

D) INSPECTION AND INQUIRIES

Merchant Bankers:

Merchant bankers and underwriters

During the year 1998-99, 4 enquiries were initiated against merchant bankers for failure to exercise due diligence.

The registrations of 8 merchant bankers were canceled, on completion of enquiry proceedings for non-payment of fees and for failure to submit information on employees. Besides, 58 merchant bankers were suspended for non-payment of fees and for failure to honour their devolvement obligations. Warning letters were issued to 11 merchant bankers. The details are given in *Annexure 5*.

Inspections and enquiries – stock brokers and sub brokers

Section 11(2) of Securities and Exchange Board of India Act, 1992 provides that SEBI shall register and regulate the working of stock brokers and sub brokers. In fulfillment of the above mentioned obligations, the SEBI carries out inspection of the books of accounts and records of stock brokers to verify whether:

- a. Books of accounts, records and other documents are being maintained in the manner specified by the Securities Contracts (Regulation) Rules, 1957 and SEBI (StockBrokers and Sub Brokers) Regulations, 1992.
- b. The provisions of the SEBI Act, the Securities Contracts (Regulation) Act and the provisions made thereunder are being complied with by the broker.
- c. Adequate steps for redressal of grievances of the investors are being taken and the conditions of registration as a stock broker are complied with.

There are 9069 brokers and 4589 sub-brokers registered with the SEBI. The SEBI inspects brokers on the basis of sample drawn for the year. During 1998-99, 103 brokers from 14 Exchanges across the country were inspected by the SEBI. The SEBI inspected the brokers of fewer exchanges during 1998-99 as most of the smaller exchanges have very little trading activities and very few active trading members. A sample of brokers was selected for inspection from medium to big exchanges.

For inspection of brokers of BSE and NSEIL, the services of Chartered Accountants were availed of whereas inspection of brokers of other Stock Exchanges was undertaken by the officers of SEBI.

During the course of inspection, following features were observed :

- a. Brokers of regional stock exchanges were hit hard by a sharp slump in their business. Many of them were either out of business or working for the brokers of bigger Stock Exchanges or have taken the terminals of BSE and NSEIL members.
- b. The response to demat trading is encouraging as it has reduced inter-alia the fear of bad delivery among the brokers.

- c. Clientele business, in general, had come down across the country.
- d. Brokers and investors were trading mainly to avail of the benefit of inter-exchange arbitrage.
- e. The rates of brokerage have come down drastically over last few years. The bye-laws of the stock exchanges provide for charging brokerage up to 2.5 per cent of value of the contract. In actual , brokerage charged ranged between 0.5 per cent and 5 per cent.
- f. Most of the brokers have computerised their books of accounts and other relevant records.

During the course of inspection the following irregularities on the part of brokers were observed :

- a. Non reporting of ‘off the floor transactions’ to the Exchange.
- b. Misuse of the Exchange Settlement Mechanism to fund loan transactions which do not have any relationship to securities business.
- c. Dealing with unregistered sub brokers.
- d. Non segregation of clients and proprietary funds.
- e. Client database and agreements with clients are not maintained/entered.

On an overall assessment, it was observed that there was a better compliance towards comprehensive margin requirements on the part of brokers. Inspection of brokers by the SEBI from time to time has resulted in better adherence by brokers to SEBI Rules/Regulations/Circulars. Comprehensive inspection manual for broker’s inspection was revised and the same was circulated to all stock exchanges and chartered accountants’ firm assigned with the job of inspection of brokers.

The break-up of inspections of brokers carried out during the year, enquiries ordered and their outcome for the years 1997-98 and 1998-99 is given in the table 3.9 and in *Annexure 4*.

Table 3.9 : Inspection of brokers carried during 1998-99

<i>Particulars</i>	<i>1997-98</i>	<i>1998-99</i>
Inspections	157	103
Enquiries ordered	62	307
Warned	52	109
Suspended	8	64
Registration cancelled	2	6
Adjudication	Nil	9
No Action	Nil	16

Source : SEBI

From the table it may be noticed that number of enquiries ordered has shown significant increase over the previous year’s figure. This is because of the large number of inspections carried out in the previous years. Further, the above figure also includes 199 enquiry directions against brokers who have failed to fulfil the underwriting devolvement in respect of various issues.

Inspection of mutual funds

Inspections of all 33 active mutual funds was ordered in March/April 1998 to be carried out by independent chartered accountancy firms covering the period till March 1999. The inspection reports in case of 33 mutual funds have been received. In case of 11 mutual funds the inspection reports have

revealed no violations of the Regulations or systemic deficiencies and their files have been closed. In 14 cases, warning/deficiency letters have been issued due to systemic deficiencies/technical violations. In case of 8 mutual funds, the reports have been processed and additional information/clarifications have been sought from the mutual funds/auditors.

Table 3.10 : Action taken during 1998-99

Sr. No.	Description	No. of Mutual Funds
1.	Adjudication	1
2.	Warning/Deficiency Letters	26
3.	Enquiry Proceedings	2

Source : SEBI

Adjudication proceedings were initiated against JM Mutual Fund for delay in listing of one of their schemes. The Adjudication Officer imposed a fine of Rs.50,000/-, which has been paid by the mutual fund.

Warning/Deficiency letters were issued to 26 mutual funds for violating Advertisement Code, non-submission of periodical reports on time, delay in redressal of investor grievances and for technical violations/systemic deficiencies observed in their inspection reports (Table 3.10).

Enquiry proceedings were initiated against two mutual funds - Asia Pacific Mutual Fund and GFC Mutual Fund due to deteriorating financial position of their sponsors and action taken by the RBI against them. Enquiry officer has recommended cancellation of their registration certificate. Thereafter show cause notices were issued to these mutual funds as to why penalty, as recommended by the enquiry officer, should not be imposed. Final orders would be passed soon. Both the mutual funds have not launched any schemes since their obtaining registration from the SEBI.