to client bank account through use of settlement bank account in case there is any pay in shortfall.

The funds were transferred from own account to client account & vice-versa, only to meet the client margin obligation at the exchange level as funds received from the clients generally get cleared after the pay in of (T+2 days). Besides as a member, earlier we were under the obligation to square up the clients position

not later than T+5 days in case the client does not honor his outstanding dues. which is now been relaxed by National Stock Exchange vide circular dated 08th May 2015. wherein a member can even grant further exposure to client beyond T+5 against the free client collateral available with the member and not construed to be a case of margin funding.

13. I have perused the material available on record and the reply submitted by the noticee in support of its contentions. I find that noticee transferring funds from own account to client bank account and vice versa is out of the scope of the current adjudication proceedings as it is observed from the available records that for this violation Adjudication was not proposed. The charge as aforesaid in the SCN is on account of noticee transferring funds to its group company, Anand Rathi Commodities Private Limited, which has been dealt with in the next Para.

14. It was alleged that the noticee has made payments of it's clients to its group company, Anand Rathi Commodities Private Limited(ARCL), a commodity broker, dealing in commodities, resulting in violation of SEBI circular dated August 27, 2003 which requires that the broker shall accept cheques drawn only by the clients and also issue cheques in favour of the client only.

15. During the inspection it was observed that there was transfer of funds between the client bank account maintained by the noticee and bank accounts of Anand Rathi Commodities Ltd dealing in commodities market.. These fund were transferred as their client in securities market were also a client with Anand Rathi Commodities Ltd. There were 21,198 instances amounting to Rs. 220 crores of transfer of funds (payments and receipts) between the noticee client bank account and Anand Rathi Commodities during the F.Y. 2012-13. Out of these fund transfers, there were a total of 11,220 instances, amounting to Rs.119 crores, of payments made from the noticee's client bank account to Anand Rathi Commodities. In 9973 instances, amounting to Rs.101 crores fund received in noticee's client bank account from Anand Rathi Commodities.

16. It was therefore alleged that the above transfers are in violation of SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 regarding regulations of transactions between clients and brokers. The circular interalia requires that the broker shall withdraw funds from the clients account towards payment of a debt due to the member from clients or money drawn on client's authority or money in respect of which there is a liability of clients to the member. This is further clarified by SEBI circular SEBI/MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 which requires that member shall accept/issue funds from/to the bank account of respective client only. In the instant matter, member has transferred/received funds on behalf of clients from/to the bank account of its group entity dealing in commodities.

17. It was alleged that the noticee has thus failed to exercise due skill and care in conduct of its business and has failed to comply with statutory requirements and therefore violated clauses A(2) and A(5) of the Code of Conduct specified under Schedule II read with Regulation 9(f) of the SEBI(Stock-Brokers & Sub-Brokers)Regulations, 1992.

18. Noticee in its reply has stated that:

> *We are maintaining separate ledgers for each segment. Relevant corresponding contra entries have been effected to in both the companies and clients ledger accounts respectively.*
>
> *We have completely stopped the practice of funds transfer of clients across the company of Anand Rathi Share & Stock Brokers Ltd to Anand Rathi Commodities Limited since 21st April 2014. We have even changed our inter segment and inter-company transfer of funds policy & LOA.*
>
> *It would not be out of place to mention that we have not made any amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the such adjustments of clients across different segments. Furthermore would appreciate the very fact that even National Stock Exchange has quoted as under*

Consideration of ledger accounts across different segments, exchanges and markets by arbitrators

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

We have not received any complaint from any client relating to such inter-company fund transfer of their balance from one segment to another. It is further submitted that, as a trading member we have always strived to be 100% compliance organization with the regulations in force & have ratified the deficiency as desired by your good self.

19. I have perused the material available on record and the reply submitted by the noticee in support of its contentions. I find that :

i) The noticee has a group company namely Anand Rathi Commodities Private Limited dealing in commodities market. During the inspection it was observed that there was transfer of funds between the client bank account maintained by the noticee and bank accounts of Anand Rathi Commodities. These fund were transferred as their client in securities market were also a client with Anand Rathi Commodities. There were 21,198 instances amounting to Rs. 220 crores of transfer of funds (payments and receipts) between the noticee's client bank account and Anand Rathi Commodities during the F.Y. 2012-13. Out of these fund transfers, there were a total of 11,220 instances, amounting to Rs.119 crores, of payments made from the noticee's client bank account to Anand Rathi Commodities. In 9973 instances, amounting to Rs.101 crores fund received in noticee's client bank account from Anand Rathi Commodities.

ii) The noticee has submitted that the funds were transferred from/to commodities account to securities account just to facilitate the client and fulfill the client obligation in respective segment for the ease of operation to client who is trading across various segments like BSE/NSE/MCX- SX/MCX/NCDEX/ACE /ICEX/NMCE.

20. I have noted that the circular dated November 18, 1993 is quite clear in its import. It has clearly brought out as to what moneys to be paid into client accounts and what moneys to be withdrawn from client accounts and clearly spelt out that no other moneys could be paid or withdrawn from client accounts. I note that circular allowed withdrawal of moneys from client account towards (i) money properly required for payment to or on behalf of clients or for or towards payment of a debt due to the broker from clients or money drawn on client's authority, or money in respect of which there is a liability of clients to the broker, provided that money so drawn shall not in any case exceed the total of the money so held for the time being for such each client; (ii) such money belonging to the broker as may have been paid into the client account under para 1 C [ii] or 1 C [iv] of the circular; (iii) money which may by mistake or accident have been paid into such account in contravention of para C of the circular. The circular states that no money shall be drawn from client accounts other than for the aforesaid purpose.

21. It is therefore I note that the circular does not permit moneys to be withdrawn from the clients account for or towards payment of debt due to the group company of the broker from the client, or, money in respect of which there is liability of client to the group company of the broker. The debt/ liability of the client towards the group company of the client cannot become the debt/ liability of the noticee with the client.

22. I note that SEBI Circular No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 states 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. It further states that all payments shall be received/ made by the brokers from/ to the clients strictly by account payee crossed cheques / demand drafts or by way of direct credit into the bank account through EFT, or any other mode

allowed by RBI. The circular states that brokers shall accept cheques drawn only by the clients and also issue cheques in favour of the clients only, for their transactions. However, in exceptional circumstances the broker or sub-broker may receive the amount in cash, to the extent not in violation of the Income Tax requirement as may be in force from time to time.

23. Thus, it is clear that SEBI Circulars No. SMD/SED/CIR/93/23321 dated November 18, 1993 and No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 did not allow transfer of funds (payments and receipts) between noticee and its group company which is a broker dealing in commodities.

24. The reply of the noticee is thus not acceptable as the findings above are in violations of SEBI circular no. SMD/SED/CIR/93/23321 dated November 18, 1993 regarding regulations of transactions between clients and brokers and SEBI circular SEBI/MRD/SE/Cir-33/2003/27/08 dated August 27, 2003.

25. It is very pertinent to note that post the Global Financial Crisis of 2008, the issue of systemic risks arising about of interconnectedness (of the markets or otherwise) has come to the fore. Erstwhile Forward Market Commission (FMC) vide its circular dated December 16, 2011 prohibited Commodities brokers from adjustment/transfer of funds between securities exchange and commodities exchange even with clients' authorisation. Further in 2013, there was risk posed on account of interconnectedness, trigger being the default occurring in commodities market. During the period under consideration, the commodities market was regulated by the erstwhile FMC wheras securities market was regulated by SEBI.

26. The noticee has followed the practice of transfer of funds between commodities and securities broking companies on a frequent and regular basis. If argument put forward by the notice that the said transfers are executed with client’s consent is accepted, it will

also convey a wrong message to the market participants that this practice has been regularised. This may also have wider implications from systemic point of view.

