

SECURITIES AND EXCHANGE BOARD OF INDIA**CORAM: G. ANANTHARAMAN, WHOLE TIME MEMBER****ORDER AGAINST M/S KHANDWALA SHAH & ASSOCIATES, SUB BROKER, UNDER REGULATION 13(4) OF SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING ENQUIRY BY ENQUIRY OFFICER AND IMPOSING PENALTY) REGULATIONS, 2002.**

- 1.1 M/s Khandwala Shah & Associates (hereinafter referred to as the sub-broker) is registered with Securities and Exchange Board of India (hereinafter referred to as 'SEBI') as a sub-broker affiliated to M/s Prakash K. Shah Shares and Securities Pvt. Ltd., [Member, Bombay Stock Exchange Ltd. (BSE)].
- 1.2 SEBI vide order dated October 20, 2000, conducted an inspection of the books of accounts, documents and other records of the sub-broker for the period 1999 – 2000 and 2000 – 2001, till the date of inspection. Some of the irregularities observed during the inspection are the following:
 - a. The sub broker had not maintained the document register for the delivery of physical shares.
 - b. The counterfoil or duplicate copies of Purchase or Sale Notes (PSN) were not maintained.
 - c. The sub broker had not segregated own funds and clients funds
 - d. The sub broker executed off the floor transactions
 - e. Non payment of annual registration fee for the year 1999 – 2000.
- 1.3 SEBI forwarded the copy of the inspection report to the sub broker for its comments. The sub broker filed its comments to the said inspection and thereafter, SEBI vide order dated September 16, 2002 read with a subsequent order dated January 22, 2003 appointed an Enquiry Officer under the provisions of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (hereinafter referred to as the Enquiry Regulations) to enquire into the alleged irregularities/ deficiencies committed by the sub-broker. The Enquiry Officer conducted the proceedings in terms of the provisions of the Enquiry Regulations and vide report dated December 21, 2004 recommended to cancel the certificate of registration of the sub broker.
- 2.1 SEBI issued a notice dated January 14, 2005 to the sub-broker in terms of the Enquiry Regulations asking it to show cause as to why appropriate penalty including the penalty as recommended by the Enquiry Officer should not be imposed against it. The sub-broker submitted its reply to the said show cause notice, vide letter dated February 09, 2005. The sub broker inter alia stated that the penalty had been recommended despite the fact that its application for cancellation of the certificate of registration was pending with SEBI. The sub-broker further added that, it had adequately maintained proper books for record purpose and maintained the document register. According to the sub broker, it had maintained the inward and outward register of shares transacted by it in addition to the record of receipt /delivery of shares from/ to clients as well as from / to the stock broker. The sub broker further stated in respect of shares and securities received and / or delivered in physical form that, it had maintained records such as delivery book in which details of the physical shares delivered to the clients on pay-out was specified, a file consisting of covering letter accompanying physical shares delivered by client on their pay-in obligation etc.
- 2.2 The sub broker submitted that, though it had maintained only one account with the bank, the operation of clients fund and income / expenditure was segregated in its books of account in such a manner so that the client fund was accounted for the transaction executed by them. The sub broker claimed that it had maintained the records of dispatch / acknowledgement of Purchase or Sale Notes (PSN). According to the sub broker, it had undertaken cross deals only in few instances and that too among client's family accounts. The sub broker stated that it had entered into internal badla financing transaction during the year 2000-2001 and had charged the badla rates as published in the BSE Bulletin. The sub broker contended that it had not violated the provisions of Securities and Exchange Board of India Act, 1992 and the Rules/ Regulations/ Circulars framed thereunder. The sub broker urged that the recommended penalty was excessive in nature.
- 2.3 SEBI granted an opportunity of hearing to the sub broker on December 1, 2006. Shri Gaurav Joshi, Advocate, alongwith Deepak Shah, Advocate and Sanjay Shah (Partner of the sub broker) made submissions before me. The submissions were made on the lines of the sub broker's reply dated February 9, 2005. He also pointed out that SEBI had taken a lenient view against various intermediaries in respect of similar violations.
- 2.4 I have perused the Enquiry Report, the show cause notice issued to the sub broker, the oral as well as written submissions made on behalf of the sub broker and other available materials on record. I note that the Enquiry Officer in his report had inter alia observed that the sub broker had failed to maintain the proper books, such as document register for record

purpose. The sub broker in its reply before me contended that it had adequately maintained proper books for record purpose and maintained the document register wherein the particulars of shares and securities received / delivered had been duly recorded during the period under inspection. Though, the sub broker contended that it had maintained various records, the inspection conducted by SEBI had observed that, it had not maintained the document register for the delivery of physical shares. In terms of Regulation 15 (2) of the Broker Regulations, a sub broker is inter alia duty bound to keep and maintain various documents as mentioned in Regulation 17 thereof. The sub broker could not satisfactorily explain that it had maintained the same (document register) during the period covered under the inspection. The non - maintenance of the document register by the sub broker is a deficiency precluding ascertainment of delay, if any, in deliveries of physical shares. Therefore, it is fairly established that the sub broker had violated the provisions of Regulation 15 (2) read with Regulation 17 of the Broker Regulations.

2.5 The Enquiry Officer also observed that the sub broker had not segregated client's funds and its own funds as required under SEBI circular dated May 21, 1997. The sub broker submitted before me that, though, it had maintained only one account with the bank, the operation of clients fund and income/ expenditure was segregated in its books of account in such a manner so that the client fund was accounted for the transaction executed by them. In terms of SEBI circular dated May 21, 1997 a sub broker inter alia shall segregate clients fund from its own funds. It was specified in the aforesaid circular that, under no circumstances, a sub broker shall mix the funds received from or payable to the one member broker with that of another member brokers. In the present matter, the sub broker had not maintained separate bank accounts for the transactions related to the clients. Therefore, it is established that the sub broker has violated SEBI circular dated May 21, 1997.

2.6 In respect of the non issuance / irregularities in the issuance of PSN, the sub broker submitted that it had maintained records of dispatch/ acknowledgement of PSN regularly. According to the sub broker, it had preserved soft copies of PSN instead of duplicate copies. As per clause B(2)(b) of the Code of Conduct for sub brokers (as existed at the relevant time) specified under Regulation 15 of the Securities and Exchange Board of India (Stock Brokers and Sub- Brokers) Regulations 1992, 'a sub broker shall issue promptly to his clients scrip wise split purchase or sale notes and similarly bills and receipts showing the brokerage separately in respect of all transactions in the specified form'. Further, as per B(6) of the aforesaid Code of Conduct (as existed at the relevant time), 'a sub broker, when dealing with a client, shall disclose that he is acting as an agent and shall issue appropriate purchase/ sale note.....' Admittedly, the sub broker had not maintained the duplicate copies of PSN and instead it had preserved only the soft copies of the same. Therefore, it is fairly established that the sub broker had violated the aforesaid B(2)(b) and B(6) of the Code of Conduct for Sub brokers specified under Regulation 15 of the Securities and Exchange Board of India (Stock Brokers and Sub- Brokers) Regulations 1992 (for short, Broker Regulations).

2.7 It is an admitted case that the sub broker had undertaken transactions of internal matching of transactions among client's family accounts, in violation of clause B (2) (d) of the Code of Conduct (as existed at the relevant time) specified under the Broker Regulations. I also note that the sub broker had executed illegal carry forward transactions. SEBI vide circular dated October 16, 1995 had permitted the modified carry forward transactions subject to the fulfillment of certain conditions by the stock exchanges. Some of the conditions are the following :

- a) The financiers funding the carry forward transactions being lenders of funds should not permitted under any circumstances to square up their positions till repayment of the loan and the shares received by such Financiers against those transactions should be deposited and kept in safe custody of the clearing house of the stock exchange/ or its Authorised Agent.
- b) The carry forward position shall be disclosed to the market scrip-wise and broker-wise by the Stock Exchanges ant the beginning of the carry forward session.

2.8 However, in the present matter, I note that by indulging in in-house carry forward transactions, the sub broker violated all the above conditions stipulated by SEBI for modified carry forward transactions and also violated Clause B (2) (d) of the Code of Conduct (as existed at the relevant time) specified in the Broker Regulations.

2.9 Thus, it is reasonably established that the sub broker had violated the provisions of the Act read with the provisions of the Broker Regulations and the SEBI Circulars, as specified. As an intermediary operating in the securities market, the sub - broker is duty bound to comply with the statutory provisions including various circulars issued by SEBI from time to time. He has a duty towards the securities market. The various requirements under the Act and Regulations in respect of an intermediary are conceived in the interests of investor protection and further to ensure that the business and conduct of the intermediaries are undertaken on the basis of sound business principle. An intermediary is inter alia required to maintain high standards of promptitude and fairness while conducting his business. Taking into account, the circumstances of the present case, the non compliance of statutory requirements on the part of the part of the sub - broker calls for a penalty as ordered hereinunder.

3.1 In view of the foregoing, I, in exercise of the powers conferred vide regulation 13(4) of Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002, hereby impose a minor

penalty of censure on the sub broker viz. M/s Khandwala Shah & Associates, (Registration number INS 010228224).

G. ANANTHARAMAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date: February 21, 2008