

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER UNDER REGULATION 23 OF 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 NLM Capital Services Limited.**

1.0 **M/S NLM Capital Services Limited.** (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 12756135 and is a member of the Ludhiana Stock Exchange Association of India Limited (hereinafter referred to as 'the LSE').

1.1 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 :-

1. Transactions had been carried out in other exchanges through members, without being registered as sub-broker, which is in violation of Section 12 of the SEBI Act, 1992, Rule 3 of SEBI (Stock Brokers & Sub-Brokers) Rules, 1992 (hereinafter referred to as the "Rules") and SEBI Circular SMD/Policy/Cir-3/98 dated 16th January, 1998.
2. Document Register maintained did not contain particulars of distinctive numbers which is in violation of Rule 15(1)(g) of Securities Contracts (Regulation) Rules, 1957 and Regulation 17(1)(g) of the said Regulations.
3. Turnover fees, as prescribed has not been paid to SEBI for the years 1994-95 and 1995-96, which is in violation of Rule 4(d) of the said Rules read with Regulation 10 (1) of the said Regulations.
4. There had been delays both in making payments and deliveries to clients which is in violation of B(1) of the Code of Conduct of Schedule-II read with Regulation 7 of the said Regulations and SEBI Circulars SMD/SED/CIR/93/23321 dated 18th November, 1993 and SMDRP/POLICY/ CIR-11/99 dated 7th May, 1999.
5. Contract notes did not bear pre-printed serial numbers which is in violation of SMD/MDP/CIR/043/96 dated 5th August, 1996.
6. Client data base and registration was not maintained as prescribed, which is in violation of SEBI Circulars SMD/POLICY/IECG/1-97 dated 11th February, 1997 and SMDRP/POLICY/CIR/5-97 dated 11th April, 1997.
7. Transactions had been carried out with unauthorized and unregistered sub Brokers, in violation of SEBI Circulars SMD-I/3118 dated 27th December, 1993 and SMD/POLICY/CIR/3-97 dated 31st March, 1997.
8. Cross deals between clients had been transacted outside the dealing system. This is in violation of SEBI Circular SMDRP/POLICY/CIR-32/99 dated 14th September, 1999, which prohibits cross deals.
9. Margin money was not collected from clients which is in violation of SEBI Circular SMDRP/Policy/Cir-35/98 dated 4th December, 1998.

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 July 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.

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

4.0. After considering the reply of the said broker and submissions made on its behalf during personal hearing before him, the enquiry officer submitted the enquiry report dated November 30, 2002. In the Enquiry Report the enquiry officer has found as under —

4.1. Acting as unregistered sub brokers

As regards the allegation that the member has acted as unregistered sub broker for 3 NSE members, 3 BSE brokers and one CSE broker as detailed in the show cause notice, the member replied that as the depth and spread of LSE was lower compared to NSE, BSE and CSE, he conducted certain transactions on these exchanges but as a client where most of the transactions were on proprietary account. It was submitted that transactions on behalf of the clients were undertaken only after he became member of NSE through the subsidiary of LSE. Out of the 7 transactions as pointed out in the inspection report which the member has conducted through SG Stock Services Ltd. – NSE, 3 transactions are on proprietary account, the rest are for clients. The details of the transactions that the member had undertaken as unregistered sub brokers with member of other stock exchanges have not been furnished. In the absence of these details, it would be difficult to hold that the member had acted as unregistered sub broker of these other members and his reply that these transactions were on proprietary account may be accepted.

However, in the case of SG Stock Services Ltd. Member of NSE, the member had conducted 4 transactions in the year 2000 as stated in the inspection report and charged commission from the clients.

It is, therefore, concluded that in respect of these transactions on NSE, the member had acted as unregistered sub broker of SG Stock Services Ltd., NSE, which is in violation of Section 12 of SEBI Act, Rule 3 of the said Rules and SEBI Cir SMD/POLICY/CIR-3/98 dated 16/01/1998.

