

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. S R Agarwal & Co., sub-broker (Registration No: INS010596117), affiliated to M/s. VSE Securities Ltd., Member of The Stock Exchange, Mumbai.

1.0 BACKGROUND

- 1.1 M/s. S R Agarwal & Co. is a sub-broker having SEBI Registration No. INS010596117 (hereinafter referred to as the sub-broker), affiliated to M/s. VSE Securities Ltd. (hereinafter referred to as 'VSE'), Member of The Stock Exchange, Mumbai.
- 1.2 Securities and Exchange Board of India (hereinafter referred to as SEBI) conducted an inspection of the books of accounts and other documents of sub-broker and observed certain irregularities allegedly committed by sub-broker, in violation of the following:
 - a) Section 12 of the SEBI Act, 1992
 - b) Rule 3 of SEBI (Stock Brokers and Sub-Brokers) Rules, 1992.
 - c) Regulation 7 SEBI read with Code of Conduct as specified in Schedule II of the (Stock Brokers and Sub-Brokers) Regulations, 1992.
 - d) SEBI Circular No. SMD/SED/Cir/93/23321 dated November 18, 1993.
 - e) SEBI Circular No. SMD-1/23321 dated November 18, 1993.
 - f) SEBI Circular No. SMD/RCG/CIR/(BKG)/293/95 dated March 14, 1995
 - g) SEBI Circular No. SMD/OPG/AA/1020/96 dated March 14, 1996.
 - h) SEBI Circular No. SMD/MDP/Cir/043/96 dated August 05, 1996
 - i) SEBI Circular No. SMD/POLICY/IECG/1-97 dated February 11, 1997.
 - j) SEBI Circular No. SMD/Policy/Circular/3-97 dated March 31, 1997.
 - k) SEBI Circular No. SMD/Policy/Circular/5-97 dated April 11, 1997.
 - l) SEBI Circular No. SMD/Policy/Cir-11/1997 dated May 21, 1997.
 - m) SEBI Circular No. SMD/Policy/Cir-3/98 dated January 16, 1998.
 - n) SEBI Circular No. SMDRP/POLICY/CIR-32/99 dated September 14, 1999.
 - o) SEBI Circular No. Sub-broker/Cir/02/2001 dated January 15, 2001.
 - p) SEBI Circular No. SMDRP/Policy/Cir-05/2001 dated February 01, 2001
 - q) SEBI Circular No. SMDRP/Policy/Cir-39/2001 dated July 18, 2001.
 - r) SEBI Circular No. SMDRP/POLICY/CIR-49/2001 dated October 22, 2001.
 - s) Bye-laws, Business rules and regulations of the Stock Exchange.

2.0 Appointment of the Enquiry Officer

- 2.1 SEBI vide order dated March 23, 2004 thus appointed an Enquiry Officer under Regulation 5 of SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing penalty) Regulations, 2002 (hereinafter referred to as Enquiry Regulations) to enquire into the violations, if any, of SEBI (Stock Broker and Sub- Broker Regulations) 1992 (hereinafter referred to as Broker Regulations), the above mentioned SEBI Circulars and the Bye-Laws, rules and regulations of the Stock Exchange.
- 2.2 The Enquiry Officer after conducting the Enquiry in terms of the Enquiry Regulations found that the sub-broker has violated the Regulation and the SEBI Circulars as stated vide para 1.2 above and submitted his Enquiry Report dated October 29, 2004, recommending a major penalty of suspension of the Certificate of Registration for a period of six months against the sub-broker.

3.0 Show Cause Notice and reply of the Sub-broker

- 3.1 A copy of the said Enquiry Report was forwarded to the sub-broker along with a Show Cause Notice dated November 03, 2004 advising him to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed on him. The said Show Cause Notice was forwarded to the sub-broker through the BSE and its broker VSE.
- 3.2 VSE however informed that the said show cause notice was sent to the sub-broker by Registered Speed Post AD twice but returned undelivered both the times with remark "receiver does not live at written address so returned". VSE also forwarded the copies of proof of despatch of the said show cause notices duly endorsed by the postal authorities as aforesaid. It is also noted that the sub-broker did not reply to the show cause notice sent by the Enquiry Officer even after so many reminders and also did not appear for personal hearing before the Enquiry Officer. As there is sufficient proof on available record of despatch of show cause notices to the sub-broker, I am proceeding in the matter on the basis of materials and records available before me.

4.0 Consideration of the Issues and findings

- 4.1 I have carefully considered the facts and circumstances of the case. I have also considered the Enquiry Report and the submissions of the sub-broker made vide its letter dated July 22, 2003 to SEBI as his reply on the violations observed by SEBI in its inspection report. I also find that the Enquiry Officer had issued show cause notice to the sub-broker vide letter dated May 03, 2004. The sub-broker however vide fax dated June 03, 2004 sought extension of time to reply to the said show cause notice on medical grounds. Then a reminder dated June 23, 2004 was sent to the sub-broker to reply to the said show cause notice but the sub-broker again vide letters dated July 07, 2004 and August 26, 2004 reiterated the same and sought extension of time. Another reminder vide letter dated September 06, 2004 was sent to the sub-broker giving him extended time upto September 15, 2004 to reply to the said notice. In the absence of any reply by the sub-broker, a last opportunity of personal hearing was also given to the sub-broker to appear before the Enquiry Officer on October 29, 2004 but the notice of granting aforesaid hearing got returned undelivered. I thus find that adequate opportunity of hearing has been given by the Enquiry Officer to the sub-broker in accordance with the principles of natural justice before recommending the penalty as aforesaid.

- 4.2 As regards the findings of the Enquiry Officer, I note following as most significant observations :

- a) **Non-maintenance of Client Agreement and Registration Form:** I note that the inspection found that the agreements entered into were not between M/s. S.R. Agarwal & Co., sub-broker of VSE and the clients but in the name of M/s. S.R. Agarwal & Co., broker of VSE and the clients. The agreements were also not on stamp papers and identity proof was not present in most of the cases. Registration forms were also not completely filled in all respects.

The sub-broker submitted that in his member client agreement he has mentioned that he is a sub-broker of VSE also. So this agreement is valid for the VSE also. He further submitted that he is ready to re-enter the agreement with the clients on new format and stamp paper. The sub-broker also submitted that he is taking necessary steps and full care that the client registration form is complete in all respects.

I note that the Enquiry Officer did not accept the reply of the sub-broker and found that the aforesaid reply amounts to admission of the lapse that the sub-broker had traded with clients without obtaining the necessary documentation and without exercising due skill and diligence in the conduct of its business and thus rightly concluded that the sub-broker has violated SEBI Circular No. SMD/Policy/Cir-11/97 dated May 21, 1997 and Clause A(2) of Code of Conduct prescribed under Regulation 15 of the Broker Regulations.

- b) (i) **Providing unauthorized trading terminals:** I note that the inspection also found that the sub-broker has given 2 trading terminals to places which are neither his registered office nor branch office etc.

The sub-broker in its reply submitted that he has transferred all the terminals to his registered office and all the terminals are being handled by his staff only.

I note that the Enquiry Officer found that the sub-broker admitted that they were operating trading terminals at unauthorized places.

- (ii) **Dealing with unregistered entities:** I further note that the inspection found that the sub-broker was dealing with 7 entities who were brokers of Vadodra Stock Exchange and in case of 5 entities shares have been received/paid to entities other than the client of the sub-broker.

The sub-broker submitted that according to his knowledge the entities were doing business on their behalf only and he has stopped taking/giving delivery from/to other than their own account.

I note that the Enquiry Officer found that 7 entities who are brokers of VSE have been receiving/giving deliveries from accounts other than their own and the sub-broker can not feign ignorance on this issue. I also note that the Enquiry

Officer correctly observed that the sub-broker should have exercised caution especially since he knew that they are members of exchange and therefore likely to deal for others.

(iii) **Dealing as Unregistered sub-broker:** I also note that the sub-broker was alleged to have dealt with SDFC Securities Ltd. and Fortune Fiscatle, members of NSE on behalf of their clients.

The sub-broker submitted that the terminal of SDFC Securities is only a viewing terminal and no order can be punched on this terminal and that right now he is not doing any business on NSE.

I note that the Enquiry Officer found that the sub-broker has dealt with SDFC Securities Ltd. and Fortune Fiscatle, members of NSE on behalf of their clients without being registered as sub-broker to these members.

The Enquiry Officer thus rightly concluded that the sub-broker is guilty of violation of the provisions of SEBI Circular No.SMD/OPG/AA/1020/96 dated March 14, 1996, SEBI Circular No.SMD/Policy/Circular/3-97 dated March 31, 1997, SEBI Circular No.SMD/Policy/Cir-3/98 dated January 16, 1998, SEBI Circular No.SMDRP/POLICY/CIR-49/2001 dated October 22, 2001 and the provisions of Clause A(2) of Code of Conduct prescribed under Regulation 15 of the Broker Regulations.

- c) (i) **Non segregation of client funds from own funds:** I note that the inspection found that the sub-broker has not maintained clear segregation between clients funds and own funds and that the sub-broker has paid money from his client account towards administrative expenses.

The sub-broker submitted that he has stopped payment from client account to anyone except client.

(ii) **Payment to clients in cash:** It was further alleged that the sub-broker was maintaining running account with his clients without obtaining consent letters and in 26 instances the sub-broker has received cash from the clients amounting to Rs.2.72 lacs. It was also alleged that the sub-broker was transferring from one client to another without collecting any authorization letter from the clients.

It was submitted by the sub-broker that in some cases he is maintaining running account but he has taken the consent of the client in writing in this regard. With regard to the allegation of transferring of one account to another, he submitted that he has taken consent of both the parties.

(iii) **Delay in delivery of securities to clients:** I also note that the inspection found that the sub-broker has not transferred the securities to Clients Beneficiary Account within the prescribed limits and they were lying in the account of sub-broker without holding consent letters in this regard.

The sub-broker submitted that in some cases running accounts are maintained but he has taken the consent of the client in writing in this regard.

I note that the Enquiry Officer did not accept the aforesaid submissions of the sub-broker as he has not shown any evidence during or after the inspection to substantiate his contention with regard to the aforesaid allegations and thus correctly concluded that the sub-broker is guilty of violation of the provisions of SEBI Circular No.SMD/Policy/Cir-11/97 dated May 21, 1997, Circular No.SMD-1/23341 dated November 18, 1993 and also the provisions of clause B (1) of Code of Conduct prescribed under Regulation 15 of the Broker Regulations.

- d) **Off the floor transactions:** I note that the inspection found that the sub-broker had entered into off the floor transactions in 25 instances.

The sub-broker submitted that out of 25 transactions, only 2 transactions were of the market which were made erroneously by his staff and he has obtained all the necessary confirmation from the clients to regularize the transactions.

I note that the Enquiry Officer did not accept the reply of the sub-broker and found that the sub-broker has not clarified which 2 transactions were due to staff error and thus rightly concluded that the sub-broker has violated the provisions of clause B(2) (d) of Code of Conduct prescribed in Regulation 15 of the Broker Regulation and Circular SMD /Policy/Circular-11/97 dated May 21, 1997.

- 4.3 On a careful perusal of the charges, findings of inspection and enquiry and the submissions made by the sub-broker, I have no substantial reason to defer with the findings of the Enquiry Officer. Regulations, Rules and Circulars are primarily to ensure integrity of the capital market, which calls for full understanding and commitment of all concerned towards total compliance of Regulations. Sub-brokers being the important intermediary, are expected to do so flawlessly.

5.0 ORDER

- 5.1 Now therefore, I, having considered the nature and gravity of the charges established, the facts and circumstances of the case, and the submissions made by the sub-broker, in exercise of the powers conferred upon me under section 19 of SEBI

Act, 1992 read with Regulation 13(4) of SEBI (Procedure for Holding Enquiry by the Enquiry Officer and Imposing Penalty) Regulations, 2002, agree with the recommendation of the Enquiry Officer and hereby suspend the Certificate of Registration of M/s. S R Agarwal & Co., sub-broker (Registration No: INS010596117), affiliated to M/s. VSE Securities Ltd., Member of The Stock Exchange, Mumbai for a period of six months.

5.2 This order shall come into force after 21 days from the date of the order.

DATE: 17.01.2006

PLACE: MUMBAI

MADHUKAR

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA