

SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: DR.T.C.NAIR, WHOLE TIME MEMBER

IN THE MATTER OF

HSE SECURITIES LTD.

MEMBER, NATIONAL STOCK EXCHANGE

SEBI REGISTRATION NO. INB231103038

DATE OF HEARING: 15.05.2006

APPEARANCES:

FOR NOTICEES: S Sarveswar Reddy

FOR SEBI : Shri P.K.Kuriachen, General Manager

Shri Rajesh Gujjar, Asst.General Manager

Ms.G.V.Chitra, Asst.Legal Adviser

ORDER

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

- 1.1 HSE Securities Ltd., (hereinafter referred to as the broker/HSESL) is a member of the National Stock Exchange (hereinafter referred to as 'NSE') and is registered with the Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a Stock broker under Section 12 of SEBI Act, 1992 with Registration Number INB231103038.
- 1.2 An Inspection of the Books of Accounts, Documents and other records maintained by the broker for the period December 2000 to April 2002 was carried out by SEBI from April 08-13, 2002. During the inspection, certain irregularities found to have been committed by the broker were observed.
- 2.1 The findings of Inspection were forwarded to the broker. After considering its reply dated 31.8.2002, an Enquiry Officer (hereinafter referred to as "EO") was appointed vide order dated September 30, 2004 under Regulation 5(1) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred as the 'said regulations') to enquire into the alleged irregularities committed by the broker.
- 2.2 A Show Cause Notice dated February 21, 2005 was issued to the broker under Regulation 6 (1) of the said regulations. The broker submitted its reply dated 05.03.05 and appeared for personal hearing before the EO on 15.04.05. The EO conducted the enquiry in terms of the said Regulations and the broker was given a fair and reasonable opportunity to make its submissions.
- 2.3 After considering the reply and the submissions made by the broker at the time of personal hearing, the EO submitted her report dated 23.6.05 recommending suspension of certificate of registration of the broker for a period of one month.
- 3.1 A copy of the Enquiry Report was sent to the broker along with a show cause notice dated June 28, 2005, in terms of Regulation 13(2) of the said Regulations calling upon it to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed on it. The broker replied to the SCN vide reply dated 18.07.2005. Thereafter, the broker was granted an opportunity of personal hearing before me on 15.5.06. The broker appeared for the hearing and thereafter made his written submissions.
- 4.1 I have carefully considered the findings of the Inspection, Enquiry and the submissions made by the broker and find as under :

4.2a) Shortfall in Base Minimum Capital

The EO found that the inspection of the records and books of accounts of HSESL was carried out from April 8, 2002 to April 13, 2002. During the inspection it was found that HSESL had allowed four of its sub-brokers to trade through them despite not maintaining the base minimum capital at HSE. The broker furnished a letter from Hyderabad Stock Exchange (HSE) as regards fulfillment of the Base Minimum Capital (BMC) requirement of the said brokers at the HSE. However, a reading of the said letter indicated that the said BMC requirements were fulfilled only in August 2002 i.e. four months after the date of inspection.

As regards the maintenance of BMC by sub-brokers at HSESL was concerned, the EO found that there were 10 sub-brokers for whom HSESL had furnished the copies of the certificates being maintained at their end stating that the sub-brokers were not permitted to trade for not having maintained the required BMC with the HSESL. However, it is seen that the requirement of BMC was not complied with by two sub-brokers namely Venugopal Malani and Vijay Growth Financial Services Ltd. The broker stated that Venugopal Malani had not commenced trading and hence BMC was not applicable to him. As regards Vijay Growth the broker stated that it had surrendered its certificate of registration and that at the time of commencement of trading, it had a sum of Rs.2.00 lakhs as BMC. However, I find that the broker has not produced any documentary proof in support of its contention. Further, the sub-broker had surrendered the certificate of registration at a much later date and therefore violated SEBI Circular No. SMD-II/ Policy/CIR-37/99 dated 26.11.99 which stipulates that sub-brokers of the subsidiary/company shall maintain a separate deposit with the subsidiary / company and the BMC deposited by the sub-broker with the promoting stock exchange shall not be transferred to the company/ subsidiary. Maintenance of BMC in the HSE is, therefore, an important requirement in order to be a sub-broker at HSESL. However, in view of the compliance of BMC requirements pursuant to the inspection, a substantive penalty may not be warranted.

b) Non-collection of Auditor's certificate.

The EO found that contrary to the requirements of the SEBI Circular SMDRP/POLICY/CIR-6/2001 dated 1.2.2001, the broker has not obtained an auditor's certificate to the effect that all clients shall maintain a deposit with the broker in the form of cash, bank guarantees, FDRs or approved securities which shall not be less than 10% of the net open positions of the client at any point of time. The broker has contended that as per SEBI Circular dated 17/05/2002, the requirement of obtaining certificates from the auditors regarding collection of margins has been replaced with a certificate from the Compliance Officer. Accordingly, an officer from the company /Individual broker as Compliance Officer declared the fulfilment of maintenance of margins in the prescribed format and thus the same was complied with.

However, I find that the period covered by the inspection was between December 7, 2000 to April 15, 2002 and hence the requirement of SEBI Circular SMDRP/POLICY/CIR-33/2000 dated July 27, 2000 which was prevalent during the said period necessarily needs to be complied with. The circular cited by the broker is dated May 17, 2002 is subsequent to the period of inspection. Since there is no finding that the clients of HSESL failed to maintain a deposit with it and taking into account that the compliance officer had certified, I am of the view that the violation of Circular dated July 27, 2000 is technical.

c) Members with negative network permitted to trade.

It was alleged that the broker had permitted certain sub-brokers to trade even when they had negative network as on 31.3.2001 which is in violation of Clause (2) and A(4) of the Code of Conduct stipulated in Schedule II read with Regulation 7 of the Broker Regulations. The broker contended that sub-brokers with negative network were initially allowed 4 to 5 times of the BMC in HSESL and sub-brokers further deposited Rs.2 lakhs towards

exposures in HSESL. The broker further stated that the exposure of the sub-brokers whose latest network was negative was reduced to 4 times of the said deposit instead of nine times of the deposit. However the EO has found that the reply of HSESL regarding names furnished, does not match with the names of the sub-brokers mentioned in the Show Cause notice.

In the written submissions dated 18/05/2006 as well as oral submissions made during the Personal Hearing before me, the broker has stated that subsequent to the inspection, they have deactivated the terminals of those sub-brokers whose network was negative in HSE. However, the broker has not submitted any documentary proof in this regard.

d) Failure to record time of placement of order

The EO found that HSESL has violated SEBI Circular No. SMD/POLICY /IECG/1-97 dated February 11, 1997 which stipulates that the broker member should maintain the record of time when the client has placed the order and reflect the same in the contract note along with the time of execution of the order.

The broker contended that the said requirement of providing the time of placement of the order was furnished in the form of bills released to the sub-brokers and that the order time log was downloaded to the sub-brokers every day. The broker enclosed a copy of the order time log generated from the system. In view of this, I am inclined to take it as substantial compliance of the aforesaid circular.

e) Violations pertaining to margin and exposure limit.

The EO found various violations pertaining to margin collection and exposure limits by HSESL and hence found the broker guilty of violating Rule 8 of SC(R) Rules, 1957 and also SEBI Circular No. SMDII/POLICY/CIR-37/99 dated 26.11.1999. It is seen from the record available and also from the submissions made by HSESL that Mark to Market Margins and Gross Exposure Margins were being collected by them in tune with the SEBI Circular but the entire margins could not be collected due to non availability of specific provisions in the software of their vendor at that point of time. From this, it is clear that there is a deviation from the rule which stipulates that the margin imposed by the subsidiary /company on its sub-broker shall not be less than the margin payable to the stock exchanges of which the subsidiary is a member. In the instant case it is seen that HSESL has provided higher exposure and trading limits to their sub-brokers while on the other hand they have failed to collect margins from them.

- 4.3 On a careful consideration of the findings of the EO, the submissions made by the HSESL as discussed above and the facts and circumstances of the case, I find that a minor penalty of censure would be adequate and appropriate.

- 5.1 Now, therefore, in exercise of powers conferred upon me in terms of Section 19 of SEBI Act, 1992 read with Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulation 2002, I hereby censure M/s.HSE Securities Ltd., Member of National Stock Exchange bearing SEBI Registration No. INB231103038.
- 5.2 This order shall come into force with immediate effect.

Place: Mumbai

Date: 12.9.06

T.C.NAIR

Whole Time Member

Securities and Exchange Board of India