

SECURITIES AND EXCHANGE BOARD OF INDIA
FINAL ORDER

UNDER SECTION 12 (3) OF SEBI ACT, 1992 READ WITH REGULATION 27 OF THE SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES) REGULATIONS, 2008.

In respect of:

NOTICEE	SEBI REGISTRATION No.
Abans Commodities (I) Private Limited	INZ000059831

In the matter of National Spot Exchange Limited

I. Background

1. Abans Commodities (I) Private Limited ("**ACIPL**" / "**Noticee**") is registered with Securities and Exchange Board of India ("**SEBI**") as a Stock Broker bearing SEBI Registration No INZ000059831. The Noticee is a commodities derivative broker and member of Multi Commodity Exchange of India Ltd ("**MCX**"). ACIPL was Member of the National Spot Exchange Limited ("**NSEL**") and National Commodity & Derivatives Exchange Ltd. ("**NCDEX**").
2. As the Noticee was a member of the NSEL and had participated in/facilitated trading in 'paired contracts' on the NSEL platform, SEBI initiated enquiry proceedings against the Noticee under Chapter V of the SEBI (Intermediaries) Regulations, 2008 (hereinafter referred to as the "**Intermediaries Regulations**") and appointed a Designated Authority (hereinafter referred to as the "**DA**") vide order dated April 27, 2020, to enquire into whether the Noticee was a 'fit and proper person' (hereinafter referred to as "**FPP**") to continue to hold the certificate of registration as Stock Broker in terms of

Regulation 5 (e) read with Regulation 27 (iv) of the SEBI (Stock Brokers) Regulations, 1992 (hereinafter referred to as the “Broker Regulations”).

II. Brief History of Illegal Forward Contracts on NSEL:

3. Before considering the compliance of the Noticee with the FPP criteria, it would be appropriate to have a preliminary discussion on the background of NSEL which forms the basis of the current proceedings.
4. NSEL was incorporated in 2005 as an exchange for spot trading of commodities. I note from the FMC Order No.4/5/2013-MKT-1/B dated December 17, 2013 (“**FMC Order**”), that on June 05, 2007, the Department of Consumer Affairs (“**DCA**”), Ministry of Consumer Affairs, Food and Public Distribution, Government of India, issued a Notification S.O.906(E) under Section 27 of Forward Contracts (Regulation) Act, 1952 (hereinafter referred to as “**FCRA**”) granting certain exemptions from the provisions of FCRA to NSEL subject to specified conditions. The relevant extract of the said notification is reproduced hereunder for ease of reference:

“...the Central Government exempts all forward contracts of one day duration for the sale and purchase of commodities traded on the National Spot Exchange Limited, from operation of the provisions of the said Act subject to the following conditions, namely:

- i. no short sale by members of the Exchange should 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;*

.....”

5. The aforesaid notification was amended on February 6, 2012 by DCA vide Gazette Notification S.O. 228(E) specifying “Forwards Market Commission, Mumbai” as the designated agency of the Central Government.
6. NSEL commenced operations in October 2008. It is seen from the FMC Order and the Judgement dated April 22, 2022 of the Hon’ble Supreme Court, in the matter of The State of Maharashtra Vs. 63 Moons Technologies Ltd, Civil Appeal Nos. 2748-49 of 2022, that NSEL, in September 2009, introduced the concept of ‘paired contracts’, which involved buying and selling the same commodity through two different contracts at two different prices, wherein investors could buy a short duration settlement contract and sell a long duration settlement contract or vice versa, with the same counterparty at the same time. In short, the ‘paired contract’ involved two simultaneous transactions being undertaken at the same time with the same counterparty—one being a purchase transaction (settling at T+2 or T+3) and the other being a sale transaction (settling at T+25 or T+36), at different prices on the platform of NSEL. “T” indicates the trade date, that is, the date on which the trade took place; and +2 or +3 or +25 or +36, indicates the number of business days after the trading day when the delivery of the commodity and the payment of price ought to have been made. The transactions were structured in a manner that the buyer of the short duration contract always ended up making profits.
7. Further, from Para 8 of the FMC Order, I note that the DCA on April 27, 2012 directed NSEL to explain as to why action should not be initiated against NSEL for violation of the conditions of the notification dated June 05, 2007. In response to the same, NSEL submitted a reply vide their letter dated May 29, 2012. DCA, vide its letter dated May 31, 2012, sought comments of the FMC on the NSEL reply. The FMC, vide its letter dated August 02, 2012 to the DCA provided its comments on the two main issues, which are relevant for consideration of the matter at hand, as paraphrased hereunder:
 - a. Short Sale by members of the Exchange: NSEL did not insist upon ownership of goods before allowing its members to place the sale order. FMC was of the view that all those sale transactions which are not

backed by the ownership of goods were in violation of the condition of *“no short sale by the members of the Exchange shall be allowed”*.

- b. Contracts in which settlement period goes beyond 11 days: In view of the definition of forward contract under FCRA, FMC was of the view that all the contracts traded on NSEL which provide settlement schedule for a period exceeding 11 days are Non-Transferable Specific Delivery contracts. Thus even if the gazette notification does not specify the delivery period, NSEL had to settle the delivery for all open position within a period of 11 days as NSEL was allowed to only trade in one-day forward contracts and was obliged to ensure delivery and settlement within 11 days.
8. I also note from Para 8 of the FMC Order that DCA, vide its letter dated July 12, 2013, directed NSEL to give an undertaking that:
 - a. *No further/ fresh contracts shall be launched by NSEL until further instructions from the concerned authority; and*
 - b. *All the existing contracts will be settled on the due dates.*
9. To sum up, as per the original notification dated June 05, 2007, NSEL was granted conditional exemption from the provisions of FCRA for all forward contracts of one-day duration for the purchase and sale of commodities. The two main conditions were that (i) there should be no short sale and (ii) all outstanding positions at the end of the day should result in delivery. Thereafter, FMC had observed with order dated December 17, 2013 that 55 contracts offered for trade on NSEL were with settlement periods exceeding 11 days and all such contracts traded on NSEL were in violation of provisions of FCRA. Under the FCRA, a *“forward contract”* is defined as a *“contract for delivery of goods and which is not a ready delivery contract”*. A *“ready delivery contract”* is defined as *“a contract which provides for the delivery of goods and the payment of a price therefor, either immediately or within such period not exceeding eleven days”*. In view of the said definition contained in FCRA, FMC was of the view that all the contracts traded on NSEL which provided settlement schedule exceeding 11 days were treated as Non-Transferable

Specific Delivery contracts. NSEL, thus, had permitted contracts of various commodities having duration longer than 11 days and these contracts were *ex facie* in contravention of the exemption granted to NSEL vide the Government Notification dated June 05, 2007.

10. Further, I note that the Hon'ble Supreme Court, in its Judgement dated April 22, 2022 in the matter of The State of Maharashtra Vs. 63 Moons Technologies Ltd, Civil Appeal Nos. 2748-49 of 2022, while drawing reference to the presentations made by NSEL in respect of 'paired contracts' had *inter alia* held that:

"44.... NSEL in the course of its brochures has held out representations about the trading and investment opportunities available for:

- a) corporate clients*
- b) high net worth individuals; and*
- c) retail investors*

45. Under the head of "contract specifications", the following representation has been held out:

<i>Commodity</i>	<i>Duration</i>	<i>Investment (lacs.)</i>	<i>Yield</i>
<i>Castor Seed</i>	<i>T+3 & T+36</i>	<i>7.5 -9 Lacs</i>	<i>16%</i>
<i>Castor Oil</i>	<i>T+5 & T+30</i>	<i>7-9</i>	<i>16%</i>
<i>Cotton Wash Oil</i>	<i>T+2 & T+25</i>	<i>10</i>	<i>16%</i>
<i>Paddy</i>	<i>T+2 & T+25</i>	<i>3.5-4.5</i>	<i>16%</i>
<i>Steel</i>	<i>T+2 & T+25</i>	<i>4.5-5</i>	<i>16%</i>
<i>Raw Wool</i>	<i>T+2 & T+25</i>	<i>3.5-4</i>	<i>16%</i>
<i>Wool Top</i>	<i>T+2 & T+25</i>	<i>1.8-2</i>	<i>16%</i>
<i>Crude Soybean Oil</i>	<i>T+2 & T+25</i>	<i>3.3.-3.5</i>	<i>16%</i>
<i>Soya DOC</i>	<i>T+2 & T+25</i>	<i>1.7-2.0</i>	<i>16%</i>
<i>Refined Mustard Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Refined Soybean Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>

<i>Refined Sunflower Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>RBD Palmolein Oil</i>	<i>T+2 & T+25</i>	<i>6.5</i>	<i>16%</i>
<i>Sugar</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>
<i>Maize</i>	<i>T+2 & T+25</i>	<i>3.0</i>	<i>16%</i>

The above representation specifies:

- (i) Commodities;*
- (ii) Duration of trades;*
- (iii) Investment; and*
- (iv) Yield.*

For example, in the case of castor seeds, NSEL held out a buy contract (T+3) and sale contract (T+36), in which the yield is stated to be 16%. Moreover, NSEL represented that:

“Opportunities

- Traders can trade and lock their return*
- Trader has to buy in near settlement contract and sell in far settlement contract simultaneously*
- Price for both settlement available*
- Exchange provides counterparty guarantee risk*
- No basis risk, No link with future contracts*

While describing the features of trading opportunity, NSEL represented that:

“Features of Trading Opportunity:

- T+2 and T+25 contract offers unique trading opportunity to traders*
- Trader purchases T+2 contract and simultaneously sells T+25 contract*
- Pay-in obligation is on T+2 while Pay-out of the funds will be on T+25. Entire settlement cycle is of 35-37 days*

- *Price differential between the two settlement dates i.e premium if annualized offers interest rate of about 16%*
- *Income arising out of such trades are treated as Business Income”*

While comparing the investment opportunities of bank fixed deposits with trading opportunities at NSEL, NSEL represented that:

“Comparison

- *Bank FD 9.25% for 390 days; NSEL Trading Opportunity 16%;*
- *Bank FD minimum duration 390 days; NSEL Trade duration 35-55 days, depending on the contract*
- *Traders have an option of rolling over their position as per their convenience*

.....

The above representation indicates that paired contracts were designed as a unique trading opportunity by NSEL under which a trader would, for instance, purchase a T+2 contract (with a pay-in obligation on T+2) and would simultaneously sell a T+25 contract (with a pay-out of funds on T+25). The price differential between the two settlement dates was represented to offer an annualized return of about 16%. NSEL categorically represented that all trades were backed by collaterals in the form of stocks and its management activities included selection, accreditation, quality testing, fumigation and insurance. Therefore, NSEL represented that on receiving money and commodities, the members would receive ‘assured returns’ and a ‘service’. Though NSEL has been receiving ‘deposits’, it has failed to provide services as promised against the deposits and has failed return the deposits on demand. Therefore, the State of Maharashtra was justified in issuing the attachment notifications under Section 4 of the MPID Act.”

11. As such, both the FMC Order and the aforesaid order of Hon’ble Supreme Court have explicitly brought out the details as to how NSEL permitted short sales - i.e. by permitting sellers to offer contract for sale of commodities on its

platform without ensuring that requisite amount of commodity is available in the warehouse.

12. It is also pertinent to note that the Hon'ble Supreme Court in another Judgement dated April 30, 2019, titled 63 Moons Technologies Ltd Vs. Union of India, Civil Appeal No. 4476 of 2019 observed that these contracts were in the nature of "financing transactions". The relevant extract of the said order is as under: -

"55.3. We have seen that neither FTIL nor NSEL has denied the fact that paired contracts in commodities were going on, and by April to July, 2013, 99% (and excluding E-series contracts), at least 46% of the turnover of NSEL was made up of such paired contracts. There is no doubt that such paired contracts were, in fact, financing transactions which were distinct from sale and purchase transactions in commodities and were, thus, in breach of both the exemptions granted to NSEL, and the FCRA."

III. Show Cause Notice, Reply and Hearing

13. In light of the background and history narrated above, the DA issued show cause notice dated September 25, 2018 to the Noticee, calling upon it show cause as to why appropriate recommendation should not be made against it as prescribed under Regulation 27 of the Intermediaries Regulation read with Section 12(3) of the SEBI Act. The Noticee vide letter dated September 28, 2018 submitted its reply to the said show cause notice. DA, vide supplementary show cause notice / letter dated June 19, 2020, has provided certain documents and advised the Noticee to file reply within 14 days from the date of receipt of the notice. Upon completion of the enquiry, the DA submitted its report dated August 31, 2020, recommending cancellation of the certificate of registration granted to the Noticee, since the Noticee was not a FPP in terms of Regulation 5(e) read with Regulation 27(iv) of the Broker Regulations and Schedule II of the Intermediaries Regulations.

14. Pursuant to the same, a post enquiry show cause notice (hereinafter referred to as the “**SCN-1**”) dated September 10, 2020, was issued to the Noticee, under Regulation 28(1) of the Intermediaries Regulations to show cause as to why action, as recommended by the DA or any other action as considered appropriate by the Designated Member, should not be taken against the Noticee. A copy of the DA’s Report was also forwarded to the Noticee along with an advice to file a reply, if any, within 21 days from the date of receipt of the notice. Along with the DA’s Report, a letter dated December 30, 2014 of the Ministry of Finance (“**MoF**”), Department of Economic Affairs (“**DEA**”) addressed to the Chairman, FMC, was provided to the Noticee, wherein it was stated that the DEA was in agreement that NSEL had violated the conditions of exemptions granted to it under the FCRA. Further, the Order dated August 22, 2014 of Hon’ble Bombay High Court, in the matter of *Jignesh Prakash Shah Vs. The State of Maharashtra*, Criminal Bail Application No. 1263 of 2014, wherein it was held that the brokers through whom the paired contracts were entered into had knowledge of the illegality of such contracts, was also furnished to the Noticee. The SCN-1 also *inter alia* highlighted the observations made by the Hon’ble Supreme Court in the matter of *63 Moons Technologies Ltd. Vs. Union of India* (order dated April 30, 2019), wherein it was held that paired contracts were in fact financing transactions in breach of exemptions granted to NSEL under the FCRA. The Noticee submitted its reply to the SCN-1 vide letter dated December 01, 2020 and requested for inspection of documents which was duly granted and availed by the Noticee on January 07, 2021. The Noticee vide letter dated January 01, 2021 has requested for certain additional documents and also requested for inspection of certain additional documents which was granted and availed by the Noticee on November 18, 2022.

