

## **H) INSPECTION AND INQUIRIES**

### ***Merchant bankers:***

#### ***Merchant bankers and underwriters***

An inspection of Systematics Corporate Services Ltd., Chennai, was conducted in terms of Regulation 29 (1) of SEBI (Merchant Bankers ) Regulations., 1992 with particular reference to due diligence exercised in respect of the issues lead managed by them. The Report is under consideration of the Board.

#### ***Inspection 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 objective, the SEBI carries out inspections of the books and records of stock brokers to verify whether:

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

As 9192 brokers and 5283 sub-brokers are registered with SEBI, it is difficult for SEBI to inspect all the brokers with its limited resources. Brokers are therefore selected for inspection on sample basis by the SEBI. Apart from SEBI, stock exchanges as self-regulatory organizations are also expected to carry out inspection of 10 per cent of their respective active member-brokers.

During 1999-2000, 80 brokers from the 14 exchanges across the country were inspected by the SEBI. The SEBI inspected the brokers of fewer exchanges this year, as most of the smaller exchanges had very little trading activities and very few active trading members. A sample of brokers was selected for the inspection from the medium to big exchanges.

For inspection of brokers of BSE and NSE, the services of Chartered Accountants were availed, whereas officers of SEBI undertook inspection of brokers of other stock exchanges. During the inspection, following features were observed:

- i. Brokers of regional stock exchanges were hit hard by 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 NSE members.
- ii. Due to boom in the latter part of the year, clientele business in general had picked up .
- iii. Brokers and investors were trading mainly to avail of the benefit of arbitrage.
- iv. Most of the brokers computerised their books of accounts and other relevant records
- v. Subsequent to dematerialisation of most actively traded scrips, the problem of bad delivery faced by the brokers has gone down substantially.
- vi. Most of the large stock broking houses are providing the services as DP.
- vii. Equity research has started to gain prominence again.

Common irregularities noticed in certain cases during inspection were the following:

- i. Non-issuance of Contract notes.

- ii. Non segregation of clients and own funds.
- iii. Client database and agreement with clients not maintained/entered.
- iv. Dealing with unregistered sub brokers.
- v. Non reporting of 'off the floor transactions' to the Exchange.

Inspections of brokers conducted by the SEBI from time to time have resulted in better compliance to SEBI Rules/Regulations/Circulars by them.

A comparative statement of inspection of brokers carried out during the year, enquiries ordered and their outcomes for the year 1998-99 and 1999-2000 are given in the Table 3.9.

**Table 3.9 : Inspection of Brokers Carried Out During 1999-2000**

Particulars	1998-1999	1999-2000
Inspections	103	80
Enquiries ordered	307	38
Warned	109	115
Suspended	64	31
Registration cancelled	6	7
Adjudication	9	3
No Action	16	43
<i>Source : SEBI</i>		

From the table it may be noticed that a number of enquiries ordered during 1999-2000 showed a significant fall over the previous year's level. This was mainly on account of 199 enquiry orders in the previous year initiated against brokers who had failed to fulfil the underwriting devolvement in various issues.

The number of cases where no action has been taken stands at 43, out of which 35 relates to enquiry against brokers who had failed to fulfil the underwriting devolvement in various issues.

### ***Inspection of mutual funds***

Since mutual funds have become important mobiliser of savings from the market and they invest in wide range of instruments in the securities, their continuous monitoring is important for the protection of investors. Hence the SEBI took disciplinary action against a number of mutual funds in the year 1999-2000, the details of which are given in the following table 3.10.

Inspections of 33 active mutual funds (including UTI) was ordered during the year to be carried out by independent chartered accountancy firms covering the period till March 1999.

**Table 3.10 : Action Taken During 1999-2000**

Sr. No.	Description	No. of Mutual Funds

1.	Adjudication Ordered	5
2.	Enquiry Ordered	1
3.	Financial Penalty and action against trustees and Key Personnel.	1
4.	Warning/Deficiency Letters	26
5.	Cancellation of Registration	2
6.	Advertisements Withdrawn	4
7.	Payment of Interest	4
<i>Source : SEBI</i>		

Two separate adjudication proceedings were ordered against Taurus Mutual Fund. The Fund's investments in unrated fixed income securities were not in accordance with the disclosures made in the offer document and also the redemption/ repurchase proceeds were not dispatched within the statutory time limit and there were inadequate disclosures in the abridged audited balanced sheet. Adjudication cases were referred against Canbank Mutual Fund and Kothari Pioneer Mutual Fund for inadequate disclosures in offer documents and against Shriram Mutual Fund for delay in despatch of repurchase proceeds for which it was also advised to pay interest to the investors.

In the case relating to irregularities in the dealings of Shriram Mutual Fund in the scrip of Videocon International Ltd. during June 1998, the Adjudicating & Enquiry Officer imposed a penalty of Rs.5 lakh on Shriram Asset Management Company Ltd. under section 15 I of the SEBI Act for having violated the SEBI (Mutual Funds) Regulations. The SEBI also ordered the sponsors of Shriram Mutual Fund, under the provisions of SEBI Act, 1992, to pay towards the corpus of the concerned schemes of mutual fund a sum of Rs. 25,62,750 with 15 per cent interest per annum, being the loss caused to the unitholders. The SEBI also directed two officials of the Asset Management Company (AMC) of the mutual fund to resign from the AMC. The SEBI further directed that its managing director shall not be eligible to hold any public position in any capital market related public institution for a period of 3 years w.e.f. February 1, 2000. The SEBI also directed to change the composition of the board of trustees. According to which, at least three trustees out of existing four trustees had to step down within a month of receipt of the order. The remaining one trustee would continue to hold office for a year to ensure smooth takeover by the new board and for the sake of continuity of operations and would have to step down after the expiry of one year from the date of constitution of the new board of trustees.

Warning/deficiency letters were issued to 26 mutual funds on the basis of findings of inspection reports, delay in submission of periodical reports, non-exercise of due diligence in drafting the offer document, not providing factually correct information to SEBI on the status of directors of trustee company – "independent" or "associates, delay in the despatch of redemption proceeds (i.e. beyond time stipulated in the Regulations), misleading advertisements, exceeding 5 per cent limit with respect to transactions through associate brokers during a quarter and non-disclosure of amount of brokerage paid to associate brokers in the annual accounts.

The SEBI had prohibited GFC Mutual Fund and Asia Pacific Mutual Fund from launching any scheme under Section 11B of the SEBI Act in June 1997 and October 1997 respectively after RBI prohibited their sponsors which were NBFCs from accepting any deposits and disposing off any of their assets. Both the mutual funds have not launched any scheme since registration. In accordance with the Regulations, their certificates of registration were cancelled.

In all Four mutual funds viz. Prudential ICICI Mutual Fund, Sun F&C Mutual Fund, SBI Mutual Fund and Alliance Capital Mutual Fund were advised to withdraw advertisements as these were misleading or the disclosures were not in accordance with the Advertisement Code.

The SEBI directed the AMCs of Taurus Mutual Fund, IDBI Mutual Fund, Reliance Capital Mutual Fund and Shriram Mutual Fund were directed to pay interest to the unitholders at the rate of 15 per cent for the delay in despatch of redemption/repurchase proceeds. A total interest of Rs.17.24 lakh was paid to 14686 investors. The details of amount paid and the number of investors who benefited are given in Table 3.11.

**Table 3.11 :Details of Refund by Mutual Funds**

<b>Name of the Mutual Fund</b>	<b>Amount Paid (Rs. Lakh)</b>	<b>No. of Investors</b>
Taurus Mutual Fund	9.94	4,945
IDBI Mutual Fund	4.95	6,182
Reliance Capital Mutual Fund	0.05	82
Shriram Mutual Fund	2.30	3,477
Total	17.24	14,686
<i>Source : SEBI</i>		