Infographics by V. Srinivasan, L. Balamurugan

Spot scam

The National Spot Exchange scam exposes the problems of deregulation. The motives of the government in facilitating such a regime need to be probed.

BY **M.R. SUBRAMANI**

On December 17, the Forward Markets Commission (FMC) made a crucial decision in the beleaguered National Spot Exchange Ltd (NSEL) saga. The commission, now functioning under the Finance Ministry, found Jignesh Shah, his company and his key personnel, Joseph Massey and Shreekant Javalgekar, not "fit and proper" to manage any commodity exchange in the country.

This, perhaps, could be the beginning of the end of Shah's dream run in the realm of commodities market ever since he floated Multi Commodity Exchange of India Ltd over a decade ago. More problems could be in store for him since the Economic Offences Wing of the Mumbai Police has not ruled out his arrest.

The origins

Shah alone cannot be faulted for the problem that has shaken the very foundation of the commodities market. There were various factors; the first and foremost is the Government Order (G.O.) passed by the Consumer Affairs Ministry on June 5, 2007, which, in trying to bypass the powers of State governments, allowed spot trading in some 50 commodities—including in bizarre ones such as raw wool—in the garb of "one-day forward" trading. Curiously, the order said trading should adhere to the rules of areas where the spot trade takes place. The exchange was exempt from the Forward Contract (Regulation) Act, 1952, which essentially took away the FMC's power to supervise its functioning.

The boom

NSEL's annual results show that the exchange really took off some time in 2011-12, the year when its profits began to zoom. The FMC says that the NSEL board of directors, at a meeting on March 30, 2012, praised former managing director and CEO Anjani Sinha for the exchange's performance. It says that NSEL and its directors were fully aware of what made things turn around during that fiscal.

The government seemed to have had an inkling of the developments in NSEL and the first step to tackle it was taken on February 6, 2012. That day, NSEL was brought under the FMC's control after the latter was given powers to control spot exchanges.

A show-cause notice was issued by the FMC on April 27, 2012, on the violations made by NSEL. But the latter chose to ignore it.

After that nothing seems to have happened even though the FMC told the Consumer Affairs Ministry on August 2, 2012, that there were violations in NSEL trading activities. On April 29 this year, FMC told Ministry that only the courts could levy fines.

Matters came to a head on July 10 after the Consumer Affairs Ministry told NSEL that it could not offer new contracts any more and all contracts had to be settled on the due date. NSEL tried in vain to get over this by attempting to introduce T+10 contracts. On July 22, it gave an undertaking to the Ministry to heed to its suggestions.

Things got murkier on July 31, when NSEL was asked to suspend its operations, leaving hundreds of investors in the lurch with dues running to Rs.5,600 crore. While the FMC and the police are looking into the issue, it would be only in the fitness of things if a high-level probe is ordered into the entire gamut of issues. In particular, it begs the question: why is the government taking such a long time to act after having issued a notice to NSEL in April 2012? The suspicion is that there could be more to it than meets the eye.

[PART II—SEC. 3(ii)]

THE GAZETTE OF INDIA: EXTRAORDINARY

MINISTRY OF CONSUMER AFFAIRS, FOOD AND PUBLIC DISTRIBUTION

(Department of Consumer Affairs)

NOTIFICATION

New Delhi, the 5th June, 2007

S.O. 906 (E). —In exercise of the powers conferred by Section 27 of the Forward Contracts (Regulation) Act, 1952 (74 of 1952), the Central Government hereby exempts all forward contracts of one day duration for the sale and purchase of commodities traded on the National Spot Exchange Ltd., from operation of the provisions of the said Act subject to the following conditions, namely :—

(i) no short sale by members of the Exchange shall be allowed;

(ii) all outstanding positions of the trade at the end of the day shall result in delivery;

(iii) the National Spot Exchange Ltd. shall organize spot trading subject to regulation by the authorities regulating spot trade in the areas where such trading takes place;

(iv) all information or returns relating to the trade as and when asked for shall be provided to the Central Government or its designated agency;

(v) the Central Government reserves the right to impose additional conditions from time to time as it may deem necessary; and

(vi) in case of exigencies, the exemption will be withdrawn without assigning any reason in public interest.

[F. No. 12/3/2003-IT(Pt.)]

PAUL JOSEPH, Senior Economic Adviser

How NSEL went off the track

1. NSEL was given permission to do only spot trading nationally by the Centre. Spot trading is a subject that comes under the jurisdiction of States. To overcome the handicap, the Centre took refuge in the technical term "one-day forward" trading (see Government Order).

2. NSEL took advantage of this and began offering T+2 and T+34 forward contracts.

3. The contracts worked thus: A broking house would attract an investor promising him 16-18 per cent returns for the money he invests.

4. Once an investor invested, the broking house would buy a commodity through the T+2 contracts. Immediately, the commodity would be sold through the T+34 contracts that would ensure the investor the promised return.

5. The T+2 contracts were usually bought from a stockist or a producer, say for example oilseed crusher. The T+34 contracts were sold to the same parties. If the contract was sold to the stockists, then he/she used it to supply commodities such as oilseeds to the producer.

6. All transactions were done on paper, through warehouse receipts. These receipts were issued to those who deposited their commodities with warehouses nominated by the exchange. However, the catch in the NSEL scheme of things was that often the producer's premises were itself treated or nominated as a warehouse. This resulted in even trash material being treated as stocks, and in some cases, the NSEL authorities went overboard to accommodate the producers to falsify records.

7. The NSEL itself is reported to have solicited investors, promising them the 16-18 per cent returns. They also got in touch with producers who were in need of capital funds. The warehouse receipt was used in trading these contracts to ensure the funding of producers.

8. Since the raw material was with the producer, the investor was exposed to default since all that he/she had was a mere paper.

9. The problem got aggravated because some of the producer beneficiaries utilised the money to buy assets such as land, thus getting the investments locked.

Jignesh Shah Chairman, Financial Technologies Ltd.

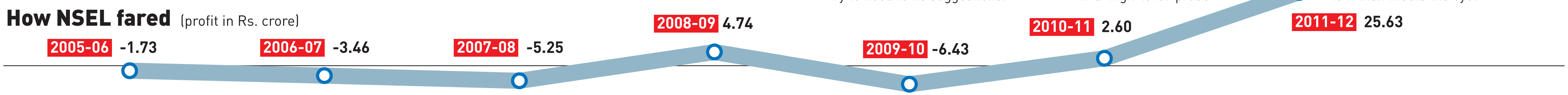
Anjani Sinha Former MD and CEO of NSEL.

Joseph Massey Former NSEL board member.

Shreekant Javalgekar CEO, Multi Commodity Exchange.

Amit Mukhejree Former business head of NSEL.

How NSEL fared (profit in Rs. crore)



Top 11 defaulters Dues*(in Rs. crore)

N.K. Proteins	ARK Imports	PD Agro-processors	Mohan India Pvt Ltd	Yathuti Associates	Loil Continental Food	Tavish Enterprises	Loil Health Foods	Lotus Refineries	Juggernaut Projects	Topworth Steels and Power Ltd
969.89	719.42	637.55	575.08	424.64	338.40	333.01	287.48	252.56	219.20	159.96

*Some firms such as Lotus Refineries are contesting NSEL's claims for dues, while others such as PD Agro, Mohan India have entered into an agreement to settle the dues.

Totally, 39 clients owe money through 24 buyer members.

Source: NSEL; Ministry of Consumer Affairs