

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER UNDER REGULATION 13 (4) READ WITH REGULATION 13 (6) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002**IN THE MATTER OF M/S CHONA FINANCIAL SERVICES PVT. LTD.**

1.0M/s.Chona Financial Services Pvt. Ltd. (hereinafter referred to as 'the said broker') is registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a broker - SEBI Registration no. INB 230754330 and is a member of the National Stock Exchange of India Limited (hereinafter referred to as 'the NSE').

1.1During inspection of the books of account, records and other documents of the said broker undertaken by SEBI from April, 1998 to December, 1999 conducted in January 2000 under Regulation 28(1) of the SEBI(Stock Brokers and Sub Brokers) Regulations, 1992 (hereinafter referred to as 'the said Regulations') following violations were observed :-

- Delay in making payments and deliveries to the clients;
- Contract notes did not bear pre-printed serial numbers;
- Client Registration and Client data base was not maintained;
- Dealing with un-registered sub-brokers;
- Following irregularities in maintenance of contract notes -
 - Time stamping of orders not done,
 - Delay in issue of contract notes,
 - Duplicate contract notes do not bear client acknowledgement,
 - Stamp duty has not been affixed as prescribed,
- Non-segregation of clients funds and own funds and misutilisation of client account;
- Default in paying margins to the NSE.

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 25.6.2002 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.

2.1The enquiry officer issued show cause notices dated 31.07.2002 and 25.10.2002 to the said broker. 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 February 28, 2003. Since SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty), Regulations, 2002 (hereinafter referred to as 'Enquiry Proceedings Regulations') commenced on 27.09.2002, the enquiry officer has completed the proceedings and recommended the penalty under the said Enquiry Proceedings Regulations. In view of the facts and findings as recorded in the enquiry report, the enquiry officer, in terms of Regulation 13 (1) b) of Enquiry Proceedings Regulations, recommended that the certificate of registration of the said broker be suspended for a period of four months.

2.3 In the enquiry report the enquiry officer has found the said broker having violated the requirements in respect of the following requirements alongwith his findings as under-

(i) Delay in making payments to clients – It was found that the said broker had been obtaining "standing instructions" from the clients in the application form itself to retain the monies of the clients in the clients account till such time he makes a request for it. The said clause reads as under :-

"It is my/our request to you that unless and until I/we requests full or part payment thereof, my credit balance in my/our account may please be retained with you in my / our account itself and adjusted towards impending margins, bad deliveries, dues or further purchases, positions that I / we may undertake. If any payment requested by me / us is not received by me/us upon request on or after due date, I / we shall inform you Registered Office at Chennai by registered post."

The Enquiry Officer has found that the general rule as specified in SEBI Circular read with Clause B (1) of the Code of Conduct as specified in the said Regulations is that the broker has to make payments in respect of securities sold to clients within 48 hours unless a client request otherwise. Thus the exception in respect of specific request from the client. However, in this case the exception has become a rule as the broker has obtained a general consent by way of universal application in an standard format. If the submissions of the said broker is accepted, it would lead to anomalous situation where each client has to make a demand for receipt of the funds. Such situation would defeat the objective of the SEBI Guidelines.

(ii) Dealing with unregistered sub-brokers – The said broker has carried out transactions with unregistered sub-brokers during the period of inspection in respect of the twelve instances listed in the Show Cause Notice issued by the Enquiry Officer.

The said broker is not in order in transferring the shares to the third party account at the request of the brokers of the Madras Stock Exchange. Under the circumstances of the case it can reasonably be expected that the said broker had

knowledge about those brokers. The details filed by the said broker along with his letter dated 20.9.02 before the Enquiry Officer show that M/s.Champak & Co. had large share transactions with the said broker. Having regard to the volume of transactions of said M/s.Champak & Co. who is also a member of Madras Stock Exchange and one of the top 20 clients of the said broker, the said broker should have acted diligently when request were coming from M/s.Champak & Co. to transfer shares to others which possibly means that M/s.Champak & Co. is trading on NSE through the said broker for his ultimate clients. Therefore, there is high preponderance of probability that M/s.Champak & Co., a member of Madras Stock Exchange was acting as unregistered sub-broker of NSE through the said broker.

(iii) Violations in respect of contract notes –

- a. Record of time of placement of order by client was not maintained – the time of placement of order by the client and time of placement of order by the broker in the system of exchange are two different things. There is no material found by Enquiry Officer to suggest that the said broker was maintaining record of time when the clients has placed the order. Therefore, it has violated SEBI Circular dated 11.2.97.
- b. Delay in issuance of contract notes to clients – the contract notes were dated 28.12.99 and the due date of delivery was 29.12.99. As on the date of inspection on 30.12.99 the broker was retaining 35 contract notes dated 28.12.99. Therefore on the date of inspection there was a delay of more than 24 hours in those instances.
- c. Deficit stamp duty on contract notes – the Enquiry Officer has not found any material to suggest that the Inspecting Officials were informed about the affixation of the stamps in the continuing sheet as claimed by the said broker. All the transactions in this regard as cited in the Inspection Report, are dated 29.12.99 and on spot verification, the Inspectors have found deficit stamp duty affixed by the said broker on the contract notes. Therefore the said broker has violated SEBI Circular no.SMD/MDP/Cir/043/96 dated 5.8.96.
- d. Duplicates of the contract notes do not bear client acknowledgment – the said broker had submitted that it did not obtain acknowledgment of the clients on the duplicate of the contract notes since it was apprehended that a duplicate contract note may not be returned by the client or may be lost in the transit. The said broker had claimed that he had maintained acknowledgement of contract notes in the form of a contract register book and proof of delivery is obtained from courier for outstation clients and filed. As per SEBI Circular SMD-1/23341 dated 18.11.93, it is mandatory for a broker to insist on clients to return the duplicate copy of the contract notes duly signed by them in token of their having received the contract notes. Therefore, by not maintaining duplicates of copies of contract notes duly acknowledged by clients, there is non compliance with the aforesaid circular of SEBI.

(iv) Non segregation of clients and own account –

The show cause notice cites three instances wherein the client's account was debited for expenditure which is not client related. The details are as under :-

Name of the client and A/c. no.	Date of expense	Amount Rs.	Description
HDFC Bank, Anna Salai, A/c. No.00700132005	29.7.1999	62,500	Bank guarantee charges
Indus Ind Bank Client A/c. Nungambakkam	8.4.1999	4,00,000	Opening of Fixed deposits
Bank of Madura, Trichy	11.3.1999	2,999	Telephone charges paid

Further, in the following instances, the said broker's income was credited to client's account.

The Enquiry Officer has found that –

1. That while the expenditure of Rs.62500 on 27.9.99 can be related to the issuance of the bank guarantee which was issued on the general account on the same day, it is not known as to why the client's account was debited for bank guarantee charges although the bank guarantee itself was issued from a different account i.e. transfer from general account. There is no material to suggest that the general account was having a credit balance of Rs.62500 on 29.7.99 after the transfer of Rs.10,00,000/- for issuance of bank guarantee as submitted by the said broker. If the funds for the issuance of bank guarantee are provided from general account, it is not known as to why the bank guarantee commission was debited to the client's account instead of general account.
2. The debit of Rs.4,00,000/- from the client's account 8.4.99 was explained by submitting that the bank had unilaterally debited the said amount to meet the margin requirement of the existing bank guarantee. The Enquiry Officer has found that the bank guarantees of Rs.20,00,000/- were renewed from 7.4.99 onwards for a period of one year and the margin money of Rs.4,00,000/- was debited to the client's account on 8.4.99. There is no reason as to why the margin money of Rs.4,00,000/- is debited to client's account instead of general account. The explanation that the said amount was debited without the knowledge of the said broker is not found correct by the Enquiry Officer. The Enquiry Officer has found that this expenditure could not have been met from out of the client's account.
3. Regarding expenditure of telephone expenses for Rs.2,999/- met from the client's account on 11.3.99, on the basis of the admission of the said broker, the Enquiry Officer has found that this expenditure being relatable to the said broker's office administration it could not have been debited to the client's account.

(v) Default in making margin money to the Exchange – Regarding default in making margin money to the exchange in two instances on 31.12.98 and 8.8.99, the said broker had explained that it was not paid due to accountant's oversight and banker's oversight respectively. The Enquiry Officer has found that the said broker did not exercise due diligence and care which resulted in the non payment of margin on 31.12.98 and the explanation of the

said broker is not found satisfactory by the Enquiry Officer. The Enquiry Officer has found that the non collection of margin is in violation of rule 4 (b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992.

4. In view of the above findings, the Enquiry Officer has recommended a major penalty of suspension of certificate of registration of the said broker for a period of four months in terms of Regulation 13(1) (b) of the Enquiry Proceeding Regulations.

3.0 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/071(m)/2003 dated March 24, 2003 was issued to the said broker. The said broker vide its letter dated 09.04.03 filed its reply. In the said reply the said broker has submitted *inter alia* as follows:-

- a. The SEBI Circular no.SMD/SED/Cir/93/23321 dated 18.11.93 provides the clients an opportunity to request otherwise which will include standing instructions regarding the payments and the practice of receiving such instructions is not against SEBI Regulations. The standing instructions is received from clients who opt to maintain a running account. The clients can choose to sign or not to sign the standing instructions portion of the client registration form. Any client had no complaint in this regard alleging late payment. This practice has not been disapproved by the exchange.
- b. M/s.Champak & Co. enrolled with the said broker during March, 99 and this client had mentioned the DP details in the client agreement form to which the said broker were instructed to transfer shares bought in the account. It had received specific instructions from the client to transfer certain shares to certain DP accounts. Until the inspection officer pointed out that they were inspecting the demat accounts to which the deliveries were being transferred, the idea that this was a way of determining that the client was acting as sub-broker did not come in its mind. The possibility of broker activity never came to the mind of the management of the said broker who believed that Champak & Co. account was the firms own account only. On specific mention by the Inspection Officers it took immediate action and terminated the account of said M/s.Champak & Co. by a letter dated 29.4.2000.
- c. In the online trading system the time of placement of order in the trading system is the exact time of placement by the client because the orders are put into the system the moment it is heard by the operator on the phone or in person. The record of time of order placement by the client is maintained by the broker electronically in the form of the order log provided by NSE itself. It is possible that NSE found it redundant to reflect the clients order placement time since in the online trading it is the same time of order placement in system. The provisions of NSE Regulations 6.1.3 B have been therefore amended to make it optional.
- d. The contract notes in respect of 35 instances were held for the clients had to pick up the following morning i.e. on 30.12.99. Even as the clients came on that morning to pick up the contracts for trading, the inspecting officers took the contract as undelivered. 18 out of 35 clients had instructed it to hold their contracts in the registration form itself. It had obtained confirmation letter from 20 clients (including 9 out of the 18 mentioned earlier) confirming that they had instructed it to hold the contracts for them and to pick up. It has submitted that if it was in the habit of issuing contract notes to clients the inspecting officials should have also found instances of non issuance of contract notes for other dates as well.
- e. The first page of the contract notes was affixed with Rs.2 stamp and the balance stamps were affixed on a separate sheet thereto to avoid stamping all over the contract note making it unreadable. The inspection team was informed of this but they may not have witnessed the actual joining together of the two sheets when it was done. They may have seen the contract notes prior to their being put together. We have no other way to establish this at this point in time, except to claim our innocence and genuineness.
- f. The cost of returning duplicate contract notes and effort involved was a major issue which was a hindrance. The duplicate contract notes are filed and maintained date-wise. The contract register serves the purpose. If SEBI feels that it should not be following this method for client contract acknowledgment, it would undertake to send the contract notes along with duplicate to the clients and insist that clients return the duplicate duly acknowledged by them.
- g. As already submitted before the Inspection Officer and to the Enquiry Officer, the debit in respect of bank guarantee charges was made without the knowledge of the said broker and there was fund in general account of the broker.
- h. The fixed deposit has been created by IndusInd Bank on 8.4.99 by debiting the client account with the knowledge of the said broker. The funds in the bank account to the tune of Rs.50 Lakhs from September, 98 belonged to the said broker since this is an overdraft account issued on the pledge of the Directors' personal property. The bank overdraft was utilized for working capital requirements. Since the said broker has acquired bank overdrafts and borrowed from other sources to pay on behalf of the clients the dues of the clients, the said broker had a right on the clients money upon receipt of the same as in terms of SEBI Circular this broker has right to withdraw from client's account such money belonging to the broker as may have been paid into the client's account.
- i. The charge that the expenditure of telephone expenses were made from client's account is erroneous since the cheque for the Rs.2999/- in respect of telephone charges was issued from the general account – Bank of Madura, Trichy Account No.18050 and not from the client account no.17941.
- j. The charge of default in payment of margin money to NSE has been denied. It is submitted that there is no shortfall of Rs.1,63,010.75 in respect of margin to NSE vide letter dated 9.4.03 the NSE has confirmed that there was no margin shortfall on 31.12.98.

4.0 Hearing

4.1 An opportunity of personal hearing was given to the said broker on 15.05.2003 when Mr.E.M.C. Palaniappan, Managing Director of the said broker appeared before me. He reiterated the submissions made in the reply dated 09.04.03. He also filed a written submission dated 15.5.03. He requested that in view of the submissions, the major penalty in the matter may not be imposed.

5.0 Findings –

5.1 I have taken into account the facts and findings recorded in the enquiry officer's report, the oral and written submissions on behalf of the said broker and the relevant material available on record. My findings on the issues in the matter are as under -

5.2 Delay in making payments to clients

5.2.1 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 to make prompt payment in respect of securities sold by clients. By the circular no.SMD/SED/CIR/93/23321 dated 18/11/1993, the SEBI has specified the norms regarding 'Regulation of Transactions Between Clients and Brokers' and it has been made compulsory for all the brokers to make payment to their clients within two working days of pay out unless the client has requested otherwise. The said circular also provides protection to the brokers in case of failure of the clients to make payment or deliver the securities sold alongwith valid transfer documents within 2 days of contract note having been delivered or before pay-in day / 48 hours contract note having been delivered or before delivery day, as the case may be. The loss on the transaction if any will be met from the margin money of the client. Thus, the guidelines contained in the circular provide for protection of the interest of the clients as well as of the stock brokers in case of defaults of the clients. The stock brokers are not supposed to deviate from the procedure as specified in SEBI Circulars and adopt any procedure not contemplated therein. The circular clearly provides that the stock broker has to make payments within two working days of pay-out unless the client has requested otherwise. The words "unless client has requested otherwise" cannot be interpreted to allow a broker to obtain a standing instruction from the clients and defer the payment indefinitely in cases generally. The regulations provide for prompt payment in order to protect the interest of the investors. The choice of requesting otherwise is left to the client and it cannot be taken as a standing instruction through client registration form. Therefore, the submission that the clients had option to sign the portion of standing instructions in the client registration form and the SEBI circular provides that the clients can give standing instructions regarding the payments is not tenable. Therefore, I reject the submissions of the said broker in this regard. Regulation 4.4.12 of the NSE Capital Market Segment – Part A (hereinafter referred to as 'the NSE Regulations'), also suggests that the trading members are under obligation to comply with guidelines issued by SEBI relating to regulation of transactions between clients and brokers.

I agree with the findings of the enquiry officer as recorded in the Enquiry Report. In this regard the said broker has violated the above mentioned SEBI circular and clause B (1) of the Code of Conduct as specified in Schedule II read with Regulation 7 of the said Regulations which requires a stock broker to make prompt payment in respect of securities sold and arrange for prompt delivery of securities purchased by clients.

5.3 Dealing with unregistered sub-brokers.

5.3.1 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 a sub-broker unless he is registered with SEBI as a sub broker or he is recognized by the stock exchange as a remiser. The stock brokers is also under obligation to obtain client registration form from the clients containing the details of the clients. It is the obligation of the stock brokers to ensure that they do not deal with unregistered sub-brokers. Vide SEBI circular no.SMD/POLICY/CIR-3/98 dated 16.1.98, it was directed that the members of the stock exchanges executed transactions of their clients through members of other stock exchanges are to be treated as "sub-broker". Accordingly, they are required to be separately registered as sub-broker with SEBI in terms of Rule 3 of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992 read with Section 12 of the SEBI Act.

5.3.2 It has been found during the inspection and enquiry that S. Anand and Champak & Co. are members of the Madras Stock Exchange. These members of Madras Stock Exchange had requested the said broker to transfer the securities to the account of their clients. Therefore, the members of the Madras Stock Exchange executing the transactions of their clients through the said broker are sub-brokers dealing as such without separate registration from SEBI. As found above, it was the responsibility of the said broker to ensure that his clients are not acting in the capacity of a sub-broker unless they are registered with SEBI as sub- brokers. I find that the said broker has violated the mandatory requirements of the SEBI circular no. SMD/POLICY/CIRCULAR/3-97 dated March 31, 1997 as found by the enquiry officer.

5.4 Violations of contract notes –

5.4.1 Record of time of placement of order by client

Vide SEBI Circular no.SMD/POLICY/IECG/1-97 dated 11.2.97 it has been specified that the brokers shall maintain record of time when the client has placed the order and reflect the same in the contract note alongwith the time of execution of the order. Regulation 6.1.1 of the NSE Regulations, provides that every trading member shall comply with all relevant Statutory Acts including the Securities Contracts (Regulation) Act, 1956, Securities Contracts (Regulation) Rules, 1957 and SEBI Act and rules, regulations and guidelines made thereunder and the requirements of directives and guidelines issued by the

Central Government and any statutory body. In terms of regulation 6.1.3 (e) of the NSE Regulations (as applicable during the relevant time) every trading member shall maintain order book reflecting inter alia the following:

- i. Identity of the person receiving the order.
- ii. Date and time of the Order.
- iii. Name of the person placing the order.
- iv. Name of the client, description and value of securities to be bought and sold.
- v. Terms and conditions of the order stating particularly the price / rate limit or price / rate related instructions and time limit of the order etc.

At the relevant time of inspection these requirements were applicable as NSE Regulation have been amended later on and requirements were not optional as contended.

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 argument that the specimen format of contract note does not provide for the client's order placement time is also not tenable. In this regard the observations of Hon'ble Securities Appellate Tribunal in the matter of Appeal No.22 of 2003 – M/s.Radar Securities Ltd. Vs. SEBI is worth mentioning. In this case vide order dated 30.5.2003, the Hon'ble Tribunal held as under –

"The Contract Note provides space for recording "Trade time". This "Trade time" is the one which refers to execution of the trade. Not the placement of the order by the client.The receipt of the order from the client and execution of order by broker are not one and the same. Stamping the receipt time is important from the investor protection angle as it has a bearing on the transaction rate. Failure to do so is a matter of concern. It is noted from the NSE Regulation (6.1.3) that a stock broker is required to maintain order book reflecting therein amongst other details, the date and time of orders received from clients. Therefore it is not that there is no other source to locate order receipt time, in the event of any dispute. But this information is not readily available to the client. The Appellant's argument that the format of the Contract Note was not amended and therefore it was not required to do time stamping has no basis."

I do not find any merit in the submissions of the said broker. These particulars are important to ascertain as to whether the stock broker has acted faithfully with the client, had acted with due skill and care etc. I find that the said broker has not maintained time of placement of order in the contract note and has violated the above mentioned SEBI circular no.SMD/POLICY/IECG/1-97 dated 11.2.97.

5.4.2 Delay in issuance of contract notes to clients -

I observe that on sample check of one day, it was observed during inspection that the said broker had delayed the issuance of contract notes in case of 35 cases beyond 24 hours. The contention that the said broker had instructions in the client registration form from the clients to the effect that they will pick up the same, is not maintainable as it is the obligation of the stock broker to issue the contract note within 24 hours and it cannot be relaxed through client registration forms. The regulations do not provide for any provision of relaxation by clients.

Clause B(2) of the Code of Conduct as specified in Schedule II read with Regulation 7 of the said Regulations provides that a stock broker shall issue without delay to his client a contract note for all transactions in the form specified by the stock exchange. By SEBI circular no. SMD/(B)/104/22775/93 dated 29/10/1993 it was advised that SEBI will take a serious view if the deficiencies inter alia with respect to issuance of contract notes to clients etc. are observed during the SEBI inspections. By the circular no.SMD/SED/CIR/93/23321 dated 18/11/1993, it has been made compulsory for all the brokers to issue contract notes for purchase / sale of securities to their clients within 24 hours of the execution of the contract. By the said circular the exchanges had been advised to make necessary provisions in their bye-laws and regulations for the purpose of regulation of transactions between clients and brokers as per the norms specified in the said circular. Regulation 3.5 of the said NSE Regulations provides that the members shall issue the contract notes for purchase / sale of securities to a constituent as specified in Annexure II and shall issue in the manner and within such time as prescribed by the exchange. I find that as specified in clause A of the Code of Conduct for stock brokers as specified in Schedule II of the said Regulations, it is the duty of every stock broker to exercise due skill, care and diligence in the conduct of all his business. I find that by delaying issuance of contract notes to its clients as found during inspection and enquiry, the said broker has violated the above mentioned SEBI circulars.

5.4.3 Deficit stamp duty on contract notes -

SEBI circular no. SMD(B)/104/22775/93 dated 29.10.93 provides that a serious view would be taken if deficiencies in the contract notes such as non-fixing of the stamps on the contract notes, etc. are observed during inspection. In terms of SEBI Circular no.SMD/MDP/CIR/043/96 dated 5.8.96 it has been advised that irregularities regarding contract notes including not affixing of stamps, not maintaining copies of contract notes and not maintaining counterfoils of contract notes without adequate details, etc. shall be viewed seriously. The requirement of affixing the stamp on Contract Note is a requirement under the Indian Stamp Act. If stamps of adequate value are not affixed, the consequences as provided under the Stamp Act will follow. However, it is for the broker to ensure that the stamps of adequate value are affixed on the contract note.

5.4.4 Duplicates of the contract notes do not bear client acknowledgment -

It may be mentioned that as per rule 15 (2) (b) of the Securities Contracts (Regulation) Rules, 1957 every stock broker is required to maintain counterfoil or duplicate of contract notes issued to clients. The acknowledgment of the clients on the counter foils is essential for adequate record / information. It was found during inspection and enquiry that the duplicate copies of the contract notes were not acknowledged by the clients. The grounds submitted by the said broker for not maintaining acknowledgment of the clients is not maintainable since the practice suggested by the broker may not be in the interest of the clients. From a copy of contract note not having acknowledgment of the client it cannot be ascertained as to whether the contract note has been actually issued to the person mentioned therein and as to whether the same has been issued within the specific time. Such acknowledgment is required to verify as to whether the stock broker has dispatched the contract notes within 24 hours as stipulated by SEBI circular No. SMD/SED/CIR/93/23321 dated 18.11.93. The SEBI Circular no.SMD-1/23341 dated 18.11.93 provides that the member broker shall insist on clients to return the duplicate copy of contract notes duly signed by them in token of their having received the contract notes. The obligation of the stock broker to insist on the acknowledgment of the client's on the duplicates of the contract notes. In terms of rule 15(2) of the Securities Contract Regulation (Regulation) Rules, 1957 every stock broker is required to maintain and preserve "counter foils or duplicates of contract notes issued to clients". The requirement is either to have the counterfoils or the duplicates of the Contract Notes issued to the clients. This is a very important requirement as it goes to establish that the Contract Note was actually issued to the client. Contract Note is a very important document in the transaction and its relevance is all the more when dispute arises between the broker and the client. If the acknowledgment of the client is not mentioned in the contract note the dispute may arise as to issue and receipt thereof.

5.4.5 The above requirements in respect of contract notes have to be fulfilled without any deviation. I find that these are mandatory requirements and have to be complied with by every stock broker. I agree with the findings of the enquiry officer as recorded in the enquiry report and reject the submissions of the said broker. I find that as specified in clause A of the Code of Conduct for stock brokers as specified in Schedule II of the said Regulations, it is the duty of every stock broker to exercise due skill, care and diligence in the conduct of all his business. The said broker should have taken care for issuing the contract notes within specified time, for affixing proper stamp duty on the contract notes and for obtaining the acknowledgement of the clients on the duplicates of the contract notes.

5.5 Non segregation of client's money and own funds

5.5.1 By the circular no. SMD/SED/CIR/93/23321 dated November 18, 1993, it has been made compulsory for all the brokers to keep the money of the client in a separate account and their own money in a separate account. Further, it has been stipulated that no payment for transactions in which the member broker is taking a position as a principal will be allowed to be made from the clients account. Regulation 4.4.12 of the NSE Regulations provides that in addition to guidelines issued by SEBI relating to the Regulation of Transactions between Clients and Brokers, the member shall at all times keep the monies of the constituent in a separate bank account. Regulation 6.1.4 (b) of the NSE Regulations provides that it shall be compulsory for all trading members to keep the money of the clients in a separate account and their own money in a separate account. No payment for transactions in which the trading members is taking position as a principal will be allowed to be made from the clients account .By the above mentioned circular and regulation 6.1.4 (c) it has been further provided that no money shall be drawn from clients account other than money properly required for payment to or on behalf of the client for or towards payment of a debt due to the member from the clients or money drawn on client's authority or money in respect of which there is a liability of clients to the trading member. Vide circular no. SMD/MDP/CIR/043/96 dated August 5, 1996 it has been directed that in case of deficiency in having separate bank account for clients but not segregating clients funds from the own funds by the brokers, a serious view will be taken.

5.5.2 It is observed that the said broker has made payments from clients account towards payment in respect of bank guarantee charges, debiting the client's account for opening fixed deposit of Rs.4 Lakhs and for making payments towards telephone charges. This is clearly in violation of the above mentioned SEBI circular and the NSE Regulations. As per these provisions money from the clients' account can be drawn only for the purposes as specified in the said circulars and NSE Regulations. Any other emergent situation is not acceptable for withdrawing money from the clients account for the purposes of computer etc. Therefore, I find that the said broker has not maintained the proper segregation between own funds and clients' funds and has committed the violation as observed in the enquiry report while using the clients money towards the expenses like computers, cash withdrawals, loan refund, fees, gratuity fund, loan etc which is in violation of the SEBI circular and the NSE Regulations. In this regard the said broker has violated a condition for grant of the certificate of registration in terms of rule 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.

5.6 Default in paying margin money to the Exchange -

5.6.1 During inspection and enquiry the said broker had submitted that the default in paying margin money to the exchange in two instances on 31.12.98 and 8.8.99, had occurred due to oversight of the accountant and the banker respectively. In its reply dated 9.4.2002 the said broker has submitted a letter dated 9.4.2003 from the NSE suggesting that there was no shortfall in margin payment to NSE on 31.12.98. In view of this, I hold that there was no margin shortfall on 31.12.98 and no violation by the said broker. Since the default on 8.8.99 occurred due to banker's oversight, I agree with the findings of the enquiry officer in this regard and take a lenient view.

6.0 In terms of rule 4 of the Securities and Exchange Board of India (Stock Brokers and Sub-Brokers) Rules, 1992, the Board may grant a certificate to a stock-broker subject to the following conditions inter alia that he shall abide by the rules, regulations and bye-laws of the stock exchange or stock exchanges of which he is a member. As found hereinabove the said broker has violated the NSE Regulations. Therefore, I find that the said broker has also violated the condition of the certificate of registration as provided in rule 4(b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.

6.1 In view of the above findings, I hold that the said broker has violated -

(a) Rules 4 (b) of the SEBI (Stock Brokers and Sub-Brokers) Rules, 1992,

(b) Clauses A(5), B(1) and B(2) the Code of Conduct as specified in Schedule II read with regulation 7 of the said Regulations,

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

(d) The NSE Regulations as found hereinabove.

7.0 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 segregation of client's money and own funds or dealing with unregistered sub-brokers are provided as measures of risk containment and to provide transparency and fairness in the transactions. The requirements regarding contract notes have been mandatorily provided as a matter of investor protection and to ensure that the business and conduct of the intermediaries are undertaken on the basis of sound business principles.

7.1 It is to be noted that the violations by a stock broker which is regulated /

prohibited for the purpose of regulation of its business, can not be allowed on the ground of any alternative practice not approved by the regulator or otherwise 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 said brokers of the stock Exchange shall adhere to the bye-laws of the Exchange.

7.2 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. Regulation 4.5.1 of the NSE Regulations provides that the trading said broker shall at all times subscribe to the code of conduct as prescribed by the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992.

8.0 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 requirements in conduct of its business as a stock broker. I find that the said broker has violated the condition of registration specified in rule 4 (b) of the SEBI (Stock Brokers and Sub-brokers) Rules, 1992. I find that the penalty as recommended by the enquiry officer be imposed in terms of regulation 13 (1) (b) (ii) read with regulation 13 (6) (b) of the Enquiry Proceedings Regulations. Looking into the violations committed by the said broker, I am satisfied that to secure the proper management of the stock broker and also in the interest of the securities market a penalty of suspension of certificate of registration for a period of four months be imposed as recommended by the enquiry officer. 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 230754330 granted to M/s.Chona Financial Services Ltd., a member of the National Stock Exchange Limited, be suspended for a period of four months.

8.1 This order shall come into effect after three weeks from the date of this order.

DATE : 14th July, 2003

PLACE: MUMBAI

G. N. BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA