

Ministry of Finance
Department of Economic Affairs
Capital Market Division
Secondary Markets

Guidance Note on Illegal Trading in Securities (Dabba Trading)

I. What is Dabba Trading or illegal trading?

1. As per the Securities Contracts (Regulation) Act, 1956 (SCRA), trading in the shares of companies between persons other than members of a recognized stock exchange is illegal. Members of stock exchange are required to get certificate of registration as "Stock Broker" from the market regulator, Securities and Exchange Board of India (SEBI) for buying, selling or dealing in the securities. However, there are instances where certain un-registered persons carry out trades in securities outside the stock exchange mechanism which are illegal trades and are referred to as "Dabba Trading".
2. Dabba trading is generally carried out by persons not registered with SEBI wherein one person or a group of persons carry out trading in securities by using price/quotes of securities available from the stock exchange trading platform / internet / television screen etc. The details of such dealings are noted down in a separately maintained book which may be either in physical or electronic form. In order to avoid audit trail, settlement of transaction is largely done by receiving/paying the difference on account of price movements of securities and without receipt/delivery of securities. Payment/receipt of funds in dabba trades is done using cash i.e. without using the banking system.

II. Consequences of Dabba Trading: Why to prevent dabba trading?

3. In dabba trading, investors are subjected to credit risk as there is a possibility of persons who has carried out dabba trading default in making payment to the investors or that person becoming an insolvent/bankrupt. In such situations, the investors would not have access to the official complaints redressal /arbitration mechanism as is available to investors who have dealt through a SEBI registered stock broker of a recognized stock exchange.

4. Some of the consequences of dabba trading are as under:

- a. The activity is carried out in cash and hence encourages growth of the "Black Money";
- b. Perpetuation of parallel economy; risk of money laundering and criminal activities;
- c. Evasion of taxes hence loss to the exchequer of Government;
- d. There is no guarantee for settlement of transaction;
- e. Circumvention of regulatory requirements as follows:
 - i) Know Your Client (KYC) norms / requirements viz., client due diligence, PAN Card and Anti Money Laundering (AML) requirements;
 - ii) Risk management and various other prudential requirements for taking membership of stock exchange, viz., capital requirement, payment of margin etc;
 - iii) Payment using banking channels;

III. Legal Provisions in Securities Laws against dabba trading

- 5. An entity who indulges in dabba trading violates the following provisions of Securities Contracts (Regulation) Act, 1956 (SCRA):
 - i) Section 13 of SCRA- Contracts in securities otherwise than between members of a recognized stock exchange in a notified area are prohibited by this section. Application of Section 13 to a particular state or area is done by Central Government through notification in the Official Gazette.
 - ii) Section 16- As notified under SCRA, all contracts in securities except spot delivery contracts and contracts permissible under SCRA and the rules, bye-laws and regulations of a recognized stock exchange, are illegal.
 - iii) Section 17 of SCRA - This section prohibits the business of dealing in securities except with a license granted by SEBI.
 - iv) Section 18A of SCRA- This Section provides that contracts in derivatives shall be legal and valid only if such contract are traded on a recognized stock exchange and settled on the clearing house of the recognized stock

exchange in accordance with the rules and bye laws of such stock exchange

- v) Section 19 of SCRA - This section specifically prohibits organizing or assistance in organizing or being a member of any stock exchange (other than a recognized stock exchange) for the purpose of assisting in, entering into or performing any contract.

IV. Are Spot delivery contracts banned under the law?

6. It is clarified that in terms of section 18 of SCRA, the provisions of Section 13, 16 and 17 of SCRA are not applicable to spot delivery contracts viz
- a) the dealings of securities between two persons on one to one basis that is settled within same day or the next day of trade and
 - b) transfer of dematerialized securities by depository from one account to another.

7. **Aspot delivery contract** as defined in Section 2(i) of SCRA means a contract which provides for actual delivery of securities and the payment of a price, therefore, either on the same day as the date of the contract or on the next day.

V. Punishment envisaged under securities laws for dabba trading

8. In terms of sections 23(1) of SCRA, any entity/person who contravenes sections 13, 16, 17 or 19 of the SCRA shall be prosecuted and on conviction, he shall be punishable with imprisonment for a term which may extend to ten years or with fine up to rupees twenty five crores or with both. As per section 25 of SCRA, offences punishable under section 23 are cognizable offences within the meaning of Code of Criminal Procedure, 1973 and as such can be investigated by state law enforcement authorities also. Further, Section 26 of SCRA permits lodging of complaints of violation of the Act by the state authorities.
9. In terms of Section 26 of SCRA, no court inferior to that of a court of Sessions shall try any offence under the Act.

VI. Relevant provision of Indian Penal Code applicable for dabba trading

10. In addition to being violative of the securities laws, dabba trading also falls within the purview of Section 406, 420 and Section 120 -B of Indian Penal Code, 1870.

VII. How to detect illegal trading?

11. Dabba trading is often accompanied by violation of Tax laws, IT Act or involvement of ill-gotten cash from the local illegal businesses. Such illegal trading activities are carried out surreptitiously. These activities can be discovered by the local police through the use of intelligence units or informers. In suspected cases of illegal trading, State law enforcement authorities may conduct search in the dabba operator's premises and seize the records - the books of account, transactions ledger, cash books, computers etc. The following details / documents indicate existence of dabba trading at the location:

- i. Trading in securities on behalf of client without a certificate of registration from SEBI
- ii. Kaccha (rough) records, register, sauda (transaction) book, challans, cash receipts, DD receipts, cash book at the premises of the entity
- iii. Evidence of cash transactions
- iv. Bills/contract notes which give the proof of trading
- v. Software programs which may be used for dabba trading
- vi. Illegal trading computer terminals which are not approved by a recognized stock exchange

The offenders may be questioned by police after detention to elicit further information and built up evidences.

VIII. How to proceed after detecting an instance of illegal trading?

12. In respect of illegal trading, being a Cognizable offence, the police is empowered to register an FIR, investigate, and arrest an accused without a court issued warrant.

13. Accordingly an FIR may be filed and the accused may be produced before a court immediately.

14. In terms of Section 26 of SCRA, no court inferior to that of a court of Sessions shall try any offence under the Act.

IX. Communicating with SEBI on finding instances of illegal trading

15. In case, any stock broker or sub-broker registered with SEBI is found to be involved in dabba trading, the State law enforcement authorities may, in addition to criminal action against him, refer the matter to SEBI for appropriate action under SEBI Act. The contact details of the SEBI are given below:

Securities and Exchange Board of India

SEBI Bhawan, Plot No. C 4-A G Block

BandraKurla Complex, Bandra-East

Mumbai 400051

Website- <http://www.sebi.gov.in>

Tel : +91-22-26449000 / 40459000

Fax : +91-22-26449019-22 / 40459019-22

16. There are also instances where SEBI directly receives complaints regarding illegal trading of shares outside the stock exchange by intermediaries registered with it. As and when such instances are reported or come to the notice of SEBI, it seeks help from State Governments and police authorities.

17. It may be noted that dabba trading/ illegal trading activities are carried out surreptitiously. These activities can be discovered by the local police through the use of intelligence units or informers. On receipt of firm evidence from police, SEBI, in addition to the action which the State Government takes, may also issue directions under section 12A of SCRA restraining any person from buying, selling or dealing in the securities market in any manner whatsoever for a specified period and also initiate adjudication proceedings for levying of monetary penalty under section 23 (1) (b) & (c) which may extend to rupees one crore under section 23H of SCRA. However, sufficient evidence should be made available to SEBI so that such actions stand scrutiny of law.

18. In view of the active involvement required from the state governments / UTs, Union Government and SEBI had already written to all States and Union Territories on various occasions to take urgent steps to contain the illegal trading. SEBI had sent

letters to all the state governments and union territories on December 5, 2002 and January 2, 2003 requesting them to take necessary action against such illegal activities. The Hon'ble Finance Minister vide letter dated October 24, 2005 had also advised all State Governments to take steps to stamp out illegal trading activities. This was followed up by Ministry of Finance through its various letters to all Chief Secretaries of the States dated 8 December 2009, 23 June 2011, 19 April 2011 and 4 January, 2012.

19. SEBI would be cooperating with the state law enforcement agencies in providing necessary technical support for taking action against illegal trading.

X. What are the preventive measures that can be adopted?

20. State Governments may instruct their Home Department / Police to pass necessary instructions to the field authorities and district administration to keep a strict vigil and implement the provisions of IPC, in case such activities are found to be happening. State Governments may also like to direct their commerce / revenue departments, tax departments, regional stock exchanges, etc for taking action. Authorities may also consider issuing public notices in leading Newspapers to alert the public against illegal trades in stocks and shares.

21. State Governments may organize training programs for police authorities/government officials for providing guidance on handling dabba trading in coordination with SEBI or the training institute- National Institute of Securities Market (NISM) established by the SEBI.
