

**BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA
CORAM: Dr. T.C.NAIR, WHOLE TIME MEMBER**

**IN THE MATTER OF M/s SMC GLOBAL SECURITIES LTD.,
MEMBER, NATIONAL STOCK EXCHANGE OF INDIA LIMITED,
REGN. NO. INB230771431**

ORDER

(Under Regulation 13(4) of SEBI (Procedure For Holding Enquiry By Enquiry Officer and Imposing Penalty) Regulations, 2002 against M/s SMC Global Securities Ltd.

1.0 Background

1.1 Securities and Exchange Board of India (SEBI) had conducted investigations into the dealings in the scrip of DSQ Biotech Ltd. (hereinafter referred as 'DSQBL') for the period from September 2000 to January 2001 at the National Stock Exchange of India Ltd. (NSE) and from July 2000 to November 2000 at the Bombay Stock Exchange Ltd. (BSE) to enquire into the alleged role of SMC Global Securities Ltd.

1.2 During the investigations, it was noticed that the company DSQBL had increased its share capital by making a preferential issue in 2000. It was observed that prior to and after the period of the issue i.e. between December 1999 to January 2001, abnormal activity in the scrip was noticed by the NSE and the BSE accompanied by a large number of structured deals wherein the buy and the sell clients were related entities.

- 1.3 At NSE, during the period December 1999 to April 2000, it was observed that the scrip was traded on 16 days rolling period out of the 99 days. The major clients in the cross deals were DSQ Industries, Square D Textiles, and Pilliyar Pattiyar Textiles Ltd., DSQ Holdings, etc. They were seen to be major buyers upto February 23, 2000 and then as consistent and heavy sellers from the period beginning February 24, 2000. At BSE during the same period, synchronised trades were entered by 12 brokers on behalf of entities relating to the DSQ group and that these synchronised trades accounted for 68.29% of the market volume during the period, and the percentage of these trades to the particular day's trading was to the extent of 21%- 100%.
- 1.4 At NSE, during the period September 2000 to January 09, 2001, it was observed that the top 15 brokers had traded on behalf of the entities of the DSQ Group and these clients had accounted for a sizable portion upto 62% of the gross quantity traded and net quantity traded in the scrip ranging from 34% on the buy side and 97% on the sell side during the aforesaid period. Further cross deals and structured deals were executed between brokers during the aforesaid period which accounted for approx. 7.24 % of the gross traded quantity in the scrip during the period under scrutiny.
- 1.5 The volume in the scrip during the above mentioned period was attributed to the synchronised trades and fictitious trades executed by the entities through accommodating brokers. Further, it was seen that trades were also used to avail of the finance from the stock exchange mechanism. The brokers also connived with the DSQ Group to trade and offload unlisted preferential shares into the market.

- 1.6 M/s. SMC Global Securities Ltd, (hereinafter referred to as “SMC”/ “the broker”) member of NSE 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 SEBI Act”) alleged to have entered synchronised transactions for the client at both the exchanges. It was alleged that the broker had actively aided and abetted the client in creation of the false market in the scrip by executing the transactions without the intention to transfer the beneficial interest in the securities.

2.0 Enquiry Proceedings

- 2.1 Pursuant to the investigation, an Enquiry Officer was appointed, vide order dated July 07, 2005, under Regulation 5 (1) of the SEBI (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as “the Enquiry Regulations”) to enquire into the dealings of the broker in the scrip of DSQBL and possible violations of SEBI (PFUTP) Regulations and Stock Brokers Regulations.
- 2.2 The enquiry officer conducted enquiry in terms of Enquiry Regulations and found that the broker had failed to exercise due care and diligence in dealing with its clients and therefore violated Clause A (2) of Schedule II read with Regulation 7 of SEBI (Stock Brokers and Sub Brokers) Regulations, 1992 read with circular dated November 18, 1993.
- 2.3 On completion of enquiry, the Enquiry Officer submitted his report dated October 18, 2006, recommending a minor penalty of censure to SMC.

3.0 Show Cause Notice and Reply

3.1 A copy of the enquiry report along with show cause notice dated November 7, 2006 was forwarded to SMC in terms of Regulation 13 (2) of the Enquiry Regulations advising it to show cause as to why appropriate penalty including penalty as recommended by the Enquiry Officer should not be imposed on it.

