

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

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

**AGAINST M/s MODERN SECURITY TRADERS, SUB BROKER
AFFILIATED TO LSE SECURITIES LTD., MEMBER OF NATIONAL
STOCK EXCHANGE OF INDIA LTD.**

ORDER

**(Under Regulation 13(4) of SEBI (Procedure for Holding Enquiry By
Enquiry Officer and Imposing Penalty) Regulations, 2002 against M/s
Modern Security Traders**

1.0 Background

- 1.1 M/s Modern Security Traders (hereinafter referred to as “the sub broker”) is affiliated to LSE Securities Ltd., a member of the National Stock Exchange of India Ltd. (hereinafter referred to as “the NSE”) and is registered with the Securities and Exchange Board of India (hereinafter referred to as “SEBI”) as sub broker under Section 12 of Securities and Exchange Board of India Act, 1992 (hereinafter referred to as “the Act”) with registration number INS231166518
- 1.2 SEBI during the year 2002 conducted an inspection of the books of accounts, documents and other records maintained by the sub broker, under Regulation 19 of the SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 (hereinafter referred to as Stock Brokers

Regulations) and the same was carried out by G. Singla & Co., Chartered Accountants on behalf of SEBI.

- 1.3 Certain irregularities/contraventions of concerned SEBI Regulations were observed during the said inspection. A copy of the findings of the Inspection Report was sent to the sub broker for comments vide letter dated April 1, 2003. However, the sub broker did not reply to the said letter despite several reminders.

2.0 Enquiry Proceedings

- 2.1 On the basis of the findings of the inspection, an Enquiry Officer was appointed by SEBI vide order dated December 16, 2003 was appointed in terms of the provisions of Regulation 5 of the SEBI (Procedure for holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as Enquiry Regulations) to enquire into the irregularities/violations committed by the sub broker. Subsequently vide order dated August 6, 2004 another Enquiry Officer was appointed who proceeded with the issuance of the show cause notice.
- 2.2 A show cause notice dated August 3, 2004 in terms of Regulation 6(1) of the Enquiry Regulations was issued to the sub broker advising it to reply to the allegations within 21 days. The said notice referred to the inspection report of SEBI containing the details of violation of various provisions of law.
- 2.3 An opportunity of personal hearing in the matter before the Enquiry Officer was scheduled on November 04, 2004 at Head Office, Mumbai.

However, the sub-broker did not appear for the aforesaid hearings. Since enough opportunities had been provided to the sub-broker, the Enquiry Officer proceeded on the basis of material available on record.

- 2.4 On completion of enquiry, the Enquiry Officer submitted his report dated November 25, 2004 recommending a penalty of suspension of certificate of registration for a period of six months.

3.0 Show Cause Notice and Reply

- 3.1 In terms of Regulation 13(2) of the Enquiry Regulation, a show cause notice dated December 06, 2004 was issued to the sub-broker advising it to show cause as to why the penalty as considered appropriate including the penalty recommended by the Enquiry Officer should not be imposed upon him. A copy of the Enquiry Report was also forwarded to the sub-broker with the said show cause notice.
- 3.2 The sub-broker vide letter dated December 30, 2004 submitted its reply to the aforesaid show cause notice and interalia made the following submissions :
- (i) *Since they have no clients, maintaining a client record does not arise.*
 - (ii) *They have never collected margin money from client and have done all the dealings through State Bank of India for the year March 31, 2001 and claim that the said information is with inspecting team.*
 - (iii) *As there are no clients, the client duplicate copies/ relevant documents were not required to be maintained and hence it has not violated any provisions.*
 - (iv) *When there are no clients, question of maintaining a formal database does not arise. Hence there is no violation of code of conduct. Further statements and Audit Reports were properly submitted to LSE Securities.*

3.3 The sub broker was granted an opportunity of personal hearing before me on July 14, 2006. However, no one appeared on behalf of the sub-broker. One more opportunity of hearing was given to the sub-broker on February 26, 2007 at Regional Office, New Delhi. Shri Vinod Arora, Proprietor of the sub broker replied vide letter dated February 15, 2007 that he being an aged person is unable to attend the hearing and requested to proceed further on the basis of the record submitted by him.

4.0 Consideration of Issues

4.1 I have carefully examined the facts and circumstances of the case, the inspection report, enquiry report and the submissions of the sub-broker. My findings are as under :

4.1.1 Non maintenance of Books of Accounts.

The enquiry officer has found that the sub broker did not maintain the books of accounts thereby violating the provisions of Regulation 15 and 17 of the Stock Broker Regulations and SEBI Circular dated August 5, 1996. The statements of accounts submitted by the sub broker for the year ended March 31, 2000 and 2001 to the inspecting team were also incomplete. Further the sub broker has not been able to produce any record on the trading done on behalf of the clients. The contention of the sub-broker that since there were no clients, there was no need to maintain the record is not acceptable. The sub broker by not maintaining the books of accounts, has violated Rule 15 of the Securities Contract (Regulation) Rules, 1957. I note that Regulation 15 of the Stock Brokers Regulations cast general obligation on the sub brokers to keep and maintain the books and documents specified under Regulation 17 of the Stock Brokers Regulations. As the sub

broker has not done so, I hold the sub broker guilty of violating the aforesaid circular and provisions of Stock Broker Regulations.

4.1.2 Non segregation of Own and Clients' Bank Account

The enquiry officer has found that no separate client account was being maintained by the sub broker. Further it is not maintaining any margin money from the client. The sub broker submitted that the sub broker was maintaining only one bank account with SBI as per the balance sheet for the year ended March 31, 2001 which was provided to the inspection team. I am of the view that the separation of the clients account and the broker's account had been done to prevent any misuse of the clients money by the broker and it is implemented as an investor protection measure. I note that SEBI vide circular no SMD/POLICY/CIRCULAR/11-97 dated May 21, 1997 had revised the model agreement to be entered between the broker and the sub broker which inter alia states that *"the sub brokers if he holds or receives money on account of a client shall forthwith pay such money to current or deposit account at bank to be kept in the name of sub broker in the title of which the word "client" shall appear. The sub broker may if he / it desires, keep one such consolidated clients account for all the clients or account in name of each client as he thinks fit."* The sub broker in the present case has failed to maintain a strict line of segregation between the client account and its own account.

4.1.3 Non Maintenance of confirmation memos

The enquiry officer has found that the sub broker did not maintain duplicate copies of the confirmation memos issued to the clients and no other record has been maintained and therefore it was not possible for the inspection team to check whether the confirmation memos

have been issued within the prescribed time or not. I note that SEBI vide circular no. SMD/POLICY/CIRCULAR/11-97 dated May 21, 1997 had revised the model agreement to be entered between the broker and the sub broker which inter alia states that “*the member broker shall issue consolidated scrip wise contract notes to the sub-broker in respect of all the scrips traded on behalf of the latter showing execution price of transaction and brokerage separately. The sub-broker, in turn, shall issue split confirmation memos to each of his clients within 24 hours of receipt of contract note from the main broker... ..*”. However after perusal of the inspection report, I find that as per the data obtained from Ludhiana Stock Exchange Association Ltd. (LSEA) during the period April to September 2002, the total turnover of the sub broker on behalf of the clients on NSE was 5.59 crore. Considering the submission of the sub broker that since there were no clients, it was not required to maintain the relevant client duplicate copies or documents is not acceptable..

4.1.4 Non maintenance of Client Database

The enquiry officer has found that neither formal database was maintained by the sub broker nor retained registration forms of the clients. The sub broker submitted that as there were no clients, the question of maintaining a formal database does not arise. I find that the sub broker as per SEBI Circular no. SMD/POLICY/CIRCULAR/11-97 dated May 21, 1997 is obliged to enter into agreements on the pattern of the format forwarded to the stock exchanges vide SEBI circular no. SMD/POLICY/CIR/5-97 dated April 11, 1997 which requires that the sub broker already registered with SEBI had to maintain database of their client /

investor. Considering the turnover of the sub broker on LSEA a benefit of doubt be given to the sub broker.

4.1.5 Non submission of Statement of Accounts

The enquiry officer has found that the sub broker did not submit statement of accounts or audit report for the year ended March 31, 2002 which should have been submitted latest by September 30, 2002. The Enquiry Officer has further observed that the balance sheet for the years ended March 31, 2000 and March 31, 2001 were also incomplete which is a violation of SEBI Circular no. SMD/SED/0072/92 dated December 31, 1992 wherein it is mandatory that the audit report for a financial year is to be submitted by September 30 for the next financial year.

4.1.6 On careful perusal of the charges and the findings, I find that the sub broker by not maintaining the books of accounts and records, non segregation of client funds from its own account, maintenance of client database, copies of confirmation memos, has violated the Stock Brokers Regulations and various SEBI circulars. I find that the above mentioned lapses have to viewed seriously to protect the interest of investors in the securities market. I am of the view that a penalty of suspension of certificate of registration for a period of six months as recommended by the Enquiry Officer would be excessive. However, I note that in terms of SEBI Circular dated August 26, 2004 and March 31, 2005 on uniform documentary requirements, a sub broker henceforth is not authorized to handle clients money as also issue contract notes / securities. Since the violations / irregularities are technical and procedural therefore a penalty of suspension of

certificate of registration for a period of fifteen days would be sufficient to meet the ends of the justice.

5.0 Order

5.1 Now, therefore, in exercise of powers conferred vide Regulation 13(4) of SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby impose a penalty of suspension of the Certificate of Registration for a period of fifteen days on M/s Modern Security Traders , sub broker affiliated to LSE Securities Ltd., INS 231166518.

5.2 This order will come into force on the expiry of 21 days from the date of this order.

Date: 7.08.2007

Place: Mumbai

T. C. Nair
Whole Time Member
Securities and Exchange Board of India