

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER UNDER REGULATION 23 OF THE SEBI (STOCK BROKERS AND SUB-BROKERS) REGULATIONS, 1992 READ WITH REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002

IN THE MATTER OF M/S R.BHAI & Co

1.0 M/S R.BHAI & Co (hereinafter referred to as 'the said broker') is registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a stock broker - SEBI Registration no. INB 012592512 and is a member of the Ludhiana Stock Exchange Association of India Limited (hereinafter referred to as 'the LSE').

During inspection of the books of account, records and other documents of the said broker undertaken by SEBI during January 2001 under Regulation 19(1) of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as 'the said Regulations') following violations were observed :-

- Document Register maintained did not contain particulars of distinctive numbers of securities received and delivered which is in violation of Rule 15(1)(g) of Securities Contracts (Regulation) Rules, 1957 and Regulation 17(1)(g) of the said Regulations.
- Turnover fees, as prescribed had not been paid to SEBI from the year 1994-95 to 1998-99, which is in violation of Rule 4(d) of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 read with Regulation 10 (1) of the said Regulations.
- There had been delays both in making payments as well as in making deliveries to clients which is in violation of clause B(1) of the Code of Conduct of Schedule-II read with Regulation 7 of the said Regulations, 1992 and SEBI Circular SMD/SED/CIR /93/23321 dated 18th November, 1993.
- Contract notes did not bear pre-printed serial numbers which is in violation of SEBI circulars SMD/MDP/CIR/043/96 dated 5th August, 1996 and SMD (B)/104/22775/93 dated 29th October, 1993.
- Order book was not maintained as prescribed, which is in violation of SEBI Circular SMD/POLICY/IECG/1-97 dated 11th February, 1997.
- Transactions had been carried out with unregistered sub Brokers, which is in violation of SEBI Circulars SMD-I/3118 dated 27th December, 1993, SMD/OPG/AA/ 1020/96 dated 14th March, 1996 and SMD/POLICY/ CIR/3-97 dated 31st March, 1997.
- For the year 1999-2000 client registrations were not obtained from 17 of the top 20 clients. For the year 2000-2001 client registrations were not obtained from 8 of the top 20 clients. This is in violation of SEBI Circular SMDRP/POLICY/CIR/5-97 dated 11th April, 1997
- Certain Off-the-floor transactions were carried out which were not reported to LSE.

2.0 After considering the inspection report and the comments of the said broker thereon, it was decided to conduct an enquiry into the affairs of the said broker, in terms of Regulation 28 of the said regulations. Accordingly, vide order dated May 31, 2002, Shri. S.V. Krishnamohan was appointed as an enquiry officer for holding an enquiry into the contraventions by the said broker of the provisions of the rules, regulations and directives as mentioned in the said order.

2.1 The enquiry officer issued a show cause notice dated August 23, 2002 to the said broker under regulation 28 (2) of the said regulations.

2.2 After considering the reply of the said broker and submissions made on his behalf during personal hearing before him, the enquiry officer submitted the enquiry report dated December 31, 2002. In the Enquiry Report the enquiry officer has found as under—

i) Non maintenance of document register : As regards the charge of non maintenance of document register it was submitted that most of the transactions undertaken by the member were in the scrips mandated to be compulsorily in the demat form by SEBI. Only few scrips were traded in physical form and the details of such scrips including distinctive no. etc were mentioned in the bills relating to such transactions. The member had also produced copies of bills which contained the distinctive nos of the scrips.

Although it is true that most of the stocks are now compulsorily traded in demat form, it is nevertheless observed that the member had also transacted in other scrips in physical form. It is shown by the member that he has been issuing bills for the transactions which gives the distinctive no. of shares amongst others. However, this does not obviate the need to maintain the statutory document register showing the distinctive number of shares received and delivered. Non maintenance of document register with the particulars of distinctive number of shares as prescribed is in contravention of Regulation 17(1)(g) of the said Regulations and Rule 15(1)(g) of Securities Contracts (Regulation) Rules, 1957.

ii) Non payment of turnover fees : As regards the allegation that the turnover fees to SEBI has not been paid for the years 1994-95 to 1998-99, it was submitted that the broking firm commenced its operation on 1994 and completed five years in the year 1998 -99.

It was submitted that in terms of SEBI Circular SMD/Policy/cir -07/2002 dated March 28, 2002, the liability of the member would be Rs. 59,690 /- and of this he had already paid Rs. 30,200/- which is more than 50% of the amount payable. It was submitted that the remaining amount would be paid with interest within a period of 2 years as permissible under the aforesaid circular. Copy of the undertaking dated 12.11.2002 with details of turnover and fees payable etc. was filed .

Letter dated 22.11.2002 issued by Ludhiana Stock Exchange was also filed which certifies that the liability of the broking firm towards SEBI fees comes to Rs 59, 385/-. It was further certified that the member had already paid Rs 30, 200 and as such nothing is due from the member on

immediate basis, in view of his undertaking as per SEBI circular dated 28/3/2002. In view of the aforesaid certificate issued by the Stock Exchange and the undertaking dated 12.11.2002 of the member , no adverse inference is drawn against the member.

iii) Delay in making payments to clients : As regards the allegation that the member had delayed payments to clients beyond the permissible period of 48 hours, the show cause notice cites 20 such instances. The member replied that in all these cases, the clients themselves had authorized the member to retain the funds and therefore, his action was within the rules in terms of SEBI circular SMD/SED/Cir/93/23321 dated 18/11/93. It was further claimed that such requests in original obtained from the clients were also produced by the member to the inspection team. On perusal of such authorization letters, it is noticed that in respect of the following clients where there is delay in making payments, the necessary letters have authorized the broker to retain the funds since they were regularly dealing with him.

Client name	Amount	Pay in date	Payment to client
Davinder Kr. Jain & Sons	27,200	22.11.99	20.12.99
Jasbir Singh & Sons	45,870	10.01.00	07.02.00
Ram Swaroop Kapoor	60,500	18.10.99	16.11.99
Rajinder Nath Bajaj	51,600	31.05.99	23.06.99
Sakattar Lal Jain	47,125	10.01.00	23.02.00
Vijay Kumar	5,575	12.11.99	02.12.99
Harsh Chander Kaura	19,925	15.07.00	17.08.00
Pramod Jain	45,425	07.10.00	14.11.00
Sushma Jain	49,770	06.05.00	02.06.00

Since , it is for the benefit of the investor that the proceeds need to be paid to him with two days as per SEBI guidelines , it is concluded that the investor in the aforesaid cases by giving such letters of authorization to the broker to retain the proceeds has waived the right to receive the proceeds within two days and therefore, it cannot be said that the broker had violated SEBI 's circular dated November 18, 1993 on the subject, since the said circular itself permits the broker at the request of the client to retain the funds beyond 48 hours. This can be inferred from the words " unless the client has requested otherwise" in the said circular.

However, it is noticed that in respect of the following clients, no such letters purporting to authorize the broker to retain the funds with him beyond the permissible period of 48 hours were filed.

Client name	Amount	Pay in date	Payment to client
Jatinder Kumar	10,875	10.01.00	09.03.00
Amit Takkar	60,800	10.01.00	09.03.00
Anil Kr. & Sons	31,700	18.10.99	16.11.99
Dinesh Kr Aggarwal	12,582.50	29.10.99	28.01.00
Janak Rani	24,640	10.01.00	01.03.00
Neelu Rani	20,700	10.01.00	01.03.00
Neeru Jain	49,150	24.05.99	08.12.99
Nirmal Kapoor	80,200	10.01.00	14.02.00
Neelam Mohindra	35,992	27.01.00	24.02.00
Rajinder Lal	20,600	24.12.99	07.02.00
Vipin Kumar	25,250	29.11.99	28.03.00

In view of the above, it is established that to the extent of the aforesaid transactions , the broker had delayed payments to clients beyond the permissible period of 48 hours which is in contravention of SEBI circular dated 18.11.93 on the subject.

iv) Delay in delivery of securities : As regards delay in delivery of securities to the client , the show cause notice cites six such instances where there is a delay of more than 48 hours in delivery of securities to the clients. This includes one case of AP Jain where the securities were not delivered till the date of inspection. It was contended by the member that in all these cases, the clients themselves had authorized the broker to retain the securities as they stated to have regular dealings with him. Since it is for the benefit of the investor that the securities need to be delivered to him within two days of the payout, it can be concluded that the investor by giving a letter of authorization to the broker to retain the securities has waived the right. It therefore cannot be said that the member had violated the SEBI circular dated SMDRP/Policy/ Cir/11-99 dated May 7, 99 in these cases, except in the case of Rajiv Bajaj where there was a delay of nearly one month in delivering 200 shares of Reliance Industries. Similarly in the case of AP Jain where 200 shares of Telco was not delivered till the date of inspection although the date of transaction was 12.06.2000 and there was no material to suggest that the actual delivery had taken place even on the date of the enquiry proceedings notwithstanding his letter dated Nil purported to be authorizing the member to retain the shares. Save these two transactions, the member had complied with the provisions of circular dated 18.11.93 in respect of other 4 transactions where there is delay in delivery of securities.

v) Contract notes did not bear pre-printed serial nos.: As regards the allegation that the contract notes did not bear pre-printed serial nos, the same was denied and it was submitted that since all the contract notes were issued to the clients within 24 hour of execution of the contract there was no possibility of insertion of any contract note at a later date. It may be noted that as per the inspection report the member is affixing the serial no of the contract by way of a rubber stamp. Such procedure is not strictly in accordance with SEBI circular dated 5.08.96 and 29.10.93 which stipulate that the contract notes should bear pre-printed serial nos.

vi) Non maintenance of order book: As regards non maintenance of order book, it was submitted that all orders were received and immediately entered into the trading system and as such there was no time gap between the time when the client placed the order and when the order was placed in the system. Although it was claimed that both time of placement of order and time of execution are being reflected in the contract notes and the member undertook to submit a sample copy of the contract notes in this regard, no such sample copy was filed. It may be relevant to note that time stamping of orders received was made mandatory vide SEBI circular dated 11.2.97, the provision for time stamping was incorporated in the VECTOR system of the exchange only on 27.1.98 and the members were asked by the exchange vide notice dated 10.04.98 to incorporate the same in their respective software by April 30, 1998. The inspection report states that the member had a large no of transactions on a principal to principal basis and was not maintaining record of time of placing the order by the client nor did he reflect the same in the contract note alongwith the time of execution of the order. No material was brought forward by the member to suggest that the contract notes issued by him reflects both the time of placement of order as well as the time of execution of order. In view of the above, it is established that the member has contravened the provisions of SEBI circular dated 11.02.1997 regarding time stamping of orders.

vii) Transactions with Neelkanth Investments Ltd. :- With regard to the allegation that the member had dealt with Neelkanth Investments Ltd, an unregistered sub broker, the member replied that M/s Neelkanth Investments was his client and as such is not required to be registered with SEBI as sub broker. Vide his letter dated 22.11.2002 it was informed that two delivery based transactions took place between the broker and Neelkanth Investments and that too in the account of Ms Richa Bajaj who is the proprietor of the said firm. Statement of demat account of Richa Bajaj was filed to show that she did not further deal with any other client. It was further submitted that there was no delivery based transactions between the member and the Neelkanth Investment from April 2000 to March 2001. Taking into account the fact that much of the delivery based trading with Neelkanth Investments was with Mrs Richa Bajaj who is the proprietor of the said firm on proprietary account and the demat account copies account does not show that the shares were transferred beyond her account and the fact that there was no delivery based trading between the member and Neelkanth Investments from April 2000 to March 2001, there is no material to suggest that the member in his dealings with Neelkanth Investments was dealing with an unregistered sub broker.

viii) Non obtention of client registration forms: With regard to the allegation that in the year 1999 -2000, client registration was not obtained from 17 of the top 20 clients and for the year 2000-01 from 8 of the top 20 clients. The member was able to register some of his clients during 1999-2000 and 2000-2001. he further submitted that he has since discontinued dealing with those clients who did not register as clients from July 2001 onwards.

Client identification is important since that makes it easier for the audit trail to identify the clients behind the transactions. Details like bank account, PAN number, introducer etc would establish the credentials of the clients and would be relevant to determine whether the member had acted in good faith and without negligence before doing business for a client. Not filling up of the client registration forms properly or non maintenance of the same is in contravention of SEBI Circular SMD-1/ 23341 dated 18th November,1993, SMD/POLICY/IECG/1-97 dated 11th February, 1997 and SMD/POLICY/Cir/5-97 dated 11th April, 1997.

viii) Off the floor transactions : As regards off the floor transactions ,the show cause notice cites 10 such transactions , the member replied that the exchange had asked the brokers to report all the spot transactions with the members of other Stock Exchanges on a floppy. It was further stated that the member had not undertaken any spot transactions and transactions with members of other Stock Exchanges during the period of inspection. Principal to principal transactions were not reported to the exchange as the exchange notice did not mention reporting of such transactions.

It was admitted by the member that these transactions were not executed in the electronic trading system of the exchange. As per SEBI circular dated 14.09.1999, off market transactions including cross deals were not permitted except on the screens of the stock exchanges, since, they are not transparent and do not contribute to the price discovery process on the stock exchange mechanism. These transactions are therefore not in conformity with the SEBI circular cited on the subject.

