

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

Coram: V.K. CHOPRA, WHOLE TIME MEMBER

Against Mukesh Babu Securities Ltd.

In the matter of Enquiry under 'Fit and Proper Regulations' and the application for renewal of the Certificate of Registration as Depository Participant.

WTM/VKC/MIRSD/35/07

Date of Hearing : July 24, 2006

Appearance

For Noticee : Shri S.H. Merchant, Advocate
Shri K. Chandrasekhar, Company Secretary
Shri O. Mohandas, Advocate

For SEBI : Shri J. Ranganayakulu, Joint Legal Adviser
Shri Suresh B. Menon., General Manager

ORDER

[Under Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 and Regulation 24 of SEBI (Depositories and Participants) Regulations, 1996]

- 1.1** Mukesh Babu Securities Ltd. (hereinafter referred to as "MBSL/DP") is a body corporate and registered with Securities and Exchange Board of India (hereinafter referred as SEBI) as a Depository Participant bearing registration no. IN-DP-CDSL-23-1999 and affiliated to Central Depository Service (India) Ltd (hereinafter referred to as CDSL). The registration was valid till June 28, 2004.
- 1.2** SEBI vide its order dated February 12, 2004 rejected the application for renewal of registration submitted by MBSL as a Depository Participant of National Securities Depository Ltd. (hereinafter referred to as NSDL) on the ground that it is not in the interest of investors in securities market in view of its involvement in Madhavpura Mercantile Co-operative Bank (hereinafter referred to as MMCB) Scam. Subsequently, MBSL had submitted an application for renewal of its registration as DP in CDSL. In the light of the order dated February 12, 2004 the renewal of certificate of registration of MBSL as a Depository Participant of CDSL was examined under the criteria set for 'fit and proper person'. SEBI *prima facie* found MBSL not a 'fit and proper' person in terms of Regulation 19 (cc) of SEBI (Depositories and Participants) Regulations, 1996 (hereinafter referred to as DP Regulations) read with clause 3(2) (f), 3(2) (h) of SEBI (Criteria for Fit and Proper Person) Regulations, 2004 (hereinafter referred to as 'Fit and Proper Person Regulations') in view of the alleged role played by it in the MMCB scam.
- 1.3** An Enquiry Officer was appointed on April 20, 2004 under Regulation 5 (1) of SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as 'Enquiry Regulations') to enquire into whether MBSL is a fit and proper person to act as a registered DP.
- 2.0** **Enquiry Proceedings**
- 2.1** The Enquiry Officer issued a Show Cause Notice (hereinafter referred to as SCN) dated June 25, 2004 under Regulation 6 (1) of Enquiry Regulations to MBSL communicating thereby the view of SEBI that it is not a fit and proper person for continuing in securities market. MBSL vide its letter dated July 26, 2004 requested for time to file the reply to the SCN. Vide another letter dated August 12, 2004, MBSL asked for some more time to file the reply. Even after providing sufficient opportunities MBSL failed to file any reply to the SCN dated June 25, 2004. Further, an opportunity of personal hearing was granted to MBSL on March 10, 2006 but this time again MBSL failed to appear before the Enquiry Officer and vide its letter dated March 09, 2006 requested the Enquiry Officer to pass an appropriate order on the basis of material already placed. In view of this Enquiry Officer proceeded on the basis of evidence available on record and submitted his report dated March 28, 2006.
- 2.2** Enquiry Officer in his report while noting that CDSL vide its letter dated March 26, 2004 forwarded to SEBI an application for renewal of certificate of registration of MBSL as its Depository Participant, found MBSL not a fit and proper person to act as a Depository Participant in terms of Regulation 3(2)(f) and 3(2)(h) of Fit and Proper Person Regulations in view of the alleged involvement of MBSL in MMCB scam.

- 2.3** In terms of Regulation 13(2) of the Enquiry Regulations, SCN dated May 03, 2006 along with a copy of Enquiry Report was issued to DP, calling upon it to show cause as to why appropriate action as recommended by the Enquiry Officer should not be taken against it. MBSL had replied to the said SCN vide its letter dated May 19, 2006.
- 2.4** MBSL was also given an opportunity of personal hearing before me on July 03, 2006. On the request of the DP, the date was changed to July 24, 2006. On the rescheduled day Sh. S.H. Merchant, Advocate, Sh. K. Chandrashekhar, Company Secretary and Sh. O. Mohandas, Advocate appeared before me and made submissions on behalf of MBSL. Copy of letter dated August 12, 2004 was also filed by them.
- 2.5** MBSL in its submissions stated that it is a Fit and Proper Person. The objective criteria laid down under Fit and Proper Regulations are not applicable to them. The order dated February 12, 2004 is pending for disposal before Hon'ble SAT. Further it has been submitted that MBSL is nowhere concerned with MMCB scam. It has stated that no incriminating evidence was found by CBI in respect of MMCB scam.

3.0 Consideration of Issues

- 3.1** I have carefully considered the facts of the case, the findings of the Enquiry Officer and the reply of the DP including the submissions made during the personal hearing. My findings are as follows;
- 3.2** With regard to the finding that MBSL is not a fit and proper person to continue to act as DP, it was submitted by MBSL that the criteria laid down in the relevant regulations are not applicable to it. However, MBSL has not substantiated as to why these regulations are not applicable to it. After perusing Regulation 3(2)(f) and 3(2)(h) of Fit and Proper Person Regulations, I find that the regulations are very well applicable on MBSL. Further MBSL has also taken the defense that the Enquiry Officer has recommended the cancellation of the Certificate of Registration on the ground of its involvement in MMCB scam. It has submitted that the MBSL is no where concerned with the MMCB scam and no criminal case is pending against it. MMCB scam has nothing to do with securities market. I have considered the arguments put forth by MBSL and am of the view that the person who was taken into custody was Sh. Mukesh Babu who is the chairman of the DP and he substantially owns/manages MBSL or otherwise is in control of MBSL.
- 3.3** I have also examined the charge sheet which has been filed by CBI before the Chief Metropolitan Magistrate, Ahmedabad in the matter of MMCB. This charge sheet clearly shows the involvement of Sh. Mukesh Babu as Accused no. 6. The charges framed therein include the offence of criminal conspiracy, offence under section 120-B (*punishment for criminal conspiracy*) read with Section 409 (*Criminal breach of trust by public servant, or by banker, merchant or agent*) and Section 420 (*Cheating and dishonestly inducing delivery of property*) of Indian Penal Code. The charge at the very first sight is a serious one. On a careful perusal of charge sheet filed by CBI, the role of Mukesh Babu Securities Ltd. (MBSL) and its Chairman Sh. Mukesh Babu is evident. I have also noted that Sh. Mukesh Babu was taken into custody and was later released on bail. Further, the table shown in charge sheet regarding outdrawn amount clearly points out the amount due by MBSL. Rs. 206 Crore out of the total loss suffered by MMCB was through the account of Sh. Mukesh Babu. His accounts were overdrawn to this extent. The relevant part of the charge sheet is reproduced below for reference:

".....

17. That, the Rs. 206 Crore overdrawn through the accounts of Sh. Mukesh Babu (A-6) had also gone to make good the losses suffered on account of speculative trading and out of Rs. 206 Crore, Rs. 98 Crore was on account of trading loss incurred by Sh. Rameshchandra Parikh (A-1), who did the trading through a terminal extended by Sh. Mukesh Babu (A-6). This clearly establishes the criminal conspiracy and overt criminal acts. In pursuance of the conspiracy, another Rs. 25 Crore was transferred from the account of Sh. Mukesh Babu (A-6) to the account of M/s Madhur Capital & Finance of A-1 and A-5, in the form of Telegraphic Transfers, effected by Sh. Jagdish Pandya (A-3).

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21. That, the investigation has clearly established criminal conspiracy among A-1 to A-11 and in pursuance of the said criminal conspiracy, they have committed various illegal acts which have resulted in wrongful loss to the depositors of MMCB and corresponding wrongful gain to themselves.....

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vi. Sh. Mukesh Babu (A-6) is the Managing Director of 5 borrowal accounts Cheques were signed and issued by him to cover the losses suffered by speculative share transactions done by Sh. Rameshchandra Parikh or by himself. Hence, his accounts ran an outstanding of Rs. 198 Crore. He is being Charged for offences punishable U/sec 120-B IPC r/w. 409, 420 IPC Substantive offence U/Sec. 420 IPC.

....."

- 3.4** In view of above, the argument put forth by MBSL that CBI had interrogated Sh. Mukesh Babu in his individual capacity is not convincing as the name of MBSL is clearly mentioned in the defaulters list and the alleged trades were entered through the terminal of MBSL. In these circumstances a bare denial is not a proper and appropriate explanation of the charge. MBSL in its reply to SCN dated May 19, 2006 has admitted that Sh. Mukesh Babu is the director and also the dominant shareholder of MBSL. Therefore the argument that MBSL is not concerned with the case and it is only attributable to Sh. Mukesh Babu in his personal capacity is devoid of any merit. The table presented in the charge sheet relating to 'loan

sanctioned and the outstanding' shows the outstanding amount of various accounts and in the case of MBSL the outstanding amount is more than 30 Crores. The promoters/directors of all these companies have been mentioned as Sh. Mukesh Babu and Ms. Meena Mukesh Babu.

3.5 The criteria for 'fit and proper' person is very broad as interpreted by Hon'ble SAT in the matter of *Jermyn Capital LLC Vs. SEBI*, which is reproduced below:

"The criteria for fit and proper person as set out in Regulation 3 of SEBI (Criteria for Fit and Proper Person) Regulations, 2004 reads as under:

3. (1) "For the purpose of determining as to whether an applicant or the intermediary seeking registration under any one or more of the relevant regulations is a 'fit and proper person', the Board may take account of any consideration as it deems fit, including but not limited to the following criteria –

- a. Financial integrity;*
- b. Absence of convictions or civil liabilities;*
- c. Competence;*
- d. **Good reputation and character;***
- e. Efficiency and honesty; and*
- f. Absence of any disqualification to act as an intermediary as stipulated in these regulations.*

(2) A person shall not be considered as a "fit and proper person" for the purpose of grant or renewal of certificate to act as an intermediary or to continue to act as an intermediary under any one or more of the relevant regulations, if he incurs any of the following disqualifications –

- a. the applicant or the intermediary, as the case may be or its whole time director or managing partner has been convicted by a Court for any offence involving moral turpitude, economic offence, securities laws or fraud;*

*b.A reading of the aforesaid provisions of the Regulations makes it abundantly clear that the concept of a fit and proper person has a very wide amplitude as the name "fit and proper person" itself suggests. The Board can take into account **"any consideration as it deems fit"** for the purpose of determining whether an applicant or an intermediary seeking registration is a fit and proper person or not. The framers of the Regulations have consciously given such wide powers because of their concern to keep the market clean and free from undesirable elements. It can take into account the financial integrity of the applicant and its competence. Absence of convictions or civil liabilities would be another relevant consideration which could weigh with the Board. Good reputation and character of the applicant is a very material consideration which must necessarily weigh in the mind of the Board in this regard. Reputation is what others perceive of you. In other words, it is the subjective opinion or impression of others about a person and that, according to the Regulations, has to be good. This impression or opinion is generally formed on the basis of the association he has with others and/or on the basis of his past conduct. A person is known by the company he keeps. In the very nature of things, there cannot be any direct evidence in regard to the reputation of a person whether he be an individual or a body corporate. In the case of a body corporate or a firm, the reputation of its whole time director(s) or managing partner(s) would come into focus. The Board as a regulator has been assigned a statutory duty to protect the integrity of the securities market and also interest of investors in securities apart from promoting the development of and regulating the market by such measures as it may think fit. It is in the discharge of this statutory obligation that the Board has framed the Regulations with a view to keep the market place safe for the investors to invest by keeping the undesirable elements out. The Regulations apply across to all sets of regulations and all intermediaries of the securities market including those who associate themselves with the market and they all have to satisfy the criteria of "fit and proper person" before they could be registered under any of the relevant regulations and this criteria they must continue to satisfy through out the period of validity of their registration and through out the period they associate with the market. The purpose of the Regulations is to achieve the aforesaid objects and make the securities market a safe place to invest. One bad element can, not only pollute the market but can play havoc with it which could be detrimental to the interests of the innocent investors. In this background, the Board may, in a given case, be justified in keeping a doubtful character or an undesirable element out from the market rather than running the risk of allowing the market to be polluted. We may hasten to add here that when the Board decides to debar an entity from accessing the capital market on the ground that he/it is not a fit and proper person it must have some reasonable basis for saying so. The Board cannot give the entity a bad name and debar it. When such an action of the Board is brought to challenge, it (the Board) will have to show the material on the basis of which it concluded that the entity concerned was not a fit and proper person or that it did not enjoy a good reputation in the securities market. The basis of the action will have to be judged from the point of view of a reasonable and prudent man. In other words, the test would be what a prudent man concerned with the securities market thinks of the entity."*

3.6 It is the duty of SEBI to keep the market clean and free from undesirable elements. It has to take into account the financial integrity, honesty, good reputation and character of the applicant/registered intermediary. The role of DP as a market intermediary is very crucial and the investor's concern is always required to be upper most. As a watchdog of the securities market and the protector of investor's interest SEBI cannot take it lightly, when leading Indian investigation agencies like CBI has found something very serious in the functioning of MBSL and filed charge sheet. In my view the charges are very serious and there is a *prima facie* case of financial crime and the involvement of MBSL. It is, therefore, imperative to keep MBSL out of securities market, in the interest of investors and the market. Keeping MBSL out from the securities market will not affect the interest of investor's as they have the opportunity to switch to some other market intermediary as they deem fit. But keeping MBSL in mainstream market may cause prejudice to the interest of investors and the safety and integrity of

the securities market. The financial crime not only has a direct monetary cost but also threatens the integrity of financial markets and the interests of investors. The acts for which Sh. Mukesh Babu has been charged by CBI are very serious in nature. In view of that the "fit and proper person" criteria in the present matter is required to be seen from wider perspective as interpreted by SAT and accordingly I, find MBSL not a fit and proper person to continue to act as DP.

3.7 I have noted that CDSL had submitted an application for renewal of registration of MBSL as Depository Participant on March 26, 2004. This application was considered in the light of Regulation 19 (cc) of DP Regulations, and Regulations 3(2) (f) and 3(2)(h) of Fit and Proper Person Regulations and a SCN dated July 13, 2004 was issued and accordingly an opportunity of personal hearing was also given by the competent authority on September 02, 2004. But the matter is kept on hold as the enquiry proceedings were going on.

3.8 With regard to the objection of MBSL that its submissions were not considered by the Enquiry Officer, I am of the view that there is a laxity on the part of DP that it had not addressed its reply to the Enquiry Officer despite the SCN specifically advising it to send the reply directly to the Enquiry Officer. Rather the reply was addressed to the department which had issued the SCN. Further MBSL should have appeared on the day when personal hearing was granted to it to make its point clear to the Enquiry Officer. However, I have taken the copy of the letter dated August 12, 2004 on record and the submissions of MBSL were duly considered along with the reply filed on May 19, 2006.

3.9 In view of the above, I find that MBSL is not a fit and proper person as per the criteria laid down by the Regulation 19 (cc) of SEBI DP Regulations read with Clause 3(2)(f), 3(2)(h) of Fit and Proper Person Regulations for getting registered as Depository Participant. However since the registration of MBSL as DP expired on June 28, 2004, the question of its cancellation as recommended by the Enquiry Officer does not arise now, but the application for renewal is to be formally rejected for the reasons stated herein above.

Order

4.1 Therefore, in exercise of the powers conferred to upon me in terms of Section 19 of SEBI Act, 1992 read with Regulation 13 (4) of the Enquiry Regulations and Regulation 24 of SEBI (Depositories and Participants) Regulations, 1996, I hereby conclude the enquiry proceedings as above and reject the application dated March 26, 2004 submitted by CDSL for renewal of registration of MBSL as Depository Participant.

4.2 This order shall come into force with immediate effect.

Mumbai

Date: 19.1.2007

V.K. Chopra

Whole Time Member

Securities and Exchange Board of India