# 8 Approach of Other Regulators

## Comparison of FMC | DCA Actions with those of Other Regulators in Other Crises

*In addressing to problems in other market segments, respective regulatory authorities have shown greater balance and maturity when compared to DCA | FMC as is evident from the following.*

| PARTICULARS | NSDL IPO IRREGULARITIES | NSEL STOCK IRREGULARITIES |
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| Background of the crisis | In 2005, SEBI unearthed and investigated certain irregularities in 21 Initial Public Offerings (IPO) which launched in the market from 2003 to 2005 | In July 2013, NSEL had to stop operations due to abrupt Government order without giving any justified reason or time to close the Exchange |
| Who were the offenders? | It was found that some 103 key operators and financiers had opened some 57900 DP (and bank) accounts in fictitious / benami names and cornered shares by using favourable allotment chances for retail investors | In August 2013, the Exchange announced a revised settlement plan in discussion with FMC and the market players. However, after the first installment one by one 22 Members defaulted in making their funds pay-in and it was found through a SGS audit that the commodity stocks which they were supposed to be maintained in their 44 warehouses were largely missing |
| Who were the sufferers? | As a result of this some 13.58 lakh retail investors, who had unsuccessfully applied through their brokers, were deprived of their rightful gains | As a result money of some 12,735 trading clients (clients of brokers), who traded through 148 brokers on the Exchange were short in their funds pay-out. If commodity stocks were maintained in the warehouses, the Exchange could have sold the stocks to pay the 148 brokers & their clients. |

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| What actions did the Regulators take | In 2007, SEBI formed a committee under the Chairmanship of a former Judge of the Supreme Court of India, to advise on the procedure of quantifying the amount of unjust enrichment that has taken place, identification of persons who might have been deprived and the manner in which reallocation of shares to such persons should take place. | Through a Sharp & Tannan audit it was confirmed that 86% of outstanding amount is due from top 7 defaulting members |
| | The Wadhwa Committee in its Report observed that the reallocation amount to the deprived applicants must be paid out of money that must first be recovered from those who unjustly benefited, such as the key operators and financiers | The Govt. of India in its Gazette Notification dated August 6, 2013, stated that "Settlement of all outstanding one-day forward contracts at National Spot Exchange Limited shall be done under the supervision of Forward Markets Commission and any direction issued by the Forward Markets Commission in this regard shall be binding upon the National Spot Exchange Limited and any person, intermediary or warehouse connected with the National Spot Exchange Limited, and for this purpose, the Forward Markets Commission is authorized to take such measures, as it deems fit". |
| | SEBI initiated proceedings against these 103 key operators and financiers to disgorge illegal gains and take appropriate action including penalties.<br>No action taken against NSDL's Board or Management<br>No action taken against NSE's Board as promoter of NSDL | Through such blanket powers bestowed on the FMC, it should have by now taken stern action against the defaulting members on NSEL and their warehouses from where the stocks went missing. However, the FMC chose to keep its focus limited on the NSEL only. Instead of taking active part in settlement of all outstanding the FMC chose to act passively by appointing MAC, comprising the Investors Forum and brokers (who have conflict of interests) to oversee the recovery and settlement process. |
| | SEBI appointed Mr. Vijay Ranjan, Retd. Chief Commissioner (Income Tax), as the Administrator to undertake the task of disbursement of the recovered amounts to the identified persons. | The FMC could have, by now, independently ascertained the liability of the top 7 defaulting member and directed them to clear their dues. This could have cleared the majority of the outstanding. |
| | On April 12, 2010 as a first step SEBI disbursed 24.4% of original unjust gains recovered from the 103 key operators and financiers to around 12.75 lakh deprived retail investors. | NSEL has achieved financial closure of e-Series contract by making payment to 33,000 e-Series clients. Further, 7000 trading clients with exposure of less than 10 lakh have received 50% of their outstanding. |

## DERIVATIVES SCAM OF 2007-08

In a similar instance, in the 2007-08 derivatives scam, certain 19 banks were accused of mis-selling currency derivatives to exporters, mainly SMEs, who had little idea about the potential dangers of such instruments. The collective loss was estimated at over Rs 30,000 crore. It was alleged that some private sector banks devised special currency derivative products which were then sold to their clients as hedging instruments, whereas actually these transactions were speculative in nature and against the RBI guidelines and policy.

According to experts, the Reserve Bank of India does not allow naked hedge transactions as it does not have the necessary underlying requirement for the hedge. Put pithily, any hedge instrument, not based on any valid import or export transaction, is not allowed under the extant RBI guidelines as it is merely speculative. Later on, businesses realised that these derivatives, instead of hedging the gyrations in the forex markets, actually enhanced their risks and increased their losses substantially. In the process, this faith of Indian business on the Indian banking industry was tremendously shaken. Trust, so very vital to the banking system and mechanism and assiduously built over decades by bankers, seemed to have evaporated within months because of the reckless actions of a few bankers.

Thus banks have been acting as (sole) advisor to these transactions with their clients. Naturally, this raises serious questions over the role of banks, corporate governance, and ethical and conflict issues. How could banks advise clients and yet be counterparty to such transactions? Crucially, how could they expect their clients to bear the losses on such transactions without any demur, especially if the banks are the beneficiaries of such losses?

In 2011, the RBI imposed penalties ranging from Rs 5 lakh to Rs 15 lakh on 19 banks for mis-selling currency derivative products. Penalty was perceived to be paltry, but it spelt the end of derivative business for banks.

## OTHER PAST CASES AND ACTION

| ISSUE | REGULATOR | ACTION |
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| Ketan Parikh Scam | SEBI | • Ketan Parikh suspended by SEBI<br>• Madhyapura Mercantile Cooperative Bank's licence was cancelled by RBI in 2012.<br>• No action against NSE or BSE |
| Flash crash at NSE and Nifty crashed by 900 points | SEBI | • SEBI continues to look into the problem<br>• SEBI reprimands NSE after 2 years to take corrective action<br>• No compensation to members or investors who lost money due to flash crash and consequent triggering of stop loss orders or other orders |
| NSE was reprimanded for not preventing tax evasion on turnover of Rs 1.5 lakh crore | SEBI | • No action taken against NSE Board or Management |

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| NSDL IPO Scam | SEBI | • No action taken against NSDL Board or Management<br>• No action taken against NSE Board as promoter of NSDL<br>• SEBI committee told Board of NSDL to take action against responsible person<br>• SEBI recovered Rs 23.3 crore from fraudulent investors and paid to investors. The recovery is 24.4% of total scam amount |
| NSEL crisis | FMC | • No action against any defaulter<br>• No action against any broker for client code modifications<br>• Not 'fit and proper' order passed against three Directors of NSEL and against FTIL as the promoter of NSEL<br>• FMC proposed merger of NSEL with FTIL. FMC has done the above selectively despite no Court having adjudicated NSEL dispute as yet and the whole matter is under investigation |

**WHAT ABOUT SEVERAL OTHERS**

There are several other corporate irregularities on which hardly any action appears to take place, whereas excessive zeal and persuasion was shown in punishing FTIL.

Recently a group of investors in a Mauritius -based reality fund of a venture capital firm that is a part of the leading financial conglomerate in India is seeking damages of US$103 million for losses suffered by them. A leading pharmaceutical firm was imposed US$500 million in penalties by the Federal Drug Administration, after pleading guilty to felony charges relating to manufacture and distribution of certain adulterated drugs. In view of such practices by some companies, US Chamber of Commerce ranked India at the bottom of 25 countries in terms of protection and enforcement of intellectual property rights. Companies with false promises during IPOs, pledging securities already pledged, fudging accounts and indulging corruption are many. Micro finance companies charging usurious interest rates that forced farmers to commit suicides are not uncommon in India. Vanishing companies is a trend that happened in front of the very eyes of the government authorities and regulators. Government and regulatory authorities in all these case have been following up gradually in accordance with the current legal framework and conventions. Nowhere forensic audits by multiple auditors were conducted and irreversible regulatory action taken when the issue is under investigation and sub judice for which outcome has yet to come. No instances of any promoter or CEO of corporate group put under custodial interrogation for a mistake that has happened in one of its subsidiaries.

Is it not important that India too should have a system that respects fair treatment of all? More so when dealing with a group such as the Financial Technologies that has the distinction of making stellar contribution to the growth of financial markets in India.