

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF THE SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 AGAINST M/S LRM SECURITIES LIMITED, MEMBER, THE DELHI STOCK EXCHANGE ASSOCIATION LIMITED, HAVING SEBI REGISTRATION NUMBER INB050988137.

1.0 FACTS OF THE CASE

1.1 M/s. LRM Securities Ltd., (hereinafter referred as “the said broker”) is a member of The Delhi Stock Exchange Association Limited (hereinafter referred to as “DSE”) and a stock broker registered with the Securities and Exchange Board of India (hereinafter referred to as “SEBI”) under certificate of registration No.INB050988137.

1.2 Inspection of the books of accounts and other records of the broker was carried out by SEBI on January 11 & 12, 2001. The inspection related to the activities of the said broker in the years 1999-2000 and 2000-2001(till the date of the inspection). During the course of the inspection, the following violations were observed:

- (a) Irregularity in maintenance of books of accounts – Document register or Stock Register did not contain particulars such as distinctive numbers of physical shares received/delivered by them.
- (b) Irregularities in Issuance of Contract notes:

- Contract notes did not bear pre-printed serial numbers.
 - Contract Notes were not issued to clients on time.
 - Contract Notes were issued in Form A, instead of Form B, for principal to principal transactions
 - Written acknowledgement was not obtained from clients for principal to principal transactions.
 - Contract notes did not contain the time of placement of order by the client.
- (c) Non-segregation of own and clients' funds.
 - (d) Dealing with unregistered sub-brokers.
 - (e) Non-maintenance of client registration forms.
 - (f) Dealing as an unregistered sub-broker.
 - (g) Indulging in off-the-floor transactions
 - (h) Delay in payment of monies to clients.
 - (i) Inadequate payment of turnover based fees to SEBI.
 - (j) Delay in settlement of Investor complaints.

1.3 A copy of the inspection report was forwarded to the broker, for his comments, on February 19, 2001. The broker submitted his reply vide letter dated May 05, 2001. Since the response of the broker was found to be unsatisfactory, an enquiry officer was appointed by SEBI, vide order dated January 27, 2003, to conduct an enquiry, as per the provisions of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as "Enquiry Regulations").

2.0 ENQUIRY PROCEEDINGS

2.1 The enquiry officer issued a show cause notice to the said broker, vide letter dated 14.02.03, under Regulation 6 of the Enquiry Regulations, delineating the violations alleged to have been committed by them and

advised them to show cause as to why appropriate penalty should not be levied on them for the said violations. The said broker sought time of 3 months to file a comprehensive reply. They also indicated a desire for personal hearing.

- 2.2 The enquiry officer, after considering the submissions made by the said broker, in the hearing granted to them on June 09, 2003, submitted her report on 25.7.2003, with the recommendation that a minor penalty of suspension of certificate of registration, for a period of 3 months, may be imposed on the said broker.

3.0 SHOW CAUSE NOTICE AND PERSONAL HEARING

- 3.1 A show cause notice dated August 01, 2003 was issued to the said broker, advising them to show cause as to why appropriate penalty, including penalty as recommended by the Enquiry Officer, should not be imposed on them. The said broker sought an extension of time till September 30, 2003 for submitting a reply to the show cause notice. This request was acceded to, by SEBI. However, instead of replying to the show cause notice, the said broker once again sought an extension till November 15, 2003, on health grounds. The said broker was then advised to be present for a personal hearing on October 30, 2003 at 3.00 pm.
- 3.2 The said broker, vide his letter dated 24.10.2003, submitted his reply to the show cause notice and requested that the hearing be re-scheduled. Accordingly, an opportunity of personal hearing was granted to the said broker on 18.11.2003. The said broker appeared before me on the said date and made submissions. Further to the said hearing, the said broker also furnished written submissions vide their letter dated November 30, 2003, reiterating the submissions made in the hearing.

