

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: PRASHANT SARAN, WHOLE TIME MEMBER

ORDER

Under regulation 28(2) of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008

In respect of SMC Global Securities Limited (*clearing member of the National Stock Exchange of India Limited with SEBI Registration No. INF 230771431*)

Dates of hearing : December 07, 2012 and January 29, 2013

Appearance

For SMC Global Securities Limited:

1. Mr. P.N. Modi, Senior Advocate
2. Mr. R.R. Bhonsale, Advocate
3. Mr. S.C. Aggarwal, its Chairman and Managing Director
4. Mr. Anurag Bansal, its Director
5. Mr. M. Yogi, its Vice President-Operations

For the Securities and Exchange Board of India:

1. Mr. Krishnanand Raghavan, General Manager
2. Ms. Anitha Anoop, Deputy Legal Adviser
3. Mr. T. Vinay Rajneesh, Assistant Legal Adviser
4. Mr. Subhash K. Sinduria, Assistant General Manager

1. During the year 2009, two stock brokers, namely, Sunchan Securities Limited ("SSL") and Ganga Yamuna Finvest Private Limited ("GYF") had defaulted in their settlement obligations to the National Stock Exchange of India Limited ("NSE"). The same had raised concerns over the clearing and risk management operations of their clearing member, SMC Global Securities Limited (hereinafter referred to as "SMC Global" or "the noticee"). The Securities and Exchange Board of India (hereinafter referred to as "the SEBI") had also received complaints from investors/clients of SSL stating that SMC Global had provided higher exposure to SSL without collecting adequate margin and the same had contributed to the

defaults by SSL. SEBI, therefore advised the NSE to examine the matter and to submit its report.

2. NSE vide its letter dated April 01, 2009 had *inter alia* informed SEBI that it conducted an inspection of the clearing operations of SMC Global pertaining to the Futures and Options (F&O) Segment during December 2008. The period selected for random inspection was from January 2008 to November 2008. NSE observed major violations relating to wrong reporting of margin and non-collection of dues from the trading members on time by SMC Global. NSE also informed that the observations and the replies of SMC Global were placed before its Internal Committee for Minor Action, which decided that a broad based audit be conducted by independent external auditors. Accordingly, M/s. Walker, Chandiok & Co., chartered accountants were appointed as the auditor. The auditors verified the books of accounts and other records of the noticee to certify the correctness of the amount reported to the stock exchange as margin received from the trading members including SSL, GYF and Nikunj Stock Brokers Limited ("NSB"). Pursuant to their examination, the auditors found that the noticee was not reporting correct margin to the stock exchange; initial margins were collected by the noticee in the form of cash, undated cheques, FDRs, Bank Guarantee, securities, immovable properties, third party shares etc.; and the noticee had allowed trading members to take excess exposure without collecting sufficient margins inspite of debit balances. In view of these irregularities, the Disciplinary Action Committee of the NSE levied a penalty of ₹ 25,00,000/- on SMC Global. An additional amount of ₹ 25,00,000/- was also retained by NSE for a period of six months to be refunded based on the improvement in compliance by SMC Global with respect to reporting of margin collected from trading members.

3. Considering the aforesaid nature of the irregularities, SEBI also conducted an inspection of the books of accounts, documents and various other records maintained and furnished by the noticee. Pursuant to the inspection, SEBI forwarded the Inspection Report to SMC Global seeking its comments/explanation on such findings/irregularities observed by SEBI in the inspection. Submissions were made by SMC Global. Based on the findings of irregularities and lapses as observed in the Inspection Report, SEBI initiated proceeding against the noticee under Chapter V of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as "the Intermediaries Regulations") and appointed a Designated Authority ("DA") in terms of the said regulations.

4. After completing his enquiry, the DA vide his Report dated December 12, 2011, found the following contraventions/irregularities/lapses against the noticee, amongst his other observations and findings :

Sr. No.	Actions/omissions committed by the noticee	Violated provision of law/Regulations/Code of conduct/Circulars
1.	There was a short fall in the collection of margin and wrong reporting on the part of the noticee resulting into excess exposure of the noticee's trading members.	(i) Clauses A1, A2, A5 and C6 of the Code of Conduct for stock brokers specified in Schedule II of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992 ("Stock Brokers Regulations") read with regulation 7 thereof. (ii) Clauses 1, 2 and 5 of the Model Clearing Member-Trading Member Agreement specified by SEBI vide Circular No. FITTC/DC/CIR-3468/98 dated December 03, 1998 and NSCCL Circular No. NSCC/F&O/C&S/132 dated October 08, 2002 and NSCC/F&O/C&S/200/2003 dated June 17, 2003.
2.	The noticee had accepted collaterals in non-permissible forms.	(i) Clause A2 and A5 of the Code of Conduct for stock brokers specified in Schedule II of the Stock Brokers Regulations read with regulation 7 thereof. (ii) NSE Circular No. NSE/INSP/2008/65 dated February 28, 2008 (iii) NSCCL Circular No. NSCC/F&O/C&S/78

		dated November 08, 2001 and (iv) NSCCL Circular No. NSCC/F&O/C&S/65 4 dated February 09, 2007
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5. The DA had recommended that the noticee may be prohibited, in terms of regulation 27 of the Intermediaries Regulations, from taking up any new assignment or contract or launch a new scheme for a period of 15 days. As the alleged violations were considered to be serious in nature, SEBI issued a show cause notice dated April 16, 2012 ("SCN") which enclosed a copy of the Report of the DA, directing the noticee to show cause as to why higher penalty should not be imposed against it as specified in regulation 27(i) to (v) of the SEBI (Intermediaries) Regulations, 2008. The SCN *inter alia* alleged that :

- (i) The noticee had collected margins in non-permissible forms from its trading members including SSL, GYF and NSB (*details of margins collected in non-permissible forms from such trading members were mentioned therein*) ;
- (ii) The collection of margin in non-permissible forms had resulted in short collection of margin from these trading members and had also resulted in wrong reporting of margins (*summary of such instances of margin short collection and wrong reporting were mentioned therein*) ;
- (iii) The short collection of margin and wrong reporting by the noticee was observed in 18 instances out of 186 instances examined during December 2008 to November 2009. The value of wrong reporting was ₹6.38 crores against the margin requirement of ₹294.19 crores on the above instances. The percentage of wrong reporting to margin requirement was 2.17%.
- (iv) The shortfall in the collection of required margins from trading members indicates that the same was funded by SMC Global to maintain the margin obligations of those trading members with NSE.
- (v) It is apparent that SMC Global failed to collect the requisite margin from its trading members and this had allowed them to take additional positions and risk in F & O segment. The position taken by SSL and GYF without payment of adequate margin had resulted in heavy losses when market moved adversely and thereby resulted in defaults in fulfilling their obligations. SSL and GYF were declared defaulters and expelled from

the members of stock exchange/s. The defaults of these trading members also resulted in various investor complaints / claims for non receipt of funds and securities.

6. The noticee vide letter dated May 14, 2012 raised certain preliminary issues stating that the same have a bearing on the disposal of the SCN and requested SEBI to keep the proceedings in abeyance until necessary rulings are made on those preliminary issues. The preliminary issues raised by the noticee are dealt with in subsequent paragraphs of this order.

7. SEBI vide its letter dated May 18, 2012 advised the noticee to submit its reply on merits. Thereafter, the noticee vide letter June 22, 2012, while reiterating the preliminary issues had sought for a personal hearing. The personal hearing was scheduled on October 04, 2012 and the same was informed to the noticee along with an advice to submit its reply. Pursuant to the requests of the noticee for rescheduling the hearings fixed on October 04, 2012 and thereafter on November 09, 2012, the personal hearing was scheduled on December 07, 2012.

8. In the personal hearing held on December 7, 2012, Mr. P.N.Modi, Senior Advocate represented the noticee. Mr. S.C.Aggarwal, Chairman and Managing Director of the noticee and Mr. Anurag Bansal, Whole Time Director of the noticee were also present. During the hearing, the reply dated December 07, 2012 was filed and the learned senior counsel reiterated the submissions of the noticee made in the above reply. As one of the charges against the noticee was that it had collected margins in non-permissible modes including immovable property transactions with the trading members, GYF, SSL etc. towards margin, it was advised to file specific submissions with respect to the same. The noticee vide letter dated January 22, 2013 made its submissions with respect to its immovable property transactions referred to in the SCN and the Report of DA. In the hearing continued on January 29, 2013, Mr. Pesi Modi, Senior Advocate, referred to the letter dated January 22, 2013 of the noticee and reiterated the submissions made therein. During the hearing, the noticee was advised to submit copy of the bank guarantee taken towards margin. The same was provided subsequently vide the noticee's letter dated January 31, 2013.

9. I have considered the findings in the Report of the DA, the charges levelled in the SCN, the replies/submissions and the documents submitted by the noticee and other material available on record. Before proceeding to give my findings and observations on the charges levelled against the noticee, I would deal with the preliminary issues raised by the noticee. The noticee has raised the following issues :-

- i) Can the Designated Member ("DM") consider material outside the Report of the DA under regulation 28 of the Intermediaries Regulations for the purpose of issuing SCN?
- ii) Can the SCN issued under regulation 28 enclose any material other than the report of the DA and rely on the same to make allegations?
- iii) Can the SCN make allegations that are contrary to the findings of the DA?
- iv) Can the SCN make allegations that are not the findings of the DA?
- v) Can the DM substitute the findings of the DA by his opinion?
- vi) Can the DM traverse beyond the Report of the DA?
- vii) Can the SEBI Inspection Team include officers of the NSE which had conducted inspection of the noticee in the same matter?
- viii) Is the inspection made by a team without a DGM valid for enforcement actions under the Intermediaries Regulations read with delegation under section 19 of the SEBI Act ?
- ix) Are the secondary findings/opinion of the inspection team valid for enforcement actions?
- x) Whether the serious irregularities as pointed out above would vitiate the report of the DA?
- xi) Whether the proceeding under regulation 28 of the Intermediaries Regulations against the noticee for the same acts and violations of the same laws which have already been adjudicated by the exchange and appropriate penalties have been levied, amount to double jeopardy?
- xii) Whether SEBI is empowered to initiate any enforcement action for default in margin collection in view of its Circular dated August 10, 2011 and various circulars of the exchange which provide a comprehensive framework to deal with default in margin collection and do not envisage SEBI to take any action for such defaults?
- xiii) Whether SEBI is empowered to treat different entities differently for the same act and for the violation of the same law?
- xiv) Whether different kinds of enforcement actions are legally permissible for violation of the same provision of law by different persons?
- xv) Whether the DM can impose a higher penalty than what is recommended by the DA?
- xvi) Whether the DM can impose a penalty even though the SCN does not allege violation of any law?

10. The aforesaid preliminary issues/questions raised by the noticee are being answered herein below. On being notified about the default of SSL and GYF with respect to their

obligations, and in view of the investor complaints alleging that the noticee had provided higher exposure to SSL without collecting adequate margins, concerns were raised with respect to the clearing operations and the risk management of the noticee (*which was the clearing member for the trades of SSL and GYF*). In the examination conducted by the NSE, violations relating to wrong reporting of margin and non-collection of dues from trading members on time were observed. The DAC of NSE had imposed penalty on the noticee. Further, in view of the seriousness of the lapses committed by the noticee led SEBI to conduct an inspection of the records of the noticee. I have perused the SEBI's order for inspection dated November 11, 2009. As per the said order, "*The inspection of books of accounts, other records and documents of M/s SMC Global Securities Ltd. shall be carried out by inspecting authorities, to verify that the provisions of Securities and Exchange Board of India Act, 1992; Securities Contracts (Regulations) Act, 1956; Depositories Act, 1996 and rules; regulations, guidelines/circulars issued from time to time are complied with.*" It was also directed that the inspecting authority shall be entitled to do all such acts, deeds as necessary for undertaking the inspection, as permitted under regulations 19 and 20 of the Stock Brokers Regulations and regulations 59 and 60 of the SEBI (Depositories and Participants) Regulations, 1996 ("DP Regulations") and submit a report as required under regulation 22 of the Stock Brokers Regulations and regulation 62 of the DP Regulations. This order does not state anywhere that the same was for ascertaining *whether the noticee was still continuing with the practice of wrong reporting of margin to the exchange and providing higher exposure to its trading members.*

11. I also note that vide letter dated November 25, 2009 SEBI informed the noticee that an inspection of its books of accounts, records and other documents pertaining to its stock broking/clearing member registrations, would be undertaken *inter alia* to verify *whether the books of accounts, records and other documents are being maintained in the manner specified by the provisions of Securities Contracts (Regulation) Act, 1956, Securities and Exchange Board of India Act, 1992, the rules, regulations and circulars made thereunder.* Further, the letter did not state that the inspection was for the purposes of ascertaining whether the noticee was still continuing with the practice of wrong reporting of margin to the exchange and providing higher exposure to its trading members. The aforesaid letter, through its questionnaire, had sought data from December 01, 2008 till November 24, 2009, as the data pertaining to previous period was already available with SEBI. Though the inspection report has, under the title "Scope" (*paragraph 5 at page 5 of the inspection report*), stated that the same was for the purposes of ascertaining whether the noticee was still continuing with the practice of wrong reporting of margin to the exchange and providing higher

exposure to its trading members, I am of the view that it cannot be concluded that the inspection was only for that very purpose.

12. I have perused the Inspection Report and note that the findings of the NSE and that of the independent auditor (*appointed by the NSE*) were part of the said Inspection Report. I have also perused the Order of SEBI dated September 02, 2010 which communicated the initiation of proceedings under the Intermediaries Regulations and appointment of the DA for conducting the proceeding against the noticee. This order had recorded the allegations levelled against the noticee. I also note that the proceedings of NSE against the noticee were under its bye-laws and the instant proceeding of SEBI is under the Intermediaries Regulations. Therefore, it cannot be said that the noticee was subjected to double jeopardy as the proceedings by NSE and SEBI could be taken simultaneously and that NSE's proceeding cannot foreclose SEBI from initiating action. The inspection report contained the findings of NSE and the independent auditor as its annexures including the findings with respect to margin collection by the noticee for the period December 2008 to November 2009. Therefore, it can be construed that the lapses of the noticee for the period of NSE inspection was part of the findings of alleged violations against the noticee.

13. I also note that in terms of the Stock Brokers Regulations, the registration granted by SEBI to a stock broker is *inter alia* subject to the condition that such stock broker shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to it. Hence the argument that violation of exchange circular is not a violation of SEBI Regulation is not maintainable as any violation of a regulation or a circular issued by stock exchanges would be a violation of the code of conduct prescribed for stock brokers under the Stock Brokers Regulations.

14. Under the scheme of regulation 28 of the Intermediaries Regulations, on receipt of the report recommending action/penalty from the DA, the DM shall consider the same and issue a SCN enclosing the Report of the DA, calling upon the noticee to show cause as to why the action, including passing of appropriate direction as the DM considers appropriate, should not be taken. It is noted that the statements/allegations in the SCN and the material placed therein were already part of the record as they were elicited only from the inspection report to which the noticee was a necessary party. The inspection report was forwarded vide SEBI letter dated March 23, 2010 which was also referred in the pre-enquiry SCN dated October 06, 2010 by the DA. Therefore, it cannot be said that the said material is outside the Report of the DA for the

purpose of issuing the SCN. The statements/allegations in the SCN are not contrary to the findings of the DA and in fact have been placed to show the allegedly serious or grave nature of the violations committed by the noticee. Therefore, in my opinion, the same do not in any way become contrary or against the provisions of regulation 28.

15. As regards the presence of NSE officers in the SEBI Inspection Team, I refer to the provisions of regulation 19(1) of the Stock Brokers Regulations which provide that SEBI may appoint *one or more persons as inspecting authority* to undertake inspection of the books of account, other records and documents of the stock brokers. Therefore, SEBI can appoint SEBI officers or other competent persons for the purpose of inspecting the books and records of a stock broker. I also note that necessary approvals had been obtained for inclusion of NSE officers in the inspection team. Therefore, the presence of NSE officers in the Inspection Team does not in any way prejudice the interest of the noticee in any manner and I find this contention to be of no merit. I also note that the Order directing inspection had clearly mentioned that the inspection would be conducted by SEBI Officers under the supervision of the Division Chief (*who is an officer of SEBI not below the rank of Deputy General Manager*) of the concerned department/division in SEBI and who would be collectively referred to as Inspecting Authority. I note that the inspection was done under the supervision of the Division Chief. It is also noted that the inspection was done in accordance with the Order. Therefore, the issue raised by the noticee in this regard is misplaced.

16. With respect to the preliminary issue "*whether the DM can impose higher penalty than what is recommended by the DA*", I refer to the provisions of regulation 28(1) of the Intermediaries Regulations. The said provision contemplates *the action including passing of appropriate direction as the DM considers appropriate*. Therefore, the DM need not necessarily follow the recommended penalty but may enhance or reduce the penalty depending upon the facts, violations and the circumstances of the case. However, in a given case if the DM is of the view that the recommended penalty is not commensurate with the violations, a higher penalty may be imposed after requiring the entity concerned to show cause why the contemplated higher penalty should not be issued. Therefore, in view of the same, the DM is empowered to impose higher penalty than that recommended by the DA if the case warrants.

17. I now proceed to consider the charges levelled against the noticee. The findings / observations of the DA in his Report have been summarised below for convenience :

- (i) The DA has observed that there was a short fall in the collection of margin and wrong reporting on the part of the noticee resulting into excess exposure to the noticee's trading members. However, according to the DA, how much was the shortfall, wrong reporting and excess exposure cannot exactly be quantified. It has also been mentioned in the Report that the percentage of wrong reporting of total margin required was 2.17% and that the noticee has referred to a circular of NSE that stipulates warning for factual wrong reporting of margin collection from constituents to total margin reported is up to 5%.
- (ii) The DA has observed that the noticee has accepted collaterals other than permissible forms and that according to the noticee, it was not a practice rather it was in exceptional circumstances due to extraordinary market behaviour in 2008. The DA has not accepted the submission of the noticee in that regard and observed that the rules, regulations, guidelines on accepting collaterals and the permissible forms are very clear and any deviation from the same by the noticee need to be considered as a violation.
- (iii) The DA was convinced with the submissions of the noticee with respect to the allegation that the noticee failed to follow the policy of compulsory square-off of the positions of the trading members widening the gap between the margin and the exposure resulting in ultimate default.
- (iv) As regards the allegation that the noticee had considered the same securities for more than one trading member, the DA has observed that the error (*after the same was pointed out by the SEBI inspection team*) was rectified by the noticee by scrutinising and submitting revised data. The DA has also observed that unintentional error on the part of the noticee should not be considered as submission of wrong information / data and treated severely.
- (v) With respect to the allegation that the noticee was involved in fund based activities, the DA has observed that the delayed payment charges were charged by the noticee only as disincentive against delay in the payments by the trading member.

18. Before proceeding further, I note the following general submissions of the noticee :

- a. The noticee as a duly registered clearing member of the NSE, was at the relevant time carrying out clearing and settlement obligations of 36 trading members.
- b. The year 2008 was an extra-ordinary period for unprecedented recessions and liquidity crisis culminating into numerous bankruptcies and defaults in the financial sector. There was also huge volatility in the stock market and at times trading was halted due to trading touching the

lowest circuit filters in the stock exchanges. Stock Exchanges were constrained to substantially increase margins five to six times during trading hours and on some trading days in January and October, there was a huge crash in the market.

- c. Numerous complaints and arbitrations were filed with stock exchanges and SEBI by parties who had lost money in the process, because of their exposure in the market and the sharp fall in the value of their investments.
- d. It was during this period that 2 out of the 36 trading members for whom the noticee was the clearing member in respect of their F & O trading in the NSE, viz., Sunchan Securities Limited ("SSL") and Ganga Yamuna Finvest Limited ("GYF") defaulted in fulfilling their obligations and were subsequently declared defaulters and expelled from the membership of the stock exchanges.
- e. Although the 2 trading members had defaulted, the noticee as their clearing member was forced to make necessary payments in respect of their transactions so as to ensure that the noticee was not declared a defaulter.
- f. Being fully aware that the entire financial burden of clearing and settlement of the trading members' obligation would fall on it, the noticee made every effort to recover its dues from the trading members and to minimise the losses suffered. Although the noticee did not permit them to take further open positions in the market, liability for their existing open positions increased substantially. The trading members faced financial difficulties since the margin requirement shot up dramatically whereas the value of the collateral security fell drastically. The noticee was even constrained to have some of their open positions squared off by the NSE.
- g. The noticee did everything in its power to try and prevent the trading members from becoming defaulters and therefore endeavoured to collect whatever security it could from them.
- h. The noticee collected whatever form of securities it could from its trading members, including shares/securities they could offer, post-date/undated cheques etc. The noticee also purchased their immovable properties and the purchase price payable by it was adjusted/credited against their liabilities/margin obligations to it.
- i. Despite every effort, the trading members could not revive their financial position and therefore the noticee was constrained to have their open position squared off or to allow the same to expire without allowing any roll over. Huge losses were sustained, which it had to bear and pay.
- j. The noticee commenced arbitration proceedings against SSL, GYF and awards were passed in its favour, which the noticee is seeking to enforce but not able to recover any further amounts.
- k. During December 2008, NSE undertook an inspection of the records of the noticee for the period January 2008 to November 2008. The findings of the said inspection culminated in an order dated September 24, 2009 passed by the Disciplinary Action Committee (DAC),

NSE, whereby a penalty of Rs.25,00,000/- was imposed and the noticee was directed to deposit a further sum of Rs.25,00,000/- for a period of six months with a direction that the same would be refunded to it after certification from an auditor that it had improved compliance of reporting correct margins. In respect of the allegation of funding the trading members by not collecting debit balances and margins, a fine of Rs.20,000/- was imposed on it. The noticee duly paid the penalty and the deposit as ordered in order to buy peace and to avoid protracted litigation.

- l. NSE had also inspected its records and performance for the years 2009-2010 and 2010-2011 and concluded that the respective short collection/wrong reporting was a miniscule 0.003% and 0.005% respectively.
- m. By an order dated November 11, 2009, SEBI ordered a special purpose inspection of the noticee to ascertain whether the noticee is still continuing with the practise of wrong reporting of margin to the exchange and providing higher exposure to its trading members. Pursuant to the same, SEBI forwarded a questionnaire that expressly stated that the inspection period was from December 01, 2008 till November 24, 2009. Thereafter a show cause notice dated October 06, 2010 was issued by the Designated Authority (DA). The said SCN did not contain any factual allegations but relied on the Inspection Report and alleged that it had accepted collaterals in non-permissible forms; not collected required margins ; wrongly reported margins collected to the exchange ; provided excess exposure to the trading members ; failed to compulsorily square-off the trading members positions resulting in their default ; and funded the trading members.
- n. Thereafter, a post-enquiry SCN was issued which contained additional allegations over and above the Report of the DA. All the allegations therein except the allegation in paragraph 5 related only to the period prior to the inspection period i.e., the same allegations pertaining to the period which had been dealt with by NSE and the NSE DAC Order.

19. With respect to the allegations in paragraph 3 of the SCN (*that the noticee had collected the required margin in non-permissible forms from its trading members including SSL, GYF and Nikunj Stock Brokers Limited ("NSB") in respect of their dealings in the F&O Segment which resulted in shortfall in the margin collection and consequent wrong reporting of collected margin to NSE*), the noticee had *inter alia* submitted that -

- (i) the allegation that it collected margin in non-permissible forms from SSL, GYF and NSB relates to the period prior to the inspection period. The inspection period was 01.12.2008 to 24.11.2009 and the said allegation refers to a period prior to 01.12.2008.
- (ii) During the inspection period, there was no allegation of collection of margin in non-permissible forms nor is the same alleged in the SCN or in the Report of the DA.

- (iii) The inspection was to ascertain whether the noticee is still continuing with the practice of wrong reporting of margin to the exchange and providing higher exposure to its trading members.

20. With respect to the allegations in paragraph 3(a) of the SCN (*that the noticee had collected FDRs amounting to ₹7.5 crore as against which it had reported to NSE that it has collected margin to the extent of ₹15 crores in the form of bank guarantee, thereby showing excess margin collection of ₹7.5 crores*), the noticee submitted that :

- (i) As per NSE's bye-law 20 in Chapter IX, margin can be collected in the form of Bank Guarantee ("BG").
- (ii) It had a facility with its bankers, *inter alia* by which BGs were issued in favour of the NSE against a 50% margin which was to be furnished to the bank in the form of cash/FDRs. SSL had furnished FDRs amounting to ₹7.5 crores which were allocated to the Bank. The equivalent BG allocation in their favour was therefore ₹15 crores.
- (iii) Therefore it is incorrect to conclude that it wrongly reported the available margin as including ₹15 crore in the form of a BG.

21. With respect to the allegations in paragraphs 3(b) and (d) of the SCN (*which mentioned that the noticee had taken undated cheques as collaterals from SSL and GYF*), the noticee *inter alia* stated the following :

- (i) At the relevant time there was great turmoil in the market and therefore the noticee was collecting whatever the nature of payments or securities which it could get from the respective trading members.
- (ii) The trading members (TMs) had therefore given the noticee undated and post-dated cheque with the clear understanding that the noticee was entitled to deposit the same from time to time to cover the margin obligations.
- (iii) The cheques were in fact deposited by the noticee from time to time. Some of them cleared immediately, some cleared shortly thereafter and few of them were dishonoured on presentation. In respect of the cheques which were dishonoured, the noticee had immediately stopped treating the amount as available margin once they were dishonoured and had also commenced criminal proceedings against the concerned party under the provisions of section 138 of the Negotiable Instruments Act.
- (iv) When cheques were given to it, it was obligated to treat the same as available margins and it is only when the same were dishonoured that the same could no longer be treated as available margins.

22. With respect to the allegations in paragraph 3(c) of the SCN (*which mentioned that the noticee had treated immovable property documents as margin collected in case of GYF*), the noticee *inter alia* stated the following :

- (i) Submissions of the noticee with respect to the claimed purchase of property from GYF situated at *Office No.205, 2nd Floor, 21st Century Plaza, Community Centre, Sector-8, Robini, Delhi-110085 along with furniture, fittings, fixtures and electronic equipments as installed at the premises:*
 - a. The Indian Stock Markets crashed continuously for 3 days – 18th, 21st and 22nd of January 2008. GYF suffered substantial MTM losses. Though the said trading member made some payments, it was not able to make good the complete shortfall.
 - b. Mr. Jagdish Chand Gupta, the CMD of GYF assured full payment and requested for time. He gave copies of title documents of the aforesaid office premises belonging to his wife-Smt. Saraswati Gupta and offered to sell the same to it along with the extensive furniture fittings and equipment therein.
 - c. While continuously following up with GYF, the noticee also sent its representative to evaluate the property. The noticee negotiated with the trading member who initially was reluctant to sell the property for the price offered by the noticee but agreed to do so during May 2008.
 - d. The noticee was buying the same as a means to recover the payments due from the said trading member and because of the then prevailing circumstances. Since the property was owned by the wife of GYF's CMD, the noticee had to pay the consideration to Smt. Sarawati Gupta who paid the same to GYF and GYF in turn paid back the same towards its outstanding dues to the noticee.
 - e. The agreement for sale of the said premises for ₹30 lakhs was duly executed on May 16, 2008 between the parties. Possession was also handed over to the noticee on the same day.
 - f. The said document was stamped and registered with the Sub-Registrar VI at Delhi. The noticee paid the consideration amount of ₹30 lakhs to Smt. Saraswati Gupta on May 22, 2008 and on the same date received payment of the equal amount from the trading member into the noticee's bank account.
 - g. The consideration was accounted in the trading member's account only after the payment was received and credited into the noticee's bank account.

- h. As per the negotiated price, GYF also issued a separate bill dated June 12, 2008 for Rs.78 lakhs to the noticee for sale of furniture and fittings installed in the premises.
 - i. The said Rs.78 lakhs was also credited to the ledger account of GYF on June 12, 2008.
 - j. There was also a terrace attached to the said premises. Since the market crashed heavily during October 2008, the trading member again suffered losses and the noticee was relentlessly demanding payments from it. Mr. Jagdish Chand Gupta then offered to sell the terrace and price was negotiated at Rs.13.51 lakhs. An agreement was executed on November 28, 2008 and duly registered. The payment was made to Smt. Saraswati Gupta and in turn the noticee received a payment of Rs.13.50 lakhs on November 28, 2008. The noticee did not consider the said amount available for the trading before November 28, 2008.
 - k. The said premises was erroneously sealed by the official liquidator in a petition filed against the trading member. The noticee has filed a petition for its release.
- (ii) Submissions of the noticee with respect to the claimed purchase of property from GYF situated at *Pent House No. 5116, 11th Floor, parker Residency, Village Rasoli, District Sonapat, Haryana* :
- a. The CMD of GYF approached the noticee with an offer to sell an under construction property belonging to him. The noticee evaluated the same and a deed for *Transfer of Flat Under Construction* was duly entered and signed by all parties.
 - b. Mr. Jagdish Gupta had availed loan from ICICI Bank for purchasing the said property.
 - c. Pursuant thereto, an Agreement dated November 06, 2008 was duly executed between the said Mr. Jagdish Chand Gupta and the noticee. Though the balance consideration of about ₹51.76 lacs was credited to the account of GYF on or about May 25, 2009, GYF was entitled to the consideration w.e.f. November 06, 2008.
 - d. The construction of the premises was completed and the builder handed over possession to the noticee on October 04, 2012.

23. With respect to the allegations in paragraph 3(e) of the SCN (*which mentioned that the noticee had treated immovable property documents as margin in case of NSB*), the noticee *inter alia* stated the following :

- (i) Due to exigencies of the crashing market on 18th, 21st and 22nd January 2008, NSB incurred MTM losses and was not able to fully pay for the same.
- (ii) NSB was the owner of the entire second floor of building no. 5, Block B/N, Local Shopping Centre, Shalimar Bagh, New Delhi 110088, admeasuring about 135 sq. mts. To meet its obligations, NSB had been trying to sell the premises but could not find a suitable buyer with ready funds. Although NSB contended that the market value of the said property was much more than ₹2 crores, it agreed to sell the same to the noticee for the price of ₹2 crores, on the condition that if within 18 months it could find a buyer at a higher price the noticee would agree to re-transfer the property upon the full payment of ₹2 crores to it. Pursuant thereto, the noticee entered into and executed an agreement on 24.01.2008 with NSB. The said Agreement expressly stipulates that the said property stands transferred and assigned to the noticee for the price of ₹2 crores, however NSB would be entitled to revoke the sale for a period of 18 months, only upon the payment of full ₹2 crores to it. The said agreement also records that NSB had handed over physical possession of the property to the noticee and that the sale consideration of ₹2 crores would not be paid to them, but would instead be adjusted by crediting the amount towards their liabilities to the noticee.
- (iii) NSB thereafter kept paying the noticee in tranches and by June 2009, they had paid the fullsum of Rs.2 crores. The trading member therefore exercised the option to revoke the agreement.
- (iv) NSB was entitled to the said credit of Rs.2 crores from the date of agreement i.e., on January 24, 2008. Therefore, it had submitted to the inspection team that the credit for the sale consideration of Rs.2 crore be considered as being available margin w.e.f. January 24, 2008.

24. With respect paragraph 4 of the SCN (*which alleged that the noticee had collected margins in non-permissible forms which resulted in short collection and wrong reporting and had given a summary of such instances*), the noticee had *inter alia* submitted that :

- (i) Initial margins as prescribed by the Exchange has to be collected on an upfront basis without which the client/TM cannot be allowed to purchase the open position. Margins are recalculated by the stock exchange 6 times a day. The MTM on the other hand is a

settlement obligation and has nothing to do with the margins. The MTM is calculated by the Exchange on the end of day position and constitutes profit /loss booked on the open position. The same is received/paid as a part of the settlement process on a T+1 basis by the client /TM.

- (ii) Even the circulars of NSE and NSCCL have also distinguished between MTM and margins. Even NSCCL circular dated September 10, 2009 bearing reference download no. NSCCL/F&O/13061 deals with MTM under "item 4" whereas it deals with margins under "item 9".
- (iii) There was no requirement to deduct the MTM from the margin collected. Margins were separately accounted for and maintained and the TM was separately called upon to meet the MTM obligation if and when the same arose.
- (iv) The NSE auditors had also verified the payments/details from our bank statements as aforesaid. As aforesaid, receiving margin payments by cheques cannot be alleged to be "non permissible form", and the same is expressly permitted.
- (v) Column O of the annexures relates to BG taken against FDRs and the full value of the BG was in favour of NSE/NSCCL and was therefore available as margin.
- (vi) Column O is captioned as "value of immovable properties". The noticee had purchased the immovable properties and the sale consideration was credited to the accounts of the respective TMs as available margin. The same amounts to cash payment, which is a permissible form of margin and therefore the same ought to have been accounted as available margin.
- (vii) With reference to column Q in annexure C relating to GYF, the noticee had purchased the premises and the payment of ₹30,00,000/- was duly credited to the ledger account of GYF.
- (viii) The cumulative effect of all the aforesaid submissions is that the particulars alleged in annexures B, C and D are incorrect and therefore the allegations against the noticee are incorrect. If the said annexures are corrected, then the net result would be as per the computations/tables annexed to the reply and the same would prove that there has been no short collections or wrong reporting of margins by the noticee at all in the case of GYF and NSB.
- (ix) In the case of SSL in column N of annexure B to the SCN the amount of ₹ 9 crore in respect of the cheques which had been given by SSL to the noticee is shown as being with effect from October 21, 2008. The noticee had received the said cheques on October 7, 2008 as *inter alia* stated at page 5 of NSE's Arbitration Award dated May 25,

2010 which was in its favour and against SSL. Therefore, after adjusting for the aforesaid discrepancy, only on a few days there was short collection i.e., on 8 days as compared to the 54 days as alleged in the SCN. Further the percentage thereof was only 1.62%.

- (x) The aforesaid short collection in the case of SSL on few days is on account of default by SSL and the noticee cannot be blamed for the same. In margin calculations, some discrepancies are bound to occur due to varying understanding of the method of valuation and computation. NSE vide its circular dated February 15, 2010 clearly provides that if the percentage of factual wrong reporting of margin collection to the total margin reported as collected is upto 5%, the penalty would only be warning. It is therefore submitted that even the aforesaid small discrepancy of 1.62% in the case of SSL cannot be considered as a grave or serious violation inviting any severe penalty as alleged in the SCN.

25. With respect to paragraph 5 of the SCN (*which stated that the short collection and wrong reporting of margin by the noticee was observed in 18 instances out of 186 instances examined during December 2008 to November 2009 and that the percentage of wrong reporting to margin requirement was 2.17%*), the noticee submitted as follows :

- (i) The aforesaid discrepancy of 2.17% as alleged cannot be considered as a grave or serious violation inviting any severe penalty as alleged in the SCN. As regards, the alleged 18 instances of wrong reporting of the margin requirements to the extent of 2.17%, it submitted that it had vide letters dated April 19, 2010, November 25, 2010 and May 9, 2011 pointed out that the allegations are factually incorrect.
- (ii) Huge volumes of data had been collected from the noticee by the SEBI inspection team and such data was demanded on an urgent basis. In the course of furnishing such data on an urgent basis, a "cut paste error" had occurred. The noticee had immediately rectified the same and furnished the correct data together with supporting documents and the relevant evidence. However, the inspection team failed to consider the same.
- (iii) The correct data showed that there would be no allegation of short collection of margins at least in 13 out of the 18 instances. The remaining 5 instances amounted to only 0.31%. As regards the said balance 5 instances of alleged shortfall/wrong reporting which amounted to only 0.31%, in 4 out of the 5 instances there was in fact no short fall. Two of such instances relate to NSB for the dates - December 16, 2008 and January 5, 2009. However, while calculating the alleged shortfall, the noticee's submission that

an additional credit of ₹68,80,190/- should be considered in their account, had been ignored. NSB owed the noticee a huge amount. NSB was facing financial difficulties and was unable to pay. On January 21, 2008 and January 22, 2008, the market had crashed and trading was even suspended for one hour. The noticee was therefore constrained to have some of their open position squared off through the NSE on January 22, 2008. A substantial loss was thereby booked out of which NSB disputed a liability of about Rs. 70,00,000. The noticee had negotiated a settlement with NSB by which the noticee agreed to give up and forego its claim to the extent to Rs. 68,80,190 on the condition that NSB would sell their property on the second floor of building no. 5 block B/N local shopping centre, Shalimar Baug, Delhi for a sum of ₹2 crore as aforesaid. Consequently NSB was entitled to get the credit of the said sum of ₹68,80,190 in its account with effect from January 22, 2008 and if the same was considered there was no shortfall at all on December 16, 2008 and January 5, 2009 since the shortfall alleged was only ₹5 to 6 lacs.

- (iv) Margin collection and calculation was independent of the MTM liability and the MTM was not required to be deducted from the available margin. Ex facie the entire dispute in respect of the said Rs. 70 lac was in relation to the settlement loss caused by the squaring off as aforesaid.
- (v) Two of such instances relate to GYF for the dates December 16, 2008 and December 17, 2008. However, while calculating the alleged shortfall, an additional credit of ₹51,76,591/- which should have been considered in their account, had been incorrectly rejected.
- (vi) Mr. Jagdish Chand Gupta, MD of GYF had entered into an agreement with a builder named "Parker Estate Developers Pvt Ltd" to purchase a flat/penthouse numbered 5116 at 11th floor (Block No. 5) in village Rasoli, District-Sonepat, Haryana. He had financed the said purchase agreement inter-alia by taking a loan from ICICI Bank. The said building was under construction at the relevant time. He offered to sell the said flat to the noticee and agreed that instead of paying him the sale consideration, the noticee should credit the sale consideration directly towards his margin obligations and /or towards his margin obligations and /or towards the other liabilities to the noticee, subject only to the condition that the bank loan be repaid, so that ICICI Bank would not object to the transfer and the sale of the flat to the noticee.
- (vii) Pursuant thereto, an agreement dated November 6, 2008 was duly executed between the said Mr. Jagdish Chand Gupta and the noticee. After paying off the bank loan, the

balance consideration of about Rs. 51.76 lacs was credited to the account of GYF by the noticee on or about May 25, 2009, however, they were correctly entitled to this credit with effect from November 6, 2008, being the date on which the said agreement was executed and the said property was sold to the noticee. If the said amount is considered as credited, then admittedly there was no shortfall, since the shortfall alleged on December 16, 2008 and December 17, 2008 was only about ₹48 lacs and ₹31 lacs.

- (viii) The only remaining allegation of short collection /wrong reporting was in respect of the TM – Bharat Rasayan Finance which was for the minuscule amount of Rs. 21,400 only as on January 28, 2009. This would amount to less than 0.00073%. The same is therefore negligible to even merit any action whatsoever.

26. I also note that the SCN in paragraph 6 had alleged that the *shortfall in the collection of required margins from trading members indicates that the same was funded by the noticee to maintain the margin obligations of those trading members with NSE*). With respect to this allegation, the noticee has *inter alia* submitted as follows :

- (i) The allegation of funding was in view of the fact that the noticee had charged Delayed Payment Charges (DPC).
- (ii) The said charges was levied only as a deterrent to avoid delayed payment and to ensure timely payments.
- (iii) SEBI vide circular dated May 07, 1997 expressly stipulated that borrowing or lending of funds in connection with or incidental to or consequential upon the securities business would not be disqualified under rule 8(1)(f) or 8(3)(f) of the SCRR. Since the charges that were levied was clearly in connection with or incidental to or consequential upon the securities business it could not be alleged that the same amounted to funding or any other violation. The SCN has not rejected any findings in the report of the DA nor does the SCN contain any reasons for deviating from the same.
- (iv) While denying that it funded any such margin requirement, the noticee submitted that if it had funded the same, then the margin was made available to NSE and it cannot be alleged that it wrongly reported the availability of the entire margins that were required.

27. With respect to paragraph 7 of the SCN (*which stated that the noticee failed to collect the requisite margin from its trading members and this had allowed them to take additional positions and risk in the F&O segment. The position taken by SSL and GYF without payment of adequate margin had resulted in heavy losses when market moved adversely and thereby resulted in defaults in fulfilling their obligations. SSL and*

GYF were declared defaulter and expelled from membership of stock exchanges. The defaults of these trading members also resulted into various investor complaints/claims for non-receipt of funds and securities), the noticee inter alia submits as follows :

- (i) The noticee never allowed the TMs to purchase any additional open positions without making available the initial margin required for the same.
- (ii) It is denied that SSL or GYF suffered heavy losses when the market moved adversely because the noticee had allowed them to take open positions without collection of adequate margin as falsely alleged. The heavy losses were suffered because of the adverse movement in the market and not because of any alleged shortfall in margins. The heavy losses would have been suffered irrespective of the quantum of the margin collected. The noticee had met and paid all their liabilities to the NSE without any default, thereby safeguarding the market at its cost.
- (iii) The noticee was not responsible for SSL and GYF being declared as defaulters and expulsion from the stock exchange. The reason of their default was because of their own inability to bear and pay their liabilities. It was their obligation to collect the requisite payments from their clients and pay us for the same. Their clients failed to pay them and therefore they failed to pay us. Therefore their clients can have no legitimate grounds for any complaints or claims as alleged in the SCN or otherwise.
- (iv) SSL had alleged that the noticee should have given greater exposure limits to it and that the noticee should not have squared off their positions etc., which are all diametrically opposite to the allegations in the SCN.

28. I have considered the submissions of the noticee. The charge against the noticee is that it had wrongly reported collection of margins and had collected margins in non-permissible forms from the concerned trading members which resulted in short collection. As the allegation against the noticee is with regard to the margin collection, it would be pertinent to note the important circulars of NSE/NSCCL that deal with the same.

29. I note that various circulars issued by NSCCL viz., NSCCL circular no. NSCC/F&O/C&S/78 dated November 8, 2001, NSCCL circular no. NSCC/F&O/C&S/132 dated October 8, 2002, NSCC/F&O/C&S/200/2003 dated June 17, 2003, NSCCL circular no. NSCC/F&O/C&S/654 dated February 9, 2007 and NSE Circular no. NSE/INSP/2008/65 dated February 28, 2008 have clearly specified the mode of payment and collection of margin by clearing members/trading members from their respective trading members/constituents and its reporting to the clearing corporation. The above circulars were issued pursuant to SEBI Circular

No. IES/DC/CIR-4/99 dated July 28, 1999, Circular No. IES/DC/CIR-5/00 dated December 11, 2000, Circular No. SMD/DC/Cir-10/01 dated June 20, 2001 and Circular No. SMDRP/DC/CIR-10/01 dated November 02, 2001 wherein the risk containment measures for Exchange Traded Index Futures, Index Option, Stock Option and stock futures Contracts were laid down.

30. NSCCL Circular no. NSCC/F&O/C&S/78 dated November 8, 2001 and NSCCL Circular no. NSCC/F&O/C&S/200/2003 dated June 17, 2003 and NSCCL circular no. NSCC/F&O/C&S/654 dated February 9, 2007 have specified that initial margins shall be payable upfront by clearing member. The modes of payment of initial margin as specified therein are :-

- **Cash**
- **Bank Guarantee** issued by any one or more of approved commercial banks
- **Fixed Deposit Receipts (FDRs)** issued by any one or more of the approved commercial banks
- **Deposit of approved securities** in Dematerialised form or such other collateral form, with a haircut, as may be specified by clearing corporation from time to time

31. NSCCL circular no. NSCC/F&O/C&S/132 dated October 8, 2002 has clearly specified that **clearing members/trading members are required to collect upfront margin from their respective trading members/constituents.** Further, NSE Circular no. NSE/INSP/2008/65 dated February 28, 2008 had clarified that clearing members and trading members are required to collect margins from trading members/constituents in the mode as stated in the NSCCL circular no. NSCC/F&O/C&S/78 dated November 8, 2001 and NSCCL circular no. NSCC/F&O/C&S/654 dated February 9, 2007 and report margin collection to NSCCL accordingly.

32. Keeping in mind the prescriptions of the above said circulars, I proceed to consider the charges. I note that, as regards the allegation that the noticee has accepted collaterals in forms other than the permitted forms, the DA has observed that the rules, regulations, guidelines on accepting collaterals and the permissible forms are very clear and any deviation from the same by the noticee need to be considered as a violation.

33. I refer to the earlier paragraph of this Order wherein I have observed that the scope of the inspection is not limited to the period as stated by the noticee. I further note that the

findings/observations of the NSE inspection and the independent auditor appointed by the NSE, are part of the SEBI Inspection report. The allegations that are levelled against the noticee in this proceeding arises out of such findings/observations. The inspection report contained its findings as mentioned in pages 11 and 12 thereof about the wrong reporting of margin by the noticee in respect of SSL, GYF and NSB (*the TMs for whom the noticee was the clearing member*) and, such TMs have defaulted in their obligations to NSE. The inspection report had also alleged that the noticee had accepted collaterals in non-permissible forms in violation of the code of conduct for stock brokers, NSE and NSCCL circulars. Hence, the same was made an allegation in the inspection report, the notice issued by the DA and also in the SCN. Incidentally, it is noted that both SSL and GYF who were trading members of the NSE, were expelled and the registration of SSL as a stock broker was also cancelled by SEBI vide Order dated December 08, 2010.

34. As regards SSL, the SCN has alleged that the noticee had collected FDRs amounting to ₹7.5 crore as against which it had reported to NSE that margins to the tune of ₹15 crores was collected in the form of Bank Guarantee ("BG"). The same indicates that the noticee had reported excess margin collection of ₹7.5 crores. I have considered the submissions of the noticee in this regard. I note that Bye-law 20 in Chapter IX of the NSE Bye Laws deals with "form of margin deposit". The said bye-law states that *"The margin to be furnished by a trading member under these Bye Laws and Regulations shall, inter alia, be in the form of cash or Deposit Receipt of or a Guarantee given by a Bank approved by the relevant authority or securities approved by it subject to such terms and conditions as it may from time to time impose....."*. A BG is thus a permissible form of furnishing margin deposit under the said bye-law of NSE. The noticee has submitted that it had an arrangement with its bankers and in pursuance thereof, for an FDR of ₹7.5 crore, it obtained BG for ₹15 crores. The noticee has submitted that it had obtained a legal opinion and that as per that opinion, BG issued to a clearing member in favour of NSE against funds in the form of FDRs provided by a trading member can fall under margin from the trading member to clearing member for the purposes of rules, bye-laws of the exchange. It is an admitted position that SSL had furnished FDRs for only ₹7.5 crore to the noticee towards margin. The noticee had in turn obtained BG for ₹15 crores from its banker and the same was shown as though the ₹15 crore BG was collected from SSL. Therefore, it becomes clear that the BG obtained by the noticee by leveraging the ₹7.5 crore FDR deposited by SSL was furnished by the noticee against margin for SSL and not furnished by the concerned trading member (SSL). In the process, it was the noticee who had received credit from a bank to meet the TMs margin

requirements. The NSE Circular no. NSE/INSP/2008/65 dated February 28, 2008, provides that clearing member and trading members are required to collect margins from trading members/constituents in the mode as stated in the NSCCL circular no. NSCC/F&O/C&S/78 dated November 8, 2001 and NSCCL circular no. NSCC/F&O/C&S/654 dated February 9, 2007 and report margin collection to NSCCL accordingly. Though FDRs and BG are permissible forms of margin collection, they are to be collected from the trading member or from a constituent, as the case may be. In the instant case, the noticee had collected ₹7.5 crores FDRs as margin from SSL but reported that margin has been collected to the tune of ₹15 crores in the form of BG to the clearing corporation. This mechanism is preposterous and the noticee's conduct shows an utter contempt for the rules laid down. It is again mentioned here that the BG was obtained by the clearing member i.e. the noticee and was not furnished by the trading member i.e., SSL, as required under the relevant norms. The same proves that the noticee was unduly supporting and accommodating the trading member, i.e., SSL, thereby risking the entire system. Such practices are against the risk containment measures prescribed to avert any settlement crisis in the stock exchanges as they lead to creation of a credit pyramid. The noticee has stated that its conduct is also supported by a legal opinion. It is not a question of law but entirely a matter of fact. The NSE/clearing house would have invoked the BG in an event of a payment crisis, and thereafter the ₹15 crore would have become due by the noticee to its bankers (*who had issued the BG*). The noticee would be having FDRs worth only ₹7.5 crore from SSL and the balance ₹7.5 crore would have to be borne by the clearing member, which is not desirable as it will strain the solvency of the clearing member. A clearing member's default would have been even a greater threat to the stability of the securities market. The above conduct shows that the noticee was trying to accommodate SSL in margin collection, in utter disregard of its role and responsibilities.

35. During the personal hearing held on January 29, 2013, the noticee was advised to submit copy of the BG taken with respect to 'margin collection' of SSL. The noticee vide letter dated January 31, 2013 submitted a copy of the BG dated February 01, 2008 for value ₹30 crore in favour of NSCCL. According to the noticee, the same was obtained under '50% deposit under lien' arrangement with its bankers. I have perused the said BG and the documents annexed to the aforesaid letter of the noticee. I note from the said documents that it has not been mentioned anywhere that the said BG is offered on the basis of the 50% deposit made by SSL. The said BG has not been mentioned in the relevant column in Annexure B (*working of margin with respect to SSL*) of the SCN. It appears therefore that the aforesaid BG has not been made

available to the auditors for their consideration. The fact about this BG has not even been mentioned in the noticee's reply dated December 07, 2013. Even if I were to consider the said BG, I note that this BG for ₹30 crore was obtained by the noticee and not furnished by SSL towards its margin, as required under the relevant norms governing margin collection and modes of payment of margin. In view of such reasons, I am not inclined to consider the document at this stage. Further, it is clear from the BG that the entire obligation in case of invocation will fall on the noticee and not on SSL.

36. I have also perused Annexure B to the SCN. The same is a chart which is the "*Margin Working Sheet*" with respect to SSL. The chart has captured the margin collections from March 25, 2008 till November 12, 2008. On a sample basis, I have perused the details for margin collection for March 26, 2008 in the chart. I note that the required margin to be collected from SSL by the noticee was ₹17,62,68,975.62/-. The same amount was reportedly claimed to have been collected by the noticee. However, the total collection towards margin from SSL was only ₹13,99,02,750.41/-, with a short fall of ₹3,63,66,225.19/- for that day. The extended value (i.e. ₹7.5 crore more than the FDR offered by SSL to the noticee) was rightly not taken into account, while calculating the margin collections. The extended value of ₹7.5 crores was shown in the chart as "*additional details (not to be considered in margin working)*". There were many days where the noticee failed to collect the required amount of margins as indicated in the chart.

37. The noticee has also been alleged of accepting undated cheques from SSL and GYF as collaterals. I have considered the submissions of the noticee in this regard. The noticee has stated that it obtained whatever form of security available from such trading members and while doing so had also taken undated and post-dated cheques from them. It is generally known that in a post-dated cheque, the value thereof cannot be realised immediately and the holder has to wait for the date written on such cheques for encashment of the cheque and that too if they get cleared. Therefore, such type of instruments cannot satisfy the margin requirements that arise on a particular day. When a cheque is dishonoured, the holder does not realise its value. In this regard, the noticee has contended that cheques should be treated as available margin and only when the same were dishonoured that the same could no longer be treated as available margin. It is preposterous to argue that post-dated cheques should be considered as margin when margin requirements can be said to be satisfied only against cleared proceeds of valid cheques/draft.

38. With respect to SSL, the Annexure B in Column N "*Cheques not presented/Cheque Dishonoured*" has mentioned the value of such instruments which have been not taken into consideration for calculating the margin money. Such instances have happened on numerous days. As regards GYF, the Annexure C, has also recorded such cases in two instances. From the NSE circulars, it is already noted that the mode of collection of margin as specified are Cash, Bank guarantee, FDRs and deposit of approved securities. Cheques when cleared for payment can only be considered as '*cash*' which was the extant rule prevalent at that time. Hence undated and post dated cheques are not permissible forms of margin collection. The noticee ought to have taken margin in the prescribed mode only.

39. The SCN has alleged that the noticee had treated immovable property documents as '*margin collected*' in the case of GYF and NSB. During the hearing held on December 07, 2012, I had advised the noticee to file submissions with respect to the immovable transactions entered into by the noticee with the concerned trading members. The noticee vide its reply dated January 22, 2013 made submissions with respect to its property transactions with its trading members, GYF and NSB. Such submissions have been mentioned in a previous paragraph of this Order.

40. In this regard, I find that the noticee has given exposure to GYF since March 03, 2008. On March 03, 2008, the margin as required to be collected by the noticee in case of GYF was ₹1,33,99,244.50 whereas the actual collection of margin was nil. Hence, there was shortfall in collection of margin of ₹1,33,99,244.50. The noticee continued to report the margin as collected from GYF despite the nil collection. As per the Annexure C to the SCN, columns D & F show that the said trading member's account was already in the negative. Later on, in May 2008, the noticee claimed to have purchased office premises situated at Rohini, Delhi owned by Mrs Saraswati J. Gupta, the wife of Mr. Jagdish Chand Gupta, MD of GYF for a consideration of ₹30 lacs on the understanding that the said cheque would in turn be paid by GYF to the noticee towards their margin obligation. The noticee has stated that the sale was duly registered and consideration was received by the noticee in its bank account. Further, as submitted by noticee, the market crashed heavily during October 2008, the trading member GYF again suffered losses. Mr. Jagdish Chand Gupta then offered to sell the terrace to the same property at Rohini, Delhi and price was negotiated at ₹13.51 lakhs. An agreement was executed on November 28, 2008 and duly registered. Even by the noticee's own submissions, the said ₹30

lakhs & ₹13.51 lakhs does not cover the entire margin requirement from the said trading member and there is still a shortfall.

41. The noticee has also claimed to have purchased furniture, fittings and other movable properties contained in the above office premises belonging to GYF vide a bill dated 12.06.2008 for the consideration of ₹78.00 lakhs. The copy of sale bill dated 12.06.2008 was submitted by the noticee as an evidence for the above purchase. Some of the items contained in the said bill are 5 units of LCD Screen @ of ₹80,000/- per unit, 29 units of home furniture @ of ₹60000/- per unit, 25 units of office furniture @ of ₹42000/- per unit, 30 units of computers @ of ₹40000/- per unit, 5 units of UPS @ of ₹1,00,000/- per unit etc. The same appears to be highly inflated and the value of furniture and fixtures is approximately 2.60 times the value of the office premises. Further, the noticee again claimed to have purchased an under-construction flat situated at Sonapat, Haryana belonging to Mr. Jagdish Chand Gupta, MD of GYF vide an agreement dated 06.11.2008. However, even as per the submissions of the noticee, the consideration of ₹51.76 lacs was credited to the noticee's account of GYF on 25.05.2009. Therefore, I am unable to accept these against margin collection as on November 06, 2008. I further note from the above submissions made by the noticee with respect to GYF that a total of ₹173.26 lacs (30+78+13.50+51.76 lacs) was adjusted towards the margin obligation of GYF on different dates i.e. 22.05.2008, 12.06.2008, 28.11.2008 and 25.05.2009 through various immovable/movable property transactions. However, as noted earlier also that the shortfall and wrong reporting of margin, in case of GYF, was continuing since March 03, 2008. The noticee is found to have accommodated the defaulting trading member, GYF through various mode of circuitous movable/immovable property transactions in 2008-09 on several occasions. As submitted by noticee, when the market crashed heavily during October 2008, the trading member GYF again suffered losses. Mr. Jagdish Chand Gupta then offered to sell the terrace to the same property at Rohini, Delhi and price was negotiated at ₹13.51 lakhs. This also shows that the noticee continued to provide exposure to GYF despite knowing its poor financial position. Therefore, when market again crashed in October 2008, the trading member GYF could not pay its liability and again the noticee tried to obtain the margin in form other than as prescribed under the regulation. GYF was ultimately declared defaulter by NSE on 27.07.2009. The mode of collection of margin as specified under SEBI/exchange circulars are Cash, Bank guarantee, FDRs and deposit of approved securities, which was not followed by the noticee.

42. In case of NSB, the noticee claimed to have purchased a property situated at Shalimar Bagh, Delhi owned by NSB for a consideration of ₹2 crore, vide an agreement dated January 24, 2008. As per the submissions and documents submitted by the noticee, the copies of the title deed and documents were handed over by NSB to the noticee and an agreement dated January 24, 2008 was entered into wherein the registration of the conveyance deed of the property was postponed for the next 18 months subject to the condition that if the vendor i.e., NSB is able to find a buyer ready to pay a higher amount within that period, the vendor could revoke the sale agreement by paying ₹2 crore. According to the noticee, the trading member, NSB was paying it in tranches and by June 2009, NSB had paid the full sum of ₹2 crores. It is the noticee's contention that since the agreement was dated January 24, 2008, NSB was entitled to the credit of ₹2 crores in its account with effect from the date of the said agreement. I have considered such submissions. When the sale has not been concluded between the parties and when the consideration has not moved from NSB to the noticee as on January 24, 2008, it is surprising to note how the noticee could vehemently contend that the trading member was entitled to the ₹2 crores as on the date of an agreement to sell. By entering into these movable/immovable transactions, the noticee has entered into an arrangement wherein instead of collecting the required margin, the noticee has actually set off the margin against the alleged dealing in the properties which is against the reasons for existence of regulations concerning margins. The mode of collection of margin as specified under SEBI exchange circulars are Cash, Bank guarantee, FDRs and deposit of approved securities which was not followed by the noticee. Further, by allowing its TMs to build up these margin short falls, the noticee has also jeopardised the normal functioning of the securities market. The DA has also observed that the rules, regulations, guidelines on accepting collaterals and the permissible forms are very clear and any deviation from the same by the noticee need to be considered a violation. The practice as suggested by the noticee is deviation and definitely amounts to a violation.

43. I also note that the SCN has given a summary of instances of short fall in the collection of margin by the noticee. The said details, mentioned in the SCN, have been tabulated below :

TM	No. of trading days	No. of days of wrong reporting of margin	Margin requirement (Rs crores)	value of wrong reporting of margin (Rs crores)	percentage of wrong reporting to margin
Period: March 2008 to June 2008 and September 2008 to November 2008					

SSL	115	54	2854.98	317.94	11.14 %
GYF	138	137	263.53	263.21	99.88 %
NSB	120	119	144.02	84.73	58.83 %

44. The summary of the shortfall in the collection of margin for the inspection period March 2008 to June 2008 and September 2008 to November 2008 in respect of SSL, GYF and NSB is given below:

(i) With respect to SSL : *(net shortfall as a % to margin required)*

no. of Instances of more than 50%	12
no. of instances of 20%-50%	16
no. of instances of less than 20%	26
Total Instances	54

(ii) With respect to GYF : *(net shortfall as a % to margin required)*

no. of Instances of more than 50%	137
no. of instances of 20%-50%	0
no. of instances of less than 20%	0
Total Instances	137

(iii) With respect to NSB : *(net shortfall as a % to margin required)*

no. of Instances of more than 50%	74
no. of instances of 20%-50%	31
no. of instances of less than 20%	14
Total Instances	119

45. As regards wrong reporting of margin for the period - **December 2008 to November 2009**, the following details found in the SEBI inspection are relevant :

Particulars	Details
Sample size	27 trading members
Total instances checked	186 (total margin required ₹2,94,19,23,520/-)
Instances wherein wrong reporting observed	18 (total margin required ₹15,19,24,412/-)
Value of wrong reporting considering debit balances of TM	₹23,23,13,579.25/-
Value of wrong reporting	₹6,38,35,801.66/-

The SCN has stated that the percentage of wrong reporting was 2.17% for the period December 2008 to November 2009. In this regard, I have perused the factual details and find that the percentage of wrong reporting averaged across entire period at 2.17% does not convey the

seriousness of the conduct of the noticee. The following table gives the instance-wise wrong reporting of margins :

18 instances/ Dates	TM Name	Margin Required (₹)	Net Shortfall (₹)	Net Shortfall as a % to margin required
27-May-09	Jalan & Co	68,68,942.50	25,89,048.98	37.69%
16-Dec-08	Nikunj Stock Brokers Limited	5,36,333.50	5,36,333.50	100%
05-Jan-09	Nikunj Stock Brokers Limited	6,66,331.00	6,66,331.00	100%
16-Dec-08	Ganga Yamuna Finvest Private Limited	47,92,003.99	47,92,003.99	100%
17-Dec-08	Ganga Yamuna Finvest Private Limited	31,35,979.40	31,35,979.40	100%
27-May-09	Time Capital Ltd.	33,07,097.50	45,171.11	1.37%
02-Sep-09	Smp Securities Ltd.	1,39,10,529.31	1,10,82,060.92	79.67%
24-Apr-09	Smp Securities Ltd.	1,24,70,457.41	80,45,022.99	64.51%
13-Nov-09	Smp Securities Ltd.	2,11,29,157.93	1,47,90,038.59	70%
28-Jan-09	Smp Securities Ltd.	1,18,25,678.08	26,22,352.52	22.18%
28-Jul-09	Varun Capital Services Ltd.	1,00,56,164.01	27,79,368.03	27.64%
28-Jan-09	Gangour Investments Ltd.	84,51,446.36	16,09,350.29	19.04%
27-May-09	Gangour Investments Ltd.	1,84,47,875.16	36,46,695.32	19.77%
09-Feb-09	Gangour Investments Ltd.	90,54,583.80	21,35,480.35	23.58%
27-May-09	Amar & Sons Stock Broking Pvt Ltd	90,23,466.21	1,11,428.90	1.23%
24-Apr-09	Castle Securities	8,56,683.00	6,06,737.52	70.82%
28-Jan-09	Bharat Rasayan Finance Ltd	1,47,46,090.51	19,96,805.51	13.54%
02-Sep-09	Bharat Rasayan Finance Ltd	26,45,592.75	26,45,592.75	100%
Total		15,19,24,412.42	6,38,35,801.66	

No. of instances of 100% shortfall	5
no. of Instances of shortfall between 50% and 99%	4
no. of instances of 10%-50%	7
no. of instances of less than 10%	2
Total of such instances	18

Such details were made available to the noticee. Thus, for the period - December 2008 to November 2009, it can be noted that the noticee has failed to collect 100% of required margins in 5 instances out of the 18 instances. Further, in four other instances, the shortfall in the collection of margin was more than 50%. As regards the above allegation of shortfall in the collection of margin, the noticee has submitted vide its letter dated December 07, 2012 that out of 18 instances of shortfall/wrong reporting of margin as alleged in the SCN, there were only 5

instances wherein shortfall/wrong reporting of margin occurred and with regard to the remaining 13 instances, the noticee claimed there were collaterals of securities and Base Minimum Capital ('BMC') with the exchanges which were not considered by the inspection team for computation of margin. However the noticee had re-submitted certain collaterals and BMC with the exchanges subsequent to the inspection and claimed to have no shortfall/wrong reporting on these 13 instances. For the remaining 5 instances, I note that shortfall/wrong reporting pertaining to NSB and GYF has occurred in 4 instances wherein the noticee has not disputed the calculation of the margin computation of inspection team vide its letter dated 19.04.2010. However, the noticee has submitted in its reply dated 07.12.2012 that margin shortfall amounting to ₹68.80 lacs pertaining to NSB have to be ignored due to certain negotiated deals for property transactions with the NSB. Further it stated that margin shortfall amounting to ₹51.76 lacs pertaining to GYF have to be ignored due to credit available to GYF on the property transactions. I note that the noticee had subsequently diverged from its earlier acceptance with the calculation of the margin computation (*by the inspection team in respect of NSB and GYF*) vide its letters dated 19.04.2010 & 25.11.2010. For the remaining one, the noticee has submitted that the shortfall/wrong reporting of margin is only ₹21,400.29/-. I note that this is due to the addition of certain additional collateral securities and BMC with the exchanges and the data of the same has been given after the SEBI inspection. In this regard, I note that the DA has also observed "*.....Hence I find that there was a short fall in the margin collection and wrong reporting on the part of the noticee resulting into excess exposure to its trading members. However, how much was the shortfall, wrong reporting and excess exposure cannot be exactly quantified.*" As required by the stock exchange/clearing corporation and SEBI, the clearing members have to keep at least 50% of the effective deposits of collaterals in the form of cash. As noticed above, the noticee has tried to account the funds which it claims to be from the property transactions it had with the concerned trading members. The fact remains that the noticee failed to collect the stipulated margins. Here the question is not whether the shortfall was for exactly x% or y%, but a situation where the noticee allowed a shortfall of margins on several occasions even to the extent of 100% and the cavalier fashion in which it tried to pass off undated cheques, property papers, leverage bank guarantee as margins.

46. The issues raised by the SMC Global on the computation of the above shortfall/wrong reporting of margin and my observations pertaining to the same are given below. The noticee has contended that the net ledger balance taken for the computation of margin requirement includes the MTM liability/debit, which was not required to be taken into account during the

relevant period of time while calculating the available margin. I note that the settlement price towards the MTM liability/losses is computed on daily basis based upon the open position held by the entity. MTM liability/debit indicates the losses already incurred on the open position which in any way is required to be paid by the trading member, hence this was deducted from the ledger balance to show the correct financial position of the trading member. The noticee has contended that additional margins/collaterals namely undated cheques, extended bank guarantee of ₹7.5 crores in favor of SSL, value of immovable properties have not been considered in the margin calculation. As I have already noted in the preceding paragraphs that such collaterals viz., post dated cheques, undated cheques, bank guarantee coming from the clearing member and not from the trading member, movable/immovable properties, are not permissible for computation of margin, and hence not required to be taken into account.

47. In view of the foregoing, there is no merit in the submission of the noticee that it did everything to prevent the trading members from becoming defaulters and therefore endeavoured to collect whatever security it could from them. From the discussions above, it can be seen that the noticee has attempted to bolster the tottering trading members, whereas it should have ideally squared off their positions quickly so as to prevent any further escalation of their exposure.

48. As regards the alleged violation of rule 8(3)(f) of the SCRR, I note that in the Report, the DA has observed that the delayed payment charges which were charged by the noticee was done only as a disincentive against delay in the payments by the trading member. Though the noticee has contended that the SCN has not rejected any findings in the report of the DA nor does the SCN contain any reasons for deviating from the same, I note that the SCN has alleged that the shortfall in the collection of required margins from trading members indicates that the same was funded by the noticee to maintain the margin obligations of those trading members with NSE. The noticee has submitted that if the margin requirement was funded by it, then there would be no shortfall of margins for the trading members and the charge in that regard cannot arise. I note that in terms of rule 8(3)(f) of the SCRR, no person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if he engages either as principal or employee in any business other than that of securities except as a broker or agent not involving any personal financial liability. As per the prevalent practice and regulations, the clients make the margin payments to the trading member and the trading member in turn makes it to their clearing member. In this case, the noticee has not collected

the required margins from the trading members. The implication of this is that it had made good the requirement to the stock exchange/clearing corporation. As noticed, the noticee has leveraged the fixed deposit of ₹7.5 crore and had obtained a BG for 50% more than the value of the FD i.e., ₹15 crore. In case of any default, the BG would be invoked. On such invocation, the noticee would be made liable for the balance ₹7.5 crore which he had leveraged for the trading member. In this manner, the noticee has involved itself in a personal financial liability, which is against rule 8(3)(f). Similar is the case when the noticee had accepted undated/post-dated cheques towards margins from the concerned trading members. The noticee was also found indulging in property transactions with its trading members. The said conduct is in contravention of the aforesaid provision. Therefore, I am not in agreement with the findings of the DA in this regard.

49. Clause A(1) of the Code of Conduct for stock brokers prescribed under the Stock Brokers Regulations prescribes that a stock broker shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business. Clause A(2) requires a stock broker to act with due skill, care and diligence of all his business. Clause A(5) mandates a stock broker to abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the stock exchange from time to time as may be applicable to him. As per the circular dated February 09, 2007 of the NSCCL, the initial margins should be collected by the clearing members from their clients/constituents and is payable upfront and to report the same. The modes of providing margin has also been mentioned therein and the relevant parts have already been mentioned/discussed. I also note that SEBI vide circular dated December 03, 1998 had *inter alia* prescribed a model format of *Clearing Member-Trading Member Agreement*. According to clause 5 (*Payment of margins*) of the said model agreement, the clearing member shall collect margins from the trading member as prescribed by the relevant authority from time to time. Therefore, having not collected adequate margins, whereas it claimed to have collected in certain modes that are not permitted, the noticee has also contravened the above provisions of law.

50. In the derivatives market, the transactions carry a higher degree of risk as a certain amount of leverage and position taken by the participant remains open for a specified period which is subject to market risk in the event of adverse market/price movement. Hence, a sound risk management system is essential for containing the risk inherent in the derivatives trading segment. Clearing Corporation of the derivatives exchange use various tools for risk

containment that includes capital adequacy requirements of members, monitoring of member performance and track record, stringent margin requirements, position limits based on capital, online monitoring of member positions and automatic disablement from trading when limits are breached, etc. A Clearing Member (CM) of a clearing corporation has the responsibility of clearing and settlement of all deals executed by its Trading Members (TMs) on the exchange and also ensuring the integrity of system by strictly adhering to the rules of risk containment measures. Primarily, the CM performs the following functions:

- (i) Clearing - Computing obligations of all his TM's i.e. determining positions to settle.
- (ii) Settlement - Performing actual settlement
- (iii) Risk Management - Setting position limits based on upfront deposits / margins for each TM and monitoring positions on a continuous basis.

A CM is required to collect the initial margin from the trading members for their clients. Further, a clearing member is required to accept only those collaterals that have been approved by the clearing corporations/stock exchanges towards margin and accordingly set exposure which is linked to the collaterals collected from its trading member. The regular administration of margins prevents participants from accumulating large unpaid losses which could impact on the financial position of other market users (systemic risk). Hence, in view of the important role played by clearing members in ensuring day-to-day clearing and settlement of operations in the securities markets and proper risk management, it is mandatory for a clearing member to display highest standards of due diligence and efficiency at all times.

51. As risk containment measures, SEBI and the stock exchanges have prescribed various regulations including that of collecting margins upfront and forms/mode in which margins should be collected. A clearing member acts as a fulcrum and is not supposed to leverage and further build-up the risks associated with the exposure taken by the trading members/clients in the securities market. It is he who is supposed to ensure the integrity of the payment process and risk management system for the position taken by its trading member. The clearing member has a trusted position in the securities market and his role is pivotal and important. Therefore, it is expected that a clearing member maintains the highest standards of propriety. By not collecting margins in the stipulated form/mode and providing positions/exposure to its trading member based on non-approved collaterals, and by reporting wrongly to the exchange that it had collected margins in approved form, the noticee has caused excessive exposure to be taken by the trading members without means to support such exposure and also compromised

the integrity of clearing and settlement system. I further note that trading members of SMC Global viz. SSL and GYF, from whom SMC had not collected proper margin and reported wrongly to the exchange about their margin deposit, had in fact defaulted in their payment obligations and were later declared as defaulters and expelled by the stock exchanges. Subsequently, the stock exchanges had to redress the investor complaints/claims by utilising the funds from the Investor Protection Fund (IPF) of the stock exchanges to make good the claims of the clients of SSL and GYF as given below:

- a. IPF of BSE to the extent of ₹1,60,81,597.84/- and IPF of NSE to the extent of ₹2,34,33,233.74/- was utilised towards the claims of investors of SSL.
- b. IPF of NSE to the extent of ₹12,84,752.80/- was disbursed towards the claims of investors of GYF.

Further, the claims of investors of SSL to the extent of ₹4,27,48,132.17/- were not fully met out of IPF (i.e. claim admitted but lesser amount disbursed to investors out of IPF due to limitation).

52. As observed above, the noticee being a clearing member has not only failed to collect the margin in the approved form/mode, it has also made wrong reporting to the exchanges and thus had failed to fulfil his duty in the proper collection and reporting of margins, as required under law. Such behaviour of the noticee is disruptive to the system. It is always expected by the regulator that persons who have a duty to safeguard the integrity and equilibrium in the securities market take a step further to ensure that the said objective is met and adhere to the rules prescribed by the stock exchange/regulator. However, in this case as noted above, the noticee has failed to adhere to the basic requirement laid down with respect to the collection of margins and reporting of the same to the exchange during the relevant period.

53. Having arrived at my findings with respect to the violations committed by the noticee, the next question would be to determine the nature and quantum of penalty that needs to be imposed on the noticee that would be commensurate with the violations. The DA has recommended that the noticee may be prohibited from taking up any new assignment or contract or launch a new scheme for a period of 15 days. The SCN which was issued to the noticee has advised the noticee why higher penalty should not be imposed against the noticee. On consideration of the violations committed by the noticee and keeping in mind the above said factors, I find that this proceeding could be disposed off with a penalty as ordered herein below. The same according to me is commensurate with the lapses/violations committed by the noticee.

54. In view of the foregoing, 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 SEBI (Intermediaries) Regulations, 2008, hereby prohibit the noticee, SMC Global Securities Limited (SEBI Registration No. INF 230771431) from taking up any new assignment or contract or launch a new scheme for a period of three months.

55. This Order shall come into force immediately on expiry of 21 days from the date of the Order.

**PRASHANT SARAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**

Date : August 2nd, 2013

Place : Mumbai