4.2. Non maintenance of document register

As the regards the charge that the member did not maintain document register with particulars of distinctive numbers, it was replied that majority of the deals are in the demat mode and complete details of distinctive numbers are mentioned in the bills relating to such transactions. Even if the member is mentioning the details of distinctive numbers of the scrip on the bill, he is nevertheless required to enter the same in the document register to be maintained for the purpose.

Document register is one of the statutory books that have to be mandatorily maintained as per Rule 15(1)(g) of Securities Contracts (Regulation) Rules, 1957, and Regulations 17 1(g) of the said Regulations. However, the fact that the distinctive number of the scrips were mentioned on the bills may be taken as the mitigating factor.

4.3. Turnover fees

As regards non payment of turnover fees for the years 1995-1996, it was submitted that earlier it was a sole proprietorship firm which was later on converted into a corporate entity in the year 1995 in the name of NLM Capital Services Ltd. It was further submitted that they have paid Rs.81,605 as fees to SEBI between 1992 and 1998. Rs.5000 was paid on 28/9/2000 and the balance to be paid was Rs.29,240/- which the member undertook to pay within 15 days. Accordingly, the member, vide his letter dated 11/10/2002 has forwarded the draft for the payment of Rs.29,242/-.

In view of the above, and in the absence of any particulars regarding the actual amount which was due and not paid by the member, no adverse finding is given against the member on this allegation. However, if the member had defaulted in paying the requisite fees to SEBI, it is open for SEBI to follow the summary procedure under the SEBI(Procedure for holding enquiry by enquiry officer and imposing penalty)Regulations, 2002 and deal with the same.

4.4. Delay in making payments and delivery of securities to the clients

In 9 instances, it was alleged that there was delay in delivering securities. In all these cases, the delay was beyond the permissible period of 48 hours. The member replied that in respect of all the clients, where funds were payable or securities are to be delivered, they were retained at the request of the clients either to meet the margin money or for future sales. Letters from the clients in this regard are enclosed.

Since it is for the benefit of the investor that the securities need to be delivered to him within 2 days of the pay out, it can be concluded that the investor by giving a letter of authorization to the broker to retain the securities for future sale has waived the right to receive the same within 2 days. It is, therefore not established that the member has violated code of conduct, clause B(1) under Regulation 7 of the said Regulations and SMDRP/POLICY/CIR/11-99 dated 7th May, 1999.

As regards the delay in making payments to the clients, there were 14 such instances as pointed out in the show cause notice where there was delay in making payment. In one case, the payment has not been made. The member has produced authorization letters etc. in support of his contention that the delay in payment was due to the instructions of the client to withhold payments and to release/adjust against future margin money/ pay-in. Letters from all the five clients in this regard were furnished.

Since it is for the benefit of the investor that the proceeds need to be paid to him within 2 days, it can be concluded that the investor by giving a letter of authorization to the broker to retain the proceeds towards margin requirements has waived the right to receive the proceeds within 2 days.

However, in the case of Ms.Jasbir Kaur, it is observed that the amount to be paid is outstanding even as on the date of inspection. No material has been brought forward by the member to suggest that this amount has been paid even as on the date of enquiry. Therefore, in the case of Ms.Jasbir Kaur, it is established that the member has not paid Rs.57,583/- since 12/01/2000 till date which is highly irregular and against the directions of SEBI that the payments have to be made within 48 hours from the pay in date.

4.5. Contract notes did not bear pre printed serial number

Although the member was issuing contract notes with continuous serial number, they are not pre printed and instead he is using a rubber stamp for the purpose. Though, this is not strictly in conformity with the requirement of Circular dated 5/8/1996, a lenient view may be taken.

4.6. Client database and registration not maintained

The reply of the member that in the cases listed in the show cause notice, client database was not maintained as the clients were not willing to provide the personal information, is not satisfactory.

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

4.7. Dealing with other unregistered sub brokers

As regards the allegations that the member has transacted business through unregistered sub-brokers, it was replied that, they were all clients having dealings with the firm in individual capacity and therefore, did not require registration. However, it may be stated that the inspection report states that the trading pattern and volume of business of these entities are indicative of their being the sub brokers of the member. The member has not replied satisfactorily on this ground with figures of trade. Having regard to the trading pattern and volume of business as stated in the inspection report, there is high preponderance of probability that atleast in cases of investment firms such as high growth Investment, HK Investments, Multi Investments, HS Investments, they are unregistered sub brokers dealing with ultimate clients. However, benefit of doubt is given to the member in respect of others who are individuals and they may not be acting as unregistered sub brokers.

4.8. Cross deal and non collection of margin from clients

As regards the allegations of a cross deal on 29/5/2000 in the scrip of Swam Software between his clients LK Gupta, seller and AK Bathla, buyer, it was replied that the seller wanted to sell the shares after trading hours and A K Bathla being the director of the company, purchased these shares for an amount of Rs.2,280/- @ Rs.11.40/- per share which was a prevailing market per day, the contract note being issued on principal to principal basis, a lenient view may be taken with regard to the solitary instance for 200 shares.

As regards non collection of margins from Asha Goyal for the purchase of 500 shares of Silverline vide contract dated 13/09/2000, it was replied that the amount of margin recoverable was less than Rs.1,00,000/- stipulated by SEBI and as such the margin was not collected. It may be noted that as per SEBI Circular, SMDRP/POLCIY/CIR-35/98 dated 04/12/1998, it shall be mandatory for member brokers to collect margins from clients in all cases where the margin in respect of the client in the settlement would work out to be more than Rs.50,000/- However, taking into account, that this was a solitary transaction where the client was known to the member and the payment was duly received and share duly delivered, a lenient view may be taken.

5.0 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 Office 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.

The enquiry report was considered and in terms of Regulation 13(2) of 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.

The said broker vide its letter dated February 28, 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 Jasbir Kaur owed him Rs.32017/- as on 17.1.2001 and Rs.72017/- as on 31.3.2001. It is stated that she makes two or three transactions in a year and deals exclusively through him.

Regarding irregularities in the maintenance of client data base the said broker has admitted not having client registration forms for three clients as they were not willing to produce the personal information. For the remaining 10 clients the said broker has submitted the forms with the reply.

An 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.

6.0 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 –

6.1. Dealing as unregistered sub-brokers:

In terms of SEBI Circular No. SMD/Policy/CIR-3/98 dated January 16, 1998, members of stock exchange who are acting as sub-brokers through the members of other exchanges should obtain certificate of registration from SEBI to act as sub-broker under the said regulations. By not registering himself as a sub-broker, but acting as such in the 4 transactions conducted through SG Stock Services Ltd. in 2000, which have not been disputed, I find that the broker is guilty of having violated the provisions of Section 12(1) of the SEBI Act read with Rule 3 SEBI (Stock Brokers and Sub-brokers) Rules, 1992 as well as the above mentioned SEBI directives and provisions of C(4) of Code of Conduct of sub-brokers specified under Regulation 15 of the said Regulations and A(5) of the Code of Conduct of Stock brokers specified under Regulation 7 of the said Regulations.

6.2 Document register not maintained properly

As per Rule 15(1) (g) of the Securities Contracts (Regulation) Rules, every stock broker is under an obligation to maintain and preserve the Document Register showing full particulars of shares and securities received and delivered which has not been done by the said broker during the inspection period. Regulation 17(1) (g) of the said regulations also require maintenance of the said

document register. I find that these provisions require inclusion of particulars of shares/securities. Such particulars of shares /securities definitely include distinctive number of the securities. In view of these statutory provisions, I find that the submission of the said broker that majority of the deals are in demat mode and complete details of distinctive numbers are mentioned in the bills relating to such transactions is not maintainable and hence rejected. I disagree with the findings of the Enquiry Officer to take a lenient view of this violation.

6.3 Turnover Fees

I observe that on the question of payment of turnover fees, the enquiry officer has not given any findings in the absence of any particulars regarding the actual amount which was due and not paid by the said broker. Instead, he has referred to Regulation 15(b) of the Enquiry Proceedings Regulations, in terms of which summary proceedings can be initiated for non payment of registration fees. As the said broker has stated to have paid 50% of the total fees, and agrees to pay the balance within two years alongwith interest, I do not see any necessity for any action at this stage in respect of the above.

6.4. Delay in making payment and delivery of securities to Clients

It is noted that regarding the payments due to one of the investors, Ms. Jasbir Kaur the said broker has submitted that she makes two or three transactions in a year for sale/purchase of shares. She has complete faith on the said broker and deals exclusively through him. On the date of inspection an amount of Rs.32017/- was due from Ms. Jasbir Kaur to the said broker and as on 31.3.2001 Rs.72017/- is stated to be due from her. However, I find that the Enquiry Officer has not given any definite finding in respect of the above. I therefore do not take any action in respect of the above, in the absence of availability of authenticated facts. Regarding the rest of the 13 instances of late payment of funds, the Enquiry Officer has observed that the funds were stated to be retained with the consent of the clients. Regarding delay in delivery of securities also the Enquiry Officer has found that consent letters have been filed in all the 9 cases, as pointed out in the Inspection Report. Therefore, I drop this charge against the broker.

6.5. 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. Non filling up of the client registration forms properly or non- maintenance of client database which has been established in the present case in respect of three clients is a violation of SEBI Circular SMD-I/23341 dated 18th November, 1993, SMD/Policy/IECG/1-97 dated 11th February, 1997 and SEBI Circular SMD/POLICY/Cir/5-97 dated 11th April, 1997 for which the said broker is hereby held liable.

6.6. Dealing with unregistered sub-broker

As regards the allegation that the broker has transacted business through unregistered sub-brokers, the said broker has replied that they are all clients having dealings with the firm in individual capacity. I agree with the findings of the Enquiry Officer that the said broker has not replied satisfactorily on the issue raised by Inspection report that the trading pattern and their volume of business is indicative of their being sub-brokers of the said broker. Though the benefit of doubt can be given to the said broker with respect of entities who are individuals, the same can not be said about the high investment firms. I agree with the Enquiry Officer that there is high preponderance of probability that high investment firms such as H K Investments, Multi Investments, H S Investments are unregistered sub-brokers dealing with ultimate clients.

Vide circular No. SMD/POLICY/CIRCULAR/3-97 dated March 31, 1997 it has been directed that no broker shall deal with a person who is acting as a sub broker unless he is registered with SEBI. It shall be the responsibility of the broker to ensure that his clients are not acting in the capacity of sub-brokers unless they are registered with SEBI as sub brokers or recognized by the stock exchange as remisers. Further, vide circular No. SMD/ POLICY /CIR-/03/98 dated January 16, 1998 the stock brokers were advised to obtain certificate of registration to act as a sub-broker through the members of other exchanges. I find that the said broker has violated the mandatory requirements of SEBI circulars as recorded by the enquiry officer. It is the obligation of the stock brokers to ensure that they do not deal with unregistered sub-brokers.

6.7 Regarding the remaining violations pointed out in the inspection report viz. cross deals between clients, margin money not collected from clients. Enquiry Officer has taken a lenient view since there were solitary cases in both violations. I agree with the findings of the Enquiry Officer and am not taking a serious view of the same.

6.8 However, I disagree with the findings of the Enquiry Office with respect to acceptability of rubber stamping of serial numbers on the contract notes. The serial numbers should either be pre-printed or computer generated but having continuous serial numbers for the entire financial year as this requirement is mandated to prevent back dated insertion / issue of contract notes. 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.

7.0. 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 said Regulations, Rule 4(b) of the said Rules, Rule 15(1) (g) of the Securities Contracts (Regulation) Rules, 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 of the said regulations read with Regulations 13 (1) (a), 13 (4) and Regulation 23 of the SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002.

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. 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.

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.

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 13(4) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby order that the certificate of registration of M/s NLM Capital Services Limited - SEBI Registration no. INB 12756135, a member of the Ludhiana Stock Exchange Association of India Limited be suspended for a period of 3 months.

8.0. The certificate of registration of M/s. NLM Capital Services Limited, sub-broker 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 :27.6. 2003

PLACE : MUMBAI

G.N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA