

THE GAZETTE OF INDIA
EXTRAORDINARY
PART – II SECTION – 3 SUB-SECTION (ii)
PUBLISHED BY AUTHORITY
SECURITIES AND EXCHANGE BOARD OF INDIA
NOTIFICATION
MUMBAI, THE 6th DAY OF JULY 2007

1.0 BACKGROUND

- 1.1. SEBI/LE/98096/2007 – Saurashtra Kutch Stock Exchange Limited (hereinafter referred to as “SKSE” or “the Exchange”) is a company limited by shares and was recognized as a stock exchange under Section 4 of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as “SCRA”) for a period of 3 years commencing on July 10, 1989. The said recognition was being renewed from time to time under Rule 7 of the Securities Contracts (Regulation) Rules, 1957 (hereinafter referred to as “SCRR”) and the last recognition granted to SKSE was valid up to July 09, 2007, subject to the conditions stated herein below:

The Exchange shall commence trading only after complying with the suggestions stated in the Report of the Inspection of the Exchange conducted by the Securities and Exchange Board of India during the period June 7-10, 2006 and communicated to the Exchange vide letter no. MIRSD/DPS III/PJ/70646/2006 dated June 30, 2006.

- 1.2. Securities and Exchange Board of India (hereinafter referred to as “SEBI”) had conducted an inspection of SKSE during June 07-10, 2006, which focused on the overall management, monitoring of the working of the subsidiary by SKSE and the financials of SKSE. An inspection report was forwarded to SKSE by SEBI vide letter dated June 30, 2006 and SKSE was advised to place the report before its Council of Management (hereinafter referred to as “Council”) and send an

initial point-wise compliance report to SEBI on the observations made in the inspection report, within 21 days from the date of the receipt of the letter. SKSE was also advised to submit the quarterly progress on the compliance of the observation in the report, beginning from quarter ending September 2006, within 15 days of the end of each quarter, after placing the report before its Council.

- 1.3. SKSE furnished the initial compliance report to SEBI, vide letter dated July 24, 2006. A meeting was convened by SEBI with the representatives of the Council on August 23, 2006 to discuss the functioning of the Exchange and also the level of rectification, with respect to the deficiencies pointed out in the inspection report. During the discussion, SKSE was advised to rectify all the deficiencies pointed out in the inspection report and submit a weekly report regarding the same which was also communicated to SKSE vide letter dated September 06, 2006. However, compliance report was submitted by SKSE vide letter dated October 20, 2006, only after reminders dated September 11, 2006 and October 16, 2006 were issued by SEBI to SKSE in this regard.
- 1.4. On perusal of the compliance report, it was noted that there were deficiencies that were yet to be rectified with by SKSE, as under:
 - i. Failure to set up the Settlement Guarantee Fund (SGF).
 - ii. Failure to appoint the Executive Director.
 - iii. Failure to appoint the Chief Executive Officer for its subsidiary company.
 - iv. Failure of the subsidiary to have its own staff.
 - v. Failure to conduct half-yearly inspection of its Subsidiary.
 - vi. Non recovery of dues leading to drain of Exchange resources.
 - vii. Failure on Valuation of Shares at VaR basis.
 - viii. Non-submission of Audit Reports by members.
 - ix. Inadequate Infrastructure.
- 1.5. Further, it was observed that SKSE, at times, has acted belligerently in defiance of SEBI directives, indulging in actions such as:

- i. Willful violation of SEBI's directives.
 - ii. Allowing broker directors to exercise financial powers.
 - iii. Not providing adequate financial powers to the Executive Director.
 - iv. Convening a press conference on July 27, 2006, which was presided over by its Executive Director (Officiating) (hereinafter referred to as "OED") and attended by two broker members of the Exchange to discuss the findings of the confidential SEBI inspection report and functioning of the Exchange.
- 1.6. SEBI also received frequent complaints on the mal-administration and mis-management by the Council of the Exchange from various important quarters like Ministry of Finance, Hon'ble Member's of Parliament, etc., *inter-alia* alleging that:
- i. Elected directors are running the administration of SKSE in accordance with their whims and wills.
 - ii. Elected directors have donated money from the treasury of the Exchange without getting permission from any authority.
 - iii. Elected directors have retained the power of signing and passing the bills and vouchers of SKSE Ltd. and SKSE Securities Ltd. instead of delegating the same to OED.
 - iv. SKSE failed to appoint a representative from the registered investor association in the IPF Trust.
 - v. Created a post of General Manager to favor a particular individual.
 - vi. Indulged in fraudulent transfer of shares worth Rs. 30 lakh belonging to two clients from the DP of SKSE Securities Ltd. to Matalia Stock Broking (P) Ltd. – DP Stockholding Corporation Ltd, during the month of December 2006.
- 1.7. SEBI Nominee Director also expressed his displeasure on the manner in which issues were being handled by SKSE during board meetings and decisions were being taken without proper representation of Government Nominee Directors.

- 1.8. It is further observed that the Council approved payment of gratuity to the ex-employees of SKSE without having any such provision in Employee Service Regulation of SKSE.

2.0 Show Cause Notice, Reply and Hearing

- 2.1 The above deficiencies were in violation of the provisions of SCRA, SCRR, the SEBI Act, 1992 (hereinafter referred to as 'the Act'), the Rules and Regulations made there under, the circulars/directives issued by SEBI and the Rules, Regulations and Bye-laws of SKSE. Hence, SEBI issued a notice dated February 27, 2007, to the Council under Section 5(1) of SCRA, read with Section 11 of the Act, calling upon them to show cause as to why recognition of SKSE should not be withdrawn under Section 5(1) of SCRA. SKSE was also advised to show cause as to why pursuant to the said withdrawal, necessary directions under Section 11 read with Section 19 of the SEBI Act should also not be passed, so to secure proper management of the assets and other properties of the exchange in the interest of investors of the said region as well as the companies listed on SKSE. Further, SKSE was advised to reply to the notice within 15 days from the date of receipt of the notice and to appear for a personal hearing before the Whole Time Member of SEBI on April 3, 2007, along with supporting documents, if any. SKSE was informed that in case they failed to reply/appear for the personal hearing as aforesaid, it shall be presumed by SEBI that SKSE had no reply to offer and had accepted the charges as alleged in the show cause notice. The matter shall then be proceeded ex-parte by SEBI on the basis of the materials available on record.
- 2.2 In response to the above show cause notice, the Council submitted its reply vide letter dated March 16, 2007 as under and requested for a personal representation to SEBI. Shri Mukesh P. Doshi, Shri B.C. Parsanna and Shri Sunil C. Shah - Broker Directors of SKSE, Shri Y.C. Anarkat - PR Director of SKSE, Shri Amitkumar Bhalodi - OED of SKSE, Dr. Alok Kumar Chakrawal - PR Director

of SKSE Securities Ltd. and Shri J.J. Bhat, Advocate appeared for a personal hearing before me on April 03, 2007. Shri J.J. Bhat, Advocate made the submissions on behalf of the Council of SKSE.

3.0 A gist of the violations alleged against SKSE and its submissions made vide letters dated March 16, 2007, April 3, 2007, May 31, 2007 and during the hearing before me, is summarized as under:

3.1 Failure to set up the Settlement Guarantee Fund (SGF):

It was observed that SKSE failed to set up SGF in violation of SEBI circular dated June 9, 1997.

In this regard, SKSE submitted that the Exchange had established SGF. However it was titled as Settlement Protection Fund (SPF) which was constituted way back in 1996 and has a corpus of Rs 36 lakh. Further, the Council in its meeting held on March 07, 2007 decided to rename the said SPF as SGF.

3.2 Failure to appoint Executive Director:

It was observed that SKSE failed to appoint an Executive Director for the Exchange since September 2004. Further, SKSE resorted to strange means to fill the post of Executive Director by violating various SEBI directives. SKSE had appointed Shri Satishkumar Nedungadi as Executive Director who did not possess the requisite qualification as prescribed in the advertisement for the said post.

In response to the above, SKSE submitted that Shri Amitkumar Bhalodi was acting as OED since February 14, 2007 in terms of the resolution adopted by the Council in its meeting held on February 13, 2007. After the resignation of Shri Nedungadi the incumbent OED of SKSE, it was imperative to entrust the day-to-day functioning and administration of SKSE and its subsidiary to someone so that normal working (i.e. pay-in/pay-out at NSE/BSE, margin collection from sub-

brokers/clients, DP activities, etc.) is not affected. Further, it is also submitted that the Council in its meeting dated February 13, 2007 reconstituted the CEO Selection Committee. Subsequently, the Committee interviewed the candidates on February 24, 2007 and February 27, 2007 and submitted its report along with the recommendation to the Council on March 2, 2007. The Council in its meeting held on March 2, 2007 accepted the recommendation of the Committee and forwarded two names for approval of SEBI vide letter dated March 2, 2007. SKSE has informed that Shri Amit Kumar Bhalodi, OED has submitted his resignation and would be relieved from the services w.e.f. May 31, 2007.

3.3 Failure to appoint the Chief Executive Officer for its subsidiary company

It was observed that SKSE failed to appoint a Chief Executive Officer for its subsidiary since August 2005. SKSE had recommended Shri Tarang Mehta as Chief Executive Officer for its subsidiary company to SEBI vide letter dated October 14, 2005. In spite of rejection by SEBI, SKSE vide letter dated December 24, 2006 once again recommended the name of Shri Mehta for the CEO of the subsidiary which was again rejected by SEBI. Subsequently, Shri Amitkumar Bhalodi was appointed as CEO (Officiating) of the subsidiary on September 26, 2006 even though he did not possess the requisite experience.

In this regard, SKSE submitted that as there was no favorable response to the advertisement and as suitable candidate was not found, the Council in its meeting held on March 07, 2007 decided to release a fresh advertisement and has invited applications for the post of CEO of SKSE Securities Ltd. Accordingly, an advertisement has been released in two newspapers on March 15, 2007 and March 21, 2007. SKSE further submitted that the Selection Committee conducted interviews for the post of CEO, General Manager and Company Secretary. The Selection Committee selected Shri Chirag Kumar who though appeared for the post of CEO of SKSE subsidiary was selected as a General Manager who will be joining w.e.f. June 8, 2007. As far as the post of Company

Secretary is concerned, Shri Rajesh Gandhi, a Company Secretary was selected and his effective date of joining is May 31, 2007.

3.4 Willful violation of SEBI's directives:

It was observed that SKSE at times had resolved to do acts in violation of SEBI directives which is evident from the decision of the Council at its meeting held on December 14, 2004 wherein it had been resolved to refund the excess of BMC above Rs. 1 lakh without obtaining NOC from SEBI.

SKSE submitted that the resolution dated December 14, 2004 for refund of excess of BMC above Rs. 1 lakh was never acted upon and has since been rescinded / withdrawn by passing a resolution at the Council meeting on March 7, 2007. Further, the Council was not aware of several reminders of SEBI as the same were not placed before the Council by the OED.

3.5 Financial powers exercised by broker directors

It was observed that the Council at its meeting held on August 25, 2005 resolved that a committee of two broker directors to look after overall administration of the Stock Exchange as well as its subsidiary in violation of SEBI circular dated March 4, 2003 read with January 10, 2000. Further, the said committee was also vested with financial delegation of powers indirectly by authorizing them to sign vouchers of expenses of Rs 5,000/- or more in violation of SEBI directives and which curtailed the operational freedom of the Executive Director.

SKSE submitted that the Council adopted a cautious approach in view of the past experience wherein certain instances of abuse of such power was noticed. It was therefore, considered view of the Council that experienced Directors of the Council be associated with the approval process in respect of all major payments so as to ensure some kind of internal control. It was a well intentioned decision

taken collectively by the Council in the interest of the Exchange. However, the power has been duly withdrawn by the Council in its meeting dated June 14, 2006 and at present elected broker directors do not authorize payment voucher nor they sign any cheque on behalf of SKSE or its subsidiary. The CEO(Off.)/OED has full administrative freedom and no elected director interferes in the day-to-day management of the Exchange.

3.6 Failure to provide adequate financial powers to the Executive Director:

It was observed during the inspection that the OED was not extended adequate financial powers for the smooth functioning of the Exchange. The OED was only delegated to authorize an amount of Rs. 5,000/- and all the expenses above Rs. 5,000/- were to be authorized by a committee consisting of two broker directors.

SKSE submitted that the exchange has given adequate powers to the OED/CEO (Off.) and the limit of Rs 5,000/- does not exist anymore. The cheque signatories are accountant and CEO (Off.).

It further submitted that the cheques are being signed by Executive Director/ Chief Executive Officer and other employees of the Exchange/subsidiary. The council of management has already withdrawn the authority given to the broker directors to sign vouchers of expenses. As such, the Executive Director has adequate financial powers in SKSE as well as its subsidiary.

3.7 Inadequate Infrastructure

SKSE failed to adopt T+2 Rolling Settlement System (RSS). Contrary to this, SKSE informed that T+2 RSS would be adopted at the time of commencement of trading. SKSE indicated that the circulars relating to trading and settlement shall be implemented as and when trading activity commences on the floor of the Exchange.

SKSE submitted that there was no trading activity on the platform of the Exchange for the last nine years. The sub-brokers of subsidiary, SKSE Securities Ltd. are operating on BSE/NSE and all requisite logistics and infrastructure are available and in place. Further, the settlement obligations of trades of sub-brokers get settled on BSE/NSE in a timely and orderly manner.

Regarding implementation of T+2 rolling settlement system, SKSE has submitted that they had started SKATE (Saurashtra Kutch Stock Exchange Automated Trading Environment) as per SEBI Guidelines to start online trading. It is also submitted that they already have necessary software, mechanism etc. for implementing T+2 RSS and T+2 RSS would be implemented as and when trading takes place on the exchange.

3.8 Non-recovery of dues to drain of Exchange resources

It was observed that an amount of approx. Rs.27.95 lakh was outstanding from brokers on various counts of which several brokers were also indicated to be active on the subsidiary. Moreover no effort has been taken by SKSE to recover the outstanding dues from the members other than resolving to render such members ineligible for voting at AGM. Further no efforts have been taken to recover outstanding dues amounting to Rs.136.57 lakh from around 195 companies towards listing fees payable to SKSE.

SKSE submitted that against Rs 27.95 lakh dues from the brokers, about Rs 20 lakh has been recovered on account of continuous follow up. For recovery of the balance amount, final reminders have been sent. It further submitted that SKSE deducted outstanding annual membership fee from base minimum capital of those brokers whose outstanding fee was Rs. 6000 or more. The brokers whose BMC has become insufficient as a result of deduction of outstanding fees have been advised to fulfill the requirement. It further informed the brokers that in case

of their failure to fulfill the requirement , necessary action including declaring them as defaulters shall be taken against them. In respect of outstanding fee below 6000, the concerned brokers have been finally advised to pay the same informing that if they failed to pay the outstanding fees, the exchange shall deduct the same from their BMC.

Further, with regard to recovery of listing fees payable by the companies, several reminders have been sent to listed companies. However, as there is no trading, the companies are reluctant to pay any listing fees.

3.9 Failure to conduct half yearly inspection of subsidiary

It was observed that SKSE did not conduct any half yearly inspections of its subsidiary SKSE Securities Ltd. (SKSESL) in violation of SEBI Circular dated February 11, 2003.

SKSE submitted that the Council in its meeting held on March 7, 2007 has appointed a Chartered Accountant to conduct the inspection of the subsidiary. It is also submitted that the subsidiary is already conducting inspection of its sub-brokers. The trading activity of the subsidiary is monitored in multiple ways and risk parameters are in place as per SEBI norms. It further submitted that the books of accounts and other documents of the subsidiary were inspected by M/s. RSD & Associates – Chartered Accountants for the half year ended on September 30, 2006. The inspection report was discussed in their Board Meeting and subsidiary has been directed to take necessary actions wherever required to rectify the deficiencies observed during the inspection.

3.10 Non submission of Audit Reports by brokers

It was observed that for F.Y 2004-05, 317 brokers did not submit their auditor's report to SKSE and a meager penalty of Rs.50 was levied for non compliance which was not deterrent in nature.

SKSE has submitted that notices dated March 13, 2007 have been issued requiring the members to submit the auditors report failing which the matter will be placed before the Disciplinary Action Committee for its consideration. It further submitted that pursuant to the notices to the brokers, SKSE has received Audit Reports from many of the brokers. However in respect of the brokers who have not furnished Audit Reports even after issuing notice, such matters will be placed before the Council and penalty may be imposed as decided by the Council.

3.11 Failure of the subsidiary to have its own staff

It was observed that most of the staff of SKSE is working concurrently at the Exchange and the subsidiary which is in violation of circular dated February 11, 2003.

SKSE submitted that at present the subsidiary has about 35 employees. In view to optimize the services of manpower, operational convenience and better utilization of manpower the staff of SKSE was used. However now there is proper segregation of staff between SKSE and its subsidiary.

3.12 Failure for valuation of shares at VaR basis

It is observed that the valuation of securities given by the members towards BMC is done twice a month keeping a hair-cut of 30%, in violation of our aforesaid circular.

SKSE has submitted that the Council in its meeting held on March 7, 2007 resolved to start valuing shares on a daily basis as per the rates of BSE/NSE.

3.13 SKSE convened a press conference on July 27, 2006 presided over by the OED and attended by two broker members of the Exchange to discuss the findings of the inspection report and the functioning of the Exchange.

SKSE submitted that certain mischievous elements were spreading rumors and orally communicating incorrect information relating to the working of SKSE and its subsidiary especially after SEBI's Inspection Report. Such rumors/reports were causing anxiety in the minds of sub-broker members and investors. Further certain false and disparaging imputations were sought to be made against the Council. It was therefore thought fit to clarify the misgivings in the minds of investors and to save reputation of the exchange. Hence, the Council was constrained to call a press conference to clarify the mischievous reports about the functioning of the Exchange. It was not strictly a press conference to discuss the SEBI inspection report but only clarifications were given to certain questions that were asked and it was assured that there was no problem at the Exchange and investors' money/securities were safe.

- 3.14** SEBI has been receiving frequent complaints on the mal-administration and mis-management by the Council of the Exchange from various important quarters like Ministry of Finance, Hon'ble Member's of Parliament, etc as , indicated in para no. 1.6 above.

On the above complaints, SKSE submitted that the elected directors were/ are not running the administration of SKSE in accordance with their whims and wills. The Council approved/ratified the donation by adopting a suitable resolution. Further, the Council has inherent powers to approve/ratify such kind of donation in respect of which decision was taken after due deliberations and the said matter was entirely within the realm of the Council. It is also submitted that the Council has appointed a representative from the registered investor association for the Investor Protection Fund Trust. The post of General Manager was created under compelling circumstances and in order to ensure smooth functioning of the Exchange.

- 3.15** SEBI received complaints about fraudulent transfer of shares worth Rs. 30 lakh belonging to two clients from the DP of SKSE Securities Ltd. to Matalia Stock Broking (P) Ltd. – DP Stockholding Corporation Ltd, during the month of December 2006. Such incidents show complete failure of the administration at SKSE to check such malpractices.

SKSE submitted that it was a stray case of fraud and a FIR was lodged with the police authorities immediately, and the culprits have been arrested. So far, the Court has not sanctioned bail of the persons arrested in this case. It is also submitted that the financial loss is Rs. 12 lakh for which an insurance claim has already been filed. The police are investigating the matter and because of the pro-active action and dexterity shown by the Council, further loss was avoided.

- 3.16** In addition to the above, it was observed that the Council had approved the payment of gratuity to the ex-employees of SKSE without having any such provision in Employee Service Regulation of SKSE.

SKSE submitted that it is well within the inherent powers of the Council to pay ex-gratia to senior employees as a mark of gratitude when they leave the organization after putting a number of years of service and especially when salary levels are comparatively low in this region. It is also submitted that the practice of payment of ex-gratia has since been discontinued.

4.0 Consideration of Issues

- 4.1** I have taken into consideration the facts and circumstances of the case and the material available on record including the show cause notice, replies and the documents submitted by the SKSE as well the submissions made before me, during the personal hearing.

- 4.2 I note that the inspection conducted during June 07-10, 2006, focused on the overall management, monitoring of the working of the subsidiary by SKSE and the financials of SKSE. Further, the renewal of recognition granted to SKSE was subject to the condition that the exchange shall commence trading only after complying with the suggestions stated in the inspection report. I also note that SEBI in its meeting dated August 23, 2006 with the representatives of the Council advised the exchange to rectify all the deficiencies stated in the inspection report and submit a weekly report. However after the perusal of the compliance report dated October 20, 2006, February 27, 2007 and May 31, 2007 submitted by SKSE, it is observed that most of the suggestions made in inspection report are not complied with. I find that there is substantial non-compliance by the SKSE with respect to the various suggestions on which the renewal of recognition of SKSE was conditional. I have also examined the reasons assigned for the said non-compliance / delayed compliances and find them inadequate to explain why these conditions have not been complied within the time frame specified by SEBI, during the discussion held by SEBI. Now I would like to deal with each issue independently.
- 4.3 SEBI vide circular dated June 09, 1997 directed all stock exchanges (including 'SKSE') to set up a clearing corporation and extend settlement guarantee or else take up the settlement of the trade through the clearing house and guarantee the trade by setting up SGF. Vide the said circular, all stock exchanges were also advised to submit the relevant information in the prescribed format to SEBI for its examination and approval for the proposal of setting up of SGF. I note that SKSE has failed to submit the proposal of SGF to SEBI for approval. However, the Council in its meeting held on March 07, 2007 has, instead of submitting a proposal to SEBI for setting up of SGF has merely changed the name of Settlement Protection Fund, which was created in 1996, to SGF. Further, the corpus of Rs. 36 lakh in SPF appears to be inadequate to meet out all the contingencies arising out of settlement liability. It is pertinent to note that mere change of name from SPF to SGF is of no consequences whatsoever as far as

implementation of the circular is concerned. It will not be out of place to record that the exchange has desperately tried to improve upon and somehow fill up the glaring deficiencies and lacuna by arriving at such a naïve decision with regard to changing the name of SPF to SGF. I therefore conclude that SKSE has failed to comply with the aforementioned circular.

4.4 I note that SKSE did not have a full time Executive Director since almost two years. Further the Exchange has been resorting to strange means to fill the post of Executive Director in violation of SEBI directives. I find that the Council in its meeting held on November 18, 2004 had constituted a committee for the selection of the Executive Director without obtaining prior approval of SEBI in violation of SEBI circular dated January 10, 1996. Shri Satishkumar Nedungadi had worked in SKSE since July 1993 to September 1998 as a Manager (Market Operations), OED and Deputy General Manager. Shri Nedungadi was considered for the post of Executive Director of SKSE and was appointed without approval of SEBI on January 4, 2006. In the light of the above irregularity, SEBI vide letter dated January 6, 2006 advised the Exchange to advise Shri Nedungadi to relinquish the post of Executive Director immediately which was relinquished by him on January 10, 2006. It is pertinent to note that Shri Nedungadi was considered for the post of Executive Director without fulfilling the basic educational criteria as prescribed in the advertisement of SKSE.

4.5 I note that SKSE appointed Shri Nedungadi as General Manager on September 2, 2006 who is again devoid of the requisite qualification as per the advertisement published in the newspaper for the said post when the exchange did not have any post of the General Manager. He was subsequently appointed as OED on September 26, 2006. From the chronology of events, it may be construed that there is some amount of favoritism in appointing him as General Manager of SKSE and that the Council had a pre-meditated design to first create a new post of General Manager and appoint him as General Manager and then elevate him as OED. On perusal of the facts and circumstances on the

appointment of Shri Nedungadi as General Manager, it may be reasonably construed that the entire course of events appear to be orchestrated by SKSE so as to allow a back door entry for him as a de-facto OED of the exchange. Further, the Council in its meeting held on December 27, 2006 entrusted him with the functions of CEO (Off.) of the subsidiary company as well (i.e. dual charge of the exchange as well as its subsidiary). However, after few days, SKSE issued a show cause notice dated January 03, 2007 to him, as to why disciplinary action should not be initiated against him. Subsequently, Shri Nedungadi resigned w.e.f. February 13, 2007.

4.6 A chronology of developments in the matter of appointment of OED and CEO (Off.) is given below:

Sr. No.	Events	Date
1.	Shri Amitkumar Bhalodi appointed as OED of SKSE	February 17, 2006
2.	Shri Satishkumar Nedungadi appointed as General Manager	September 2, 2006
3.	Shri Nedungadi was given charge of OED of SKSE from Shri Bhalodi	September 26, 2006
4.	Shri Amitkumar Bhalodi was given charge of CEO (Off.) of Subsidiary	September 26. 2006
5.	Shri Nedungadi was given charge of CEO (Off.) of subsidiary from Shri Bhalodi	December 27, 2006
6.	On resignation of Shri Nedungadi on February 13, 2007, Shri Bhalodi was given charge of OED of SKSE and CEO (Off.) of subsidiary	February 14, 2007

I note that SKSE appointed Shri Amitkumar Bhalodi, aged only 23 years as OED of SKSE on February 18, 2006. He does not possess the requisite experience for the said post considering the complexity of the functions/market. Such an arrangement is inappropriate particularly since the subsidiary is active and an

experienced person should have been considered for the said post. The entire series of events as narrated above smacks of some sort of collusion between the office bearers of the exchange/subsidiary and the Council of the exchange. Such a flip flop to fill the post of OED/CEO (Off.) is not appreciable all the more when the candidates are not professionally qualified nor have adequate experience. From the chronology of events, it is evident that the Exchange has been resorting to very strange means to fill the important post of OED of the exchange/CEO (Off.) of the subsidiary.

- 4.7 I note that SKSE is not able to appoint a Chief Executive Officer (CEO) for its subsidiary since August 2005. I note that SKSE vide their letter dated October 14, 2005 recommended a person by the name of Shri Tarang Mehta as CEO for its subsidiary. However SEBI did not approve the name of Shri Mehta as CEO of the subsidiary and vide its letter dated November 04, 2005 advised the Exchange to re-commence the process of appointment of the CEO. However, SKSE vide letter dated December 24, 2006 once again recommended the name of Shri Mehta for the CEO of the subsidiary whose name was rejected by SEBI. Subsequently, Shri Amitkumar Bhalodi was appointed as CEO (Officiating) of the subsidiary on September 26, 2006 even though he did not possess the requisite experience which is inappropriate particularly since the subsidiary is active and has average daily turnover of Rs. 36 crore (approx.) for FY 2006-07. I have noted the submission of SKSE that since the Selection Committee did not find any suitable candidate for the post of CEO the Committee came to a conclusion of a fresh exercise of the selection procedure should be started. I note that the Council in its meeting dated March 07, 2007 decided to release a fresh advertisement and has invited applications for the post of CEO of SKSE Securities Ltd. through advertisement in two newspapers dated March 15, 2007 and March 21, 2007. However, in spite of the fresh exercise undertaken by the exchange and even after considerable lapse of time, the exchange is yet to appoint a CEO for the subsidiary.

4.8 It is observed that SKSE at times had resolved to do acts in defiance of SEBI's directives.

4.8.1 One such incident was when the Council in its meeting dated December 14, 2004 resolved to refund the excess of BMC above Rs. 1 lakh without obtaining the No-Objection Certificate (NOCs) from SEBI. I note that SEBI vide its circular dated June 18, 2003 had stipulated that the excess of the BMC over Rs. 1 lakh may be refunded to the members subject to conditions which *inter-alia* included that the exchange shall ensure that the member has paid the SEBI turnover fees and has obtained a NOC from SEBI in this regard. However, the contention that the resolution is not given effect to is not convincing enough, since the Council has passed a resolution in violation of the circular which itself demonstrates its ill intention and respect to the directives of SEBI.

4.8.2 In another similar incident of violation of SEBI directives, the Council in its meeting held on March 22, 2005 had resolved to continue with existing Executive Director selection committee despite being brought to the notice of the Council by the then OED that SEBI had advised for reconstituting the Committee. Further the Council in its meeting held on January 04, 2006 resolved to form a committee comprising solely two broker directors in violation of SEBI circular dated January 10, 2000 to look after overall administration of the Stock Exchange and to take necessary decisions as may be required.

4.9 I find that the Council had authorized a committee comprising two broker directors to look after overall administration of the Exchange despite forming a Management Committee for ensuring smooth functioning of the Exchange as advised by SEBI. I note that SEBI vide circular dated March 4, 2003 (read with directions vide SEBI circular dated January 10, 2002) had categorically reiterated that no broker of the stock exchange shall be office bearer of an Exchange. The circular also made it clear that the member broker directors on the Governing

Board shall not be eligible to sign cheques on behalf of the Exchange. I find that the Exchange has resorted to an ingenious manner of obviating the stipulations of SEBI with regard to financial powers exercised by broker directors which is in violation of SEBI Circulars dated March 4, 2003 and August 12, 1999 wherein in it has been mandated that the ED should be vested with adequate financial powers and that broker directors not to be authorized to sign any cheques or operate any bank accounts on behalf of the stock exchange.

- 4.10 I have noted that the Executive Director has not been extended adequate financial powers for the smooth functioning of the Exchange. It was observed that even though OED had been authorized to sanction amount up to Rs.5,000 there were instances wherein amount as high as Rs. 25,000 had been sanctioned by an official of the Exchange. I note that SEBI vide its circulars dated August 12, 1999 and March 4, 2003 advised all the Stock Exchanges to accord adequate financial powers to the ED of the Stock Exchanges for the smooth functioning of the Stock Exchange. I find that even though the existing delegation of financial powers at the Exchange were not appropriate and were in violation of SEBI directives yet what had been resolved was also not being followed and financial powers were being exercised by people not authorized in this regard. SKSE has submitted that the Council in its meeting dated June 14, 2006 has discontinued such practice and that adequate financial powers have been given to the OED/CEO (Off.) Further the cheques are now signed by accountant and CEO (Off.).

I note that it is paramount for a stock exchange to follow the guidelines/directives issued by SEBI/Govt. of India from time to time as the same has been issued in the interest of investors for the betterment and safety of small investors investing in the stock market. However, I find that the directives/guidelines of SEBI have been flouted by SKSE as is apparent from the resolutions passed by the Council. It is pertinent to note that merely because SKSE has subsequently overturned

the aforesaid decisions, the decisions taken by the Council during the relevant time would not become immune from further scrutiny.

- 4.11 With regard to the status of the exchange trading system, it was indicated by the Exchange that there was no trading at the Exchange since 1997-98 and therefore the Exchange did not adopt T+2 Rolling Settlement System and the Exchange would adopt the same at the time of starting trading. Further, SKSE also indicated that the circulars relating to trading & settlement shall be implemented as and when trading activity commences on the floor of the Exchange. However, SKSE vide letter dated May 31, 2007 has informed that the exchange has started SKATE (Saurashtra Kutch Stock Exchange Automated Trading Environment) as per SEBI guidelines to start online trading. It is also submitted that the exchange already has necessary software, mechanism, etc. for implementing T+2 Rolling Settlement System and the same would be implemented as and when trading takes place in the exchange.

I note that during the oral and written submissions, SKSE did not indicate of trading software being developed by them which would be in tune for implementing the T+2 Rolling Settlement System. The pace at which SKSE started SKATE to start online trading within a span of two months cast a doubt on the readiness and the ability of the exchange to implement the trading software. Further, in their instant letter they have not even mentioned the details of the supplier/vendor of the software, the cost at which the same was procured, etc. Moreover, the various parameters of the software has to be validated, tested and confirmed in accordance with the various circulars of SEBI with regard to trading, settlement and risk management. Foremost among them is SEBI circular dated February 23, 2005 on the Comprehensive Risk Management Framework for the Cash Market. In terms of the said circular, the Stock Exchanges are required to put in place the necessary systems to ensure the operationalization of the comprehensive risk management framework with effect from May 30, 2005. Further, the exchanges were to ensure that they have tested the software and

removed any glitches in its operation well before the above mentioned date to avoid any problems in the live environment.

Considering the submission of the exchange that the circulars relating to trading & settlement shall be implemented as and when trading activity commences on the floor of the Exchange, I am of the considered view that the various parameters of the software is yet to be tested. Hence, the submission of SKSE that the exchange has started SKATE as per SEBI guidelines to start online trading system is of no consequences.

- 4.12 I note that there were huge amounts outstanding from the brokers towards the Exchange, certain of which were being carried over for the years. I note that SEBI had emphasized that the amount due was high and that the members' who has outstanding dues may be declared as defaulters as a result of which the amount recovered would substantially improve the financial position of the Exchange. I find that no efforts put in by SKSE to recover the outstanding dues from the members other than resolving to render such members in-eligible for voting at AGM. However, I have noted the submission of SKSE that an amount of Rs. 20 lakh out of Rs 27.95 lakh has been recovered. As regards balance of amount, final reminders have been sent by the Exchange.
- 4.13 As regards recovery of outstanding listing fees payable by the listed companies, SKSE submitted that since there is no trading on the Exchange, the listed companies are reluctant to pay any listing fees.
- 4.14 I note that SEBI vide its circular dated February 11, 2003 had mandated that the parent exchange shall be responsible for all risk management of the subsidiary company and shall set up appropriate mechanism for the supervision of the trading activity of subsidiary company and that such mechanism *inter-alia* shall include conducting of half yearly inspections of the subsidiary and 20% of its sub-

brokers and placing such reports before the Governing Board of the Exchange. It was observed that the Exchange did not conduct any half yearly inspections of its subsidiary. Further, Exchange has also not set up or followed appropriate mechanism for the supervision of the trading activity of its subsidiary as specified in the aforesaid circular. SKSE has submitted that Council in its meeting held on March 7, 2007 has appointed a Chartered Accountant to conduct the inspection of the subsidiary. I note that SKSE has admitted the lapse on their part that they had so far not conducted any inspection of its subsidiary.

- 4.15 Apart from the above, I note that for the financial year 2004-05, as much as 317 brokers of the total 399 brokers did not submit their auditor's reports to SKSE. Further for this non-compliance, SKSE levied a meager penalty of Rs. 50/-. I find that any penalty would generally be deterrent in nature; however SKSE by levying a penalty of only Rs. 50 towards non compliance has rendered it as ineffective.
- 4.16 SEBI vide circular dated February 11, 2003 has stipulated that the subsidiary shall have its own staff none of whom shall be concurrently working for or holding any position of office in the parent exchange. However, I note that most of the staff of SKSE is working concurrently at the Exchange and its subsidiary. SKSE has submitted that necessary steps have been taken to optimize the services of manpower and for better operational convenience and there is proper segregation of staff between SKSE and its subsidiary.
- 4.17 It was observed that the Exchange is not valuing the securities at VaR% on daily basis. The valuation of securities given by the members towards BMC is done twice a month keeping a hair-cut of 30%. SEBI vide circular dated February 23, 2005 had stipulated that the valuation of the liquid assets which also include the equity shares is required to be done on a daily basis. SKSE has submitted that the Council in its meeting held on March 7, 2007 resolved to start valuing shares on a daily basis as per the rates of BSE/NSE.

- 4.18 Besides these technical irregularities, I note that SKSE had convened a press conference presided over by OED and attended by two broker members of the Exchange to discuss the findings of the inspection report and the functioning thereof. I find it surprising, shocking and unusual for an Exchange to discuss the confidential SEBI inspection report with the press in open, which has never happened in the history of the capital market. Moreover, the press conference was held without the approval of the entire Council especially Public Representative Directors and SEBI Nominee Directors. This demonstrates the casual approach of the functioning of the Exchange, irresponsibility of the OED and other elected broker members of Council of SKSE.
- 4.19 Further I have noted that SEBI has been receiving frequent complaints from various important quarters on the mal-administration and mis-management by the Council of the Exchange. In light of the serious nature of the complaints alleging financial mis-management and irregularities, the above observations were considered during the inspection of June 2006. After analyzing the same, I find that the committee consisting of Public Representative Directors were authorized vide Council resolution dated August 25, 2005 to look after overall administration of the stock exchange as well its subsidiary and to take necessary decision as required, in the same meeting the broker directors were also authorized to exercise financial powers over expenses of Rs. 5,000/- or more. There are also instances of financial irregularities wherein an amount of Rs 25,000/- was debited to donation account but there was no supporting papers attached to the said voucher. It has also been observed that the fact relating to accounting and record keeping practice being followed by the exchange is not appropriate. I note that stock exchange being a public institution is expected to ensure proper record keeping of documents. The donation made without proper approval/documents is not appreciable and cast doubt on the handling of funds of the exchange.

- 4.20 From the material on record, it is apparent that the affairs of the Council of Management of SKSE are not being managed and conducted in a free and transparent manner but are being managed by couple of elected directors, who have misused and abused their position. The purpose of establishment of a recognized stock exchange has to be in the interest of the trade and investors. However in the present case, I find this objective to be deficient as is evident from the current inspection.
- 4.21 Apart from the irregularities mentioned above, I have noted that SEBI has been receiving complaints about fraudulent transfer of shares worth Rs. 30 lakh belonging to two clients from the Depository Participant (DP) of SKSE Securities Ltd. to Matalia Stock Broking (P) Ltd., DP of Stockholding Corporation of India Ltd, during the month of December 2006. SKSE has submitted that a FIR was lodged with the police authorities immediately, and the culprits have been arrested. It is also submitted that the financial loss is Rs. 12 lakh for which an insurance claim has already been filed.
- 4.22 Further, the Council has approved the payment of gratuity to the ex-employees of SKSE without having any such provision in Employee Service Regulation of SKSE. SKSE has submitted that it is in the inherent powers of the Council to pay ex-gratia to senior employees as a mark of gratitude when they leave the organization and that the practice of payment of ex-gratia has since been discontinued. I note that the pay, allowance and other benefits to an employee of a stock exchange is governed by the provisions stipulated in the employee services regulation of a stock exchange. However, in the absence of proper policy, there could be a discretion with respect to the amount paid as ex-gratia to employees.
- 4.23 Stock Exchange being a “Self Regulatory Organization” is a first level regulator and has a responsibility to oversee the management, administration, trading and settlement of the exchange, to regulate its own members, trading and settlement

and monitor the functioning of its subsidiary. Besides, as has been observed by the Hon'ble Supreme Court of India in K. C. Sharma Vs. Delhi Stock Exchange and others, the stock exchanges are "State" within the meaning of Article 12 of the Constitution of India. SKSE is a public institution that regulates the dealings in shares and securities and is incorporated under the SCRA and is guided not only by its own Rules, Bye-laws and Regulations but is also controlled by the directives issued by SEBI/Govt. of India from time to time and is mandatorily required to follow them. On perusal of the compliance reports dated October 20, 2006 and February 27, 2007, I find that SKSE had substantially not complied with the observations stated in the inspection report. However, pursuant to the show cause notice dated February 27, 2007 SKSE convened a meeting on March 7, 2007 and adopted certain resolutions in conformity with some of the observations of the inspection report. I note that stock exchange being first level regulator; a duty is cast upon them to continuously comply with the various statutory Acts, Rules, Regulations, Bye-laws, etc. of the stock exchange. By their above actions, I find that SKSE complied with the observations stated in the inspection report only after a regulatory action was cast upon them.

- 4.24 In spite of the fact that there is no trading on SKSE since 1998, it is incumbent upon a stock exchange to supervise its trading members comply with the Rules, Bye-laws and Regulations of the exchange at all times during their period of holding of membership of an exchange irrespective of whether they trade or not. However, I find that certain observations like submission of audit reports, maintenance of BMC, collection / recovery of outstanding dues from the brokers etc. are not complied with by the members of the exchange. It is equally shocking to know that the exchange did not deem fit necessary to impose fine/penalty or any other disciplinary action on its members.
- 4.25 Knowing fully well that listing fee is an important source of income for an exchange, it is impossible to believe that the exchange has not put in efforts to recover outstanding dues amounting to a huge sum of Rs.136.57 lakh from

around 195 companies on the pretext that since there is no trading, companies are reluctant to pay listing fees.

4.26 SEBI has time and again impressed upon the stock exchanges the necessity to have an independent management devoid of any broker influence. However, I find that there are severe and intentional lapses in the appointment of Executive Director for the exchange and Chief Executive Officer for its subsidiary. There is no denying the fact that the exchange has over the years adopted strange means to fill the position of the Executive Director/Executive Director (Officiating)/Chief Executive Officer/ Chief Executive Officer (Officiating). However, I note that the exchange has forwarded two names for the post of Executive Director for SKSE for the consideration and approval of SEBI. The exchange has, however, till date failed to complete the process of appointment of CEO for its subsidiary which is disheartening particularly when the subsidiary has an average daily turnover of Rs. 36 crore.

4.27 It is imperative to mention that the SKSE can commence trading only after establishment of SGF by the exchange and duly approved by SEBI. However, SKSE is yet to initiate any concrete and realistic action towards the establishment of SGF. I have also noted that the members of the exchange continue to concentrate only on their trading in the subsidiary of SKSE, as against developing SKSE or taking steps to revive the trading on the exchange. It also appears that SKSE is not interested in reviving trading on the exchange, if SKSE had been serious about reviving trading on the exchange, it would have prepared itself by setting up a SGF, modified the software to meet the current requirement of the latest trading and settlement cycle system, established connectivity with the depository, etc. Mere existence of a stock exchange without possession of basic requirements to function as a stock exchange would not essentially serve any purpose towards the protection of interest of the investors and public at large as well as development of the capital market as a whole. It will not be out of place to record that SKSE has ceased to perform the basic

economic function for which it was set up as there is no trading since 1998 and no fresh listing of companies. Moreover, the continued existence of the exchange is a regulatory burden on SEBI.

- 4.28 Apart from the serious irregularities observed in the inspection report, I find that there are lapses in the basic functioning and administration of the Exchange in terms of the SEBI directives, circulars, SCRA and SCRR. Further there have also been non-compliances by SKSE of various circulars / directives/ instructions issued by SEBI time and again which displays an apparent disregard for statutory compliance requirements. I believe that it is imperative that an exchange should not only comply with the directives issued by SEBI and the provisions of law, but also ensure the smooth functioning of the exchange in accordance with law, business ethics, corporate governance etc and in tune with the developments of securities market. However, in the instant case, the deficiencies elaborated above are indicators of a stock exchange functioning in a manner against the interest of the public at large.
- 4.29 Considering the current scenario of the capital market, where only those institutions, which are capable of adapting to the rapidly changing market structure, alone can survive, SKSE with the aforesaid inadequacies even in the basic requirements to exist as a stock exchange, would only find itself redundant, especially in view of the absence of any realistic efforts on the part of the Council for the revival of the exchange. If SKSE is allowed to function in the present manner without any immediate remedial action, it would not only lose its relevance as a public institution but also erode the confidence of the investors, which would in turn compromise the orderly development of the securities market.
- 4.30 When the activities of an exchange are carried out contrary to the interest of the investing public and in a manner which is adverse to the interest of the investors, members and the public; the same is bound to injure and damage their interests.

Moreover, failure of the Council to ensure proper governance and implementation of the provisions of the SC(R)A, Bye-Laws of the Exchange and the SEBI directives, circulars etc could erode the confidence of the investors.

- 4.31 The deficiencies and non-compliances brought out supra, proves beyond doubt that SKSE has time and again acted contrary and in defiance of SEBI directives/guidelines issued from time to time. I have noted the prolonged vacuum at the top management, the failure of the exchange to appoint a suitable candidate for the post of Executive Director for the exchange/CEO for the subsidiary, broker's interference in the day-to-day functioning of the Exchange and the ill-functioning of the Council. I have also noted that the members of the exchange are not interested in reviving trading on the exchange and would like to concentrate only on their trading in the subsidiary of SKSE. I have noted that SKSE is virtually defunct for several years and did not serve any economic purpose. Further it provides neither a trading platform nor serve any public interest. In my view, SKSE has ceased to perform the basic economic function for which it was set up.
- 4.32 In view of the above facts and circumstances, and in exercise of the powers conferred upon me under Section 19 read with Section 11 of the Securities and Exchange Board of India Act, 1992 and Section 5(1) of the Securities Contracts (Regulation) Act, 1956, read with the Government of India Notification number F. No. 1/57/SE/93 dated September 13, 1994, I hereby withdraw the recognition granted to SKSE.
- 4.33 In view of this Order, SKSE shall cease to be a recognized stock exchange and therefore, it is imperative to pass necessary directions in the interest of investors/shareholders of the listed companies in SKSE and in the overall interest of the securities market. I, therefore, in exercise of powers conferred upon me under Section 19 read with section 11 of SEBI Act, 1992 and section 5(1) of SCRA pass the following directions:

- 4.33.1 The money available in the Investor Protection Fund and Investor Services Fund of SKSE lying un-utilized shall be transferred to SEBI Investor Protection and Education Fund within 15 days from the date of notification of the order.
- 4.33.2 SKSE shall set aside sufficient funds in order to provide for settlement of any claims, pertaining to pending arbitration cases, pending non-implemented arbitration award, if any, liabilities/claims of contingent nature, if any, and unresolved investors complaints/grievances lying with the exchange, on the date of this Order.
- 4.33.3 The companies which are exclusively listed at the SKSE may consider seeking listing at other stock exchanges or provide for exit option to the shareholders as per SEBI Delisting Guidelines / Regulations.
- 4.33.4 Consequent upon withdrawal of recognition of SKSE, the trading members of SKSE shall cease to be trading members of SKSE and therefore liable to be de-registered as stock brokers, and hence, their certificate of registration granted by SEBI shall stand automatically cancelled. However, the said brokers/trading members of SKSE shall be liable to pay SEBI registration fees as per Schedule III of the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 till the date of this Order.
- 4.33.5 Pursuant to withdrawal of recognition of SKSE, the exchange is directed to refrain from using the expression 'stock exchange' or any variant in its name or in its subsidiary's name.

4.33.6 SKSE is restrained from transferring or alienating any movable or immovable property of the exchange including Bank Accounts in any manner till further directions by SEBI in this regard.

F.No. SEBI/LE/98096/2007

Date : 05.07.2007

Place : Mumbai

T.C. NAIR

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA