



National Spot Exchange Limited

Circular

SETTLEMENT OF OUTSTANDING LIABILITY AS PER RULES AND BYE-LAWS OF THE EXCHANGE

Ref. No.: NSEL/C&S/2015/006

August 04, 2015

This refers to the circulars issued by NSEL dated July 31, 2013 and Aug 12, 2013 regarding downloading of obligations by Clearing Members hereinafter referred to as Brokers of NSEL. The NSEL took various legal, regulatory and business decisions to recover the dues from the defaulting Brokers so as to pay the same to the eligible and bonafide parties who may be found to be entitled to receive payment as per the provisions of the Rules and Bye-Laws of the NSEL including bye-laws Nos. 3.7, 3.8, 3.10, 3.13, 5.26, 7.9, 12, 14 & 16 and Rule 42 besides others.

During the last many months, certain legal proceedings have been initiated by and against NSEL which are pending. The Bombay High Court by its order dated 2nd September 2014 (passed in Notice of Motion No. 240 of 2014 in Suit No. 173 of 2014) has appointed a three member fact finding Committee (HCC) to assist the High Court in settlement and recovery as set out in the said Order and the proceedings before the HCC is also going on. The HCC in its functions, inter alia, under clause 5 c) i of Minutes of Order dated 27 August 2014 is entitled to seek appropriate directions from the Court pursuant to the report made by the HCC to sell / monetize assets and also to hold assets as interim security until sale and realization of monies. The HCC, in terms of clause 10 of the Minutes of Order dated 27 August 2014, shall also recommend the distribution of amounts to the non-defaulting Brokers and parties entitled to the same, after making a Report to the Hon'ble High Court.

Several defaulters have been made parties to the suits filed against NSEL, and NSEL has also filed various proceedings against the defaulters, as ultimately the recoveries are to be made from the defaulters to enable NSEL to complete the settlement under the byelaws.

The HCC has made the following observations in the Report No. 1 of 2015 dated 5 March 2015 filed by them with the Hon'ble High Court:

"11. The Committee passed this Order under the belief that under Minutes of Order dated 27th August 2014 marked Exhibit 'X' to the Order dated 2nd September, 2014 and para 10 thereof (extracted in para 1 supra) the intention behind constituting this Committee is to lessen the work of the Hon'ble High Court of considering the entitlement of each party.

36. At this stage, the Committee is of prima facie view that this information may be relevant while considering distributions to be made by NSEL amongst non-defaulting members and their clients. The relevant information needs to be called form the investors at this stage to consider genuineness, entitlement and correctness of their claim, since it involve huge exercise of collecting data."

The above Report, has been accepted by the Hon'ble High Court vide Order dated 1 April 2015 and the HCC is required to collate data to ascertain the same. While accepting this Report, the Hon'ble High Court, has observed that:

"3. There is also no doubt that the matter of distribution of amounts amongst non-defaulting members and parties entitled to the same arises after the amounts have been collected from defaulting members and their clients in terms of the order passed by this Court. Yet, at the same time, the Committee is well within its mandate to call for information with a view to enable it finally to prepare a report this Court in terms of the order."

Pursuant to the above, Public Notice was published on 20 May 2015 calling upon the Trading Brokers / Trading Clients to submit the information sought for by the HCC in the form of a questionnaire annexed to the Public Notice. The last date for the submission of such information was fixed at 30 June 2015.

The HCC, thereafter, on 4 July 2015 on the request made by some Trading Clients extended the time granted for submitting the data called for by the Committee till 31st July 2015. In this Order dated 4 July 2015, the HCC has observed that:

"7. The Committee, after having considered the rival contentions, makes it clear that till today 4500 (approximately) sealed envelopes are received by the Committee. The possibility of some of the envelopes containing more than one claim cannot be ruled out.

8. It is no doubt true that the possibility of some manipulation in the claim cannot be ruled out. However, the Committee before allowing any claims is bound to go into the genuineness of each claim, if necessary by resorting forensic audit of the Books of Accounts of the Claimants."

As per the above, the HCC is required to examine the genuineness, correctness and entitlement of claims and entitlements of each trading client / Brokers. After examining the same, the HCC will make a report to the Hon'ble High Court regarding the amounts to be paid to each trading client/broker.



In addition to the above, NSEL is of the view that pursuant to the recent amendment to Prevention of Money Laundering Act, 2002 (PMLA) as set out below, the proceeds will be disbursed to the claimants who are able to establish that their claim is genuine, in terms of the provisions of the PMLA.

The newly inserted sub-section (8) of Section 8 of the said Act states:

" where a property stands confiscated to the Central Government under sub-section (5), the Special Court, in such manner as may be prescribed, may also direct the Central Government to restore such confiscated property or part thereof of a claimant with a legitimate interest in the property, who may have suffered a quantifiable loss as a result of the offence of money laundering; provided that the Special Court shall not consider such claim unless it is satisfied that the claimant has acted in good faith and has suffered the loss despite having taken all reasonable precautions and is not involved in the offence of money laundering".

In the meantime, complaints have been received by NSEL directly and through Forward Markets Commission (FMC) alleging manipulation of ledgers, forgery of documents, false trades and false claims by brokers. The Economic Offence Wing (EOW) of Mumbai police in their remand applications relating to the arrests of key officials of some brokers have charged that several unauthorized, illegal and wrongful acts have been committed by Brokers including rampant client code modification, inducement, funding and misuse of the NSEL platform, and investigations are continuing. Some trading clients have appeared and made complaints before the HCC against their Trading Brokers.

NSEL is of the view that several purported transactions could have been executed in a fraudulent manner or done as financial transactions or structured deals or designed to defraud the Settlement Guarantee Fund, which are not entitled to central counter party benefit pursuant to the proviso to clause 5.26 of the Byelaws and Rule 42. NSEL reserves its rights under proviso to Bye-law 5.26 and Rule 42 besides other Rules and Bye laws. The proviso to Bye-law 5.26 provides that if any transaction/s in any commodity are found to have been executed in a fraudulent manner and/ or are done as financial transactions or structured deals and/ or with a design to defraud the Settlement Guarantee Fund, the Exchange shall have the absolute authority and discretion to withdraw itself as a legal counter party to such transaction/s.

As per bye laws of the NSEL, the provisions of bye laws 12.9.2 and 12.10 would be triggered to complete settlement if and when NSEL is held liable to discharge any obligation as central counterparty [without prejudice to NSEL's arguments and



contentions before the Hon'ble High Court] subject to compliance with all bye laws, including those referred above, and after verification of genuineness of transaction/s by the NSEL and the High Court based on the report which may be filed by the HCC. The Byelaws including Clause 12.9.2 and 12.10 would be applied in respect of only such transactions which do not come under the purview of proviso to Clause 5.26 and Rule 42.

NSEL hereby puts the non-defaulting clearing brokers on notice that if and when NSEL is held liable to discharge any obligation as central counterparty [without prejudice to NSEL's arguments and contentions before the Hon'ble High Court, inter alia, that:

(a) it is not central counterparty; (b) if it is a counterparty then such guarantee is limited to the Settlement Guarantee Fund; and (c) that NSEL has the authority to withdraw itself as a counterparty from the transactions which are financial transactions or structured deals or transactions designed to defraud the Settlement Guarantee Fund], subject to NSEL's right to invoke proviso to bye-law 5.26 and Rule 42, NSEL will become entitled to act under bye-law 12.9.2 and 12.10 and other related bye-laws, whereupon the provisions thereof will become applicable and consequences will follow accordingly on the non-defaulting Clearing brokers, and they would be required to pay such amounts to complete the settlement to the ultimate trading clients found entitled to payment, as determined by the Hon'ble Court under the applicable byelaws. The end intent and purpose of these byelaws is that the residual loss if any, is to be borne by the non-defaulting clearing brokers. As and when amounts are recovered from the defaulting Clearing Brokers, the same will be repaid to the non-defaulting Clearing Brokers who have paid amount pursuant to the invocation of bye-law 12.9 and 12.10.

FMC has maintained in their averment that "it is only the NSEL, which has the responsibility to take all possible coercive measures as per their rules / bye laws and other laws of the land, to ensure that the outstanding dues of all investors is settled."

**For and on behalf of
National Spot Exchange Ltd.**

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