

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

Order under Section 4(3) of the Securities and Exchange Board of India Act, 1992 read with Regulation 13 of the of Securities and Exchange Board of India (Procedure for holding enquiry by Enquiry Officer and imposing penalty) Regulations, 2002 in the matter of enquiry against Integrated Enterprises (India) Ltd.

- 1.0 Integrated Enterprises (India) Ltd. (hereinafter referred to as “IEL”) was registered as Registrar and Share Transfer Agent (Category 1) with effect from 1.11.1994 and the registration was valid till 31.10.2003. Securities and Exchange Board of India (hereinafter referred to as “SEBI”) issued a Certificate of Registration to Integrated as a Stock Broker under the (Stock Brokers and Sub Brokers) Regulations 1992 with effect from 20.11.1998. Integrated was also issued a Certificate of registration (Registration No. IN-DP-NSDL-83-99) dated 22.02.99, as Depository Participant (in broker category) of National Securities Depositories Limited (NSDL) under the SEBI (Depositories and Participants) Regulations 1996 (hereinafter referred to as “the said Regulations”) with effect from 22.02.1999 which was valid till 21.02.2004.
- 2.0 SEBI vide its letter dated August 31, 2001 advised IEL to stop accepting any fresh business and opening of fresh accounts, since the aggregate value of the custody holdings of IEL, as a Depository Participant (hereinafter referred to as IEL-DP) was crossing the permissible limits of 100 times of its networth as stipulated under Regulation 19 (a) (viii) of the said Regulations.
- 3.0 Despite the directive issued by SEBI IEL-DP had opened 561 new accounts and had collected an amount of Rs.4.97 Lakhs as advances from the clients and the aggregate value of the custody holdings of IEL-DP

crossed by 180%.In view of this, IEL-DP was advised to bring down its aggregate value of the custody holdings limits to 100 times its networth within a time limit of 3 months. However IEL-DP failed to monitor and bring down the holding limits below 100 times.

- 4.0 SEBI conducted an inspection on 13th and 14th September, 2001 of Depository Participant activities of IEL and communicated its findings to IEL-DP on 22.10.2001. In the reply dated. 2.11.2001 IEL-DP contended that they were entitled for conversion of status from Stock Broker to Registrar and Share Transfer Agent and hence there was no violation of the said Regulations by IEL-DP. IEL-DP had also made a representation dated 27.12.2001 explaining their stand regarding their right for conversion as STA / RTI DP from Broker DP and they also submitted a legal opinion from the Former Chief Justice of India, Mr. M.H. Kania. This was followed by further letters/ submissions dated. 8.1.2002, 24.01.2002, 4th Feb 2002 and 6.2.2002. In all these submissions, IEL-DP reiterated that they had not violated SEBI's directions in this regard.
- 5.0 On examining the replies of IEL-DP and not being satisfied with the same, an enquiry officer was appointed vide order dated 18.04.2002 to enquire into the said alleged contraventions by IEL-DP.
- 6.0 The Enquiry officer submitted his report to SEBI on 23.09.2002.
- 6.1 The Enquiry Officer, in the said report, found that IEL-DP has violated the following:
 - 6.1.1 IEL-DP exceeded the permissible custody holdings as laid down in Regulation 19 (a) (viii) of the Regulations.

6.1.2 IEL-DP had opened new accounts in violation of the directive issued by SEBI.

6.1.3 IEL-DP changed its status from broker DP to registrar and share transfer DP without taking specific approval from SEBI.

The enquiry officer, therefore, recommended that the certificate of registration granted to the Integrated Enterprises (India) Ltd., may be suspended for a period of six months.

7.0 A show cause notice dated 04.10.2002, in terms of Regulation 67(1) of the said Regulations, was issued to IEL-DP to show cause as to why the penalty as recommended by the enquiry officer should not be imposed on it. IEL-DP was advised to submit its reply, if any, within 14 days of the receipt of the show cause notice. IEL-DP was also asked to intimate along with the reply whether it desired a personal hearing.

8.0 M/s Guru & Ram (Chartered Accountants) on behalf of IEL-DP vide its letter dated 09.10.02, sought for the following documents in order to set up effective defence to the charges leveled against IEL-DP in the said show cause notice:

- 1) Copy of the correspondence, if any between NSDL and SEBI in connection with IEL-DP's application for migration of status from "Broker Depository" to " RTA Depository"
- 2) Any other independent communication in connection with the issue of migration of status of Depository Participants.

- 9.0 In reply to the letter dated 09.10.02 from IEL-DP, SEBI vide its letter dated 24.10.02, communicated to IEL-DP that the Enquiry officer had given an interpretation of the press release dated 16.08.99 and had not relied on any other document and a copy of the said press release was sent to IEL-DP.
- 10.0 M/s Guru & Ram (Chartered Accountants) on behalf of IEL-DP vide its letter dated 06.11.02, reiterated their stand and sought for a personal hearing.
- 11.0 Vide their letter dated 16.12.02 IEL-DP forwarded a Legal opinion from Mr. M.H. Kania, Former Chief Justice of India. The extracts of the opinion is reiterated below:

The press release provides for automatic migration of status to persons, who are registered as Broker DPs and who are also registered with SEBI as Registrar to an issue or Share Transfer Agent under the relevant Regulations of SEBI

In any event, under the press release, SEBI is mandated to allow conversion/ migration of status and has no discretion in disposing off the application seeking migration of status other than allowing migration as sought for in the application except to the limited extent set out earlier which have no application in the case of Integrated.

As a public authority, SEBI is normally bound by the policy declarations that it makes as the declarations are a set of promise in the form of policies or guidelines held out by SEBI to the public that it would follow the declarations. Even under Contracts Act, if the promisee alters his position on the basis of a promise by the promisor, the promisor cannot go back on his promise and is bound to perform his promise. This doctrine is called

the doctrine of estoppel. The doctrine of estoppel can be urged even against government if publicly announced policy or legislation is changed.

12.0 On 18.12.02, the personal hearing as scheduled was held and an opportunity to make further submissions was granted to IEL-DP. Availing the same, IEL-DP made further written submissions vide its letter dated 26.12.02 as under:

- (i) That IEL-DP had filed an application before SEBI on 22.01.00 seeking confirmation of the migration of its status as a Registrar and Share Transfer Agent Depository Participant under the said Regulations and that the application had not been rejected by SEBI and that NSDL, which is the Depository under which Integrated functions as DP, had recommended that the application of IEL-DP for migration as a Registrar DP be accepted by SEBI and in spite of repeated requests by IEL-DP, the fact of this recommendation by NSDL to SEBI to accept the application of IEL-DP for migration of status as a Registrar DP had been withheld from IEL-DP and after this recommendation by NSDL, SEBI having already considered and granted the requisite permission for IEL-DP to carry on business as a DP, cannot and could not have rejected the application of IEL-DP for migration as Registrar DP even de hors the contention of Integrated that it is entitled for automatic migration under the Press Release dated 16th August, 1999.
- (ii) That after this recommended by NSDL, there was no communication from SEBI to IEL-DP. Even after the recommendation of NSDL, if SEBI had decided to reject the application, under Regulation 24(1) of the said Regulations, SEBI is mandated to provide a personal opportunity to IEL-DP. Since SEBI had not granted any opportunity in regard to the application even

after a lapse of considerable time, IEL-DP was legally entitled to presume that its application had been accepted by SEBI.

- (iii) That the Press Release provided for automatic migration of IEL-DP's status as a Registrar DP. Further, the application filed by IEL-DP seeking confirmation of the migration had not been rejected by SEBI and in any event, could not have been rejected in view of the mandate contained in the Press Release and also in view of the recommendation by NSDL. Accordingly IEL-DP accepted business as a Registrar DP and 18 months after IEL-DP had made the application seeking confirmation of migration of status, on 31.08.01, the Manager of D&CC, SEBI advised IEL-DP not to open fresh accounts. This advice was neither an order under the said Regulations nor a direction under the SEBI Act. If it were an order under the said Regulations, an order cannot be passed without providing for an opportunity nor can it be considered as a direction under Section 11(1) of the SEBI Act. The Authority under Section 11(1) of the SEBI Act can be exercised only by the Board or the Chairman of SEBI under delegation by the Board. Therefore this unilateral advice was not binding on IEL-DP.
- (iv) As regards the specific query as to whether IEL-DP had complied with the advice dated 31.08.01, IEL-DP submitted that even though IEL-DP was legally advised, the advice in the nature of direction was not legally valid and not binding. IEL-DP had taken sufficient care to ensure that the number of beneficiary accounts had not increased from August 2001. As against 2,24,076 accounts held by IEL-DP in August 2001, IEL-DP holds only 2,17,276 accounts as on 30.11.02. In respect of the 561 new accounts, which were mentioned in the Enquiry Order dated 18th April 2002 as having been opened after the advice dated 31st August 2001, it was

submitted that those accounts were in pipeline even when the advice was being received by IEL-DP, that is at the time of receipt of the advice, the process for opening the accounts had already been initiated at the IEL-DP's end at their various branches throughout the country by the customers and cannot therefore be considered as having been opened in violation of the advice of SEBI dated 31st August 2001 and in fact the number of new accounts in the pipeline at the time of enquiry was 1043 and not 561.

13.0 Further submissions were made by IEL-DP vide its letter dated 10.01.03 which more or less reiterated the same statements as made in the submissions made on 26.12.02.

14.0 The following issues arise for consideration:

- a) whether IEL-DP exceeded the permissible custody holdings as laid down in Regulation 19 (a) (viii) of the said Regulations and whether it was entitled for automatic change of status from Broker DP to Registrar and Share Transfer DP:***

Regulation 19 (a) (viii) of the said Regulations provide as under:

“19. For the purpose of grant of certificate of registration, the Board shall take into account all matters which are relevant to or relating to the efficient and orderly functioning of a participant and in particular, whether the applicant complies with the following requirements, namely :-

- (a) the applicant belongs to one of the following categories –

(viii) a stock broker who has been granted a certificate of registration by the Board under sub-section (1) of Section 12 of the Act:

Provided that the stock broker shall have a minimum net worth of rupees 50 lakhs and the aggregate value of portfolio of securities of the beneficial owners held in dematerialised form in a depository through him, shall not exceed 100 times of the net worth of the stock broker :

Provided further that if the stock broker seeks to act as a participant in more than one depository, he shall comply with the criteria specified in the first proviso separately for each such depository; or

*(x) a registrar to an issue or share transfer agent who has a minimum net worth of Rs.50 Lakhs and who has been granted a certificate of registration by the Board under sub-section (1) of Section 12 of the Act;”

(* inserted by the SEBI (Depositories and Participants) Amendment Regulations, 1999 w.e.f. 20.5.99).

As on June 30, 2001 IEL-DP had crossed the permissible limits by exceeding the holding by 180% representing the total holding of about Rs.2800 crores (networth of IEL-DP is 14.93 crores and the eligible limit to hold the securities is Rs. 1493 crores , the excess holding is Rs. 1394 crores.). As per the Enquiry Report, despite SEBI's advice dated 31.08.01, not to open any fresh accounts, IEL-DP opened accounts after 31.08.01, which was not disputed. Further, IEL had referred to SEBI press release dated 16.08.1999, which reads as follows

"The Broker DPs who are also registered with SEBI as share transfer agents shall be allowed to change their broker DP status to that of share transfer agent / Registrar DP". IEL-DP contended that by virtue of the above press release which says "shall be allowed" makes it clear that SEBI has no discretion as to the acceptance of change of status of broker DP to RTI / STA.

The relevant amendment was made with effect from 20.05.1999. As per the same IEL-DP was required to get the status changed to that of RTI/STA-DP. It is clear that IEL-DP has exceeded the permissible limits of custody holdings, which are permitted to a broker DP in terms of Regulation 19(a) (viii) of the said Regulations. It has also opened fresh accounts despite SEBI's advice not to do so. However, IEL-DP maintained that pursuant to press release issued by SEBI and amendments made to the said Regulations, it is entitled automatically to migrate to the share transfer agent / registrar DP. Consequent upon the same the limits on the custody holdings are not applicable on it. IEL-DP argued that press release issued by SEBI casts an obligation on it to allow change in status of Depository Participants. IEL-DP maintained that "the effect of the above publicly declared policy is that it mandated migration from broker DP status to Registrar and Transfer Agent DP status. It does not leave it to the discretion of SEBI, but makes the migration effective on its own terms." IEL on 22.01.2000 sought for conversion of its status as depository participant from the category of broker to the category of Registrar and Transfer Agent. "This application for formal entry of IEL as a Registrar and Transfer Agent DP is still on the record of SEBI. As there was no response, IEL-DP stated that they thought that obviously SEBI had considered that no further formality was needed and had allowed the mandatory migration."

I have considered the above arguments of IEL-DP.

Press release issued by SEBI is only a policy intent, which cannot override the specific requirements of the Regulations. Moreover, the said Press Release was just a reproduction of the minutes of the Meeting of the Registrars taken by SEBI on July 27, 1999. The law that was in force as on the relevant period was Regulation 19(a) (viii) of the said Regulations, which could not have been amended by a press release.

A perusal of the amendment made to the said Regulations reveals that it included Registrars to an Issue and Share Transfer Agents as one of the eligible categories for grant of certificate of registration as a depository participant. The amendment is effective from 20.05.1999. It is clear from the same that the amendment does not provide for automatic migration as contended by IEL-DP. It requires a positive approval of SEBI, in terms of Regulation 19 of the said Regulations. Without such approval, IEL-DP cannot presume the same and convert its status on its own. This is vindicated by the fact that IEL-DP made an application for conversion.

In this case, IEL-DP had not only exceeded the permissible limits of custody holdings but also continued to open new accounts despite SEBI's advice not to open new accounts, as communicated vide letter dated 31.08.2001, stating that unless IEL has converted into a Registrar and Share Transfer Agent DP by getting registered in terms of the Regulation 19 (x) of the said Regulations, it can only act as a Broker DP and all the conditions applicable to a Broker DP have to be strictly adhered to. Accordingly IEL-DP is bound to keep itself within the limits laid down on custody holdings in terms of Regulation

19 (a) (viii) of the said Regulations. If it crosses the limits, same would be in flagrant violation of the said Regulations and IEL-DP is liable for the consequences of penal action for such a violation in terms of Regulation 64 of the said Regulations.

Hence I agree with the findings of the Enquiry Officer and hold IEL-DP guilty of the above violations.

I further note that the manner in which the networth is calculated by IEL-DP is defective as it has included the deposits / advances collected from their demat account holders and also has not taken into account the contingent liabilities, which is against the spirit of the NSDL Bye-laws framed under the Regulations. Calculation of networth is equally important as that of the permissible limits on custody holdings, otherwise the very objective of laying down limits on the basis of net-worth would be defeated. Further if the networth is calculated in the above manner, it facilitates the depository participant to inflate its networth thereby enabling it to hold increased custody holdings. Such circumventing of the regulatory framework that too by using the very deposits / advances given by the demat account holders needs to be viewed seriously.

b) whether IEL-DP had opened new accounts in violation of the directive issued by SEBI and thus failed to put in place adequate monitoring system as required under Regulation 46 of the said Regulations:

Vide letter dated August 31, 2001 SEBI had advised IEL-DP, not to accept any fresh business till the networth requirements are complied with. However, IEL-DP has opened 561 new beneficiary accounts after 31.08.2001 and collected an amount of Rs.4.97 Lacs despite

SEBI's advice not to open any fresh accounts. IEL-DP has not denied that it has opened fresh accounts after 31.08.2001.

The Enquiry Officer in his report found that no specific instances could be cited in the Inspection report to substantiate the deficiency in the monitoring system. I agree with the findings of the Enquiry Officer.

15.0 In view of above, I find that the submissions of IEL-DP are not convincing and tenable. Therefore, IEL-DP is guilty of violating Regulation 19(a) (viii) of the said Regulations.

16.0 Therefore, it is found that :

- a) IEL-DP exceeded the permissible custody holdings as laid down in Regulation 19 (a) (viii) of the said Regulations.
- b) IEL-DP had opened new accounts in violation of the directive issued by SEBI.

17.0 *Whether the penalty recommended by the Enquiry Officer is to be imposed on the said broker.*

Regulation 64 of the said Regulations provide as under:

“The Board may suspend the certificate of registration granted to a depository or a participant, if such depository or participant :

- (a) contravenes any of the provisions of the Act, the Depositories Act, the Bye-laws, agreements and these Regulations.

- e) fails to comply with any direction of the Board issued under Section 18 of the Depositories Act;

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However the above Regulation has been substituted by the following Regulation w.e.f. : 27.09.2002:

Regulation 64: Liability for action in case of default.

A depository or a participant who –

- (a) contravenes any of the provisions of the Act, the Depositories Act, the bye-laws, agreements and these regulations;
- (b)
- (c)
- (d)
- (e) Fails to comply with any direction of the Board issued under section 18 of the Depositories Act;

shall be dealt with in the manner provided under the Securities and Exchange Board of India (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

The said amendment also repealed Regulation 65 to 69 of the said Regulations.

Regulation 23(1) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as “the Enquiry Regulations”) provides for the above as under:

Regulation 23(1):

“Notwithstanding amendment of the regulation as specified in regulation 21, anything done or any action taken including any proceeding for inspections or investigations or enquiry commenced or any notice issued under the said regulations before the commencement of these regulations shall be deemed to have been done or taken under the corresponding provisions of these regulations.”

Thus by virtue of the above, I observe that an order can be passed under the Enquiry Regulations in respect of a violation committed under the SEBI (Depositories and Participants) Regulations 1996.

I further note that Regulation 13 of the Enquiry Regulations provides for imposition of minor penalties and major penalties. The minor penalties include warning or censure and suspension of the certificate of registration for a period upto 3 months. The major penalties include cancellation of the certificate of registration and suspension for a period exceeding 3 months. I further find that in case of major penalties sub-regulation 6 of Regulation 13 provides for the circumstances under which major penalties may be imposed. These include violation of the conditions of registration, and failure to obey directions of SEBI passed under Section 11 or Section 11B of the Securities and Exchange Board of India Act, 1992.

- 18.0 I have found in Paragraphs supra, IEL-DP has violated the provisions of SEBI (Depositories and Participants) Regulations, 1996.

The mandate of SEBI is to protect the interests of the investors and orderly development of the securities market. As a part of this, SEBI takes several measures as prescribed by Section 11 of the SEBI Act. The Depositories Regulations were framed under the Depositories Act and Depositories and Depositories Participants have been included as intermediaries under SEBI Act. The Depositories and the Depository Participants registered with SEBI should necessarily follow the regulatory discipline of the day. Any intermediary including a Depository Participant, who transgresses the Regulations, if left unpunished, will send wrong signals to the market and also will create an atmosphere which is not conducive for the orderly development of the securities market.

A broker who is also acting as a Depository Participant is literally using his network for dual purposes, one for having exposure on Exchange and the other for having custodial holdings of beneficial owners of the Participant. Any transgression of the limits in either of the areas will have grave repercussions on the other activities. IEL-DP by not bringing down the custodial holdings to the approved limits has put the whole market, more specifically the clients of IEL as a broker and the beneficial owner who opened accounts with IEL-DP were exposed to grave risk. In view of the above, I find that the recommendations of the Enquiry Officer are adequate and I agree with the recommendations of the Enquiry Officer.

- 19.0 Therefore, I, in exercise of powers conferred on me under Section 4(3) of the SEBI Act and Regulation 13(4) of the Enquiry Regulations, do hereby suspend the certificate of registration granted to the Integrated Enterprises (India) Ltd., as a Depository Participant, for a period of six months.

However in order to protect the interests of investors having DP accounts with IEL-DP, one month's time is given to IEL-DP for making alternative arrangements for such investors. The order therefore shall come into force only after the expiry of one month from the date of the order.

Place: Mumbai

G. N. BAJPAI

Date: July 02, 2004

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA