BEFORE THE ADJUDICATING OFFICER
SECURITIES AND EXCHANGE BOARD OF INDIA
[ADJUDICATION ORDER NO. Order/BM/GN/2022-23/24250]

UNDER SECTION 15-I OF SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992, READ WITH RULE 5 OF SEBI (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) RULES, 2005.

In respect of:
MCX (PAN: AADCM8239K)

In the matter of
Trading in MCX by Sikkim based clients

BACKGROUND:

1. Securities and Exchange Board of India (hereinafter referred to as **'SEBI'**) came across various Newspaper articles regarding trading in MCX (hereinafter referred to as **Noticee / Exchange**) wherein it was alleged that since Sikkim residents enjoyed exemptions, they were being used as proxy by traders from other states, unidentified people from outside are taking undue advantage given to Sikkim people and these traders were also indulging in money laundering. It also came to the knowledge of SEBI that trades in exchange from Sikkim based clients had seen a spurt from less than 0.01% in June 2020 of exchange's total turnover to 5.46% in February 2022, which subsequently declined to be 0.01% in June 2022. Thereafter SEBI sought information from the exchange and the reply of the exchange was analysed.

2. Based on the examination conducted by SEBI, it was alleged that the Noticee violated provisions of Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018 (hereinafter referred to as **SECC Regulations, 2018**) and circulars issued by SEBI.

APPOINTMENT OF ADJUDICATING OFFICER

3. SEBI, vide communique dated November 24, 2022, appointed the undersigned as the Adjudicating Officer under Section 19 of the Securities and Exchange Board of India Act, 1992 (hereinafter referred to as **SEBI Act**) read with Sub-section 1 of Section 15-I of the SEBI Act and Rule 3 of SEBI (Procedure for Holding Inquiry and Imposing Penalties) Rules, 1995 (hereinafter referred to as the **SEBI Rules**) and Section 23 I of the Securities Contracts (Regulation) Act, 1956 (hereinafter referred to as **SCRA, 1956**) and rule 3 of Securities Contract (Regulations) (Procedure for Holding Inquiry and Imposing Penalties) Rules, 2005 (hereinafter referred to as **SCR Rules**) to inquire into and adjudge under the provisions of Section 15HB of the SEBI Act and Section 23H of the SCRA, 1956 for the violations alleged to have been committed by the Noticee.

SHOW CAUSE NOTICE, REPLY AND HEARING

4. Show Cause Notice (hereinafter referred to as **"SCN"**) dated November 30, 2022 was issued to the Noticee under rule 4(1) of the SEBI Rules and Rule 4(1) of the SCR Rules to show cause as to why an inquiry should not be held against it in terms of Rule 4 of SEBI Rules read with Section 15-I of SEBI Act and Rule 4 of SCR Rules read with Section 23 I of SCRA, 1956 and penalty, if any, be not imposed on Noticee under Section 15HB of the SEBI Act read with Section 23H of the SCRA, 1956.

5. The allegations levelled against the Noticee are summarized below:

6. From various newspaper articles dated April 2022-May 2022, it came to the knowledge of SEBI that trades in exchange from Sikkim based clients had seen a spurt from less than 0.01% in June 2020 of exchange's total turnover to 5.46% in February 2022, which subsequently declined to be 0.01% in June 2022. It was alleged by newspaper articles that,

   - Since Sikkim residents enjoyed exemptions, they were being used as proxy by traders from other states.
   - Unidentified people from outside are taking undue advantage given to Sikkim people.
   - It is also alleged that these traders were also indulging in money laundering.

SEBI's Observations

UCC Database & KYC mapping by Exchange

7. As per MCX's circular dated December 11, 2019 issued to Trading members, State details as mentioned in UCC database shall be used for determining domicile state for payment of Stamp duty. Thereafter based on communication from DEA vide its letter dated August 19, 2020, Noticee informed its members that no stamp duty would be required to be collected for the State of Sikkim.

In the case of 50 clients:

8. In respect of these clients it is noted from the reply of the Noticee that incorrect client details (State code as 'Sikkim' and city code belonging to Sikkim state) were uploaded for 50 clients by 7 Trading Members in UCC database of the Exchange. The same was not matching with KYC database/ KYC documents of clients, which was having state code other than Sikkim. Also, within the same UCC database, PIN code did not match with State/City Code, such that PIN code belonged to State other than Sikkim. Apparently the same was to avail stamp duty exemption taking advantage of content of MCX circulars of the exchange.

9. It is also alleged that MCX failed to detect these irregularities during on-site/off-site supervision of Trading Members and/or by having necessary system based validations/alerts while uploading client information in UCC database.

10. Given that this also resulted in avoidance of collection of Stamp Duty of the concerned clients, following corrective measures were noted to be taken by Noticee:

- Noticee collected Stamp Duty of Rs. 65,535 from 7 Members (involving 50 client codes)

- Noticee levied penalty of Rs. 5 lakhs (i.e., Rs. 10,000/- per client for the 50 client codes) to these 7 trading members on June 27, 2022, as the act of incorrect upload of state (Sikkim) in UCC database (under a similar provision on 'Material discrepancy in Client registration documents').

11. In respect of the above, it is observed that while stamp duty was collected by Noticee, it is on post-facto basis (post carrying-out analysis of trades till May 2022), pursuant to

aforementioned newspaper articles and various enforcement bodies initiated their examination on the matter, as per abovementioned newspaper articles.

12. Further, while fine was collected from Trading members, it is a minimal fine charged on a not-related clause. It is added herein that the act of trading member to wrongly mention State code as 'Sikkim' in UCC database, apparently to avail stamp duty exemption, is not a "material discrepancy in client registration document (viz. Photograph not provided, no signature, no Pan Card details, No Proof of Address/Identity provided)" viz. the penalty clause under which Noticee has charged concerned trading member; rather no documents were involved here while inputting incorrect State code in UCC database, but it prima facie was a malafide intent of Trading Members to get stamp duty exemption by taking advantage of MCX circulars, which lead loss to exchequer .

13. Furthermore, while Noticee has now initiated verifying and confirming existing and new Sikkim-based accounts and carry, the exchange was obligated to carry-out the same earlier, as per SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021.

14. The purpose of CKYC/eKYC is to have single version of truth of investors' details. However, as noted in case of abovementioned 50 clients, Brokers uploaded different State & City code (that of Sikkim) in UCC database, in complete variance with that of KYC database (that of other states) and with no system-based check to reconcile UCC database with KYC database. In addition, in UCC database itself, PIN code was noted to be different state than State & City code inputted in UCC database, with no system based validation within the same database.

In view of the above, following are alleged against the Noticee:-

15. Alleged failure on the part of Noticee to verify that abovementioned 50 clients were not actual resident of Sikkim State, despite KYC documents of clients reflecting the same; resulted in alleged non-compliance by Exchange with Clause 3 and 4 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021 that required them to ensure having a system proper verification to verify concerned investors are residents of the State of Sikkim.

16. Alleged failure on the part of Noticee to ensure that its members inter alia, cross-checks clients details (including client's address) in UCC database with the clients details on IT department's website and verify the documents submitted with respect to the unique code; which resulted in non-compliance by Exchange with Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021.

17. During Inspection of trading members, Noticee was earlier not verifying KYC related documents of Sikkim-based clients and also that the abovementioned irregularities were failed to be detected in routine inspections conducted by Noticee, resulting in alleged non-compliance with Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010.

18. Noticee allegedly also failed to ensure that TMs don't change the UCC details with malafide intent to take advantage of MCX circular for avoiding stamp duty exemption thereby causing loss to exchequer. Hence, for failure to carry-out its role as 1st level regulator, it is alleged that Noticee violated Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018.

On another 2 LLP clients:

19. On further analysis of Sikkim-based client's data and KYC details as provided by Noticee, it was noted that 1 separate client Valley Distributors LLP (PAN: AANFV0425D) was registered through 2 different associated brokers (East India Securities and East India Commodities Ltd.) and was having 2 different address at the end of review period. This client's trading volume amounted to 95% of MCX's Sikkim-based trading volume during the review period.

20. On further enquiry, Noticee submitted that, the client had registered with Broker 1 - East India Securities since July 2016, with address belonging to West Bengal. On Sept. 16, 2020, client updates its address to that of Sikkim, by providing supporting documents to the concerned broker. The date of changing address is noted to be same as the date when client applied for trading in commodity segment at NSE & BSE and subsequently on March 15, 2021 at exchange. Simultaneously, on September 16, 2020, the client (Valley Distributors LLP) opened a new account with Broker 2 - East India Commodities Ltd. with Sikkim based address.

21. Subsequently, in April 2022, client (with same PAN) changes address with 1st Broker back to West Bengal, whereas address with 2nd Broker remains that of Sikkim. As such, for same client / same PAN, trading through 2 associated brokers, 2 different addresses are reflected in Noticee's database since April 2022. In MCA database, as on September 2022, the address of client is noted to be of Kolkata, West Bengal. Assuming the trades were executed from state other than Sikkim, the stamp duty not collected amounts to Rs. 3.14 crore.

22. It is noteworthy to mention that, the West Bengal address of said LLP client is same as address of both Brokers of the said client. Also, as confirmed by Noticee, partners of the said LLP client are also promoters of both the Brokers of the client (East India Securities and East India Commodities Ltd.).

23. It was also alleged that another client (JMVD Market Solutions LLP), having 5% of Sikkim-based MCX volume during review period, was similarly mis-using Sikkim address and that the client has common partners as directors/promoter of Delhi-based PACE Commodity Brokers. Here the Sikkim address provided in MCA database (as on Sept. 2022) is same as that in client's account opening form belonging to Sikkim state (as provided by Noticee) (Annexure 4). Further, from MCA database, one partner of this LLP client is noted to be director of the Delhi-based broker, via whom this client was trading through.

24. As mentioned by Noticee, no anomalies were observed in KYC documents of clients. As such, despite being top 2 Sikkim-based clients of MCX by trading volume and despite having common partners/directors with both brokers via whom they traded, no further due diligence were carried-out by them to ascertain genuineness of client's address. Further, for client Valley Distributors LLP (that amounted to 95% of trading volume), address changed from Sikkim to West Bengal state at end of 1 associated broker was not effected at another associated broker end and thus same client was trading with 2 associated brokers through 2 different addresses (one Sikkim-based and one West Bengal based). Regardless of the same, no anomalies were noted by Noticee, no further examination was carried-out to examine if their systems were being mis-used to avoid stamp duty payment and also no penalty were thereby imposed on concerned Trading Members.

25. In view of the above, Noticee allegedly failed to carry-out additional due-diligence to ascertain genuineness of the address of these Sikkim-based client and thereby failed to carry-out its role as 1st level regulator in respect of these 2 clients (Valley Distributors LLP

and JMVD Market Solutions LLP) whose cumulative trades amounted to 99.6% of MCX's Sikkim-based trading volume during review period. The same was also not verified during inspection of TM's.

26. Hence, in view of the same, it is alleged that Noticee has not complied with Clause 3-5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021 and Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010. Noticee also allegedly failed to carry-out additional due diligence to ascertain genuineness of the address of Sikkim based clients and thereby failed to carry out its role as 1st level regulator, and therefore allegedly violated Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018.

Delegation for levy of penalty contrary to SEBI Circular & no specific head for penalty charged:

27. As mentioned by Noticee, as the extant policy did not provide for a specific penalty provisions applicable to Brokers for uploading incorrect client details in UCC database of the Exchange, thereby Rs. 10,000/- per client was charged by Noticee as per similar provision on "material discrepancy in client registration document (viz. Photograph not provided, no signature, no Pan Card details, No Proof of Address/Identity provided)".

28. It is observed that, while no provision existed in the Exchange's policy for uploading incorrect client details in UCC database, in place of taking up the matter before MCSGFC for formulating policy & thereby levying penalty to Brokers, Noticee levied monetary fine under some other clause that per se was not related to incorrect client details inputted in UCC database. This resulted in non-compliance of SEBI circular dated January 10, 2019 circular. This is despite considering severity of the instant matter, wherein TMs are noted to upload incorrect client details to a particular state, with apparent malafide intent to mis-use provision of MCX circulars, which lead to non-collection of stamp duty from the client.

29. Further, as per SEBI circular dated January 10, 2020, MCSGFC is the authority to take appropriate action against trading members. However, as informed by Noticee, the 'Relevant Authority' for taking disciplinary actions was changed by Board in its meeting dated October 15, 2020 from MCSGFC to MD&CEO, which is in contradiction to SEBI circular dated January 10, 2020. If penalty levying especially in such cases of fraudulent / intent to misuse is left to MD rather than MCSGF committee, which is a statutory committee

comprising of majority of PIDs, there is borne to be conflict. This is considering that MD also has to take care of commercial role of MII, along-with operational and regulatory role, vis-à-vis PIDs who are representing the interests of investors in securities market, in terms of SECC Regulation, 2018.

30. In view of the above it is alleged that Noticee has not complied with 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019, as per which-

i. Monetary fine shall be levied on broker based on policy approved by MCSGF, however in instant case while no provision existed, in place of taking up the matter before MCSGFC for formulating policy, monetary fine was levied under some other clause.

ii. MCSGFC is the authority for taking appropriate action against Trading members, as against action approved by MD&CEO in instant case.

31. The SCN was issued at the last known address of Noticee through Speed Post Acknowledgment Due (SPAD) which was delivered. SCN was also sent through Digitally Signed E-mail dated December 06, 2022 which was delivered and the delivery of the notice is on record. Vide email dated December 20, 2022 Authorised representative (hereinafter referred to as **AR**) of the Noticee sought inspection of the relied upon documents of the SCN. Vide email dated December 23, 2022 opportunity to inspect and collect copies of the documents was given to the Noticee and its AR on December 27, 2022. On December 27, 2022 Noticee and its AR inspected and collected copies of the documents sought, further Noticee was advised to submit its reply by January 20, 2023. Vide Hearing Notice dated January 12, 2023, opportunity of hearing was given to the Noticee on February 14, 2023. Hearing Notice was issued to the Noticee through SPAD was delivered and Hearing Notice was also sent through Digitally Signed E-mail dated January 13, 2023 which was delivered and the delivery is on record. Vide email dated January 18, 2023 AR sought extension till February 10, 2023 for submission of reply. Vide email dated January 20, 2023 request of the Noticee was acceded to and extension for submission of reply was given till February 10, 2023. Vide email dated February 10, 2023, AR on behalf of the Noticee submitted the reply dated February 10, 2023 which is summarized below-

Enquiry by SEBI pursuant to newspaper articles

I. AR submitted that, it was observed by the Noticee that for 50 client codes (which had traded through 7 TMs), the state details appeared to have been wrongly updated to Sikkim by their concerned members in the UCC database of the Noticee. While Noticee regularly conducts inspections of its members, neither is it expected of the Noticee nor is it required under any SEBI circulars to verify the KYC details of all the clients of Noticee's members. Thus, in the inspections conducted on a sampling basis, the variations between KYC details and UCC database did not come to light. It should be noted that this issue is not restricted to only the Noticee, but the same issue has been observed in other stock exchanges.

II. AR further submitted that the matter pertaining to trading by Sikkim based clients was discussed with SEBI. SEBI advised the Exchange to seek explanation from the TMs regarding the reason for uploading incorrect address details on the UCC database and initiate action against such TMs, as deemed appropriate. It should also be noted that the seven TMs are leading brokers with hundreds/thousands of clients. On asking for an explanation, all the members said that it was an error in back office /typographical/human error while uploading or revising the UCC details in the database.

III. Further, AR submitted that the Noticee took multiple corrective measures as soon as the issues came to light. The Noticee advised MCXCCL to collect stamp duty amounting to INR 65,535/- from the 7 TMs which had provided services to the 50 Clients. The collected stamp duty was remitted to the concerned state governments. Additionally, the Noticee also levied a penalty of INR 5,00,000 (i.e., INR 10,000/- per client for the 50 client codes) on the 7 TMs on June 27, 2022.

IV. AR submitted that the additional verification of the addresses of Sikkim based clients was also discussed with SEBI by all exchanges, which subsequently implemented a verification process for the review and deactivation of any new client uploaded in UCC database of Exchange, having state as Sikkim. It should be noted that this verification process is not a requirement emanating from any circulars or guidelines issued by SEBI. The proactive action has been taken by the Noticee and other exchanges to ensure that stamp duty exemption is not received by any client, except Sikkim based clients, either intentionally or unintentionally. As per the new process, when a new Sikkim based client is on boarded by the TM and uploaded in UCC database, the Noticee marks such client as inactive and seeks the KYC *and address proof of such client codes, irrespective of whether PAN has been submitted for such client or not. Pursuant to confirming that such client is indeed a resident of Sikkim, based on the documents submitted by the concerned TMs, the Noticee activates the client for trading. For the existing clients, reconfirmation of the KYC details of all existing Sikkim based clients is carried out. The Noticee and all other exchanges have mandated TMs to furnish an auditor's certificate confirming the accuracy of the said details (resident), as an additional layer of verification for the existing clients. Also, the Noticee (vide its circular dated October 18, 2022 titled 'Submission of Internal Audit Report for the half year ended on September 30, 2022') made it obligatory for the internal auditors to verify whether TMs have conducted proper due diligence/verification before registering/accepting the clients seeking exemption of PAN viz. investors residing in the state of Sikkim.'*

V. *AR further submitted that, at the time of TM inspection, document verification will also be done for all Sikkim based client codes, instead of verification by sampling basis. The above process will also be followed for any such special category of client codes, if notified in future. The same was also informed to SEBI in the monthly surveillance meeting held on June 30, 2022.*

PRELIMINARY SUBMISSIONS OF THE NOTICEE

VI. *Noticee submitted the following:-*

a) *In Para 9(a) and Para 18 of the Notice, it is erroneously stated that the Noticee issued a circular dated December 11, 2019 in relation to the use of the client's address entered on the UCC database for determining the domicile state for the payment of stamp duty. Further, it is also incorrectly stated that the Noticee, on the basis of communication received from DEA, informed its TMs that no stamp duty would be collected for the state of Sikkim. In this regard, it is clarified that the circular dated December 11, 2019 was, in fact, issued by the MCXCCL vide Circular No. MCX/MCXCCL/697/2019, a clearing corporation and a separate entity which provides clearing and settlement services to the Noticee, and not the Noticee. The same was reiterated under sub-point (viii) of point number (3) of the MCXCCL Circular No. MCX/MCXCCL/738/2019 dated December 31, 2019. Further, on receiving an intimation of the DEA letter, it was MCXCCL, and not the Noticee, which issued a circular, numbered MCX/MCXCCL/600/2020, informing TMs of the non-collection of stamp duty for Sikkim residents.*

b) *In Para 36 of the Notice, Valley Distributors LLP ("VDL") and JMVD Market Solutions LLP ("JMVDL") have been erroneously identified as the "the top 2 Sikkim based clients of MCX". It is submitted that VDL and JMVDL are not clients of MCX but are clients of the TMs of MCX.*

SUBSTANTIVE SUBMISSIONS OF THE NOTICEE

Alleged failure to detect irregularities in routine inspections conducted by the Noticee and verify the KYC documents of Sikkim-based clients.

VII. *Noticee submitted that the scope of the inspection that an exchange is required to carry out over the TMs is limited to examining the TMs' compliance with rules, regulations and circulars issued by SEBI or the exchange, as applicable at the time of inspection, and the efficacy of investor grievance redressal mechanisms.*

Scope of inspection vis-a-vis circulars issued by SEBI

VIII. *AR submitted that the scope of inspection to be carried out by an exchange, with specific reference to circulars issued by SEBI in respect of the UCC database, can be determined by looking at the compliance requirements set out by SEBI in relation to the information contained within the UCC database, vide circulars dated September 16, 2016 and March 08, 2021 ("SEBI UCC Circulars").*

IX. *Further, AR submitted that from a bare reading of the SEBI UCC Circulars, it is clear that TMs, not the exchanges, are obligated to use the UCC for all client transactions on the exchange, and to collect, verify and maintain copies of the client's Permanent Account Number ("PAN") issued by the IT Department for the purpose of uploading the details on the UCC database. In terms of the SEBI UCC Circulars, an exchange is obligated to ensure that a TM: firstly, collects copies of PAN cards issued to clients, post verification with the original; secondly, that the TM cross-checks the PAN details with the details available on the IT Department database; and thirdly, that the TM uploads the PAN details collected to the UCC database of the exchange. Further, an exchange is required to set up a system for verification of the place of residence of Sikkim residents, who are exempt from the requirement of furnishing PAN details. Thus, it is observed that an exchange's supervision over TMs under the SEBI UCC Circulars is confined to ensuring that accurate PAN details are collected from clients, cross checked with the IT Department database, which only reflects the PAN and* *name of an individual, and consequently uploaded to the UCC database, prior to carrying out any transaction on the exchange. Thus, it may be noted that barring the PAN and name of an individual, an exchange cannot access any other details on the IT Department database for the purpose of cross verification. It is further submitted that despite the exemption from stamp duty requirement being granted in August 2020 by the DEA, there were no further guidelines or circulars released by SEBI in respect of verification requirements surrounding KYC details or physical addresses of a TM's clients.*

Scope of inspection vis-a-vis circulars issued by stock exchanges/clearing corporations

X. *AR said that the scope of inspection to be carried out by an exchange, with specific reference to circulars issued by stock exchanges/clearing corporations in respect of the UCC database, can be determined by looking at the compliance requirements set out by the Noticee, in respect of the UCC database, vide circular October 21, 2016.*

XI. *AR further submitted that considering the domicile state of the client shall be used for determining payment of stamp duty, the TMs are required to verify, update and ensure that the addresses of its clients are recorded in an accurate manner on the UCC database. In terms of the provisions of the Master Circular, the Noticee is required to inspect whether the circulars issued by it are complied with. However, such an obligation does not extend to undertaking a thorough audit of the UCC details of each and every client of every TM.*

XII. *AR submitted that the Noticee carried out routine and / or joint inspection with SEBI and other Exchanges of TMs between July 2020 to May 2022 ("Review Period") using a sampling technique. Pertinently, most of the 7 TMs, which had incorrect client codes, had joint inspections conducted by SEBI during the Review Period. By way of sampling technique, a randomized set of clients were selected as a sample per TM, following which the documents, processes and compliance in respect of the sample clients, including the TMs' duty to ensure the entering of accurate address details of the clients on the UCC database, were scrutinised by the Noticee. AR submitted that the degree of scrutiny involved in these inspections was confined to the proper collection, verification and upload of PAN details to the UCC database, and the verification of KYC details, for a sample set of clients per TM. AR submitted that hundreds of TMs are registered with the Noticee and each one of them have hundreds/thousands of clients. It is not humanly possible for an exchange to check every detail, including whether KYC is proper or whether the upload to the UCC database of the client details is proper etc., for each and every client of each and every TM. AR further* *submitted that in respect of entering address details by the TM, the Noticee was merely tasked with inspecting the TM's compliance with the said obligation. There was no mandatory obligation on the Noticee to check the details entered for each client. Further, there was no suspicion that could have led to the Noticee to expand the scope of inspection to specifically review the details of the Sikkim based clients. SEBI cannot impute this obligation on the Noticee with the benefit of hindsight.*

XIII. *AR submitted that the scrutiny of KYC details was done on a limited scale, for sample clients of any TM, and could not have been carried out for all clients, keeping in mind the extensive clientele of the TMs. Further, the percentage of Sikkim clients whose addresses were incorrectly updated to overall clients who traded during the review period of 7 TM's is in the range of 0.0007% to 0.13%. Therefore, probability of these instances being covered in the sample inspection instances is dim. AR further highlighted that the verification of KYC details and reconciliation of the same with the UCC database, is the responsibility of the TMs. While no action has been taken against the TMs by SEBI for failing in their primary responsibility, the Notice attempts to impose liability of TMs' negligence on the Noticee.*

XIV. *AR submitted that during the inspection conducted in the Review Period, the clients of TMs were found to have provided their PAN details, including Sikkim residents who had the option of availing the exemption for mandatory PAN requirements. Thus, having received the PAN details of Sikkim residents, AR submitted that the Noticee was under no obligation to set up a system for verification of the place of residence of such residents. In any case, it is submitted that the setting up of such system for verification of the place of residence was intended towards ensuring that the PAN exemption was validly availed by an actual resident of Sikkim. Thus, the requirement of setting up such systems was not applicable in the event Sikkim residents furnish their PAN details to TMs. In light of the same, AR submitted that the allegation pertaining to failure to detect irregularities and verify the KYC details during inspection cannot be sustained and ought to be set aside.*

XV. *Further, AR submitted that it must be borne in mind that the Noticee, at the time, had no reasons to suspect any irregularities in the entering of details on the UCC database, and cannot be expected to have undertaken the inspection during the Review Period with a suspicious frame of mind. However, on being apprised of the irregularities between April 2022-May 2022, the Noticee took immediate and proactive measures to rectify the situation. AR submitted that pursuant to the surveillance meeting held with SEBI on June 30, 2022, and July 28, 2022, the Noticee and all other exchanges have implemented additional controls* *in its systems. These include examination of the KYC details of all new clients in respect of whom the UCC is generated and reconfirmation of the KYC details of all existing Sikkim based clients. The Noticee and all other exchanges have also mandated TMs to provide an auditor's certificate confirming the accuracy of said details, as an additional layer of verification.*

The Noticee has taken consistent and proactive efforts to remedy the situation in coordination with other exchanges and SEBI

XVI. *AR submitted that the Noticee fully appreciates its responsibility as a first-level regulator and has always endeavoured to follow the letter and spirit of the law while performing its duties. After the information about the above stated irregularities surfaced in and around April – May 2022, the Noticee went well beyond the scope of its duty to inspect and review the KYC documents of all clients traded having state as Sikkim during the period July 2020 to May 2022. On review, the Noticee found that the address details for 50 clients of 7 separate TMs had been wrongly updated in the UCC. The fact of the same was duly brought to SEBI's attention during the surveillance meeting held on May 26, 2022, wherein the Noticee was advised to seek responses from the TMs regarding the irregularities and take appropriate action, if needed. AR submitted that the Noticee took several pro-active steps in remedying the situation, including inter alia, seeking responses from TMs, directing the TMs to rectify the incorrect details and issuing circulars advising the TMs to exercise caution in uploading the address details of its clients on the UCC database.*

XVII. *AR submitted that the Noticee also initiated disciplinary proceedings against the TMs involved in the matter and advised MCXCCL to collect stamp duty amounting to Rs. 65,535/- in toto which was remitted to the concerned state governments by MCXCCL. Further, MCX also imposed a penalty of Rs. 5 lakhs, i.e., Rs. 10,000/- per client on the TMs as against the avoidance of stamp duty of Rs. 65,535/-.*

XVIII. *AR submitted that as more information pertaining to the irregularities in respect of Sikkim based clients came forth, the Noticee engaged with other exchanges on the matter, which were also found to be dealing with similar challenges in respect of Sikkim based clients. The Noticee, along with other exchanges, subsequently discussed the matter with SEBI in the surveillance meeting held on July 28, 2022, wherein a joint process note, containing proposed additional controls to be implemented was submitted to SEBI. As per the said process note it was also mentioned that in case any such irregularities observed, penalty of*

Rs. 10,000/- per client code will be levied. AR submitted that SEBI has noted the process note submitted by the exchanges in the Surveillance meeting held on July 28, 2022 and there were no suggestion/ comments from SEBI related to quantum/ appropriateness of the penalty for such irregularity.

XIX. *In light of the above, AR submitted that the Noticee has consistently demonstrated its commitment towards resolving the issue and has taken measures towards the prevention of such instances in the future, in consultation with SEBI and other exchanges. The Noticee is cognizant of its responsibilities as a market infrastructure institution and has dealt with the situation in a pro-active manner. In light of the same, the allegations levelled in the Notice are unwarranted and ought to be set aside.*

Alleged failure to ensure that the TMs don't change the UCC details with mala fide intent to take advantage of the stamp duty exemption

XX. *AR submitted that the Noticee's supervisory role over a TM, in terms of the circulars issued by SEBI, was confined to ensuring that the PAN details of clients are collected, cross-checked with the IT Department database, which only reflects the PAN and name of an individual, and uploaded on the UCC database, prior to executing any transactions on the exchange. The Noticee ensures the same through UTI Infrastructure Technology and Services Limited, which validates the PAN details uploaded by a TM, in accordance with the details available on the IT Department database. In the scenario that there is a mismatch between the information contained in the UCC database and the PAN database, the UCC of the client is marked as 'inactive' by the Noticee, and trading is restricted. By logical extension, the Noticee is under no obligation to examine the KYC details of a TMs' clients and reconcile them with the UCC database, much less examine the presence or lack thereof of any mala fide intent. Thus, AR submitted that liability for any irregularities in the changes made to the UCC database, regardless of whether these changes were made with mala fide intent, cannot be attributed to the Noticee. Further, the Noticee, having received the PAN details of Sikkim based clients, was also under no obligation to set up separate verification to verify the place of residence of such residents, and thus, was not bound to examine changes in addresses and whether the said changes have been motivated by mala fide intent.*

XXI. *Further, AR submitted that out of the 50 clients, 25 client codes, spread across 7 TMs, were uploaded in the Noticee's UCC database well in advance of the gazette notification issued by the Ministry of Finance on August 19, 2020, directing not to collect stamp duty for the state* *of Sikkim. Thus, the details pertaining to the said 25 client codes, which were uploaded prior to the release of DEA's directive dated August 19, 2020, could not have been seen as having been wrongly uploaded with the malafide intent to take advantage of the stamp duty exemption by the Noticee.*

XXII. *Thus AR submitted that the above allegation imposes a fictitious and onerous responsibility on the Noticee with no backing under any regulations or circulars framed by SEBI. The Noticee has followed the standard operating procedure, as required and expected from an exchange, with utmost sincerity and had no reason to believe that there existed any mala fide intent on part of any of its TMs' clients during the Review Period. AR further submitted that SEBI, prior to levelling the above allegation, has not established mala fide intent on part of the TMs, or investigated the same.*

The attendant circumstances did not give rise to the suspicion of mala fide intent

XXIII. *AR further submitted that the circumstances that existed during the Review Period did not give rise to an iota of doubt over the presence of mala fide intent on part of the TMs to wrongfully avail the stamp duty exemption granted in favour of Sikkim based clients. AR submitted that the 50 clients spread over 7 TMs, in respect of whom mala fide intent has been alleged in the SCN, contributed to a mere 0.002% of the total turnover of the Noticee (futures and options - notional based) during the Review Period. Moreover, the stamp duty that is alleged to have been avoided by the TMs amounted to a meagre Rs. 65,535/- for the said 50 clients during the Review Period of around two years. Considering the miniscule quantum of stamp duty that is alleged to have been avoided, and the stature and scale of the TMs involved, which include inter alia Zerodha Broking Ltd, Angel Broking Ltd, etc., it is difficult to fathom that the irregularities could have been effected with mala fide intent. AR submitted that even post the Review Period, the responses sought by the Noticee from all 7 TMs indicated that the irregularities arose on account of technical or manual errors in the TMs' systems and were rectified immediately.*

XXIV. *Thus, AR submitted that the attendant circumstances during and post the Review Period do not, by any standards, suggest the presence of mala fide intent, and thus, the Noticee cannot be held liable for failure to ensure against upload / change in the UCC database with malafide intent.*

The Notice is vague and contains bald assertions of mala fide intent

XXV. *AR submitted that the Notice does not contain any references or evidence of any erstwhile instances that may indicate such malafide intent on part of the TMs, at the time. An attempt to obtain the same was made by the Noticee on December 27, 2022, wherein a request was made for the documents relied on for the purpose of arriving at the inference of malafide intent on the part of the TMs. However, SEBI merely provided a copy of the Notice and no other relevant document for the purpose. In this regard, AR mentioned the case of* ***Commissioner of Central Excise, Bangalore v. Brindavan Beverages (P) Ltd. and Ors.,*** *wherein the Hon'ble Supreme Court observed that:*

"10. There is no allegation of the respondents being parties to any arrangement. In any event, no material in that regard was placed on record. The show cause notice is the foundation on which the department has to build up its case. If the allegations in the show cause notice are not specific and are on the contrary vague, lack details and/or unintelligible that is sufficient to hold that Noticeee was not given proper opportunity to meet the allegations indicated in the show cause notice."

XXVI. *Further, the Hon'ble Supreme Court in* ***T. Takano v. SEBI****, held:*

39. The following principles emerge from the above discussion:

(i) A quasi-judicial authority has a duty to disclose the material that has been relied upon at the stage of adjudication; and

(ii) An ipse dixit of the authority that it has not relied on certain material would not exempt it of its liability to disclose such material if it is relevant to and has a nexus to the action that is taken by the authority. In all reasonable probability, such material would have influenced the decision reached by the authority.

[…]

51. […]

(iii) The disclosure of material serves a three- fold purpose of decreasing the error in the verdict, protecting the fairness of the proceedings, and enhancing the transparency of the investigatory bodies and judicial institutions."

XXVII. *In light of the above decisions, AR submitted that a show cause notice should markedly point* *out the facts and circumstances that the regulatory authority has relied upon to hold a Noticee liable for committing a violation. For every violation of any provision of law alleged against the Noticee, the show cause notice must provide the facts leading to the apprehension of such violation having been committed, and the facts to show the justification for any assertion made in the show cause notice.*

XXVIII. *AR submitted that the Notice alleges that the Noticee has violated Regulation 7(3)(e) and Regulation 12(5) of the SECC Regulations, this provisions require an exchange to 'have an adequate facility to admit and regulate its members', which mandated an exchange to have broad policies and processes towards admitting and regulating its members. AR submitted that the Noticee has adequate facilities and has prescribed processes towards admitting and regulating its members. These procedures have evolved over a period of time based upon the rules and regulations framed by SEBI, and has been the subject matter of various inspections and review by SEBI.*

XXIX. *AR submitted that the Noticee cannot be alleged of not having adequate processes to regulate its TMs merely on the bald assertion that the Noticee failed to detect mala-fide intent and prevent the changes made to the UCC details by its TMs. AR submitted that the Noticee as an exchange could not be expected to prevent all frauds and malafide actions by clients of TMs and all such frauds and malafide actions cannot be seen as failure of Noticee's processes in regulating its TMs. In the instant case, the Noticee had acted diligently but the circumstances that existing during the Review Period did not give rise to any suspicion of malafide intent on part of the TMs. Therefore, the allegation against the Noticee of not having adequate processes do not stand and should be dismissed.*

Alleged failure on part of the Noticee to verify that the 50 clients were not actual residents of Sikkim

XXX. *AR submitted that an exchange's obligations under Clause 3 and 4 of the SEBI UCC Circulars are limited in scope. As far as the verification of the TMs' clients is concerned, the role of an exchange is confined to ensuring that accurate PAN details are collected from clients by TMs, cross checked with the IT Department database and consequently uploaded to the UCC database, prior to carrying out any transaction on the exchange.*

XXXI. *AR further submitted that as per Clause 4 of the SEBI UCC Circulars, PAN is a unique identifier. However, investors residing in Sikkim are exempted from the mandatory* *requirement of PAN and exchanges are required to ensure proper systems for verifications for only for such investors. It may be noted that none of the above-referred client/ investors of these 7 TMs availed the exemption from the mandatory requirement of PAN and thus, did not warrant any verification except PAN. It was observed that a similar circular was issued by SEBI for depositories vide Circular MRD/DoP/Dep/Cir-09/06 dated July 20, 2006, wherein a similar verification requirement for PAN exempt investors was specified.*

XXXII. *The requirement to put a verification system in place for Sikkim based clients, is only applicable in the event the aforementioned exemption is availed, to ensure that such exemption is validly availed only by Sikkim residents.*

XXXIII. *AR also submitted that apart from the said circulars, SEBI has not issued any other guidelines, circulars or directions in respect of the verification of KYC details of a TM's clients by an exchange. Thus, AR submitted that the obligations of an exchange in respect of verification is limited to ensuring that the details entered on the UCC database are in accordance with the PAN details of the said client, which do not reflect the place of residence, as only the PAN and names of the clients are available on the IT Department database for verification by the exchange. AR further submitted that the verification of details entered in the UCC database with the KYC details of the client is not envisaged within an exchange's obligations and belies practical considerations. The Noticee is neither bound to conduct such verification, nor is such verification humanely possible, considering the extensive clientele of each TM. Further, there are no guidelines or SEBI circulars which prescribe that the UCC details need to be verified with KYC database, which is maintained by KRA (a SEBI regulated entity). In any case, an exchange is allowed access to this KYC database only for the limited purpose of client investigation.*

XXXIV. *AR submitted that the verification of the KYC details of clients, and reconciliation of the said details with the UCC database is the TMs' responsibility and liability for any lapse on part of the TMs cannot be fastened on the Noticee. In this regard, AR mentioned the Bombay High Court's observations in* ***Principal Commissioner of Income-Tax v. National Stock Exchange****, wherein the court, while dealing with the question of whether the National Stock Exchange ("NSE") should be liable for under-collection of securities transaction tax, the responsibility for which was assigned to the TMs, categorically held:*

"12. […] All the securities transaction tax have been collected through and under the client codes of the members. It is not the case that the assessee has not collected the securities

transaction tax under the given client code. ***If a member/broker does not collect securities transaction tax through client code or has not taken the separate client codes in case of FIIs, then so far as the assessee is concerned, no liability can be fastened on the NSE.***

The duty of the NSE so far as the provisions of Securities Transaction Tax Act read with Securities Transaction Tax Rules are concerned, is to collect the tax at a correct rate of purchase and sale of shares executed through particular client code. If there is default by a member either at the time of collecting the securities transaction tax in accordance with the client code; or certain additional amount of securities transaction tax is to be collected on account of any compliance of SEBI Regulations, which has not been done without adherence of client code; then, the assessee cannot be held responsible or liability can be fastened (on the exchange).

The assessee can only ensure the determination of value of taxable securities transaction purchased and sold through a client code and in accordance with the prescribed rate. ***Beyond that, there is no mechanism provided under the Act or Rules that the assessee should mandatorily collect securities transaction tax beyond the client codes.****" (emphasis supplied)*

XXXV. *In light of the principle enunciated above, AR submitted that liability for non-performance of an obligation placed on a TM, cannot be fastened on the Noticee, without identifying the provisions of law that provide for the liability for breach of such obligation/s to be attributed to an exchange.*

XXXVI. *AR said that SEBI only issued clear instructions to the exchanges and formed a view on the irregularities only after the same came to light sometime between April 2022-May 2022, i.e., in response to an existing market challenge that was brought to its attention. Pursuant to the same, AR submitted that the Noticee and other exchanges inter alia sought responses from the TMs and implemented additional controls in its systems, including the examination of the KYC details of all new clients in respect of whom the UCC is generated and reconfirmation of the KYC details of all existing Sikkim based clients. Considering the absence of any clear guidelines or circulars on KYC verification at the time, the liability for failure to verify the KYC details and addresses of Sikkim based clients cannot be imposed in a post facto manner, on the basis of and in response to information that surfaced much later.*

XXXVII. *AR submitted that the TMs are also SEBI registered intermediaries and the task of verification of KYC details has been fastened upon TMs under the SEBI (Stock Brokers) Regulations,* *1992 and various circulars issued by SEBI. Any violation of these obligations by TMs should not be fastened upon the Noticee without having basis in law and cannot be seen as a reasonable expectation originating from the duties and functions of an exchange. Thus, AR submitted that the allegations made in the Notice are unfounded and there is no material on record to show that the Noticee had any obligation to carry out diligence for the verification of the addresses of the clients in the above case.*

<u>Alleged failure on part of the Noticee to ensure cross-verification of the details entered in the UCC database with the IT Department database by the TMs</u>

XXXVIII. *AR submitted that on cursory reading of the Clause 5 of the SEBI UCC Circulars, it clearly indicates that an exchange's core obligation is to secure the generation of a UCC for all clients, prior to executing their transactions on the exchange. For the generation of the said UCC, TMs are required to collect and verify their clients' PAN, which is treated as the sole identification number that must be provided, as a pre-requisite to transacting on the exchange. It must be noted that the SEBI UCC Circulars require TMs to collect PAN details for the purpose of uploading said details to the UCC database of the exchange. Thus, the PAN is treated as the sole document that must be collected and verified, for the purpose of generating the UCC. Besides the PAN, the SEBI UCC Circulars do not specify any other document that must be submitted with respect to the UCC. Moreover, an exception is carved for Sikkim based clients who can avail the exemption granted in respect of mandatorily submitting their PAN details. These clients choose to submit other documents, as a substitute to PAN details, for the generation of the UCC.*

XXXIX. *However, since Sikkim based clients are exempt from the mandatory requirement of submitting their PAN, exchanges are required to set up a system to verify that such clients are indeed residents of Sikkim. In this regard, it is submitted that the requirement to set up such a system is intended to verify the actual place of residence of the Sikkim based clients, if the said clients avail the exemption, to ensure that the exemption is validly availed. Thus, it is submitted that the requirement is only applicable in the eventuality that Sikkim based clients choose to avail the given exemption, and it would be absurd to read the requirement as one of the exchange's obligations if the PAN details, are in fact, provided by said clients.*

<u>Alleged failure on part of the Noticee to carry out adequate due diligence to ascertain genuineness of the addresses of VDL and JMVDL, two Sikkim based clients</u>

(i) VDL did not have two separate addresses concurrently

XL. *AR submitted the sequence of events pertaining to the change in address of VDL and its* *association with the two brokers.*

Sr. no	*Date*	*Particulars*
		Summary of VDL with EI Commodities
1	*July 2005*	*EI Commodities became a member of the Exchange*
2	*September, 2020*	*VDL became a client of EI Commodities. EI Commodities uploaded the UCC details of VDL with the address as Sikkim on September 16, 2020 and started trading from September 17, 2020. VDL continued to trade through EI Commodities till June 14, 2021. The last trade date of EI Commodities was also June 14, 2021.*
3	*August 2021 to March 14, 2022*	*EI Commodities submitted application for surrender of membership in August, 2021 and finally, after completion of all processes, in March 14, 2022 EI Commodities surrendered its membership. At the time of surrender of membership, the address of VDL was Sikkim and once the membership is surrendered, no changes can be made in any details including UCC.*
		Summary of VDL with EI Securities
1	*2016*	*VDL was a client of EI Securities since 2016. EISL was not a member of the Noticee at the relevant time.*
2	*September 2018*	*EI Securities became a member of the Noticee.*
3	*March 2021*	*EI Securities uploaded the UCC details of VDL with address as Sikkim on March 16, 2021 and started trading from March 31, 2021.*
4	*April 26, 2022*	*EI Securities changed address of VDL from Sikkim to West Bengal*

XLI. AR submitted that as stated in the table above, VDL shifted its address from West Bengal to Sikkim in September 2020. EI Commodities was a member of the Noticee. To trade on MCX, VDL became a client of EI Commodities in September 2020 and gave its Sikkim address to the member. Thus, all trades were executed through EI Commodities by VDL when it had its registered office in Sikkim.

XLII. AR submitted that in 2017, SEBI had integrated the stock broking and commodity broking activities and removed the restriction on stockbrokers to act as commodity brokers. EI Securities and EI Commodities are related entities. In order to bring all its business under the same entity, EI Securities became a member of the Noticee in 2018. Gradually, EI Commodities began phasing out its activities on the exchange and all trades were routed through EI Securities. To this effect, EI Commodities submitted an application for surrender of membership on August 31, 2021; and finally, after completion of all procedures, EI Commodities surrendered its membership on March 15, 2022.

XLIII. AR submitted that VDL had been a client of EI Securities since 2016. However, VDL did not execute any transactions through EI Securities on MCX till March 2021. On March 16, 2021, EI Securities uploaded details of VDL in UCC database of the Exchange with state mentioned as Sikkim and thereafter, VDL started trading from March 31, 2021. Within a few months, by June 2021, VDL stopped trading through EI Commodities.

XLIV. AR submitted that in April 2022, VDL once again shifted its address back to West Bengal *and EI Securities updated the UCC records. The records of EI Commodities could not be updated as the Noticee does not allow any change in details after the termination of membership. It is only because of this reason that there are currently two addresses of the same client, i.e., old Sikkim address with EI Commodities and new West Bengal address with EI Securities.*

XLV. *AR submitted that from the above, it is amply clear that VDL did not have two addresses at the same time at any point in time. All the addresses were changed after complying with all formalities by the concerned TM of VDL. SEBI has not appreciated all the facts and formed its conclusions based on incomplete details.*

That the allegation that JMVDL misused its address is baseless

XLVI. *AR submitted that with regard to JMVDL, merely a blanket statement has been made in the Notice that JMVDL has misused its address, in a manner similar to VDL, without substantiating this allegation in any manner.*

XLVII. *During the inspection, on making a request to the concerned TM, Noticee received documents evidencing the alleged misuse of the Sikkim address by JMVDL. The documents received include a copy of the record of JMVDL from the MCA database, KYC document of JMVDL, copy of board resolution based in the meeting of JMVDL, LLP amendment agreement of JMVDL and the rent agreement of JMVDL. It is pertinent to note that in all these documents, the address of JMVDL is of Sikkim. Thus, the address of JMVDL uploaded in the UCC database of the exchange was in line with the KYC document received from the TM.*

XLVIII. *Therefore, AR submitted that the whole allegation with respect to JMVDL is based on surmises and conjectures and no documents or proofs have been relied upon to establish the allegation against the misuse of the Sikkim address by JMVDL.*

Mere connection with TM does not warrant suspicion

XLIX. *AR submitted that the Notice has failed to provide any circulars, guidelines, or regulations which require an exchange to probe the bona fide of client of a TM merely because the TM and client are related or have same addresses, mere connection between the brokers and their clients does not warrant suspicion. AR submitted that, without prejudice, the Notice fails to bring out any malice which can be attributed and which Noticee failed to detect in terms of extant regulations to such connection between VDL/JMVDL and their TMs.*

Noticee had not violated any of the SEBI regulations as alleged

L. *AR submitted that from the submissions made hereinabove, it is amply clear the addresses* *uploaded in respect of VDL and JMVDL to the UCC database by the concerned TMs were in line with the KYC documents. All the allegations made in the Notice against the Noticee were based on incomplete details and on conjectures and surmises. Thus, AR submitted that the allegation in relation to the Noticee's failure to monitor the two entities, VDL and JMVDL, deserves to be dismissed summarily for want of any basis and evidence.*

Alleged failure by the Noticee to appropriately levy penalty on TMs

LI. At the outset, AR submitted that SEBI did not take into consideration the decisions taken by the MCSGFC and Board of the Noticee in 2020 before alleging that the provisions of the January 10, 2019 circular have been violated. After the issuance of the January 10, 2019 circular, in its meeting dated February 25, 2019, the Board approved the proposal specifying MCSGFC as the relevant authority for various issues, including declaring a member as a defaulter (under Rule 41A) and expelling a member (under Rule 43). In its meeting dated October 01, 2020, the MCSGFC considered the terms of reference provided under the January 10, 2019 circular and the relevant byelaws and rules of the Noticee, and was of the opinion that matters pertaining to the declaration of a member as a defaulter was not in the terms of reference issued by SEBI. AR submitted that this understanding is accurate as the terms of reference only provide MCSGFC the authority to formulate policy for declaring a member as a defaulter, but does not explicitly state that the committee should also consider cases of violation and declare a member as defaulter. Thus, unwilling to exceed the scope outlined by SEBI, the committee was of the view that the relevant provisions relating to declaration as defaulter be reviewed and a note be placed before the Board of the Noticee. On October 15, 2020, the Board of the Noticee reviewed the suggestion and MD&CEO was appointed as the relevant authority to declare a member as defaulter and for expulsion of a member and other disciplinary action.

LII. AR submitted that the Noticee was aware of the gravity of the issue of wrong entries in the UCC database by the seven TMs. In accordance with the gravity of the issue, the seven TMs were proceeded against in terms of Rule 43(b) of the Rules of the Noticee read with Byelaw 14A & 14A.1, which provide for actions that can be taken against a member for misconduct:

"43. Power of the Board to define the grounds of suspension/expulsion

If any Member of the Exchange is guilty of such conduct or act or omission that under the aforesaid Bye-Laws, Rules and Regulations made in that behalf render him liable to suspension, expulsion or other consequences, the Board or the relevant authority shall suspend, expel or impose other consequences as the Board or ***the relevant authority*** *may* *deem fit.*

14A. Misconduct, Un-business like conduct, Unprofessional Conduct and Prohibition of Fraudulent and Unfair Trade Practices:

Members shall be liable to expulsion, suspension and / or withdrawal of all or any of its membership rights and / or to payment of a fine and / or to be censured, reprimanded or warned for any misconduct, un-business like conduct or unprofessional conduct, fraudulent and unfair trade practices in the sense of the provision in that behalf contained herein

14A.1. Misconduct: Members shall be deemed guilty of misconduct for any of the following or similar acts or omissions namely:

b) Violation: If it has violated provisions of any statute governing the activities, business and operations of the Exchange, Members and Commodities business in general;"

LIII. *AR submitted that in accordance with the due process, an explanation was sought from the TMs by the Noticee for the wrong entry of state / city code in the UCC database. It was informed by the TMs that it was a technical or manual error on their part while uploading the entries on the database. AR submitted that all the members who have entered the wrong details are members with hundreds of clients. The Noticee noted that in around 50 cases, the entries were wrongly entered. It should also be noted that the TM itself did not gain anything from this error, and the stamp duty exemption availed was also only around INR 65,000. As it cannot be stated that there was a malafide intent to gain anything by the members. Moreover, there was no circular issued by SEBI providing a penalty for incorrect details entered by the TMs in the UCC database.*

LIV. *AR submitted that no separate provision existed for incorrectly entering the KYC details in the UCC database, the relevant authority, which in this case would be the MD & CEO in terms of the decision of the Board of the Noticee taken in its meeting dated October 15, 2020, took a decision to impose a penalty after considering the gravity of the violation. For the purpose of determining the quantum of penalty, similar provision as prescribed in as per Point 3(d) "PENALTIES / DISCIPLINARY ACTIONS FOR PROCEDURAL VIOLATIONS" of Annexure A Part 1(b) of MCX circular dated October 30, 2017, bearing reference no. MCX/INSP/400/2017 was considered. This provision states that in case of material discrepancy in the client registration document, a penalty of INR 10,000/- is applicable. The provision is as follows: "Material Discrepancies (viz. Photograph not provided, No signature, No Pan Card details, No Proof of Address/Identity provided) in Client registration documents". Since the UCC database captures all the information as mentioned in the client registration* *document, the relevant authority was of the opinion that this provision is applicable to the facts of the current matter and the quantum of penalty is also commensurate with the violation. Thus, AR submitted that it is incorrect to say that the monetary fine was levied under some other clause.*

LV. *AR submitted that SEBI had delegated the responsibility to formulate a policy for regulatory actions and to impose regulatory measures on the members of exchanges to the MCSGFC of said exchanges. The MCSGFC had interpreted this circular and rightfully made the MD&CEO the relevant authority for certain actions. AR further submitted that this decision was taken in 2020, much prior to the imposition of penalty on the members and it was not an ad-hoc decision taken for this specific instance. Further, SEBI had been aware of this decision pursuant to its inspection of MCX for the period April 01, 2020 to September 30, 2021, wherein Noticee had shared all the Committee/Board minutes to the SEBI inspection team for the mentioned inspection period.*

LVI. *Similarly, AR submitted that in the joint process note, with other exchanges, submitted to SEBI by the Noticee on July 21, 2022, it was mentioned that since there is no specific provision in the Rules and Byelaws of Noticee, penalty of INR 10,000 per client will be imposed on the concerned TMs. Further, in the surveillance meeting held on June 30, 2022, the Noticee had informed SEBI of the imposition of this penalty.*

LVII. *Furthermore, AR submitted that the entire allegation that the penalty provision is improper is flowing from SEBI's mistaken assumption that the TMs had committed this violation in a malafide manner with an intent to gain.*

LVIII. *Thus, in view of the above, AR submitted that the MD&CEO is the relevant authority and the penalty provision has been appropriately applied by the Noticee. Further, a note was also placed before MCSGFC in it meeting held on October 28, 2022 informing the Committee about the matter and imposition of penalty on 7 members.*

Failure to implement ROC decision to conduct forensic audit on Sikkim matter

LIX. *AR submitted that in the meeting held on May 12, 2022, the ROC, along with the proposal to conduct a forensic audit, also directed the management to examine whether the ROC itself had the authority to recommend such an audit. Subsequently, on June 16, 2022, the MD and CEO of MCX responded to the queries raised in the ROC meeting dated May 12, 2022 and stated that the committee does not have the authority to direct a forensic audit, and recommended that the proposal be placed before the audit committee or the competent authority. Subsequently, responses to the queries raised were submitted to the ROC,* *following which the ROC reiterated its decision to conduct the forensic audit on obtaining the necessary approvals to which MD & CEO stated that the proposal shall be placed before the audit committee for deliberation. Shortly thereafter, on July 30, 2022, the Noticee's board directed that the said proposal shall be placed before the audit committee, and an opinion from the statutory auditors must be taken on the forensic audit, and whether it requires the prior approval of the audit committee. The proposal was then placed before the statutory auditor, who provided its opinion vide letter dated October 17, 2022. It is submitted that the said opinion was to be taken up for discussion by the audit committee through a meeting scheduled to be held on October 22, 2022. However, on account of the letter having been received near the date of audit committee meeting, the matter was deferred due to paucity of time to review the opinion. On December 06, 2022, the matter was finally taken up by the board of directors, who authorised the management to appoint an auditor and proceed with conducting the special audit and not a forensic audit. At present, request for proposals was issued to audit firms and the auditor (Ernst and Young LLP) has been selected for conducting audit, which is currently underway.*

LX. AR submitted that the decision to conduct an audit and appointment of auditors are major decisions that necessitates proper consideration and internal approval by the appropriate authority within the Noticee. As demonstrated above, the Noticee has given serious consideration to the ROC's proposal to conduct an audit and has taken concrete steps towards implementing the same. It is further submitted that the Noticee had simply attempted to form a well-informed view on the proposal and obtain all necessary internal approvals and authorisations, prior to implementing the proposal.

CONCLUSION

LXI. In light of the factual and legal submissions made above, AR requested to dismiss the allegations in the Notice and discharge the Noticee from the present proceedings, and accordingly pass a reasoned order to that effect. AR reiterated the grounds hereinbelow:

(a) That the Noticee appropriately carried out inspection of its members and did not fail to detect irregularities during inspection, and thus, has not contravened Para 4(a) of the Master Circular.

(b) That the Noticee did not fail to ensure TMs do not change details uploaded in the UCC database with the malafide intent to wrongfully avail the stamp duty exemption, and thus, has not violated Regulation 7(3)(e) read with Regulation 12(5) of the SECC Regulations.

(c) That the Noticee has appropriately fulfilled its obligations stated in Clauses 3 and 4 of the

SEBI UCC Circulars, and has not violated the same.

(d) That the Noticee has duly exercised oversight and fulfilled its obligations stated in Clause 5 of the SEBI UCC Circulars, and has not violated the same.

(e) That SEBI did not appreciate all evidence while alleging VDL and JMVDL had incorrect addresses and the Noticee has not failed in conducting its due diligence to ascertain the same, and thus, Noticee has not violated Clause 3 and 5 of the SEBI UCC Circulars, Para 4(a) of the Master Circular, and Regulation 7(3)(e) and Regulation 12(5) of the SECC Regulations.

(f) That the Noticee has not violated Clause 2 and 3 of the terms of reference of the MCSGFC prescribed in Annexure A of January 10, 2019 circular issued by SEBI;

(g) That the Noticee has not failed to implement the suggestion of the ROC to conduct a forensic audit on the Sikkim matter.

32. In the interest of Natural Justice, opportunity of hearing was given to Noticee on February 14, 2023 vide hearing Notice dated January 12, 2023. The Noticee nominated an AR to appear on its behalf for hearing on February 14, 2023 vide e-mail dated February 13, 2023 and February 14, 2023.

33. On the date of hearing, the AR appeared along with the Noticee. The AR reiterated the submissions made vide letter dated February 10, 2023. AR also sought time till February 17, 2023 for making submission of the following documents:-

    a) Minutes of board meeting of December, 2022.

    b) Minutes of Member & Core SGF Committee meeting.

    c) Minutes of Regulatory Oversight Committee meeting.

    d) Documents pertaining to surrendering of membership of East India Commodities Ltd.

    e) Copy of the SAT orders referred to during the hearing.

34. AR vide email dated February 17, 2023 submitted the following documents:-

    a. Relevant extract of the minutes of board meeting dated February 25, 2019.

    b. Relevant extract of the minutes of board meeting dated October 15, 2020.

    c. Relevant extract of the minutes of board meeting dated July 30, 2022.

    d. Relevant extract of the minutes of board meeting dated December 06, 2022

    e. Relevant extract of the minutes of the Member and Core Settlement Guarantee Fund

Committee ("MCSGFC") meeting dated October 01, 2020

f. Relevant extract of the minutes of MCSGFC meeting dated October 28, 2022

g. Relevant extract of the minutes of the Regulatory Oversight Committee meeting dated May 12, 2022

h. Copy of documents pertaining to the surrender of membership by East India Commodities Pvt. Ltd.

i. Chronology of events in the matter

j. Copy of order by the Securities Appellate Tribunal in Toubro Infotech & Industries Ltd. v. Kanwar Deep Singh

k. Copy of the Hon'ble High Court of Bombay in Principal Commissioner of Income Tax v. National Stock Exchange

ISSUES FOR CONSIDERATION, EVIDENCE AND FINDINGS

35. I have taken into consideration the facts and circumstances of the case and the material available on record. The issues that arise for consideration in the present case are:

ISSUE I: Whether Noticee violated the provisions of Clause 3 and 4 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021, Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021, Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018, Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010, 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019?

ISSUE II: Does the violation, if any, on part of the Noticee attract penalty under Section 15HB of SEBI Act read with Section 23H of the SCRA?

ISSUE III: If so, how much penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act and 23J of the SCRA?

36. Before proceeding further, it will be appropriate to refer to the relevant provisions:

SEBI circular dated March 08, 2021

Clause1-SEBI had issued circular no. SEBI/HO/CDMRD/DMP/CIR/P/2016/87 dated September 16, 2016 which, inter-alia, provided guidelines on use of Unique Client Code (UCC) and mandatory requirement of Permanent Account Number (PAN) for trading on commodity derivative exchanges(now referred as Exchanges having commodity derivatives segment).

Clause 2.In the Union budget 2020, launch of instant PAN facility was announced and subsequently, Income Tax (IT) Department launched the facility of e-PAN which is generated instantly through Aadhaar based e-KYC.

Clause 3:- In order to rationalize the compliance requirement of collecting and maintaining copies of PAN of clients by their respective members and enhance the use of e-PAN, it has been decided to modify certain provisions of SEBI circular dated September 16, 2016 which are as follows:

3.1 Clause 3 of the Circular is modified as under:

"It shall be mandatory for the members of the exchanges having commodity derivatives segment to use Unique Client Code (UCC) for all clients transacting on the commodity derivative segment. The exchanges with commodity derivatives segment shall not allow execution of trades without uploading of the UCC details by the members of the exchange. For this purpose, members shall collect after verifying the authentic city and maintain in their back office the copies of Permanent Account Number (PAN) issued by the Income Tax (IT) Department, for all their clients.

However, in case of e-PAN, members shall verify the authenticity of e-PAN with the details on the website of IT Department and maintain the soft copy of PAN in their records."

3.2. Clause 5 of the Circular is modified as under:

"The exchanges having commodity derivatives segment shall ensure that the members of their exchanges shall:

i. collect copies of PAN cards issued to their existing as well as new clients after verifying with the original.

ii. cross-check the aforesaid details collected from their clients with the details on the website of the Income Tax (IT) Department. However, in case of e-PAN, verify the authenticity of e-PAN with the details on the website of IT Department and maintain the soft copy of PAN in their records."

iii. upload details of PAN or e-PAN so collected to the Exchanges as part of Unique Client code.

iv. verify the documents with respect to the unique code and retain a copy of the document.4.The provisions of this circular shall come into effect from April 1,2021.All other provisions in the circular dated September 16, 2016 shall continue to remain in force.

Clause 4- The provisions of this circular shall come into effect from April 1,2021. All other provisions in the circular dated September 16, 2016 shall continue to remain in force.

Clause 5.This Circular is issued in exercise of powers conferred under Section 11 (1) of the Securities and Exchange Board of India Act, 1992, to protect the interests of investors in securities and to promote the development of, and to regulate the securities market.

Clause 6.The Exchanges with commodity derivatives segment are advised to:

6.1 to make necessary amendments to the relevant bye-laws, rules and regulations; 6.2 bring the provisions of this circular to the notice of the stock brokers/members of the Exchange and also to disseminate the same on their website; and

6.3 communicate to SEBI, the status of the implementation of the provisions of this circular.

Clause 7. This circular is available on SEBI website www.sebi.gov.inunder the category "Legal -Circulars" and "Info for Commodity Derivatives

SEBI circular dated September 16, 2016

Clause 3- It shall be mandatory for the members of the commodity derivatives exchanges to use Unique Client Code (UCC) for all clients transacting on the commodity derivatives exchanges. The commodity derivatives exchanges shall not allow execution of trades without uploading of the UCC details by the members of the exchange. For this purpose, members shall collect after verifying the authenticity and maintain in their back office the copies of Permanent Account Number (PAN) issued by the Income Tax Department, to all their clients.

Clause 4- PAN would be the sole identification number and mandatory for all entities/persons who are desirous of transacting on the commodity derivatives exchanges.

However, the investors residing in the State of Sikkim are exempted from the mandatory requirement of PAN. The exchanges should, however, ensure a system of proper verification to verify that such members / investors are residents of the State of Sikkim.

Further, PAN may not be insisted in the case of Central Government, State Government, and the officials appointed by the courts e.g. Official liquidator, Court receiver etc. (under the category of Government) for transacting in the securities market. The intermediary shall verify the veracity of the claim of the specified organizations, by collecting sufficient documentary evidence in support of their claim for such an exemption.

Clause 5- The commodity derivatives exchanges shall ensure that the members of their exchanges shall:

- *collect copies of PAN cards issued to their existing as well as new clients after verifying with the original.*
- *cross-check the aforesaid details collected from their clients with the details on the website of the Income Tax Department.*
- *upload details of PAN so collected to the Exchanges as part of Unique Client Code.*
- *verify the documents with respect to the unique code and retain a copy of the document.*

Securities Contracts (Regulation) (Stock Exchanges and Clearing Corporations) Regulations, 2018

Clause 7- Consideration of grant of recognition

(3) An applicant seeking recognition as a stock exchange shall, in addition to the conditions as specified in sub-regulations (1) and (2), comply with the following conditions, namely:—

(e) the applicant has necessary capability to have a nationwide network of trading members and has adequate facility to admit and regulate its members;

Clause 12- Renewal of recognition

(5) The recognised stock exchange and recognised clearing corporation shall comply with the applicable conditions specified in sub-regulation (3) and sub-regulation (4) of regulation 7, as the case may be, on a continuous basis.

Master Circular on Oversight of Members (Stock Brokers/Trading Members/Clearing Members of any Segment of Stock Exchanges and Clearing Corporations) dated March 17, 2010

Para 4. The inspection shall cover:

a. Compliance with the relevant provisions of the Act, Rules and Regulations made there under, Rules and Regulation of the Stock Exchange / Clearing Corporation and the circulars issued by SEBI and Stock Exchanges / Clearing Corporations from time to time

SEBI circular dated January 10, 2019

Committees at Market Infrastructure Institutions (MIIs)

- *Formulate the policy for regulatory actions including warning, monetary fine, suspension, withdrawal of trading, declaring a member as defaulter, expulsion, to be taken for various violations by the members of the exchange.*
- *Based on the laid down policy, consider the cases of violations observed during inspection, etc. and impose appropriate regulatory measures on the members of the exchange.*

37. Before proceeding with the matter on merits, I first deal with preliminary submissions of the Noticee that circular no. MCX/MCXCCL/697/2019 dated December 11, 2019 and circular no. MCX/MCXCCL/600/2020 dated August 19, 2020 were issued by the MCXCCL and not by the Noticee. In this regard, I observe from the material available before me that the aforesaid circulars were indeed issued by the MCXCCL and not by the Noticee. Further, Noticee submitted that the Valley Distributors LLP **("VDL")** and JMVD Market Solutions LLP **("JMVDL")** are the clients of the Trading Members **(TMs)** of MCX and not of the MCX. In this regard, I observe from the material available before me that VDL and JMVDL are the clients of TMs of the Noticee and not of the Noticee. I now proceed to deal with the merits of the case in respect of the alleged contraventions by Noticee.

<u>FINDINGS</u>

38. On perusal of the material available on record and giving regard to the facts and circumstances of the case and submissions of the Noticee I record my findings hereunder:

ISSUE I: Whether Noticee violated the provisions of Clause 3 and 4 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021, Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021, Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018, Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010, 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019?

Allegation with regard to 50 Sikkim based clients:-

- It has been alleged that Noticee failed to verify that 50 clients were not actual resident of Sikkim State, despite KYC documents of clients reflecting the same which resulted in alleged non-compliance by Noticee with Clause 3 and 4 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021 that required them to ensure having a system of proper verification to verify concerned investors are residents of the State of Sikkim.

- Noticee allegedly failed to ensure that its members inter alia, cross-checks clients details (including client's address) in UCC database with the clients details on IT department's website and verify the documents submitted with respect to the unique code; which resulted in non-compliance by Noticee with Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021.

- Noticee allegedly was not verifying KYC related documents of Sikkim-based clients and also that the abovementioned irregularities were failed to be detected in routine inspections conducted by Noticee, resulting in alleged non-compliance with Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010.

- Noticee allegedly also failed to ensure that TMs don't change the UCC details with malafide intent to take advantage of MCX circular for avoiding stamp duty exemption thereby causing loss to exchequer. Hence, for failure to carry-out its role as 1st level regulator, it is alleged that Noticee violated Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018.

39. I observe that, from newspaper articles dated April 2022-May 2022, it came to the knowledge of SEBI that trades in exchange from Sikkim based clients had seen a spurt from less than 0.01% in June 2020 of exchange's total turnover to 5.46% in February 2022, which subsequently declined to be 0.01% in June 2022. It was alleged by newspaper articles that,

    - Since Sikkim residents enjoyed exemptions, they were being used as proxy by traders from other states.

    - Unidentified people from outside are taking undue advantage given to Sikkim people.

    - It is also alleged that these traders were also indulging in money laundering.

40. I observe that SEBI sought following information from the Noticee subsequent to the news articles

    a) SOP/Process followed by Noticee to examine compliance by its Trading members (hereinafter referred to as TMs) with KYC & UCC related norms and any findings thereof for Sikkim-based clients;

    b) Reconciliation of KYC and UCC Database

    c) Details of Brokers with clients from Sikkim, along-with client's trading details

d) Action taken by Exchange for any lapses noted on the matter and head under which penalty was levied.

e) Whether the actions taken by Exchange were placed before concerned statutory committee (MCSGFC). Information on Delegation by committee and Board minutes with respect to such delegation.

f) Whether matter was discussed in ROC and Governing Board of MCX.

g) Sikkim-based client's trading volume, their broker and details captured in their KYC, along-with KYC related documents of top two clients.

41. On enquiry sought by SEBI in this regard Noticee vide email dated August 13, 2022 submitted that on December 11, 2019, MCXCCL issued circular that client's permanent address as per UCC database shall be considered for determining the domicile State of the buyer for payment of stamp duty to the respective States. Thereafter based on communication from Department of Economic Affairs vide its letter dated August 19, 2020, MCXCCL informed its members that no stamp duty would be required to be collected for the State of Sikkim.

a) On examination of Sikkim based clients Noticee stated that it has examined 125 client codes who had traded during the period July 2020 to May 2022 (hereinafter referred as "Review period") and reviewed KYC documents downloaded from KRA / concerned Broker , and noted the following:

- **Clients with valid PAN:** In respect of Income Tax, all clients who were residing in the State of Sikkim and had traded during the review period, were having valid PAN and none of the client availed the PAN exemption. Also, no anomalies were observe in KYC documents.

- On 50 Clients where client address as Sikkim in UCC database, which was in discrepancy with Pin Code in UCC database and State/ address in KYC database:

i. In case of 50 clients (traded through 7 TMs and contributed 0.15% of MCX's total turnover from Sikkim during review period), State and City were incorrectly uploaded as 'Sikkim' in UCC database by concerned trading members. This was variance with KYC database, wherein clients' address was noted to be of State other than Sikkim in line with KYC documents.

ii. Similarly, within UCC database, while State/City code was mentioned as 'Sikkim', pin code was uploaded as per KYC records, which belonged to State other than Sikkim.

iii. As no specific penalty provisions is mentioned for uploading incorrect client details in UCC database of the Exchange, it was considered as "material discrepancy in client registration document" as per Annexure A – Part I(b) of Circular no.: MCX/INSP/400/2017 dated October 30, 2017. Accordingly, the Exchange has levied a penalty of Rs. 10,000/- per client (total Rs. 5 lakhs for the 50 client codes) to these 7 trading members. As per exchange's Governing Board meeting dated October 15, 2020, MD & CEO is the Relevant Authority for taking disciplinary action and hence this action was taken with due approval from MD & CEO.

- **On rest 75 Clients:** For rest 75 clients, Noticee informed that all orders were routed through approved terminals of the members and no anomalies were observed in KYC documents.

Alleged violation of para (3) & (4) of SEBI circular dated September 16, 2016 read with SEBI circular dated March 08, 2021:-

42. I observe that para (3) & (4) of SEBI circular dated September 16, 2016 states as follows:

3 - *It shall be mandatory for the members of the commodity derivatives exchanges to use Unique Client Code (UCC) for all clients transacting on the commodity derivatives exchanges. The commodity derivatives exchanges shall not allow execution of trades without uploading of the UCC details by the members of the exchange. For this purpose, members shall collect after verifying the authenticity and maintain in their back office the copies of Permanent Account Number (PAN) issued by the Income Tax Department, to all their clients.*

4 - *PAN would be the sole identification number and mandatory for all entities / persons who are desirous of transacting on the commodity derivatives exchanges. However, the investors residing in the State of Sikkim are exempted from the mandatory*

requirement of PAN. The exchanges should, however, ensure a system of proper verification to verify that such members / investors are residents of the State of Sikkim.

43. Further Circular dated March 8, 2021 has modified the clause 3 of the SEBI circular dated September 16, 2016, which states as follows:

    "It shall be mandatory for the members of the exchanges having commodity derivatives segment to use Unique Client Code (UCC) for all clients transacting on the commodity derivative segment. The exchanges with commodity derivatives segment shall not allow execution of trades without uploading of the UCC details by the members of the exchange. For this purpose, members shall collect after verifying the authenticity and maintain in their back office the copies of Permanent Account Number (PAN) issued by the Income Tax (IT) Department, for all their clients. However, in case of e-PAN, members shall verify the authenticity of e-PAN with the details on the website of IT Department and maintain the soft copy of PAN in their records."

44. On perusal of clause 3 of SEBI circular dated September 16, 2016 read with SEBI circular dated March 08, 2021, I observe that as per clause 3 it is the responsibility of the trading members to collect the Permanent Account Number (PAN) after verifying the authenticity of the PAN and to maintain the copies of the PAN so collected in their back office. In view of the same, I observe that clause 3 of the SEBI circular dated September 16, 2016 read with SEBI circular dated March 08, 2021 casts the responsibility solely on the trading members of the exchange for verification of PAN. Noticee's role is limited to the extent of ensuring that the UCC details are uploaded before allowing the investors to trade. In view of the above I am of the opinion that clause 3 does not apply to the exchanges and hence the Noticee and thus the allegation of violation of Clause 3 of SEBI circular dated September 16, 2016 read with Clause 3.1 of SEBI circular dated March 08, 2021 does not stand established with respect to the Noticee.

45. On perusal of clause 4 of the circular I observe that in respect of investors residing in the State of Sikkim PAN is not a mandatory document. However Exchanges has to ensure a system of proper verification that such investors are residents of Sikkim. Noticee in its reply stated that as far as the verification of the trading members (TMs) clients are concerned, the role of the Noticee is confined to ensuring that accurate PAN details are collected by the TMs, cross checked with the IT Department database and consequently uploaded to the UCC database, prior to carrying out any transaction on the exchange. As per the clause

4, investors residing in Sikkim are exempted from the mandatory requirement of PAN and exchanges are required to ensure proper system for verification for only such investors as the investors of the 7 TMs did not avail exemption from the mandatory requirement of PAN it did not warrant any verification except PAN. I observe from the circular that it doesn't say if PAN is submitted then there is no requirement for ensuring proper verification. Notice has wrongly interpreted that verification system should be put in place only when no PAN is submitted. It is a prudent practice to put in place a proper system of verification irrespective of PAN is submitted or not. Hence Noticee has violated Clause 4 of SEBI circular dated September 16, 2016.

46. I further note that the Noticee has now put in place a system of verification for the review and deactivation of any new client uploaded in UCC database of Exchange, having state as Sikkim. As per the new process, when a new Sikkim based client is on boarded by the TM and uploaded in UCC database, the Noticee marks such client as inactive and seeks the KYC and address proof of such client codes, irrespective of whether PAN has been submitted for such client or not. Pursuant to confirming that such client is indeed a resident of Sikkim, based on the documents submitted by the concerned TMs, the Noticee activates the client for trading. For the existing clients, reconfirmation of the KYC details of all existing Sikkim based clients is carried out by the Noticee. Further the Noticee has mandated TMs to furnish an auditor's certificate confirming the accuracy of the said details (resident), as an additional layer of verification for the existing clients. Therefore, I note that the Noticee has thus rectified the deficiency.

Alleged violation of para (5) of SEBI circular dated September 16, 2016 read with SEBI circular dated March 08, 2021:-

47. It was observed during review of inspection by the Noticee with respect to the 50 clients that the TMs uploaded different State & City code (that of Sikkim) in UCC database, in complete variance with that of KYC database (that of the other states) and with no system-based check to reconcile UCC database with KYC database. In addition, in UCC database itself, PIN code was noted to be different state than State & City code inputted in UCC database, with no system based validation within the same database. In view of the above it has been alleged that - Noticee failed to ensure that its members inter alia, cross-checks clients details (including client's address) in UCC database with the clients details on IT department's website and verify the documents submitted with respect to the unique code;

which resulted in non-compliance by Exchange with Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021.

48. Clause 5 of SEBI Circular dated September 16, 2016 and SEBI Circular date March 8, 2021 provide as follows:

Para 5 of SEBI Circular dated September 16, 2016 is as follows-

5 - *The commodity derivatives exchanges shall ensure that the members of their exchanges shall:*

- *collect copies of PAN cards issued to their existing as well as new clients after verifying with the original.*
- *cross-check the aforesaid details collected from their clients with the details on the website of the Income Tax Department.*
- *upload details of PAN so collected to the Exchanges as part of Unique Client Code.*
- *verify the documents with respect to the unique code and retain a copy of the document*.

Para 3.2 of Circular dated March 8, 2021 provides as follows-

3.2 Clause 5 of the Circular is modified as under:

"The exchanges having commodity derivatives segment shall ensure that the members of their exchanges shall:

i. *collect copies of PAN cards issued to their existing as well as new clients after verifying with the original.*
ii. *cross-check the aforesaid details collected from their clients with the details on the website of the Income Tax (IT) Department.*
However, in case of e-PAN, verify the authenticity of e-PAN with the details on the website of IT Department and maintain the soft copy of PAN in their records."
iii. *upload details of PAN or e-PAN so collected to the Exchanges as part of Unique Client code.*
iv. *verify the documents with respect to the unique code and retain a copy of the document.*

49. Noticee submitted that SEBI UCC Circular require TMs to collect PAN details for the purpose of uploading said details to the UCC database of the exchange. In terms of

supervision, an exchange is required to oversee collection of PAN cards by the TMs, cross-verification with the details available on the IT Department database, and upload of the PAN details on the UCC database. Therefore an exchange is required to exercise a limited degree of oversight over its TMs, and exchange is not bound to verify the accuracy of all the details entered in the UCC, including KYC details for each client of each TM. For this purpose, to fulfill the exchange's obligation to exercise oversight over TMs under Clause 5 of the SEBI circular dated September 16, 2016, the Noticee has engaged the services of UTI Infrastructure Technology and Services Limited to verify the authenticity of the PAN details uploaded by TMs, against the details available on the IT Department database. On verification, the UCC is treated as active, and in case of any inconsistency, the UCC is treated as inactive, and trading is restricted.

50. Noticee further submitted that details entered on the UCC database are in accordance with the PAN details of the said client, which do not reflect the place of residence, as only the PAN and names of the clients are available on the IT Department database for verification by the exchange.

51. As observed from the Circular it casts responsibility on the Exchanges to ensure that members upload details on the UCC database after verifying with the PAN. I tend to agree with the submission of the Noticee that an exchange is required to exercise a limited degree of oversight over its TMs. From the narration given by the Noticee I observe that Noticee has in place system to verify the accuracy of the details entered in the UCC through the services of UTI Infrastructure Technology and Services Limited. Hence, I observe that the allegation of violation of Clause 5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021 does not stand established.

Alleged violation of Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010

52. It was observed that during inspection of TMs, Noticee was earlier not verifying KYC related documents of Sikkim-based clients and also that the above mentioned irregularities were failed to be detected in routine inspections conducted by Noticee. In view of the same it is alleged that the Noticee did not comply with Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010.

53. Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010 states as follows:

4. *The inspection shall cover:*

a. Compliance with the relevant provisions of the Act, Rules and Regulations made there under, Rules and Regulation of the Stock Exchange / Clearing Corporation and the circulars issued by SEBI and Stock Exchanges / Clearing Corporations from time to time,

54. With regard to Master Circular dated March 17, 2010, Noticee submitted that it carried out routine and / or joint inspection with SEBI and other Exchanges of TMs between July 2020 to May 2022 ("Review Period") using a sampling technique. Pertinently, most of the 7 TMs, which had incorrect client codes, had joint inspections conducted by SEBI during the Review Period. By way of sampling technique, a randomized set of clients were selected as a sample per TM, following which the documents, processes and compliance in respect of the sample clients, including the TMs' duty to ensure the entering of accurate address details of the clients on the UCC database, were scrutinised by the Noticee. Further Noticee submitted the degree of scrutiny involved in these inspections was confined to the proper collection, verification and upload of PAN details to the UCC database, and the verification of KYC details, for a sample set of clients per TM. Noticee further submitted that hundreds of TMs are registered with the Noticee and each one of them have hundreds/thousands of clients and it is not humanly possible for an exchange to check every detail, including whether KYC is proper or whether the upload to the UCC database of the client details is proper etc., for each and every client of each and every TM. Noticee further submitted that there was no mandatory obligation on the Noticee to check the details entered for each client and the scrutiny of KYC details was done on a limited scale, for sample clients of any TM, and could not have been carried out for all clients, keeping in mind the extensive clientele of the TMs.

55. From the reply submitted by the Noticee it is observed that joint inspection with SEBI was conducted of the 7 TMs and on sample basis they had checked the documents including the KYC for sample clients on sample basis. It is not a case against the Noticee that the inspection report revealed accounts for "Sikkim based clients" and that the same were not unearthed by the Noticee. It is a matter of fact that the sample did not show up any such cases and thus the Noticee had no occasion to verify the details. This has also not been

disputed by SEBI. In view of the above, I tend to agree with the submissions made by the Noticee. Thus the allegation of violation of Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010 by Noticee does not stand established.

Alleged violation of Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018

56. It is observed from the reply of the Noticee given to SEBI during the examination that when explanation was sought by the Noticee from the 7 TMs who had uploaded incorrect address, all TMs said that it was error in back office/ typographical/human error while uploading or revising the UCC details in the database. In view of the same it has been alleged that the Noticce failed to ensure that TMs don't change the UCC details with malafide intent to take advantage of MCX circular for avoiding stamp duty exemption thereby causing loss to exchequer. Hence, for failure to carry-out its role as 1st level regulator, it is alleged that Noticee violated Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018.

57. Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018 provides as follows-

Clause 7- Consideration of grant of recognition

(3) An applicant seeking recognition as a stock exchange shall, in addition to the conditions as specified in sub-regulations (1) and (2), comply with the following conditions, namely:—

(e) the applicant has necessary capability to have a nationwide network of trading members and has adequate facility to admit and regulate its members;

Clause 12- Renewal of recognition

(5) The recognised stock exchange and recognised clearing corporation shall comply with the applicable conditions specified in sub-regulation (3) and sub-regulation (4) of regulation 7, as the case may be, on a continuous basis.

58. I note that Noticee submitted that the Noticee’s supervisory role over a TM, in terms of the circulars issued by SEBI, was confined to ensuring that the PAN details of clients are collected, cross-checked with the IT Department database, which only reflects the PAN and name of an individual, and uploaded on the UCC database, prior to executing any

transactions on the exchange. Noticee further submitted that it is under no obligation to examine the KYC details of a TMs' clients and reconcile them with the UCC database, much less examine the presence or lack thereof of any mala fide intent. It submitted that having received the PAN details of Sikkim based clients, was also under no obligation to set up separate verification to verify the place of residence of such residents, and thus, was not bound to examine changes in addresses and whether the said changes have been motivated by mala fide intent. It was further submitted that out of the 50 clients, 25 client codes, spread across 7 TMs, were uploaded in the Noticee's UCC database well in advance of the gazette notification issued by the Ministry of Finance on August 19, 2020, directing not to collect stamp duty for the state of Sikkim. Thus, the details pertaining to the said 25 client codes, which were uploaded prior to the release of DEA's directive dated August 19, 2020, could not have been seen as having been wrongly uploaded with the malafide intent to take advantage of the stamp duty exemption by the Noticee. Noticee further submitted that it has adequate facilities and has prescribed processes towards admitting and regulating its members. These procedures have evolved over a period of time based upon the rules and regulations framed by SEBI, and has been the subject matter of various inspections and review by SEBI.

59. I observe from the clause 5 of SEBI circular dated September 16, 2016 that the role of the Noticee is confined to the extent of ensuring collection of copies of PAN card by the TMs, verifying and cross checking with the original and the IT Department database which are uploaded as part of UCC. There are no documents available on records to show that Noticee's role traverse beyond what is given in the Circular and as submitted by the Noticee. In view of the same I tend to agree with the submission made by the Noticee and thus the allegation of violation of Regulation 7(3)(e) read with Regulation 12(5) of SECC regulations, 2018 does not stand established.

With regard to two LLP clients:

60. During examination it was observed from the client's data and KYC details of Sikkim based clients'' that 1 separate client Valley Distributors LLP (PAN: AANFV0425D) was registered through 2 different associated brokers (East India Securities and East India Commodities Ltd.) and was having 2 different address at the end of review period. This client's trading volume amounted to 95% of MCX's Sikkim-based trading volume during the review period.

61. It was observed that the client had registered with Broker 1 - East India Securities since July 2016, with address belonging to West Bengal. On Sept. 16, 2020, client updates its address to that of Sikkim, by providing supporting documents to the concerned broker. The date of changing address is noted to be same as the date when client applied for trading in commodity segment at NSE & BSE and subsequently on March 15, 2021 at exchange. Simultaneously, on September 16, 2020, the client (Valley Distributors LLP) opened a new account with Broker 2 - East India Commodities Ltd. with Sikkim based address.

62. Subsequently, in April 2022, client (with same PAN) changes address with 1st Broker back to West Bengal, whereas address with 2nd Broker remains that of Sikkim. As such, for same client / same PAN, trading through 2 associated brokers, 2 different addresses were reflected in Noticee's database since April 2022. . Also, it was observed that partners of the said LLP client were also promoters of both the Brokers of the client (East India Securities and East India Commodities Ltd.).

63. It was also alleged that another client (JMVD Market Solutions LLP), having 5% of Sikkim-based MCX volume during review period, was similarly mis-using Sikkim address and that the client has common partners as directors/promoter of Delhi-based PACE Commodity Brokers. Here the Sikkim address provided in MCA database (as on Sept. 2022) is same as that in client's account opening form belonging to Sikkim state Further, from MCA database, one partner of this LLP client was noted to be director of the Delhi-based broker, via whom this client was trading through.

64. In view of the above, it was alleged that Noticee failed to carry-out additional due-diligence to ascertain genuineness of the address of these Sikkim-based client and thereby failed to carry-out its role as 1st level regulator in respect of these 2 clients (Valley Distributors LLP and JMVD Market Solutions LLP) whose cumulative trades amounted to 99.6% of MCX's Sikkim-based trading volume during review period. The same was also not verified during inspection. Thus Noticee allegedly violated Regulation 7(3)(e) read with Regulation12(5) of SECC Regulations, 2018.. Further allegedly Noticee has not complied with Clause 3-5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021 and Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010.

65. I note that, Noticee in its reply to the SCN has submitted the following sequence of events pertaining to the change in address of VDL and its association with the two brokers.

Sr. no	Date	Particulars
Summary of VDL with EI Commodities		
1	July 2005	EI Commodities became a member of the Exchange
2	September, 2020	VDL became a client of EI Commodities. EI Commodities uploaded the UCC details of VDL with the address as Sikkim on September 16, 2020 and started trading from September 17, 2020. VDL continued to trade through EI Commodities till June 14, 2021. The last trade date of EI Commodities was also June 14, 2021.
3	August 2021 to March 14, 2022	EI Commodities submitted application for surrender of membership in August, 2021 and finally, after completion of all processes, in March 14, 2022 EI Commodities surrendered its membership. At the time of surrender of membership, the address of VDL was Sikkim and once the membership is surrendered, no changes can be made in any details including UCC.
Summary of VDL with EI Securities		
1	2016	VDL was a client of EI Securities since 2016. EISL was not a member of the Noticee at the relevant time.
2	September 2018	EI Securities became a member of the Noticee.
3	March 2021	EI Securities uploaded the UCC details of VDL with address as Sikkim on March 16, 2021 and started trading from March 31, 2021.
4	April 26, 2022	EI Securities changed address of VDL from Sikkim to West Bengal

66. I note from the above table that at no point VDL had two different addresses with the two brokers, i.e., EI Securities and EI Commodities. I note from the reply of the Noticee that VDL shifted its address from West Bengal to Sikkim in September 2020. EI Commodities was a member of the Noticee. To trade on MCX, VDL became a client of EI Commodities in September 2020 and gave its Sikkim address to the member. Thus, all trades were executed through EI Commodities by VDL when it had its registered office in Sikkim.

67. I further note that SEBI had integrated the stock broking and commodity broking activities and removed the restriction on stockbrokers to act as commodity brokers. EI Securities and EI Commodities are related entities. In order to bring all its business under the same entity, EI Securities became a member of the Noticee in 2018. Gradually, EI Commodities began phasing out its activities on the exchange and all trades were routed through EI Securities. To this effect, EI Commodities submitted an application for surrender of membership on August 31, 2021; and finally, after completion of all procedures, EI Commodities surrendered its membership on March 15, 2022. I further note that the Noticee has provided the copy of the application for surrender of membership of MCX and/or MCXCCL of East India Commodities Pvt. Ltd.

68. I note from the submission of the Noticee that VDL had been a client of EI Securities since 2016. However, VDL did not execute any transactions through EI Securities on MCX till March 2021. On March 16, 2021, EI Securities uploaded details of VDL in UCC database of the Exchange with state mentioned as Sikkim and thereafter, VDL started trading from March 31, 2021. Within a few months, by June 2021, VDL stopped trading through EI Commodities.

69. I further note from the submission of the Noticee that in April 2022, VDL once again shifted its address back to West Bengal and EI Securities updated the UCC records. The records of EI Commodities could not be updated as the Noticee does not allow any change in details after the termination of membership. It is only because of this reason that there are currently two addresses of the same client, i.e., old Sikkim address with EI Commodities and new West Bengal address with EI Securities.

70. With regard to JMVDL, Noticee submitted that the whole allegation with respect to JMVDL is based on surmises and conjectures and no documents or proofs have been relied upon to establish the allegation against the misuse of the Sikkim address by JMVDL. Noticee submitted that the Notice has failed to provide any circulars, guidelines, or regulations which require an exchange to probe the bona fide of client of a TM merely because the TM and client are related or have same addresses, mere connection between the brokers and their clients does not warrant suspicion. Noticee further submitted that, during inspection, Noticee has examined the KYC documents of JMVDL and it found that in all the documents the address of JMVDL is of Sikkim, therefore, it concluded that the address of JMVDL uploaded in the UCC database of the exchange was in line with the KYC document received from TM. Noticee submitted that, without prejudice, the Notice fails to bring out any malice which can be attributed and which Noticee failed to detect in terms of extant regulations to such connection between VDL/JMVDL and their TMs.

71. In view of the submissions made by the Noticee and the material available before me, I observe that the East India Securities and East India Commodities are related entities. EI Commodities submitted an application for surrender of membership on August 31, 2021 and finally, after completion of all procedures, East India Commodities surrendered its membership on March 15, 2022. I further observe that VDL had been a client of EI Securities since 2016. However, VDL did not execute any transactions through EI Securities on MCX till March 2021. On March 16, 2021, EI Securities uploaded details of VDL in UCC database of the Exchange with state mentioned as Sikkim and thereafter, VDL started trading from March 31, 2021. Within a few months, by June 2021, VDL stopped trading through EI Commodities. In April 2022, VDL once again shifted its address back to West Bengal and East India

Securities updated the UCC records. The records of East India Commodities could not be updated as it had already surrendered its membership and hence on record two addresses were appearing against one client. With regard to the allegation against the clients JMVD Market Solutions LLP I note that Noticee examined the KYC documents of JMVDL which reflects Sikkim address. Further, I did not find any material on record to substantiate that it was misusing Sikkim address.

72. In view of the same, I observe that Noticee has not violated Clause 3-5 of SEBI circular dated September 16, 2016 read-with SEBI circular dated March 8, 2021, Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010 and Regulation 7(3)(e) read with Regulation 12(5) of SECC Regulations, 2018.

Delegation for levy of penalty contrary to SEBI Circular & no specific head for penalty charged:

73. With regard to the incorrect uploading of State and City as ‘Sikkim” in UCC database by the concerned TMs it was submitted by the Noticee that as the extant policy did not provide for a specific penalty provisions applicable to Brokers for uploading incorrect client details in UCC database of the Exchange, thereby Rs. 10,000/- per client was charged by Noticee as per similar provision on “material discrepancy in client registration document (viz. Photograph not provided, no signature, no Pan Card details, No Proof of Address/Identity provided)”. As per exchange’s Governing Board meeting dated October 15, 2020, MD & CEO is the Relevant Authority for taking disciplinary action and hence this action was taken with due approval from MD & CEO.

74. It was observed by SEBI that, while no provision existed in the Exchange’s policy for uploading incorrect client details in UCC database, in place of taking up the matter before MCSGFC for formulating policy & thereby levying penalty to Brokers, Noticee levied monetary fine under some other clause that per se was not related to incorrect client details inputted in UCC database. This resulted in non-compliance of SEBI circular dated Jan. 10, 2019 circular.

75. Further, as per SEBI circular dated January 10, 2020, MCSGFC is the authority to take appropriate action against trading members. However, as informed by Noticee, the ‘Relevant Authority' for taking disciplinary actions was changed by Board in its meeting dated October 15, 2020 from MCSGFC to MD&CEO, which is in contradiction to SEBI circular dated January 10, 2020. If penalty levying especially in such cases of fraudulent /

intent to misuse is left to MD rather than MCSGF committee, which is a statutory committee comprising of majority of PIDs, there is borne to be conflict. This is considering that MD also has to take care of commercial role of MII, along-with operational and regulatory role, vis-à-vis PIDs who are representing the interests of investors in securities market, in terms of SECC Regulation, 2018.

76. In view of the above, it is alleged that the Noticee has not complied with 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019, as per which-

a) Monetary fine shall be levied on broker based on policy approved by MCSGF, however in instant case while no provision existed, in place of taking up the matter before MCSGFC for formulating policy, monetary fine was levied under some other clause.

b) MCSGFC is the authority for taking appropriate action against Trading members, as against action approved by MD&CEO in instant case.

77. It has also been alleged that the Noticee did not implement ROC decision to conduct forensic Audit on Sikkim matter.

78. It is observed that as per Regulation 29 of SECC Regulations, 2018,

"(1) Every recognized Stock exchange / recognized clearing corporation shall constitute the committees as per sub-regulation (2) and sub-regulation (3).
(2) Functional committees, comprising of:
(a) Member and Core Settlement Guarantee Fund committee;
(b)…
(c)….
(3) Oversight committees, comprising of:
(a),,,
(b)…
(c) Regulatory oversight committee; and
(d)…"

79. <u>On ToR of MCSGFC and levy of penalty:</u> As per 2nd and 3rd clause of ToR prescribed in Annexure A of Member & Core SGF Committee (MCSGFC) prescribed in SEBI circular dated January 10, 2019, this committee comprising PID, SHD and MD&CEO, is *inter alia* required to:

"b. <u>Formulate the policy for regulatory actions</u> including warning, monetary fine, suspension, withdrawal of trading, declaring a member as defaulter, expulsion, to be taken for various violations by the members of the exchange.

c. <u>Based on the laid down policy</u>, consider the cases of violations observed during inspection, etc. and <u>impose appropriate regulatory measures on the members</u> of the exchange."

80. <u>On ToR of Regulatory Oversight Committee (ROC):</u> As per SEBI circular dated January 10, 2019, ROC comprising of PIDs and IEP, is *inter alia* required to:

"a. Oversee matters related to member regulation such as admission of members, inspection, disciplinary action, etc.

w. Monitor implementation of SECC Regulations and other applicable rules and regulations along-with SEBI Circulars and other directions issued thereunder."

81. <u>On Inspection of Trading members by Stock exchanges:</u> According to Para 4(a) of SEBI Master Circular SEBI/MIRSD/Master Cir-04/2010 dated March 17, 2010, the inspection of members by stock exchanges shall cover compliance with the relevant provisions of the Act, Rules and Regulations made there under, Rules and Regulation of the Stock Exchange and the circulars issued by SEBI and Stock Exchanges from time to time.

82. <u>On Penalty:</u> As per Annexure A – Part I(b) of MCX's Circular dated October 30, 2017 captioned Revised Penalty Structure, for "Material Discrepancies (viz. Photograph not provided, No signature, No Pan Card details, No Proof of Address/Identity provided) in Client registration documents", Rs. 10,000/- per client shall be charged to Trading members.

83. I note that, Noticee submitted that SEBI did not take into consideration the decisions taken by the MCSGFC and Board of the Noticee in 2020 before alleging that the provisions of the January 10, 2019 circular have been violated. After the issuance of the January 10, 2019 circular, in its meeting dated February 25, 2019, the Board approved the proposal specifying MCSGFC as the relevant authority for various issues, including declaring a member as a defaulter (under Rule 41A) and expelling a member (under Rule 43). In its meeting dated October 01, 2020, the MCSGFC considered the terms of reference provided

under the January 10, 2019 circular and the relevant byelaws and rules of the Noticee, and was of the opinion that matters pertaining to the declaration of a member as a defaulter was not in the terms of reference issued by SEBI. Noticee submitted that this understanding is accurate as the terms of reference only provide MCSGFC the authority to formulate policy for declaring a member as a defaulter, but does not explicitly state that the committee should also consider cases of violation and declare a member as defaulter. Thus, unwilling to exceed the scope outlined by SEBI, the committee was of the view that the relevant provisions relating to declaration as defaulter be reviewed and a note be placed before the Board of the Noticee. On October 15, 2020, the Board of the Noticee reviewed the suggestion and MD&CEO was appointed as the relevant authority to declare a member as defaulter and for expulsion of a member and other disciplinary action.

84. Noticee further submitted that the Noticee was aware of the gravity of the issue of wrong entries in the UCC database by the seven TMs. In accordance with the gravity of the issue, the seven TMs were proceeded against in terms of Rule 43(b) of the Rules of the Noticee read with Byelaw 14A & 14A.1, which provide for actions that can be taken against a member for misconduct:

"43. Power of the Board to define the grounds of suspension/expulsion

If any Member of the Exchange is guilty of such conduct or act or omission that under the aforesaid Bye-Laws, Rules and Regulations made in that behalf render him liable to suspension, expulsion or other consequences, the Board or the relevant authority shall suspend, expel or impose other consequences as the Board or the relevant authority may deem fit.

14A. Misconduct, Un-business like conduct, Unprofessional Conduct and Prohibition of Fraudulent and Unfair Trade Practices:

Members shall be liable to expulsion, suspension and / or withdrawal of all or any of its membership rights and / or to payment of a fine and / or to be censured, reprimanded or warned for any misconduct, un-business like conduct or unprofessional conduct, fraudulent and unfair trade practices in the sense of the provision in that behalf contained herein

14A.1. Misconduct: Members shall be deemed guilty of misconduct for any of the following or similar acts or omissions namely:

b) Violation: If it has violated provisions of any statute governing the activities, business and operations of the Exchange, Members and Commodities business in general;"

85. Noticee submitted that in accordance with the due process, an explanation was sought from the TMs by the Noticee for the wrong entry of state / city code in the UCC database. It was informed by the TMs that it was a technical or manual error on their part while uploading the entries on the database. Noticee further submitted that all the members who have entered the wrong details are members with hundreds of clients. The Noticee noted that in around 50 cases, the entries were wrongly entered. It should also be noted that the TM itself did not gain anything from this error, and the stamp duty exemption availed was also only around INR 65,000. As it cannot be stated that there was a malafide intent to gain anything by the members. Moreover, there was no circular issued by SEBI providing a penalty for incorrect details entered by the TMs in the UCC database.

86. Noticee submitted that no separate provision existed for incorrectly entering the KYC details in the UCC database, the relevant authority, which in this case would be the MD & CEO in terms of the decision of the Board of the Noticee taken in its meeting dated October 15, 2020, took a decision to impose a penalty after considering the gravity of the violation. For the purpose of determining the quantum of penalty, similar provision as prescribed in as per Point 3(d) "PENALTIES / DISCIPLINARY ACTIONS FOR PROCEDURAL VIOLATIONS" of Annexure A Part 1(b) of MCX circular dated October 30, 2017, bearing reference no. MCX/INSP/400/2017 was considered. This provision states that in case of material discrepancy in the client registration document, a penalty of INR 10,000/- is applicable. The provision is as follows: "Material Discrepancies (viz. Photograph not provided, No signature, No Pan Card details, No Proof of Address/Identity provided) in Client registration documents". Since the UCC database captures all the information as mentioned in the client registration document, the relevant authority was of the opinion that this provision is applicable to the facts of the current matter and the quantum of penalty is also commensurate with the violation. Thus, Noticee submitted that it is incorrect to say that the monetary fine was levied under some other clause.

87. Noticee submitted that SEBI had delegated the responsibility to formulate a policy for regulatory actions and to impose regulatory measures on the members of exchanges to the MCSGFC of said exchanges. The MCSGFC had interpreted this circular and rightfully made the MD&CEO the relevant authority for certain actions. Noticee further submitted that this decision was taken in 2020, much prior to the imposition of penalty on the

members and it was not an ad-hoc decision taken for this specific instance. Further, SEBI had been aware of this decision pursuant to its inspection of MCX for the period April 01, 2020 to September 30, 2021, wherein Noticee had shared all the Committee/Board minutes to the SEBI inspection team for the mentioned inspection period.

88. Furthermore, Noticee submitted that the entire allegation that the penalty provision is improper is flowing from SEBI's mistaken assumption that the TMs had committed this violation in a malafide manner with an intent to gain. Thus, in view of the above, Noticee submitted that the MD&CEO is the relevant authority and the penalty provision has been appropriately applied by the Noticee. Further, a note was also placed before MCSGFC in it meeting held on October 28, 2022 informing the Committee about the matter and imposition of penalty on 7 members.

89. It is observed that ROC reiterated its decision to conduct forensic audit, however Board of directors went ahead and suggested special audit and not the forensic audit. It may be mentioned that Board of director cannot interfere in the decision of a Committee which is empowered under SEBI circular. Hence, forensic audit should have been conducted and implemented as per decision by ROC.

90. I observe that the as 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019 provides that the MCSGF shall Formulate the policy for regulatory actions including warning, monetary fine, suspension, withdrawal of trading, declaring a member as defaulter, expulsion, to be taken for various violations by the members of the exchange and based on the laid down policy, consider the cases of violations observed during inspection, etc. and impose appropriate regulatory measures on the members of the exchange. Thus, as per the circular Member and Core Settlement Guarantee Fund committee (hereinafter referred to as MCSGFC), comprising of Board Members along-with MD, is relevant authority to formulate policy as well as impose appropriate regulatory measures, including for levying monetary fine, suspension, expulsion, etc., based on the policy. However as per the reply of the Noticee I observe that the relevant authority for taking disciplinary action was changed by the Board in its meeting dated October 2020 from MCSGFC to MD&CEO. I observe that the circular clearly puts the responsibility on MCSGFC for taking action and the Board cannot abrogate the power of the committee. Hence, the submission of the Noticee in this regard is untenable.

91. Further, I note that the Noticee submitted that the Noticee along with other exchanges, subsequently discussed the matter with SEBI in the surveillance meeting held on July 28, 2022, wherein a joint process note, containing proposed additional controls to be implemented was submitted to SEBI. It was also mentioned in the said process note that in case any such irregularities observed, penalty of Rs. 10,000/- per client code will be levied. I observe that the said process note was submitted to SEBI on July 28, 2022 from futuristic perspective, whereas the Noticee already imposed a penalty of 10,000/- per client on June 27, 2022, therefore, I observe that the joint process note which was submitted to SEBI on July 28, 2022 cannot make the past action of MCX of levying penalty correct.

92. Further I observe that as per Point 3(d) "PENALTIES / DISCIPLINARY ACTIONS FOR PROCEDURAL VIOLATIONS" of Annexure A Part 1(b) of MCX circular dated October 30, 2017, bearing reference no. MCX/INSP/400/2017 for "Material Discrepancies (viz. Photograph not provided, No signature, No Pan Card details, No Proof of Address/Identity provided) in Client registration documents", Rs. 10,000/- per client shall be charged to Trading members. I note that the instant case pertains to incorrect input of State code and City code as Sikkim which does not cover under Material Discrepancies. Hence as per the TOR MCSGFC is the authority to formulate policies for regulatory actions. Noticee in its submission stated that it was aware of the gravity of the issue of wrong entries in the UCC database by the seven TMs. Thus, admittedly Noticee was aware of the gravity of the case and hence was required to take it to the committee which is empowered to frame policy without imposing penalty under material discrepancy.

93. In view of the above I observe Noticee has not complied with 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019, as per which-

   i. Monetary fine shall be levied on broker based on policy approved by MCSGF, however in instant case while no provision existed, in place of taking up the matter before MCSGFC for formulating policy, monetary fine was levied under some other clause.

   ii. MCSGFC is the authority for taking appropriate action against Trading members, as against action approved by MD&CEO in instant case.

94. In view of the above I conclude that Noticee violated 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019.

ISSUE II: Does the violation, if any, on part of the Noticee attract penalty under Section 15HB of SEBI Act?

95. As has been established in the foregoing paragraphs that Noticee has violated the provisions of Clause 4 of SEBI circular dated September 16, 2016 and 2nd and 3rd clause of ToR of Member & Core SGF Committee prescribed in Annexure A of SEBI circular dated January 10, 2019.

96. The Hon'ble Supreme Court of India in the matter of SEBI vs. Shri Ram Mutual Fund interalia held *"once the violation of statutory regulations is established, imposition of penalty becomes sine qua non of violation and the intention of parties committing such violation becomes totally irrelevant. Once the contravention is established then the penalty is to follow."*

97. Therefore, I am convinced that it is a fit case for imposition of penalty under the provisions of Section 15HB of the SEBI Act which reads as given below:

Section 15HB of SEBI Act: - Penalty for contravention where no separate penalty has been provided:

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 shall not be less than one lakh rupees but which may extend to one crore rupees.

ISSUE III: If so, how much penalty should be imposed on the Noticee taking into consideration the factors mentioned in Section 15J of the SEBI Act?

98. While determining the quantum of penalty under sections 15HB of the SEBI Act and it is important to consider the factors stipulated in section 15J of SEBI Act which reads as under:-

15J - Factors to be taken into account by the adjudicating officer

While adjudging quantum of penalty under section 15-I, 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."

99. In the present matter, it is noted that no quantifiable figures are available to assess the disproportionate gain or unfair advantage made as a result of the defaults by Noticee. It is not possible from the material available on record to ascertain the disproportionate gain or unfair advantage made by the Noticee or the amount of loss caused to an investor or group of investors as a result of the default. I also note that there are no past instances of violation of SEBI circulars by the Noticee. Noticee as an MII needs to adhere to the rules and regulations as prescribed by SEBI. However, nature of default by the Noticee to adhere to the laid down obligations and SEBI circulars as observed in this case would compromise the regulatory framework and should be dealt with by imposing monetary penalty so as to send an effective message to the market participants as a whole.

ORDER

100. Having considered the facts and circumstances of the case, the material available on record, the factors mentioned in Section 15J of the SEBI Act taking note of Section 15HB of the SEBI Act, and also taking into account judgment of the Hon'ble Supreme Court in *SEBI vs. Bhavesh Pabari (2019) 5 SCC 90* and in exercise of power conferred upon me under section 15-I of the SEBI Act, 1992 read with rule 5 of the SEBI Rules, 1995, I hereby impose following penalty under section 15HB of the SEBI Act, 1992 on the Noticee:

S. No.	**Name of entity**	**Penalty Provisions**	**Penalty (Rs.)**
1	MCX	Section 15HB of SEBI Act, 1992	6,00,000/- (Rs Six Lakh Only)

101. I am of the view that the said penalty is commensurate with the lapse/omission on the part of the Noticee.

102. The Noticee shall remit / pay the said amount of penalty within 45 days of receipt of this order either by way of Demand Draft in favour of "SEBI - Penalties Remittable to Government of India", payable at Mumbai, OR through online payment facility available on the website of SEBI, i.e. www.sebi.gov.in on the following path, by clicking on the payment link: ENFORCEMENT → Orders → Orders of AO → PAY NOW. In case of any difficulties in payment of penalties, Noticee may contact the support at portalhelp@sebi.gov.in.

103. The aforesaid Noticee shall forward said Demand Draft or the details / confirmation of penalty so paid to "The Division Chief (Enforcement Department 1 DRA-2), Securities and Exchange Board of India, SEBI Bhavan, Plot No. C/7, "G" Block BKC, Bandra Kurla Complex, Bandra (E), Mumbai – 400 051." The Noticee shall also provide the following details while forwarding DD / payment information:

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)	

104. In the event of failure to pay the said amount of penalty within 45 days of the receipt of this Order, SEBI may initiate consequential actions including but not limited to recovery proceedings under section 28A of the SEBI Act, 1992 for realization of the said amount of penalty along with interest thereon, inter alia, by attachment and sale of movable and immovable properties.

105. In terms of the provisions of rule 6 of the SEBI Rules, a copy of this order is being sent to the Noticee and also to the Securities and Exchange Board of India.

Place: Mumbai **BARNALI MUKHERJEE**

Date: February 28, 2023 **ADJUDICATING OFFICER**