

## SECURITIES AND EXCHANGE BOARD OF INDIA

**ORDER AGAINST M/S HEXAGON CAPITAL MARKETS LIMITED, MEMBER, BANGALORE STOCK EXCHANGE LTD., UNDER REGULATION 13(4) OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002 FOR THE IRREGULAR TRANSACTIONS IN THE SHARES OF HOME TRADE LTD.**

**WTM/GA/100/ISD/11/06**

### 1.0 BACKGROUND

- 1.1 M/s Hexagon Capital Markets Ltd. (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 said Act) with registration number INB081008934.
- 1.2 The shares 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 shares of HTL both at PSE and BgSE. The price of the share of HTL reached Rs.315/- within two weeks of its listing, i.e. by December 06, 1999. The subsequent rise in the price of the shares of HTL is as detailed below:

| Date              | Price (Rs.) |
|-------------------|-------------|
| December 30, 1999 | 525.00      |
| January 31, 2000  | 735.00      |
| March 31, 2000    | 809.00      |
| April 10, 2000    | 825.25      |

- 1.3 The maximum rise in the price of the shares of HTL took place between November 16, 1999 and March 31, 2000, when it moved from Rs.275/- to Rs.815/-.
- 1.4 SEBI conducted an investigation into the buying, selling and dealings in the scrip of HTL inter alia by the members of BgSE including the Broker for alleged circular trading and price manipulation thereby contravening the provisions of Securities and Exchange Board of India (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). It was noticed that the Broker along with other members of BgSE had contributed more than 98% of the volumes in the shares of HTL and it was alleged that the Broker had resorted to circular trading in the shares of HTL with the other members of BgSE.
- 1.5 The transaction details of the Broker in the shares of HTL on behalf of his sole client, Smt. Pukhraj Devi Sanhceti are mentioned below:

| Period                              | Gross Purchase (shares) | % to the total buy volume at BgSE | Gross Sales (shares) | % to the total sell volume at BgSE |
|-------------------------------------|-------------------------|-----------------------------------|----------------------|------------------------------------|
| April 01, 2001 to December 31, 2001 | 34,852                  | 11.96%                            | 34,801               | 11.94%                             |

### 2.0 APPOINTMENT OF ENQUIRY OFFICER

- 2.1 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 made by the Broker in the shares of HTL.
- 2.2 A show cause notice was also issued to the Broker and the alleged violations leveled against the Broker are the following:

"1. The broker traded for the client without any introduction. The details of the introducer including the address in the client introduction form is not filled which is in violation of SEBI Circular No. SMD/POLICY/CIRCULAR/5-97 dated 11.04.1997.

2. 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.
3. The broker had not entered into member client agreement which is in violation of SEBI Circular No. SMD/POLICY/CIRCULAR/5-97 dated 11.04.1997.
4. 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 Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Markets) 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 Pursuant to the said show cause notice, the Enquiry Officer had given the Broker a fair and reasonable opportunity to make his submissions. The Broker inter alia submitted before the Enquiry Officer that Shri Raju, husband of the client had approached him and expressed his willingness to trade in the shares of HTL. Therefore, the details regarding the name of the introducer was not filled in the client registration form. The Broker had admitted before the Enquiry Officer that the member client agreement was not entered into as the client had not returned the form duly signed by her. The Enquiry Officer concluded the enquiry in terms of the 2002 Regulations and vide report dated November 08, 2004, the Enquiry Officer had recommended for the imposition of a minor penalty of censure against the Broker. The Enquiry Officer had observed in his report that the member client agreement was not entered into by the Broker and the same was in violation of the SEBI Circular dated April 11, 1997. The Enquiry Officer also observed that there was no material to suggest that the Broker had assessed the financial capacity of the client before permitting her to trade significant volumes in the shares of HTL.

### **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.
- 3.2 The Broker vide reply dated December 07, 2004 inter alia submitted that, the husband of client approached the Broker and expressed his willingness to trade in the shares of HTL in the name of his wife. The said Shri Raju had also informed the Broker that he would be placing the orders on behalf of his wife. The Broker further stated that he had received the client registration form duly attested and certified by the Manager, Standard Chartered Bank, Calcutta. The Broker also stated that he had informed the husband of the client that the orders would be executed only after the receipt of the full money (100%) in advance, either in the form of cheque or demand draft or through the banking channels. The Broker contended that the member client agreement was sent to the client for signature. However, he had not received back the same from the said client.
- 3.3 It was also stated by the Broker that the quantity traded was very less and that he did not notice any volatility in the price movement in the shares of HTL. The Broker further submitted that his client used to trade in other shares like Silverline Industries, reliance Industries, Satyam Computers, TISCO etc. in addition to HTL. The Broker contended that he had acted in good faith while transacting on behalf of his client in the shares of HTL and further assured that he would be more cautious in dealing with the clients in future, especially with unknown clients.
- 3.4 While considering the Enquiry Report, I observed that the Broker had prima facie violated the allegations specified at para 2.2 above ( page 2 and 3 of the Enquiry Report) and the said violations call for a penalty higher than that recommended by the Enquiry Officer. Accordingly, a notice dated September 27, 2006 was issued to the Broker to show cause as to why a penalty of suspension of the certificate of registration for a period of 15 days should not be imposed upon him. The Broker was also advised to file his reply within 15 days of the receipt of the said notice. The Broker vide reply dated October 09, 2006 inter alia reiterated the submissions made by it in its reply dated December 07, 2004 and stated that the client registration form which was attested and certified by the Manager, Standard Chartered Bank, Kolkata was obtained by the Broker and thereby he had confirmed the identity and genuineness of the client. It was stated by the Broker that he had carried out the transaction in good faith and that the payments were made by the investor by way of crossed demand draft. It was further stated that the member client agreement was sent to the client for signature. However, the same was not received. It was further stated that the client (from Rajasthan) approached the Broker (in Bangalore), as the shares of HTL were only listed in BgSE and PSE. It was claimed that the quantity of shares traded were very less and that BgSE had never cautioned about the transactions. The Broker further assured that he would be more cautious in dealing with the investors/clients in future.

- 3.5 The Broker was also granted an opportunity of hearing on October 30, 2006 wherein Shri B Venkatachalam, Managing Director of the Broker appeared and made submissions before me on behalf of the Broker. Shri B Venkatachalam reiterated the submissions made by the Broker in its replies mentioned above. The Broker further submitted that he had traded for his client even after his reminder letters to the client requesting her to forward the member client agreement.
- 3.6 I have perused the report of the Enquiry Officer, the show cause notices issued by SEBI to the Broker, the replies filed by the Broker and other materials available on record. As the Enquiry Officer had not recorded any specific findings in respect of the violation of the provisions of FUTP Regulations, I deal with the other alleged violations attributed to the Broker.
- 3.7 The fact that the Broker had traded on behalf of his client in the shares of HTL substantially, is an undisputed fact. On a perusal of the trading details, it can be seen that the Broker had executed various transactions on behalf of his client in the shares of HTL. It is an admitted fact that the Broker had not entered into the member client agreement as stipulated in terms of SEBI Circular dated April 11, 1997. In terms of the said circular, SEBI had developed a uniform format of the Client Registration Form and the Broker - Client Agreement and further desired that the brokers might seek additional information, if any, so as to satisfy himself about the antecedents of his client and that it would be the responsibility of the stock brokers to provide for clients' details as and when need arose. The Broker stated that as the client did not return the form (member client agreement) duly signed, he could not enter into the member client agreement. In order to substantiate his claim, the Broker had furnished the copy of the letters dated June 15, 2001, June 19, 2001 and October 31, 2001 (addressed by him to the client; seeking the demat account details of the client and the broker client agreement), before the Enquiry Officer. The copies of the said letters were also submitted by the Broker during the course of hearing.
- 3.8 I note that, being an intermediary registered with SEBI, the Broker 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. I note from the submissions made by the Broker at the time of the hearing that he had commenced and continued to execute trades on behalf of his client, in the absence of the member client agreement. The Broker should not have commenced and continued the trades in the absence of the member client agreement, especially when he did not receive any response to the letters addressed by him to the client. In view of the above, the explanation of the Broker that he had not received the member client agreement can not be accepted, as he is expected to comply with the regulatory requirements. Therefore, it is fairly established that the Broker had violated the SEBI circular dated April 11, 1997 while trading on behalf of his client in the shares of HTL.
- 3.9 Further, in terms of the circular dated April 11, 1997, a stock broker has to provide for clients' details as and when need arose. 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.
- 3.10 I note that, though the Broker had obtained the client registration form, the name and address of the introducer was not mentioned in the said form. The contention of the Broker was that the husband of the client, Shri Raju (new to the Broker) came to the Broker and expressed his willingness to trade in the shares of HTL on behalf of his wife. If the client was introduced by the husband of the client, there was nothing to prevent the Broker to mention the same in the client registration form. The Broker had failed to incorporate the said details in the client registration form and thereby, violated the provisions of circular dated April 11, 1997. I also note that there was nothing on record to show that Shri Raju and Smt. Pukhraj Devi Sancheti were husband and wife. The said fact was more important, when said Shri Raju was new to the Broker at the time of the transaction executed by the Broker in the shares of HTL. Further, Shri B Venkatachalam submitted before me that he had forwarded a cheque dated March 30, 2002 for Rs. 45,145 to his client. However, the same was not debited so far. He also submitted that he had not received any instructions from his client regarding the 50 shares of HTL belonging to his client.
- 3.11 Further, the Broker could not produce any material to suggest that he had assessed the financial capacity of his client before permitting his client to trade in the shares of HTL, substantially. I also note that the client of the Broker was belonging to Rajasthan whereas his Bank account was that of Standard Chartered Bank of Kolkata Branch. The Broker could not satisfactorily explain the above peculiarity. The Broker had not obtained any financial statements of his client to assess her financial capacity and the annual income of the client was shown as Rs.60,000/-. In this context, I note that the value of the transactions executed by the Broker in the shares of HTL on behalf of his client was significant compared to the price of the shares of HTL (approximately Rs.150/- per share). The financial capability of the client is an important factor to be taken into account by the Broker before undertaking trading on behalf of his clients and such assessment is relevant even for the transactions which were squared off. In view of the above, it is established that the Broker had failed to assess the financial capacity of his client, which is one of the due diligence exercise to be made by a stock broker before trading on behalf of his clients, as required under the Know Your Client (KYC).

- 3.12 The Broker submitted that the husband of his client (from Calcutta) was placing orders to trade in the shares of HTL. In this regard, the Broker could not produce any satisfactory evidence to show that his client had given specific authorization in favour of her husband to trade on her behalf. In the facts and circumstances of the case, the transactions made by the Broker in the shares of HTL, as per the instructions of a third party without any specific authorization from the client, will establish that the Broker had failed to exercise due skill, care and diligence while trading on behalf of his client in the shares of HTL. Therefore, I hold that the Broker had violated the provisions of Clause A (2) specified in Schedule II of the Code of Conduct of the Broker Regulations.
- 3.13 In view of the above, it is fairly established the Broker had violated the SEBI Circulars dated April 11, 1997 , Clause A(2) of the Code of Conduct of Schedule III of the Broker Regulations read with regulation 7 of the Broker Regulations and the above violations calls for a higher penalty than that recommended by the Enquiry Officer.

4.0 **ORDER**

In view of the foregoing, 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 suspension of the certificate of registration of M/s Hexagon Capital Markets Ltd (INB 081008934), Member, Bangalore Stock Exchange Ltd., for a period of fifteen days.

This order shall come into effect on expiry of 21 days from the date of the order.

**G.ANANTHARAMAN**

**WHOLE TIME MEMBER**

**SECURITIES AND EXCHANGE BOARD OF INDIA**

**Place: Mumbai**

**Date: 14-11-06**