

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

Mumbai, the 12 day of July, 2002

ORDER U/S 11 OF THE SECURITIES CONTRACTS (REGULATION) ACT, 1956 SUPERSEDING THE BOARD OF DIRECTORS OF THE UTTAR PRADESH STOCK EXCHANGE ASSOCIATION LTD.

S.O.No.732(E) Based on the correspondence received from the Public Representatives on the Board of the Uttar Pradesh Stock Exchange (hereinafter referred to as "UPSE") the then Nominee Director of the Securities and Exchange Board of India (hereinafter referred to as "SEBI") on the Board of UPSE and the then Executive Director of UPSE and based on the observations made in the inspection report of UPSE conducted by SEBI from March 12-17, 2001, the compliance reports and monthly development reports submitted by the UPSE, SEBI had conducted an enquiry into the following irregularities:

- (i) Interference from the elected directors and brokers in the functioning of the exchange making it difficult for the Executive Director (ED) to function as required under the bye laws of the exchange and SEBI directives,
- (ii) Unruly behaviour of the brokers in the Board meeting held on July 27, 2001 and attempt to threaten and restrain the Public Representative Director from discharging their functions,
- (iii) Process of recruitment of ED without following the guidelines issued by SEBI,
- (iv) Non attendance by the President and restraining the ED from attending the meeting convened by SEBI on August 14, 2001 to discuss the plan of each exchange for Demutualization/ corporatisation,
- (v) Non compliance of SEBI directives,
- (vi) Delay in considering the inspection report and forwarding the compliance report with reference to violation of SEBI directives,
- (vii) Board meeting not conducted as per rules and bye laws of UPSE.

2 Thereafter SEBI issued a notice dated September 03, 2001 under Section 11 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as SCRA) upon the Governing Board of the UPSE (here after referred to as "the Governing Board") advising them to show cause as to why the Governing Board should not be superseded in view of the above mentioned instances of mismanagement and irregularities in the functioning of the exchange. The Governing Board was called upon to submit their reply to the show cause notice within 15 days from the date of the receipt of the notice and indicate their preference for a personal hearing, if they so desired.

3 The Governing Board vide their letter dated September 13, 2001 sought time of 10 days to submit the reply and thereafter submitted their reply to the show cause to SEBI on September 19, 2001. The Board also sought an opportunity to be heard in person. An opportunity of hearing before the Chairman, SEBI, was granted to the President, Vice-President and two members of the Board on November 05, 2001. Subsequently, upon request of the Governing Board, the hearing was fixed on November 19, 2001.

4 The President, Vice-President and two elected directors of the Governing Board besides SEBI Nominee Director attended the hearing before the Chairman, SEBI on 19.11.2001. In the course of hearing, the elected broker directors refuted the various allegations raised against the Board.

5 Thereafter, vide letter dated November 29, 2001, SEBI forwarded the documents relied upon by it for issuing the show cause notice, to the Governing Board, and sought their submissions in regard to the same within 15 days of the receipt of the said letter

6 Subsequently, the Governing Board, vide their letter dated December 05, 2001, sought for certain clarifications from SEBI and also requested for extension of time of 20 days from the date of their Board meeting scheduled on December 14, 2001 to make their submissions. Although SEBI provided the necessary clarifications to the Board, the request for extension of time for submission of the reply was denied. Subsequently however, pursuant to a further request for extension of time made vide letter dated December 11, 2001, SEBI granted time until December 20, 2001.

7 However as the submissions made by the Governing Board vide their letter December 20, 2001 found to be unsatisfactory, the Chairman, SEBI granted another opportunity of hearing to the Board on March 15, 2002. On the said date, the President and the Officiating Executive Director of UPSE appeared on behalf of the Governing Board before the Chairman and made their submissions. They requested for additional time for compliance with the directions of SEBI. Accordingly UPSE was granted time of one month to take corrective measures to stabilise the trading system and rectify the irregularities in the exchange.

8 Thereafter, SEBI, vide its letter dated March 26th 2002 called upon the UPSE to inter alia comply with the conditions imposed at the time of renewal of recognition granted to the UPSE, observations in the inspection report for 2000-2001, stabilizing the trading system, certifying that activities such as unauthorized carry forward transactions, interference by the elected directors in the day-to-day administration of the exchange had been stopped and steps have been taken to appoint Executive Director and operationalise the SGF of the exchange as per the scheme approved by SEBI and submit a compliance report, failing which SEBI would be constrained to take such measures as it deems fit including supersession of UPSE.

9 Thereupon, UPSE vide their letter dated April 22, 2002 submitted their report which allegedly detailed the manner in which they had rectified the irregularities. However, on perusal of the said report it is observed that UPSE have not rectified many of the irregularities mentioned in the show cause notice with the directives of SEBI. It was observed that SEBI has issued the following directions to UPSE:-

- (i) The exchange is advised to hold the Annual General Meeting within the stipulated period.
- (ii) The Exchange should vigorously follow with the members for:
 - (a) submission of the statement regarding engagement/ non-engagement in other business.
 - (b) for submission of information for broker database.
- (iii) The Exchange should ensure that its member brokers get their sub-brokers registered with SEBI, before starting their dealings with them in accordance with provisions of Chapter III of SEBI (Stock Brokers and Sub Brokers) Regulations 1992.
- (iv) Access to the software program (for calculation of margin) is not restricted making the system vulnerable to unauthorized changes. Changes in parameters should be made only after proper documentation through sanction from competent authority. The Surveillance department should be subjected to systems/ EDP audit to plug the discrepancies in the control, systems and operations.
- (v) The Exchange is advised to follow the practice of immediately stopping the trading of members who do not pay up the margin in time.
- (vi) It appears that the cheques collected toward margin payment in some cases were not deposited in the bank. The Exchange did not furnish any clarification on these cases during the period of inspection. Such instances have serious implication. The Exchange should specifically explain these instances and ensure to implement a proper system for timely collection of margin in all due cases.
- (vii) The Exchange is advised to ensure that all penalties are recovered from members unless waived by appropriate competent authority which should include the Executive Director. The waiver of small amounts should not emerge as an accepted policy at the Exchange.
- (viii) The Exchange must discharge its responsibility of authenticating the turnover of its members for calculation of fee diligently and ensure timely remittance of fee to SEBI by all members.
- (ix) UPSE should examine listing compliance of companies trading which were suspended in other exchanges.
- (x) There should be predetermined criteria for selection of members for inspection on basis of surveillance action. The possibility of arbitrariness and susceptibility to misuse should be minimised.
- (xi) The Exchange is advised to ensure that bank guarantees on behalf of brokers are taken in the proper format and are renewed timely, if required.
- (xii) The Exchange shall take immediate measures to stop the practice of unofficial carry forward of transactions, and impose deterrent punishment to the brokers who have been involved in such trades.
- (xiii) The exchange is advised to ensure that the surveillance set-up is as specified in SEBI circular no. IEMI/LKS/MI/2990/95 dated August 8, 1995 and shall maintain the hierarchy.
- (xiv) The exchange shall take steps to comply with SEBI Circular dated July 2, 1999 and accept scrips from approved securities for the purpose of capital adequacy and ensure that the members maintain the minimum BMC.
- (xv) The Exchange shall take immediate steps for the installation of the software for compliance of suggestions of the inspection report for the year 1999-2000 & 2000-2001, which have not been complied on account of non-availability of software.
- (xvi) The UPSE shall operationalize the SGF of the exchange in terms of SMD SEBI Circular no. 13 dated June 9, 1997.
- (xvii) The UPSE shall take immediate steps to appoint the Executive Director.
- (xviii) UPSE should comply with the observations made in the inspection report for the year 2000-2001 & 2001-2002.
- (xix) Deterrent action should be taken by exchange against members who intentionally failed to submit their reply towards the findings of inspection
- (xx) The Grievance committee is dominated by member brokers. The constitution of the committee is apparently not in the interest of investors. The committee should be reconstituted to increase the representation of non-members.
- (xxi) The Exchange is advised to take steps to recover the arrears from Brokers towards Infrastructure Development Fund.
- (xxii) The UPSE is advised to draw a schedule of investor-related activities and implement a yearly program.
- (xxiii) Emphasis should be made towards improving the quality of inspection of brokers by also examining unauthorized badla, price manipulation, circular trading, improper utilization of clients' funds etc.
- (xxiv) Media reports should be seen / examined for any price sensitive information/ rumour in respect of companies listed at UPSE.
- (xxv) The Exchange is advised to recover annual charges from the members who have not paid.

(xxvi) The Exchange is advised to reformulate its accounting policies with regard to listing to present a true and fair picture of listing fees recoveries.

(xxvii) It is suggested that defaulting companies may be served legal notices to the company and directors, action u/s 23 of the SCRA, 1956, winding up proceedings in accordance with section 433 and 434 of the Companies Act, 1956 may be initiated for recovery of the listing fee.

(xxviii) The Exchange with its investments to the extent of Rs 10.00 crore should explore other avenues of investments and take steps i.e. Outlining an investment portfolio with possible investment avenues in other "Zero" risk products including government securities and maximizing the yield on investments by selecting the optimum product mix. The exchange is also advised to have a proper investment policy for investing surplus funds.

(xxix) The Exchange should introduce internal audit by way of an independent internal auditor or concurrent audit by a firm of Chartered Accountants reporting to the Board.

(xxx) (a)The Exchange should adopt a system of periodical hardcopy backup of all the books of account of the Exchange

(b)The Exchange needs to frame rules in respect of -

(1) Backup register specifying the mode and periodicity of the backup and

(2) Passwords register detailing the secret passwords and periodic changes of passwords to be kept under the safe custody of the GM/President/ED.

(xxxi) The procedure for physical verification of Fixed Assets being followed by the Exchange needs to be improved and all Fixed Assets should be physically verified as at the year end by a team of official(s) assisted by the Statutory Auditors/Internal Auditors instead of adopting the system of departmental confirmations, as prevalent currently.

(xxxii) The Exchange should work out a system of apportioning the common pool expenses between itself and the subsidiary. The expenditure incurred only for its subsidiary should be recovered from it.

(xxxiii) The Exchange is advised to formulate a strategy to improve the financial health of the Exchange as the financial condition has deteriorated over the last few years. It should look into the quantum of user charges being recovered from its members and should consider increasing it.

10 It is also noted that UPSE has failed to comply with the conditions stipulated by SEBI at the time of renewal of recognition of UPSE. It is relevant to note that SEBI has received reports of interference by the elected directors in the day-to day management of UPSE which is in violation of the SEBI circular no. SMD-II/ALLSE/CIR-02/2000 dated January 10, 2000. In fact reports have also been received by SEBI as regards the establishment of an online trading ring to facilitate the integration of carry forward and hawala transactions into the main trading system of the exchange and the officers and staff of the exchange being coerced into acting against the interest of the exchange and /or directives of SEBI and the harassment and victimisation of the employees of the exchanges not cooperating in such matters by withholding increments /promotion, or holding out the threat of compulsory retrenchment..

11 Due opportunity was given to the Governing Board to show cause as to why it should not be superseded. The Governing Board has not cared to address or rectify the allegations of mismanagement levelled against them. In fact, SEBI, vide its letter dated May 17, 2002, informed the UPSE that since the undertaking given by the UPSE as regards the compliance of the various conditions as directed by SEBI vide its letter-dated March 26, 2002, was found to be unsatisfactory, SEBI would, in the facts and circumstances of the case, be constrained to initiate immediate action against the UPSE, which may include supersession of the Governing Board.

12 In the course of hearing before the Chairman, the President and Officiating Executive Director of the UPSE submitted that they have complied with all conditions imposed at the time of granting renewal to UPSE, that the irregularities observed in the inspection report have been rectified, that there is no interference in the day-today affairs of UPSE by the elected directors, that steps have been taken to appoint Executive Director and that they have stopped the practice of carry forward. They also submitted that UPSE is not in a position to operationalise the SGF on account of expiry of Rs.500 lakhs sanctioned by Vysya Bank and that software upgradation is not complete for lack of fine tuning, which is being done by CMC Ltd.

13 However, reports continue to be received that unofficial carry forward transactions continue in the floor of the exchange. It may be relevant to note that pursuant to the special inspection of the Exchange conducted on November 2001, enquiry proceedings have already been initiated by SEBI against 14 brokers of the Exchange for entering into unofficial carry forward transactions. It is also noted that despite the order of SEBI under section 8 of SCRA, amending the articles of association notified on May 20, 2002 stock brokers are still holding the post of President and Vice President. The day-to-day administration, signing of cheques, staff matters, purchases, etc. of the UPSE are still being handled by the President, elected directors and other brokers. Further, reports have been received that the Exchange has appointed the Executive Director without the approval of SEBI. There have also been reports of misuse of the funds of the Exchange by the elected directors and contributors to the subsidiary projects have been refunded Rs.50,000/- each totalling to Rs.23 lakhs at a loss to the exchange. A proposal to refund the initial contribution to the SGF @ Rs.25,000 per member has been announced by the Chairman of the newly formed UPSE member's association with the tacit blessings of the elected directors. Furthermore, the UPSE has not operationalised the SGF under one pretext or the other. Model Rules for stock exchanges have also not been made applicable. Complaints have been received from public representatives and the SEBI nominee director as regards the President of the Exchange not abiding by the SEBI directives, and the interference of the elected office bearers in the day to day functioning of the Exchange. In terms of the inspection report, the functioning of the surveillance set up is also not in accordance with the SEBI Circular No. IEMI/LKS/MI/2990/95 dated August 8,1995. The Surveillance department does not have access to real time scrip prices at the BSE. Lacunae exists in the trading software and the settlement mechanism. Price-sensitive information received by the Exchange is not forwarded to the surveillance department for examination of price /volume movement in a prior period and media reports are not seen / examined for any price sensitive information or a rumour in respect of the companies listed on the exchanges. There have been reports of the creation of the artificial markets and trades being executed at unusual prices.

14 In view of the above facts, I am convinced that the Governing Board of UPSE has failed to ensure proper governance and implementation of the provisions of the SCRA, Bye-Laws of the Exchange and SEBI directives. As a result of this the confidence of investors in transparent and impartial working of the stock exchange has been impaired. I am also convinced that there is interference from the elected directors and brokers in the day-to-day functioning of UPSE making it difficult for the exchange to function as required by the byelaws of the exchange and SEBI directives. I am also convinced that there has been non compliance with SEBI directives, that there has been undue delay in taking up the inspection report for the year 2001-02 for consideration by the Governing Board, that the meetings of the Board of Directors are not conducted as per rules and byelaws, that the Executive Director of UPSE is prevented from discharging his duties in the manner provided in the Rules and Bye-Laws of the exchange due to interference by the elected directors and members of the exchange.

15 Therefore, I am of the opinion that it is essential that immediate measures are adopted to ensure the safety and integrity of the stock exchange and to ensure that transactions on UPSE are carried out as per the regulatory framework and that the interest of investors are not jeopardised further.

16 SEBI is mandated to ensure that the systems and the procedures on an exchange are such, that transactions are carried on in a lawful manner and without adversely affecting the interest of investors. In order to ensure that such systemic improvements take place on the exchange, the persons who have prevented transactions from being carried on in a lawful manner need to be excluded from governance of the exchange. In order to ensure that systemic improvements take place on the exchange, it is necessary that an independent and impartial person is appointed.

17 In view of the above and in exercise of the powers conferred on me under Section 11 of the Securities Contracts (Regulation) Act, 1956 to be read with the Government of India Notification number S.O. 573 dated July 30, 1993 and Section 4 (3) of the SEBI Act, 1992, the Board of the Uttar Pradesh Stock Exchange is hereby superseded for a period of one year with effect from July 12, 2002 and Shri. M. N. Sabharwal is hereby appointed as an Administrator to exercise and perform all the powers and duties of the Governing Board. Shri. Sabharwal may take assistance of such persons as he thinks it necessary.

Dated this 12 day of July, 2002

File no. SEBI/LE/ 12829 /02

G. N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA