

SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: DR. K. M. ABRAHAM, WHOLE TIME MEMBER

ORDER UNDER REGULATION 28(2) OF SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008 IN THE MATTER OF KB CAPITAL MARKETS PRIVATE LIMITED, PORTFOLIO MANAGER.

Date of hearing: December 19, 2008

Appearance:

For KB Capital Markets Private Limited: Mr. Prashant Khandelwal, Director
Mr. Kaushik Poddar, Director
Mr. Rakesh Gupta, Executive

For Securities and Exchange Board of India: Mr. Jayanta Jash,
General Manager
Mr. Vijayakrishnan G,
Assistant Legal Advisor

1. Securities and Exchange Board of India (hereinafter referred to as SEBI) conducted an inspection of the books of accounts, documents and other records of the Portfolio Manager namely, KB Capital Markets Private Limited on 18th to 25th of January 2006 for the period 2004-2005 and from 2005 till the date of inspection. KB Capital Markets Private Limited is hereinafter referred to as the noticee for the sake of brevity. The inspection thus carried out observed certain irregularities committed by the noticee. Thereafter, SEBI forwarded the copy of the inspection report to the noticee for its comments in respect of the findings of the said report. Pursuant to the receipt of the comments from the noticee, SEBI, vide order dated November 28, 2006 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Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (since repealed) to enquire into the alleged violations committed by the noticee, as stated therein. The Enquiry Officer/Designated Authority (hereinafter referred to as the Enquiry Officer for the sake of shortness), vide report dated September 19, 2008 recommended to impose a penalty of warning to the noticee. Pursuant to the submission of the Enquiry Report, a notice dated October 16, 2008 was issued to the noticee by SEBI asking it to show cause as to why action should not be taken against it as recommended by the Enquiry Officer or as it considered appropriate. The noticee vide letter dated October 22, 2008 accepted that it had committed an unintentional mistake in respect of charge of violation of Regulation 20(3) of Securities and Exchange Board of India (Portfolio Managers) Regulations, 1993 (hereinafter referred to as the Portfolio Managers Regulations). However, according to the noticee, it was not a dishonest mistake. Regarding the observation of the Enquiry Officer in respect of the violation of Know Your Clients (KYC) requirements, the noticee contended that the Enquiry Officer had not taken into account its submissions. The noticee further assured that it would be more vigilant, cautious and careful in all its future dealings and transactions and that it would maintain highest standards of professionalism and ethics in all its business transactions. SEBI also granted an opportunity of hearing to the noticee on December 19, 2008. Mr. Prashant Khandelwal and Mr. Kaushik Poddar (Directors of the noticee) and Mr. Rakesh Gupta (Executive of the noticee) appeared before me and made submissions on behalf of the noticee on the lines of its reply dated October 22, 2008.

2. I have considered the Enquiry Report, show cause notice issued to the noticee, the oral as well as written submissions made on behalf of the

noticee, as stated above and other materials available on record. According to the Enquiry Officer, the noticee committed certain violations. Some of which are:

(i) In some cases, the noticee had made investments for its clients even though the clients' accounts did not have sufficient balances and thereby the funds of one client were utilized for the investments of others in violation of Regulation 15(1) and 15(3) of the Portfolio Managers Regulations.

(ii) The noticee had failed to get the portfolio accounts of the clients audited by an independent Chartered Accountant as required under Regulation 20(3) of the Portfolio Managers Regulations. Besides, the disclosure document furnished to the clients was not certified by an independent Chartered Accountant as stipulated under Regulation 14(2) (c) of Portfolio Managers Regulations.

(iii) The noticee had not entered into agreement with the clients in the specified format.

(iv) The noticee had failed to obtain the general information about the clients in violation of Clause 1 under Schedule V read with Regulation 14 and Clause 12(a) of Code of Conduct prescribed under Schedule III read with Regulation 13 of the Portfolio Managers Regulations.

(v) There were instances of early termination of the agreement between the noticee and the clients without issuance of thirty days notice, which was in violation of Clause 12(a) of Code of Conduct prescribed under Schedule III read with Regulation 13 and 14(1)(b)(vii) of the Portfolio Managers Regulations.

3. In the facts of the case, I consider it appropriate to deal with only those findings which were the basis for the recommendation of the Enquiry

Officer. As Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 was repealed with effect from the notification of Securities and Exchange Board of India (Intermediaries) Regulations, 2008, I proceed with this matter in terms of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008. One of the findings of the Enquiry Officer is that the noticee had made investments for its clients even though the clients' accounts did not have sufficient balances and thereby the funds of one client were utilized for the investments of others. The said act of the noticee is in violation of Regulation 15(1) and 15(3) of the Portfolio Managers Regulations. In this context, I consider it necessary to quote the said provisions for the sake of easy reference:

"15(1) The discretionary portfolio manager shall individually and independently manage the funds of each client in accordance with the needs of the client in a manner which does not partake character of a Mutual Fund, whereas the non-discretionary portfolio manager shall manage the funds in accordance with the directions of the client.

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(3) The portfolio manager shall transact in securities within the limitation placed by the client himself with regard to dealing in securities under the provisions of the Reserve Bank of India Act, 1934 (2 of 1934)"

4. The Enquiry Officer observed certain discrepancies of shortfall in case of outstation collection in two instances. The noticee had admitted before the Enquiry Officer that its programme had not detected the said shortfall. Such

plea is too naive to accept. The noticee cannot take shelter under such technical default considering its nature of duties specified under the Portfolio Managers Regulations. The noticee is duty bound to comply with such duties. Thus, it is established that the noticee violated the provisions of Regulation 15(1) and 15(3) of the Portfolio Managers Regulations. The Enquiry Officer further found that the noticee had failed to get the portfolio accounts of its clients audited by an independent chartered accountant as required under Regulation 20(3) of the Portfolio Managers Regulations. Admittedly, the noticee had not engaged an independent chartered accountant. They accepted the violations. According to the noticee, it believed that the audit by its statutory auditor would satisfy the requirement of Regulation 20(3) of the Portfolio Managers Regulations. I am unable to agree with the noticee. In terms of Regulation 20(3) of Portfolio Managers Regulations, it is the duty of the noticee to get its portfolio accounts audited by an independent chartered accountant. Further, in terms of Regulation 14(2)(c) of the Portfolio Managers Regulations, the contents of the Disclosure Document shall be certified by an independent chartered accountant. The provisions of Regulation 20(3) and 14(2)(c) are extracted below:

14(2)(c): The contents of the Disclosure Document shall be certified by an independent chartered accountant.

20 (3): The portfolio accounts of the portfolio manager shall be audited annually by an independent chartered accountant and a copy of the certificate issued by the chartered accountant shall be given to the client.”

5. The noticee claimed that it had complied with the above requirements by getting its portfolio accounts audited by the statutory auditor. I am not convinced by the argument of the noticee that the statutory auditor is an independent chartered accountant in the context of the requirement under Regulation 20(3) of the Portfolio Managers Regulations. If the portfolio accounts are to be audited by its statutory auditor, the Portfolio Managers Regulations would have specified that. The provisions of Regulations 14(2)(c) and 20(3) of the Portfolio Managers Regulations specifically mention "independent chartered accountant". If the intention was audit by any chartered accountant, it would have mentioned otherwise in the said provisions. This is evident from the provisions of Regulation 20 of the Portfolio Managers Regulations itself. In terms of Regulation 20(2), the books of account shall be audited yearly by a qualified auditor. It does not mandate audit by an independent chartered accountant. However, Regulations 14(2)(c) and 20(3) stipulates audit by an independent chartered accountant. The noticee should have understood such distinction. If the Regulation stipulates an act to be done in a particular manner by an intermediary, then it is the duty of such intermediary to do such acts in that manner. It cannot decide its own mode to comply with such act. Thus, I do not have any hesitation to hold that the noticee violated Regulations 14(2)(c) and 20(3) of the Portfolio Managers Regulations. Besides, the noticee was failed to enter into agreement with the clients in the specified format. The inspection conducted by SEBI observed that the agreement entered by the noticee with the clients was not as per the prescribed format. The noticee is failed to satisfactorily explain before me that it had entered into the agreement with the clients in the specified format. The main contention is that the Enquiry Officer had not taken into account its submissions. However, I am unable to accept the said contention. The contention of the noticee that other Portfolio

Managers had been using a different format did not found favour with the Enquiry Officer. The Enquiry Officer is correct in rejecting such claim. The noticee has violated the provisions of Regulation 14(1)(a) of Portfolio Managers.

6. Further, I note that the noticee admitted before the Enquiry Officer that it was not maintaining separate Know Your Client (KYC) requirements for its different activities (Portfolio, Stock Broking, Depository Participant etc.) in order to avoid duplication of documents. In terms of Clause I of Schedule V of the Portfolio Managers Regulations (in respect of the 'Disclosure Document'), the Disclosure Document is to be given to the prospective client along with the account opening form (as per Format I) at least two days in advance of signing of the agreement. Besides, there were instances of early termination of the agreement between the noticee and the clients without issuance of thirty days notice. I observe that the noticee in its reply before the Enquiry Officer submitted that it wanted to grant complete flexibility to its clients and therefore, an option was given to them to terminate the agreement without giving a notice of thirty days.

7. As an intermediary, the noticee has a duty to comply with various statutory requirements issued by SEBI from time to time. He is *inter alia* required to maintain high standards of promptitude and fairness while conducting his business. The noticee could not satisfactorily controvert the findings of the Enquiry Officer. Once the default is established, the penalty must follow. It is only the quantum of penalty that is discretionary. In the present case, the penalty recommended is the minimum prescribed and therefore, in the totality of the facts of the case, I do not consider it appropriate to interfere with the recommended penalty. According to me, a

penalty of warning would meet the ends of justice in the matter. Accordingly, I dispose of the present enquiry proceedings, as ordered herein under.

8. In view of the foregoing, I, in exercise of the powers conferred on 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 warn the portfolio manager namely, KB Capital Markets Private Limited (Registration No. INP 000001041) to be more cautious in the conduct of its business and to adhere to and comply with all statutory provisions/instructions received in the discharge of its function as a portfolio manager without any fail.

K. M. ABRAHAM

WHOLE TIME MEMBER

SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai

Date: December 31, 2008