BEFORE THE ADJUDICATING OFFICER

SECURITIES AND EXCHANGE BOARD OF INDIA

[ADJUDICATION ORDER NO. Order/AA/AR/2020-21/8024]

UNDER SECTION 15 - I OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH RULE 5 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES) RULES, 1995 AND UNDER SECTION 23-I OF SECURITIES CONTRACTS (REGULATION) ACT, 1956 READ WITH RULE 5 OF SECURITIES CONTRACTS (REGULATION) (PROCEDURE FOR HOLDING INQUIRY AND IMPOSING PENALTIES BY ADJUDICATING OFFICER) RULES, 2005.

In respect of

Shriram Insight Share Brokers Ltd

In the matter of

Shriram Insight Share Brokers Ltd

FACTS OF THE CASE

1. The Securities and Exchange Board of India (**SEBI**) conducted an inspection of the stock broker Shriram Insight Share Brokers Ltd (hereinafter referred to as **'SISBL'/ 'noticee'**) during January 30, 2012 to February 08, 2012 for the period starting from April 01, 2010 till the date of inspection viz. January 29, 2012 (hereinafter referred to as '**Inspection period**') to assess its risk management system, investor grievances handling mechanism and internet trading related operations.

2. Based on the findings of the inspection, it is alleged in the inspection report (hereinafter referred to as '**the IR**') that the noticee has, prima facie, violated the provisions of the SEBI (Stock Broker and Sub-brokers) Regulation, 1992 (hereinafter referred to as '**Broker Regulations**'), SC(R) Rules, 1957 (hereinafter referred to as '**SCR Rules'**) and certain circulars of SEBI (hereinafter collectively referred to as '**SEBI Circulars**') and

National Stock Exchange (hereinafter collectively referred to as '**NSE Circulars**').

APPOINTMENT OF ADJUDICATING OFFICER

3. The undersigned was appointed as the Adjudicating Officer, vide communique dated July 10, 2019 under section 15-I of the SEBI Act, 1992 (hereinafter referred to as '**SEBI Act**') read with rule 3 of the Securities and Exchange Board of India (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 1995 (hereinafter referred to as '**Adjudication Rules'**) and also under section 23-I of Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as **'SCRA')**, read with rule 3 of Securities Contracts (Regulation) (Procedure for Holding Inquiry and Imposing Penalties by Adjudicating Officer) Rules, 2005 (hereinafter referred to as **'SCRA Adjudication Rules'**) to inquire into and adjudge under the provisions of section 23H of the SCRA and sections 15C and 15HB of the SEBI Act, the alleged violations of relevant provisions of the SCRA, SEBI Act, SEBI Circulars and NSE Circulars committed by the noticee.

SHOW CAUSE NOTICE, REPLY AND PERSONAL HEARING

4. A Show Cause Notice dated December 12, 2019 with reference number SEBI/EAD/AA/ASR/33170/2019 (hereinafter referred to as '**SCN'**) was issued to the noticee under rule 4 of the Adjudication Rules and SCRA Adjudication Rules to show cause as to why an inquiry should not be held against it and why penalty should not be imposed on it under sections 15C and 15HB of the SEBI Act and under section 23D of the SCRA for following alleged violations:
    - **i.** Deficiencies noticed in Know Your Clients (KYC) forms.
    - **ii.** Deficiency in Power of Attorney (PoA) Revocation clause.
    - **iii.** Delay in opening accounts of its clients.
    - **iv.** Allotment of a single e-mail id to multiple clients.
    - **v.** Deficiency in Electronic Contract Notes (ECN) Authorization.
    - **vi.** Non redressal of Investor complaints.

vii. Computer-to-Computer Link (CTCL) / Intermediate Layer (IML) mismatch.
viii. Deficiency in Order Management.
ix. Short collection of margin from clients in derivative segment.
x. Funding of clients.
xi. Non-settlement of Running A/c.
xii. Margin Funding - shortage of maintenance margin.
xiii. Violations with respect to Internet based trading.
xiv. Other Systems Deficiencies

5. The noticee vide its letter dated January 06, 2020 requested for additional time to submit its reply to the SCN, which was accordingly granted to the noticee. Thereafter, noticee vide its letter dated January 31, 2020 submitted its reply to the SCN. The same is discussed in later paragraphs and not reiterated here for the sake of brevity.

6. In the interest of natural justice, an opportunity of hearing was provided to the noticee on February 25, 2020. The Authorised representatives of the noticee appeared on behalf of the noticee for the personal hearing and reiterated the submissions made by the noticee in its reply dated January 31, 2020 and also submitted additional reply in the matter.

CONSIDERATION OF ISSUES AND FINDINGS

7. I have carefully perused the SCN, submissions made by the noticee and all the documents/ evidence available on record. Before moving forward, the relevant extracts of the provisions of the SCR Rules, Broker Regulations, allegedly violated by the noticee are mentioned as under-

BROKER REGULATIONS

SCHEDULE II
CODE OF CONDUCT FOR STOCK BROKERS

A. General

(2) *Exercise of due skill and care: A stock-broker shall act with due skill, care and diligence in the conduct of all his business.*

(5) *Compliance with statutory requirements: A stock-broker shall 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.*

B. Duty to the Investor

(2) *Issue of Contract Note: A stock-broker shall issue without delay to his client or client of the sub-broker, as the case may be a contract note for all transactions in the form specified by the stock exchange SCR Rules*

SCR RULES

Qualifications for membership of a recognised stock exchange.

8. *The rules relating to admission of members of a stock exchange seeking recognition shall inter alia provide that:*

(1) *No person shall be eligible to be elected as a member if—*

(f) *he is engaged as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability unless he undertakes on admission to sever his connection with such business:*

(2) *No person who is a member at the time of application for recognition or subsequently admitted as a member shall continue as such if—*

(f) *he engages either as principal or employee in any business other than that of securities or commodity derivatives except as a broker or agent not involving any personal financial liability, provided that—*

(i) *the governing body may, for reasons, to be recorded in writing, permit a member to engage himself as principal or employee in any such business, if the member in question ceases to carry on* *business on the stock exchange either as an individual or as a partner in a firm,*

8. Now, I will proceed to discuss the various allegations levelled against the noticee, the replies submitted by the noticee and record my observations/findings as under:

A) Deficiencies noticed in Know Your Clients (KYC) forms.

<u>Allegations:</u>

i. A sample of new KYCs were examined on a test check basis and following deficiencies were observed:

  a) Application signed and sent to HO without filling up any client details
  b) Excess number of signatures by the clients
  c) Not striking off the relevant boxes where no trading preference has been indicated by the client
  d) Delay between agreement date and account opening date
  e) Tariff sheet signed without filling up the details.

ii. Thus, it is alleged that the notice has violated the provisions of SEBI circular no. CIR/MIRSD/16/2011 dated August 22, 2011.

<u>Submissions of the noticee:</u>

iii. The noticee has submitted that as directed vide SEBI Circular No. CIR/MIRSD/16/2011 dated August 22, 2011, it had started using the new KYC forms for all its clients getting registered after September 22, 2011. However, due to the short span of time between the date (August 22, 2011) of issuance of aforesaid circular and the proposed implementation date (September 22, 2011), and also due to the fact that the noticee operates through a large network of branches spread out throughout the country, during transition phase many of the branches had both the new and old forms at their disposal. In the two cases mentioned in the IR, the

Branch-in-Charge of the "KOL HRIDAYPUR NS ROAD" branch by mistake sent two sets of old KYCs. However, the accounts were opened based on the new KYC.

iv. The noticee has submitted that the alleged instances are isolated incidents at a branch and it had made aware all its employees at the branch level about the aforesaid SEBI circular and the accounts were opened with new KYC only.

v. The noticee also made submissions on the other alleged deficiencies in KYC such as application signed and send to HO without filling up any client details, excess no. of signatures by the clients, not ticking off the relevant boxes where no trading preferences has been indicated by the client, delay between agreement date and UCC allotment date, tariff sheet singed without filling up the details.

Findings:

vi. It is observed that the noticee has not contended the fact that there were deficiencies in the KYC forms of a few of its clients as alleged in the SCN. However, I am unable to accept the submission of the noticee that the lapses in implementation of SEBI circular dated August 22, 2011 occurred due to the paucity of time. It is the duty of the noticee to adhere to the timelines mentioned in the SEBI circulars as a responsible Stock Broker. Any lapses in this regard indicate the lack of proper training among the employees of the stock broker at branch/franchisee offices while dealing with the clients for KYC related matters.

vii. Further, on perusal of the submissions of the noticee on KYC forms having excess signatures of the clients and relevant boxes not ticked where no trading preference has been indicated by the client, it is observed that noticee has merely mentioned that apart from the documents mandated by SEBI, it was also getting its clients sign voluntary documents. Such lapses occur due to signatures of the clients on the voluntary documents. I cannot agree with the aforesaid submission of the noticee. It is highly probable that by not striking off the relevant boxes where no trading preference has been indicated by the client, the account of the client could be misused for unauthorised trading.

viii. Thus, in view of the findings above, I conclude that the noticee has violated the provisions of SEBI circular no. CIR/MIRSD/16/2011 dated August 22, 2011 and is liable for penalty under section 15HB of the SEBI Act.

B) Deficiency in Power of Attorney (PoA) Revocation clause.

Allegations:

i. SEBI vide its circular CIR/MRD/DMS/40/2010 dated December 31, 2010 has, *inter alia*, stated that the PoA submitted by a client shall be revocable at any time, without notice. However, it is observed that w.r.t. the PoA between the noticee and its clients, it has been mentioned by the noticee that PoA continues until the client gives 15 days' notice in advance in writing.

ii. Therefore, it is alleged that the noticee has violated the provisions of SEBI Circular No. CIR/MRD/DMS/40/2010 dated December 31, 2010.

Submissions of the noticee:

iii. Noticee has submitted in its reply that in the sample instances mentioned in the IR, the PoA was activated prior to May 31, 2010. Further in compliance with SEBI Circular No. CIR/MRD/DMS/28/2010 dated August 31, 2010, it had intimated its existing clients about the changes in relevant clauses specifically that the time frame for revocation of PoA is no longer applicable and clients may terminate their specific PoA agreement with the noticee at any time. Therefore, noticee has denied to have violated the provision of SEBI Circular No. CIR/MRD/DMS/40/2010 dated December 31, 2010.

Findings:

iv. With respect to the submission of the noticee pertaining to the revocation of the PoA, it is observed that the circular dated December 31, 2010 has specifically mentioned that the Stock Broker may revoke those authorizations that are inconsistent with the guidelines by communicating the inconsistent clauses to their existing clients. However, during the inspection it was observed that there were still PoA, at that time, which was not revocable without notice. For the purpose of illustration, IR mentions 8 such accounts where PoA was not revocable without notice. It is observed that the noticee has produced no evidence to show that it had made attempts to send intimation to these 8 clients regarding guidelines in SEBI circular dated December 31, 2010 regarding revocation of PoA without notice, at clients' will.

v. Therefore, it is established that the noticee has violated the provisions of SEBI Circular No. CIR/MRD/DMS/40/2010 dated December 31, 2010 and is liable for penalty under section 15HB of the SEBI Act.

C) Delay and other lapses pertaining to opening of accounts of its clients.

Allegations

i. It is alleged in the SCN that during the period of August 2011 till September 2011, the noticee made its clients enter into two agreements for opening accounts violating the SEBI circular no. CIR/MIRSD/16/2011 dated August 22, 2011. A sample of 7 clients was also mentioned in the SCN / IR indicating delay in opening accounts of the clients due to such practice adopted by the noticee of making its clients enter into two agreements.

ii. It is further alleged that the applicants were made to sign on the blank KYC documents by the noticee and in one of the cases, the tariff sheet has been kept blank by the noticee even though the applicant has put in his signature.

iii. Therefore, it is alleged that the noticee has violated the provisions of SEBI Circular Nos. SMD/Policy/Cir/5-97 dated April 11, 1997, SEBI/MIRSD/DPS-1/Cir-31/2004 dated August 26, 2004, SEBI Circular No. MIRSD/SE/CIR-19/2009 dated December 3, 2009, CIR/MIRSD/16/2011 dated August 22, 2011 and Clause A(2) & A(5) of

Code of Conduct prescribed under Regulation 7 of the Broker Regulations.

Submissions of the noticee:

iv. Noticee submitted that due to the short span of time between the date of issuance of circular no CIR/MIRSD/16/2011 dated August 22, 2011 and the proposed implementation date (September 22, 2011), and also due to the fact that the noticee operates through a large network of branches spread out throughout the country, during transition phase many of the branches had both the new and old forms at their disposal. Hence in a few cases the branch personnel might have got the clients to sign both the set of document to avoid any regulatory violation.

v. Noticee further submits that it follows a two-layered checking system of the client documents, first at the branch level and then at the centralized head office level (checking of PAN, phone no. verification, PMLA aspects etc.) before allotting code to the client and in case of any deficiency in the documents the code is allotted only after the same is rectified. Thus, the delay observed may be attributed to the factors such as non-receipt of Annual Maintenance charges (AMC) cheque for the demat account, non-verification of phone no., missing address proof, illegible documents.

vi. As regards the alleged violation that the noticee obtained signature of clients on blank KYC documents, the noticee has submitted that there is the process of rechecking/scrutinizing certain aspects of the KYC and supporting documents which are either beyond control of the noticee (i.e. PMLA aspects/online PAN verification/debarred entity etc.) or wherein errors / omission may occur at the time of collection of KYC documents from the client. Whenever such discrepancies were found those KYC/documents were returned to the respective branch under intimation to the client and the Unique Client Code (UCC) is allotted only after receipt of rectified KYC form and documents.

vii. Noticee, has also submitted that the discrepancies observed by the inspection team are either practical problem faced by it while implementing the relevant circulars or clerical error, since it was dealing with a large base of retail investors mostly in Tier-II and Tier-Ill cities hence it is not an intentional system or policy violation on their part.

Findings:

viii. It is clear from the submissions of the noticee that it has admitted to the lapses on its part in implementing various circulars of SEBI pertaining to opening of accounts of its clients and the KYC process. Further, I do not find any submission made by the noticee to be satisfactory to absolve it from its responsibility in implementing the circulars of SEBI. I find that the aforementioned instances of lapses show not only lack of training among the staff of the noticee in dealing with its clients but also absence of proper infrastructure in terms of adequate systems in place to handle such critical functions related to its clients. A prudent stock broker is expected to have systems in place for the opening of accounts and other KYC related functions. I don't find merit in the submission of the noticee that lapses occurred due to practical difficulties. The noticee has also termed these as clerical errors and not an intentional system or policy violation on its part. These submissions of the noticee are untenable and is unacceptable. The noticee has admitted to the lapses alleged in the SCN and IR.

ix. Therefore, in the light of the above discussion, it is established that the noticee has violated the provisions of SEBI Circular Nos. SMD/Policy/Cir/5-97 dated April 11, 1997, SEBI/MIRSD/DPS-1/Cir-31/2004 dated August 26, 2004, SEBI Circular No. MIRSD/SE/CIR-19/2009 dated December 3, 2009, CIR/MIRSD/16/2011 dated August 22, 2011 and Clause A(2) & A(5) of Code of Conduct prescribed under Regulation 7 of the Broker Regulations and is liable for penalty under section 15HB of the SEBI Act.

D) Allotment of a single e-mail id to multiple clients.

Allegations:

i. It is alleged that the noticee has issued e-contract notes (ECNs), statement of accounts and daily margin statement in electronic mode to a single email id for multiple clients. Further, on examining the database of the clients who have opted for e-contract notes, it is observed that only 34,555 email-ids have been allotted to 35,352 clients i.e. the total number of e-mail ids allotted is much less than the total number of clients who have opted for ECNs.

ii. Therefore, it is alleged that the noticee has violated the provisions of Circular No. MRD/DoP/SE/Cir-20/2005 dated September 8, 2005 r/w Regulation 7(B)(2) of Schedule II of Code of Conduct prescribed for Stock brokers in Broker Regulations.

Submissions of the noticee:

iii. As regards the allegation pertaining to the instances of multiple clients being allotted common email ids, the noticee has submitted that it accepted the common email id for more than one client where the clients belongs to the same family and the "family" is as described in the SEBI circular no CIR/MIRSD/15/2011 dated August 02, 2011. The same was done at the specific written request of the clients. Noticee also submitted copies of the specific requests that were made by its clients for allotting common email ids belonging to other members of their family.

Findings:

iv. I have perused the submission made by the noticee and also the copies of specific request letters submitted by the clients of the noticee for allotment of common email ids. It is observed that the noticee has allotted common email ids to the clients on the basis of specific requests. I am satisfied with the request letters submitted by the noticee and conclude that same are in line with the requirement of allotting common email ids for issuance of ECN, as stipulated in the SEBI circular no CIR/MIRSD/15/2011 dated August 02, 2011.

v. In view of the above, it is established that the noticee has not violated the provisions of Circular No. MRD/DoP/SE/Cir-20/2005 dated September 8, 2005 r/w Regulation 7(B)(2) of Schedule II of Code of Conduct prescribed for Stock brokers in Broker Regulations.

E) Deficiency in Electronic Contract Notes (ECN) Authorization.

<u>Allegations:</u>

i. The SCN has alleged that in several instances the authorization of Electronic Contract Notes did not contain the clause that any change in the email-id shall be communicated by the client through physical letter to the trading member. Therefore, it is alleged that the noticee has violated the provisions of NSE Circular dated December 03, 2009 NSE/INSP/13606 and NSE Circular dated February 03, 2010 NSE/INSP/14048.

<u>Submissions of the noticee:</u>

ii. As regards the ECN Authorisation, the noticee has submitted that the clause regarding "any change in the email id shall be communicated by the client through physical letter to the trading member" is applicable from December 03, 2009 viz. date of SEBI Circular no. MIRSD/SE/Cir-19/2009 and NSE circular no. NSE/INSP/13606. The noticee further submitted that out of the thirteen instances highlighted by the inspection team, the letter for ECN authorization for five clients were received prior to December 03, 2009. Therefore, the noticee has contended that there was no scope of existence of the mentioned clause in the ECN Authorization for those five cases.

iii. Noticee further states that in case of the rest of the eight cases, it had inserted the abovementioned clause in its ECN mandate Form and accordingly implemented while collecting new ECN authorization form from these clients, after the aforesaid circulars came into force.

<u>Findings:</u>

iv. On perusal of the documents and submissions made by the noticee regarding abovementioned allegations, it is observed that the IR has mentioned thirteen instances of lapses on a sample basis and it appears that there were several other instances of lapses pertaining to ECN authorization. However, as IR only gives specific details of thirteen instances, the noticee has also made submissions regarding thirteen instances. I have considered the submission of the noticee and I am in agreement with its contention that the noticee cannot be held liable for lapses in the case of five clients, as the ECN authorization process had occurred prior to the implementation of the aforesaid circulars by SEBI and NSE. As regards the remaining eight clients, I observe that the noticee has submitted adequate documentary evidence to suggest that it had added the clause that "any change in the email id shall be communicated by the client through physical letter to the trading member" in the appropriate documents.

v. Therefore, I conclude that the noticee has not violated the provisions of NSE Circulars no. NSE/INSP/13606 dated December 03, 2009 and NSE/INSP/14048 dated February 03, 2010.

F) Non-redressal of Investor complaints.

Allegations:

i. The inspection had found that a number of complaints were lying pending/ unresolved for a long time from the date of receipt. Therefore, it is alleged that the noticee has violated the provisions of clause A (5) of the Code of Conduct prescribed in Schedule II under Regulation 7 of the Broker Regulations and section 15C of the SEBI Act.

Submissions of the noticee

ii. Noticee has submitted that on receipt of a complaint from its clients directly or through respective Exchange, it immediately initiates necessary investigation regarding the matter and reply accordingly either directly to the client or to the Exchanges within the scheduled date and time allotted by the Respective Exchanges. The noticee has also given details of the complaints that were alleged to be pending in the IR on a sample basis.

Findings:

iii. A few complaints were found pending at the noticee's end for a period of more than one month. The IR mentions about five (5) such pending complaints. The noticee has provided details of these complaints and it is observed that all these complaints have now been resolved or have been pending at the complainants' end for further information and not at the noticee's end.

iv. Thus, it is established that the noticee has failed in its responsibility as a diligent stock broker by not adhering to the circulars/clauses/regulations regarding the redressal of investor grievances by keeping few of the complaints pending for more than one month. Therefore, the noticee has violated the provisions of clause A(5) of Code of Conduct prescribed in Schedule II under Regulation 7 of Broker Regulations and is liable for penalty under section 15C of the SEBI Act.

G) Computer-to-Computer Link (CTCL) / Intermediate Layer (IML) mismatch.

Allegations:

i. The Stock Exchanges offer a facility to its trading members by which members can use their own trading front-end software in order to trade on the Exchange trading system. This facility is called Computer-to-Computer Link (CTCL) for NSE and Intermediate Layer (IML) for BSE. The broker is required to intimate the details of id and location of CTCL/IML in the respective exchange or upload in the exchange system. However, the inspection has found that on several occasions, the noticee had sent wrong/delayed intimation of the details of id and location of CTCL/IML to the Exchange.

ii. Therefore, it is alleged that the broker has not complied with the provisions of NSE Circular No. NSE/INSP/2010/111 dated December 24, 2010 read with Regulation 7 (A) (2) and 7 (A) (5) of Schedule II of Code of Conduct prescribed for stock brokers in Broker Regulations.

Submissions of the noticee:

iii. W.r.t the abovementioned allegations, the noticee has submitted that the alleged violation of the mismatch in CTCL/IML was not intentional and was a clerical mistake and all the mismatches mentioned in the IR were rectified immediately or with a maximum lag period of two days after it has come to its notice. Noticee further states that the relevant penalty have been imposed by the respective exchanges.

Findings:

iv. Therefore, in the light of the admission of the noticee regarding the aforesaid violation of IML/CTCL mismatch, it is established that the noticee has not complied with the provisions of NSE Circular No. NSE/INSP/2010/111 dated December 24, 2010 read with Regulation 7 (A) (2) and 7 (A) (5) of Schedule II of Code of Conduct prescribed for stock brokers in Broker Regulations.

H) Deficiency in Order Management

Allegations:

i. It is observed that the SEBI circular no. SMD/POLICY/IECG/1- 97 dated February 11, 1997, *inter alia*, states that '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’.

ii. During the course of inspection, it was observed that the noticee, *prima facie*, does not maintain record of time when the client has placed the order. It was further noted that 26 out of 84 complaints received by the noticee during the period under inspection pertain to unauthorized trading. Therefore, it is seen that the noticee does not have proper order management system in place and it has therefore violated the provisions of SEBI Circular no. SMD/POLICY/IECG/1- 97 dated February 11, 1997.

Submissions of the noticee:

iii. As regards the allegation of complaints received from clients pertaining to unauthorized trading, the noticee has stated that it has a retail client base of around 1.55 lacs out of which around 60 thousand clients were active during the inspection period and on an average it is handling 85,000 to 95,000 orders in a day. Noticee states that it has only received 26 complaints wherein clients have complained about unauthorized trading or trade denial which constitute a very insignificant percentage of its total client base. The Noticee further submitted that all the cited cases have been resolved at exchange level as on date.

Findings:

iv. It is observed from the submission of the noticee that it has not contended the fact that it has received 26 complaints regarding unauthorised trading without providing any further explanation. The noticee has also submitted a copy of the contract note in support of his contention that it was maintaining the record of order placement time which was also intimated to the clients. However, it is observed from the said document that the said contract note was for trading done on May 25, 2012 which is after the inspection was conducted by SEBI. Therefore, the said document is irrelevant in arriving at any conclusion in favour of the noticee.

v. In view of the above discussions, it is concluded that the noticee has violated the provisions of the SEBI Circular no. SMD/POLICY/IECG/1- 97 dated February 11, 1997.

I) Short collection of margin from clients in derivative segment.

Allegations:

i. The brokers are mandated by SEBI to collect the requisite amount of upfront margins from their clients for the trades in the derivative segment. During the course of inspection, it was observed that the broker has permitted many of the clients to trade in spite of absence of margin money proportionate to the exposures provided to the clients. On a random basis, a few days were selected by the inspection team to test check the collection of required margin by the broker and it was observed that the total short collection of margin from the instances examined by the inspection team on a sample basis was Rs. 15,85,822.76. There have been 1584 of such instances during a sample period from September 2011 to January 2012.

ii. The short-collection of margin results in over-leveraging by the clients and exposes the broker and the exchange to risks associated with possible defaults. Therefore, it is alleged that the noticee has violated the provisions of SEBI Circular no. SMDRP/POLICY/CIR-33/2000 dated July 27, 2000 and SEBI Circular no. SMD/Policy/Cir-12/2002 dated May 17, 2002.

Submissions of the Noticee:

iii. Noticee has submitted that it is part of their policy to collect upfront margin from each and every client before punching of order irrespective of exchange or segment where daily limits are a function of the net surplus (summation of fund and stock after haircut value) calculated from the risk matrix where the function varies on different market factors. In other words, it can be described that allowable exposure on T day is calculated based on client's deposits vis-a-vis open position up to T-1 day. As per the submission of the notice, it is allowing the exposure in derivative market where SPAN is compulsory element of margin to be collected upfront from clients before punching any order and MTM is collected either in the form of fund and/or security or by squaring off the excess position by T+1 day.

Findings:

iv. It is observed that the noticee permitted many of its clients to trade without having adequate margin money in proportion to the exposures provided to such clients. The IR reveals that there were 1584 such instances noticed during a sample period from September 2011 to January 2012. The short collection of margin is evident from the reply to the MG-13 reports uploaded by the noticee in the Exchange system. Therefore, the submissions of the noticee, in this regard are irrelevant.

v. It is a well-established fact that the short collection of margin by the stock broker results in over-leveraging by the clients and exposes the stock brokers to risks associated with possible defaults by the clients. Thus, the noticee has violated the provisions of SEBI Circular no. SMDRP/POLICY/CIR-33/2000 dated July 27, 2000 and SEBI Circular no. SMD/Policy/Cir-12/2002 dated May 17, 2002.

J) Funding of clients.

<u>Allegations:</u>

i. It has been observed during the inspection that several clients of the noticee are having huge balances due to the Noticee for a long period. It is further observed that the member is charging 'Penal charges from client' for late payment of the dues. However, it is observed that during the same period for which the 'Penal charges' are being levied by the noticee for debit balances, it has allowed those same clients to make net purchases for which the pay in obligations have been met by the noticee itself. Therefore, it is alleged that the noticee is, *prima facie*, funding the clients' trades and charging interest thereto in the garb of 'late payment charges'. The noticee has allegedly earned Rs. 27.23 crores during 2010-11 and Rs. 7.96 crores during the first six months of 2011-12 from the aforesaid 'late payment charges'.

ii. It is also observed during the course of inspection that apart from pledging the securities of its clients with the exchange for margin purpose, the noticee was also following the practice of pledging the securities of its clients with the bank. Further, the clients were, prima facie, not given any credit arising out of the pledging of their securities with the bank.

iii. It is observed that the noticee submitted before inspection team that the securities which remain in the 'Client Beneficiary Account' due to non-payment of pay-in obligation by the client were used for pledging with banks by it. The noticee has further submitted that the fund arising out of such pledging have been used to meet the pay-in obligation of the noticee to the exchange. However, it is alleged that while noticee is paying around 11%-13% p.a. interest to its clients on such loan against the pledging of securities, it is charging 18% to 36% p.a. interest from its clients in the form of 'Penalty for Late Payment Charges'. Thus, it is alleged that the noticee is, *prima facie*, earning a margin as high as 23% p.a. Thus, it is alleged that the noticee is encouraging its clients to continue with Debit balance in the ledger as most of its clients are having Debit balance in the ledger for long duration. Therefore, it is alleged that the noticee has violated the provisions of Rules 8(1) (f) and 8(3) (f) of SCR Rules read with SEBI circular no. SMD/POLICY/CIR-6//97 dated May 07, 1997.

Submissions of the noticee:

iv. Noticee has submitted that it does not allow fresh exposure to clients with negative fund balance beyond T+2+5 days unless and until there is a confirmed delivery sell or a positive fund inflow by way of cheque and or electronic fund transfer. Further, as a registered financial intermediary with NSE & BSE, the noticee is bound to meet the funds pay-in obligation to the exchange as otherwise it will be declared as defaulters by the concerned Exchanges. Noticee further submitted that sample instances of debit in settlement ledger beyond T+2+5 as pointed out during inspection were clarified to the inspecting team.

v. As regards the finding in the IR that the clients of the noticee were not given any credit arising out of the pledging of their securities with the bank, the noticee submitted that it is their practice to meet pay-in obligation towards Exchange arising out of the transactions, either from their own working capital or fund received from client as margin. In case of any short fall, the noticee borrows the required fund from financial institution by pledging only unpaid stock of the client i.e. the stocks which have been retained by the noticee under the right of lien as per SEBI regulation of transactions between clients and brokers.

Findings:

vi. It was clarified by the NSE vide its circular dated April 26, 2012 that "if debit balance arise out of client's failure to pay such amount for more than fifth trading day reckoned from day of pay-in, and further exposure is granted to the client, it would be construed as a funding violation even if fully paid collaterals are available for margin”. However, the aforesaid circular was issued after completion of the inspection in the instant matter and therefore cannot be applied to the activities of the noticee during the inspection period. Further, during the course of inspection noticee had also submitted its clarification on the sample instances where the debit in settlement ledger was beyond T+2+5 days.

vii. However, the noticee has not addressed the issue that it was imposing significantly higher late payment charges on its clients and was receiving the interest rate differential arising out of pledging of client securities. As alleged the late payment charges was resulting in interest payment of 18%-36% for its clients which is significant and cannot be ignored. When such huge penal charges imposed by the noticee are considered along with the fact that for several of its clients the noticee was allowing debit balance to continue, it is clear that the noticee was benefiting out of such late payment charges, at the cost of its clients. This is also corroborated from the fact that the noticee earned Rs. 27.23 crores during 2010-11 and Rs. 7.96 crores during the first six months of 2011-12 from the aforesaid 'late payment charges'.

viii. It is clear from the above observations that the Noticee was involved in the funding activities with its clients in the garb of imposing late payment charges and pledging their securities. The Stock Broker Regulations, various SEBI circulars and the provisions of SCR Rules, in this regard have very clearly restricted stock brokers from indulging in funding activity / fund based activity and therefore, the aforementioned activity of the Noticee cannot be viewed lightly as any adverse and unforeseeable event may lead to failure of the Noticee in continuing its activity as a stock broker, which is detrimental for its clients and the entire securities market.

ix. Therefore, from the above observations, I hold that Noticee has violated the provisions of Rule 8(1)(f) and 8(3)(f) of the SCR Rules and also SEBI Circular SMD/POLICY/CIR-6//97 dated May 7, 1997 on "Fund Based Activities of Brokers"

K) Non-settlement of Running A/c.

Allegations:

i. As per the SEBI Circular No. MIRSD/ SE /Cir-19/2009 dated December 03, 2009, a client may specifically authorize the stock broker to maintain a running account subject to, *inter alia*, the condition that the actual settlement of funds and securities shall be done by the broker, at least once in a calendar quarter or month, depending on the preference of the client. Although it appears that the noticee has been settling the clients' accounts on a regular basis, in a few cases, the cheques which were issued to the clients were allegedly taken back from the clients.

ii. It is also seen that instead of actually transferring the funds to its clients, the noticee was making mere book entries to bypass the regulatory requirement and thus defeating the spirit of the regulations. Therefore, it is alleged that the noticee has violated the provisions of SEBI Circular No. MIRSD/SE /Cir-19/2009 dated December 03, 2009.

Submissions of the noticee:

iii. Noticee has submitted that with reference to the SEBI circular no. MIRSD/SE/Cir-19/2009 dated December 03, 2009 regarding the actual settlement of funds and securities, the noticee settled the client account i.e., both funds and securities on a regular basis in accordance with the preference opted by the client and sent a statement of the same to the declared address of the client. However, in some instances, cheques issued in favour of the clients were taken back only on specific request/consent from the client to allow fresh exposure without delay. If the client opted for ECS payout, there is no scope of taking back the fund until the client himself transfer the fund by way of cheque or transfer electronically and the securities transferred to the client demat account were never taken back. In all cases, the cheques issued from banks were sent to the clients and returned under specific cancellation request. Thus, the noticee has contended that this does not indicate that it has done mere book entries as instruments were generated from the bank and sent to client and returned to it for cancellation.

iv. In all the cases where the cheques were taken back, all are backed by a specific request/consent from the client and these were verified by the inspection team during the course of inspection.

Findings:

v. It is noted that the noticee has made a submission that the cheques were being returned from the clients on the specific requests from its clients. However, the noticee has not provided any evidence in the form of such requests made by its clients. In the absence of any documentary evidence to support the contention of the noticee, I am unable to accept the submission made by the noticee in this regard. Therefore, I conclude that the noticee has violated the provisions of SEBI Circular No. MIRSD/SE /Cir-19/2009 dated December 03, 2009.

L) Margin Funding - shortage of maintenance margin.

Allegations:

i. The SEBI circular no. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004 on margin funding has, *inter alia*, stipulated that the initial and maintenance margin for the client shall be a minimum of 50% and 40% respectively, to be paid in cash and for this purpose. However, it is seen that in several cases the maintenance margin kept by the noticee for its clients was much below the stipulated 40%.

ii. Therefore, it is alleged that the noticee has violated the provisions of SEBI circular no. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004.

Submissions of the noticee:

iii. The noticee has submitted that the margin funding was allowed by it to those clients who have signed margin funding agreement and placed fund margin minimum to the extent of 50% as initial margin. However, the Noticee monitored the cases following consolidated position method where debit balance aggregated were compared to the aggregated stock value of a client where there was a short fall of maintenance margin. If consolidated position of the client was favourable, no action was taken.

Findings:

iv. The noticee has admitted in its submission that it was not maintaining a maintenance margin of 40% as stipulated in the SEBI circular dated March 19, 2004. Therefore, it is established that the noticee has violated the provisions of SEBI circular no. SEBI/MRD/SE/SU/Cir-15/04 dated March 19, 2004.

M) Violations with respect to Internet based trading.

Allegations:

i. During the course of inspection, the noticee submitted before the inspection team that it has developed an in-house internet-trading software which has been approved by the NSE. It is observed that the noticee had allowed internet trading to around 35,000 clients. The Internet Based Trading (IBT) set-up of the noticee has 10 cluster servers each of which can accommodate 300 application based connection / 3000 web based connections. The noticee further informed that the aforesaid capacity is scalable in a day's notice.

ii. However, the aforementioned capacity of the combined servers of the noticee was found to be not sufficient to cater to the total number of IBT clients registered with it and in case of higher number of clients trading through internet at a particular point of time, some of the clients could be deprived of the trading opportunity. Therefore, it is alleged that the noticee has failed to comply with the provisions of SEBI Circular no. SMDRP/POLICY/CIR-06/2000 dated January 31, 2000 r/w Regulation 7 read with Clauses A (2) & A (5) of the Broker Regulations.

Submissions of the noticee:

iii. With respect to the point regarding present insufficient capacity of the combined servers of IBT, the noticee submitted that its server can accommodate 30,000 concurrent connections and it is easily scalable in a day’s notice by way of adding a new Cluster Server. The numbers of IBT registered clients during the relevant period of time was around 35000 and on an average 2128 odd clients were connected concurrently in a day with the maximum connection of 2614 clients during the inspection period.

Findings:

iv. It is observed that noticee had a capacity to cater to 30,000 IBT clients while it was having a total of 35,000 IBT clients. Thus, if all the 35,000 IBT clients trade simultaneously, the server would not have been able to handle the load. However, it is seen that during the inspection period, the maximum number of clients that had simultaneously connected to the IBT system were 2614 and on an average 2128 clients were logging for IBT simultaneously. Therefore, it is seen that the IBT capacity of 30,000 concurrent connection was much higher than the load on the system observed. Further, the system was easily scalable to cater to 35,000 concurrent connection on a day’s notice. Thus, I am inclined to give benefit of doubt to the noticee and do not hold the noticee liable for violation of SEBI Circular no. SMDRP/POLICY/CIR-06/2000 dated January 31, 2000 r/w Regulation 7 read with Clauses A (2) & A (5) of the Broker Regulations.

N) Other Systems Deficiencies:

Allegations:

i. The systems audit report for the year 2011-12 conducted in the month of June 2011 pointed out the following, *prima facie*, deficiencies in their report:

1. Business Continuity Plan (BCP) is not well documented. Further, although a process of setting BCP has started at Chennai, it is yet to be tested.
2. Unlocking of users are not always done on documentation in case of Computer to Computer Link (CTCL).

ii. During the course of inspection, the noticee submitted that they have documented the BCP and have submitted a copy of the same to NSE. However, the proposed BCP was not set up and tested.

iii. In view of the above-mentioned statements of the noticee, it was alleged that the noticee has violated the provisions of SEBI Circular no: SMDRP/POLICY/CIR-06/2000 dated January 31, 2000.

Submissions of the noticee:

iv. Noticee has submitted that with respect to the system audit, the documented copy of BCP was handed over to the inspection team during the course of audit. Noticee also submitted that the site for back office is already operational. Further, with respect to the documentation of unlocking of CTCL users is concerned, the noticee submitted that it has started the same as per advice of the inspection team.

Findings:

v. It is seen from the submission of the noticee that it has admitted to the allegation regarding system deficiencies. The noticee has violated the provisions of SEBI Circular no: SMDRP/POLICY/CIR-06/2000 dated January 31, 2000 and is liable for penalty under section 15HB of the SEBI Act.

9. It is necessary that registered intermediaries follow the various procedures and practices prescribed for smooth and transparent functioning of the securities market. The noticee has committed irregularities w.r.t it's functioning as a stock broker as mentioned in the paragraphs above. The irregularities committed by the noticee, as brought out at paras 8 - (A), (B), (C), (F), (G), (H), (I), (J), (K), (L) and (N) above, are liable for penalty. Specifically, the fact that noticee indulged in fund based activity and earned considerable interest apart from the brokerage income cannot be viewed lightly. The noticee has also admitted to certain lapses as mentioned above. Clearly, the above irregularities have not only resulted in the violation of the provisions of various SEBI and Stock Exchange

circulars (mentioned under the respective paras above) but have also resulted in the violation of the provisions of Clauses A(2) and A(5) of the Code of Conduct prescribed for stock brokers contained in Schedule II read with Regulation 7 of Stock Broker Regulations. Besides, the fact that the Noticee had indulged in fund based business has also resulted in the violation of SCR Rules by the noticee, details of which are mentioned at para 8-(J) above.

10. I observe that the noticee while contending the fact that the violations committed by it are technical in nature has asked for a lenient view to be taken in the matter. The noticee has also raised the contention that there have been a delay of more than 7 years in the appointment of AO in the matter after inspection was completed. The noticee has also drawn reference to various judgments of Hon'ble SAT in support of its argument viz. Ashlesh Gunvantbhai Shah vs SEBI (SAT Order dated January 31, 2020), Sanjay Jethalal Soni vs SEBI (SAT Order dated November 14, 2019) and Ashok Shivlal Rupani vs SEBI (SAT Order dated August 22, 2019). I have perused the above judgments of SAT and note the delay involved in the matter. I also take note of the fact that many a discrepancy/irregularity have been rectified by the noticee. However, I am of the view that noticee cannot be completely absolved from the liable penalties for the lapses/violations observed. As the noticee has failed to act with skill, care and diligence in the conduct of its business as a stock broker, I hold that noticee has not only violated various SEBI and NSE circulars, as discussed in paragraphs above, but also violated the provisions of Clauses A(2) and A(5) of the Code of Conduct for stock brokers contained in Schedule II read with Regulation 7 of Stock Broker Regulations. Further, in view of the fact that noticee had indulged in funding activity, as mentioned in para 8-(J) above, I hold that noticee has also violated Rule 8(1)(f) and 8(3) (f) of SCR Rules.

11. The noticee has therefore violated Clauses A(2) and A(5) of the Code of Conduct for stock brokers contained in Schedule II read with Regulation 7

of Stock Broker Regulations (after the amendment, Regulation 9(f) of the SEBI (Stock Brokers and Sub-Brokers) (second amendment) Regulations, 2013), SEBI Circulars and NSE Circulars and the provisions of the SCR Rules, as mentioned at preceding para (A), (B), (C), (F), (G), (H), (I), (J), (K), (L) and (N). Having established these violations, I am convinced that it is a fit case for imposing monetary penalty on the noticee under sections 15C and15HB of the SEBI Act, 1992 and under section 23H of the SCRA.

12. In this context, I would like to place reliance on the observations of the Hon'ble Supreme Court of India in the matter of *Chairman, SEBI Vs Shriram Mutual Fund { [2006]} 5 SCC 361 } – wherein it was observed by Hon'ble SC that "In our considered opinion, penalty is attracted as soon as the contravention of the statutory obligation as contemplated by the Act and the Regulations is established and hence the intention of the parties committing such violation becomes wholly irrelevant….."*

13. In view of the violation of the statutory provisions of law by the noticee, as established above, the noticee is liable for monetary penalty under the provisions of sections 15C and 15 HB of the SEBI Act and under section 23 H of the SCRA, which reads as under:

<u>SEBI Act</u>

<u>Penalty for failure to redress investors' grievances.</u>

15C. *If any listed company or any person who is registered as an intermediary, after having been called upon by the Board in writing, to redress the grievances of investors, fails to redress such grievances within the time specified by the Board, such company or intermediary shall be liable to a penalty of one lakh rupees for each day during which such failure continues or one crore rupees, whichever is less*

<u>Penalty for contravention where no separate penalty has been provided.</u>

15HB. *Whoever fails to comply with any provision of this Act, the rules or the regulations made or directions issued by the Board thereunder for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.*

SCRA

Penalty for contravention where no separate penalty has been provided.

23H. *Whoever fails to comply with any provision of this Act, the rules or articles or bye- laws or the regulations of the recognized stock exchange or directions issued by the Securities and Exchange Board of India for which no separate penalty has been provided, shall be liable to a penalty which may extend to one crore rupees.*

14. In this regard, the provisions of Section 15J of the SEBI Act r/w Adjudication Rules and Section 23J of the SCRA r/w Rule 5 of the SCRA Adjudication Rules require that while adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors namely:-

15. In this regard, the provisions of Section 15J of the SEBI Act r/w Adjudication Rules and Section 23J of the SCRA r/w Rule 5 of the SCRA Adjudication Rules require that while adjudging the quantum of penalty, the adjudicating officer shall have due regard to the following factors namely:-

    (a) the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;

    (b) the amount of loss caused to an investor or group of investors as a result of the default;

    (c) the repetitive nature of the default.

16. With regard to the above factors to be considered while determining the quantum of penalty, it may be noted that the inspection conducted by SEBI in the said matter has not quantified the profit/loss for the violations committed by the noticee. No quantifiable figures or data are made available on record to assess the disproportionate gain or unfair advantage and amount of loss caused to an investor/clients or group of investors/clients as a result of the default of the noticee, most of which are merely technical in nature. I also note that as regards the allegation of delay in resolving investor complaints, those complaints which were pending were subsequently resolved, although with a delay of

more than one month as mentioned above. I have also perused the Adjudication order no. Order/KS/VC/2020-21/7594 dated April 30, 2020 against the noticee and observe that the lapses regarding collection of maintenance margin were continued by the noticee atleast till October 2013.

ORDER

17. Having considered all the facts and circumstances of the case, the material available on record, the submissions made by the noticee and also the factors mentioned in section 15J of the SEBI Act and section 23J of the SCRA and in exercise of the powers conferred upon me under section 15-I of the SEBI Act read with Rule 5 of the Adjudication Rules and under section 23-I of the SCRA read with Rule 5 of the SCRA Adjudication Rules, I hereby impose a penalty of Rs 10,00,000/- (Rupees Ten Lakh only) on the noticee viz. Shriram Insight Share Brokers Ltd under the provisions of section 23H of the SCRA and sections 15HB and 15C of the SEBI Act. I am of the view that the said penalty is commensurate with the lapse/omission on the part of the noticee.

18. The noticee shall remit / pay the said total amount of penalty within 45 days of receipt of this order in either of the way, such as by following the path at SEBI website www.sebi.gov.in, ENFORCEMENT >Orders >Orders of AO >PAY NOW; OR by using the web link https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html. In case of any difficulties in payment of penalties, the noticee may contact the support at portalhelp@sebi.gov.in.

19. The said confirmation of e-payment made in the format as given in table below should be sent to "The Division Chief, EFD1-DRA-II, Securities and Exchange Board of India, SEBI Bhavan, Plot no. C- 7, "G" Block, Bandra Kurla Complex, Bandra (E), Mumbai - 400 051” and also to e-mail id:- tad@sebi.gov.in

1. Case Name:	
2. Name of payee:	
3. Date of payment:	
4. Amount paid:	
5. Transaction no.:	
6. Bank details in which payment is made:	
7. Payment is made for: (like penalties/ disgorgement/recovery/ settlement amount and legal charges along with order details)	

20. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, recovery proceedings may be initiated under section 28A of the SEBI Act for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties.

21. In terms of the provisions of Rule 6 of the AO Rules, a copy of this order is being sent to the noticee viz Shriram Insight Share Brokers Ltd and also to the Securities and Exchange Board of India.

Date: June 26, 2020 **Dr. ANITHA ANOOP**

Place: Mumbai **ADJUDICATING OFFICER**