15. In the meantime, while the proceedings in the present matter were ongoing, Whole Time Member, SEBI (“**WTM**”) passed certain orders rejecting the applications of five other entities for registration as commodity brokers. The Hon’ble Securities Appellate Tribunal (“**Hon’ble SAT**”) vide its order dated June 9, 2022 remitted the matters to the WTM to decide the matter afresh after

giving an opportunity of hearing to the brokers. Further, Hon'ble SAT had observed that *"...It will be open to the WTM to rely upon other material such as the complaint letters of NSEL, EOW report, EOW charge sheet, etc. provided such copies are provided to the brokers and opportunity is given to rebut the allegations. Such additional documents relied upon by SEBI should form part of the show cause notice for which purpose, it will be open to the WTM to issue a supplementary show cause notice"*.

16. In light of the order of Hon'ble SAT dated June 9, 2022, supplementary show cause notice dated October 07, 2022 (hereinafter referred to as "**SCN-2**") was issued to the Noticee. Vide the SCN-2, additional documents viz. SEBI's complaint dated September 24, 2018 to Economic Offence Wing ("EOW"), First Information Report ("FIR") dated September 28, 2018 filed by SEBI and the amended Schedule II of the Intermediaries Regulations were furnished to the Noticee calling upon it to show cause as to why information/material provided therein along with the Enquiry Report should not be considered against the Noticee.
17. In response to the SCN-2, the Noticee vide letter dated December 14, 2022 has submitted its reply in line of the earlier submissions made by it.
18. In order to proceed with the matter, a hearing was granted to the Noticee in terms of Regulation 27(4) of the Intermediaries Regulations as the DA had recommended cancellation of the certificate of registration of the Noticee. The hearing was held on December 15, 2022 during which the Noticee, through their Advocates viz. Mr. Ravichandra S. Hegde, Mr. Paras Parekh, Mr. Samyak Pati, and Mr. Kandarp Trivedi and reiterated the submissions made in replies dated September 28, 2018, December 01, 2020 and December 14, 2022. Subsequent thereto, the Noticee vide letter dated December 23, 2022 filed additional submissions. The summary of the said replies of the Noticee is given hereunder:
 - a. Inordinate delay in initiation of proceedings, as the show cause notice was issued after a gap of almost 8 years for the alleged paired trades

which was executed in the year 2012, the Noticee inter-alia referred certain judicial pronouncements.

- b. The due process of law has not been followed, as the DA failed to provide an opportunity of being heard or seeking clarification / information. The show cause notice was in gross violation of the basic principles of '*audi alteram partem*'. The Noticee referred to certain judicial pronouncements.
- c. The SCN-1 was issued without providing the requisite documents which is in gross violation of principles of natural justice. The Noticee requested for inspection of documents and copies thereto.
- d. The trade on NSEL was in its own proprietary account and was not carried out on behalf of its clients. Thus, the case against the Noticee is in the shoes of an investor and cannot be coloured as a 'close association' as in case of other entities.
- e. ACIPL itself is a victim and intermittently receiving pay outs from NSEL and continues to have substantial receivable, to the tune of Rs. 85,59,550.17 in dues from NSEL.
- f. With respect to the findings that the Noticee has executed buy and sell trades in paired contracts on behalf of one of its clients having client code 12140 on June 20, 2013 and June 21, 2013, the Noticee submitted that the code '12140' was of ACIPL's Trading and Clearing Member Code with NSEL and not a client code. The Noticee provided details for the trades of June 20, 2013 and June 21, 2013 and stated that the DA Report erroneously misattributed the alleged sole instance of trade in paired contracts as one being carried out on behalf of a client.
- g. The SCN dated June 19, 2020, provides a list of members along with corresponding amounts indicating the default amount of clients who traded through brokers, the Noticee is not named as one of the broker in the list.
- h. The whole allegation in the Complaint is against NSEL and its alleged violation of FCRA and there is no specific allegation against any broker including the Noticee. The alleged violation does not pertain to any

securities laws within the definition prescribed in the Intermediaries Regulations.

- i. There is nothing in the SCN-2 or otherwise to demonstrate that there was any violation of securities laws by the Noticee. Any such allegation, even levelled, would be contrary to the correct legal position. This is because only on September 29, 2015, with the passing of the Finance Act, 2015 the commodities derivatives became 'securities' under the Securities Contract (Regulation) Act, 1956 ("**SCRA**"). The dealing on the NSEL were going on till July-August 2013. This means that any dealing on the NSEL prior to this period was not in relation to any 'security' under the SCRA, since the Regulation 23 of the Intermediaries Regulations allows initiation of proceedings only in case of violation of securities laws and there were no dealings in securities by ACIPL and therefore no violation of securities laws.
- j. The 'Earlier Show Cause Notice', the DA Report and the Supplementary Show Cause Notice has failed to demonstrate the violation of any specific securities laws and on account of which, such enquiry is warranted. Apart from allegations pertaining to being a trading member of NSEL and allegedly facilitating / participating in trading of 'paired contracts' on NSEL, there is no case made out for violation of any securities laws under the Intermediaries Regulations.
- k. The Noticee submitted that by virtue of Hon'ble SAT Order on June 09, 2022 in the matter of five other entities, as mentioned at paragraph 15, SEBI cannot rely upon documents of these nature to arrive at a finding of fit and proper status of a broker. SEBI is obligated to decide the issue of fit and proper status of each broker independently by relying upon relevant material which demonstrates direct connection and / or involvement of a broker with NSEL and its role concerning the paired contracts and not on the basis of adverse inferences made exclusively against NSEL. As such, the Hon'ble SAT Order effectively invalidates the basis upon which the DA Report as well as the SCN-1 has been issued and the same have effectively become redundant by virtue of the same.

- l. The SCN-2 and / or the annexures thereto does not contain any material particulars about any wrong-doing or violation by the Noticee. It is trite law that a show cause notice ought to contain specific allegations to enable the Noticee to deal with the same. This fundamental requirement has been ignored while issuing SCN-2. Apart from the SEBI Complaint and the FIR, there is no other material provided along with the SCN-2 to allege or demonstrate any wrongdoing by ACIPL. This demonstrates that there is no merit in the contentions and there is nothing to demonstrate or support the allegation about ACIPL being not fit and proper.
- m. None of the documents relied upon contain any particulars about any specific conduct, violation, and / or wrong-doing by ACIPL but are merely broad allegations without any supporting material or evidence. SEBI Complaint is merely a letter requesting the EOW to investigate the issues. The same cannot be treated as evidence in support of any allegation of wrong-doing. Similarly, the FIR is also a document stating that on the basis of the SEBI Complaint, the matter ought to be investigated. Such SEBI Complaint and FIR cannot by any stretch be considered as evidence necessary for demonstrating a serious allegation of being not fit and proper.
- n. The Noticee placed reliance on the judgement in the matter of *Jermyn Capital LLC v. SEBI*, where the Hon'ble SAT has ruled that allegations of market manipulation and insider trading, being serious allegations, which need to demonstrate on the basis of pre-ponderance of probabilities. The categorization of an intermediary as not 'fit and proper' has graver implications than those of market manipulation or insider trading.
- o. Mere criminal complaint alone and without any other material in its support, cannot be the legitimate basis for determination of ACIPL's fit and proper status. Further the FIR in question was filed in 2018 and over the course of four years since, no action has been taken and / or charges been filed against ACIPL. The Competent Authority ought not to mechanically apply the provisions of Schedule II but judiciously examine

the material before it, or lack of any, which would lead to the inevitable conclusion that the FIR has no implication, especially in view of the fact that the FIR does not disclose any violation by ACIPL.

- p. The criteria of factors for determining fit and proper status, as detailed in Schedule II of the Intermediaries Regulations underwent change and included a detailed list of disqualifications including a '*criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973*' as a material factor for assessment of an entity. A mere criminal complaint alone, cannot be the legitimate basis for determination of ACIPL's fit and proper status. It is trite law that, unless otherwise specified, any change in law ought to be applied only prospectively and this has been reiterated in the recent ruling of the Hon'ble Supreme Court in *SEBI vs, Sunil Krishna Khaitan* (Order dated July 11, 2022 in C.A. No. 8249 0/2013).
- q. The Noticee had submitted itself to the scrutiny of 'fit and proper' at the time of obtaining its certificate of registration and, in any event, the amendment to Schedule II of the Intermediaries Regulations has come into effect only from November 17, 2021 and therefore cannot apply to the case of ACIPL where the FIR is dated 2018, i.e., prior to the amendment of the Intermediaries Regulations.

IV. Consideration of Issues

- 19. I have considered the SCN-1, SCN-2, the Enquiry Report submitted by the DA, Noticee's replies dated September 28, 2018, December 01, 2020, December 14, 2022 and December 23, 2022 and other material available on record. Having regard to the same, I now proceed to deal with the issues in the present matter.
- 20. It is alleged that the Noticee has violated Regulation 9(b) and (f) read with Clause A(1), A(2) and A(5) of the Schedule II of the Broker Regulations and Regulation 5(e) of the Broker Regulations read with Schedule II of the Intermediaries Regulations. The relevant provisions are reproduced hereunder: -

Provisions of Broker Regulations:

Consideration of application for grant of registration.

5. The Board shall take into account for considering the grant of a certificate, all matters relating to trading, settling or dealing in securities and in particular the following, namely, whether the applicant, -

.....
(e) is a fit and proper person based on the criteria specified in Schedule II of the Securities and Exchange Board of India (Intermediaries) Regulations, 2008.

Conditions of registration.

9. Any registration granted by the Board under regulation 6 shall be subject to the following conditions, namely, -

.....
(b) he shall abide by the rules, regulations and bye-laws of the stock exchange which are applicable to him...

.....
(f) he shall at all times abide by the Code of Conduct as specified in Schedule II

SCHEDULE II

Securities and Exchange Board of India (Stock Brokers) Regulations, 1992

CODE OF CONDUCT FOR STOCK BROKERS

[Regulation 9]

A. General.

(1) Integrity: A stock-broker, shall maintain high standards of integrity, promptitude and fairness in the conduct of all his business.

(2) Exercise of due skill and care : A stock-broker shall act with due skill, care and diligence in the conduct of all his business.

(3).....

(5) Compliance with statutory requirements: A stock-broker shall abide by all the provisions of the Act and the rules, regulations issued by the Government, the Board and the Stock Exchange from time to time as may be applicable to him.

Provisions of Intermediaries Regulations:

“SCHEDULE II

SECURITIES AND EXCHANGE BOARD OF INDIA (INTERMEDIARIES)

REGULATIONS, 2008

[See regulation 7]

(1) The applicant or intermediary shall meet the criteria, as provided in the respective regulations applicable to such an applicant or intermediary including:

- (a) the competence and capability in terms of infrastructure and manpower requirements; and*
- (b) the financial soundness, which includes meeting the net worth requirements.*

(2) The 'fit and proper person' criteria shall apply to the following persons:

- (a) the applicant or the intermediary;*
- (b) the principal officer, the directors or managing partners, the compliance officer and the key management persons by whatever name called; and*
- (c) the promoters or persons holding controlling interest or persons exercising control over the applicant or intermediary, directly or indirectly:*

Provided that in case of an unlisted applicant or intermediary, any person holding twenty percent or more voting rights, irrespective of whether they hold controlling interest or exercise control, shall be required to fulfill the 'fit and proper person' criteria.

Explanation– *For the purpose of this sub-clause, the expressions “controlling interest” and “control” in case of an applicant or intermediary, shall be construed with reference to the respective regulations applicable to the applicant or intermediary.*

(3) For the purpose of determining as to whether any person is a 'fit and proper person', the Board may take into account any criteria as it deems fit, including but not limited to the following:

- (a) integrity, honesty, ethical behaviour, reputation, fairness and character of the person;*
- (b) the person not incurring any of the following disqualifications:*
 - (i) criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;*
 - (ii) charge sheet has been filed against such person by any enforcement agency in matters concerning economic offences and is pending;*
 - (iii) an order of restraint, prohibition or debarment has been passed against such person by the Board or any other regulatory authority or enforcement agency in any matter concerning securities laws or financial markets and such order is in force;*
 - (iv) recovery proceedings have been initiated by the Board against such person and are pending;*

(v) an order of conviction has been passed against such person by a court for any offence involving moral turpitude;
(vi) any winding up proceedings have been initiated or an order for winding up has been passed against such person;
(vii) such person has been declared insolvent and not discharged;
(viii) such person has been found to be of unsound mind by a court of competent jurisdiction and the finding is in force;
(ix) such person has been categorized as a wilful defaulter;
(x) such person has been declared a fugitive economic offender;
or
(xi) any other disqualification as may be specified by the Board from time to time.

(4) Where any person has been declared as not 'fit and proper person' by an order of the Board, such a person shall not be eligible to apply for any registration during the period provided in the said order or for a period of five years from the date of effect of the order, if no such period is specified in the order.

(5) At the time of filing of an application for registration as an intermediary, if any notice to show cause has been issued for proceedings under these regulations or under section 11(4) or section 11B of the Act against the applicant or any other person referred in clause (2), then such an application shall not be considered for grant of registration for a period of one year from the date of issuance of such notice or until the conclusion of the proceedings, whichever is earlier.

(6) Any disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub-clause (b) of clause (3), shall not have any bearing on the 'fit and proper person' criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter: Provided that if any person as referred in sub-clause (b) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall replace such person within thirty days from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against the intermediary: Provided further that if any person as referred in sub-clause (c) of clause (2) fails to satisfy the 'fit and proper person' criteria, the intermediary shall ensure that such person does not exercise any voting rights and that such person divests their holding within six months from the date of such disqualification failing which the 'fit and proper person' criteria may be invoked against such intermediary.

(7) The 'fit and proper person' criteria shall be applicable at the time of application of registration and during the continuity of registration and the intermediary shall ensure that the persons as referred in sub-clauses (b) and (c) of clause (2) comply with the 'fit and proper person' criteria."

21. I note that the Noticee has contended that there is a delay in initiation of proceedings. In this regard, I note that the NSEL scam unfolded in 2013 after which several agencies such as EoW, Serious Fraud Investigation Office ("SFIO"), Directorate of Enforcement ("ED"), etc. conducted investigations into what had transpired therein. Charge sheets are still being filed in the matter by these agencies. A large number of brokers had participated in the illegal forwards contracts. After the merger of FMC with SEBI on September 28, 2015, some of these brokers applied for registration with SEBI. Subsequently, the FMC and the Hon'ble Supreme Court had made very critical observations about the trades on NSEL being short sale of commodities without ensuring availability of commodity in the warehouse and that they were 'paired contracts' which were in fact 'financing transactions' etc. as brought out in paragraph 7 to 12 above. It is true that the trades and actions were of the year 2012-2013. However, the jurisdiction was conferred on SEBI only on September 28, 2015. Thereafter assessing all the factual circumstances available before SEBI and considering the importance of fulfilling FPP criteria by commodity brokers, action was duly initiated against the set of brokers who executed the alleged trades. Further, as noted at paragraph 15 above, while the instant matter was under consideration, the Hon'ble SAT vide its order dated June 9, 2022 remitted certain orders pertaining to some other brokers who had also participated in paired contracts on NSEL to SEBI to decide the matter afresh. The Hon'ble SAT left it open to SEBI to rely on other material like EOW charge sheet, complaint letters etc., after providing the same to the appellants therein. Keeping in line with the aforesaid order of the Hon'ble SAT, the SCN-2 was issued to the Noticee on October 7, 2022. I also note that all documents sought by the Noticee have been provided to them. The Noticees have also filed detailed replies in the matter. Unlike other cases where delay may be a vitiating factor, depending on the facts and circumstances in which certain transactions

were allegedly executed, the core issue in the instant case pertains to the adjudication of FPP criteria of the Noticee and the same being a continuing criteria, I am of the view that delay cannot be attributed to the initiation of the proceedings.

22. The Noticee contended that the DA did not provide opportunity of hearing before issuance of SCN-1. In this regard, I note that prior to amendment on January 21, 2021 in the Intermediaries Regulations there was no specific mandate on the DA to provide hearing. I note that the DA Report was submitted prior to the said amendments. I also note that before issuance of SCN-1, vide digitally signed email dated June 19, 2020 delivered at email id acipl@abans.co.in, the Noticee was provided the list of documents relied upon and advised to submit its reply within 14 days. However, no reply was filed by the Noticee. Further vide reminder email dated July 14, 2020, the Noticee was again advised to submit its reply by July 28, 2020 and mentioned that in case of failure the matter shall be proceeded on the basis of material available on record. However, no submission has been made by the Noticee, therefore, contention of the Noticee that the opportunity of hearing has not been provided before issuance of SCN-1 is not tenable.
23. From the reply of the Noticee, it is seen that the Noticee has admitted to the fact of execution of certain trades, referred to as “paired contracts” by FMC and the Hon’ble Supreme Court. I note that the Noticee has submitted that it only executed trades in proprietary capacity on NSEL. On perusal of reply of the Noticee, I find that as a broker with sufficient experience and knowledge, the Noticee ought to have refrained from participating in the subject contracts on such platform, going by the very structure of the back-to-back contracts. It appears to be the case of the Noticee that since everything was in public domain and it was all being done with the knowledge of regulators, it presumed that the activities were legally valid and that there was nothing that raised his suspicion. In this context, I note that NSEL itself was advertising such contracts as an alternative to fixed deposits. The return offered was 16% across all commodities irrespective of the nature of the contract or the duration. Also,

these contracts were structured in a manner which ensured that the buyer always made pre-determined profits. I am, therefore, of the view that while participating in such contracts, the Noticee failed to examine the basic nature of the product and also failed in understanding the source of powers relied upon by NSEL for selling such products which other exchanges were not offering. Thus, the Noticee failed to conduct proper and effective due diligence on these aspects of paired contracts which were not essentially spot contracts. It is also relevant to state that the Noticee has contended that it was in the shoes of an “investor” and not acted as a Broker. This would not make any difference as the Noticee was trading as a Broker executing proprietary trades on NSEL platform.

24. The Noticee has also contended that there is no violation of securities laws. In this regard, I note that as the commodity derivatives are now under the purview of SEBI, following the amendments to the FCRA, these contentions are no longer relevant.
25. I further note that the SCN-1 dated September 10, 2020 provided the Noticee with the DA's Report along with the letter dated December 30, 2014 of the DEA, MoF addressed to FMC and copy of Order dated August 22, 2014 passed by the Hon'ble Bombay High Court in the matter of *Jignesh Prakash Shah vs. The State of Maharashtra*. I do not find that the said documents are relevant for consideration in the instant matter.
26. I also note that vide SCN-2, additional documents viz. SEBI's complaint dated September 24, 2018 to EOW, FIR dated September 28, 2018 filed by SEBI and the amended Schedule II of the Intermediaries Regulations was provided to the Noticee. I note that Schedule II of the Intermediaries Regulations was amended vide SEBI(Intermediaries) (Third Amendment) Regulations, 2021, w.e.f. 17.11.2021 and the following disqualifications have been included amongst others:

“(i) criminal complaint or information under section 154 of the Code of Criminal Procedure, 1973 (2 of 1974) has been filed against such person by the Board and which is pending;”

27. I also note that as per the amendment, the disqualification of an associate or group entity of the applicant or intermediary of the nature as referred in sub-clause (b) of clause (3) of Schedule II to the Intermediaries Regulations, shall not have any bearing on the FPP criteria of the applicant or intermediary unless the applicant or intermediary or any other person referred in clause (2), is also found to incur the same disqualification in the said matter.
28. It is pertinent to note that in terms of Regulation 5(e) of Broker Regulations, the eligibility criteria for an entity to get registered as a stock broker includes that it should be a ‘fit and proper person’ based on the criteria specified in Schedule II of Intermediaries Regulations. It has been specified in Clause 7 of Schedule II of Intermediaries Regulations that the said criteria are required to be satisfied by the intermediary at the time of registration as well as during the continuity of registration with SEBI. Therefore, even if the Noticee fulfilled the eligibility requirements at the time of grant of certificate of registration, it is required to continually comply with the criteria including those conditions which are incorporated subsequently.
29. It is a matter of record that SEBI has filed a complaint dated September 24, 2018 with Economic Offence Wing (EOW), seeking appropriate action against the brokers/members of NSEL, including the Noticee as mentioned at serial no. 5, and certain other persons in the NSEL matter under Sections 20 and 21 and other appropriate provisions of FCRA. Additionally, SEBI has filed a FIR No. Spl LAC No. 110/18 dated September 28, 2018 under section 154 of the Code of Criminal Procedure, 1973 at the MIDC Police Station, Mumbai requesting it to take lawful action against trading members of NSEL and other members of NSEL who were involved in trading of illegal forward contracts in violation of FCRA. The same list of members provided by SEBI in its complaint made to EOW was annexed to the said FIR. I note that both the criminal

complaint and FIR are currently pending with the respective authorities. In view thereof, I note that disqualifications contained in paragraph 3(b)(i) of Schedule II of Intermediaries Regulations are attracted against the Noticee.

30. When the pendency of a criminal complaint or FIR filed by SEBI is prescribed as a negative criterion / disqualification from eligibility under Schedule II of the Intermediaries Regulations, it is imperative for me to consider the same while adjudging the eligibility of the Noticee to continue to hold the authorization granted. In my view, the amendment of Schedule II of the Intermediaries Regulations merely encapsulates the criteria in the form of specific parameters, which would apply uniformly to all intermediaries. The FPP criteria, being an eligibility criteria which has to be complied, on a continuing basis, the question of prospective application does not arise, as contended by the Noticee. To reiterate, the fact that SEBI has filed a complaint and FIR against the Noticee and the fact that both are pending, by itself constitutes a disqualification from satisfaction of eligibility criteria to function as an intermediary.
31. The evaluation of the facts and legal provisions as brought out above, compels me to arrive at the conclusion that the Noticee is not a 'fit and proper' person and hence is not eligible to continue its business as a stock broker using the certificate of registration no. INZ000059831 granted by SEBI.

DIRECTIONS

32. In exercise of powers conferred upon me under Section 19 read with Section 12(3) of the SEBI Act, 1992 and Regulation 27 of the Intermediaries Regulations, 2008, I, hereby, cancel the Certificate of Registration bearing no. INZ000059831 of the Noticee i.e. Abans Commodities (I) Private Limited.
33. Upon receipt of this Order, the Noticee shall immediately inform its existing clients, if any, about the direction at paragraph 32 above.

34. Notwithstanding the direction at paragraph 32 above,
- a. the Noticee shall allow its existing clients, if any, to withdraw or transfer their securities or funds held in its custody, within 15 days from the date of this order. In case of failure of any client to withdraw or transfer their securities or funds within the said 15 days, the Noticee shall transfer the funds and securities of such clients to another broker within a period of next 15 days thereon, under advise to the said clients; and
 - b. the Noticee shall square off open positions, if any, within 30 days from the date of this order.
35. The Order shall come into force with immediate effect.
36. A copy of this order shall be served upon the Noticee and the recognized Stock Exchanges, Depositories and Clearing Corporations for necessary compliance.

Date: March 28, 2023

Place: Mumbai

Sd/-
GEETHA G
CHIEF GENERAL MANAGER
SECURITIES AND EXCHANGE BOARD OF INDIA