

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER REGULATION 13(4) OF SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002.

AGAINST M/S CHOLAMANDALAM SECURITIES LTD., SEBI No. INB 0230759932

1. Securities and Exchange Board of India (hereinafter referred to as SEBI) conducted investigation into the dealings in the scrip of Moschip Semiconductors Limited (hereinafter referred to as 'Moschip') for the period May 07, 2001 to May 31, 2001, noticing unusual price rise during the said period. Two entities, namely M/s Vijay Growth Financial Services (VGFL) and Shri B. Jayaprakash, one of its employee were found to have traded substantially in 'Moschip' during the investigation period. Which resulted in the establishment of higher price level for 'Moschip' during the said period. It was also found that M/s Cholamandalam Securities Limited (hereinafter referred to as 'Cholamandalam') had bought 12,625 shares and sold 1,000 shares of Moschip on behalf of Shri B Jayaprakash over a period of 3-4 days in May and June 2001.
2. Based on the findings of investigation, an enquiry under Regulation 4 (a) of SEBI (Proceedings for Holding Enquiry and Imposing Penalty) Regulations, 2003 (Enquiry Regulations) was ordered by SEBI vide its order dated September 24, 2003 to enquire into the alleged violations committed by M/s. Cholamandalam, a member of the Stock Exchange, Mumbai (hereinafter referred to as 'BSE') in respect of their dealing in the scrip of 'Moschip'.

FINDINGS AND RECOMMENDATIONS OF ENQUIRY OFFICER

3. A full fledged enquiry was conducted by the Enquiry Officer (hereinafter referred to as 'E.O.'). During the enquiry, I note that inter alia statements of Mr. D.B. Reddy, Director of VGFL and that of Shri Pandiyen dated December 18, 2002 recorded during the investigations before SEBI have been noted by the EO. Other relevant records have also been dealt with by the E.O.
4. After completion of enquiry, the Enquiry Officer gave following findings:
 - a) Cholamandalam accepted cheques issued by M/s Vijay Growth Financial Services Ltd. for purchase of shares by Shri B. Jayaprakash.
 - b) Cholamandalam accepted Shri B. Jayaprakash as a client without proper verification about his employer.
 - c) Cholamandalam executed orders on behalf of Shri Jayaprakash for Rs.6.19 lakhs in the scrip of Moschip whereas his annual income was Rs.3 lakhs only.

On the basis of above findings, EO concluded that Cholamandalam failed to exercise due diligence, care and skill expected of a registered stock broker under clause A (2) of the code of conduct for brokers specified in schedule II of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 and recommended that a penalty of suspension of registration for a period of 2 months be imposed on 'Cholamandalam'.

SHOW CAUSE NOTICE

5. A show cause notice (hereinafter referred to as SCN) dated April 7, 2004 enclosing therewith the enquiry report was sent to M/s. Cholamandalam asking them why action as recommended by Enquiry Officer should not be taken against them. They were asked to furnish reply in 15 day's time.

REPLY

6. A reply dated April 22, 2004 was received from Cholamandalam. The submissions made by Cholamandalam are as under:
 - i. Except to the extent specifically accepted or admitted, all the contentions in the SCN are denied.
 - ii. the findings of the investigation by SEBI was "M/s Cholamandalam Securities Limited accepted cheques issued by M/s Vijay Growth Financial Services Ltd. for payment of shares (*sic*) by Shri. B. Jayaprakash has bought through it which is violation under clause A (2) of the code of conduct for brokers specified in schedule II of SEBI (Stock Brokers and Sub-brokers) Regulations, 1992.". Thereafter, the E.O. in his report has traversed beyond the findings of investigation. Additional violations have been raised by E.O. that Cholamandalam had accepted Shri Jayaprakash as a client without proper verification about his employer and that it executed an order on behalf of Shri Jayaprakash for Rs 6.75 lakh shares in 'Moschip' whereas his annual income was only Rs 3 lakhs. These additional grounds were not matters for which they were directed to show cause. Thus the findings of E.O. are bad in law and against the principles of natural justice.

- iii. Clause 2 of Code of Conduct of Stock Broker Regulations has not been violated by them and they had exercised due skill, care and diligence in the conduct of their business.
- iv. Cholamadam is a part of Rs.4200 crore Murugappa Group – the South India based group having other reputed companies also in its group. This group is known for high level business ethics and moral values, always ahead in good corporate governance. The group was awarded with IMD family business award 2001. All the businesses are run by professionals. Cholamadam is a wholly owned subsidiary of Cholamandalam Investment and Finance Co. Ltd. (CIFCL). CIFCL is a public listed 'AAA' rated company with a clean track record of regulatory compliance and corporate governance of 25 years. Cholamadam is in the stock brokerage business since 1995 and it has reputed institutional clients like UTI, LIC, GIC, ICICI Bank, Prudential ICICI Mutual Fund etc. They also have 1100 non institutional clients across the country.

Cholamandalam is a corporate member of NSE, BSE and Depository Participant at NSDL. They are managed by a team of professionals and Price Water House is their statutory auditors. They had always maintained high level of compliance with the rules and regulations of SEBI and Exchanges. No disciplinary action was taken against them till date.
- v. Shri Jaiprakash had become a client of Cholamadam on 15.05.2001. He was introduced by their already existing client M/s Andhra Pradesh Industrial Corporation (APIDC) Venture Capital Ltd. Cholamadam had obtained "Know Your Client" form / "Individual Client Registration Form" from Shri Jaiprakash apart from the execution of member client agreement. All these agreements / forms were annexed to the reply.
- vi. They claimed that "know your client" forms obtained from Shri Jaiprakash and VGFL were strictly in consonance with SEBI circular No. SMD I/23341 dated 18.11.93. All relevant details were taken from Shri Jaiprakash and all the trades executed by Shri Jaiprakash were settled within the statutory limits. They have not funded Shri Jaiprakash for the trades and there was no connection / link / relation whatsoever with Shri Jaiprakash except that of a client. All the obligations vis-à-vis the client were complied with by them and hence they cannot be accused of non exercising due skill and care.
- vii. While admitting the rise in the price and volume of the scrip of Moschip from May 7, 2001 to May 31, 2001, they denied that Shri Jaiprakash and VGFL traded substantially in the scrip during the said period.
- viii. They pleaded ignorance of the fact that Shri Jaiprakash & VGFL were common clients of Cholamandalam & Techo Shares and Stock Ltd. and denied the finding that the trading by Shri Jaiprakash & VGFL resulted in the establishment of higher price in the scrip of Moschip in levels from Rs.25.80 to Rs.50/-.
- ix. With respect of the finding of EO that trading of Shri Jaiprakash for an amount of Rs.6,75,000 in a single month, who had indicated an annual income of Rs.3 lakhs in the client registration form should have raised doubt in the mind of Cholamandalam, it was submitted that these details in the client registration form are basically nothing but self certification / declaration by the client regarding his personal information. In the ordinary course, the member is supposed to accept the said self declaration unless something is patently wrong. Also the information regarding the income given by the client is at a particular time for the previous years and the same can never be constant. It was further submitted that at the relevant time, they had 1790 clients dealing in over 1500 scrips. Scrutinizing the transactions of the clients vis-à-vis the income disclosed by him in the client registration form would have neither been pragmatic nor operationally flexible. Shri Jaiprakash was dealing with them since May 2001 and had traded in a number of scrips like Moschip, Satyam, Wipro etc. In all the transactions he was regular in making the payments and delivering the shares towards the pay in obligations. They never had any occasion to doubt the credibility of Shri Jaiprakash in terms of meeting his obligations. The volume of trades of Shri Jaiprakash was less than 0.01% of the company's overall business volume for the year 2001-2002.

It was further submitted that the client may have various sources of income. Certain times the clients raised loans for trading in the market, which might be over and above their disclosed income in the client registration form. If the member ensures that the client is able to meet his pay in obligations vis-à-vis the member, the same would amount to exercise of reasonable diligence. Their assessment of the financial credibility of the client was correct as may be seen from the fact that Shri Jaiprakash did not default in the transactions entered through them.

So far as the source of funds of the client is concerned, the member has no locus to question the client. Also it was not feasible for the member to get into the details as to why a particular client is trading in a particular scrip and with what intention. They submitted that the regulations prescribed by SEBI do not lay down anything to the effect that a client's transactions with the member should be restricted to the income as declared by the client in his application form. Therefore, the EO has no valid ground to hold an enquiry for an alleged violation of a non existent regulatory provision. This they said was without prejudice to the ground that the findings of EO not forming part of the show cause notice and hence the enquiry was non est.

- x Regarding the observation of EO that the scrip was not so frequently traded, Cholamandalam submitted that scrip was fairly liquid having volume of 181571 shares in BSE during the period April 2 to May 14 2001, when they started trading for Mr. Jaiprakash. Even during the period May 15 to 31, 2001, Cholamandalam traded in 15350 shares of Moschip for Mr. Jaiprakash against the market volume of 61355 shares. Also there was no palpable fluctuation so as to arise any doubt in the mind of the member regarding his trading.
- xi. With respect to the finding of EO regarding the employment of Shri Jaiprakash, Cholamandalam submitted that they had obtained all the details / forms from the client as mandated by SEBI. They submitted that the client registration form do not provide for obtaining the details of the employer of the clients. They had obtained the details of the occupation of the client, and the client indicated "service". Further, even the availability of the details of the employer on the date when the alleged transaction took place, would not have made any difference as there was no nexus between the trading pattern of the client and the details of the employer.
- xii. As regards the finding of the EO that " I also do not find explanation that there is no bar regarding acceptance of payment from third party as satisfactory", it was submitted that the same was fallacious and untenable. It was further submitted that the acts of the member should be judged in the light of rules and regulations prevalent at the time when the alleged violation took place, in May 2001. While referring to the circulars governing the transactions between the member and the client

(a) SMD/SED/CIR/93/23321 dated 18.11.93

(b) Letter No. SMD-1/23341 dated 18.11.93

It was submitted that both the circulars viz. (a) & (b) are silent on the aspect of "third party payment".

The circular dated 27.08.2003 has come into effect on 27.08.2003, whereby the acceptance of cheques from third parties was prohibited and since the receipt of cheques from Mr. Jaiprakash was in May 2001, much prior to the circular dated 27.08.2003, the charge that Cholamandalam violated the provisions of the regulations cannot stand scrutiny.

It further stated that the EO has not quoted any specific provision of SEBI rules / regulations / circular or bye laws of the Exchange which prohibits acceptance of third party payments by the broker on behalf of the clients. Thus the finding of EO was based on non existent provision and deserves to be set aside especially when the consequence of the finding was penal in nature.

- xiii The observation of EO to the effect that their actions disturbed / compromised the safety and integrity of the market, was stated to be incorrect and misleading. They argued that there was no case of EO that they manipulated / aided or abetted in the manipulation / had the knowledge of manipulative intent / traded in the scrip so as to earn profits, and thus have failed in their duty to maintain safety and integrity of the market.
- xiv They further stated that if their alleged actions had the capacity to disturb the safety and integrity of the market, the EO should have held them guilty of violating clauses A(3) and (4) of Code of Conduct, which is not the case. Allegations of the violation of Clause A(2), by the EO, were not in sync with the facts of the case and his own findings. Since, there was no legal bar to accept payment from third party on behalf of the clients, the cheque was accepted. However, the moment they noticed the same in the payment details, they intimated the client their inability to accept the third party cheques in future as a prudent business practice and thereafter all the payments from Shri Jaiprakash were received directly. After receipt of summons from SEBI, they have severed their relationship with the client on 04.12.2002. Therefore, they cannot be alleged non diligent or that their acts even remotely disturbed the safety and integrity of the market.
- xv The imposition of a penalty of suspension for two months, they said, for the alleged non existent provisions of Clause A (2) of the Code of Conduct was unjustified and exceedingly harsh. It is an established principal of law that the quantum of penalty should have nexus with the nature of violation and it should not be disproportionate.
- xvi. The following findings/observations from certain judgments were cited by Cholamandalam in support of their contentions :

a) M J Patel v/s SEBI (2002) 38 SCL 889

"suspension or cancellation of the certificate granted to carry on broking business is not a matter which could be treated lightly. In the absence of sufficient justification supported with reasonable evidence, such a penal action cannot be sustained"

b) Hindustan Steel v/s State of Orissa AIR 1970 SC 253

"An order imposing penalty for failure to carry out a statutory obligation is the result of a quasi criminal proceeding and penalty will not be ordinarily imposed unless the party obliged either acted deliberately in defiance of law or

was guilty of conduct contumacious or dishonest or acted in conscience disregard of its obligation. Penalty will not also be imposed for failure to perform a statutory obligation is a matter of discretion of relevant circumstances. Even if a minimum penalty is prescribed the authority competent to impose the penalty will be justified refusing to impose penalty, when there is a technical or venial breach of provisions of the act or where the breach flows from a bonafide belief that the offender is not liable to act in the manner prescribed by the statute."

c) Ex-Nayak Sardar Singh v/s UOI (1991) 3 SCC 212.

" the penalty imposed must be commensurate with the gravity of the misconduct and that any penalty disproportionate to the gravity of the misconduct would be violative of Article 14 of the Constitution."

HEARING AND WRITTEN SUBMISSIONS

7. An opportunity of hearing was granted to Cholamandalam on October 12, 2004, which was communicated vide letter dated September 20, 2004. On the said date of hearing, Shri D J Khambata & Shri Vinay Chauhan, Advocates, S Bhaskar and R Pandiyen from Cholamandalam appeared before me. Shri Khambata made the oral submissions on behalf of Cholamandalam.

8. Subsequently, vide letter dated October 15, 2004 interalia, following submissions were made:

(A) As far as the violation of the Clause A (2) of Code of Conduct for Brokers as specified in Schedule II of SEBI (Stock Brokers and Sub Brokers) Regulations 1992 is concerned, Cholamandalam submitted:

(a) At the relevant time, they had no reason to doubt the bonafides of the client, Jaiprakash since he was introduced by Mr. A. Ramesh, Vice President of Andhra Pradesh Industrial Corporation (APIDC), an institutional client of theirs.

(b) SEBI Circular No.SEBI/MRD/SE/Cir-33/2003/27/08 dated August 27, 2003 prohibiting acceptance of third party cheques on behalf of clients by the Brokers came into effect only in August 2003, whereas they had accepted third party cheque on behalf of Mr. Jaiprakash in June 2001. The issuance of said Circular by SEBI is clear indicator of the fact that prior thereto acceptance of third party cheques was a normal market practice.

(c) Since the law at the relevant time was not clear with regard to the acceptance of third party cheques and also there was no express legal bar on the same, they cannot be held guilty of violation of Code of Conduct on this account.

(d) The retrospective effect cannot be given to the said SEBI circular, which would be against the well established cannons of law.

(e) They had accepted third party cheques on behalf of Mr. Jaiprakash only on three occasions i.e. on 29/5/01, 7/6/01 & 9/6/01. The said cheques were against the payment obligations of Mr. Jaiprakash towards purchase of many shares including Moschip.

(f) Save and except the aforesaid three cheques, subsequent to 9/6/01 they have obtained cheques directly from Mr. Jaiprakash.

(g) Since said cheques were received alongwith the covering letters from M/s. Vijay Growth Financial Services, they accepted the same for adjusting the amount towards the already accrued liability of Mr. Jaiprakash.

(h) The Client Registration Form as prescribed by SEBI was got duly filled in by Mr. Jaiprakash. Column for occupation as stipulated in the Client Registration Form does not require the details of the Employers to be filled in by the Client.

(i) In view of the aforesaid, they exercised adequate due skill, care and diligence as expected from a broker in terms of Code of Conduct and there was no violation of the provisions of the same.

(B) Citing the orders passed by SEBI in the cases of M/s. Batliwala Investment, M/s. J.M. Morgan Stanley Retail Services Pvt. Ltd, M/s. Bama Securities, M/s. Ratanbali Capital Markets Ltd., M/s. Twenty First Century Shares & Securities Ltd., M/s. Sanjay C. Bakshi, M/s. Mahesh Kothari Share & Stock Brokers Pvt. Ltd., and M/s. Mukesh Sawhany, it was submitted that nature of violations in those cases were more grave as compared to their alleged violations. Cholamandalam said that SEBI had issued simple warning to the said brokers and proposed to suspend them for 2 months.

(C) Cholamandalam also referred to the orders passed by Hon'ble Securities Appellate Tribunal in Appeal Nos 53/2003 (Samkit Share & Stock Brokers Pvt Ltd vs SEBI) dated 31/08/04 and Appeal No 95/2003 (Chona Financial Services Pvt Ltd vs SEBI) dated 23/08/04 wherein Hon'ble SAT has reduced the penalty from suspension to warning after taking into account the following factors:

a) whether there was irregularity;

b) whether the irregularities were merely of technical nature or were serious irregularities

c) what is the nature of penalty to be imposed.

(D) Cholamandalam submitted that following mitigating factors may also be considered while taking a view in the matter:

- 1) Impeccable track record
- 2) Non action taken by any Regulatory Body including SEBI and NSE till date.
- 3) No proprietary trading done by them during the relevant period.
- 4) No trading done by the directors/employees/relatives/associates during the relevant period in the scrip of Moschip.
- 5) No funding/financing done by them for the alleged manipulation done by Mr. Jaiprakash.
- 6) The transactions done by Mr. Jaiprakash, through them, constituted only 0.01% of the total turnover of our company that year.
- 7) No prejudice has been caused to any investors in the market.
- 8) In the alleged transactions, they have only earned the brokerage.
- 9) No default done either by Mr. Jaiprakash or by them in meeting its payment/delivery obligations. They were not aware that Mr. Jaiprakash was trading through other brokers also for manipulating the price of the scrip as alleged.

To sum up, it was submitted that they have not violated Clause A(2) of Code of Conduct for Brokers as specified in Schedule II of SEBI (Stock Brokers & Sub Brokers) Regulations 1992 and that they have conducted business with due skill, care and diligence and hence the charge as alleged in the show cause notice may be dropped.

CONSIDERATION OF ISSUES AND FINDINGS :

- 9 I have carefully considered the findings of Investigation Report, Show cause notice, the findings of Enquiry Officer, reply and written submissions of Cholamandalam. From the price movement data, I find that there was a rise from Rs. 25.80 on May 7, 2001 to Rs. 50.85 on May 31, 2001 in Moschip. I observe that increase in the price and volume of the Moschip was sudden. Two entities namely VGFL and Shri. B. Jayaprakash were found to be trading substantially in Moschip. I also find that Shri B. Jayaprakash, an employee of VGFL and VGFL itself were the common clients of Techno Shares & Stocks Ltd. a BSE Member and Cholamandalam. I also find that transactions by above entities had resulted in the establishment of higher price level for scrips of Moschip from Rs. 25.80 to Rs. 50.00 during the said period in May, 2001. Proceedings under Section 11B of SEBI Act, 1992 are pending against Shri Jayaprakash. The certificate of registration of VGFL has already been cancelled after summary proceedings. I understand on the basis of information from Hydrebad Stock Exchange, where VGFL was registered as a member as well as from the official liquidator that company, VGFL has been wound up.
- 10 I find that Cholamandalam had bought 12,625 shares and sold 1,000 shares of Moshcip on behalf of Shri B Jayaprakash on 6 days during May and June, 2001. It had sold 2275 shares of Moschip for other clients also.
- 11 I find that Shri B Jayaprakash bought 31,639 shares of Moschip during the said period. Shri B. Jayaprakash traded with Cholamandalam and M/s Paark Securities, sub-broker with the BSE broker M/s Techno Shares & Stock Brokers Ltd. He has bought 12,385 shares of Moshcip through Cholamandalam and 19,254 shares through Paark Securities. I find that VGFL paid Rs. 6.75 lakhs for the shares of Moschip bought by Shri. B. Jayaprakash through Cholamandalam vide cheque nos. 213634 dt May 29, 2001 for 2.25 lakhs, 213662 dt June 7, 2001 for Rs 4 lakhs and 213672 dt June 9, 2001 for Rs. 50,000. This is also corroborated by statement of Mr. D. B. Reddy, Director of VGFL, who stated as under: (reproduced):-

"Cholamandalam Securities approached us for trading in securities since M/s Vijay Growth Financial Services Ltd. (VGFL) had no membership at BSE. Shri B Jayaprakash who handles our securities trading business was authorized to deal with Cholamandalam Securities. I understand now that since client account opening in the name of the company was likely to take a couple of weeks because the headquarters of Cholamandalam Securities is located at Chennai. Shri B Jayaprakash has bought these shares in his own name and the payment was made by M/s Vijay Growth Financial Services Ltd. (VGFL) for about Rs. 8,75,000 for these transactions. I agree that it was an irregular transaction and I request that this may be treated as procedure lapse."

Mr. R. Pandiyen, Senior Manager, Cholamandalam in his statement dated December 18, 2002 recorded during the investigating officials from SEBI stated that they have traded on behalf of Shri B. Jayaprakash, Mr. G. S. Prasad, Mr. P. P. Shastri, Mr. K. Angurathinam, Mr. R. V. Ramamurti and Mr. S. Venkatesh during the period May-June, 2001. In reply to a question regarding payments received from Shri B. Jayaprakash, he stated as under:

"Payment was received from Shri. B. Jayaprakash. However, we noticed certain account payments given by Shri B. Jayaprakash were cheques drawn by Vijay Growth Financial Services Ltd. vide cheque nos. 213634 dt May 29, 2001 for 2.25 lakhs, 213662 dt June 7, 2001 for Rs 4 lakhs and 213672 dt June 9, 2001 for Rs. 50,000 towards the trading of approximately 16 scrips namely Global Telesystem, Satyam Computers, Infosys etc. including Moschip Semiconductors Ltd. In view of the huge outstandings we have taken these cheques initially and as a matter of business prudence we have refused to accept third party cheques for future transactions. Except the above, all other payments of Rs. 8.5 Lakhs (approximately) vide cheque nos. 213679 (Rs. 2 Lakhs), 213681 (Rs. 2 Lakhs), 214507 (Rs. 1 Lakh), 214508 (Rs. 2 Lakhs), 873370 (Rs. 1 Lakh) and 873378 (Rs. 50,000) were directly issued by Shr. B. Jayaprakash in June and July, 2001. All the shares purchased by Shri B. Jayaprakash i.e. 18,850 shares have been transferred directly to his depository account no. 20203187 with SHCIL irrespective of the receipt of the payments and the copy of the transfer instructions are enclosed. For the sale through us, we have received 2,500 shares from his client ID with the depository Karvy consultants with client ID no. 10015508. Subsequent to our refusal to accept third party cheques from Shri B. Jayaprakash, Vijay Growth Financial Services Ltd. has opened a separate account for trading in BSE through us on October 24, 2001. Subsequent to this date both the accounts were operated independently. Currently, we have stopped trading on behalf of these clients.

13. When asked to inform the name of broker with whom Shri B. Jayaprakash used to trade in the scrip, before he started trading with Cholamandalam,

Shri Pandiyan stated :

"The reference for Shri Jayaprakash and Vijay Growth Financial Services Ltd. were given to us by our existing institutional customer APIDC and we were not aware of their dealings with other brokers. He has not disclosed in the client registration form about the dealings with other brokers. Mr. Rajamohan Shetty, General Manager (F) and company secretary of Vijay Growth Financial services Ltd. while enrolling the company as non individual client have also not stated the broker or the exchange they were dealing with".

14. When asked to comment whether Shri B. Jayaprakash was an employee with Vijay Growth Financial services Ltd. with Rs. 14,000/-, and he has shown an income of Rs. 3 Lakhs in their client form, he replied as below:

"As per our client identification form, he has indicated his annual income as Rs. 3 Lakhs. He has not stated that he was an employee of Vijay Growth Financial services Ltd. either in the registration form or in the member client agreement form. However, in the occupation column he has indicated as 'Service', and he did not mention his PAN No. in the column for Income Tax No. (PAN/ GIR)."

From the above, I find that VGFL has funded the purchases made by Shri Jayaprakash by paying Rs. 8.75 lakhs to Cholamandalam. Cholamandalam accepted the cheques issued by VGFL for the payment Shri Jayaprakash was to make for his purchases in the scrip.

I also find that facts as narrated by the director of VGFL during the investigation before SEBI are entirely different. These set of facts do not find place in the reply/submissions of Cholamandalam at any point of time. As seen from the statement of VGFL at para 10 above, since VGFL was not a member of BSE, Cholamandalam approached VGFL to trade in shares. And since the account opening in the name of a company was likely to take time, Shri Jayaprakash, who handles the securities trading business of VGFL and who is the authorised person of VGFL to deal with Cholamandalam, bought the shares in his name. The facts that emerge from the above are that VGFL is regularly involved in the securities trading business and in the instant case, Cholamandalam was the one who approached VGFL. This fact has not been denied by Cholamandalam anywhere, and in contradiction to the facts stated by VGFL, it submitted that Shri Jayaprakash approached it.

In the circumstances of the case, I find that the E.O has rightly found that Cholamandalam has not exercised due caution, care and diligence. I also agree with E.O that Cholamandalam, while taking the payment from VGFL ought to have been careful. This becomes more relevant in view of the fact that the purchase of the shares by Shri Jaiprakash and VGFL did result in manipulation of the price of the scrip, 'Moschip'. I find that VGFL became a client of Cholamandalam only in October, 2001. Cholamandalam has said that it was not aware of VGFL when it accepted its cheque made on behalf of Shri Jayaprakash. I find that details of cheque entered in the ledger shows the cheque numbers of VGFL. I find that Shri Jayaprakash who was a client of Cholamandalam from May, 2001, had indicated that his annual income is Rs. 3 lakhs in the client registration form submitted with the member. This is also corroborated in the statement given by Shri Pandiyan dated 18.12.2002 to investigating officer. Trading of shares by Shri Jayaprakash in the scrip like Moschip which is not so frequently traded upto Rs.6,75,000/- (that too in a single month) when his annual income is Rs. 3 lakhs p.a., should have created suspicion in the mind of Cholamandalam. I find that Cholamandalam has stated that it was not aware that Shri Jayaprakash was an employee of VGFL. Even assuming this to be correct, according to me, had Cholamandalam exercised due care and diligence while taking Shri Jayaprakash as its client and in executing trades on accepting third party cheques for Rs.6.75 lakhs from VGFL and 8.5 lakhs from Shri Jayaprakash in a month when his annual income was Rs.3 lakhs, the manipulation in the shares could have been checked. Although the veracity of statement made by Cholamandalam has to be doubted, in view of the statement of VGFL, I do not agree with the submission of Cholamandalam that "If the member ensures that the client is able to meet his pay in obligations vis-à-vis the member, the same would amount to exercise of reasonable diligence."

I agree that 'reasonable diligence' is a subjective criterion. However, the responsibility of a registered intermediary vis-à-vis securities market is of higher degree compared to the clients who trade through them. On obtaining a certificate of registration from regulator the intermediary has to conduct himself in a serious, careful and diligent manner, complying with respective regulations and upon cognizance of the violations by registered intermediary during investigation, a full fledged enquiry is conducted against them. Against the clients, proceedings under 11B or 11(4) of SEBI Act, 1992 are initiated, pursuant to investigation. The registration granted by SEBI to an intermediary attaches responsibility upon the said intermediary to act diligently and in accordance with applicable rules and regulations and sound market practices. A broker who is an important intermediary in the capital market has an obligation to carry out its business in a manner so that safety and integrity of the market may be maintained.

I note that Chola mandalam has contended that there is no prohibition in SEBI regulation for accepting cheque issued by 3rd parties towards discharge of liabilities of the clients of brokers. The circular applicable on the issue has come into force subsequent to the alleged violations. In this regard, I note that the byelaws of the exchange lays down norms for 'know your client' and obligations to, 'keep money or securities of clients separately' etc.

I have gone through the replies and submissions made by Chola mandalam. The charge against the member has never been that any circular of SEBI was violated, as argued by Chola mandalam. On the other hand, the conduct expected from it as a registered intermediary is not being delivered. Based on the facts found by the E.O. along with the contradictions noted in the stand taken by Chola mandalam and VGFL, I find that the conduct of Chola mandalam has resulted in the violation of Clause A (2) of Schedule II of SEBI (Stock Broker and Sub-broker) Regulations, 1992, which reads as follows:

Code of Conduct for Stock Brokers

A (2) Exercise of due skill and care: A stock broker shall act with due skill, care and diligence of all his business.

ORDER

20. In view of the above, I in exercise of powers conferred upon me under section 4(3) of SEBI Act, 1992 read with SEBI (Stock Broker and Sub-broker) Regulations, 1992 and Regulation 13(4) of SEBI (Procedure For Holding Enquiry By Enquiry Officer And Imposing Penalty) Regulations, 2002 direct that certification of registration bearing SEBI Registration no.INB 0230759932 be suspended for a period of two months.

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

Date : January 27, 2005

Place : Mumbai

G.N.BAJPAI

CHAIRMAN

SECURITIES AND EXCHANGE BOARD OF INDIA