

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 MPSE SECURITIES LIMITED, MEMBER, THE STOCK EXCHANGE, MUMBAI HAVING SEBI REGISTRATION NOS. INB011102739.

1.0 BACKGROUND

1.1 M/s. MPSE Securities Limited (hereinafter referred to as "the broker") is a member of The Stock Exchange, Mumbai ("BSE") registered with SEBI as a stock broker under section 12 of SEBI Act, 1992 with SEBI Registration No. INB011102739.

1.2 Inspection of the books of accounts, documents and other records of the broker was carried out by SEBI and certain irregularities found to have been committed by the broker were observed.

2.0 ENQUIRY PROCEEDINGS

2.1 In view of the above, an Enquiry Officer (EO) was appointed vide SEBI Order dated May 14, 2004 under Regulation 5(1) of SEBI (Procedure for Holding Enquiry) Regulations, 2002 (hereinafter referred to as the "said Regulations") to inquire into the irregularities observed during the inspection of books of accounts of the broker. The EO after conducting the enquiry in terms of the said regulations submitted his report on 09.06.05 recommending for imposition of a minor penalty of censure on the broker.

2.2 A copy of the Enquiry Report was sent to the broker on 14.06.05, in terms of Regulation 13(2) of the said Regulations, advising it to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed.

2.3 The broker replied vide letter dated 2.07.05 and submitted that the operational discrepancy observed by the inspecting authority have been rectified and complied with and the systems have been changed to prevent such occurrences in future. The broker requested that it may be pardoned.

3.0 CONSIDERATION OF ISSUES

3.1 I have carefully considered the findings of inspection, enquiry and the submissions made by the broker and note significant points as under :

a) **Acceptance of shares instead of cash towards BMC and Additional Capital**

It has been alleged that the broker accepted shares towards BMC and Additional Capital. The broker admitted the violation and stated that earlier it used to accept shares as part of deposit BMC/Additional Capital and after the inspection this practice has been stopped. The broker further stated that the Additional Capital would be accepted in the form of cash/bank guarantee or fixed deposit. The members who had already deposited AC in demat shares had been given one week's time to replace the same and the software for calculation/monitoring of BMC was being modified to ensure online checks. The broker has admitted the irregularity and thus the EO found him guilty.

b) **Lack of proper system to monitor the various components of BMC/Additional Capital**

It has been alleged that the broker had resolved that BMC would be Rs.50,000/- and 100% in cash. Since it was a normal practice of the broker to adjust various margin obligations of the sub-brokers from the BMC on day-to-day basis, the BMC often went below the minimum stipulated level of Rs.50,000/- and at times even became negative due to the obligations being greater than the BMC/Additional Capital itself. Further the broker failed to maintain the BMC requirement in the form of 25% cash and 75% irrevocable bank guarantee/fixed deposit in certain instances. The broker admitted the mistake and submitted that the additional capital is now being maintained in the ratio of 25% cash and 75% FDR. The EO found that subsequent to inspection necessary rectification was carried out in the software by the broker.

c) **Permitted sub-brokers to trade without sufficient BMC**

It has been alleged that the broker allowed sub-brokers to have a minimum limit of Rs.5 lacs and Rs.17 lacs as gross exposure and intra day exposure limit irrespective of the quantum of the BMC of the sub-brokers. The

trading and exposure limits allotted by the broker to its sub-brokers were not in conformity with the limits allowed by BSE. It was further alleged that certain sub-brokers were allowed to trade even after their BMC fell below the stipulated level of Rs.5000/- and their terminals were not deactivated. The broker submitted that it had already decided that the BMC of Rs.0.5 lakh should not be allowed to meet margin obligations. The margins would be allowed to be adjusted only out of Additional Capital and if the margin exceeds the available Additional Capital, the terminals would be deactivated till payment. The EO found that it was highly irregular of the broker to have permitted sub-brokers to trade even when the BMC fell below the minimum level of Rs.50,000 without taking steps to de-activate the terminals.

d) **Permitted higher exposure limits to sub-brokers across rolling settlements**

It has been alleged that the gross exposure of the members across rolling settlements i.e. trading day plus previous unsettled settlements, exceeded 15 times of their BMC plus Additional Capital deposited with the exchange. The system of calculation of gross exposure limits was not proper since the outstanding positions of the previous settlements were not considered as required under the rolling settlement. The broker admitted that pay-in of funds was carried out one day in advance than stipulated by BSE. The broker further submitted that the software has now been modified to consider outstanding obligations of previous settlements. The broker had also decided that the gross exposure would be allowed at 15 times of the BMC/Additional Capital i.e. trading day plus outstanding of previous day. The EO recommended that since the broker has admitted his mistake and rectified the deficiencies, a lenient view may be taken in the matter.

e) **Defect in the system designed to prevent the breach in the exposure limit**

It has been alleged that there were deficiencies in the systems designed to prevent breaching of exposure limit allowed to the sub-broker. A trade entered at the 99.99% level of the allowed exposure limit could be executed subject to the group-wise limits fixed by the broker thereby resulting in breaching of 100% of the permissible limit. The broker submitted that there had been no such instance in the past 3 years of their operations where the limit had been breached and terminal locked. The broker further stated that the above defect could be rectified by modification in BOLT software and they had taken up the issue with BSE. However, the broker stated that breaching of the limits could not be ruled out. The EO found that though the broker had taken up the matter with BSE, the progress thereto had not been informed. The EO found that the broker had not strictly adhered to SEBI Circular dated 26.11.99.

f) **Failure to provide system log to sub-brokers and scope for alteration of entries**

It has been alleged that the broker could not provide the system log for the trading and exposure limits allowed to the sub-brokers and the only available record were the limit sheets. Any change made in the limit of the sub-brokers which was not recorded would go unnoticed. The system does not capture the person who may have made any change in the limits by using the administrative command. The broker enclosed letter dated 10.2.05 downloaded from BSE Website to suggest that system log on admin terminal was now available for verification. As regards, identification by the system as to the person who made the changes in the limits, it was submitted that the limits could be changed only by three authorized persons who were required to enter the same in a register kept for the purpose. However, it was admitted that there was no provision whereby the system itself captures electronically the identity of the person who makes the changes in the limit. The broker submitted that it had contacted BSE about the same and is following up the matter. The EO recommended that the broker should immediately pursue with BSE to make provision for electronically capturing the identity of the person who makes the changes.

g) **Absence of System Alerts**

It has been alleged that there was no monitoring by the broker in respect of the trading levels of its sub-brokers during the day as it does not have provisions for any alerts etc., and the broker happens to know about the same only in the evening. Hence, it was alleged that there were no system generated alerts of sub-brokers trading levels available to the broker before deactivation of the terminals. The broker submitted that such alerts were given at 70%, 80% and 90% levels to the sub-brokers directly by the BOLT before the terminal is deactivated. However, such system generated alerts were not available at the admin servers of the broker. The broker submitted that it had informed BSE about the same and is following up the matter. The EO found that it is desirable that the broker is also put on notice as to the sub-brokers who are receiving such alerts directly from BOLT for necessary action.

h) **Failed to allow exemption in VaR margins**

It has been alleged that the broker does not follow proper practice of allowing exemption in Value at Risk margins due to early pay-in of securities. The same was not actually levied, instead an average rate of 30% as indicated by

the concerned sub-broker was levied. The broker submitted that it has since implemented software for charging VaR margin. The broker further submitted that It was not correct to allege that earlier the margin was levied at an average rate of 30% of the rate as indicated by the concerned sub-broker. The same was verified by the Exchange with the available quotations at BOLT. The EO found that the broker has not complied with SEBI Circulars dated 26.11.99 and 2.7.99. The EO further found that the broker rectified the defect only after the same was pointed out by the inspection team.

i) **Absence of system to record advance deliveries**

It has been alleged that there was no system of recording the advance deliveries including verification of the authorized personnel for enhancing the exposure limit based on such advanced deliveries and corresponding adjustment to exposure limit. The broker submitted that there were 3 persons who were authorized personnel for recording the advanced deliveries and enhancement of limits based on such advance deliveries. The EO found that there was no reply as to whether the advance deliveries were being recorded in a register before enhancement of limits based on such advance deliveries. The EO further found that there should be proper supervision on the work of the authorized personnel and maintenance of records of advance deliveries.

- j) As regards the other violations like failure in maintaining BMC, non-maintenance of additional capital in the ratio stipulated, permitting sub-brokers to trade without fulfilling their BMC requirement in the parent exchange, non-adherence of board resolution to collect Additional Capital in multiples of 1 lakh, rounding of practices leading to higher trading limits, computation and allocation of trading limits not fully automated, absence of policy for delegation, unrestricted movement of persons in the server room, flat penalty structure in respect of default in pay-in of funds, permitting sub-brokers to value securities for margin exemption, non-maintenance of updated copy of business rules, day to day procedures and delegations not formally documented, poor infrastructure for support functions, failure in obtaining NOC from sub-brokers, modification of trade log by the broker, unsigned bank book, undelivered scrips in stock holding, irregularities regarding contract notes, permitting sub-brokers to trade without bank guarantee, failure to inspect sub-brokers etc., the EO recommended that since the broker has rectified the deficiencies, his submissions may be accepted and a lenient view may be taken.

- 4.0 The EO found that most of the irregularities pointed out in the inspection report have since been rectified by the broker and hence recommended a minor penalty of censure on the broker. On a careful perusal of the charges, findings of inspection and enquiry and the submissions made by the broker, I have no substantive reason to differ with the findings of the EO.

5.0 ORDER

- 5.1 Now, therefore, in exercise of the powers conferred upon me in terms of Section 19 of the SEBI Act, 1992 read with Regulation 13(4) of the said Regulations, I hereby censure M/s MPSE Securities Ltd, Member, BSE bearing SEBI Registration No.INB 011102739.

- 5.2 This order shall come into force with immediate effect.

PLACE: MUMBAI

DATE : 2.2.06

MADHUKAR

WHOLE TIME MEMBER

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