

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 AGAINST M/S. SPICA FINSTOCK LTD.

1.0 BACKGROUND OF THE CASE :

- 1.1 M/s. Spica Finstock Ltd. (hereinafter referred to as the broker) is a member of Ahmedabad Stock Exchange (hereinafter referred to as ASE) and registered with Securities and Exchange Board of India (hereinafter referred to as SEBI) vide registration no. INB 021032132.
- 1.2 An inspection of books of accounts, documents and other records of the broker was conducted on 18.01.2001. A copy of the inspection report was forwarded to the broker by SEBI vide letter dated 17.4.2001 advising the broker to submit reply vis-à-vis inspection report. The broker submitted its reply vide letter dated 19.6.2001. On not being satisfied with the reply of the broker vis-a-vis the inspection report, an enquiry officer was appointed vide Order dated 07.02.2002 to conduct an enquiry into the contravention/s alleged to have been committed by the broker.

2.0 ENQUIRY REPORT AND RECOMMENDATION :

- 2.1 The enquiry officer, after conducting the enquiry as per the procedure laid down in SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as "the said regulations") submitted a report dated 31.01.2003. The enquiry officer has concluded that the broker had committed irregularities pertaining to contract notes, failure to maintain client database properly, non segregation of client's account from his own account and dealing with unregistered sub-brokers. The enquiry officer recommended that the registration of the broker be suspended for a period of three months.

3.0 SHOW-CAUSE NOTICE AND HEARING :

- 3.1 Pursuant to the above, a show cause notice dated 11.02.2003 was issued to the broker along with a copy of the enquiry report. The broker submitted a reply vide his letter dated 28.02.2003. In the interest of natural justice, an opportunity of personal hearing was granted to the broker on 09.4.2003. The broker appeared before me and reiterated his submissions made in his letter dated 28.02.2003. I have perused the findings of the enquiry officer mentioned in his enquiry report dated 30.01.2003. I have also taken into consideration the reply submitted by the broker vide letter dated 28.02.2003 and also the submissions made by the broker during the course of hearing held on 09.4.2003.

4.0 ISSUES FOR CONSIDERATION :

- 4.1 I proceed to examine the allegations, the reply submitted by the broker as under.

5.0 ALLEGATION AND REPLY :

- 5.1 With regard to the charge that the broker failed to maintain adequate client database as required under circular dated 11.4.97, the broker submitted that the circular was issued to all regular clients to furnish the details and some of the clients have not furnished the details.

5.2 FINDING :

Client identification is important in verifying the identity of the clients with regard to the transactions done by them. The particulars of the client such as bank account, PAN number etc. would establish the credentials of the clients and the same would help the broker in acting with due skill, care and diligence in the conduct of his business. I agree with the finding of the enquiry officer in holding that the delay and non – compliance was on the part of the clients and as such no adverse conclusion could be drawn against the broker.

6.0 ALLEGATION AND REPLY :

- 6.1 As regards the charge that the broker has failed to ensure preprinted serial numbers and also failed to obtain acknowledgement from clients, the broker submitted that due to standard programme the contract notes were generating serial numbers on daily basis.

6.2 FINDING :

The explanation of the broker is not acceptable in as much as contract notes are required to have preprinted continuous serial numbers and also the broker should have obtained acknowledgments from the clients in terms of the circular dated 5.8.96. This would prevent the possible misuse of contract note system. Therefore, I hold the broker guilty on this count.

7.0 ALLEGATION AND REPLY :

- 7.1 As regards the charge that the broker has failed to maintain segregation of clients account and also his own account, the broker has submitted that due to over sight having same account in the same branch of same bank, the staff might have committed mistake in issuance of cheque and pleaded for a lenient view in the matter. The broker also submitted that they would be taking due care to maintain the segregation of accounts as per the guidelines issued by SEBI.

7.2 **FINDING :**

I feel that the conduct of the broker in not segregating the client's account from his own account is not acceptable in as much as the broker has paid office expenses, through client account and did IPO funding through client account and also routed the director funding of IPOs through client account. The credit amounts lying in the client's accounts are required to be maintained with utmost care and trust. The objective of opening and maintaining a separate account for the client's funds is to segregate and identify them separately and to prevent its misuse so that they are beyond the reach of the broker. I am not convinced with the reply of the broker and I feel that the broker has failed to comply with the provisions of the circular dated 18.11.93 vis-à-vis maintaining segregation of the broker's account and client's account. Therefore, I hold the broker guilty on this score and I agree with the findings of the Enquiry Officer in this regard.

8.0 **ALLEGATION AND REPLY :**

- 8.1 With regard to the charge that the broker had been dealing with **(1).** M/s. Interface Brokerage and Research Limited, **(2).** M/s. Jagruti Securities Limited without obtaining registration as a sub-broker of these entities, the broker submitted that as per clause 2 (f) of SEBI (Stock Brokers and Sub Brokers) Rules, 1992 (the said Rules) a member of a stock exchange cannot be a sub-broker, therefore, the allegation is misconceived.

8.2 **FINDING :**

The interpretation given by the member that a stock broker cannot at the same time be a sub-broker having regard to the definition of sub-broker under Rule 2(f) of the said Rules is not correct. A sub-broker means any person including a stock broker who is not a member of a particular stock exchange and therefore who may act on behalf of a member of that particular stock exchange as an agent or otherwise for assisting the investors in buying, selling or dealing in securities through such stock brokers. A perusal of SEBI's Circular dated 16.1.1998 also gives the background for insisting on members of one stock exchange to become sub-brokers with member of another stock exchange with separate registration in such cases. It was stated therein that the issuance of circular has become necessary in view of the fact that the stock exchanges had expressed difficulty arising out of such transactions carried out by the member of stock exchange on another stock exchange in which he is not a member. The stock exchanges had to declare some of the members who were acting as sub-brokers as defaulters since they defaulted to the investors for the transactions done through member of other exchange, although there was no default to the parent exchange.

SEBI vide its circular dated 16.1.98 had advised the members of exchanges who are acting as sub-brokers through the members of other exchanges to obtain separate registration to act as sub-brokers. It is therefore not correct as contended by the member that a stock broker of one exchange cannot be a registered sub-broker of another stock exchange. Further, as per section 12(1) of the Securities and Exchange Board of India Act, 1992 (the SEBI Act), no stock broker or sub-broker shall buy, sell or otherwise deal in securities except under and in accordance with the conditions of a certificate of registration obtained from SEBI in accordance with the regulations made under the SEBI Act. The regulations namely, the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (SEBI Regulations) framed under the SEBI Act lay down, inter alia, the eligibility criteria and procedure for registration of sub-brokers (regulations 11 and 12). The broker has not complied with the SEBI Regulations, the said rules, SEBI Circular No.SMD/POLICY/CIR-98 dated 16.1.98 and also Section 12 of SEBI Act and as such I hold the said broker guilty of violating the same.

9.0 **CONCLUSIONS :**

- 9.1 In view of the above, I do not see any reason to differ with the findings of the enquiry officer mentioned in the enquiry report dated 31.01.2003. I am fully convinced that the broker has committed irregularities pertaining to contract notes, non segregation of client's account from his own account, acting as unregistered sub-broker and failure to maintain adequate database.

- 9.2 Regulation 7 of the said Regulations provides that the stock broker holding the certificate shall at all times abide by the Code of Conduct as specified in Schedule II. Further, Clause A (5) of Schedule II provides that a stock broker shall abide by all the provisions of the Act and the Rules, Regulations issued by the Government, SEBI and the Stock Exchange from time to time as may be applicable to him. In view of the foregoing, I conclude that the said broker is guilty of having violated,

- (a) section 12 of the SEBI Act,
- (b) the provisions of clause A(5) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI Regulations,
- (c) regulation 11 and 12 of the SEBI Regulations,
- (d) the condition of registration specified in Rule 4(b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992,
- (e) SEBI directives contained in the circulars and the ASE Bye-laws as found hereinabove.

In view of the same, the said broker is liable for action under regulation 13(1)(b) of the SEBI Enquiry Proceedings Regulations.

- 9.3 Under section 11 of the SEBI Act, SEBI can take measures to protect the interests of investors and to regulate the securities market inter alia by registering and regulating the working of stock brokers. The directives contained in the SEBI circulars are the measures for regulating the working of the stock brokers. Further, the Code of Conduct specified in Schedule II of the SEBI Regulations also provides for the minimum standards for the working of the stock brokers. If the regulatory requirements are violated by the stock brokers without attracting any action, the measures taken by SEBI for regulation of the stock brokers would be rendered nugatory and the regulatory function would be jeopardized. It is to be

noted that indulgence of the said broker in the transactions which are prohibited can not be allowed especially when such transactions are likely to have a detrimental effect on regulation of the securities market. Further, every stock broker is under obligation to comply with the provisions of the Act and the Rules and Regulations made thereunder as also the circulars and guidelines issued by the Board from time to time. It is also imperative that all the members of every Stock Exchange shall adhere to the bye-laws of the Exchange.

10.0 ORDER :

- 10.1 I find that the said broker has committed several violations as observed above and has not taken due care and diligence in observance and compliance of the statutory requirement in conduct of its business as a stock broker. Looking into the violations committed by the said broker, I am satisfied that it is necessary to secure the proper management of the stock broker and also in the interest of the securities market that a penalty of suspension of certificate of registration for a period of three months as recommended by the enquiry officer is imposed. Therefore, in exercise of the powers conferred upon me by virtue of sub section (3) of section 4 of the SEBI Act read with regulation 13 (4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 I hereby order that the certificate of registration no. INB 021032132 of M/s. Spica Finstock Ltd., a member of the Ahmedabad Stock Exchange, be suspended for a period of three months.

This order shall come into force with effect from three weeks from the date of the order.

PLACE: MUMBAI

DATE : 30-May-2003

G. N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA