

SECURITIES AND EXCHANGE BOARD OF INDIA**ORDER UNDER SEBI(PROCEDURE FOR HOLDING ENQUIRY AND IMPOSING PENALTY) REGULATIONS, 2002 IN THE MATTER OF PROSOFT SYSTEMS LTD. AGAINST M/S INDEX FINLEASE SERVICES LTD., MEMBER, BANGALORE STOCK EXCHANGE, SEBI REGN NO INB 08 1025430.**

- 1.0 Prosoft Systems Ltd. (hereinafter referred to as "Prosoft") was incorporated as private limited company on July 28, 1993. It was converted into a public limited company on January 19, 2002. During October 2000, the company came out with a public issue of 61.60 lacs of shares at par aggregating to Rs.616,00,000 (Rs.2.50 on application and Rs.7.50 on allotment). The issue closed on October 23, 2000 and the shares got listed on November 17, 2000. Bangalore Stock Exchange(BgSE) had permitted trading in this scrip to commence on December 27, 2000. Trading was permitted in compulsory demat mode.

INVESTIGATION AND ENQUIRY:

- 1.1 There was variation in the price of the scrip of Prosoft listed on BgSE between Rs.25.15 and Rs.36.40 between December 27, 2000 and January 16, 2001.i.e., an increase of about 45% in 15 trading days. On receipt of Investor complaints, SEBI had asked BgSE to carry out an investigation. BgSE observed inter alia that a client of a particular broker had contributed significantly to the total volume during the period by executing trades both as buyer and seller through different brokers.
- 1.2 In view of the above, SEBI conducted detailed investigation into the market manipulation in the scrip of Prosoft. One Shri Pravin Panwar, associated with Prosoft was found to have executed substantial trades in the scrip acting through two different brokers namely, Sunil Investments and M/s Index Finlease Services Ltd. at increasing rates, thus, rigging up the price of the scrip.
- 1.3 Pursuant to the investigation, an Enquiry Officer was appointed by SEBI, vide order dated 20th June, 2002, to inquire into the role of M/s Index Finlease Services Ltd.,(hereinafter referred to as "IFSL")

The Enquiry Officer conducted the enquiry in accordance with the procedure laid down by SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty)

Regulations, 2002 and submitted his report on August 29, 2003. The findings of the Enquiry Officer are as follows:

The client agreement was not obtained by IFSL and the duplicate copies of the contract note was not maintained, which is in violation of 15(2)(b) of SCR Rules, 1957 and Regulation 17(1)(k) of SEBI(Stock Broker and Sub Broker) Regulations, 1992.

Margin was not collected, which is in violation of SEBI circulars SMD/SED/Cir/93/23321 dated November 18, 1993, SMDRP/POLICY/CIR/35/98 dated December 04, 1998 and SMDRP/POLICY/CIR-07/99 dated February 04, 2000.

Not maintained a record of time when the client had placed the order, which is in violation of circular dated February 11, 1997.

SHOW CAUSE NOTICE:

- 2.0 On consideration of the Enquiry Report, a show cause notice was issued to IFSL under Regulation 29(1) of SEBI(Stock Brokers and Sub Brokers) Rules and Regulations, 1992 read with Regulation 13(2) of the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 against IFSL vide letter dated September 09, 2001. In the show cause notice, IFSL was alleged to be guilty of violating the provisions of SCR Rules 1957, SEBI(Stock Brokers and Sub Brokers) Rules and Regulations, 1992 and SEBI Circulars dated November 18, 1993, December 04, 1998, February 04, 2000 and February 11, 1997. It was also mentioned therein that the Enquiry Officer had recommended a minor penalty of suspension of the certificate of registration granted to IFSL for a period of one month and IFSL was called upon to show cause as to why the said penalty should not be imposed on it. Copy of the Enquiry Report was also forwarded therewith.

REPLY BY IFSL.

- 2.1 IFSL vide its letter dated September 30, 2003 replied to the show cause. In its reply, IFSL had submitted that it was wrong to have presumed that Client Registration form was obtained only after the exchange had sought details of trading and not before undertaking the business. It has also denied that there was nothing to suggest that IFSL had traded for Pravin Panwar in any other stock between January 19, 2000 till December 2000. According to them, the client registration form had been obtained in January 2000 itself. Further, it has submitted that Shri Pravin Panwar had traded in ITC shares during February 02, 2000 to February 24, 2000, much before trading in the shares of Prosoft. It was also submitted that IFSL had collected the margin from Shri Panwar before it allowed him to trade in ITC shares. The documents, which according to it would prove his

transactions with IFSL in the shares of ITC were also produced along with its reply. It was further stated by it that the client registration form which had been obtained before it allowed Shri Panwar to trade in ITC shares, could not be collected when the BgSE had sought the details of trading in Prosoft. The reason stated by IFSL was that Shri Panwar was not responding to the phone calls of IFSL at such point of time and also was not available in the address given to it.

- 2.2. It was submitted by IFSL that Shri Panwar had traded through it not only in the shares of Prosoft. IFSL submitted that settlement of ITC shares had been made by Shri Panwar by way of cheques (details of which were also given). With regard to not obtaining details of the depository account of Shri Panwar, it was submitted that at the time of obtaining client registration form during January 2000, only few shares were under compulsory demat trading. It was also stated by IFSL that client's demat account number was insisted upon only in cases where transactions of shares under compulsory demat mode was involved. IFSL also submitted that since Shri Panwar had squared off the ITC transactions, the details of the demat account was not insisted upon. Regarding the client agreement, IFSL submitted that being a new member at the BgSE, they had inquired with the other members about the prevalent practice and they were told that obtaining client registration form with photographs and bank account details was enough. According to IFSL, it had complied with this before their transactions with Shri Panwar in the scip of ITC. It was also submitted by IFSL that at the time it enrolled Shri Panwar, there was no prevailing practice in BgSE to obtain client agreement.
- 2.3. With respect to duplicate copies of the contract note, IFSL denied that it had not maintained the same but admitted that they did not obtain confirmation on contract notes with respect to Shri Pravin Panwar. According to them, it had maintained the duplicate copies of the contract note in respect of all clients including Shri Panwar. IFSL also produced duplicate copies of the contract note issued to Shri Panwar along with its reply. They also submitted that same had been produced for verification to the Enquiry Officer.
- 2.4. Regarding collection of margin, IFSL had submitted a statement which according to them would show that on any given date from December 27, 2000 to January 12, 2001, credit balance in the account of Shri Panwar was higher than the margin payable by him and hence, there was no need for collection of margin. With respect to placing of orders by the client, IFSL had submitted that the moment they received any phone calls or instructions for purchase or sale of shares from its client, they punch the order immediately and therefore, the time of placing of order by the client and entering the

same in the system is one and the same. IFSL also submitted that such time which is automatically recorded in the system would be stored in their back office. Some files, they stated, had got corrupted, which included the file containing time of placing of order. Although, IFSL had requested the exchange to provide it with the backup, it said, the details given by exchange did not contain the time of placement of order and hence, it was unable to produce the same to the Enquiry Officer. IFSL, along with its reply enclosed a statement certified by BgSE regarding the detailed transactions in the shares of Prosoft from December 27, 2000 to January 19, 2001 which indicated order entry time and date.

- 2.5. IFSL further submitted that there was no provision for reflecting the time of placing the order in the contract note in the proforma issued by BgSE. It also attached the format of the contract note issued by BgSE Financial Services Ltd. (subsidiary of BgSE).
- 2.6. IFSL further requested for condoning the unintentional procedural lapse on their part in not obtaining the client registration agreement and confirmation on contract notes. It was submitted that it had exercised due diligence and care in dealing with Shri Pravin Panwar and also had obtained client registration form before allowing him to trade. It also submitted that it had cooperated with enquiry/ investigation in respect of the transactions in Prosoft and also had complied with BgSE and SEBI Rules and Regulations.

HEARING:

- 3.0 An opportunity of hearing was afforded to IFSL on November 06, 2003 which was communicated vide letter dated October 21, 2003. A letter dated October 27, 2003 was received from IFSL whereby it informed that its representative Shri G.L. Kothari, Director, IFSL will attend the hearing on November 06, 2003. Shri G.L. Kothari appeared on the said note and made submissions on behalf of IFSL. He admitted the lapses on their part and stated that their business would collapse if the action as proposed in the notice is taken against them.

FINDINGS

- 4.0 I have carefully considered the findings of Enquiry, the reply dated September 30, 2003 of IFSL and the submissions made by it during the hearing held on November 06, 2003, I find that Shri Pravin Panwar, a client of IFSL has traded heavily in the scrip of Prosoft

between 27/12/2000 and 16/01/2001 when the share price had spurt from Rs.14 to Rs.28 on 27/12/2000 immediately after listing. The trading in the scrip of Prosoft had commenced from 27th December, 2000 at Bangalore Stock Exchange. Investigations revealed that demat credit of the fully paid up shares was given by Prosoft only on 12th and 22nd January 2001 through the depositories only to Shri Praveen Panwar whereas, the demat credits to the other shareholders was given only after 22nd January, 2001. I find that taking advantage of the shortage of the scrip due to non credit of demat accounts, Shri Pravin Panwar has created artificial volumes and price rise through his trading with the member. Already action has been taken against Shri Pravin Panwar by SEBI vide order dated December 12, 2002 whereby he has been prohibited from dealing in securities for a period of two years.

- 4.1 I also find that the client Shri Praveen Panwar 's turnover in the exchange in the scrip through IFSL was 1600 shares on 27.12.00 and constituted 17% of total turnover in the exchange. It was contended by IFSL, that his volumes were not significant because there was generally high trading volumes in stocks in information technology at that time. The trading details of Shri Panwar through the member, IFSL during the period of investigation (mention period) is as under :

Date	Purchase	Sale	Net Position
27/12/2000	600	1000	-400
28/12/2000	7300	8200	-900
29/12/2000	5100	4300	800
01/01/2001	1500	1000	500
02/01/2001	6301	6301	0
03/01/2001	6300	5200	1100
04/01/2001	0	1100	-1100
09/01/2001	200	100	100
12/01/2001	900	1000	-100
	28201	28201	0

Although the total number do not appear to be high except on 27/12/2000 when 17% of the volume in the scrip by IFSL was for Shri Praveen Panwar, they are nevertheless significant viewed from the background of illiquidity in the scrip at the relevant time. I find that Shri Pravin Panwar was mainly responsible in creating artificial liquidity as no investor was given demat credit until 12.01.01 by NSDL and 22.01.01 by CDS. By that time, much of the artificial liquidity was created and the client and the client stopped trading on 12.01.01 itself through IFSL. Admittedly IFSL had not obtained client agreement. I find that the details of Depository Account of the client was not maintained by IFSL, which is a fundamental requirement while registering a client without which

transfer of shares in electronic form cannot take place. This goes to show that IFSL did not exercise due diligence and care while dealing for its client Shri Panwar. Having failed to obtain the client registration agreement and obtain confirmation on contract notes, the member IFSL has violated the circulars of SEBI dated April 11, 1997 and February 11, 1997. Further, payments were not by cheques. It was observed by the E.O. that these two requirements which are not complied with would make it difficult to trace the audit trail of securities as well as funds flow. I am therefore, inclined to agree with the findings of the Enquiry Officer.

- 4.2 IFSL also admitted that duplicate copies of the contract notes was not maintained, which was in violation of 15(2)(b) of SCR Rules 1957 and Regulation 17(1)(k) of SEBI (Stock Broker and sub broker) Regulations, 1992.
- 4.3 Further, the time of placement of order by the client and time of placement of the order by the broker into the system are two different things, as rightly observed by the E.O. As per SEBI circular dated 11/2/1997, the broker member should maintain record of time when the client has placed the order and reflect the same in contract notes. There is no material to suggest that IFSL was maintaining record of time when the client has placed the order. Therefore, I find that the member IFSL has not complied with the Circular of SEBI dated 11/2/1997.
- 4.4 I agree with the finding of Enquiry Officer that the charge of making delayed payment of Rs. 401.59 as delivery of securities to the client for 1000 shares is not established in view of the submission that Rs.401.59 was payable by client to the broker and not vice versa. It was also explained that in view of the said non payment, the broker had withheld delivery of 1000 shares to the client on 19/01/2001. The broker has a lien on shares purchased on behalf of its client and can insist on payment for such purchases.
- 4.5 I also note that IFSL cannot be said to have known that Shri Praveen Panwar was the common client for him as well as for Sunil Investments, since purchase and sale transaction by the member were through different brokers of the exchange as detailed in his reply. There is no material to suggest that the broker knew about this. Therefore, violation of clause A(3) of the Code of Conduct against the broker is not established. It is a common feature in the order and time priority of trades in the electronic system, the anonymity of the buyers and sellers and the counterparty brokers is protected. I find that there is no material or circumstantial evidence in the facts and circumstances of the case to take a different view.

- 4.6 Further, the member should not have received payments in cash as the same is in violation of SEBI Circular dated 18th November, 1993 as per which all receipts should be in the form of crossed cheques only. The Enquiry Officer had recommended that this isolated transaction may not be viewed seriously, considering that the amount received is only Rs. 25,000/- which the member stated that he received the same after lot of persuasion as he was eager to secure payment. I am inclined to concur with the recommendation of Enquiry Officer as the same cannot be viewed seriously.
- 4.7 I therefore, conclude that IFSL by not executing client agreement form and not maintaining time of placement of order etc. had not exercised due care and diligence as is required under Regulation 7 read with Code of Conduct for Stock Brokers in terms of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992. There is also the violation of SEBI circulars dated April 11, 1997 and February 11, 1997.
- 4.8 I have noted the submission of IFSL that all its trades were on behalf of clients and none were proprietary trades. IFSL had also submitted that impugned transactions were conducted in good faith with a view to earn brokerage. During the hearing before me, it was submitted by IFSL that it was new to the stock broking business with little over 2 years experience and requested to take a lenient view.

ORDER.

- 5.0 Therefore, in exercise of the powers conferred upon me in terms of Section 19 of SEBI Act, 1992 read with 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 I hereby suspend the certificate of registration of M/s Index Finlease Services Ltd, member Bangalore Stock Exchange, having SEBI Registration number, INB NO 08 1025430 for a period of Ten days.
- 5.1 This order shall come into force on expiry of three weeks from the date of this order.

**A.K.BATRA
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**

**Place : Mumbai
Date : January 31, 2004**

