

MCX STOCK EXCHANGE LTD.
DISCIPLINARY ACTION COMMITTEE
ORDER UNDER RULES 1 & 2 OF THE RULES OF MCX STOCK EXCHANGE LIMITED

1. BACKGROUND

- 1.1. Swastika Investmart Limited (SIL or the "Member") (Member ID 48300) is a Trading Member on the Currency Derivatives (CD) segment of MCX Stock Exchange Ltd. ("the Exchange") and is registered with Securities and Exchange Board of India (SEBI) as a trading member on CD segment of the Exchange with registration No. INE261328210 dated October 6, 2008.
- 1.2. A regular inspection of SIL covering the period October 01, 2010 to September 30, 2011 was conducted by the Exchange in December, 2011.

2. Inspection Finding – False Reporting of Client Margin Collection

- 2.1. During the inspection, one of the items verified was whether the reports of client margin collections submitted by the Member to the Exchange/Clearing Corporation were in order. 32 instances of client margin reporting were verified on sample basis. Out of the said 32 instances, it was observed that in one instance (on September 23, 2011), in case of a corporate client, Bhaskar Foods Pvt. Ltd., the Member had reported to the Exchange that an amount of Rs. 1,82,000/- was collected from the client. The required amount of margin to be collected was Rs. 1,81,990/-. On verification of the ledger of Bhaskar Foods Pvt. Ltd. maintained by the Member, it was observed that the client had a debit balance of Rs. 16,26,475/- on the said date.
- 2.2. When the Inspection team queried on the same, the member submitted that Bhaskar Foods had a relative of its Director by name Ms. Uma Agarwal, who was also a client of the Member and she had apparently given an authorization to use the free balance in her ledger with the Member towards the obligations of Bhaskar Foods. In support of its explanation, the Member submitted a CA certificate certifying that Rs. 29 lakh was available in the ledger of Ms. Uma Agarwal, who was the niece of one of the Directors of Bhaskar Foods Pvt. Ltd.
- 2.3. An observation letter dated January 31, 2012 was issued to the Member, *inter alia*, advising it to submit explanation with regard to the above.



3. Member's Explanation on false reporting of margin:

3.1. The Member submitted its reply to the observation letter, by its letter dated February 8, 2012. A summary of the Member's reply is as under:

- a) Definition of 'family' was given by the Exchange pursuant to its Circular No. MCX-SX/INSP/667/2011 only on December 20, 2011 ("December 2011 Circular") and the Member's transaction was prior to date, i.e. on September 23, 2011. He seems to suggest that adjustment of margins between family members was permissible with authorization and was duly done in the present case, which was before the new definition of 'family' issued by the Exchange in its December 2011 Circular.
- b) The Margin was collected as per the applicable rules and regulations prevailing at the time of the transaction.
- c) From the date of the December 20, 2011 circular, i.e. December 20, 2011, the Member strictly adhered to the definition of 'family' for considering the margin.
- d) There was no short/wrong reporting of margin. Margin was properly collected properly before and after September 01, 2011.

4. Disciplinary Action Proceedings:

4.1. Hearing Notice

By letter no. MCX-SX/INSP/866/2012/3911 dated May 7, 2012, the Exchange granted personal hearing to the member before the DAC on May 22, 2012.

4.2. Personal Hearing before the Disciplinary Action Committee

4.2.1. SIL was granted an opportunity of hearing before the Disciplinary Action Committee of the Exchange on May 22, 2012. Ms. Archana Matta, the authorised signatory of SIL, appeared in person before the Committee. She made the following submissions during the hearings:

- a) SEBI circular on margin reporting came on August 10, 2011 and the Exchange clarification on the same came on December 20, 2011.
- b) In the meantime, the member collected the margin as per the earlier practice.

- c) The margin for Bhaskar Foods P. Ltd., the corporate client, was available with the niece (Ms. Uma Agrawal) of one of the directors of the corporate client.
- d) Hence the same should not be treated as margin false reporting and penalties should be levied as per the earlier penalty rates.
- e) The Committee advised Ms Matta to provide necessary documents establishing a relationship between Ms Uma Agarwal and the director of the corporate client viz. Bhaskar Foods Pvt. Ltd.
- f) Ms Matta submitted a copy of the authority letter dated June 17, 2010, of Ms. Uma Agarwal, provided by her to SIL. In the said letter Ms. Agarwal categorized two accounts viz. Umesh Kumar Singh and Bhaskar Foods Pvt. Ltd. as her family accounts and authorised SIL to utilize the credit balance in her account against margin and mark-to-market positions for the said two accounts. However, the letter did not specify the relationship between Ms Agarwal and the said two clients.
- g) Since Ms. Archana Matta could not submit necessary document establishing relationship between Ms. Uma Agarwal and the Director of Bhaskar Foods Pvt. Ltd. on the day of the meeting, she was advised to submit such documents within 15 days from the date of the meeting to the Committee
- h) The Member, by his letter dated May 31, 2012 (received by the Exchange on June 6, 2012), has stated as under:
- "Before the circular no. MCX-SX/INSP/667/2011 dated December 20, 2011 there were no specific instructions issued by the authorities in this relation for the maintenance of documents for the purpose of establishing relationship between two clients. On the basis of the confirmation from the client, no documentary proof were collected for the same. In the mentioned case, the client gave instructions to map the code with the other code which was duly certified by Chartered Accountant. As per the request of the client the same was done. We also mention that the account of our client Bhaskar Foods Pvt. Ltd. is an inactive account and on requesting the client to furnish the required documents, the client has denied for the same as the account is inactive."

5. **CONSIDERATION OF ISSUE**

5.1. We have carefully considered the material on record including the replies filed and submissions made by SIL.

5.2. We understand that SIL was also informed in writing vide letter no. MCX-SX/INSP/866/5679 dated May 25, 2012 about submitting necessary document establishing relationship between Ms Uma Agarwal and the Director of Bhaskar Foods Pvt. Ltd. within 15 days from the date of the meeting. The member vide his letter dated May 31, 2012 has expressed his inability to produce necessary document establishing relationship between Ms Uma Agarwal and the Director of Bhaskar Foods Pvt. Ltd and stated that the client is now inactive.

5.3. The regulatory requirements relating to reporting of client margin collections have undergone a significant change with the issue of SEBI Circular dated August 10, 2011, which has been effective from September 1, 2011. We understand that prior to SEBI's implementation of SEBI circular dated August 10, 2011, there was a practice of considering the margin of one client for another client with specific authorisation. Regulation 3.1.6 of the Exchange Regulations provided for the same, which is reproduced below:

"The Trading Member cannot utilise the funds and securities of one constituent for and on behalf of another constituent except on specific authorisation of the constituent whose funds or securities are utilised."

5.4. The Exchange, however, used to consider the funds / securities of one client as a valid adjustment for obligations of another client only if a certificate of a Chartered Accountant which certified the collection of authorization from the 'other' client for use of his funds / securities was produced. Even in such a case, the members were still liable for penalty if such adjusted amount exceeded a particular percentage of the margins collected in the sample. There was a provision in the Exchange penalty circular no. MCX-SX/INSP/528/2011 dated March 1, 2011 for levying penalty in such cases.

NA.

- The penalty structure for such margin is as under:

VII - Margin reporting requirement		
(b)	if % of margins not properly accounted for (excess margin available with member in the accounts of relatives, with specific authorizations) to total margin reported as collected is :	
	Up to 5%	Advice
	> 5% and up to 10%	0.5% of the wrongly reported amount, subject to a maximum of Rs. 25,000/-
	> 10% and up to 25%	0.75% of the wrongly reported amount, subject to a maximum of Rs. 50,000/-
	> 25% and up to 50%	1% of the wrongly reported amount, subject to a maximum of Rs. 75,000/-
	> 50%	1.25% of the wrongly reported amount, subject to a maximum of Rs. 1,00,000/-

- 5.5. If the above scale is applied (assuming the margin was validly adjusted pursuant to an authorization by Ms. Agarwal), the instance would amount to about 85% of the total margin collected and the case would fall within the last slab of the above table. Applicable penalties, if calculated as per the above penalty structure for the Member with reference to the instance of Bhaskar Foods would then be a monetary penalty of Rs. 2,275/-.
- 5.6. The SEBI Circular dated August 10, 2011 did not make any specific mention about the practice of adjustment of margins from balances of relatives. However, the Exchange had issued a further clarification to the same, pursuant to decisions at a Joint Meeting of all Exchanges taken by SEBI, pursuant to the December 2011 Circular. In the paragraph 10 of the said circular, it is provided as follows:

Margin collected/available in approved form from entities related to the clients as mentioned below and certified by independent professionals including Chartered Accountant with specific authorization/ consent

- i. In case of individuals having relationship as spouse, dependent children and parents with clients.
- ii. In case of 'UF, any of the Co-parceners
- iii. In case of a Trust, any of the trustees or beneficiaries.
- iv. In case of Partnership firm, the partners, their spouse, dependent children and parents

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- v. in case of Corporates, the promoters having controlling shareholdings, their spouse, dependent children and parents


- 5.7. It is noteworthy that in terms of the said circular, in case of corporate clients such adjustment is possible only in respect of balances of their "promoters having controlling shareholdings, their spouse, dependent children and parents". The instance of Bhaskar Foods obviously fails this test, in as much as the balance belonged not to any permitted category of persons as above, but to a cousin/ niece of a Director. The question is whether this clarification could be applied to the transaction that took place in September 23, 2011, prior to issue of such clarification.
- 5.8. We are of the considered view that paragraph 10 of the December 2011 Circular was a substantive requirement which cannot be applied retrospectively. As such, at the relevant point of time, the Exchange's regulation 3.1.16 still continued, which has been followed by the Member in the instance involving Bhaskar Foods.
- 5.9. In light of the above, we find that it is not a case of false reporting in terms of the law as it stood on September 23, 2011. At the most, it is a case of excessive adjustment of margin of relatives in terms of the above table extracted from Exchange Circular dated March 1, 2011. In terms of the calculation mentioned above, the monetary penalty liable to be levied on such footing is Rs. 2,275/-.

6. DIRECTIONS

- 6.1. It is hereby directed that the penalties prescribed vide Exchange circular No. MCX-SX/INSP/528/2011 dated March 1, 2012 may be imposed on the Member as it cannot be taken as a case of false reporting in terms of the law as it stood at the material point of time.
- 6.2. Accordingly, a monetary penalty of Rs. 2,275/- is hereby imposed on the Member and the Member is also advised to ensure strict adherence to the circulars of SEBI and the Exchange on margin reporting in future.



Asha Das
21 August, 2012
New Delhi



Prem Rajani
24 August, 2012
Mumbai

For MCX-Stock Exchange Ltd.


Company Secretary