

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

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

ORDER

UNDER REGULATION 28 (2) OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008 AGAINST MEHTA EQUITIES LTD. (FORMERLY KNOWN AS RENAISSANCE SECURITIES LTD.), DEPOSITORY PARTICIPANT.

Date of Hearing: March 26, 2008

Appearance:

For noticee:

Shri Ashish Sharma, Director, Mehta Equities Ltd.
Shri S.K. Gogia.

For Securities and Exchange Board of India:

Shri Vijayakrishnan G., Asst. Legal Advisor
Shri Debashish Bandyopadhyay, Asst. General Manager

1.1 Mehta Equities Ltd. (formerly known as Renaissance Securities Ltd.) is registered with Securities and Exchange Board of India (for short, SEBI) as a stock broker and also as a Depository Participant. The said Mehta Equities Ltd. is hereinafter referred to as RSL for the sake of brevity. In respect of the depository participant operations of RSL, SEBI received certain complaints from one Shri Paras Ram Baheti (Beneficial Owner Account No.: 12013700002726) and Smt. Shakuntala Devi Baheti (Beneficial Owner Account No.: 120137000002707). In the said complaints, it was inter alia stated that they had not received dividends with respect to the shares of Ranbaxy Laboratories Ltd. held by them in their respective beneficial owner accounts. In view of the above complaints, SEBI conducted an inspection at the Udaipur branch of RSL during September 2004 in respect of their depository participant operations and the

possible violations of the provisions of Securities and Exchange Board of India Act, 1992 (Act) and Securities and Exchange Board of India (Depositories and Participants) Regulations, 1996 (said Regulations). Simultaneously, SEBI also conducted an inspection at the Head Office of RSL at Mumbai. A brief summary of the observations of the aforesaid inspections are as under:

- a) Instruction slips were executed without signature of the beneficiary owners. In many cases Debit Instruction Slips (DISs) were missing or valid DIS was not found.
- b) Providing doctored, fabricated, fraudulent statement / holdings to clients; Securities were fraudulently unauthorisedly transferred to various brokers / sub-brokers on account of trading transactions undertaken at the office of RSL.
- c) Non-monitoring of practices and not carrying out periodical operational review, evaluation of Udaipur branch office and various other branch offices.
- d) Non-reporting of violations relating to unauthorized transactions carried out at Udaipur office to the competent authorities.
- e) Irregularities in demat account opening.
- f) Delegation of Depository Participant operations to sub-broker without approval from competent authorities and non-segregation between broking /sub-broking activities and DP operations.
- g) Violation of various clauses of Code of Conduct viz. Clauses 1,2,3,4,5,14,15,16,17,19,20 specified in Schedule III of the said Regulations.

1.2 Prior to the aforesaid inspections, Central Depository Services Ltd. (CDSL) had also conducted an inspection of the Depository Participant activities of RSL through M/s.D.R. Mohnot & Co for the period January 2003 to September 2003. The said inspection report (dated September 29, 2003) was forwarded to RSL by CDSL vide letter dated October 8, 2003. Pursuant to the same, an internal audit of the Udaipur office of RSL was also undertaken by M/s. Sagar Golcha & Co.

2.1 Thereafter, SEBI appointed an Enquiry Officer vide order dated January 25, 2006 under the then existing 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 violations committed by RSL. The Enquiry Officer, after

considering the submissions of RSL, vide report dated September 5, 2006 recommended to debar its Udaipur Branch from carrying out their activities for a period of 4 months.

2.2 Pursuant to the Enquiry Report, a notice dated September 22, 2006 was issued to RSL asking it to show cause as to why the action as considered appropriate should not be taken against it. RSL, vide letter dated October 5, 2006 inter alia stated that CDSL had introduced the requirement of maker checker only in July 15, 2004. RSL claimed that the alleged violations were located only in their Udaipur Branch and that they had already suffered severally for the said violations. RSL further contended that the internal control system followed in their Udaipur branch was similar to the one which was prevalent in their other branches. According to RSL, it had carried out the depository participant operations in accordance with the said regulations /guidelines issued by CDSL from time to time. RSL submitted that as soon as the fraud came to its notice, it had discontinued the depository participant operations at its Udaipur branch from the premises of the sub broker and thereafter the depository participant operations were centralized at its head office at Mumbai after CDSL's approval. RSL added that after the centralization of operations at Mumbai, it had closed down the operation of its Udaipur branch.

2.3 An opportunity of hearing was granted to RSL on March 26, 2008. Shri Ashish Sharma, Director of RSL appeared and made submissions before me on the said date. Shri S.K. Gogia, Advisor to RSL was also present at the time of hearing. While admitting the alleged violations, Shri Ashish Sharma inter alia stated that the business activities of RSL is centralized at their Head Office at Mumbai and the Udaipur Branch, at present, is acting only as a collection centre. He also submitted that, RSL had made good the losses suffered by the investors by depositing shares in the respective accounts of various Beneficial Owners and that it had redressed the grievances of the investors. He further requested to take a lenient view in the matter. Though, the said Enquiry Regulation was

repealed with effect from the notification of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, anything done and any action taken under the said Enquiry Regulations shall be deemed to have been done or taken or commenced under the corresponding provisions of Securities and Exchange Board of India (Intermediaries) Regulations, 2008. Therefore, I proceed with the matter in terms of the provisions of Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

2.4 One of the allegations leveled against RSL was that it had transferred the securities belonged to various investors out of their account, without their necessary instructions and that the said securities were transferred out of the beneficial owner account without the DIS. The inspection conducted by SEBI noticed that the same person was authorized to enter the data and verify and release the same at the Udaipur branch of RSL. Further, there were certain other instances at its Mumbai Office where neither the maker nor the checker signed the DIS. Some of such instances are as under:

S.No.	DIS No.
1.	93728
2.	106821
3.	83292
4.	93762
5.	93729
6.	87294
7.	106785

S.No.	DIS No.
8.	66981
9.	98524
10.	75272
11.	85329
12.	29043
13.	67297
14.	93832
15.	79951

S.No.	DIS No.
16.	67652
17.	48162
18.	79932
19.	67657
20.	65501
21.	67046

2.5 The inspection carried out on RSL observed that the Depository Participant operations of RSL at Udaipur branch were mainly looked after by one, Shri Sunil Kumar Sharma and Shri Vikas Mehta (directors of Liberty Stock Links Pvt Ltd.{sub broker of RSL}) and one Shri Nikhil Arya, since April 2002. Though, there were 702 active Beneficial Owner accounts in the Udaipur branch of RSL

for the period January 2003 to August 2003, admittedly only one employee managed the entire Depository Participant operations of the branch. The inspection conducted by M/s. D. R. Mohnot on RSL (for the period January 1, 2003 to September 9, 2003) observed that the person in charge of depository participant operations of RSL at its Udaipur branch was Shri Sunil Sharma who was also the authorized signatory and the compliance officer. Even the internal auditors, Sagar Golchha and Co. had confirmed in their report that two persons were authorized to access the Centralised Depository Accounting System (CDAS). However, the names of the said two persons were not given in the said report. Instead as stated above, Shri Sunil Sharma was only shown as the person in-charge of the depository participant operations of RSL of its Udaipur branch. Thus, only one person Shri Nikhil Arya was authorized to do all the activities of RSL at its Udaipur branch. He was found doing DIS entry, verification and releases etc. This can be seen on a perusal of DIS slips enclosed with the inspection report. Though, at the end of instruction slips, there were provision for the verification (by the office of the Depository Participant) of the signature of the Beneficial Owner and various other details entered into by him, I note that the same were not followed by the Udaipur branch of RSL. The heads 'signature verified by' and 'transaction entered by' were verified by Shri Nikhil Arya alone. The inspection conducted by SEBI revealed that some of the data pertaining to DIS were entered into by one Shri Vikas Mehta who also released the same into the CDSL system without following the maker and checker system. Thus, the Udaipur branch of RSL had miserably failed to comply with the maker checker concept, which was made to ensure the accuracy of the data and as a mechanism to check the unauthorized transactions. It is fairly established that RSL had failed to check the processes to be carried out by persons on jobs in the day-to-day activity. The essence of assigning different people to handle separate tasks reduces the chances of mis-appropriation, frauds etc and helps in controlling their activities. Failure to adhere to this rule can lead to fraudulent practices as was admittedly happened in the case of RSL, where, despite two people being authorized to look after the depository participant operations, only

one person viz. Shri Nikhil Arya alone was entrusted with all the activities, including DIS entry, verification and release.

2.6 In terms of Regulation 20A of the said Regulations, (inserted vide an amendment with effect from October 1, 2003), all participants are required to abide by the Code of Conduct as specified in Clause 16 of the Third Schedule of the said Regulations which in turn reads as under :

“A participant shall follow the maker checker concept in all its activities to ensure the accuracy of the data and as a mechanism to check unauthorized transactions.”

2.7 According to RSL, CDSL had introduced the maker – checker concept only as per its circular dated July 15, 2004. However, I am unable to accept such plea in the facts and circumstances of the present case. The maker checker concept was already in existence in Schedule III (Clause 16) of the Code of Conduct specified in the said Regulations since October 2003 and that the same was made mandatory as per Regulation 20 A of the said Regulations. As per Clause 16, a Depository Participant shall follow the maker checker concept in all of its activities to ensure the accuracy of the data and as a mechanism to check unauthorized transactions and a Depository Participant shall comply with the same in the interest of investors. Further, CDSL vide circular dated July 15, 2004 inter alia has stipulations that Depository participants should exercise caution while accepting instruction slips and should execute transactions emphasizing the requirement of two officials trained at CDSL, separately, to verify the correctness of the signatures on the instruction slips. The contention that, at the time of irregularities there was no guidelines issued by CDSL, cannot be accepted in the facts and circumstances of the case. The objective of maker checker concept was clearly spelt out in clause 16 (as stated above) and one cannot ignore the same. In the present case, the non compliance of the maker checker concept admittedly led to the large scale irregularities/loss to the

investors. Such non compliances should not be viewed lightly, especially when RSL was aware of such irregularities through the inspection conducted by CDSL way back in 2003 and the report of which was made available to it by CDSL in October, 2003. Despite such observations made I the said report, no corrective steps were taken by RSL to cure such deficiencies / irregularities even after the lapse of one year. Thus, RSL had failed to comply with Regulation 20A read with clause 16 of the Code of Conduct specified in Schedule III of the said Regulations.

2.8 Further, I note that the Enquiry Officer had pointed out various irregularities which were observed during the course of inspection and were further explained in the show cause notice issued by her. Some of the irregularities were, transfer of securities without valid DIS, intra adjustments without obtaining the requisite DIS slip, fabrication of holding statement etc. The instances of fabrication of holding statements (some of them) are reiterated below for the sake of reference.

Name of the Investor, Beneficial Owner with ID	Details as per the fabricated /fraudulent holding statement	Details as per correct Transaction Statement obtained from CDSL
Smt Shakuntla Devi Baheti 1201370300002726	Fraudulent holding statement dated June 05,2004 showing 902 Ranbaxy Laboratories Ltd. shares	Transaction statement from June 23, 2001 till June 23, 2004 reflecting that all the Ranbaxy shares were debited between August 1, 2003 and October 10, 2003.
Shri Paras Ram Baheti 1201370300002707	Fraudulent holding statement dated June 05, 2004 showing 2288 Ranbaxy laboratories Ltd. shares	Transaction statement from April 01, 2002 till July 05, 2004 reflecting that all the Ranbaxy shares were debited between June 16,2003 and December 9, 2003.

2.9 As per Regulations 42(2) and 42(3) of the said Regulations, a Depository Participant inter alia shall register the transfer of the securities to and from the Beneficial Owners account only on receipt of the instructions from him (and confirm the same to the Beneficial Owner in the specified manner). The same should also be supported by the electronic instructions or any other mode of instruction received from the Beneficial Owner, as per the terms of the agreement. Thus, the transfer of securities from one account to another account can be made only on the basis of instructions received from the respective

Beneficial Account holder, as specified in Regulation 42(2) and 42(3) of the said Regulations.

2.10 Further, there were fraudulent transfers of securities (45) by using fake DIS slips which were explained in detail in the Enquiry Report. The Enquiry Officer had also explained various fraudulent transfers taken place at Udaipur branch of RSL since February 2003 *inter alia* through MPS Securities (Sub Broker of RSL), Capman Capital Market Ltd. etc. Though, the instances of such fraudulent transfers had been explained in detail in the Enquiry Report, RSL could not give any explanation in this regard. The large scale irregularities admittedly took place at the Udaipur branch of RSL went unnoticed. This shows the lack of proper control measures and absence of systems in place and also lack of supervision by RSL. RSL had even failed to furnish the statement of accounts to the Beneficial Owners and the same was furnished only when sought for by the Beneficial Owners. In terms of Regulation 43 of the said Regulations, providing the transaction statement / statement of accounts is one of the mandatory requirements to be complied with by a Depository Participant. Thus, RSL violated the provisions of Regulation 43 of the said Regulations. Even the various reports of CDSL including one dated October 8, 2003 (in respect of an inspection conducted by D. R. Mohnot & Co for the period from January 01, 2003 to September 09, 2003) corroborate the said violations. Some of the observations in the said reports are as follows:

- Most account opening forms were not properly filled.
- The authorized signatory has not signed the agreements in some cases.
- The transaction statements were issued to the Beneficial Owners as and when demanded by them. RSL had not issued the transaction statements to all the Beneficial Owners at the required intervals.
- RSL had not furnished the audit report for the half year ended December 31, 2002.
- Many instances were found where the delivery instruction slips were executed without the Beneficial Owners' signature on the slips.

2.11 In addition to the above instances of violation, I note that RSL had also not followed various procedures while opening the Beneficial Owner accounts, as stipulated in SEBI Circular dated August 4, 2000. Some of the irregularities such as non verification of identity and address proof with the original, non obtaining of identity and address proof etc. were explained in detail in the Enquiry Report. RSL failed to controvert such observations, before me. In terms of the SEBI Circular dated August 4, 2000, *inter alia*, all applicants (the beneficial account owner) are required to carry original documents as specified for verification by an authorized official of the depository participant, under his signature. Thus, in terms of the said circular, the original copies of the identification of the applicants / beneficial owners shall be verified by the Depository Participant. However, the same was not done in the present case. The non observation of such requirement / compliance finally culminated in the loss to investors. Had RSL been prompt in complying the said requirements, the investors would not have suffered such losses. Therefore, it is fairly established that RSL had violated the provisions of SEBI Circular dated August 4, 2000. I note from the inspection report of CDSL (by M/s. Mohnot & Co.) that RSL had not provided copies of the agreements entered into by them with various Beneficial Owners. The above said irregularities had been pointed out in around 123 such account opening forms and agreements, out of a total of 702 active accounts as on September 9, 2003. Though, RSL, had carried out the internal audits of its Udaipur branch through M/s. Sagar Golcha & Co., it had failed to notice the above mentioned irregularities. Though, the systematic deficiencies noticed in the functioning of RSL at its Udaipur branch were pointed out by CDSL in its inspection, RSL had failed to rectify the same. Had RSL taken adequate care, it could have avoided the large scale irregularities occurred at its Udaipur branch.

2.12 The non adherence by RSL to regulatory norms was due to the lack of internal control systems which had finally resulted in the poor functioning of the branches of RSL. RSL was also not having systems in place for the purpose of reviewing, monitoring and evaluating the participant's internal accounting control

systems. The above instances would further establish that RSL had failed to monitor the periodical operational review and monitor and evaluate the internal accounting control system as required under Regulation 46 of the said Regulations. Further, admittedly, the Compliance Officer of the Mumbai Branch of RSL, Shri Suresh Kamat, had not brought any irregularities to the Competent Authorities, as required under Regulation 58B(2) of the said Regulations. Being the compliance officer, it was the duty of Shri Suresh Kamat to ensure that the systems at all branch offices were adequately monitored and the irregularities / deficiencies, if any, brought to the notice of the Head Office.

2.13 Further, it was also observed that RSL had delegated its Depository Participant operations to its sub broker viz. Liberty Stock Links Pvt Ltd without approval from the competent authorities. Admittedly, the office of the sub broker and the Udaipur office of RSL were functioning from the same premises. Admittedly, Shri Sunil Kumar Sharma (director of Liberty Stock Links Pvt Ltd.) simultaneously acted as the compliance officer of RSL at its Udaipur branch. Further, Shri Nikhil Arya, who was earlier in the Liberty Stock Links Pvt. Ltd. was the operator dealing in the depository participant activities of RSL at its Udaipur branch. In addition to the above, the inspection report clearly stated that, the display board situated outside the office of RSL at its Udaipur branch showed the name "Liberty Stock Links Pvt. Ltd." It was not mentioned that the same was the office of RSL, which is one of the mandatory eligibility criteria laid down by CDSL for setting up the branch. Even the visiting cards (obtained during the course of inspection) of Shri Vikas Mehta and Shri Sunil Kumar Sharma showed that they were the directors of Liberty Stock Links Pvt. Ltd. and not employees of RSL. Thus, it cannot be viewed lightly that the Depository Participant operations were carried out from the same premises as that of Liberty Stock Links Pvt. Ltd. which was incidentally the residence of Shri Vikas Mehta (director of Liberty Stock Links Pvt. Ltd.). Besides, the reply of RSL (dated October 5, 2006) stated that as soon as fraud came to light they discontinued Depository Participant operations at Udaipur branch from the premises of the sub broker and once got the approval of

the CDSL to centralize all the DP operations at its Head Office at Mumbai. This confirms that RSL had delegated the Depository Participant operations to their sub broker viz. Liberty Stock Links Pvt. Ltd. without the approval of Competent Authorities. Regulation 52 of the said Regulations prohibits assignment of Depository Participant activities to any other entity / person without the prior approval of the Depository. It is, accordingly, fairly established that RSL had violated the provisions of Regulation 52 of the said Regulations. RSL also found to have violated various clauses viz. Clause 1, 2, 3, 4, 5, 14, 15, 16, 17, 19, 20 of the Code of Conduct as specified in the Third Schedule of the said Regulations. Though the said violations were explained in detail in the said Enquiry Report, RSL could not give any satisfactory explanation in respect of the said violations.

2.14 Shri Ashish Sharma (Director of RSL) during the course of hearing admitted the irregularities / violations which were taken place at their Udaipur branch. He claimed that RSL made good the losses suffered by the investors. Further, RSL in its reply dated October 5, 2006 *inter alia* stated, “As already submitted earlier, the system and we both were victims of a fraudster at Udaipur and for that we have already suffered severally.” It, further stated that as soon as fraud came to light they discontinued Depository Participant operations at Udaipur branch from the premises of the sub broker and once got the approval of the CDSL to centralize all the Depository Participant operations at its Head Office at Mumbai.

2.15 As an intermediary operating in the securities market, RSL is duty bound to comply with the statutory provisions including various circulars issued by SEBI from time to time. It has a duty towards the investors as well as the securities market. The various requirements under the Act and Regulations in respect of an intermediary are envisaged 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. RSL requested to take a lenient view in the matter. Taking into account the circumstances of the present case, the non compliance of statutory requirements, as explained above, on the part RSL call for a penalty, in the interest of investors in the securities market, as ordered herein under.

3.1 In view of the foregoing, I, in exercise of the powers conferred upon me, in terms of Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 28 (2) of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, hereby debar the Udaipur Branch of Mehta Equities Ltd., formerly known as Renaissance Securities Ltd., {Depository Participant (Reg. No. IN-DP-CDSL-35-99) of Central Depository Services Ltd.}, from carrying out the depository participant activities for a period of one month.

3.2 This order shall come into force immediately on the expiry of twenty one days from the date of this order.

T. C. NAIR
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date: 02-12- 2008