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   RESULTS & DISCUSSION

   FINDINGS

   RECOMMENDATIONS/SUGGESTIONS

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   APPENDIX/ANNEXURE

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HARD HIT INVESTORS: GOVERNANCE LAPSES OF NSEL SCAM

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ABSTRACT
With increasing stock scams being unearthed in India and with crores of lost money, the investors who are the catalytic agents of economic development unfortunately bear the wrath innumerable times. The new National Spot Exchange Limited (NSEL) scam that involves more than 15000 retail HNI Investors with an investment of Rs. 5600 crore seems to be moving on the same track alike the Harshad Mehta scam and Ketan Parekh scam. After 33 weeks of closure of scam hit spot exchange, only Rs 330 crore has been paid to the investors as on April 6, 2014. In the paper, the authors have made an attempt to study and put forth the happenings of the National Spot Exchange Limited scam.

KEYWORDS
Forward Markets Commission, National Spot Exchange Limited, Warehouse receipt, Multi Commodity Exchange of India Limited.

1. INTRODUCTION
NSEL was a platform of national level spot market providing its operations in 16 states in India trading in 52 commodities. It was providing delivery based spot trading facilities for purchase and sale of various commodities across India. It is incorporated as a company limited by shares under the Companies Act, 1956 in May 2005 and widely accepted as a developing body either as a service centre, electronic marketing platform, Issuance of license by Govterments of states for setting up spot exchange etc. NSEL has also extended its operation and ties with Eastern European countries like, Republic of Belarus, Russia, Ukraine, Kazakhstan. It received Shariah certification for trading e-Lead, e- Zinc, e-Nickel, e-Copper, e-Gold and e-Silver etc. It has also set up Dubai Gold & Commodities Exchange (DGCX) in Dubai jointly with Dubai Multi Commodities Centre (DMCC) and Multi Commodity Exchange of India Limited (MCX).NSEL operations was infull swing without having any regulator until February 6, 2012, when it was brought under Forward Markets Commission (FMC). Same year in December FMC received a complaint against NSEL for illegal financing operations. After investigation, On July 16, 2013 FMC issued a notice to NSEL to cut the contract cycle to T+10. Investors were not happy with this decision as the reduction of settlement cycle had increased number of trades and thereby transaction cost. The problem started brewing when some of the investors had decided not to roll over. The borrowers were expecting the contracts to roll over and were not ready to pay which caused most of the borrowers to default. This led to suspension of trading of all contracts on 1st August 2013. Further E-series contracts were suspended on 5th August 2013 leading to the complete shutdown of the exchange.

2. OPERATIONS OF NSEL
Spot market is the market where execution takes place immediately after the contract is entered i.e. commodities and money get transferred immediately. Trading in NSEL was different from ordinary Spot market in the sense that NSEL got special notification by Department of Consumer Affairs on June 5, 2007 to trade in “One day duration forwards Contract” i.e. the contracts can be completed in 2 days (T+2) i.e. delivery of goods and transfer of money. Meanwhile NSEL started offering pair contracts of buy and sell for T+2 & T+23, T+2 & T+30 etc. NSEL also got licenses by State Governments to launch contracts for agricultural commodities under State APMC Acts.

3. NSEL (EXCHANGE WITH SPECIAL FEATURES)
In the spot market buyer and seller agree on a price and delivery is made immediately by both the parties. NSEL had made spot trading more convenient and attractive by adding electronic feature in it. This had helped buyers and sellers to enter the contract even if they were at different locations and did not know each other. Other important feature that NSEL had added was that it had taken counter guarantee to all the contracts to ensure the contracts are settled without any default. To facilitate trading, exchange had warehouses at different location in India where seller should keep the goods to avoid default. In case of buyer’s default the Exchange had right to sell the goods. At the time of accepting the goods in warehouse it was tested and verified for quality and weight and warehouse receipt (WR) was issued that was used for electronic trading. This warehouse receipt was transferred to the buyer of the goods at the time of purchase which acted as claim and authorized the buyer to take possession of the goods from warehouse. Here it is up to buyer to take immediate possession or to retain the goods in warehouse to sell them later by paying rental charges.

4. MODUS OPERANDI AT NSEL
As per Forward Contracts Regulation Act, only contract that are settled within 11 days are called spot. Within this time period the buyer and seller are permitted to complete the contract by delivering goods and transferring money. If the duration of settlement is more than T+11 days it becomes a “forward” contract and falls under the purview of FMC regulation. As Forward Commodity trading is regulated by Forward Market Commission (FMC), NSEL being spot exchange was not supposed to have a contract of more than T+11 settlement. But in fact NSEL was offering pair contracts ranging T+1 to T+35 settlement cycles; this was in principle a forward contract. The investors in NSEL were buying T+2 or T+3 contracts and selling T+25 or T+33 contracts. It was like arbitrage trading where they used to make more than 15% annual return from price difference of the two contracts.

To understand the operations in simple words, if you are an investor you will trade in a pair contract wherein you will buy T+2 and sale T+ 32 settlement contract. Here you need to pay cash as per T+2 settlements. Electronically generated WR will be transferred to you and you are owner of the commodity for around 32 days. You will get your money back as per as T+32 settlement after returning the WR to the exchange. In NSEL no one is allowed to have only one side of the contract (The contracts were always sold in pairs in NSEL). The goods would lie in the same warehouse and be sold from there. Warehouse storage charges and VAT will be charged accordingly. After meeting all these charges, the brokers were guarantying 15% return without any risk as exchange was taking counter guarantee of all the contracts. The traders who were on the other side of the contracts were Borrowers. They were selling the T+2 contracts and buying T+32 contract to finance their short term requirement of working capital (Raw material- Inventory). Commodities placed in warehouse works as collateral for borrowing money for a short period of time. These borrowers were also known as planters and were 24 in number and were members of exchange. Effective cost of borrowing to these planters was little more than 15%, which is reasonable for those who don’t get loan from a bank.

5. FOUL PLAY OF THE BORROWERS

Planters knew that the goods they sell will remain at a warehouse inside their premises. Hence the malpractice by making fake WR without adding goods in the warehouse. On the basis of this fake WR, planters started selling spot (T+2) and buying forward (T+32) to borrow for a month or so. On the maturity, most of the contracts were being rolled over. If borrower has not rolled over and contract requires to be settled then they again borrow against imaginary stock for making the payment. This practice was continued till the time trading was halted by NSEL as most of the investors were rolling over their contracts by entering into a new contract. They did not receive any interest in cash as they used to purchase new contract with interest money. The planters were not paying any money as interest and simply creating new warehouse receipts giving it to investors against interest.

6. ROLE OF THE EXCHANGE IN THE FRAUD

NSEL was aware that the warehouses had very less or no commodities. Planters/borrower had created fraudulent products, based on bogus stocks. They were generating artificial market turnover to create bogus liquidity. On enquiry it has come to light that four to five people involved in the exchange received 3 per cent commission on each deal and today the beleaguered National Spot Exchange (NSEL) is struggling to pay its brokers and investors. When the trading was suspended on instructions from the Ministry of consumer affairs to the exchange, asking it not to offer future contracts, the investors were left holding contracts that the members couldn't buy because they didn't have the money to do so.

7. BORROWERS (THE REAL LOOTERE)

Some of the prime defaulters being NK Proteins, which manufactures Tirupati brand of edible oil, were the first company that had borrowed Rs.350 crores from NSEL. Among the entire borrower NK Proteins is the largest borrower with outstanding amount of Rs.968.89 crores. The company has used the amount to expand its edible oil business into a joint venture with Adani Group, which later discontinued all business ties with NK group. Mohan India is the Second biggest borrower among the two dozen members. It owes Rs 952 crore to the exchange. Another big borrower Lotus Refineries has filed a claim suit worth Rs 2,773.29 crore against NSEL in Bombay High Court. Lotus has alleged that Rs. 1,704 crores were shown paid to them as per records of the stock exchange were never credited to their bank accounts and has accused the spot exchange of faking the Real Time Gross Settlement Systems (RTGS) details. NSEL has not reacted to this claim of Lotus Refineries which has been made public. Lotus Refineries have demanded a stringent probe into the settlements procedure of NSEL stating that the amount might have been used for money laundering.

BOX - 1: LIST OF BORROWERS WITH OUTSTANDING AMOUNT AS ON MARCH31, 2014 (in crores)

Sl. No.	CM Id.	Name of the Borrowers	Total Outstanding Amount (O/S)	Amount Paid	Net O/S
1	13960	AASTHA MINMET INDIA PVT LTD	26.47	3.02	23.45
2	14070	ARK IMPORTS PVT LTD	719.42	0.05	719.37
3	14770	JUGGERNAUT PROJECTS LTD.	220.2	1	219.2
4	14460	LOIL CONTINENTAL FOOD LTD	356.21	8.5	347.71
5	14470	LOIL HEALTH FOODS LTD	294.48	7	287.48
6	14350	LOIL OVERSEAS FOODS LTD	86.19	1.08	85.11
7	14180	LOTUS REFINERIES PVT LTD	252.56	0.08	252.48
8	14680	METKORE ALLOYS & IND. LTD.	114.28	19.2	95.08
9	14510	MOHAN INDIA PVT LTD	600.08	52	548.08
10	14260	MSR FOOD PROCESSING	10.05	1.24	8.82
11	12510	N K PROTEINS LTD	969.89	17.48	952.41
12	13990	NAMDHARI FOOD INT. PVT LTD	53.07	2.05	51.02
13	14170	NAMDHARI RICE & GEN. MILLS	10.75	0.36	10.39
14	14230	NCS SUGARS LIMITED	58.85	5	53.85
15	13790	P D AGROPROCESSORS PVT LTD	644.55	12.96	631.59
16	14270	SANKHYA INVESTMENTS ***	7.74	7.23	0.51
17	13780	SHREE RADHEY TRADING CO	35.34	0.75	34.59
18	14630	SPIN COT TEXTILES PVT LTD	38.26	-	38.26
19	13910	SWASTIK OVERSEAS CORP.	102.98	9.44	93.54
20	14740	TAVISHI ENTERPRISES PVT. LTD.	333.01	-	333.01
21	14660	TOPWORTH STLS & PWR PVT. LTD.	188.01	175.25	12.76
22	14160	VIMLADEVI AGROTECH LIMITED	14.02	0.08	13.94
23	14050	WHITE WATER FOODS PVT LTD	86.12	1.3	84.82
24	14310	YATHURI ASSOCIATES	424.64	19.04	405.6
		Total	**5647.17**	**344.11**	**5303.07**

Source: http://www.nationalspotexchange.com/

8. BROKERS (THE REAL GAINER)

Top broking firms such as Motilal Oswal, Anand Rathi, IIFL and Asit Mehta and many more were making huge brokerage by selling this product from both legs of transaction. They were targeting HNI or retail investors having a capacity to invest two to ten lakhs rupees and selling the NSEL's pair contracts as 100 per cent risk-free investment products to investors. Sometimes they used to show them the detailed charts of previous return earned to lure them. They were also promising that all risks were covered by insurance policies, hence it totally risk free. Among the 32 brokers, involved with the exchange 14 are from Gujarat, 7 from Rajasthan and others are from states like Maharashtra, Delhi, Andhra Pradesh and Punjab.

9. DELAYED ACTION OF REGULATORY

Investors pressurized NSEL to take necessary action against defaulters, so that they can get their money back. Having no other option NSEL filed case against defaulters. "We have filed a case with the Economic Offences Wing of Maharashtra police as the defaulters, despite repeated pleas, have not paid their dues," said an NSEL official. Finally regulatories have come into action. Several raids and arrest were made. Arrests of Amit Mukherjee, Jai Bahukandi, Anjabi Sinha and Nilesh Patel employees of NSEL have been made, by the economic offences wing (EOW) of Mumbai police on 22 October. Patel is the son-in-law of NSEL's former Chairman Shankarlal Guru, who resigned from his post on 19 August. The latest is the sixth arrest, Mr. Surendra Gupta M.D of PD Agro processor has been made who is the third biggest defaulter owing 600 crores to the commodity exchange. Further, the books of AWN Agro of Adani Group having a tie of a joint venture with N.K. Proteins have been investigated EOW attached the property of N.K. Proteins, which also recovered Rs 145.57 crores. Chokshi & Chokshi have been appointed to conduct the forensic audit of NSEL e-series. Charges against the defaulters would not be withdrawn. Violations of Companies Act and Corporate governance have also been surfaced and reported both by Ministry of Corporate affairs and SEBI.

10. RECOVERY ACTION INITIATED BY NSEL

NSEL has tried to show that it concerned with investors loss. It has made a weekly collection schedule with borrowers to collect Rs. 174.72 cr every week for next five months. The biggest defaulter N.K. Proteins has agreed to pay Rs.25 crore upfront and Rs.5 crore every month to NSEL over the next four years as a part of settlement in Bombay high court. But NSEL failed to pay out the promised amount to investors. Total amount collected so far is only Rs.344.11 Cr (Refer Box-1). Then NSEL has invited sealed bids for auctioning of the following properties for recovery of dues.

BOX – 2: LIST OF PROPERTIES FOR AUCTION

SALE OF MOHAN INDIA GROUPS ASSETS

On account of the payment default done by Mohan India Group as per the payment schedule in settlement agreement dt. 31/10/13, NSEL proposes to auction the below mentioned assets of Mohan India group after receiving approval from the Hon. MPID court for the same-

ASSET DETAILS
1 **Bungalow & land at Delhi** Bungalow no. 7, Court Road, Civil Lines, Delhi (comprising bungalow with land admeasuring 15666 sq. yds.)
2 **Land at Bikaner, Rajasthan** Total land area: 500.5 acres (800 pucca bhiga and 16 biswa)

Vimladevi Agrotech Ltd.

Vimladevi Agrotech Ltd. is ready to sell his soyabean and mustard solvent plant located at Kota, Rajasthan.

Selling price range: Rs 12-14 crores including land, machinery and all other necessary licences.

Metkore Alloys & Industries Ltd.

NSEL is looking for buyers for 14000MT (approx.) of ferrochrome stocks of Metkore.

Source: http://www.nationalspotexchange.com/

11. CONCLUSION

A plethora of measures and series of steps are been taken to tackle the scam which seem insignificant with the long drawn unclear process, the brunt obviously being faced by the investors with the NSEL case proceedings being adjourned by the Bombay High Court. The investors have moved the High Court to direct the payment of their dues through the funds received by FTIL through a deal at Singapore. With such development across the country was it a show biz on the macro level but an inherent perceived interest by a few to defraud the minority. Lapse in the ethical governance is clearly visible.The scam was a result of unholy nexus of NSEL, planters and brokers. The Financial statements of NSEL shows huge amount of window dressing and visible lacunas. The External auditor was changed in the year 2011. The reactive developments occurring on a continual basis in the fate of NSEL investors are many but what would be the ultimate decision which would steer their destiny is awaited.

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