2.3 Since SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as Enquiry Proceeding Regulations) came into force from 27.9.2002, the Enquiry Officer submitted his report in terms of the Enquiry Proceeding Regulations. In view of the facts and findings as recorded in the enquiry report, the enquiry officer in terms of Regulation 13 (1)(a) of the Enquiry Proceedings Regulations recommended a minor penalty of suspension of certificate of registration for a period of three months.

3.0The enquiry report was considered and in terms of Regulation 13(2) of the Enquiry Proceedings Regulations, a show cause notice no. SMD/DBA-I/Enq/AM/3244/2003 dated February 07, 2003, was issued to the said broker enclosing therewith a copy of the enquiry report calling upon it to show cause as to why the penalty as recommended by the enquiry officer should not be imposed upon it. It was also advised to reply to the same together with the documents if any, that it may choose to rely upon in support of its reply, within 15 days of the receipt of the same, failing which it would be presumed that it has no explanation to offer. The said broker was also advised to intimate its desire of personal hearing along with its reply.

3.1The said broker vide its letter dated February 25, 2003 submitted its reply. In its reply the stock broker has generally reiterated its submissions made before the Enquiry Officer. The said broker has made following additional submissions as under:

Regarding delayed payments to clients, the said broker submitted that "since the clients had stopped trading, consent in writing could not be collected." The said broker furnished the consent letters with the reply to the show cause notice.

Regarding delayed deliveries to clients, the said broker submitted the written consent of Rajiv Bajaj and stated that written consent in case of AP Jain was already submitted to SEBI.

3.2An opportunity of personal hearing was granted to the said broker on 8.05.2003. During the hearing the said broker reiterated its submissions made earlier.

4.0 Findings –

I have taken into account the facts and findings recorded in the enquiry officer's report and submissions of the said broker and the material available on record. My findings are as under –

4.1. Order Book not maintained

As per Clause B (1) of the Code of Conduct as specified in Schedule II read with Regulation 7 of the said Regulations, it is the obligation of a stock broker that he faithfully executes the orders for buying and selling of securities for clients at the best available market price. The time when the order is placed and the time when the order is executed is very important. The trading system at the stock exchange can only show the time of execution of the order and not the time when the order was placed by the client. The order book is necessary for establishing as to when the order was placed and also the facts as mentioned above namely the name of the client, description and value of securities, terms and conditions of the order etc. These particulars are important to ascertain as to whether the stock broker had acted faithfully with the client, had acted with due skill and care etc. Vide SEBI circular no. SMD/POLICY/IECG/1-97 dated 11.2.97, it was stipulated that the broker member broker should maintain record of time when the client has placed the order and reflect the same in contract note along with the time of execution of the order. The submissions of the said broker that the orders received from the clients were entered into the VECTOR Trading System of the Exchange and as such there is no time gap between the time when the client has placed the order and the time when the order was entered into the system is not a sufficient and satisfactory reason/explanation for not maintaining the order book showing the particulars mentioned above. Therefore, I find that the said broker has not maintained the order book and has violated the above mentioned SEBI circular no.SMD/POLICY/IECG/1-97 dated 11.2.97.

4.2. Document Register not maintained

Rule 15(1) (g) of the Securities Contracts (Regulation) Rules,1957 states that every stock broker is under an obligation to maintain and preserve the Document Register showing full particulars of shares and securities received and delivered. Regulation 17(1) (g) of the said regulations also requires maintenance of the said document register. I agree with the finding of Enquiry Officer that issuance of bills relating to the transactions containing the distinctive number of the scrips does not obviate the need to maintain the statutory document register showing the distinctive number of shares received and delivered. The said broker is held liable for violation of the above mentioned Rules & Regulations, since he has admittedly failed to maintain the document register.

4.3. Delay in delivery of securities to clients

The Enquiry Officer has concluded that the said broker had complied with the provisions of circular dated 18.11.93 in respect of 4 transactions where there was delay in delivery of securities. About the remaining two viz. Rajiv Bajaj and A P Jain also, the said broker has submitted the consent letter from Rajiv Bajaj and consent letter of A P Jain to SEBI. Since the consent letters of the clients have been obtained in all the 6 cases pointed out in the Inspection Report, I am inclined to take a lenient view and drop this charge against the broker.

4.4. Delay in payment to Clients

The said broker has vide his reply dated 25.2.2003, submitted that the funds standing in the credit of the clients mentioned in the show cause notice had been retained with their consents. Since they had stopped trading through it, it could not collect the consent in writing from them. They have, however, collected the said consents in writing and sent them to SEBI with the reply. I agree with the findings of Enquiry Officer that since it is for the benefit of the investor that the proceeds need to be paid to him within two days as per SEBI guidelines, it can be concluded that these investors by giving such letters of authorization to the broker to retain the proceeds have waived their right. Now written consents from all the clients listed in the inspection report have been obtained. I, therefore, take a lenient view and drop this charge against the said broker.

4.5. Contract note do not bear pre-printed serial numbers

I agree with the findings of the Enquiry Office that rubber stamping of serial numbers on the contract notes is not in accordance with SEBI circulars dated 5.8.96 and 29.10.93 which stipulate that the contract notes should bear pre-printed serial numbers. The serial numbers should either be pre-printed or computer generated but having continuous serial numbers for the entire financial year. I hold the said broker guilty of contravention of SEBI circular no. SMD/MDP/CIR/043/96 dated 5.8.96 wherein it was stated that a serious view would be taken if such a deficiency was observed during the course of future inspection of the brokers by SEBI.

4.6. Irregularities in maintenance of Client Data Base

I agree with the findings of the enquiry officer that maintenance of client registration forms and client agreement forms is important. They are required to be maintained in respect of each client. Client identification is important since that makes it easier for the audit trail to identify the clients behind the transactions. Details like bank account, PAN number, introducer, etc would establish the credentials of the clients and would be relevant to determine whether the member had acted in good faith and without negligence before doing business for a client. As has not been disputed the said broker has not obtained client registration for 17 of the top 20 clients in 1999-2000 and for 8 of the top 20 clients in 2000-01. Non filling up of the client registration forms properly or non- maintenance of the same is a contravention of SEBI Circular SMD/POLICY/Cir/5-97 dated 11th April, 1997 for which the said broker is held liable.

4.7. Off the Floor transactions not reported to the Exchange

Ten such instances were cited in the show cause notice to the said broker. The broker had replied that these were not reported to the stock exchange as the LSE circular no. LSE/97/6199 dated 25.7.97 required reporting of all the spot, transactions and off the floor transactions with the members of other stock exchanges. It was further stated that the broker had not undertaken any spot transactions and transactions with members of other stock exchanges. Principal to Principal transactions were not reported to the stock exchange, as it was not required by the LSE notice. I agree with the findings of the Enquiry Officer that these transactions were not in conformity with the SEBI circular dated 14.9.99

which requires that off market transactions including cross deals were not permitted except on the screens of the stock exchanges, and hold the broker guilty of violation of the said circular.

- 5.0 In view of the above observations I find that the said broker is guilty of having violated the provisions of clauses A(5) and B(1), of the Code of Conduct as specified in Schedule II read with Regulation 7 of the Regulations and Rules 4(b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992, rule 15(1) (g) of the SC(R)R, regulation 17 (1) (g) of the said regulations, LSE Bye-laws and SEBI directives contained in the circulars as found hereinabove. In view of the same, the said broker is liable for action under regulation 25 and 26 of the said regulation read with regulations 13 (1) (b), 13(6) read with regulation 23 of the SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.
- 5.1 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. These requirements of contract notes, time stamping etc are the requirements which SEBI has put in place for the purpose of investor protection and to remove certain mala fide practices. Further the requirements regarding prohibiting off the floor transactions are provided as a measure of risk containment and to provide for transparency and fairness in the transactions. The requirements regarding maintenance of records etc. have been mandatorily provided to ensure that the business and conduct of the intermediaries are undertaken on the basis of sound business principles and to ensure that the regulator can regulate the business of stock brokers through inspections / enquiries.
- 5.2 It is to be noted 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 the stock Exchange shall adhere to the bye-laws of the Exchange. 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.
- 6.0 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. 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 is reasonable in view of the above facts and violations committed by the said broker. 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 regulation 29(3) of the said regulations I hereby order that the certificate of registration of M/s R. Bhai & Co.- SEBI Registration no. INB 012592512, a member of the Ludhiana Stock Exchange Association of India Limited be suspended for a period of 3 months.
- 7.0. The certificate of registration of M/s. R Bhai & Co., Member of LSE Securities Ltd. which the said broker enjoys by virtue of his membership of LSE, shall also be suspended concurrently. This order shall come into effect after three weeks from the date of this order.

DATE : June 25 , 2003

PLACE : MUMBAI

G.N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA