

SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER AGAINST M/S INDAVARA SECURITIES, MEMBER, BANGALORE STOCK EXCHANGE LTD., SEBI REGISTRATION NO. INB080800718, UNDER REGULATION 13(4) SEBI (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 FOR THE IRREGULAR TRANSACTIONS IN THE SCRIP OF HOME TRADE LTD.

WTM/GA/92/ISD/09/06

1.0 BACKGROUND

1.1 M/s Indavara Securities (hereinafter referred to as the Broker) is a member of the Bangalore Stock Exchange Ltd. (hereinafter referred to as BgSE) and is registered with the Securities and Exchange Board of India (hereinafter referred to as SEBI) as a stock broker under section 12 of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the Act) with registration number INB080800718.

1.2 The scrip of Home Trade Ltd. (hereinafter referred to as HTL) was listed at Pune Stock Exchange Ltd. (hereinafter referred to as PSE) on November 15, 1999 at Rs 250/- and at BgSE on November 16, 1999 at Rs.275/-. There was a very sharp rise in the price of the scrip of HTL both at PSE and BgSE. The price of the scrip of HTL reached Rs.315/- within two weeks of its listing, i.e. by December 06, 1999.

1.3 The subsequent rise in the price of the scrip of HTL is as detailed below:

1.4	The maximum rise in the price of the scrip of HTL took place between November 16, 1999 and March 31, 2000, when it moved from Rs.275/- to Rs.815/-.	Date	Price (Rs.)
		December 30, 1999	525.00
		January 31, 2000	735.00
		March 31, 2000	809.00
		April 10, 2000	825.25

1.5 SEBI conducted an investigation under the provisions of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) Regulations, 1995 (hereinafter referred to as FUTP Regulations) and SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 (hereinafter referred to as the Broker Regulations) into the buying, selling and dealings in the scrip of HTL inter alia by the members of BgSE including the Broker for their involvement in the alleged circular trading, price manipulation etc.

1.6 The transaction details of the Broker in the scrip of HTL on behalf of his only client, Shri Mahendra Kumar Sancheti, at BgSE are as follows:

Period	Buy Qty (shares)	% to total volume at BgSE	Sell Qty. (shares)	% to total qty at BgSE
April 01, 2001 to December 31, 2001	34,950	12.00%	34,851	11.96%

2.0 APPOINTMENT OF ENQUIRY OFFICER

2.1 On completion of the investigation, SEBI appointed an Enquiry Officer, vide order dated May 28, 2003 under regulation 5(1) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as the 2002 Regulations) to enquire into the alleged irregular transactions of the Broker in the scrip of HTL.

2.2 A show cause notice was also issued to the Broker in which the following allegations were leveled against him.

"The broker traded for the client without any introduction. The details of the introducer including address in the client introduction form are not filled which is in violation of SEBI Circular No. SMD/POLICY/CIRCULAR/5-97 dated 11.04.1997. The broker accepted the orders from third party and had not exercised due care and diligence while admitting and trading in the scrip of HTL for the client. This is in violation of Clause A(2) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (SB&SB) Regulations, 1992 and SEBI Circular No. SMD/POLICY/IECG/1-97 dated 11.02.97.

That the broker had not entered into member client agreement is in violation of SEBI Circular No. SMD/POLICY/CIRCULAR/5-97 dated 11-04-1997.

The broker had actively traded in the scrip of HTL and resorted to circular trading with other members of BgSE wherein the shares were traded amongst themselves by trades which were not genuine and created artificial volumes. It is, therefore, alleged that the broker had contravened provisions of the Regulation 4(b) of SEBI(Prohibition of Fraudulent and Unfair Trade Practices relating to Securities Market) Regulations, 1995 and violated Clause A(3) of the Code of Conduct as specified in Schedule II read with Regulation 7 of SEBI (SB&SB) Regulations 1992”.

- 2.3 The Broker submitted before the Enquiry Officer that the 2002 Regulations could not be invoked for transactions which were completed prior to the coming into force of the 2002 Regulations. The Broker further submitted that his client himself had expressed his willingness to trade in the scrip of HTL and therefore, the name of the introducer was not filled in the client registration form. The Broker had also stated that he had collected Rs.50,000/- from his client before he started trading on behalf of the said client. It was also submitted by the Broker that the member client agreement was not entered into as it was thought that the client registration form containing the terms and conditions was sufficient.
- 2.4 The Enquiry Officer submitted his report dated November 08, 2004 and recommended for the imposition of a minor penalty of censure on the certificate of registration of the Broker, in terms of regulation 13(1) (a) (i) of the 2002 Regulations. The Enquiry Officer observed that the alterations in procedural law were generally held to be retrospective in the sense that they applied to the future as well as the pending actions. The Enquiry Officer further observed that the Broker did not exercise due skill, care and diligence in obtaining the KYC form as he did not assess the financial worthiness of the client before commencing the trades on his behalf. The Enquiry Officer observed that the member client agreement was also not entered into by the Broker, which was in violation of SEBI Circular dated April 11, 1997. However, taking into account certain mitigating circumstances, the Enquiry Officer recommended for the imposition of a minor penalty of censure against the Broker, in terms of 2002 Regulations.

3.0 CONSIDERATION OF ISSUES AND FINDINGS

- 3.1 Based upon the recommendation of the Enquiry Officer, a show cause notice dated November 22, 2004 was issued to the Broker under regulation 13(2) of the 2002 Regulations asking him to show cause as to why the penalty as considered appropriate should not be imposed upon him. A copy of the Enquiry Report was also forwarded to the Broker with the said show cause notice. Sufficient time was given to the Broker to file his reply to the show cause notice. But the Broker failed to file any reply till date.
- 3.2 The Broker had admitted before the Enquiry Officer that that he had not entered into the member client agreement as stipulated in terms of SEBI Circular dated April 11, 1997. The Broker explained that he thought that the client registration form containing the terms and conditions was sufficient. The said explanation can not be accepted as the Broker, being an intermediary registered with SEBI, is required to comply with the regulatory requirements which are meant for the protection of the interest of the investors and the securities market in general. Further, SEBI had also developed a uniform format of the client registration form and the member client agreement separately. In view of the above, I hold that the Broker had violated the above mentioned circular while trading on behalf of his client in the scrip of HTL.
- 3.3 The Broker contended that the 2002 Regulations were not applicable to his transactions, which were executed prior to the commencement of the said Regulations. However, I note that, in terms of regulation 23 of the 2002 Regulations, any action taken, inter alia including any proceeding for investigation which had commenced under the provisions of any of the Regulations mentioned in the 2002 Regulations shall be deemed to have been done or taken under the corresponding provisions of the 2002 Regulations. I further note that the present proceedings are initiated under the 2002 Regulations. In view of the above, the contention made by the Broker in this regard is not tenable and therefore, the same is liable to be rejected.
- 3.4 Further, SEBI by its circular dated February 11, 1997 had advised the stock brokers to maintain a database of their clients. SEBI, vide Circular dated April 11, 1997, had again advised the stock brokers to follow the circular dated February 11, 1997 and further desired that the stock brokers might seek additional information, if any, so as to satisfy themselves about the antecedents of clients. Also it was stressed that it would be the responsibility of the brokers to provide for client details as and when need arose. In terms of the said circulars, a stock broker has to ensure that his client is personally known to him or has been introduced to him by a person known to him for the purpose of satisfying that his clients are genuine.
- 3.5 I note that, though the Broker had obtained the client registration form, the name of the introducer was not mentioned in the said form. The very purpose of client registration form is to provide various details of the clients so as to enable the stock broker to evaluate the client before the broker takes up trading for him. In this context, a stock broker has to verify the financial capacity of his clients before executing trades on their behalf. Such assessment of financial capacity of the client is necessary in order to avoid the risk. When a stock broker fails to perform the above primary requirements and if he is transacting on behalf of such unknown clients without knowing their details and financial capacity, he is putting the entire system in jeopardy. In the present matter, it is noted that the annual income of the client, in terms of the Know Your Client (KYC) form was stated to be Rs.75,000/-. Having regard to the price of the scrip which was about Rs.150/-, the value of the trades (for the buy quantity of 34,950 shares) made by the Broker for his client was much higher than the annual income of the client, who had just started trading in the scrip of HTL. In this context, I also note that the client was

belonging to Rajasthan whereas his Bank account was that of Standard Chartered Bank of Kolkata Branch. This should have aroused the suspicion of the Broker and he should have taken more care while dealing with such client. The Broker had not given any satisfactory reply to the said discrepancy. The Broker also could not adduce any evidence to suggest that his client was trading in any other scrips other than HTL.

- 3.6 In these circumstances, the Broker should have exercised more care while dealing with his client, considering the annual income of the client, the price of the scrip, the trades executed etc. The Broker also could not produce any material to suggest that he had observed the financial capabilities of his client, before executing transactions on his behalf. In view of the above, it is established that the Broker had failed to assess the financial capacity of his client, which was one of the due diligence exercise to be made by a stock broker before trading on behalf of his clients, as required under the KYC norms and therefore, I hold that the Broker had failed to exercise due skill, care and diligence in the conduct of his business while dealing with his client in the scrip of HTL and thereby, violated the provisions of SEBI Circular dated February 11, 1997 and clause A (2) of the Code of Conduct specified in Schedule II of the Broker Regulations.
- 3.7 However, I note that at the time when the Broker executed transactions on behalf of his only client in the scrip of HTL, the price of the said scrip was comparatively low. I note that the Broker had collected Rs.50,000/- from his client before executing trades on behalf of him and he had also collected Rs.30,000/- from his client, subsequently. The Broker stated that the trades were executed as per the instructions of his client. I also note that the Broker had entered into the client registration form in which the name of the introducer was absent. The Broker had submitted before the Enquiry Officer that as the client met him personally and expressed his willingness to trade in the scrip of HTL, the name of the introducer was not mentioned in the client registration form. I also note that the Broker had also verified the signature of his client, which was attested by the branch manager of Standard Chartered Bank, Calcutta. I further observe that the Broker had not executed any proprietary trading in the scrip of HTL. Further, it is the submission of the Broker that he had made the payments to his client as borne out by Bank's letters. In this regard, the Broker had produced the letter dated January 30, 2003 from Karnataka Bank stating that the demand draft dated February 18, 2002 made by the Broker in favour of his client was paid in Kolkata on February 21, 2002, to show that the payments were made to the client. Taking into account the above mentioned mitigating circumstances, I am inclined to agree with the recommendation made by the Enquiry Officer.

4.0 ORDER

In view of the foregoing and taking into account the mitigating circumstances as stated above, I in exercise of powers conferred vide regulation 13(4) of (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations 2002, hereby impose a minor penalty of censure on the certificate of registration of M/s Indavara Securities (INB080800718), Member, Bangalore Stock Exchange Ltd.

G. ANANTHARAMAN

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date : September 25, 2006