

## 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 KORP SECURITIES LTD., MEMBER, NATIONAL STOCK EXCHANGE, HAVING SEBI REGISTRATION NO. INB230905936****1.0 BACKGROUND**

- 1.1 Korp Securities Ltd. (hereinafter referred to as "KSL") is a member, National Stock Exchange, ("NSE") having SEBI Registration No. INB230905936.
- 1.2 An inspection of the books of accounts, other records and other documents of the broker was carried out for the period from 01.04.2000 to 30.09.02. The following irregularities were observed during the said inspection:
- Violation of 8(1) (f) and 8(3) (f) of Securities Contract Regulation Rules
  - Violation of SEBI circular dated 31.3.1997 and section 12 of the SEBI Act.
  - Violation of Regulation 17(1) of SEBI Stock Brokers Regulations, Regulation 18 of SEBI Stock Broker Regulations, 1992 and SEBI circular no.: SMD/ POLICY/ IECG/ 1-97 dated February 11, 1997.
  - Violation of SEBI Circular no. SMD/SED/CIR/93/23321 dated 18.11.93
  - Violation of SEBI Circular no. SMDRP/Policy/Cir-05/2001 dated February 01, 2001
  - Violation of SMD/POLICY/CIRCULARS/5-97 dated 11.04.1997
  - Violation of SEBI Circular No. SMDRP/Policy/CIR-39/2001 dated July 18, 2001
  - KSL indulged in trade transfers.
  - Violation of Rule 4 (c) of SEBI (Stock brokers and Sub-brokers) Rules, 1992.

**2.0 ENQUIRY PROCEEDINGS**

- 2.1 In view of the above, an Enquiry Officer (EO) was appointed vide SEBI Order dated 04.12.03 under Regulation 5(1) of SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as Enquiry Regulations) to enquire into the alleged contraventions observed during the inspection of books of accounts of the broker. The EO submitted his report on 28.06.04. The EO concluded that KSL is guilty of the violations found during inspection as listed at paragraph 1.2 above.
- 2.2 After considering all the issues, the Enquiry Officer recommended suspension of certificate of registration of KSL for a period of six months.

**3.0 SHOW CAUSE NOTICE AND KSL'S SUBMISSIONS**

- 3.1 A show cause notice dated 30.06.04 was issued to KSL, in terms of regulation 13(2) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as 'the said regulations'), advising it to show cause as to why the appropriate penalty including the penalty as recommended by the EO should not be imposed on it.
- 3.2 KSL replied to the said show cause notice vide its letter dated 20.07.04 and submitted that the errors reflected in the inspection report as well as the show cause notice had been committed inadvertently due to ignorance and lack of proper knowledge. It further stated that the director was unable to concentrate on the business proceedings due to prolonged illness which led to inadequate documentation and improper furnishing of details to the inspecting authorities. It further stated that there was no willful negligence and they acted in good faith.
- 3.3 It further pleaded that they have already suffered heavily due to the inspection proceedings. It also stated that it had transferred the shares of the broking company without prior intimation to SEBI and NSE and hence NSE had disabled its terminal from 24.04.04.

- 3.4 Therefore it pleaded for a lenient view and stated that they would comply with all the requirements of SEBI in future and would ensure that the errors are not repeated.

#### **4.0 CONSIDERATION OF ISSUES**

I have carefully examined the facts and circumstances of the case, the findings and recommendations of the Enquiry Officer and the submissions made by the broker. I find that adequate opportunity has been given to KSL in accordance with principles of natural justice.

The following issues arise for consideration:

##### **4.1. Whether KSL indulged in fund based activity**

In respect of indulging in fund based activity and thereby violating Rule 8(1) (f) and 8(3) (f) of Securities Contract (Regulations) Rules, 1957 (hereinafter referred to as "S.C. (R) Rules" ). KSL stated that they have not undertaken any activity apart from broking activity. KSL further stated that amounts in question were small and have been received as advance against shares. Since certain transactions had not materialized and the money was returned back, the cheques received/given as mentioned in the report were all incidental to security business.

I note that the inspection report shows that KSL received money from the client or credit balance in the client account which was brought forward for a number of months, though no transactions were being carried out with such clients. In certain cases, money was paid to the client even though no transactions were carried out with the client. In some cases the money was received but no transaction took place and the report stated that the money was still lying with KSL. In view of this, the contention of KSL is not convincing and tenable. I have noted that Rule 8(ii)(f) and 8(3) (f) of SCR Rules have been incorporated in the Bye-laws/Rules of the exchange. The requirement to abide by rules, bye-laws of stock exchange is one of the conditions of registration under Rule 4(b) of stock broker rules.

Therefore I agree with the findings of the Enquiry Officer and hold KSL guilty of violation of Rule 4(b) of Stock Broker Rules.

##### **4.2. Whether KSL dealt with un - registered sub- brokers**

As brought out from the inspection and enquiry reports, I note that KSL dealt with unregistered sub-brokers such as Global Stock and Finance Services, Anuj Goenka, Pramod Vaid etc. KSL however claimed that they were their regular clients. KSL submitted that in some cases the parties instructed to directly transfer the shares in certain demat accounts and accordingly they have executed the transfers. It was further stated that they had not knowingly dealt with any unregistered sub-brokers.

I find that the scrutiny and cross-checking of the Demat Statement of the Pool Account with the client ledger of KSL by inspecting authority showed that few firms/ persons claimed to be clients of KSL were actually transacting not for themselves but for others, which proves that KSL has acted as unregistered sub-broker.

I have noted that though the transactions in the books were shown in the name of 'Global Stock Financial Services', Pool A/c of Korp Securities Ltd. showed that there were many instances where the shares were actually delivered to/ from other miscellaneous Demat Accounts, thus indicating that the securities were actually delivered to/from a number of other persons, which are the clients of 'Global Stock Financial Services' itself. These instances where the shares were traded in the name of 'Global Stock Financial Services' and actually transferred to/ from other Demat Accounts are furnished in the inspection report .

In the case of the client, 'Anuj Goenka' as per the information and authorization letter furnished to inspection team, the shares of this client were kept in the beneficiary account of KSL and no information was available regarding the own Demat Account of Anuj Goenka, which indicates that Anuj Goenka is not the ultimate client of KSL and accordingly KSL has dealt with unregistered sub-broker. I find instances where the shares have been traded in the name of 'Anuj Goenka' and actually transferred to/ from a number of other Demat Accounts as furnished in inspection report. Further, a few instances were noted by inspection team where the shares were traded in the name of 'Anuj Goenka' but the same did not figure in the Pool Account at all. In fact a detailed scrutiny by inspection team gives an indication that number of shares purchased/sold by Anuj Goenka was not routed through the Pool Account at all.

The explanation offered by KSL with regard to the Demat Account of client, Mr. Pramod Baid was the same as in the case of Anuj Goenka. It was explained that as per the authorization letter, the shares of the client were kept in the beneficiary account of KSL. I find that though the transactions in the books were shown in the name of 'Pramod Baid', a scrutiny of the Pool A/c of KSL by inspecting team shows instances where the shares were actually delivered to/ from other miscellaneous Demat Accounts, thus indicating that though transactions were shown in the name of 'Pramod Baid', the securities were actually delivered to/from a number of other persons, the clients of 'Pramod Baid'. The instances, where the shares were

traded in the name of 'Pramod Baid' and actually transferred to/ from other Demat Accounts were furnished in the inspection report.

I, therefore agree with the findings of inspection team and the Enquiry Officer. Thus KSL dealt with unregistered sub-broker and the same is in violation of SEBI circular dated 31.3.1997 and section 12 of the SEBI Act.

**4.3. *Whether Order Book was properly maintained by KSL.***

KSL has not denied that Order Book was not maintained by them. It was stated that the Order Book was not maintained as an undertaking was taken

**from all clients for doing the sauda verbally and confirming them and contract notes are issued and dispatched in next 24 hours of trade done.**

**The above reply of KSL cannot be accepted. Regulation 17(1) of SEBI Stock Brokers Regulations provides for maintenance of books and records, order book is to be maintained by the broker .Again as per Regulation 18 of SEBI Stock Broker Regulations, 1992 such books of accounts and other records are to be preserved for a period of five years. SEBI has provided vide CIR NO: SMD/ POLICY/ IECG/ 1-97 Dt. February 11, 1997 that the broker should maintain record of time when the client has placed the order and reflect the same in contract notes along with time of executing the order.**

**Thus I agree with the finding of the Enquiry Officer and hold KSL guilty of violation of above regulation and circular.**

**4.4. *Whether KSL failed to Segregate Client Funds from Own Funds.***

**It was observed during the course of inspection that KSL used client account for purposes other than specified. Only one 'Client Bank Account' was maintained by KSL. The finding of inspection showed that computer maintenance, Office Expenses, Legal Charges, Telephone Charges etc. were all paid through the Client Bank Account (with HDFC Bank, Kolkata Branch, A/C No. 79168009). KSL admitted that they maintained one account and also that day to day expenses were paid out of the same amount. However, it was denied that they had used the funds of clients. It was submitted that those expenses have been debited from the brokerage income of KSL credited to the same account. The inspection team also found Transfer of Money from Settlement Account to Client Account.**

During the course of inspection several instances were noted where amounts were directly transferred from the Settlement Account to Client Account. I find that the payment of day to day expenses of KSL from the client account is sought to be justified on the ground that the same was referable to the brokerage income of KSL credited to the same account. Even if the above is accepted as true it cannot be disputed that KSL has failed to segregate funds of clients with his own.

As per SEBI Circular no. SMD/SED/Cir/93/23321 dated November 18, 1993 issued, non segregation of clients funds and own funds is a violation of above circular and byelaws of the exchange as client and member relationship. I therefore agree with the finding of the Enquiry Officer and hold KSL guilty of violation of above circular and bye laws of the exchange.

**4.5. *Whether there were discrepancies in Contract Notes***

Finding of inspection showed that duplicates of the Contract Notes issued were maintained for the Financial Year 2001-2002. However, certain Contract Notes having the same serial number were maintained in the name of two clients. Contract Note Nos. 62 to 160 were all found having duplicate copies maintained in the name of two clients.

The explanation furnished by KSL with respect to the same was that though 'the saudas and dates are different but due to problem in back office the contract nos. were regenerated and released by his accountant.

The duplicate copies of certain contract notes were found to be altogether missing. Contract notes nos. 351 to 437 were entirely missing. In reply to the Memo No. 2 issued on 23.9.2002, the same were furnished to inspection team the next day i.e. on 24.9.2002. However, these Contract Notes lacked any information to indicate that the Contract Notes have been issued to the client. The signatures of the client on all the 99 contract notes (No. 351 to 437) were missing. In addition, Contract Note Nos. 0056 to 0069 were missing.

However, KSL stated that "0056 to 0069 no contract notes were there as contract note nos. skipped in the back office system and the following nos. were left blank.

The signatures of the clients on many Contract Notes were missing. Nowhere on the duplicate Contract Notes, was the date of signature by the client mentioned. Hence, there was no information to indicate whether the Contract Notes were issued

to the clients within 24hrs. Thus, in the absence of dated acknowledgements on the duplicate copies of the Contract Notes, delay if any, in issuance of Contract Notes could not be ascertained by the inspection team.

KSL stated that contract notes were available in other office and therefore same could not be presented. KSL did not deny about the discrepancies pointed out by inspection team. Certain deficiencies in respect of contract notes were attributed to back office problems. I find that neither the Duplicates nor the Counterfoils of Contract Notes were furnished to inspection team for the Financial Year 2000-01.

Regulation 18 of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 provides that every member of recognized Stock Exchanges shall maintain and preserve counterfoil or duplicate of the contract notes issued to the clients for a period of five years.

In view of the above instances, I agree with the finding of the Enquiry Officer and hold KSL guilty of violation of above regulations and circular dated 29.10.93.

#### **4.6. Whether there was delay in payment of funds**

The observation of inspection team showed that there existed no system of Settlement-wise payment to the client. Client Account was maintained on a running account basis. It was stated by the KSL that running account of client was operated on the basis of authorization letter received from the respective clients and that same was available with them.

SEBI Circular no. SMD/SED/CIR/93/23321 dated 18.11.93, provides that Member Brokers shall make payment to their clients or deliver the securities purchased within two working days of pay-out unless the client has requested otherwise'.

Based on the explanation of KSL, the Enquiry Officer has given a benefit of doubt to KSL, on the above allegation. The allegation is that KSL has no system of settlement –wise payment to the client. KSL explained that on the basis of authorization given by the clients, running accounts were maintained. Since there was no specific case of delay in payment to clients brought out against KSL nor any investor complaint, I am inclined to agree with the Enquiry Officer.

#### **4.7. Whether KSL delayed delivery/transfer of securities from pool account**

I find that KSL did not deny delivery of securities beyond 48 hours. KSL stated that the same was done as per the instruction of client. I observe that no proof of such authorization was furnished. There were many instances where delay in delivery of securities i.e. delay in delivery of more than 48 hours, were noticed.

SEBI Circular no. SMDRP/Policy/Cir-05/2001 dated February 01, 2001, with effect from February 12, 2001, clearing member shall be required to transfer the securities from their respective CM Pool account to the respective beneficiary account of their clients within 6 calendar days after the pay-out day, instead of the earlier time limit of 15 days. With effect from April 2, 2001, the time limit of 6 calendar days after the pay-out day for transferring the balances to the beneficiary accounts of clients has been reduced to 4 calendar days or 2 working days, whichever is later. KSL contended that the circular allows retention of securities if the clients have requested for the same and in this regard letters from the clients are available with it. I find that KSL has not produced such letters to the inspection team, the Enquiry Officer or before me. In view of this, I am inclined to accept the finding of the Enquiry Officer and find KSL guilty of violating the circular dated February 12, 2001.

#### **4.8. Whether KSL failed to maintain "Know Your Client" (KYC) database**

KSL stated that they have client registration form in old format and same can be produced. However, the Agreement and Registration Forms of many of these constituents were found missing. KSL has now claimed that same can be produced. Even it is accepted that such forms were maintained, it cannot be accepted as has been maintained as per the requirement due to the following discrepancies:-

- a) The letter from the Banker certifying the Account no. and the period from which the account is in operation was missing in most cases.
- b) In most cases, agreement and registration forms were obtained much after the date of commencement of transactions on behalf of the clients.
- c) In many cases, the registration forms were incomplete, both in the case of individual and corporate clients as under:-
  - i) Personal Details of the Directors/ Partners were incomplete as in case of 'Suvarna Commercial Pvt. Ltd.' and 'A.K. Commercial & Co.'
  - ii) In case of Individual Client Registration forms also, almost all the registration forms were incomplete.

I find that as per circular no. SMD/POLICY/IECG/1-97 dated 11.02.97 the member brokers have to maintain a database of their clients. As per SMD/POLICY/CIRCULARS/5-97 dated 11.04.1997, a uniform format has been prescribed by SEBI regarding 'Know Your Clients'.

In view of the above, I agree with the finding of the Enquiry Officer and hold KSL guilty of violation of above circulars dated 11.2.97 and 11.4.97.

#### **4.9. *Whether Unique Client Code (UCC) was maintained by KSL***

KSL stated that UCC was not updated at the time of inspection but were updated in the time frame allotted by NSE. I do not find the above explanation satisfactory. The finding of inspection record shows that no Unique Client Code was maintained by KSL. A perusal of the agreement/ registration forms register by inspection team also indicated that there was no system of maintenance of PAN numbers of the clients in the back office. Neither were other client related details were kept in proper order.

SEBI Circular No. SMDRP/Policy/CIR-39/2001 dated July 18, 2001 has mandated that, it will be mandatory for all brokers to use unique client codes for all clients.

Thus I agree with the finding of the Enquiry Officer that KSL failed to comply with the above circular.

#### **4.10 *Whether KSL undertook Trade Transfers***

I find that the Inspection report showed instances of trade transfer for which no satisfactory answer has been given. In the case of many clients such as Dinesh Kr.Singhanian, Ranjit and Rajesh Vaid etc., a comparison of the client ledger and the 'trade report' revealed that the sauda, especially difference bill transactions had been carried on in the name of a different client (mostly, in self account) and recorded in the back-office in the name of another client.

#### **4.11 *Whether any discrepancies were observed in the Final Settlement Obligation***

I note that a comparison of the Scrip-wise Settlement Trial (from the back office) with the 'Final Settlement Obligation' issued by NSCCL, was carried on by inspection team. A few instances were observed where the Total number of Buys and Sells in a particular Scrip as recorded in the back office exceeded the Turnover Quantity reflected in the NSCCL Report. Discrepancies were enumerated in the inspection report.

The explanation furnished by KSL in respect of above was that "at that time ALBM was on, and the sauda carried forward was reflected in the final obligation hence the difference noted as above is equal to the sauda carried forward through ALBM."

Thus, in these cases I agree with the inferences drawn by inspection team and the finding of the Enquiry Officer that Saudas are being punched in the back office, without actual transactions being carried out on the Terminal.

#### **4.12 *Whether KSL changed the shareholding pattern in violation of Rule 4 (c) of the SEBI(Stock Brokers and Sub-brokers) Rules, 1992.***

I note that Rule one of the conditions of registration under Rule 4(c) of broker rules is that the stock broker shall take prior permission of SEBI for any change in status and constitution. KSL admitted that due to lack of knowledge he did transfer the shares of the broking company without prior intimation of SEBI and NSE. It was stated that NSE has disabled the terminal for the said violation.

I note that the SAT in the case of Kinglet Finlease & Securities Ltd., vs. SEBI (Appeal No.88/2002) vide its judgment dated January, 2003 has held that any action by the exchange against its members will not preclude SEBI from taking action against a stock broker which may also be violative of its rules/regulations.

Thus I agree with the finding of the Enquiry Officer and hold KSL guilty of violation of Rule 4 (c) of SEBI (Stock brokers & Sub-brokers) Rules, 1992.

#### **5.0 ORDER**

5.1 I note that the Enquiry Officer has recommended suspension of registration of the sub-broker for a period of 6 months. I agree with the findings of the Enquiry Officer and I am satisfied that this is a fit case to impose a penalty of suspension of certificate of registration of KSL.

Therefore, in exercise of the powers conferred upon me, by Section 19 of SEBI Act, 1992 read with sub-regulation (4) of Regulation 13 of the said Regulations, I hereby suspend the certificate of registration of Korp Securities Ltd., member, National Stock Exchange, having SEBI Registration No. INB230905936, for a period of six months.

5.2 This Order shall come into effect on the expiry of 21 days from the date of this Order.

**PLACE: MUMBAI**  
**DATE : 27.12.2005**

**MADHUKAR**  
**WHOLE TIME MEMBER**  
**SECURITIES AND EXCHANGE BOARD OF INDIA**