

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 KAYNET CAPITAL LIMITED.

1.0 BACKGROUND OF THE CASE :

- 1.1 Kaynet Capital Limited (hereinafter referred to as the broker) is a member of Bombay Stock Exchange (hereinafter referred to as BSE) and registered with Securities and Exchange Board of India (hereinafter referred to as SEBI) vide registration no. INB011056737.
- 1.2 An inspection of books of accounts, documents and other records of the broker was conducted in November 2000 by V. Parekh & Associates (Chartered Accountants) on behalf of SEBI. A copy of the inspection report was forwarded to the broker by SEBI vide letter dated 9.3.2001. The broker submitted its reply and on not being satisfied with the reply of the broker vis-a-vis the inspection report, an enquiry officer was appointed vide Order dated 08.5.2002 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 under SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (hereinafter referred to as "the said regulations") submitted a report dated 30.11.2002. The enquiry officer has concluded that the broker had committed irregularities pertaining to dealing with un-registered sub-brokers, failure to enter into agreement with sub-brokers, delay in delivery of securities to clients, delay in issuance of contract notes, failure to maintain order book, failure to maintain client registration agreement and failure to ensure continuous preprinted serial numbers on the issued contract notes. The enquiry officer recommended that the registration of the broker be suspended for a period of four months.

3.0 SHOW-CAUSE NOTICE AND HEARING :

- 3.1 Pursuant to the above, a show cause notice dated 07.02.2003 was issued to the broker along with a copy of the enquiry report. The broker submitted a reply vide his letter dated 20.02.2003. An opportunity of personal hearing was granted to the broker on 09.04.2003. The representatives of the broker appeared before me and reiterated the submissions made in their letter dated 20.02.2003. I proceed to examine the issues as under.

4.0 ISSUES FOR CONSIDERATION :

4.1 ALLEGATION AND REPLY :

With regard to the charge of failure to maintain preprinted serial numbers on the contract notes, the broker submitted that they have started using pre printed serial numbers on the contract note, however at the time of inspection they were not following the same.

4.2 FINDING :

The system of continuous pre-printed serial numbers is to prevent the possible misuse of contract notes such as pre-dating of a contract. It is clear that the broker failed to maintain pre-printed serial numbers on the contract notes and I hold the broker guilty of violating the provisions of clause A (5) of Code of Conduct as contained in Schedule II of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as 'the said regulations') read with the circular no.SMD/MDP/CIR/043/96 dated 5.8.96 issued by SEBI.

5.0 ALLEGATION, REPLY AND FINDING:

- 5.1 As regards the charge that the broker has failed to maintain segregation of client's account and also his own account, the enquiry officer concluded that the charge of misutilisation of client's funds by the broker was not established. I don't see any reason to differ with the findings of the enquiry officer and hold the broker not guilty on this count.

6.0 ALLEGATION AND REPLY:

- 6.1 As regards failure to maintain order book, the broker submitted that it was practically impossible and the practice was outmoded, therefore, they do not maintain it. The broker also submitted that the circular dated 11.02.1997 does not prescribe any form for maintaining any such book and the said circular refers to the contents of a contract requiring to show the specific time when the order was placed and executed and their contract notes specified the order number which can trace back the time and denied having violated the said circular.

6.2 **FINDING :**

From the reading of the circular dated 11.02.97 it is clear that it requires the broker to maintain record of time when the client has placed the order and reflect the same in contract notes alongwith time of execution of order and non compliance of the same is in violation of the provisions of clause B (1) of Code of Conduct as contained in Schedule II of the said regulations read with circular no.SMD/POLICY/IECG/1-97 dated 11.2.97 issued by SEBI. As per the Code of Conduct, a broker is required to execute the order at the best available market price. The details in respect of placing of order and the time as to when the order was placed is very important as the client can know whether the broker has executed the order at the best price and also to know whether he is charging the correct price vis-à-vis comparing the same with market price at the time of placing or execution of the order.

7.0 **ALLEGATION AND REPLY :**

7.1 As regards the failure to maintain client registration agreements in 58 cases as mentioned in the show cause notice and also 20 cases where there were some deficiencies relating to PAN number, proof of identity, stamps, photographs not obtained etc. The broker submitted that the client agreements are available in respect of the said 58 clients, though some of them may be unstamped.

7.2 **FINDING :**

Though the client states that the agreements are available, they have not produced them either before the inspection team or before the Enquiry Officer. This shows the lack of bonafides on part of the said broker. I am not inclined to accept the submission of the broker that the client agreements are available with him in view of the fact that they were not produced either before the inspecting team or the Enquiry Officer even though the member has got enough opportunity to produce them. Client identification is important since it is aimed at identifying the clients behind transactions. This would establish the credentials of the clients and would help the broker in acting diligently in doing business for his clients. Failure to fill up client registration forms properly or non maintenance of the same is in contravention of the provisions of clause A (5) of Code of Conduct as contained in Schedule II of the said regulations read with circular no.SMD-1/23341 dated 18.11.93, SMD/POLICY/IECG/1-97 dated 11.2.97 and SMD/POLICY/CIR/5-97 dated 11.4.97 issued by SEBI. Therefore, I hold the broker guilty on this count and I agree with the findings of the Enquiry Officer in this regard.

