

THE GAZETTE OF INDIA
EXTRAORDINARY
PART – II SECTION – 3 SUB-SECTION (ii)
PUBLISHED BY AUTHORITY
SECURITIES AND EXCHANGE BOARD OF INDIA
NOTIFICATION

Mumbai, the 25th day of March, 2003

**ORDER UNDER SECTION 11 OF THE SECURITIES CONTRACTS
(REGULATION) ACT, 1956 SUPERSEDING THE GOVERNING BOARD OF
AHMEDABAD STOCK EXCHANGE**

S.O. 314 (E) In the course of Annual Inspection of the Ahmedabad Stock Exchange (hereinafter referred to as “ASE”) conducted by the Securities and Exchange Board of India (hereinafter referred to as “SEBI”) on August 05, 2002, it was, inter alia, observed that members of ASE were carrying on unofficial trading in securities in the Stock Exchange premises. Thereupon, vide letter dated August 26, 2002, SEBI advised ASE to take immediate steps to stop the unofficial trading in securities and to investigate and take necessary steps against members of the exchange who were involved in the said trading. SEBI also advised ASE to submit a report on the action taken by them. ASE vide letter dated August 30, 2002, informed that they are initiating enquiry into the matter and shall submit a report in the matter. ASE also informed that they have issued a circular warning members to refrain from unofficial trading. Subsequently, on September 17, 2002, ASE submitted a report on the unofficial trading to SEBI. The said report of ASE was annexed as Annexure A to the Show Cause Notice dated 25.9.2002.

2.0 The said report of ASE dated September 17, 2002, stated that:

- a) There is no unofficial market operational within the official premises of the Stock Exchange, Ahmedabad and that there is no assembly of members/non-members either during the trading hours or after closure of the trading session for any such activity.
- b) In one open space in Kamadhenu Complex, Panjarapole, where the Stock Exchange is located, there is a regular assembly of persons after close of trading session.
- c) An official of the exchange deputed to observe the activities during the unofficial trading session reported that –
 - members of their exchange were not participating in the unofficial market
 - a number of other persons who are not connected with the exchange do participate in the said market
 - the duration of the session is around one hour everyday and the process of settlement among participants is payment and receipt in cash directly.
- d) The reasons for participation by persons in such unofficial market was stated to be –
 - They have no access to the equity and derivatives market.
 - They want to avoid the cost of transaction, margining and risk management.
 - They have confidence in each other and hence have no problem in settlement.
 - They are not registered with SEBI as stock brokers or sub-brokers and so are able to avoid all regulatory compliance.

- Option contracts are not available in ASE whereas these persons have been operating a unique type of options contract called “phatak”.
- e) The unofficial market is not carried on for purchase or sale of securities and is therefore not reflected in the equity trading system of the exchange at any time. The options contracts are not settled by way of delivery, rather, they are always settled by way of price difference in cash. These contracts are not identical or similar to regular purchase and sale of shares and therefore there is no threat to market integrity.
- f) The trading methodology of the unofficial market is termed in the local language as “Phatak” which means derivatives contracts and “Phatak” consists of three different types of transactions namely - Jota, Bhav Bhav and Teji Mandi.

3.0 Subsequently, on September 19, 2002, SEBI conducted a surprise inspection of ASE. The inspecting officer of SEBI observed that an unofficial market in an open outcry fashion was being held within the stock exchange premises and members of the exchange were also participating in the same. When confronted by the inspecting officer with the observation that unofficial trading was going on in the premises of the exchange by the members of the exchange, the Executive Director of ASE issued a letter to SEBI on the same day confirming that an unofficial market for Jota Phatak was going on as observed by him also on that day.

3.1 In his report dated September 20, 2002 (annexed as Annexure B to the Show Cause Notice dated 25.9.2002) the inspecting officer has mentioned that:

- a) ASE has not taken any steps to stop the unofficial market despite instructions from SEBI vide letter dated August 26, 2002.

b) ASE has submitted a false report to SEBI vide their letter dated September 17, 2002 that -

- The unofficial market was not conducted within the official premises of the Stock Exchange
- Members of ASE are not participating in such unofficial market

4.0 Thereafter, vide letter dated September 20, 2002, ASE informed SEBI that they have lodged a complaint with the Ellis Bridge Police Station with a request to do the needful to prohibit the illegal transactions. However, they failed to confirm that unofficial trades in the premises of the stock exchange were prohibited.

5.0 Besides the failure to prohibit unofficial trading, in a matter where SEBI had initiated Enquiry proceedings against 20 brokers for indulging in unauthorized carry forward transactions, ASE referred the matter to the Disciplinary Action Committee and levied a penalty of Rs.1000.00 each on them.

6.0 In view of the report of the inspecting officer and the failure of ASE to curb the unofficial trading in the premises of the stock exchange, a show cause notice was issued on September 25, 2002 under section 11 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as "SCRA") to the Governing Board of ASE advising them to show cause why appropriate action including supersession should not be taken against them. Alongwith the said show cause notice the report of the ASE, the report of the inspecting officer submitted on 20.09.2002, SEBI warning letters dated April 24, 2002 and July 05, 2002 (annexed as Annexure C and Annexure D to Show Cause Notice 25.9.2002) were also sent to the Governing Board of ASE.

7.0 The Governing Board of ASE submitted their reply to the said show cause notice vide their letter dated October 9, 2002. In the reply, they stated inter alia that:

- i) In order to prevent any unofficial transactions within the vicinity of the exchange, ASE has filed a police complaint and requested police authorities to take appropriate action under law to prohibit such illegal activities relating to unofficial transactions
- ii) The exchange has taken due precaution to prevent any unofficial transactions within the premises of the exchange.
- iii) In order to have an impartial check on the behavior of members as well as their financial transactions, the governing board in its meeting held on 26.7.2002 decided to conduct inspection of accounts of the members by M/s C R Shredalal & Co who are independent auditors.
- iv) They do not have any concrete evidence of the participation of brokers of their exchange in the unofficial market within the official premises of the stock exchange.
- v) The decision to impose penalty on the 20 brokers against whom Enquiry has been initiated by SEBI was taken by the Disciplinary Action Committee. However, the Governing Board will be more vigilant in future.
- vi) ASE has not obtained permission to trade in derivatives and therefore have not launched trading in derivatives. They do not offer facility to trade in derivatives either to members or non-members. Further, ASE ensures that none of the floor transactions entered into outside the premises can be entered in the trading system of ASE because of the price-time priority maintained by the system.

7.1 In view of the above, ASE have submitted that they have taken sufficient precautions to stop the unofficial trading in securities by virtue of which

such trading has practically stopped, that trading in derivatives is not carried out in ASE and therefore, there is no violation of the SCRA, that no undesirable transactions in securities are being carried out to the knowledge of the Governing Board of ASE and hence they have submitted that they have never allowed any such transaction.

8.0 The Governing Board of ASE also sought a personal hearing before me in this regard. Personal hearing was granted to members of the Governing Board on November 20, 2002. They submitted in their reply dated 9.10.2002 that they have filed a police complaint and are taking all necessary action to prohibit unofficial trading in securities. In view of the submission made by the Governing Board in their reply that unofficial trading had stopped, an inspection team was deputed by SEBI on November 15, 2002, to confirm the veracity of the said submission. The inspecting team during the inspection on 15.11.2002 found that an open outcry system of trading was being carried out by members at the basement and near HDFC Bank in the premises of ASE. The members of the said inspecting team were present during the personal hearing as on 20.11.02 before me in case the members of the Governing Board desired to put any questions to the said inspecting team. The inspecting team stated before me and members of the Governing Board that during the said inspection on 15.11.2002, they had observed that unofficial trading was taking place in the premises of ASE even during trading hours. It was submitted on behalf of the Governing Board that the alleged transactions were outside the stock exchange and it was not possible for them to monitor the same.

9.0 I find that unofficial trading in the premises of ASE was observed during inspections carried out by SEBI on 5.8.02 and 19.9.02 the same was also corroborated by the Executive Director of the stock exchange vide his letter dated 19.9.02. The same was brought to the notice of officials of

ASE and they were advised to take steps to prohibit the same. The Officials of ASE promised to take steps to curb the unofficial trading and in their reply dated 9.10.2002, the Governing Board stated that the exchange has taken due precaution to prevent any unofficial transactions within the premises of the exchange. They have also stated that they do not have any concrete evidence of participation of their members in the unofficial market and that the exchange has put in place a strong mechanism to prevent and curb any such practices and that the said unofficial trade has practically stopped. However, the inspection team deputed by SEBI during their visit to the Exchange premises on 15.11.2002 observed that unofficial trading in open outcry system was taking place in the premises and that members of the exchange were involved in the same.

10.0 In this regard, it would be appropriate to refer to relevant provisions of the law. Section 16 of the SCRA provides that :

“16(1) if the Central Government is of the opinion that it is necessary to prevent undesirable speculation in specified securities in any state or area, it may by notification in the official gazette declare that no person in the state or area specified in the notification shall, save with the permission of the Central Government (or SEBI/RBI), enter into any contract for the sale or purchase of any security specified in the notification except to the extent and in the manner, if any, specified therein.

(2) All contracts in contravention of the provisions of sub-section (1) entered into after the date of notification issued there under shall be illegal.

In accordance with the above, a notification no SO 184(E) was published in the Gazette of India on March 01, 2000 stating that

“ in exercise of the powers conferred by sub-section (1) of section 16 of the Securities Contracts (Regulation) Act, 1956 read with Government of India Notification no 573(E) dated 30th July, 1992 and notification no 183 (E) dated 1st March , 2000 issued under section 29A of the said Act, the Securities and Exchange Board of India (hereinafter referred to as “the Board”) being of the opinion that it is necessary to prevent undesirable speculation in securities in the whole of India, hereby declare that no person in the territory to which the said Act extends , shall, save with the permission of the Board, enter into any contract for sale or purchase of securities other than such spot delivery contract or contract for cash or hand delivery or special delivery or contract in derivatives as is permissible under the said Act or the Securities and Exchange Board of India, Act , 1992 and the Rules and Regulations made under such Acts and Rules , Regulations and Bye-laws of a recognized Stock Exchange :

Provided that any contract for sale or purchase of government securities, gold related securities , money market securities and ready forward contracts in debt securities entered into on the recognized stock exchange shall be entered into in accordance with –

- a) the rules or regulations or the bye-laws made under the Securities Contract (Regulations) Act , 1956 (42 of 1956) or the Securities and Exchange Board of India Act, 1992 (15 of 1992) or the directions issued by the Securities and Exchange Board of India under the said Acts ;
- b) the rules made or guidelines or directions issued under the Reserve Bank of India Act , 1934 (2 of 1934) or the Banking Regulation Act, 1949 (10 of 1949) or the Foreign Exchange Regulation Act , 1973 (46 of 1973) by the Reserve Bank of India;

c) The provisions contained in the notifications issued by the Reserve Bank of India under the Securities Contract (Regulations) Act , 1956 (42 of 1956) “

10.1 I also find that ASE in its letter dated September 17, 2002 has admitted to an unofficial market in derivatives also being carried on in the premises of the Stock Exchange. In their complaint to the Ellis bridge Police Station dated 20.9.2002, the stock exchange has mentioned that some unscrupulous persons are carrying out illegal transactions in securities within the premises of the stock exchange and that the same is a cognizable offence under the SCRA. In this regard, Section 18 A of the SCRA states that notwithstanding anything contained in any other law for the time being in force, contracts in derivatives shall be legal and valid if such contracts are: (a) traded on a recognized stock exchange; (b) settled on a clearing house of the recognized stock exchange in accordance with the rules and bye-laws of such stock exchange.

10.2 I find that the unofficial market was carried on in the premises where ASE is located in contravention of the provisions of Sections 16 and 18A of the SCRA. I find that although in their reply dated 9.10.2002, ASE has submitted that they have taken all necessary steps to prevent any illegal trading, during the inspection by SEBI officials on 15.11.2002 it was observed that the illegal trading was still being carried on. By allowing the unofficial trade to continue despite directives from SEBI to prohibit the same, ASE has failed to ensure compliance with the said provisions of SC(R)A. The submission that it is not possible for ASE to monitor such transactions as it is outside the stock exchange is not tenable. The finding in preceding paras, particularly in para 9.0 shows that such

unofficial transaction was taking place in within the premises of the exchange and some of the members were also involved in the same. Even if it is presumed as contended by noticees that such transactions were outside the stock exchange, in view of the provisions of Section 16, 18A, 19 of SC(R) Act and notification issued under Section 16, it is the duty of the Exchange to prevent such transactions.

- 11.0 I find that the exchange has not complied with the directives / circulars etc. of SEBI within the stipulated time–frame and has shown disregard to deadlines set by SEBI in complying with its directives. In this regard, I also note that SEBI has issued two warning letters dated April 24, 2002 & July 05, 2002 in the current financial year for non implementation of system based gross margin in cash market and disruption in trading.
- 12.0 I find that ASE failed to comply with the order issued by SEBI under section 8 of SC(R) Act dated January 10, 2002 wherein the exchange was directed to amend their Rules, Articles etc. within a period of two months to give effect to the segregation of ownership and trading membership from management of stock exchange. Thereupon SEBI was constrained to amend the rules of ASE vide notification dated April 16, 2002 to give effect to the same.
- 13.0 It may be observed that the Joint Parliamentary Committee in its report which was laid before Parliament on 19.12.2002, has also observed that illegal financing in various forms appear to be resurfacing in exchanges like Ahmedabad. Synchronized deals and gathering of brokers at fixed time on a particular day in a week in trading hall of the exchange / corridors of the exchange to fix badla charges is common knowledge. There is need for SEBI to take immediate action.

14.0 I find that no effective steps have been taken by the Governing Board in respect of filing an FIR before the Police Authorities and in taking disciplinary action against members of the exchange found to be involved in the unofficial transactions. ASE, vide their letter dated 30.12.2002, sent in reply to SEBI's letter dated 23.10.2002, have stated that when the ED of the Stock Exchange met the Station in charge (SHO) of Ellisbridge Police Station to convert their complaint into an FIR, the SHO advised them to submit a detailed note on the relevant sections under which the FIR should be registered and also to explain whether such offence is cognizable under Law. The ED also stated that he would be able to forward the copy of FIR registered with the Police to SEBI latest by 01.01.2003. However, the copy of the FIR is yet to be received by SEBI.

The ED in his letter has also stated that it would be difficult to initiate any disciplinary proceedings against persons found to be standing in the corridor of the stock exchange on 19.09.2002, since there was a lack of identification and evidence. In this regard, I note that the ED in his letter dated 19.09.2002 had stated that among other persons a few brokers were also found to be standing in the corridor where the unofficial market for trading jota phatak contracts was going on.

It is evident from the above that the stock exchange authorities and the Governing Board have failed to effectively follow up the complaint with the police to ensure action against persons involved in the illegal transactions and also failed to ensure that appropriate disciplinary action is taken against members of the stock exchange who were found to be involved in the said illegal transactions.

15.0 In view of the above facts, I am convinced that the Governing Board of ASE has failed to ensure proper governance and implementation of the provisions of the SCRA and SEBI directives.

- 16.0 The Governing Board of ASE has been informed that unofficial trading is being carried on in and near to their premises. One step which the ASE has taken is to inform the police. During the hearing also, on behalf of ASE it was mentioned that beyond this what could they do to curb the unofficial badla? If SEBI has to make suggestions and bring it to the notice of the exchange that unofficial badla is being carried on in or near to their premises, then surely, it is possible for a stock exchange which is a regulatory body to regulate and control the contracts under SC(R) Act and bye laws of the Exchange to ensure that such activities are not carried on in their vicinity. The Stock Exchanges need to put security guards in place, have continuous monitoring by dedicated officers, warn brokers, take action, all to ensure that there is no unofficial badla. A Governing body which cannot even think of ways and means to ensure that illegal activities are not being carried on does not deserve to continue. Unofficial badla works not only to the detriment of stock brokers, but also to the detriment of investors and the securities market. Therefore, I am of the opinion that it is essential that immediate measures are taken to ensure the safety and integrity of the market and to restore the confidence of investors in the functioning of the Stock Exchange.
- 17.0 SEBI is mandated to ensure that the systems and the procedures on an exchange are such that the transactions are carried on in a lawful manner and without affecting the interest of investors. In order to ensure that such systemic improvements take place on ASE it is necessary that the persons who have failed to take effective action need to be excluded from governance of the exchange and an independent and impartial person is appointed.
- 18.0 In view of the above and in exercise of the powers conferred on me under Section 11 of the Securities Contracts (Regulation) Act, 1956 read with

Government of India Notification No. S.O.573 dated July 30, 1993 and Section 4 (3) of the Securities and Exchange Board of India Act, 1992, I hereby supersede the Governing Board of Ahmedabad Stock Exchange with effect from March 25, 2003 for a period of one year and appoint Shri P K Ghosh as an administrator to exercise and perform all the powers and duties of the Governing Board. Shri P K Ghosh may take the assistance of such persons as he deems necessary in discharge of his duties as administrator.

[F.No.SEBI/LE/ 2096 /03]

**G.N.BAJPAI
CHAIRMAN
SECURITIES AND EXCHANGE BOARD OF INDIA**