SEBI/WTM/GM/EFD/41/2019-20

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

ORDER

UNDER SECTION 12(3) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 READ WITH REGULATION 28(2) OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008.

IN THE MATTER OF PUG SECURITIES (P) LTD.

Background –

1. PUG Securities (P) Ltd. ("**PSPL**" / "**noticee**") is a Registered Stock Broker having membership of BSE Ltd. (SEBI Registration Nos. INB/INF 011200731), National Stock Exchange of India Ltd. (SEBI Registration Nos. INB/INF/INE 231200735) and Metropolitan Stock Exchange of India Ltd. (SEBI Registration No. INE 261200735). The noticee is also a Depository Participant of CDSL and NSDL.

2. SEBI initiated Enquiry Proceedings against the noticee in respect of alleged contravention of the provisions of Clause A(1), (2) and (3) of Code of Conduct prescribed under SEBI (Stock Brokers and Sub-brokers) Regulations, 1992 ("**Broker Regulations**") and SEBI Circular Nos. SMS/SED/CIR/93/23321 dated November 18, 1993 and MRD/DoP/SE/Cir-11/2008 dated April 17, 2008 read with Clause A(5) of Code of Conduct prescribed under SEBI (Stock Brokers and Sub-brokers) Regulations, 1992.

3. The facts in the instant proceedings as noted from the Enquiry Report dated April 27, 2017 ("**DA Report**") are provided below:

a. SEBI conducted inspection of the books and accounts of PSPL from February 28, 2013 to March 01, 2013 to examine whether the requirement of segregation of funds and securities of clients have been complied with by the noticee.

b. The inspection indicated that the noticee, inter-alia, provided misinformation about its pro-trading activities, failed to maintain segregation of clients securities, did not follow standard practice for settlement of securities, did not credit the amount raised by pledging clients securities into their respective accounts and made financial gains by doing so and by charging more than bank interest from the clients.

c. The Inspection Report containing the aforesaid observations were forwarded to the noticee for its comments vide letter dated July 19, 2013. The noticee, vide letter dated August 27, 2013, provided point-wise replies to the observations made in the Inspection Report. Upon consideration of the said reply, SEBI initiated Enquiry Proceedings against the noticee in respect of alleged contravention of the provisions of Clause A(1), (2) and (3) of Code of Conduct prescribed under Broker Regulations and SEBI Circular Nos. SMS/SED/CIR/93/23321 dated November 18, 1993 and MRD/DoP/SE/Cir-11/2008 dated April 17, 2008 read with Clause A(5) of Code of Conduct prescribed under erstwhile Regulation 7 of Broker Regulations.

4. The Designated Authority / Enquiry Officer ("**DA**"), upon consideration of the facts before him and after granting an opportunity of hearing, found the noticee to be liable for having violated the aforesaid provisions of Broker Regulations. Accordingly, the DA, vide his report dated April 27, 2017, recommended that the noticee may be suspended for a period of one month for the aforesaid violations committed by it.

5. A Show Cause Notice dated July 12, 2017 ("**post-enquiry SCN**") under Regulation 28(1) of the SEBI (Intermediaries) Regulations, 2008 ("**Intermediaries Regulations**") was issued by SEBI calling upon the noticee to show cause as to why action as recommended in the DA Report or any other higher penalty should not be taken against it, by the Competent Authority, in respect of the following violations / observations in the DA Report:

i. Misinformation about the pro-account trading: DA, inter-alia, observed that the noticee was engaged in pro-trading till 2008. However, some shares still remained in the pro-trading account out of which some were sold in July 2010 and there were credit entries in the pro-account during the inspection period on account of dividends received on the shares still lying in the said account. In view of the above, DA concluded that the noticee was involved in pro-account trading and it has misinformed SEBI about the same.

ii. Non-segregation of clients funds and securities maintained by the noticee: DA, *inter-alia*, observed that the securities of the clients have been lying in own beneficiary account and concluded that the noticee was receiving securities from the client beneficiary accounts for the settlement purpose but was not giving back / returning securities to the client beneficiary account.

iii. No standard practice for the settlement of securities: DA, *inter-alia*, observed that there have been direct transfer of securities to the pool account no. 1203470000000372 implying that there was no standard practice being followed by the noticee for the settlement of securities and there were no credit entries to the client beneficiary account no. 1203470000000032 from the pool account no. 1203470000000372 implying that there was no practice of keeping the securities of clients in the client beneficiary account.

iv. Delay in furnishing pledge details to SEBI: DA observed that the noticee had deliberately not provided the pledge details as on February 27, 2013 so that it could release most of the pledged securities by the date, the details of which are provided and concluded that the noticee delayed the process of inspection and tried to hide the true picture of the pledged securities of its clients as on February 27, 2013.

v. Defrauding the clients by pledging their shares without the knowledge of clients: DA observed that the noticee itself has admitted that there might be inadvertent possibility that securities of some inactive clients might have remained pledged.

vi. Non-credit of benefit out of pledged shares to the client account: DA observed that the noticee did not credit the money raised through pledging of clients' securities to their respective accounts and charged the penalty on the total debit balance, which was not the true debit balance.

vii. Personal gain made by the noticee on the money raised out of pledged securities: DA observed that the noticee levied late payment charges @18% p.a. whereas the bank was charging only 16% p.a. on the money raised out of pledged securities thereby making a gain of 2%p.a.

Reply and Submissions

6. The noticee, vide letter dated April 14, 2019, submitted para wise replies against the findings of the DA. Submissions made therein are summarized below:

a. Misinformation about the pro-account trading: The noticee submitted that it had not indulged in pro-account trading during the period of Inspection (i.e. April 01, 2011 to February 28, 2013) and thereafter. It had entered into pro-account trading only up to the year 2008-09 and discontinued the pro-account trading thereafter and there has not been any sale or purchase transaction in the pro-account. The credit balance of Rs.5.71 lakh appearing in the pro-account was due to sale of shares lying in the pro-account on July 27, 2010. Further, the few credit entries in the account amounting to Rs.952 was on account of dividend received on such shares lying in the pro-account. Merely having a

credit balance in the pro-account or having few credit entries due to receipt of dividend did not tantamount to pro-trading as there was no purchase or sale of shares during the Inspection period.

b. Non-segregation of client funds and securities maintained by the Noticee: Since the noticee has not indulged in Pro-account trading during the period of inspection and all the beneficiary accounts were used for client purpose only, the need to segregate own securities and client securities would arise only when the noticee indulged in pro-account trading. It was also submitted that the noticee was maintaining the clients' funds and securities on running account basis and clients had consented and authorized the noticee to keep their securities as margin in the noticee's beneficiary account. The noticee had also enclosed a sample copy of such authorization. It was also stated that there has not been any transaction in Pro-account after July 27, 2010.

c. No standard practice for the settlement of securities: It was submitted that the noticee had followed the standard practice for the settlement of securities through their pool account No. 1203470000000372 only and the findings of the DA is factually not correct. However, noticee has admitted that in 7 instances during the inspection period, few clients had given the securities to the beneficiary account No. 1203410000000032 and such securities have been transferred to the pool account for the settlement purpose as per the standard practice for settlement of securities.

d. Delay in furnishing pledge details to SEBI: Since preparation of details of securities pledged as on February 27, 2013 was taking time, it was suggested by the Inspection team on March 19, 2013 to submit the details of securities pledged as on the latest date and accordingly, the noticee submitted the pledge details as on March 19, 2013. Further, when the noticee was asked again for the details as on February 27, 2013, the said details were submitted without any delay. The noticee also stated that there may be a possibility that a few securities of some

clients, who were inactive and having credit balances, might have remained pledged but corrective measures have been taken by the noticee immediately as and when suggested by the Inspection Team. The credit facility utilised by pledging the securities as on February 27, 2013 and on March 19, 2013 were Rs.1,57,18,000 and Rs.1,50,58,000 respectively and the amount has subsequently been reduced to nil.

e. Defrauding the clients by pledging their securities without the knowledge of clients: It was submitted that the securities of the clients were pledged with their due authorization and consent and sample copy of such authorization was enclosed along with the reply. Hence, the finding that securities were pledged without the knowledge of the clients, is not correct.

f. Non-credit of benefit out of pledged shares to the clients account: The observation was not denied. The money raised against the pledged securities were not directly credited to the client's financial ledgers due to non-compatibility of such automatic entries in the noticee's back office software. However, it should not amount to the conclusion that the benefit of such securities was not given to the clients. While allowing trading limits, the benefit of whole amount of securities pledged were provided to the clients.

g. Personal gain made by noticee on the money raised out of pledged securities: As regards the allegation of charging late payment charges @18% p.a. as against the bank interest of 16% p.a. on the money raised out of pledged securities, it should not be construed as making a personal gain of 2% p.a. The noticee had made arrangement with Bank to avail credit facility against the pledging of client securities only to facilitate the clients for carrying out their trading activity freely and smoothly. Further, considering the proportionate costs involved in pledging / un-pledging shares, the cost involved may be even more than the 2% possible gain as alleged.

7. The noticee has further stated that it is a law abiding company and had carried on its business in accordance with the Rules and Regulations framed by SEBI. It was also submitted that the noticee was in the process of closing down its business operations since the year 2013 and almost 95% of the trading accounts have been settled and closed and remaining accounts were likely to be closed by the end of the financial year.

8. In view of the above, the noticee prayed that no action or penalty be imposed on it and its certificate of registration as a stock broker should not be suspended.

9. Thereafter, an opportunity of personal hearing was granted to the noticee on August 20, 2019, wherein it was represented by its authorised representatives, viz. Shri. N. P. Sahni, Chief Advisor and Shri. Piyush Pandey, Compliance Officer.

10. During the hearing, the noticee reiterated the submissions made in its reply dated April 14, 2019 and submitted copies of earlier correspondences and submissions made to SEBI in the matter. The Noticee, through its representatives, made oral submissions refuting the allegations contained in the SCN dated July 12, 2017 and also made the following submissions:

a. The company is in the process of closing down its business and had surrendered its BSE membership. NSE membership was also being surrendered and client's dues were being settled.
b. Its business was affected due to closing down and sealing of its office premises by NDMC.
c. Consequently, it had changed address and new address was intimated to SEBI.
d. The delay in providing information on pledge sought by SEBI was not intentional and there was no mala fide intention as the information was provided as and when received from the bank. Further, the quantum of pledged securities in both the statements were almost similar and hence, no motive could be attributed to the delay.

e. The company has stopped proprietary trading since 2008-09 and the subsequent use of demat accounts in own name for clients' securities was inadvertent mistake. Hence it may not warrant a harsh penalty as no *malafide* intention or misuse of clients securities for own purpose has taken place and the notice did not get any undue benefit therefrom.

f. There were no complaints from clients alleging misuse of their funds / securities during the period.

11. Based on the above, the noticee submitted that the violations, if any, were technical in nature and hence a reduced penalty may be considered in view of the same.

Findings

12. I have considered the findings of the DA Report along with the written and oral submissions made by the noticee. My observations and findings with respect to each of the allegations dealt with in the DA Report, are given below:

a. In relation to the first allegation, i.e. misinformation about pro-account trading, the noticee had admitted that they were into pro-account trading till the year 2008 and had also sold shares lying in the pro-account in July 2010 resulting in a credit entry of Rs.5.80 lakh in its pro-account. It was also admitted that there has been some credit entries to the pro-account (CT001) on account of dividend amounting to Rs.952 received on shares still lying in the said account. The noticee submitted that they have not indulged in pro-account trading during the period of inspection (i.e. April 01, 2011 to February 28, 2013) and thereafter and credit entries in the account amounting to Rs.952 were on account of receipt of dividend on few shares lying in the said account. Noticee has also furnished copies of financial ledger of their pro-account (CT001) in support of their claim to provide that there were no transactions in the said account during the inspection period except as mentioned above. I note from the materials available in record that there have not been any sale or purchase of shares in the pro-account during the inspection

period and the only sale transaction in the said account post 2008 was the sale of shares amounting to Rs.5.80 lakh in July 2010. Further, the documentary evidence produced before me does not indicate that the noticee had, undertaken any pro-account trading after 2008. One standalone transaction done during July 2010 to sell the shares lying in the pro-trading account may not, by itself, lead to a conclusion that pro-account trading has been carried out by the Noticee. Further, the Inspection questionnaire sent by SEBI pertained to the Inspection Period and the query regarding proprietary trading was "Do you carry out proprietary trading" which was replied by the noticee in negative. Since the entity did not undertake any pro-account trading after 2008, the disclosure made in 2013 that it was not doing pro-account trading cannot be said to be a misinformation. I further find that the noticee cannot be said to have involved in pro-account trading as alleged in the SCN merely because there was an account named as pro-trading account, which continued as it is, even after the noticee had stopped trading in that account. However, the noticee ought to have been more precise and complete while making submissions in response to the queries from the Inspection Team.

b. In relation to the second allegation on non-segregation of client funds and securities maintained by the noticee, the DA has observed that securities of the clients had been kept in own beneficiary account and there have been to and fro transactions between own beneficiary account and client beneficiary account. The noticee submitted that since it was not into any pro-account trading, all the beneficiary accounts were used for client purposes only and therefore, there was no need to segregate securities between own securities and clients' securities. It was also submitted that clients securities were kept in the own beneficiary account as margin with clients' consent and authorization. I note that SEBI circular bearing Ref. No. SMD/SED/CIR/93/23321 dated November 18, 1993, clearly lays down the requirement for segregation of own and clients' securities, the relevant extract of which is reproduced below:

"2. It shall be compulsory for all Member brokers to keep separate accounts for client's securities and to keep such books of accounts, as may be necessary, to distinguish such securities from his/their own securities. Such accounts for client's securities shall, inter-alia provide for the following:-

a. Securities received for sale or kept pending delivery in the market;

b. Securities fully paid for, pending delivery to clients;

c. Securities received for transfer or sent for transfer by the Member, in the name of client or his nominee(s);

d. Securities that are fully paid for and are held in custody by the Member as security/margin etc. Proper authorization from client for the same shall be obtained by Member;

e. Fully paid for client's securities registered in the name of Member, if any, towards margin requirements etc.;

f. Securities given on Vyaj-badla. Member shall obtain authorization from clients for the same."

I note that the noticee has admitted to having kept the securities belonging to its clients in both the own beneficiary account (A/c No. 1203470000000013) and the client beneficiary account (A/c No. 1203470000000032). Further, it was also observed from the DA Report that own beneficiary account (demat a/c no. 1203470000000013) was used by noticee for pledging the securities of clients. In view of the above, I note that the noticee has failed to maintain segregation of clients securities which were kept in demat accounts earmarked as own beneficiary account. At the same time, since the noticee has not undertaken any pro-account transaction during the inspection period and no observation on misuse of client's securities has been made out in the DA Report, I would like to view it as a technical breach of the requirements, stated above.

c. As regards the third allegation in the DA Report, i.e. no standard practice for the settlement of securities being followed, I note from the DA Report that the noticee had admitted to lack of standard procedure

for settlement of securities and stated that a few clients have given securities in beneficiary account no. 1203470000000032 instead of giving it in the pool account. However, I also note from the submissions made by the noticee that there were only 7 such instances during the inspection period and it could possibly be due to the clients quoting the wrong beneficiary account.

d. With regard to the fourth allegation in the DA Report on delay in furnishing pledge details to SEBI, I note that the noticee initially failed to provide the details of pledged securities as on February 27, 2013 and the inspection team was given the status of pledged securities as on March 19, 2013. The status of pledged securities as on February 27, 2013 was provided to the Inspection Team only after constant follow-up. The noticee admitted that there was delay in furnishing pledge details as on February 27, 2013 as preparation of the information was taking time. Further, I note from the DA Report that shares of inactive clients having credit balance remained pledged and the noticee has admitted to the same and submitted that corrective measures have since been taken. I note that the noticee had admitted to both the allegations of delayed submission of pledge related information and pledge of shares of inactive clients having credit balance. I note that the failure of the noticee in submitting the pledge details on time has caused undue delay in finalization of the inspection process and no valid reason or documentary evidence to substantiate the inevitability of the delay has been submitted on record. In view of the above, I agree with the observations of the DA that the noticee has delayed the process of inspection by not providing pledge details of securities as on February 27, 2013 on time. I also note that the noticee has admitted to having pledged shares of inactive clients having credit balance, which is serious in nature and raises doubts on the adequacy of systems and procedures adopted by the noticee to prevent misuse of client securities.

e. As regards the fifth observation in the DA Report, i.e., defrauding the clients by pledging their shares without the knowledge of clients, I note

that the noticee has refuted the allegation and stated that the securities of the clients were pledged with their due authorization and consent and submitted a sample copy of such authorization. I note that the said copy of the authorization, inter-alia, empowered the noticee to place the securities placed as margin by the clients, as margin with banks, exchanges or such other institutions, as and when required. I also note that the said authorization, *inter-alia*, provided that in the event of margin shortfall, the noticee may sell, dispose, transfer or deal in any other manner the securities placed as margin by the clients, without further reference to the client. In view of the above, it cannot be said that the shares were pledged without the knowledge of the clients. However, the aforesaid authorization does not enable the noticee to pledge securities of clients having credit balances and hence I find the noticee to be liable for pledge of securities of clients who were having credit balances.

f. As regards the sixth allegation in the DA report, i.e., the non-credit of benefit out of pledged shares to the client account, it was alleged that the money raised against the pledged securities have not been credited in the clients' financial ledgers and by doing so the noticee was not showing true and fair picture of the clients' financial position. It was also alleged that charging penalty on the entire debit balance of the client without adjusting the amount raised by the noticee by pledging the clients' securities amounted to defrauding the clients. The noticee has admitted that the money value raised against pledging clients' shares have not been credited in client's financial ledgers as its back office software was not compatible for such entries. It was also submitted that benefit of whole amount of securities pledged had been provided to clients while allowing trading limits. In this regard, I note that the noticee has raised funds by pledge to finance the interim shortfall in the funds, caused by failure of its clients to pay up on time, and the liability for repayment thereof rests with the noticee. If the funds so raised by the Noticee were to be adjusted against the clients' accounts, it would result in wrongly projecting reduced dues from the clients. Accordingly, I do

not find anything illegal in the practice of not adjusting the amount raised by pledging their securities against the balance due from them as even otherwise, the clients are obliged to pay up the gross amount due to the noticee. I also do not find anything irregular in charging interest on the entire amount due from clients as the client continues to owe full amount of dues to the noticee.

g. As regards the seventh allegation in the report on personal gain made by the noticee on the money raised out of pledged securities, the DA, inter-alia, observed that the noticee was making a personal gain to the extent of 2%p.a. by charging penalty for late payment @18%p.a. while the bank was charging the noticee only 16%p.a. for funds raised through pledging clients' securities. The noticee, in their reply, refuted the allegation and submitted that there is no correlation between the penalty and interest charged by the bank and the point made was only hypothetical and added that, apart from the interest, the noticee had to incur additional expenses involved in pledging / un-pledging securities. In this regard, I note that the noticee had levied penalty @18% p.a. from clients for late payment and no illegality thereon has been alleged in the DA report. I note that the delayed payment charges are levied on the total dues of the clients as per the covenants of the agreement and may not bear a necessary correlation to the actual cost incurred by the noticee to raise funds by pledging the clients' securities.

Conclusion

13. Amongst all the allegations / findings contained in the DA Report, I find that the allegations of failure to maintain segregation of clients' securities and pledge of shares of inactive clients having credit balance are serious violations warranting appropriate directions. Other allegations in the DA Report regarding lack of standard procedure for settlement of securities and delayed submission of pledge information do not appear to be serious enough to warrant an action under the extant proceedings. Further, the allegations pertaining to misinformation about pro-account trading, defrauding the clients by pledging their shares without the knowledge of

clients, non-credit of benefit out of pledged shares to the client account and personal gain made by the noticee on the money raised out of pledged securities do not stand established.

14. I note that the failure of the noticee to maintain segregations of clients' securities would result in violation of SEBI circular bearing Ref. No. SMD/SED/CIR/93/23321 dated November 18, 1993, the relevant provisions whereof have been reproduced in Para 12(b) above. I further note that the failure to maintain segregations of clients' securities and pledge of shares of inactive clients having credit balance, would also result in violation of Regulation 9 (f) (erstwhile Regulation 7) read with Clause A(1), A(2) and A(5) of Schedule II of the Broker Regulations the relevant extracts of which are reproduced below:

Erstwhile Regulation 7 of Broker Regulations

"7. The stock broker holding a certificate shall at all times abide by the Code of Conduct as specified in Schedule II.

….."

Regulation 9(f) of Broker Regulations

"Conditions of registration.

9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely,-

(a)…….

……..

(f) he shall at all times abide by the Code of Conduct as specified in Schedule II; and"

SCHEDULE II of Broker Regulations

"CODE OF CONDUCT FOR STOCK BROKERS

A. General.

(1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

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

…….

(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him."

15. The DA, in his report, has recommended that the certificate of Registration of the noticee as a stock broker be suspended for a period of one month for the aforementioned violations. However, as discussed at Para 13 above, I note that only two major violations which stand established and other allegations are either not serious violations warranting action under the extant proceedings or were unsubstantiated. Hence, I am inclined to modify the action recommended by the DA in the extant matter as given in the heading "Directions".

Directions

16. Therefore, in exercise of powers conferred on me under Section 12 (3) of the SEBI Act read with Regulation 27 and Regulation 28 of the SEBI (Intermediaries) Regulations, 2008, upon consideration of the facts and circumstances listed in this Order, applicable legal provisions and submissions of the Noticee, I hereby direct that the Noticee i.e. PUG Securities Pvt. Ltd., shall not take on board any new client for a period of 2 months from the date of this order. Nothing in this order shall prohibit the Noticee from continuing to provide services to its existing clients. PSPL shall disclose the contents of these directions on its website immediately.

DATE: October 17, 2019 **G. MAHALINGAM**

PLACE: Mumbai **WHOLE TIME MEMBER**

SECURITIES AND EXCHANGE BOARD OF INDIA