8.0 **ALLEGATION AND REPLY :**

8.1 As regards the delay committed in transfer of demat shares from broker's pool account to the respective client's account, the broker submitted that they were holding written instructions from the respective constituents/ brokers authorizing them to retain the said shares. The broker also submitted a list of client letters vide his letter dated 20.02.2003 together with copies of the authorising letters purportedly given by his clients.

8.2 **FINDING :**

I note that the said broker has submitted authorization letters from the 27 clients for the first time before me. They were not produced either before the inspection team or the Enquiry Officer (E.O.). This makes further verification of the authenticity of the letters impossible. I have perused the letters. All of them are in the same format and font, with the client's name and date being filled up in hand. This fact further leads me to doubt their authenticity. Moreover, the broker has not given any explanation as to why they were not produced before the inspection team or the E.O. Therefore, I am not inclined to attach any significance to the letters filed by the said broker with his reply dated 20.02.2003.

As per SEBI Circular no.SMDRP/POLICY/CIR-11/99 dated 7th May, 1999 the pool account balances have to be transferred to the clients account within a period of 15 days. It is clear that there was delay in transferring the pool account balances to the clients' account which is highly irregular and in contravention of the aforesaid circular of SEBI. This circular does not make an exception from this obligation in any case where the client has authorized retention of securities in pool account beyond 15 days Therefore, the authorization letters of clients, filed by the broker are immaterial and I hold the broker guilty of violating the provisions of clause A (5) of Code of Conduct as contained in Schedule II of the said regulations read with Circular no.SMDRP/POLICY/CIR-11/99 dated 7th May, 1999 issued by SEBI.

9.0 **ALLEGATION AND REPLY :**

9.1 As regards the transactions carried out with unregistered sub-brokers and un-registered remisers, the broker vide his letter dated 20.02.2003 submitted that they had not taken any undue advantage by disregarding the guidelines of SEBI and the irregularities, if any, were unintentional and were committed on account of inadvertence. As regards, the transactions carried out with the entities that were not registered as remisers with BSE, the broker submitted that they have already lodged the applications with the BSE for registering all those persons as their remisers and also submitted that the said mistake was unintentional on account of lack of knowledge of procedure.

9.2 **FINDING :**

It is clear that the broker has carried out transactions with un-registered sub-brokers thereby violating the provisions of clause A (5) of Code of Conduct as contained in Schedule II of the said regulations read with circular No. SMD/POLICY/CIR/3/98 dated 16.01.1998, circular No. SMD/POLICY/CIR-11/97 dated 31.03.1997 issued by SEBI. The broker also carried out transactions with un-registered remisers thereby violating the provisions of bye-law No. 218 of Bye laws of BSE read with rule 4 (b) of SEBI (Stock Brokers and Sub Brokers) Rules, 1992 (hereinafter referred to as 'the said rules'). In view of this, I agree with the findings of the enquiry officer in this regard and hold the broker guilty on this count .

10.0 **ALLEGATION AND REPLY :**

10.1 As regards the charge of failure to enter into agreements with the sub-brokers, the broker submitted that agreements with the sub-brokers were entered and the same was submitted to SEBI for grant of certificate of registration to the sub-brokers. He has also submitted copies of the said agreements.

10.2 **FINDING :**

The broker vide his letter dated 20.02.2003 submitted the copies of the agreements entered with sub-brokers specifying the scope of authority and responsibility and rights and liabilities. In view of this, I hold that the broker is not guilty of this charge.

11.0 **ALLEGATION AND REPLY :**

11.1 As regards the delay in making payment as well as making deliveries to clients, the broker submitted that the delay was due to the request made by the clients to keep the amount for pay-in obligations in the subsequent settlements and the letters of the clients to this effect were submitted to the enquiry officer and the enquiry officer accepted the submissions of the broker in this regard. The broker vide his letter dated 20.02.2003 submitted a list of clients stating that those clients have authorised him to retain the securities. The broker vide the said letter also submitted that the names of 10 clients mentioned in the Enquiry Report are the clients of their sub-broker i.e. Kaynet Finance Limited. The broker further submitted that the said 10 clients are not their clients and Kaynet Finance Limited has authorised the broker to withhold the deliveries. The broker also produced the letter from Kaynet Finance Limited clarifying that the 9 clients mentioned in the enquiry report are the client of Kaynet Finance. He has also submitted that one of the said clients, viz., Mr. Dhiren Raja was the proprietor of M/s. Chirag Investments, which has given an authorization letter to withhold delivery of securities beyond the prescribed period. He has also produced a copy of the said letter.