27. I find from the reply of the noticee that Noticee has completely stopped the practice of funds transfer of clients across the company of Anand Rathi Share & Stock Brokers Ltd to Anand Rathi Commodities Limited since 21st April 2014 and Noticee has even changed its inter segment and inter-company transfer of funds policy & LOA.

28. Thus, I note that to that extent the Noticee has accepted that transfer of client's moneys from/ to any of its group companies cannot take place. Hence, admittedly , transfer of funds (payments and receipts) undertaken between Noticee and its commodity company during the Inspection period was in violation of SEBI Circulars No. SMD/SED/CIR/93/23321 dated November 18, 1993 and No. MRD/SE/Cir-33/2003/27/08 dated August 27, 2003.Hence, I conclude that the Noticee has admittedly violated SEBI Circular dated November 18, 1993 and August 27, 2003 for a total of 21298 instances for a total amount of Rs. 220 Crores and thereby also violated Clause A(2) and A(5)of the Code of Conduct specified under Schedule II read with Regulation 9(f) of the Brokers Regulations in the matter.

29. In view of the foregoing, the allegations made against the Noticee stand established resulting in violation of SEBI Circular dated November 18, 1993 and August 27, 2003 resulting in failure to exercise due skill and care in conduct of its business and has failed to comply with statutory requirements and therefore violated clauses A(2) and A(5) of the Code of Conduct specified under Schedule II read with Regulation 9(f) of the SEBI(Stock-Brokers & Sub-Brokers)Regulations, 1992.

30. In view of the above, i would like mention here that 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…".

31. 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. The provisions of section 15HB of SEBI Act is mentioned hereunder:-

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

32. While imposing monetary penalty under section 15HB of SEBI Act, it is important to consider the factors stipulated in section 15J of SEBI Act, which reads as under:
"15J - Factors to be taken into account by the adjudicating officer
While adjudging quantum of penalty under section 15-I, the adjudicating officer shall have due regard to the following factors, namely:-
(a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
(b) the amount of loss caused to an investor or group of investors as a result of the default;
(c) the repetitive nature of the default."

33. Based on the material available on record, it is not possible to quantify the disproportionate gain or unfair advantage enjoyed by an entity or the losses suffered by the investors. I find that violation by the noticee is repetitive in nature to the extent that the noticee has followed a practice throughout the period under consideration which is violative as brought out above.I also note that earlier Adjudicating Order No. VSS/AO-66/2009 dated May 04, 2009 was passed against the noticee imposing monetary penalty.

34. In addition to the aforesaid, I am also inclined to consider the following mitigating factors while adjudging the quantum of penalty:

a. Earlier vide Adjudicating Order No. VSS/AO-66/2009 dated May 04, 2009, on the similar facts against the noticee, the Adjudicating Officer had found merit in the submissions of the noticee as brought out above.

b. National Stock Exchange has quoted as under:

Consideration of ledger accounts across different segments, exchanges and markets by arbitrators

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

c. Noticee *has completely stopped the practice of funds transfer of clients across the company of Anand Rathi Share & Stock Brokers Ltd to Anand Rathi Commodities Limited since 21st April 2014. Noticee has even changed its inter segment and inter-company transfer of funds policy & LOA.*

ORDER

35. After taking into consideration all the facts and circumstances of the case and material available on record, I hereby impose a monetary penalty of Rs.30,00,00/- (Rupees Thirty Lacs Only) on the Noticee which , in my view, will be commensurate with the default committed by it.

36. The Noticee shall pay the total penalty of Rs. 30,00,000/- (Rupees Thirty Lakhs only) under section 15HB of SEBI Act by way of demand draft in favour of "SEBI -

Penalties Remittable to Government of India", payable at Mumbai, within 45 days of receipt of this order. The said demand draft should be forwarded to Mr. Sujit Prasad, Chief General Manager, MIRSD, SEBI, SEBI Mittal Court Office, B & C Wing, 1st Floor, 224, Nariman Point, Mumbai – 400 021.

37. 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 31, 2015** **PRASAD JAGADALE**

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