

BEFORE THE SECURITIES APPELLATE TRIBUNAL
MUMBAI

Order Reserved on : 06.12.2013

Date of Decision : 31.01.2014

Appeal No. 152 of 2013

SMC Global Securities Ltd.
11/6B, Shanti Chamber, Pusa Road,
New Delhi- 110 005

...Appellant

Versus

Securities and Exchange Board of India,
SEBI Bhavan, Plot No. C-4A, G-Block,
Bandra-Kurla Complex, Bandra (East),
Mumbai – 400 051.

...Respondent

Mr. P. N. Modi, Senior Counsel with Mr. R. R. Bhonsale, Mr. Prakash Shah, Advocates for the Appellant.

Mr. Shiraz Rustomjee, Senior Advocate with Ms. Najma Shaikh, Ms. Khushboo J. Tatia, Advocates for the Respondent.

CORAM : Justice J.P. Devadhar, Presiding Officer
Jog Singh, Member

Per : Jog Singh

The core issues in the present appeal are the form and the mode of collection of margin money by a Clearing Member (CM) as required from time to time from its Trading Members (TMs) and the manner of its reporting to the stock exchange.

2. The appellant, namely, SMC Global Securities Limited, hereinafter referred to as 'SMC', has preferred the present appeal against the impugned order dated August 02, 2013, passed by the respondent's Whole Time Member, hereinafter referred to as 'WTM', under Section 19 of the SEBI Act, 1992, read with Regulations 28 (2) of the SEBI (Intermediaries) Regulations, 2008, prohibiting the appellant from taking up any new assignment or contract or launch a new scheme for a period of three months.

3. Briefly stated, the facts of the case are that SMC is a company incorporated under the Companies Act, 1956 and is stated to be registered with several Stock and Commodities Exchanges, including the NSE and the BSE, as a Trading Member, hereinafter referred to as 'TM'. It also acts as a Clearing Member, hereinafter referred to as 'CM, in the NSE and BSE. During the relevant time period in the year 2008, the appellant acted as a CM for 36 TMs towards their clearing and settlement obligations. Two out of these 36 TMs, for whom the appellant acted as CM in respect of their Future and Options, hereinafter referred to as 'F&O', trading in the NSE, defaulted in fulfilling their obligations to the appellant in respect of the payment of margin money. These two TMs are Sunchan Securities Limited, hereinafter referred to as 'SSL', and Ganga Yamuna Finvest Limited, hereinafter referred to as 'GYF'. In other words, the appellant failed to collect the requisite margin money from the two TMs before allowing them to trade.

4. SSL and GYF were formally declared defaulters on July 11, 2009 by the BSE and on May 18, 2009 by the NSE, respectively, and expelled

from the membership of the Stock Exchange(s). The appellant submits that it deposited the requisite margin money out of its own funds. The appellant, however, tried its best to recover its dues from the TMs and to minimize the loss suffered. All this is stated to have happened due to recession in the year 2008. The margin requirement shot up drastically, whereas the value of the collateral security fell. In this background, the appellant submits that it tried to prevent the TMs from becoming defaulters by endeavoring to collect securities from them in any form. The appellant submits that by exercising its discretion, it managed to limit the loss to what could be borne and paid by itself. The appellant, therefore, contends that it did not violate any law, rule, regulation or circular, as alleged by the respondent.

5. In December 2008, NSE undertook an inspection of the appellant for a period ranging from January, 2008 to November, 2008. Based on the inspection report, NSE issued a notice dated December 30, 2008, to the appellant, inter alia, alleging that the appellant had collected margin in non-permissible forms such as undated cheques and immovable property. Subsequently, the NSE appointed an external Auditor, who undertook a detailed audit of the appellant's accounts and records; and by a report dated August 21, 2009 came to the conclusion that there had been short collection of margin money.

6. In the meanwhile, the respondent, being the main regulator of such matters in the capital market, by letter dated March 26, 2009, also called upon the NSE to examine the matter and submit a report. NSE, accordingly, submitted its report dated April 01, 2009.

7. The Disciplinary Action Committee, hereinafter referred to as ‘DAC’, of the NSE passed an order dated September 24, 2009, holding that the appellant had accepted undated cheques and treated immovable property documents as margin, which was legally impermissible. It was also held by the DAC that the appellant wrongly reported details of margin collection to the NSE. A penalty of Rs. 25 lac was imposed on the appellant with a further direction to deposit a refundable sum of Rs. 25 lac for a period of six months, to be refunded to the appellant after certification by an Auditor to the effect that the appellant had improved compliance of reporting correct margin. An additional fine of Rs. 20,000/- was imposed on the appellant for funding the TMs by not collecting the debit balance and margin.

8. The respondent decided to order special purpose inspection of the appellant’s affairs by letter dated November 11, 2009. This appears to have been done by the respondent with a view to unearth the lapses with respect to margin collection on part of the appellant so that the system pertaining to the collection of margin could be further streamlined and also to ascertain whether the appellant had stopped the practice of short collection and wrong reporting of margin to the Exchange and providing higher exposure to its TMs. On November 25, 2009, an “Inspection Questionnaire” with respect to the period from December 01, 2008 to November 24, 2009 was served upon the appellant by the respondent. During the said inspection, the respondent directed the appellant to submit a detailed explanation on the form of securities taken by it as collateral towards margin requirements during the period between December 1,

2008 – November 24, 2009 for three TMs, i.e., SSL, GYL and Nikunj Stock Brokers, hereinafter referred to as ‘NSB’.

9. After considering the appellant’s reply dated March 05, 2010, the respondent forwarded a copy of the Inspection Report to the appellant by letter dated March 23, 2010. The appellant denied allegations contained in the Inspection Report by reply dated April 19, 2010, reiterating its earlier stand taken in the matter. After considering the Inspection Report and the reply submitted by the appellant, an SCN dated October 6, 2010 was issued by the Designated Authority, hereinafter referred to as ‘DA’, of the respondent under Regulation 25 of the SEBI (Intermediaries) Regulations, 2008.

10. The SCN mainly charged the appellant with not accepting collaterals in the permissible forms; not collecting the required margin from the TMs before allowing them to trade; wrongly reporting margins collected by it to the exchanges; providing excess exposure to the TMs; failing to compulsorily square off the TMs’ position resulting in their default; and in funding the TMs. The appellant was, thus, alleged to have violated clauses A1, A2 and A5 of the Code of Conduct for Stock Brokers specified in Schedule-II read with Regulations 7 of the SEBI (Stock Brokers and Sub-Brokers) Regulations, 1992, along with clauses 1, 2 and 5 of the Model Clearing and Trading Member Agreement and various circulars issued by SEBI and the NSE from time to time.

11. In response to the SCN, the appellant filed its reply dated November 25, 2010 and written submissions dated May 09, 2011, before the respondent, reiterating its earlier stand in detail. The DA considered

the said reply and other material brought on record and vide report dated December 12, 2011, inter alia, held that there was a shortfall in the margin collection and wrong reporting by the appellant resulting into excess exposure to the TM's in question. It was further held that the shortfall, wrong reporting and excess exposure could not be exactly quantified. Similarly, the DA noted that the appellant has a right and not an obligation to close-out open position in case of any shortfall in minimum deposit. Further, the DA observed that the fact that the amount collected by the appellant as delayed payment was quite high and the fact that the appellant's ledgers did not have the TM's name or codes are not sufficient evidence to prove that the appellant was involved in fund based activities. Turning to the contention of the appellant that he never took property or property papers of TM's as collateral in margin, the DA held that the practice as suggested by the appellant in this regard is a deviation and amounts to violation of the rules, regulations and guidelines on accepting collaterals in the permissible forms. The DA also held that the appellant had failed to follow the policy of compulsory squaring-off of the positions of the two TM's, thereby, widening the gap between the margin and the exposure resulting in the ultimate default. After holding as such, the DA recommended the prohibition of the appellant from taking up any new assignment or contract or launch any new scheme for a period of fifteen days under Regulation 27 of the Intermediaries Regulations.

12. The learned Designated Member (DM), who happens to be the Whole Time Member (WTM) of the respondent, issued a post-enquiry SCN dated April 16, 2012 along with the DA's report dated December 12, 2011, spelling out his reasons for disagreement with the penalty

recommended by the DA. The appellant, by its letters dated May 14, 2012, June 22, 2012 and September 25, 2012, opposed issuance of such post-enquiry SCN which allegedly contained allegations beyond the inspection period. The appellant contended that the respondent had itself left it to the NSE to adjudicate upon the said allegation and that the DAC of the Stock Exchange had already passed an order punishing the appellant. Therefore, it amounted to double jeopardy. It was also submitted that the learned DM should not have entered the arena by making additional allegations as it amounted to partiality and bias.

13. The respondent refused to treat the above said submissions of the appellant as preliminary, as requested by the appellant before the learned DM, and so the appellant filed a detailed reply on December 07, 2012, denying all the allegations raised in the post enquiry SCN dated April 16, 2012.

14. In consonance with the norms of law and principles of natural justice, the learned DM granted a personal hearing to the appellant on December 07, 2012 and January 29, 2013. The appellant also filed certain additional submissions in respect of the immovable property transaction on January 22, 2013. Similarly, on January 31, 2013, the appellant forwarded a copy of the Bank Guarantee, “BG” for short, to the respondent.

15. After considering the detailed submissions made by the appellant and the documents brought before the learned DM, he held the appellant guilty of the said charges and enhanced the punishment to a period of

three months by the impugned order dated August 02, 2013, which is challenged before this Tribunal in the present Appeal.

16. At this stage we would like to deal with the Appellant's submissions before us in brief. First and foremost, the appellant states that the two defaulter TMs were declared as such by the NSE owing to their misdeeds in connection with the cash market segment in May-July 2009, and not any default in the F&O segment as the appellant had himself paid the margin due on behalf of the two TMs. The case of the appellant is that the alleged complaints by the TMs are untenable. The TMs were declared as defaulters due to the former's default in respect of cash market trades, with which the Appellant is not concerned. The alleged violation of collection of margin in non-permissible forms refers to a period prior to the inspection period i.e., pre-December 01, 2008. As to the Bank Guarantee, hereinafter referred to as "BG", furnished by the Appellant and the allocation of a BG of Rs. 15 crore to SSL, the appellant submits that a BG is a permissible form of margin deposit and that the finding in the impugned order that ought to have been furnished by SSL is incorrect and false since the only condition to be met at the time was that the CM would make the margin money available to NSCCL for the TMs. Subsequent to an NSE Circular dated June 02, 2009 which clarified that a BG from a Member would not be considered towards margin collection, the Appellant has not furnished any such BG for margin.

17. Moreover, the appellant puts forth that by virtue of SEBI's circular dated August 10, 2011, the stock exchanges were given control over violations related to the short/non-collection of margin by brokers

registered with the particular stock exchanges. As such, after having directed NSE to look into the matter, SEBI ought not to have initiated proceedings under the Intermediary Regulations as this amounts to double jeopardy. In the Inspection Report, SEBI's scope was recorded as being limited to ascertaining whether or not SMC was still continuing with the practice of wrong reporting of margin to the exchange and providing higher exposure to its trading members.

18. Even though the impugned order holds that SEBI may include NSE Officers in its Inspection team and that approvals for the same had been obtained, no such approval has been brought on record. There is also nothing to show that the inspection was supervised by a Division Chief. The appellants submit that the DM is not empowered to frame new allegations under regulation 28(1) of the Intermediary Regulations, but he may only enhance the penalty beyond the DA's recommendation.

19. The appellant also submits that there was no legal obligation on them to square off the open positions of the TMs involved. Moreover, the appellants had no power as a CM to itself square off the TMs' position, and requested NSE to do so. However, owing to the volatility of the market at the time, NSE could not square off all the open positions of the TMs. The dues of the TMs having already been paid off by the appellant, it was the latter's endeavour to recover the same as soon as practically possible, but squaring off open positions was not a viable option at the time.

20. Further, it is submitted by the appellants that the measure of providing undated and postdated cheques was undertaken keeping in mind

the sudden collapse and financial difficulties which arose in the year 2008 which in turn prompted them to collect securities in whatever form they could. As regards the immovable property transactions, the appellant submits that there is no law, rule, regulation, bye law/circular which prohibits a CM from entering into such a transaction with a TM. It has been contended on behalf of the appellants that if the quantum of shortfall cannot be ascertained, the charge must fail and the appellants must be given the benefit of doubt. The Appellant as a CM did everything it could do to mitigate the losses / damages, including collecting alternate forms of security to prevent the TMs from committing any default. TM's default in payment cannot be construed as funding by the CM in question. Further, NSE's circular dated June 2, 2009 for the first time clarified that post dated cheques should not be considered towards margin calculation.

21. Regarding the immovable property transactions, it is submitted by the appellant that the negative ledger balance comprised of MTM liability and that MTM and margins are allegedly separate and distinct issues. The respondent's finding with respect to the agreement with Nikunj Stock Brokers Limited on January 24, 2008 that the sale was not concluded is incorrect since it stems purely from the agreement to retransfer the asset if Rs. 2 crore was paid within 18 months. A CM is not prohibited from entering into a property transaction with a TM under any law.

22. With respect to the wrong reporting of margin amounting to 2.17%, it is put forth that the amount itself is miniscule. Out of the 18 instances pointed out by the respondents, 13 are allegedly based on incorrect data, and the remaining 5 have, as accused by the appellant, been

incorrectly calculated by the Inspection Team. Accusations of the respondent regarding collection of undated cheques, property transactions, bank guarantees do not pertain to the period ending December 2008 to November 2009 but to the period ending November 2008.

23. Per contra, the case of the respondents is that the appellant was unduly supporting and accommodating the TMs, thereby risking the entire system and leading to the creation of a credit pyramid. The respondent, in its submission, reiterates the findings in the Impugned Order, SEBI's Inspection Report, the DA's Report and the SCN dated April 16, 2012.

24. The respondent has contended that its inspection report contained the findings of the NSE and that of independent auditor as its annexure, including details of margin collection for the period from December 2008 to November 2009 and hence, the lapses of the appellant for the period of the NSE inspection was part of the findings of the alleged violations.

25. The respondent submits that under the SEBI (Stock Brokers and Sub Brokers) Regulations, 1992, the registration granted to any intermediary is subject to the stock broker abiding by the rules, regulations and bye-laws of the stock exchange which are applicable to it. Further, the argument that the violation of an exchange circular is not a violation of a SEBI regulation is logically invalid. The proceedings of NSE were under its Bye Laws and the SEBI proceedings have been initiated under the Intermediaries Regulations and such proceedings can take place simultaneously and therefore no question of double jeopardy arises. Further, in regard to the provisions of Regulation 28 of the Intermediaries Regulations on the receipt of the report recommending

action/penalty from the DA, the DM considered the same and issued an SCN to the appellant dated April 16, 2012 to show cause as to why action, including the passing of a direction as the DM considers appropriate, should not be taken. This is in accordance with the provision, intention and purpose of the procedure set out in the Intermediaries Regulation.

26. As per Regulation 19(1) of the Stock Brokers Regulations, SEBI can appoint its officers or other competent persons for the purpose of inspecting the books of account and records of a stock broker. The necessary approvals in this respect had been obtained for inclusion of NSE officers in the inspection team and that the inspection was conducted by the Division Chief, collectively referred to as Investigating Authority, hereinafter referred to as “IO”. Moreover, under the SEBI Act, 1992 and the Stock Broker Regulations, the respondent has the discretion to take one or more enforcement actions, for the breach of laws committed by an intermediary.

27. With respect to the shortfall in margin collections, the respondent has relied on the NSSCL circulars dated November 8, 2001, dated June 17, 2003 and dated February 9, 2007 wherein the modes of payment of initial margin have been specified as: Cash, Bank Guarantee, FDRs issued by any one or more of approved commercial banks, and Deposit of approved securities in dematerialized form or such other collateral form as may be specified by the clearing corporation from time to time. NSCC/F&O/C&S/78 dated October 8, 2002 specifies that CMs/TMs are required to collect upfront margin from their respective trading members/

constituents. This position is reiterated by NSE Circular dated February 28, 2008.

28. The respondent submits that the role of the CM is to collect the initial margin from the TMs for their clients. The BG obtained by the appellant by leveraging the Rs. 7.5 crore FDR deposited by SSL was shown as margin and was not furnished by the TM, namely SSL. Hence, the appellant received credit from a bank to meet TM's margin requirements, which is contrary to the intention and purpose of the risk containment requirements. The undated and post dated cheques were held as impermissible forms of margin collection as the same cannot be construed as cash. The appellant had accommodated the defaulting TM, GYF, through various modes of circuitous movable / immovable property transactions in 2008-2009 on several occasions and GYF was declared defaulter by NSE on July 27, 2009.

29. In regard to the matter of MTM, the respondent submits that the settlement price towards the MTM liability/losses is computed on a daily basis upon the open position held by the entity and that MTM indicates losses already incurred on the open position which in any way is required to be paid by the TMs. The TMs in the present matter were already in financial crisis. The appellants claimed to have purchased a property from a TM, namely NSE, and the registration of the conveyance deed was delayed on the condition that the sale agreement would be revoked by paying the consideration of Rs. 2 crore to the appellant if the vendor i.e. NSB finds a buyer ready to pay a higher amount. The appellant claims that such amount was paid in tranches and was completed by June 2009

and therefore the argument that NSE was entitled to a credit of Rs. 2 crore effective from the date of the agreement should not be accepted. The respondent submits that when the sale was not concluded and the consideration had not been paid by the NSE to the appellant, it cannot be concluded that the TM was entitled to the Rs. 2 crore as on the date of an agreement to sell. The appellant allowed a shortfall of margins on several occasions, even to the extent of 100%, and tried to pass off undated cheques, property papers, leverage bank guarantee as margins.

30. The respondent submits that in terms of Rule 8(3)(f) of the SCRA, 1956, a member cannot continue as a member if he engages, either as principal or employee, in any business of securities except as a broker or agent not involving any personal financial liability. Further, a SEBI circular dated December 03, 1998 had prescribed a model format of CM-TM Agreement. As per clause 5 (payment of margins) of the said model agreement, **the CM shall collect margins from the TM as prescribed by the relevant authority from time to time.** The appellants have not collected adequate margins while collecting it through modes that are not permitted.

31. Due to the default of the TMs, namely, SSL and GYF in their payment obligations, the stock exchanges had to redress investor complaints/claims by utilizing funds from the Investor Protection Fund to make good the claims of the clients of SSL and GYF. Given the facts and circumstances of the case, the appellant was rightly prohibited from taking on any new assignment or contract or launch a new scheme for a period of three months.

32. We have heard the learned senior counsel for both parties at length and perused the appeal alongwith the documents attached therewith.

33. To begin with, we would like to deal with the appellant's contention that SEBI ought not to have looked into the matter having previously asked the NSE to investigate the same and report accordingly. In this regard the appellant has relied on SEBI's circular dated August 10, 2011 which deals with "Short-collection/Non-collection of client margins (Derivative Segment)". A perusal of the same reveals that the stock exchanges have been empowered to penalize brokers regarding infractions committed with respect to margin collection. We have dwelled upon this issue at length and it is our considered opinion that ultimate power in respect of all matters related to the capital market rests with SEBI except statutorily excluded subjects. Clause 5 pertinently notes that "All instances of non-reporting shall amount to 10% shortfall collection and the penalty as applicable shall be charged on these instances in respect of short collection". When and where regulatory intervention is required is the sole prerogative of the SEBI as a regulator. Undoubtedly such a decision to intervene in the affairs of a company broker or sub-broker or other intermediaries is a subjective one to be taken by the regulator after taking into consideration various factors and attending circumstances. In the instant case, SEBI ordered a special purpose inspection of the appellant's affairs by letter dated November 11, 2009 after being alarmed by the two TM's being declared defaulter and on receipt of certain complaints. Although, SEBI had already called upon the NSE to look

into the matter and submit a report which was done by the stock exchange, this fact in itself cannot amount to estoppel qua SEBI not to initiate any proceedings against the appellant under Intermediaries Regulations, 2008 or any other relevant provision of law. Therefore, we hold that the factum of SEBI's calling upon the NSE to look into the matter and submit a report does not preclude SEBI from taking action against the appellant as per law as the Chief Regulator of the Market.

34. Turning once again to circular dated August 10, 2011, we note that it does not feter the hands of the respondent to take cognizance of blatant violations pertaining to the collection/non-collection of margin money in the overall interest of the capital market. It follows, therefore, that SEBI would always have the authority to inquire and impose punishment in those matters which, in its expert opinion, have not been dealt appropriately by the stock exchange concerned. It is not a question of the punishment being mild or severe, but that of regulating the market at a level far beyond the scope and reach of an individual stock exchange which is concerned primarily with its own members and their respective clients. Clause 8 of the circular particularly states that "SEBI shall examine the implementation of this circular during inspection of the stock exchange". The insertion of this particular clause removes any doubt which may have crept into our minds in light of the relentless argumentation on part of the appellant's learned lawyers. While issuing this circular, SEBI did not intend to abdicate its responsibility with respect to such a vital capital regulatory measure as the collection of margin money. We would hasten to add that stock exchanges have also been conferred with regulatory powers under the SCRA, 1956 and the rules

framed thereunder. However, this per se can never be construed as precluding SEBI from acting in a particular matter which calls for intervention in the facts of a given case. SEBI, in the circular itself, has retained the right to supervise the margining system in the market. Another aspect that comes to our notice from a minute examination of the circular is that it does not deal with the mode of collection of margin money which indisputably is one of the critical constituents of the margining system. No one can disagree when we say that SEBI could not have intended that the mode of collection of margin money remain unregulated. This particular circular deals specifically with short-collection/non-collection of margin money. So as to consider the mode of collection, SEBI would have to step into the arena. The contention of the learned senior counsel for the appellant, Shri P. N. Modi, in this regard is, therefore, liable to be rejected.

35. From the records it is seen that SEBI's order for inspection dated November 11, 2009 doesn't mention the scope of SEBI's investigation to be restricted to, as the appellants have claimed time and again, ascertaining whether the appellant was still carrying on the practice of wrong reporting of margin to the exchange. It is also a fact that letter dated November 25, 2009 from SEBI informed the appellant that an inspection of its records, accounts and other documents would be conducted, inter alia, to verify whether the books of accounts, records and other documents are being maintained in the manner specified by the provisions of the SCRA, 1956; SEBI Act, 1992, the rules, regulations and circulars made thereunder. Even though the Inspection Report does specify the scope of the investigation to be as stated by the appellants, it

would be a fallacy to actually construe those words in the strictest sense. As explained above in detail, the right to regulate various facets of the capital market is inherent in the constitution of SEBI. Further, NSE undertook the inspection under its own bye-laws, whereas SEBI conducted its proceedings under the Intermediaries Regulations. Such fatuous arguments cannot bar SEBI from exercising its right as the market's Chief Regulator. The next contention of the respondent that SEBI allegedly exceeded the scope of its inspection as provided for in the Inspection Report is therefore dismissed.

36. Further, the appellant contends that the Hon'ble DM exceeded his authority by including new allegations in the SCN he issued to the appellant. It is pertinent to reproduce the provisions of law dealing with this issue :-

Securities and Exchange Board of India (Intermediaries) Regulations, 2008

Appointment of designated authority

“24. (1) Where it appears to the designated member, that any person who has been granted certificate of registration under the Act, regulations made thereunder has committed any default of the nature specified in regulation 23, he may appoint an officer not below the rank of a Division Chief, as a designated authority:

Provided that the designated member may, at his discretion, appoint a bench of three officers, each of whom shall not be below the rank of a Division Chief.

Provided further that such bench shall be presided by the seniormost amongst them and all the decisions or recommendations of such bench shall be by way of majority.”

Issuance of notice.

“25. (1) The designated authority shall, if it finds reasonable grounds to do so, issue a notice to the concerned person requiring him to show cause as to why the certificate of registration granted to it, should not be suspended or cancelled or why any other action provided herein should not be taken.

(2) Every notice under sub-regulation (1) shall specify the contravention alleged to have been committed by the noticee indicating the provisions of the Act, rules, regulations, circulars or guidelines in respect of which the contravention is alleged to have taken place.

(3) There shall be annexed to the notice issued under sub-regulation (1) copies of documents relied on in making of the imputations and extracts of relevant portions of documents, reports containing the findings arrived at in an investigation or inspection, if any, carried out.

(4) The noticee shall be called upon to submit within a period to be specified in the notice, not exceeding twenty-one days from the date of service thereof, a written representation along with documentary evidence, if any, in support of the representation to the designated authority.”

Reply by the noticee.

“26. (1) The noticee shall submit to the designated authority its written representation within the period specified in the notice along with documentary evidence, if any, in support thereof :

Provided that the designated authority may extend the time specified in the notice for sufficient grounds shown by the noticee and after recording reasons in writing.

(2) If the noticee does not reply to the show- cause notice, the designated authority may proceed with the matter ex parte recording the reasons for doing so and make recommendation as the case may be on the basis of material facts available before it.”

Action in case of default

“27. After considering the representations, if any, of the noticee, the facts and circumstances of the case and applicable provisions of law or directions, instructions or circulars administered by the Board the designated authority shall submit a report, where the facts so warrant recommending, --

- (i) suspension of certificate of registration for a specified period;
- (ii) cancellation of certificate of registration;
- (iii) prohibiting the noticee to take up any new assignment or contract or launch a new scheme for the period specified in the order;
- (iv) debarring a principal officer of the noticee from being employed or associated with any registered intermediary or other registered person for the period specified in the order;
- (v) debarring a branch or an office of the noticee from carrying out activities for the specified period;
- (vi) warning the noticee.”

Procedure for action on receipt of the recommendation

“28. (1) On receipt of the report recommending the measures from the designated authority, the designated member shall consider the same and issue a show-cause notice to the noticee enclosing a copy of the report submitted by the designated authority calling upon the noticee to submit its written representation as to why the action, including passing of appropriate direction, as the designated member considers appropriate, should not be taken.

(2) The noticee may, within twenty one days of receipt of the notice send a reply to the designated member who may pass appropriate order after considering the reply, if any, received from the noticee and providing the person with an opportunity of being heard, as expeditiously as possible and endeavour shall be made to pass the order within one hundred and twenty days from the date of receipt of reply of the notice or hearing.”

On a perusal of the Intermediary Regulations as reproduced above it becomes clear that the DA's report is nothing but a recommendation to the DM elucidating the nature of the violation committed by the wrongdoer. The DM is under no obligation to stick to the charges as levelled in the

DA's report or to go by the penalty recommended therein, and there is nothing in the Intermediaries Regulations to suggest otherwise. For purposes of the Intermediaries Regulations, the DA's report is the result of merely an inspection conducted by the DA to give the DM a preliminary opinion on facts and the law with respect to the violation in question. Nowhere in the Intermediaries Regulations is there even a semblance of suggestion that the DA's report is binding on the learned DM in any form regarding any element contained therein. The learned DA's report is, as clearly spelt out in the Intermediaries Regulations themselves, only a recommendation and as such giving it any kind of tangibility is out of the question. The DM has all the necessary discretion to enhance or reduce the penalty recommended by the DA depending upon the facts, violations and the circumstances of the case. Therefore, the learned DM followed the law by looking at the matter afresh and framing allegations followed by a penalty he deemed fit.

37. Circulars dated February 9, 2007 and November 8, 2001 issued by the NSCCL state that initial margin shall be payable on all open positions of Cms, upto client level, and shall be payable upfront. Initial margin shall include SPAN margins, premium margin, assignment margin and such other additional margins as may become due from time to time. Circular dated February 28, 2008 issued by the NSE provides that TMs/CMs shall collect margin money from TMs/constituents and report margin collection to the NSCCL in terms of the NSCCL circulars mentioned above. The modes of payment of initial margin as specified in the circulars are Cash; bank Guarantee; Fixed Deposit Receipts (FDRs); and Deposit of approved securities in dematerialized form or such other

collateral form, with a haircut, as may be specified by the clearing corporation from time to time.

38. From the facts on record we note that FDRs had been made available by SSL to the appellant only for 7.5 crore as margin. The appellant on the other hand obtained a BG for Rs. 15 crores from its banker and passed the entire 15 crore off as having been obtained from SSL. It is evident that in order to fulfill the margin requirement of its TM the appellant received credit from its bank. As rightly stated in the Impugned Order, *“It is not a question of law but a matter of fact. The NSE/clearing house would have invoked the BG in an event of a payment crisis, and thereafter the Rs. 15 crore would have become due by the noticee to its bankers (who had issued the BG). The noticee would be having FDRs worth only Rs. 7.5 crore from SSL and the balance Rs. 7.5 crore would have to be borne by the clearing member, which is not desirable as it will strain the solvency of the clearing member. A clearing member's default would have been even a greater threat to the stability of the securities market. The above conduct shows that the noticee was trying to accommodate SSL in margin collection, in utter disregard of its role and responsibilities.”* We are, therefore, agree with the learned DM in that FDRs and bank guarantees being acceptable modes of margin collection, the same must be received from a TM or a constituent as the case may be. The appellant having received 7.5 crore in FDRs from SSL incorrectly reported the collection to be Rs. 15 crore. This unacceptable orchestration by the appellant of succouring the TMs exposed the market equilibrium to a very serious risk.

39. The appellant also accepted undated/ post-dated cheques from SSL and GYF as collateral. In the case of a post-dated cheque, the holder must wait till the date shown on the cheque before he/she can encash it. The value of such a cheque cannot be considered towards margin collection since its worth cannot be realised instantly. It can only be accounted for once it is encashed, assuming it gets cleared. The appellant's odd contention that even such post-dated cheques should be treated as available margin and should be discounted only if dishonoured cannot be accepted. The simple reason for this being that margin requirements arising on a particular day would not be satisfied if such collateral were to be accepted, defeating the entire purpose for which the margining system has been put in place.

40. We now come to the allegation of immovable property being treated as margin collected by the appellants. It is a matter of record that exposure was given to GYF since March 3, 2008. On that day itself no margin was collected when the actual amount that should have been collected was Rs. 1,33,99,244.50. The appellant, however, constantly reported the margin as being collected inspite of the fact that the collection was non-existent. The appellant entered into property transactions with the wife of the managing director of GYF on two occasions and negotiated a price of Rs. 30 lac in one case and Rs. 13.51 lac in another, both to go towards margin collection. Even so there was a shortfall in margin collection. The appellant bought movable property belonging to GYF at inflated prices. The same is clear from the records. In all, the appellant tried to aid the TM through other tortuous transactions in many instances in the year 2008-2009. Although the shortfall in

margin collection was occurring since March 3, 2008, the appellant continued adjusting the margin collection and incorrectly reporting it to the stock exchange even till May 25, 2009. This is an admitted position. We fail to understand why the appellant persisted in giving exposure to GYF even when it was well aware of the poor financial condition that GYF was clearly facing. The appellants have stated that a CM is not prohibited from entering into a property transaction with a TM. However, we note that a CM may certainly not do so to shield a TM's default in respect of collection of margin money.

41. The appellant has further referred to circular dated December 27, 2012 issued by the NSE which recommends that for factual wrong reporting of margin collection from constituents when the total margin reported is upto 5%, a warning to the entity in question would be sufficient. On examining the circular we note that the language of the circular cannot be construed as mandatory in any respect. It is explicitly noted in the second paragraph that the penalties are merely indicative in nature, and depending on the gravity and frequency of the violations the penalty may undergo change. The relevant paragraph is reproduced hereinbelow :-

“2.0 Monitoring of utilisation of Issue Proceeds:

2.1 As per SEBI (Disclosure and Investor Protector) (DIP) Guidelines, 2000, every issuer company making a public or rights issue of more than Rs. 500 crores is required to appoint an agency to monitor the utilisation of issue proceeds. SEBI has, vide circular dated November 29, 2007 amending the SEBI (DIP) Guidelines, mandated that a monitoring agency shall henceforth be required to file its report with the issuer company instead of with SEBI.

2.2 Presently, clause 49 of Equity Listing Agreement requires the Audit Committee of an issuer company to monitor the utilisation of issue proceeds and to make appropriate recommendations to the Board of the issuer company. It is therefore felt that even where a monitoring agency has been appointed, the report submitted by such agency may be placed before the Audit Committee of the issuer company, so as to enable the Audit Committee to make appropriate recommendations to the Board of the issuer company. Accordingly, it has been decided to amend clause 49 of Equity Listing Agreement, requiring the issuer company to place the monitoring report filed with it before its Audit Committee.

2.3 Further, every issuer company shall be required to inform material deviations in the utilisation of issue proceeds to the stock exchange and shall also be required to simultaneously make the material deviations / adverse comments of the Audit committee / monitoring agency public through advertisement in newspapers.”

42. The appellant has submitted that it is not involved in any fund based activity by collecting Rs. 3104251.90 towards delayed payment charges. The margining system works in a rather simple manner. Once the TM collects margin money from the client, it then makes the necessary payments to the CM. The CM finally fulfills the requirement of margin money by paying the stock exchange concerned. In this case, as rightly noted by the learned DM, the appellant *“has leveraged the fixed deposit of 7.5 crore and had obtained a BG for 50% more than the value of the FD i.e., 15 crore. In case of any default the BG would be invoked.”* In such a case the appellant would be made liable for leveraging the balance of Rs. 7.5 crore for the TM. Regulation 8(3)(f) of the SCRR, 1957 lays down categorically that members of a stock exchange shall not be engaged in any business as principal or employee other than that related to the stock market except as broker or agent not involving any personal financial liability. In addition to this, the appellant accepted undated/post-dated

cheques as from the TMs, alongwith entering into property transactions with the latter. The appellant's exploits clearly depict the appellant's involvement in a personal financial liability, which is a contravention of the regulation stated hereinabove.

43. The primary charge as reflected in SCN dated 6.10.2010, read with post inquiry SCN dated April 16, 2010, against the appellant is that it collected the required margin in non-permissible forms from its TMs, particularly SSL, GYF and NSB, regarding their dealings in the F&O segment. This in turn resulted in shortfall in margin collection as well as the consequent wrong reporting to the NSE of the collected margin. The growth of any financial market flows from its integrity. Therefore, to pre-empt any market failure and to protect investors, SEBI has evolved margining as an extremely important/crucial tool of a comprehensive Risk Management System. In order to act as an effective risk mitigant, margin must be, firstly, accessible at the time of need and secondly, in a form that can be liquidated rapidly in a period of financial stress at a predictable price. Various SEBI circulars, as discussed above, have laid a lot of importance to the form in which margin should be collected by a broker. The obvious purpose is to ensure that the assets collected as collateral for the purposes of the initial margin can be liquidated in a reasonable amount of time to generate proceeds that could sufficiently protect collecting entities covered by the proposed requirements from losses occurring in the event of a counter-party default. Therefore, the assets should be highly liquid and should be able to hold their value in a time of financial stress, after accounting for an appropriate haircut.

44. The significance of the concept of margin lies in the fact that it is treated as 'defaulter-pay'. This means that in the event of a counter-party default, margin protects the surviving party by absorbing losses using the collateral provided by the defaulting entity. Each portfolio has its own designated margin for absorbing the potential losses in relation to that particular portfolio. In addition to the initial margin, another equally important risk management technique is the daily margining, i.e., collateralization of credit risk. Here margining is not static and has to be recalculated or adjusted six times a day as the risk rises or falls. On the basis of his volatility in any given scrip, the clients are asked for margin money over and above the initial margin already paid upfront. This is collected as additional margin, and comprises an equally important facet of the Risk Management System. For this purpose, the risk management method should be adequate. It is a stock-broker's professional responsibility, rather it is his duty, to investigate the financial capability of an investor entering a margin transaction and to inform that investor of the implication of a margin transaction. The form of collection of margin money, its adequacy and deposit, including limit on exposure, are extremely important ingredients of a purposeful and effective margining system in the present day capital market culture. Expeditious and correct reporting of margin also acquires great significance towards this end.

45. The thrust of the arguments advanced by Shri P. N. Modi, learned senior counsel on behalf of the appellant, is that there was unprecedented recession in the capital market all over the world in 2008. Volatility in the market was huge. Liquidity had dried up and the market depth was very shallow. All this led to defaults and even bankruptcies. At that time the

appellant had acted as CM for almost 36 TMs out of which two TMs i.e. “SSL” and “GYF” heavily defaulted in the matter of margin. The appellant made good the short-falls in margin out of his pocket, as such, the counter parties did not suffer. It is, thus, suggested by Shri Modi, that due to the good gesture displayed by the appellant during the crisis to save the TMs as well the market, the whole financial burden of clearing/settlement of the transactions undertaken by the said two TMs fell on the appellant. In this background, the appellant collected whatever security it could procure from the two TMs in the form of shares, post dated and undated cheques, purchase of property or property documents etc. Accepting any sort of security such as post and undated cheques, property, property documents or furniture and fixtures by a CM from TMs is neither conceived in the SEBI circulars or NSE circulars nor can it be termed a prudent risk management measure. The reality is that “SSL” and “GYF” continued to default in fulfilling their margin obligation towards the appellant and the appellant went on giving excessive exposure to the two TMs which has been rightly viewed seriously by SEBI.

46. Additionally, SEBI has prescribed a model Clearing Member-Trading Member Agreement vide circular dated December 3, 1998. According to clause 5 of this agreement, the CM shall collect margins from the TM as prescribed by the relevant authority from time to time. Not having done the same, the appellant is also in contravention of these provisions. Clauses A(1) (2) and (5) of the Code of Conduct for stock brokers provide that stock brokers shall maintain high standards of integrity, promptitude and fairness in the conduct of all business while

acting with due skill, care and diligence; and abiding by all the provisions of the law applicable to stock brokers.

47. Margin money has always played an important role in containing risks which are inherent in the functioning of any capital market. Owing to its non-adherence huge market crashes have been witnessed all over the globe in the recent past. The vital position that the margining system holds as a crucial instrument to maintain market equilibrium can never be undermined. It is, therefore, pertinent for all market players to maintain the sanctity of margining as a risk management tool while dealing in securities, be it in the cash or in the F&O segment.

48. We, therefore, find no reason to interfere with the Impugned Order, which is hereby upheld, and the appeal is dismissed with no order as to costs.

Sd/-
Justice J.P. Devadhar
Presiding Officer

Sd/-
Jog Singh
Member

31.01.2014
Prepared & Compared by
Pk/PTM