11.2 **FINDING :**

I agree with the findings of the enquiry officer as regards making payment to the clients. However, as regards the charge of committing delay in delivery of securities to the clients, the broker vide letter dated 20.02.2003 submitted that the names of 10 clients mentioned in the Enquiry Report are the clients of their sub-broker i.e. Kaynet Finance Limited. The broker also submitted that the said 10 clients are not their clients and Kaynet Finance Limited has authorised the broker to withhold the deliveries. The broker also produced the letter from Kaynet Finance Limited clarifying that the 9 clients mentioned in the enquiry report are the client of Kaynet Finance. I am not inclined to accept the argument of the broker that the 9 clients mentioned in the enquiry report are the clients of their sub-broker Kaynet Finance Ltd. but not their clients. This argument does not hold good in view of the responsibility cast on the broker in terms of clause No. (12) of the Standard Agreement entered into by the broker with its sub-brokers. Clause No. (12), inter alia, enjoins the broker to inform the sub-broker and keep him apprised about trading / settlement cycles, **delivery** / payment schedules, any changes therein from time to time. In view of this, the contention of the broker in passing on the buck to the sub-broker Kaynet Finance Ltd. is not acceptable and I hold the broker guilty on this count and agree with the finding of the enquiry officer in holding that the broker has violated the provisions of B (1) of Code of Conduct as contained in Schedule II read with regulation 7 of SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 and also the directive No. SMD/SED/CIR-93/23321 dated 18.11.1993 issued by SEBI in this regard.

12.0 **ALLEGATION AND REPLY :**

12.1 As regards the delay in issuing contract notes to the clients, the broker submitted that there were only 7 instances of delay in issuing contract notes to the clients and requested SEBI to exonerate it of the charge since it was a clerical mistake and not an intentional one.

12.2 **FINDING :**

It is clear that the broker had committed delay in issuing contract notes to the clients which is violative of the provisions of clause A (5) of the Code of Conduct as contained in Schedule II of the said regulations read with circular No.

SMD/SED/CIR/93/23321 dated 18.11.1993 issued by SEBI and also the provisions of bye law No. 247 A (4) of Bye laws of BSE read with Rule 4 (b) of the said Rules and I hold the broker guilty on this count.

13.0 ALLEGATION AND REPLY :

13.1 As regards, the failure to report off the floor transactions to the stock exchanges, the broker submitted that the same was not intentional nor they have derived any benefit out of it and submitted that they would be strictly following the guidelines of SEBI in this regard.

13.2 FINDING :

The enquiry officer has not given any finding regarding this charge. However, this charge was pointed out to the broker during the course of hearing held on 09.04.2003 and the broker pleaded for a lenient view in this regard. After examining the material available on record in the inspection report and also in the enquiry report, it is clear that the conduct of the broker in not reporting off the floor transactions to the stock exchange is in violation of the provisions of clause A (5) of Code of Conduct as contained in Schedule II of the said Regulations read with circular No. SMD/POLICY/ CIR-32/99 dated 14.09.99 issued by SEBI. In view of this, I hold the broker guilty on this count.

14.0 CONCLUSIONS :

14.1 In view of the above findings, I am fully convinced that the broker had committed irregularities pertaining to dealing with un-registered sub-brokers, delay in issuance of contract notes and making deliveries to the clients, failure to maintain record of time of placing and executing the order, failure to maintain client registration agreement, failure to ensure continuous preprinted serial numbers on the issued contract notes and failure to report off the floor transactions to the stock exchange.

14.2 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, the Board and the Stock Exchange from time to time as may be applicable to him. In view of the findings as given in paras 4.0 to 13.2, I conclude that the said broker is guilty of having violated,

(a) the provisions of clauses A(5) and B(1) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992,

(b) the condition of registration specified in Rule 4(b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992,

(c) SEBI directives contained in the circulars as found hereinabove.

In view of the same, the said broker is liable for action under regulation 13(1)(b) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

14.3.1 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 said 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.

15.0 ORDER :

15.1 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 four months as recommended by the enquiry officer is reasonable. Therefore, in exercise of the powers conferred upon me by virtue of sub section (3) of section 4 of the Securities and Exchange Board of India Act, 1992 read with regulations 13 (4) and 13 (6) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 I hereby order that the certificate of registration no. INB 011056737 of M/s. Kaynet Capital Ltd., a member of the Stock Exchange, Mumbai be suspended for a period of four months.

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

PLACE: MUMBAI

DATE : 12-Jun-2003

G. N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA