

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

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

ORDER

UNDER REGULATION 28 (2) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008 AGAINST ALKA SECURITIES LIMITED

Date of hearing: September 9, 2009

Appearance:

For Alka Securities Limited: Mr. Sean Wasoodean, Advocate and Mr. Mahendra Pandey

For the Securities and Exchange Board of India: Mr. Piyoosh Gupta, General Manager

Mr. Vijayakrishnan G., Deputy Legal Adviser

Mr. Gyanendra Niraj, Assistant General Manager

Mr. T. Vinay Rajneesh, Legal Officer

1. The Securities and Exchange Board of India (hereinafter referred to as SEBI) had conducted an inspection of the books of accounts, documents and other records of the stock broker namely Alka Securities Limited (hereinafter referred to as the stock broker) during March, 2003 for the financial year 2001-2002 and from April, 2002 till the date of inspection. The stock broker is a member of the National Stock Exchange of India Limited (hereinafter referred to as NSE). The inspection so conducted noticed certain irregularities allegedly committed by the stock broker. As the reply/submissions of the stock broker in respect of the findings of the inspection were not satisfactory, SEBI initiated enquiry proceedings against the stock broker in accordance with the provisions of the Securities and Exchange Board of India (Procedure for Holding Enquiry by Enquiry Officer and Imposing Penalty) Regulations, 2002 (since repealed) by appointing an Enquiry Officer, vide order dated February 10, 2004 read with a

subsequent order dated September 30, 2004. The Enquiry Officer, vide report dated May 31, 2005 found that the stock broker had contravened the following:

- a. Section 12 of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as the said Act) read with Rule 3 of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992 (since Rescinded) ;
- b. SEBI Circular No. SMD/POLICY/CIRCULAR/3-97 dated March 31, 1997;
- c. SEBI Circular No. SMDRP/POLICY/CIR-49/2001 dated October 22, 2001 and SEBI Circular No. SUB-BROK/CIR/02/2001 dated January 15, 2001;
- d. Regulation 17 (1) of the Securities and Exchange Board of India (Stock brokers and Sub-brokers) Regulations, 1992 (hereinafter referred to as the Stock Brokers Regulations) and Rule 15(1) of the Securities Contracts (Regulation) Rules, 1957;
- e. SEBI Circular No. SMD/SED/CIR/93/23321 dated November 18, 1993;
- f. Rule 4 (c) of the Securities and Exchange Board of India (Stock brokers and Sub-brokers) Rules, 1992 (hereinafter referred to as the Rules)
- g. SEBI Circular SMD/POLICY/IECG/1-97 dated February 11, 1997 and SMD/POLICY/CIRCULAR/5 -97 dated April 11, 1997

The Enquiry Officer further recommended that the certificate of registration granted to the stock broker be suspended for a period of two months.

2. Thereafter, a notice dated June 15, 2005 was issued by SEBI to the stock broker enclosing therewith the Enquiry Report, calling upon 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 stock broker filed its reply to the said notice, vide letter dated July 5, 2005. Thereafter, an opportunity of hearing was granted to the stock broker on September 25, 2008. The stock broker, vide letter dated September 17, 2008 had informed SEBI that, it was in the process of applying for a consent order in terms of SEBI circular dated April 20, 2007 in the matter and subsequently, vide letter dated November 4, 2008, forwarded its application with regard to the same. In view of the aforesaid application, the present proceedings in respect of the stock broker were kept in abeyance. Thereafter, as the aforesaid application filed by the stock broker was rejected by the High Powered Advisory Committee (constituted in terms of the aforesaid circular), the present proceeding was resumed and the stock broker was granted an opportunity of hearing on August 4, 2009. As requested by the authorized representative of the stock broker, the said hearing was adjourned to August 28, 2009. This was again rescheduled to September 9, 2009, in view of another request of the stock broker. On the said date, the stock broker was represented by Mr. Sean Wasoodean, Advocate and Mr. Mahendra Pandey. The learned advocate made submissions in the matter on the lines of the reply of the stock broker dated July 5, 2005.

3. I have considered the Enquiry Report, the show cause notice issued to the stock broker, its reply dated July 5, 2005, submissions made during the personal hearing and the other material available on record. My findings in respect of the charges against the stock broker are as under:

4. The stock broker had objected to the present proceedings on two preliminary grounds. In its reply dated July 5, 2005, the stock broker contended that that no proceedings 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) could be resorted to, as neither in the show cause notice nor in the inspection report was there any allegation regarding the breach of any regulation as detailed in Regulation 4 thereof. In this regard, I refer to the provisions of the Enquiry Regulations (now repealed). Regulation 4 of the Enquiry Regulations empowers SEBI to initiate an enquiry for the purpose of passing an order in respect of the contravention of any of the provisions of the Regulations (as amended from time to time) mentioned therein, which included the Stock Brokers Regulations. Further, Regulation 27 of the Stock Brokers Regulations provided that a stock broker or a sub-broker shall be liable for any action as specified in the Enquiry Regulations including suspension or cancellation of his certificate of registration. Regulation 27 (xvi) of the Stock Brokers Regulations, empowered SEBI to initiate action under the Enquiry Regulations if any stock broker or a sub-broker failed to comply with the circulars issued by SEBI. The allegation against the stock broker is that it had *inter alia* violated the provisions of various circulars of SEBI. Thus, non-compliance with the provisions of the circulars set and enforced by SEBI, as has happened in the present case, necessitated the initiation of action under the Enquiry Regulations. The continuance of this action derives its legality under the saving clause provided in Regulation 38 of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008 (hereinafter referred to as the Intermediaries Regulations) as the Enquiry Regulations was repealed with effect from the date of publication of the Intermediaries Regulations. In view of the same, the submission of the stock broker that no proceeding under the Enquiry Regulations can be held is only to be rejected as the same is without any merit.

5. The second objection raised by the stock broker is that NSE had already imposed penalties on it for the same reasons and grounds as mentioned by the Enquiry Officer and that it cannot be vexed twice for the same reasons. In its

reply dated July 5, 2005, the stock broker stated *"More so, as the Noticee has already paid penalty amounting to Rs 5,10,000 (Five lakhs ten thousand rupees only) to the National Stock Exchange for the same alleged acts and omissions and furthermore, the noticees's trading terminal was deactivated by the National Stock exchange between 11 Jan 2004 and 21 Jan 2004"*. On a perusal of the relevant Regulations mentioned above in this order, it is beyond any doubt that SEBI is empowered to initiate actions against the stock broker in respect of the alleged violations committed by it. With regard to the submission that the stock broker is being vexed twice for the same reasons as NSE had already imposed penalties on it, I find that NSE had imposed penalties on the stock broker for its contravention of its byelaws, rules/regulations, whereas the present proceedings have been instituted against the stock broker *inter alia* for the violations of the provisions of the Stock Brokers Regulations and various SEBI circulars. With regard to the objection of the stock broker that no penalty of any sort be levied, I note the following observation of the Hon'ble Securities Appellate Tribunal, in the matter of Kinglet Finlease & Securities Ltd. Vs Securities and Exchange Board of India (order dated January 29, 2003):

".....In my view the fact that NSE had deactivated the trading terminal of the Appellant and that a sum of Rs.29 lacs was debited towards "fines and penalties" does not in any way preclude the Respondent exercising its powers under the Broker Regulations and the FUTP Regulations. It is not material as to whether the facts relied on by the Respondent and NSE are one and the same. It is the distinct nature of the offence that matters. Offence is relatable to the omission or commission made punishable by any law. The action taken by NSE and the Respondent is not with reference to the same offence. It is well settled that imposition of monetary penalty as a result of a domestic enquiry can not be considered as punishment for the purpose of considering protection from "dual jeopardy." I do not find any merit in the Appellant's argument that since NSE had deactivated the Appellant's trading terminal and collected Rs.29 lacs as penalty,

the Appellant is immune to any other action for violation of the Broker Regulations and FUTP Regulations, based on the same facts relied on by NSE. It is not that a broker who has been punished by an exchange under its bye laws/regulations is untouchable by SEBI. (Emphasis supplied)

In view of the above, the plea of the stock broker that it is vexed twice for the same offence needs to be brushed aside.

6. The Enquiry officer had found that the stock broker violated Rule 3 of the Rules read with Section 12 of the SEBI Act and SEBI Circular dated March 31, 1997. The Enquiry Officer observed that the stock broker had rented out its NSE Wholesale Debt Market (WDM) Card to an entity namely Optima Securities India Private Limited (hereinafter referred to as Optima), an unregistered sub-broker. In this regard, the stock broker in its reply dated July 5, 2005 submitted that the Enquiry Officer had totally misconstrued the provisions of Rule 3 of the said Rules read with Section 12 of the SEBI Act. The stock broker further submitted that there was only an allegation of a breach of the SEBI Circular dated March 31, 1997 and this did not warrant any action or enquiry under the Enquiry Regulations. I am unable to accept the argument that the violation of SEBI Circular by a stock broker would not invite actions by SEBI against him given that there are express provisions in the Enquiry Regulations and the Stock Brokers Regulations explained in detail in the preceding paragraphs. During the personal hearing, it was submitted that, the stock broker had entered into an agreement with Optima for developing and marketing its business and therefore had assigned and transferred its "WDM business" to Optima. According to the stock broker, Optima was only developing the business based on the exclusive agreement entered with it and that all contract notes were raised in the name of the stock broker and payments were received by it. It was claimed that only the brokerage was shared between them under

the agreement. The stock broker further submitted that during the inspection conducted by NSE, it was pointed out that such an agreement was not permissible and because of the same, it had terminated the said agreement. The stock broker contended that the said agreement was not a "sub broker arrangement" as Optima was only a '*remisier*' and that such arrangements were permitted under various circulars. It pleaded that since NSE had deactivated its terminal for 10 days and also imposed a fine of Rs.5 lakhs, SEBI ought not to have proceeded against it. On perusing the various agreements entered into by the stock broker with Optima, the Enquiry Officer observed that the '*WDM Card*' of the stock broker was given to Optima. I note that the stock broker had obtained the certificate of registration from SEBI in respect of its WDM Segment operations in the year 1994. However, it commenced its operations only after four years i.e in 1998. This delay in commencing the operations cannot be considered very significant as far as the alleged violations are concerned. However, what is more crucial is the unauthorized act of the stock broker in allowing Optima to carry on business in its WDM Card by entering into an agreement, in an unrecognized manner. Thus, it was not the stock broker who commenced its activities, but a third party by virtue of an agreement which was recognized neither by NSE nor SEBI. The stock broker has not denied the execution of agreements with Optima and the same is further evident from the observation of the Enquiry Officer that *"20. I have also perused the copy of the agreement dated November 13, 2003 terminating the arrangement between Optima & ASL as brought out vide their letter dated October 25, 2003. The letter addressed to Optima, clearly states that "since the agreements entered into between them do not satisfy NSE/SEBI requirements, the same stand terminated w.e.f October 31, 2003".*

7. In respect of the nature of agreements entered into between the stock broker and Optima, the Enquiry Officer had quoted certain excerpts (from the

agreement dated August 14, 1998) in the Report. A portion of such an extracts is reproduced below:

“AND whereas it is mutually agreed between the Company and the Associates that the Associates will exclusively develop, carry on and execute the WDM operations on the NSE Card of the Company on certain terms and conditions.....”

“Associates will hire such personnel and Executives as it may find necessary.....”

“The Company will not carry on any WDM operations or business directly or indirectly on its NSE Card and Associates alone shall be entitled to carry such operations and business in the name of and on behalf of the company.....”

(The Company and the Associates mentioned above would refer to the stock broker and Optima.)

8. Thus, in terms of the agreements entered into with Optima, the stock broker was not supposed to carry on any WDM operations or business, directly or indirectly, when the permission to carry out such business was exclusively given to it. The agreement empowered only Optima to carry on such operations when the membership in the WDM segment was granted by NSE to the stock broker. The SEBI Circular dated March 31, 1997 *inter alia* prescribed that “No broker shall deal with a person who is acting as a sub-broker unless he is registered with SEBI. It shall be the responsibility of the broker to ensure that his clients are not acting in the capacity of a sub-broker unless he is registered with SEBI as sub-broker or is recognized by the stock exchange as a remisier.”

Optima was found to be a member of the Over the Counter Exchange of India Limited (OTCEI). It is not the case of the stock broker that, Optima is registered as a sub broker with SEBI. Further, the stock broker could not establish the fact that Optima was a remisier with any recognized stock exchange. Despite the same, Optima was handling the WDM operations solely, even to the exclusion of the stock broker. It would establish that the stock broker had allowed Optima to deal with its NSE Card (WDM segment) without fulfilling the statutory requirements. Needless to say, the stock broker had dealt with an entity that was not registered with SEBI or recognized by any of the stock exchanges as a remisier. The very act of the stock broker in allowing Optima to deal on its Card without fulfilling the statutory requirements cannot be considered as trivial. The stock broker, through an agreement allowed an entity which was not registered with SEBI to deal in securities is in violation of Section 12 of the SEBI Act read with Rule 3 of the Rules. The following observation of the Hon'ble Securities Appellate Tribunal in the matter of **Ganpati Finsec Private Limited and others vs. Securities and Exchange Board of India and another** [Appeal No.178 of 2007; decided on 19.03.2008], is pertinent in this context.

“The fact that it executed a franchisee agreement on September 19, 2002 with SMC is not in dispute. This agreement provides that Ganpati is desirous of becoming an affiliate of SMC with the object of allowing its clients to deal through SMC in the primary and secondary markets. The agreement further provides that Ganpati is affiliated to SMC and the former shall within the scope of the authority given under the agreement be entitled to act as an intermediary between SMC and the clients for assisting them in dealing in the primary and secondary markets. It is further provided in the agreement that Ganpati shall conduct the business on behalf of its clients with SMC and that the business would be carried on at 37-K Block, Sriganganagar (Rajasthan). A reading of this agreement leaves no room for doubt and it is also the admitted case of the appellant that Ganpati was a franchisee of SMC which is a registered stock

broker. It is obvious that Ganpati was to be an intermediary between the clients and the broker and that role has been described in the agreement as that of a franchisee. A franchisee means an agent of the broker and that franchisee is not a term recognized by section 12 of the Act. In another words, franchisee by itself may not be an intermediary of the market but nevertheless it is an agent of the broker and is required to do all such acts under the agreement as are required to be done by a sub broker. As an agent of the broker, Ganpati can only be a sub broker. In view of this agreement we have no hesitation in holding that Ganpati on its own showing is an agent/sub broker of SMC and since it had not been registered with the Board under section 12 of the Act, it could not act and conduct business as a sub broker. Having done so, it violated the provisions of law. The first charge levelled against Ganpati and its Director's stands established." [Emphasis supplied]

9. Therefore, I am of the considered view that, by allowing Optima to conduct the business through its WDM Card, the stock broker had committed a serious misconduct. Merely saying that it had terminated the arrangement it had with Optima as soon as the same was brought to its notice by NSE would not mitigate the gravity of the said contravention. Further, the certificate of registration granted by SEBI and the permit to trade in the WDM segment by NSE was only to the stock broker after verifying its worthiness (including other requirements) to deal on behalf of clients. However, in stark deviation, the stock broker had allowed Optima to deal with its Card. The said act on the part of the stock broker is nothing short of breach of trust reposed upon it by SEBI and NSE. Such practices of market intermediaries, which clearly are not in the interest of the investors, cannot surely be countenanced. SEBI is required to take stringent action against those found violating the norms put in place for the protection of the securities market and investors. Thus, I do not have any hesitation to hold that the stock broker has violated the Circular dated March

31, 1997 and it further allowed an unregistered entity to deal in securities in violation of Section 12 of SEBI Act and Rule 3 of the Rules.

10. With regard to the charge that the stock broker did not have proper address and that the trading terminals were placed at unauthorized locations, the Enquiry Officer had found that the corporate address (as mentioned in the correspondence sent by the stock broker to SEBI) was found to be closed. The Enquiry Officer had also observed that the telephone numbers were found to be fictitious. The Enquiry Officer observed from the correspondence sent by the stock broker to SEBI that, it (stock broker) was located at different places. The said locations and the addresses were mentioned in the Enquiry Report. In respect of the Corporate Office of the stock broker, the address of which was mentioned in the Enquiry Report, the Enquiry Officer had observed *“However, the Corporate Office at the address mentioned above, was found to be closed for the last 2 years and the telephone numbers 2652130 and 2672601 were found to be fictitious”*. The Enquiry Officer had also observed the non existence of the stock broker at other locations, such as Goregaon (Mumbai), Vadodara (Gujarat) and Juhu-Vile Parle (Mumbai). The inspection conducted by SEBI could observe the board “Optima” at the entrance of the premises of the stock broker at 7, Rahimitoolah House, Homji Street, Fort, Mumbai-400001 (This address was admitted by the stock broker to NSE, vide letter dated December 19, 2001). It was also observed that Optima was using the name of the stock broker in their contract notes & bills. In the context of non existence of the stock broker at the address given, the Enquiry Officer observed *“25. However, the letter head of the reply of ASL dated June 9, 2003 shows the address of 54, Bombay Mutual Chambers, Hamam Street, Mumbai – 400 023 which as per the findings of inspection was not in existence at the time of inspection since the last 2 years. Through this letter ASL had forwarded copies of various documents relating to the change in addresses”*. The Enquiry Officer was of the

view that the stock broker was trying to evade regulatory attention for reasons best known to it. The above facts would indicate that the stock broker had unauthorisedly extended its trading terminals granted by NSE to Optima unauthorisedly, as it was not found to be a registered sub-broker to the stock broker or a remisier recognized by the stock exchange. It is already established that the stock broker had allowed Optima to trade in the WDM Segment through its card totally excluding the stock broker also. SEBI circular dated January 15, 2001, provided that sub-brokers would be permitted to start business only after clearance and registration certificate from SEBI. Stock brokers have been advised adequately that their sub brokers would be permitted to start business only on clearance and receipt of registration certificate from SEBI. The said circular also mentioned that any person who contravenes or attempts to contravene or abets the contravention of the above said rule, shall be punishable in terms of Section 24(1) of the SEBI Act. Further, SEBI, vide Circular dated October 22, 2001 had advised that the trading terminals were to be granted only at the stock broker's registered office, branch offices and their registered sub-broker's offices. The said circular was issued by SEBI on noticing that the trading terminals granted to the stock brokers at various locations were being mis-utilised for unregistered sub-broking activities. Further, the Enquiry Officer had observed that *".....Optima, an unregistered sub-broker was allowed by ASL to operate from the office of ASL, against the spirit of the said SEBI Circulars and there cannot be enough justification for such an action. Hence such an action ought to be suitably penalized."* The very act of the stock broker of providing the trading terminal (to Optima) admittedly not belonging to any of the authorized locations (stock broker's registered office, branch offices and their registered sub-broker's offices) as specified in SEBI circular dated October 22, 2001 is clearly in violation of the said circular. Thus, the said acts are in contravention of the SEBI Circulars dated January 15, 2001

and October 22, 2001. Such activities of the stock broker pose a serious threat to the integrity of the securities market.

11. In respect of the charge of issuing wrong contract notes by the stock broker for 'debt' trades of its clients, the Enquiry Officer, had observed that the stock broker may be suitably censured for issuing contract notes with errors, more so when it was dealing with around 150 institutional clients, and had failed to exercise adequate care and caution while executing trades involving huge flow of funds. It is a fact that the stock broker had issued contract notes containing wrong particulars which were corrected subsequently, for which the stock broker needs to be reprimanded. The stock broker was also alleged to not have obtained client acknowledgement on the duplicate copies of the contract notes. The stock broker had contended that the contract notes were sent at the relevant time by courier or delivery and to that effect had undertaken to produce the copies of the courier bills. The Enquiry Officer has observed that no documents were furnished by the stock broker to substantiate its stand that the contract notes were sent at the relevant time by courier or by hand delivery. In this regard, the following observation of the Hon'ble Securities Appellate Tribunal in Appeal No. 22 of 2003 [Radar Securities Limited vs. SEBI], decided on May 30, 2003 is worth noting:

"It is seen from the said format that there is a provision for the client to acknowledge the receipt of the Contract Note by affixing his signature and the counterfoil so signed is required to be returned to the broker. The requirement is either to have the counterfoils or the duplicates of the Contract Notes issued to the clients. This is a very important requirement as it goes to establish that the Contract Note was actually issued to the client. Contract Note is a very important document in the transaction and its relevance is all the more when dispute arises between the broker and the client."

[Emphasis supplied]

In view of the above and in the default of the stock broker in furnishing proof to the contrary as observed by the Enquiry Officer, the stock broker is advised to ensure that such irregularities do not recur in future.

12. The Enquiry Officer had also found that the stock broker had failed to maintain the order book and had also not mentioned particulars in the contract notes, as specified in terms of SEBI Circular dated February 11, 1997. In terms of the said circular, "The broker member should maintain record of time when the client has placed the order and reflect the same in contract note along with the time of execution of the order." The Enquiry Officer also found that the stock broker had not maintained the sauda books (register of transactions) *inter alia* in violation of the provisions of Regulation 17 (1) of the Stock Brokers Regulations. With regard to the said charges, the stock broker had submitted that the order books and sauda books had been properly maintained and furnished to SEBI from time to time. I note that Rule 15 (1) of the Securities Contracts (Regulation) Rules, 1957 mandated that every member of a recognised stock exchange shall maintain and preserve the Register of transactions (Sauda book), Clients' ledger, General ledger, Journals, Cash book, Bank pass-book and documents register showing full particulars of shares and securities received and delivered, for a period of five years. Further, Rule 15 (2) of the aforesaid Rules prescribes that every member of a recognized stock exchange shall maintain and preserve the member's contract books showing details of all contracts entered into by him with other members of the same exchange or counterfoils or duplicates of memos of confirmation issued to such other members, counterfoils or duplicates of contract notes issued to clients and written consent of clients in respect of contracts entered into as principals for a period of two years. The aforesaid documents/records are also to be maintained by a stock broker under Regulation 17(1) of the Stock Brokers Regulations. The stock broker has not adduced proper evidence to

show that it had maintained the order books and the sauda books. Merely asserting that '*it maintained them and had shown them to SEBI*' would not suffice. In view of the foregoing, I find the stock broker guilty of contravening the provisions of Regulation 17 (1) of the Stock Brokers Regulations and Rule 15 (1) of the Securities Contracts (Regulation) Rules, 1957.

13. One of the charges was that the stock broker had misutilised the funds of its clients for its purposes. The Enquiry Officer had pointed two instances, the first wherein, the stock broker had through cheques drawn on the erstwhile Global Trust Bank (GTB) for Rs.19,585/- and Rs.12,839/- paid the equated monthly installments (EMIs) for cars purchased by its promoters from the clients' funds. In the second instance, it was found that payments were made to Alka Technologies (a group company) from the clients' funds. In this regard, the stock broker had submitted that the same were inadvertent and that NSE had already levied a penalty on it. This charge is very serious. The stock broker actually misappropriated the funds of its clients for own purposes when it is expected to be a guardian for the funds and securities of its clients kept with it. Before the Enquiry Officer, the stock broker contended that bank account in GTB was its own but was not able to substantiate its claim with documents. NSE had also found that the said account belonged to clients and this finding was not challenged by the stock broker. In terms of SEBI Circular dated November 18, 1993, the stock brokers were directed to keep the money of the clients and their own money in separate accounts. The said circular also provided for the purposes for which money could be withdrawn from the accounts of their clients. The act of the stock broker is not covered any of the instances covered under the circular. Thus, in the absence of any evidence to support its stand and its admission that such acts were "inadvertent", I find the stock broker guilty of having contravened the aforesaid circular.

14. In respect of failure of the stock broker to maintain member client agreement, the Enquiry Officer had observed that the stock broker did not furnish the client registration form of Sharecare Investments Cons Private Limited. In view of the same, the stock broker is cautioned and advised to comply with the requirements of SEBI circulars dated February 11, 1997 and April 11, 1997. The 'know your client' forms and member-client agreements were introduced, vide SEBI Circulars dated February 11, 1997 and April 11, 1997. The reason for stipulating such documents is to ensure availability of all details of the clients and also to define the rights/obligations/duties of members (stock brokers) vis-a-vis their clients.

15. The Enquiry Officer also found that the stock broker had failed to obtain prior approval of SEBI for the change in the constitution of the board of directors of the stock broker. One of the directors of the stock broker, Mr. Mahendra Pandey had resigned from the board. This resignation was accepted and a resolution passed to that effect on September 21, 2001 by the board of directors. But, this change was not intimated to SEBI. In terms of Rule 4 (c) of the Rules, any change in the status and constitution of the stock broker has to be approved by SEBI for it to continue to buy, sell or deal in securities in any stock exchange. Any change in the designated/whole time director would be a change in the status and constitution of the stock broker. This was further clarified by SEBI, vide circular dated July 9, 2003. Though NSE was intimated of the same by the stock broker, no permission was sought from SEBI nor was SEBI intimated of the same.

16. In view of the foregoing, I find that:

- a. The stock broker had entered into an agreement with Optima for carrying out its operations in the Wholesale Debt Market segment at

National Stock Exchange of India Limited; the said arrangement is not recognized under the Securities and Exchange Board of India (Stock brokers and Sub-brokers) Regulations, 1992 and bye laws/Regulations of NSE. The act of the stock broker in dealing with an unregistered entity (neither a sub-broker nor a remisier) in an unrecognized manner violates SEBI Circular dated March 31, 1997. By allowing an unregistered entity to deal in the securities market, the stock broker has abetted the contravention of Section 12 of the Securities and Exchange Board of India Act, 1992 and Rule 3 of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992;

b. The stock broker had placed its trading terminals in the office premises of Optima, which was not an authorized place of business, in violation of SEBI Circular dated October 22, 2001;

c. The stock broker had no proper place of business as the address and telephone numbers furnished by it were found to be false and fictitious;

d. The stock broker had misutilized the funds of its clients for paying EMIs of cars purchased by its promoters and diverting funds to its group company, in violation of SEBI Circular November 18, 1993;

e. The stock broker had issued erroneous contract notes, though the same were rectified earlier;

f. The stock broker had failed to maintain order and sauda books in contravention of Regulation 17 (1) of the Securities and Exchange Board

of India (Stock brokers and Sub-brokers) Regulations, 1992 and Rule 15(1) of the Securities Contracts(Regulation) Rules, 1957;

g. The stock broker failed to produce the client registration form and the member-client agreement in respect of its client, in violation of SEBI Circulars dated February 11, 1997 and April 11, 1997;

h. In contravention of Rule 4 (c) of the Securities and Exchange Board of India (Stock Brokers and Sub-brokers) Rules, 1992, the stock broker failed to obtain prior approval for the change in the constitution of its board in view of the resignation of one of its directors, Mr. Mahendra Pandey.

17. From the foregoing, I find that the stock broker had committed serious irregularities/misconduct such as allowing an unregistered third party to deal in the securities market without the certificate of registration or recognition on the basis of an agreement and its WDM Card, extending its trading terminals to unauthorized locations, misusing clients' funds for its own purposes etc. SEBI grants registration to an entity to act as a stock broker only after it satisfies various requirements prescribed under the SEBI Act, Stock Brokers Regulations etc. The registration is granted to that entity alone and it is not open for the said entity to allow third party to conduct its business permissible under the registration though any kind of arrangement except as provided under law. I note that the stock broker can conduct its business only through persons who are recognized under law. Such persons could be registered sub-brokers or recognized remisiers. Further, SEBI, vide Circular dated October 22, 2001 has identified certain places/locations where the trading terminals allotted to the stock broker can be kept, which includes the stock broker's registered office, its branch offices and its registered sub-broker's offices. By allowing an

unregistered and unrecognized entity to deal in the securities market, it had not only violated the securities law as mentioned above, but also breached the trust reposed on it. By doing so, the stock broker has transferred the legal obligations and duties cast upon it to another entity. This deviates from what is provided for under SEBI Circular dated March 31, 1997. The stock broker had also allowed its trading terminals to be kept at places not authorized by SEBI and the stock exchanges. This again is a serious threat to the integrity of the securities market. Such practices cannot be encouraged and needs to be curbed wherever they are noticed. The conduct of the stock broker had put the securities market in peril endangering the interests of the investors also. Another serious violation established against the stock broker is that it had misused the clients' funds. The stock broker has been found to have misappropriated funds lying in its clients' accounts for own purposes like making EMI payments for the cars purchased by the promoters of the stock broker and transferring funds to its group company. These instances would clearly indicate breach of trust on the part of the stock broker. To summarize, the case against the stock broker is very serious in nature, *inter alia* for the following reasons:

- a. The membership card granted by National Stock Exchange of India Limited to the stock broker to carry on business in its Wholesale Debt Market segment was given by the stock broker to a third party who is neither recognized nor registered.
- b. The stock broker could not be located at its corporate office and at other locations. The board of Optima was found at the entrance of the premises of the stock broker at 7, Rahimitoolah House, Homji Street, Fort, Mumbai- 400001 (as observed in the Enquiry Report).

- c. The stock broker admittedly misutilised the clients' funds for its own purposes (to pay the equated monthly installments for cars purchased by its promoters and transferring funds to its group company).

The above mentioned instances among other things cannot be justified by any standards. A stock broker is one of the key intermediaries functioning in the securities market. A stock broker shall maintain high standards of integrity and fairness in the conduct of his business. In the present case, the stock broker did not abide by the requirements stipulated by the Regulator and NSE. It had *inter alia* allowed a third party to deal in securities without any registration/authorization and betrayed the trust of its own clients by misutilising their funds for its own purposes. Such an intermediary, who has deliberately allowed an unregistered/unrecognised entity to carry on operations, cannot be trusted to discharge its duties properly. It would be wrong to expect that such a stock broker would function in the overall interests of the investors in the securities market.

18. The stock broker had failed to exercise necessary care and diligence that an intermediary is expected of. The acts of the stock broker in allowing an unregistered /unrecognized entity (Optima) to carry on its business, allowing its trading terminals to be operated by Optima in unauthorized locations, misuse of clients' funds and failure to maintain order and sauda books are very serious. As stated above, the contraventions by the stock broker are serious enough and merit a suitable deterrent penalty. As an intermediary functioning in the securities market, the stock broker was required to abide by the rules, regulations and circulars framed by SEBI which govern its conduct in the securities market. These provisions are put in place for the smooth functioning and regulation of the securities market and for the protection of the investors in

the securities market. I find that the Enquiry Officer had recommended the suspension of the certificate of registration only for a period of two months. The contention of the stock broker that it was already penalized by NSE would not legally stand as discussed above in this order. Considering the seriousness of the violations committed by the stock broker, I do not find any reason to disagree with the recommendation of the Enquiry Officer. The nature of violations committed by the stock broker does not deserve any leniency. The stock broker carried on its business in total disregard to norms set by SEBI/NSE and acted in a manner detrimental to its own clients. Accordingly, the present enquiry proceeding initiated against the stock broker is disposed of as ordered herein under.

19. In view of the forgoing, I, in exercise of the powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Regulation 28(2) of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008, suspend the certificate of registration of the stock broker namely, Alka Securities Limited (Registration Number INB230629237), Member, National Stock Exchange of India Limited, for a period of two months.

20. This Order shall come into effect immediately on expiry of twenty one days from the date of the order.

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DR. K. M. ABRAHAM
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

Place: Mumbai
Date: October 30, 2009