3.2 SMC replied to the aforementioned show cause notice, vide letter dated November 24, 2006 and inter-alia made the following submissions :

- (i) SMC insisted that they had exercised due skill, care and diligence at the time of induction of their clients. They had obtained Know Your Client Form as prescribed by SEBI and executed Client Agreement in the proper format. They further stated that in their KYC form one of the fields required to be filled in by the client in the information memorandum includes the number of brokers the client is doing business with. In case of the said clients, no information was filed by them. It was presumed that they are not dealing through multiple brokers. Non submission of details by clients even when asked for cannot be found as lapse on their part.
- (ii) As the clients had not given the relevant particulars they had not contacted the previous broker to get an opinion from him about the dealings of the said clients.
- (iii) The said clients honoured their financial commitments at the relevant time and they were not aware of the fact that their clients were doing business in association with other entities in DSQ scrip through other brokers also. Hence they submitted that there

was no lack of due diligence to be exercised by them in dealing with the aforesaid clients.

- (iv) They further reiterated that their clients have honoured their financial commitments at the relevant time and hence have not violated guidelines issued vide SEBI Circular dated November 18, 1993 and Clause A(2) of the Code of Conduct prescribed in Stock Brokers Regulations.

4.0 Consideration of Issues

- 4.1 I have carefully considered the investigation report, the show cause notice issued to SMC and the Enquiry Report and the submissions of SMC. The issue that arises for examination is whether SMC has exercised due skill and care in dealing in the scrip of DSQBL on behalf of 16 clients during the investigation period. My findings are as under:
- 4.2 I note that SMC dealt in the scrip of DSQBL for 16 clients at the NSE during the period September 2000 to January 2001. The total quantity traded by SMC during the period was 5406558, which constituted 2.53% of the total market volume. The dealings of SMC for its various clients during the period on the NSE is as under:

Client	Gross Buy	Gross Sell	Gross Trade	Net Buy	%
Arun Polymers Pvt. Ltd.	720000	0	720000	720000	0.34
Cooltex Commodities Pvt. Ltd.	1195000	0	1195000	1195000	0.56
Harish Chandra Biyani	360000	0	360000	360000	0.17
O K Gupta	3000	13520	16520	-10520	0.01
V V Investment	5500	5500	11000	0	0.01
Apan Investment	11901	11641	23542	260	0.01
Aspolight Barter	710000	0	710000	710000	0.33

Client	Gross Buy	Gross Sell	Gross Trade	Net Buy	%
Jayambay Share Broking	11900	11900	23800	0	0.01
Joel Securities	80928	80928	161856	0	0.08
S Krishna & Co.	8333	8969	17302	-636	0.01
Share Bazar Finance Services	5500	5550	11050	-50	0.01
Share Line	34484	51559	86043	-17075	0.04
SRB Financial Services	11000	0	11000	11000	0.01
Subhra Jain	19000	28000	47000	-9000	0.02
Svan Securities P. Ltd.	1269508	443519	1713027	825989	0.80
Vardhaman Associates	13000	13000	26000	0	0.01

4.3 The Enquiry Officer found that the clients Arun Polymers, Aspolight Barter, Cooltex Commodities have been introduced by DSQ Holdings Ltd. With regard to other 13 clients in the above table, there was no charge pointing out the nexus in the show cause notice which gives an inference that SMC was also trading for other clients both buying and selling. The buying was restricted to only 3 clients namely Arun Polymers Pvt. Ltd., Cooltex Commodities Pvt. Ltd. and H. C. Biyani who were supposedly related entities. SMC submitted that as per the show cause notice the volume of business in DSQBL was 2.53% of the total market volume, which was insignificant and meager during the relevant period and therefore it cannot contribute to artificial trading to have any impact on the price. In the context of allegations of offloading of unlisted preferential shares into the market, SMC submitted that the fact deliveries were taken from the market by the clients is a pointer of genuine transactions and is contrary to the allegation of fictitious transactions and offloading of unlisted shares. Considering the submission and the trading pattern of the broker, I agree with the enquiry officer that the broker cannot be held responsible for offloading of unpaid and unlisted shares, as it was only buying the shares of DSQ.

4.4 With regard to the charge of synchronised transactions and circular trading, the Enquiry Officer found that the three clients namely Arun Polymers Pvt. Ltd., Cooltex Commodities Pvt. Ltd. and H. C. Biyani were related entities who had purchased the shares through the broker. I am of the view that although the trades may be synchronized by the clients, the charge of circular trading can not be levied against the broker as it was only buying and the client was taking delivery of shares. It was however, possible to levy this charge if it is proved that there was a nexus of the broker with the client and the counter party selling broker. There is nothing on record to prove the same. It is a settled position of law that synchronization of trades *per se* are not illegal unless they are manipulative or otherwise declared as fraudulent.

4.5 The Enquiry Officer further found that Arun Polymers Pvt. Ltd. and SMC Global Securities Ltd. appeared in the list of persons acting in concert with the company, DSQBL. I have noted the submission of SMC that it has nothing to do with DSQBL and that they are doing only brokerage business. Further two of the clients of SMC namely, Essel International and Aroma Securities also appeared in the list of promoters of DSQBL. To this SMC replied that as far as their knowledge is concerned these two clients are not the promoters of the company. In support of this the broker has also filed affidavits of the said clients inter alia denying their association with the company / directors directly or indirectly.

4.6 From the facts and circumstances of the case, I do not find any basis on which the entities were shown as persons acting in concert (PAC), neither the SCN deals with the basis on which the broker can be

regarded as PAC to DSQ. From the enclosures of the said letter, it is observed that the only basis which is possible is that the broker was holding 191235 shares of DSQ. In this regard the broker submitted during the personal hearing that out of 191235 shares they were holding only 23000 shares as an investment and rest were held for the client Aspolight Barter Pvt. Ltd as margin, and it can not be a basis for declaring any person as PAC. I am also of the view that for a person to be PAC, he should satisfy conditions as laid down in SAST Regulations in the definition of PAC, which is found missing in the instant matter. I would rather say that there is no independent investigation findings suggesting the broker as PAC. I am therefore not inclined to accept that the broker was PAC of DSQBL.

4.7 It is alleged that the clients Harish C Biyani, Arun Polymers P. Ltd. and Cooltex Commodities Pvt. Ltd. had dealt through other brokers also in this scrip during the period September 2000 to January 2001. When enquired from the broker whether as part of their due diligence they had sought to know whether the client was also operating through other brokers in the scrip the broker stated that they were not aware whether the client was dealing with any other brokers and also that they did not pose any query on this aspect to the clients.

4.8 I note that the induction of the client by a broker requires the exercise of due care and diligence. The information about the clients acting through multiple brokers is required to be captured during the process of the induction of the client for doing business with the broker. In the KYC forms, as one of the fields required to be filled in by the client in the information memorandum includes the number of brokers the clients is doing business with, it is mandatory for the broker to collect this information from their clients before granting them permission to

trade. I find it to be a lapse on the part of the broker not bothering for this information from the client.

4.9 I further note that in 1993, SEBI had issued guidelines dated November 18, 1993 regarding the precautions to be exercised by the broker in dealing with clients. It was mentioned therein that as per clause (b)(iv) the brokers are required to exercise extra caution while dealing with client registered with multiple brokers. This was important so that the broker can ascertain the levels of trading and services to be granted to the client. The very fact that the broker did not bother to have this information leaves me in no doubt that there was a lack of due diligence exercised by the broker in dealing with clients.

4.10 I find that these transactions executed by the broker were merely entered to facilitate the financing transaction of the counterparty associated/related clients, which were given the colour of sale and purchase of shares on the stock exchanges. While in the ordinary course of settlement the proceeds of the sales would be due to be paid by the broker to the client only after the pay-out declared by the exchange, on the buy side the payment for the buy position has to be made before the pay-in, which always precedes the pay out. By employing this mechanism, the brokers were able to bail out the entities by entering into fictitious transactions and allowing the entity to trade without involving its own money which it would have to arrange if it had not got the advance payment from the selling brokers. In this regard, I do not find any relevance of the above stated charge with respect to the broker as it was only buying the shares for the related clients and not making any advance payments against the delivery of the shares.

4.11 On careful perusal of the charges and the findings, I find no reason to defer with the findings of the Enquiry Officer. Considering the circumstances of the case, imposition of penalty of censure would be adequate to meet the ends of justice.

5.0 Order

5.1 Therefore, in exercise of the powers conferred upon me by virtue of Section 19, read with Regulation 13(4) of SEBI (Procedure For Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, I hereby 'Censure' M/s SMC Global Securities Limited, Member, NSE, to the effect that SMC should be careful in future and exercise due care and diligence in the conduct of its affairs as a capital market intermediary. I also direct SMC to note that any instances of violation or non-compliance with the SEBI Act, Rules and Regulations in future shall be dealt with stringently.

Date: 01.01.2008

Place: Mumbai

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