4.0 **CONSIDERATION OF ISSUES**

4.1 I have considered the Inspection report, the report of the Enquiry Officer, the reply and submissions of the said broker and other material on record. My findings on the allegations made against the member-broker are as follows :

4.2.1 I note that the said broker has submitted that their contract notes did not bear pre-printed serial numbers for the financial year but that the numbers were generated on day to day basis, with the numbers starting afresh every day. Computer generated serial numbers are also acceptable, provided they run continuously from first day till the last day of the financial year. In the absence of such a system of numbering the contract notes, it would be possible for the brokers to insert back dated contract notes or to take out contract notes, for the period at the end of each day. In order to avert the possibility of such manipulations by brokers, SEBI had, vide circular dated August 05, 1996, directed all stock brokers to ensure continuous numbering of contract notes. Therefore, I find that the said broker has violated the provisions of the said circular.

4.2.2 As regards the allegation that the said broker was not issuing contract notes on time to their clients, the said broker has stated that they have issued all contract notes on time. They have further stated that the inspection kept the printers busy throughout the day and hence, they were not in a position to issue the contract notes to their clients, for the transactions done during and immediately before the inspection. Brokers are required to issue contract notes to their clients within 24 hours, which was not done in the instant case. However, in view of the submissions made by the said broker and also the fact that no instances of non/late

issuance of contract notes have been brought out for any period, other than that immediately before the dates of inspection, I would like to give the benefit of doubt to the broker on this issue.

4.2.3 Regarding the principal to principal transaction, the contention of the said broker was that it was a genuine purchase by the client, to replace the shares lent by them to the client earlier, so as to prevent auction of his position at the exchange. The explanation submitted by the broker regarding the aforesaid transaction is difficult to accept, especially in view of the inspection finding that there was no corresponding transaction on the exchange. Hence, it appears that the broker has sold these shares to his client on a principal to principal basis. Moreover, brokers are not allowed to lend shares to their clients, under any circumstances. However, considering the fact that this was the only instance pointed out in the inspection report, I am inclined to grant the benefit of doubt to the said broker.

4.2.4 As regards not stamping the order/transaction time on the contract notes, the said broker has admitted that time of placement of order, as well as their execution time, was not reflected on the contract notes. They have further stated that this was on account of the fact that they were using the stationery already available with them, which did not provide for capture of such details. They also stated that it is not possible to print the time of placement of order on the contract note, as the orders were received at different times. In this regard, I note that SEBI had, vide circular dated February 11, 1997, directed that a contract note should reflect the time of placement of order and time of execution of order. The arguments put forth by the said broker are not acceptable. Use of excess stationery can not be at the cost of regulatory compliance. Therefore, I hold the broker guilty of non-compliance with the provisions of the aforesaid circular.

4.3 Regarding non-segregation of own and client accounts, the said broker has submitted that they had been using their own account as client's account. No reasonable explanation has been offered by the broker as to why they have been using their own account as client account, especially when they were maintaining an inoperative current account with the same bank branch. SEBI had advised segregation of the client account from the broker's account; vide its circular dated November 18, 1993. It was clearly stated in the said circular that the broker has to maintain separate accounts for his funds and that of his clients, so as to identify the clients' funds separately and to prevent possible misuse of clients' funds by the broker. Thus, I find that the failure on the part of the said broker to maintain a separate client account is in violation of the SEBI circulars dated 18.11.1993 and 5.8.1996.

4.4.1 I find that the said broker has been dealing with sub-brokers viz. SUP Investment and Estate Traders Pvt Ltd and M/s Vijay Ahuja/Shivam Investment. These sub-brokers were affiliated to M/s L R Munjal & Co, whose assets and liabilities were transferred to the said broker, on corporatisation of the membership of M/s L R Munjal & Co. The said member's contention that the affiliation of the sub-brokers continues even after corporatisation of the membership, is unacceptable. As per the SEBI circular dated March 04, 1998, the sub-brokers of members, whose memberships had been corporatised, were required to apply for transfer of affiliations to the new entities. The aforesaid sub-brokers have not applied for transfer of their affiliations. The consequence of failure to transfer the affiliation of SUP Investment Finance and Estate Traders Pvt. Ltd. and Vijay Ahuja is that the said sub-brokers would have to be treated as unregistered intermediaries.

4.4.2 In the case of Investor Helpline, which was actually registered as a sub broker to IKM Securites Ltd., the certificate of registration was sent to the said broker by mistake. The said broker cannot take advantage of this

inadvertent mistake on the part of SEBI, since Investor Helpline is not registered as their sub broker. However, I am inclined to give the benefit of doubt to the said broker in the case of Investor Helpline.

4.4.3 As regards dealing with Munjal Online Stock Access (MOSA), the said broker has submitted that MOSA was registered with SEBI. It is true that MOSA is registered with SEBI as a dealer on Over the Counter Exchange of India. However, if the said broker wished to execute the transactions of MOSA's clients on DSE, they had to get MOSA registered with SEBI, as their sub-broker.

4.4.4 In view of the above, as well as the fact that they were executing the transactions of MOSA's clients, I find that the said broker was dealing with unregistered sub-brokers. Thus, the said broker has violated the directives of SEBI circulars dated 27.12.1993 and 5.8.1996, directing stock brokers not to deal with unregistered sub-brokers.

4.5 I note that the said broker has acted as sub broker to M/s. Mefcom Securities Ltd, member, The Stock Exchange, Mumbai and also to Munjal Leasing Ltd., member, National Stock Exchange of India Ltd. I observe from the reply of the said broker that they have apparently not understood the allegation. The allegation is that the said broker acted as an unregistered sub – broker of the said brokers. The said broker should have obtained registration from SEBI to act as a sub broker of the two brokers, in case they wished to execute the transactions of their clients through BSE/NSE respectively. However, they failed to do so. Moreover, instead of issuing confirmation memo for such transactions, the said broker has issued Contract notes. I find that the act of the said broker was a violation of SEBI Circular dated January 16, 1998, Section 12 of SEBI Act, 1992, Rule 3 of the SEBI (Stock brokers and sub brokers) Rules, 1992; as well as Clause A(5) of the Code of Conduct as specified

in Schedule II read with Regulation 7 of the SEBI (Stock brokers and sub brokers) Regulations, 1992.

4.6 I note from the inspection report and report of the Enquiry Officer that the said broker had failed to produce client registration forms and broker client agreements before the inspecting officials and the Enquiry Officer, thus leading to an inference that these were not obtained from clients. The said broker has submitted that they had maintained client registration forms for all their clients. They further submitted that some of the balances in their books pertained to old clients that existed before the implementation of the requirement of client registration form. The rest of the forms were produced before the Enquiry Officer. In the light of the submissions by the said broker, I am inclined to give them the benefit of doubt, although I observe that the said broker had failed to extend due co-operation to the inspecting authorities.

4.7.1 I note that there have been several instances of delay on the part of the said broker in payment of monies to clients. In this regard, the inspection report and the Enquiry Officer have specifically referred to the accounts of Karishma Malhotra, S K Srivastava, Mahesh Garg and N R Dongre with the said broker, where there were credit balances at the time of inspection. In this regard, I note that the said broker has submitted that certain Journal Vouchers were to be passed in the accounts of S K Srivastava, Mahesh Garg and N R Dongre and hence the credit balance. He also submitted that Karishma Malhotra had another account with them which was in debit, above the amount in credit in this account. Thereafter, before the Enquiry Officer, the said broker produced account statements showing debit entries in respect of Karishma Malhotra, S K Srivastava and Mahesh Garg. However he failed to produce details of the second account allegedly maintained by Karishma Malhotra. The enquiry officer

has mentioned in her report that the said broker has tried to mislead her in the matter by falsifying the records.

4.7.2 Further, in his reply to the show cause notice, the said broker has submitted that since the inspection took place in January and the accounts were audited only after March 31st, there may have been entries of error or journal entries to be made later. In respect of the account of Karishma Malhotra, the said broker has stated in his reply that the other account was in the name of Kamal Malhotra and that details of both accounts were given to the Enquiry Officer. I find from the above that the broker has not produced sufficient proof to counter the allegation regarding delayed payment to his clients. He had produced copies of ledger entries showing debit balance in the accounts of the aforesaid clients, as on various dates, reflecting debit balances. However, the Enquiry Officer has held that the said broker had attempted to mislead the Enquiry Officer by falsifying the records. The said broker has not produced any additional documents to substantiate his claim regarding the existence of debit balances in these clients' accounts. Hence, I am unable to agree with his submissions in this respect. I find the explanations of the said broker to be unsatisfactory and hence hold that there was a delay on his part to make payment to clients.

4.8 In respect of other alleged irregularities viz non-payment of registration fees to SEBI and non-redressal of investor grievances, I find that the Enquiry Officer has held the said broker to have paid the fee and settled all grievances (except one complaint under arbitration). Hence, I refrain from making any finding of violation in respect of the same.

5.0 I note that the said broker has raised a contention that the Enquiry Officer asked the inspecting officer to be present during the enquiry and discussed at length with him, each and every violation and therefore, the

enquiry proceedings were not held in accordance with the provisions of Regulation 5 of the Enquiry Regulations. In this regard, I note that Regulation 5 of the Enquiry Regulations only provides that no officer who has dealt with the matter or is an interested party shall be appointed as an Enquiry Officer. It is not the case of the said broker that the Enquiry Officer is an interested person or that she has dealt with the matter. With regard to the Enquiry Officer calling for details from the inspecting official, I find that the Enquiry Officer is competent to do so, and in any case, no prejudice is caused to the said broker since she called for details in front of the said broker himself and he had had an opportunity to rebut the same. Hence, I find no merit in the submission of the said broker that the enquiry was not conducted in accordance with the Enquiry Regulations.

6.1 I find that the said broker has

- i. failed to comply with several requirements in respect of issue of contract notes,
- ii. failed to maintain separate accounts for clients' funds and own funds,
- iii. acted as sub-broker without obtaining registration from SEBI as such,
- iv. dealt with unregistered sub-brokers,
- v. failed to make payments to clients in time
- vi. attempted to mislead the Enquiry Officer and SEBI.

6.2 In view of the above, I agree with the recommendation of the Enquiry Officer that a suitable penalty ought to be levied on the said broker, for having violated the various regulatory requirements. I have also noted from the submissions made by the said broker, in response to the allegations made against them, that they have poor knowledge of the regulatory requirements with respect to a registered broker. In addition, they have delayed payments to their clients, acted as sub-brokers to

brokers of other exchanges, allowed brokers of other exchanges to act as their sub-brokers, lent securities to their clients etc. They have also failed to implement several SEBI directives viz maintenance of separate client/own account, running serial numbers for contract notes etc.

- 6.3 In view of the above, despite having given the benefit of doubt to the said broker on some allegations, I feel that that the penalty of suspension of registration for a period 3 months, as recommended by the Enquiry Officer, should be imposed on the said broker, given the facts and circumstances of the case.

7.0 **ORDER**

Therefore, I, in exercise of powers conferred on me under Section 19 of the SEBI Act, 1992, read with Regulation 13 (4) of the Enquiry Regulations, do hereby suspend the certificate of registration, bearing No. INB050988137, granted to M/s LRM Securities Limited, for a period of three months. This Order shall come into effect on the expiry of 21 days from the date of this Order.

Place: Mumbai

Date : June 17, 2004

A K BATRA

Whole Time Member

Securities and Exchange Board of India