WTM/PS/ISD/ 48/DEC/2011

BEFORE THE SECURITIES AND EXCHANGE BOARD OF INDIA

CORAM: PRASHANT SARAN, WHOLE TIME MEMBER

ORDER

DIRECTIONS UNDER SECTIONS 11(1), 11(4) AND 11B OF THE SECURITIES AND EXCHANGE BOARD OF INDIA ACT, 1992 IN THE MATTER OF ALLEGED MARKET MANIPULATION USING GDR ISSUES AGAINST INDIA FOCUS CARDINAL FUND

1. The Securities and Exchange Board of India (hereinafter referred to as SEBI) had vide an ex-parte ad interim Order dated September 21, 2011 (hereinafter referred to as the Order) directed, amongst others, India Focus Cardinal Fund (hereinafter referred to as the entity), a sub-account, not to deal in securities or instruments with Indian securities as underlying, in any manner whatsoever, until further orders. Pursuant to an opportunity of inspection of documents given in the matter, an opportunity of personal hearing was afforded to the entity on November 23, 2011 which was adjourned to November 30, 2011, as requested by the entity. On the said date, Mr. Deepak Dhane, Advocate appeared and submitted that the appeal memorandum (in Appeal No. 193 of 2011-India Focus Cardinal Fund vs. Securities and Exchange Board of India), filed before the Honourable Securities Appellate Tribunal, be treated as the entity's reply/submissions to the allegations/observation made in the Order. The submissions/averments made in the said appeal memorandum, *inter alia* are that:

a. it is a sub-account of European American Investment Bank (hereinafter referred to as EURAM bank) which is a Foreign Institutional Investor (FII) registered with SEBI;
b. it holds a Category 1 Global Business License issued by the Financial Services Commission (FSC) of Mauritius and is authorized to operate a collective investment scheme, under the Securities Act, 2005, Mauritius. It receives funds from investors and the same is invested *inter alia* in shares and securities in India

and other parts of the world. The investors of the entity are foreign corporate and institutional investors and none of them are Indians or NRIs. Its investors subscribe to different classes of investments including buying GDRs and canceling and selling the converted shares for arbitraging. The entity, therefore, as a regular permissible strategy, purchases GDRs in the foreign stock exchanges where the same are listed, then cancels the GDRs and converts the same into equity shares and sells the said equity shares in the local secondary market in India vide the screen based platform/trading system of the Indian stock exchanges.

c. As and when it decided to sell shares, it would merely give sell orders to its stock brokers and they in turn would execute the same as they deemed fit. It never instructed the stock brokers to match any trades with any particular counterparty.
d. Some of the GDRs were held by it for even over two years before their cancellation and that there is no restriction as to the time within which GDRs may be converted into shares.
e. The Entity was not aware of and has never been aware of the identity of any of the counter parties to its trades, since all trades were executed by the stock brokers in the trading system of the stock exchanges where the identity of the counter parties is never known. The entity submitted that there was no 'pre-arrangement' in selling the shares by Foreign Institutional Investors (FIIs) to the counter parties, the extent of matching would have been 100%.
f. During the entire investigation period of 344 trading days, as compared to the trades executed by the Group (161 to 326 days), the sub-accounts (put together) traded for only 7 to 36 days. Out of the total number of shares allegedly purchased by the Group, the quantity bought from the sub-accounts is only a small fraction.
g. Mere substantial volume of trading can never amount to any violation and that its stock brokers merely placed the sell orders on the trading system and allowed the system to match the same with buy orders which may have been already pending or which came in later. Since it is the allegation that the scrips were illiquid, there would be a substantial increase in the traded volumes when large scale orders were placed by the sub-accounts. The arbitraging of the entity in buying GDRs and converting the same into shares and selling in the Indian markets, is not an investment strategy available to the local investors.
h. In the scrip of Asahi Infrastructure and Projects Limited (Asahi), when the group purchased 6,10,19,672 shares, the sub-accounts sold only 3,17,71,646 shares. Further, when the sub-accounts had sold the aforesaid shares on 31 days, the counterparty purchasers from the group had traded for only 1,97,13,709 on 17 days.
i. Out of the total 2,82,71,646 shares sold by the entity, the alleged group purchased only 1,69,62,954 shares.
j. Their trades did not result into any fluctuations in the shares price of the companies listed in the Order.
k. In the scrip of Avon Corporation Limited (Avon), out of 341 trading days the entity and another sub-account sold shares only on 35 days.
l. The transactions between the sub-accounts and the group were only for 79,05,709 shares on 20 days and therefore, it is incorrect to allege that the group provided to

an exit to the sub accounts. There is no connection between the group and the sub-accounts.

m. In the scrip of CAT Technologies Limited, similar to the aforesaid scrips, the sub accounts had traded only on few days (18 days) as compared to the trading by the group i.e. on 233 days. Further, when the sub accounts had sold a total of 37,55,001 shares, the group purchased only 12,19,639 shares from them.

n. The allegation that when the Entity sold 245,000 shares, the counter parties of the group purchased 2,44,989 shares cannot be suspected to be pre arranged and synchronised. The allegation that the group had given an exit option to the sub accounts is not correct as there were large number of other buyers in the market.

o. In the scrip of IKF Technologies Limited, the trades of the entity were made on 11 days as against the groups trading on 170 days. Out of the total sale of the entity i.e. 1,96,07,456 shares, the group had purchased 1,48,35,662 shares and that the same would indicate that there was no pre-arrangement. Further, for the trades on November 23, 2009, there was no synchronisation. While the trades of the entity on the said date were at ₹4.50/-, the trades between the group inter se from October 30, 2009 till November 13, 2009 were at higher rates ranging from ₹4.63 to ₹5.47, which also belies the allegation/finding of prearrangement, conspiracy and synchronization by the sub-accounts and the group.

p. In the scrip of K Sera Sera Limited, the entity and another sub-account traded only on 36 days as against the group's trading on 326 days and that when they had sold 2,91,21,430 shares, the group purchased only 1,40,54,743 shares. This would indicate that there was no connection between the entity and the group. The entity sold the shares on both BSE and NSE and therefore, the alleged percentage of matching between itself and the group is incorrect.

q. In the scrip of Maars Software Technologies Limited, the sub accounts traded only on 7 days as against the group which had traded on 139 days. When the sub accounts had sold 1,52,18,242 shares on 7 days, the counterparty purchasers of the group purchased only 70,99,356 shares. It is also contended that the Order does not show any link or arrangement between itself and the group entities and therefore it is incorrect to allege that the trades between the entity and the group were synchronised or pre-arranged. It is further stated that the entity is still holding some of the GDRs in the said company.

r. The allegation that between 17.75% and 78.49% of the GDR'ss issued for the said 6 companies were converted into equity shares is totally irrelevant, *inter alia* since it is the admitted terms and conditions of all GDR Issues that the same can be converted into equity shares whenever the GDR holder desires to do so. Similarly the allegations that the floating stock in the Indian Exchanges substantially increased after the conversion of the GRD's, the same is an obvious and necessary consequence and is clearly anticipated and permitted.

s. The allegation that Mr. Arun Panchariya had control over the placement of GDR's, the exit of the holders thereof and/or the subscribers is baseless. It was submitted that the entity during the relevant period had converted GDRs and sold shares of 26 companies and that it had already disclosed its investment strategy of arbitraging in the initial document filed with SEBI for registration as a sub account. It had also

signed an agreement with the domestic custodian, the ICICI Bank Limited, as required under Regulation 16 of the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995 and that it was not aware that Pan Asia was an arranger of GDR issues of 21 companies.

2. I have considered the submissions of the entity and other material available on record. In short, the submission of the entity is that no malafides can be attributed in its conduct when it converted and sold shares of the six companies in the Indian stock exchanges and that it did not have any arrangement with the counter parties (alleged group) for purchasing the shares sold by it. It was also submitted that its sell quantities were lower than the purchase quantities of the group and that it did not have any malafide intention while transacting in the shares of the select companies. In terms of the Order, the entity was one of the sub-accounts which had traded in the shares of Asahi Infrastructure and Projects Limited**,** Avon Corporation Limited, CAT Technologies Limited, IKF Technologies Limited, K Sera Sera Limited and Maars Software International Limited (the scrips which had been selected for examination by SEBI). Further, from the table at pages 29 & 30 of the Order, it can be seen that the entity had converted considerable quantity of GDRs of the identified six scrips, into equity shares. In the shares of Asahi Infrastructure and Projects Limited, the entity had sold a total of 2,82,71,646 shares and out of the same, 1,69,62,954 shares were purchased by the alleged Group entities-Basmati Securities Private Limited, JMP Securities Private Limited and SV Enterprises. In the shares of Avon Corporation Limited, the entity had sold 1,23,58,611 shares and out of the same, 72,54,423 shares were purchased by the alleged Group entities-Basmati Securities Private Limited, Oudh Finance & Investment Private Limited and SV Enterprises. While trading in the shares of CAT Technologies Limited, the entity had sold 2,45,000 shares and almost the entire quantity (2,44,989 shares) was purchased by the Group entities-Basmati Securities Private Limited and Oudh Finance & Investment Private Limited. The entity had also sold 1,96,07,456 shares of IKF Technologies Limited of which the Group entities-Alka India Limited, Basmati Securities Private Limited, JMP Securities Private Limited, Oudh Finance & Investment Private Limited and

SV Enterprises purchased 1,48,35,662 shares. With respect to its trading in the shares of K Sera Sera Limited, the entity had sold a total of 1,35,45,000 shares and of which 80,10,347 shares were purchased by the Group entities-Basmati Securities Private Limited, JMP Securities Private Limited, Oudh Finance & Investment Private Limited and SV Enterprises. Thus, the entity had sold substantial quantities of shares and that majority of the same had been purchased by the alleged Group entities. There is no dispute regarding such facts. It is important to note that in all the aforesaid scrips, when the entity was selling shares (after cancellation of GDRs and conversion into underlying shares), the Group entities have been regular in their presence as buyers of substantial quantities from the entity. The Order has also observed that the said six companies had weak financial fundamentals for them to attract investors and that they had issued GDRs more than their existing issued capital. Such details had been given in pages 25 and 26 of the Order. It has also been observed that the aforesaid six companies had engaged Pan Asia and Mr. Arun Panchariya, as advisors for their GDR issuances. It has also been observed that the proceeds of the GDR issues were deposited in one bank namely, European American Investment Bank AG [Euram Bank]. Though, the entity had contended that it had no role in the alleged manipulation, it is observed that:-

i. the companies did not have strong financials to raise such a huge capital through GDRs, which was several times the size of the issued capital,
ii. the companies had a common arranger/advisor, Pan Asia, for their GDR issues (except in the case of Cals Refineries Limited),
iii. there were similar set of GDR subscribers,
iv. the same bank (Euram Bank) where the issue proceeds through GDRs were credited,
v. the entity is a registered as sub account under the FII, Euram Bank
vi. Mr Arun Panchariya led Pan Asia had a joint venture with Euram Bank called Euram Bank Asia Limited,
vii. Mr Arun Panchariya was the director of the entity until October 28, 2010

viii. same set of FIIs who had sold shares after converting the GDRs of the select companies,

ix. a same set of entities who allegedly acted as counterparties to the selling FIIs,

x. During the period January 1, 2009 to December 31, 2010, there were 21 such companies for which Pan Asia was the arranger of the GDR issues and the entity was observed cancelling GDRs and selling shares in Indian Market.

The entity has argued that it is not connected any longer with Mr. Arun Panchariya and he does not take their investment decision and therefore their action should be viewed in isolation. I am not convinced, as the role of the entity is quite central in the manipulative scheme indicated above. The facts given in the Order are sufficient to make a *prima facie* case against the entity that it had a role in the alleged manipulation. As a securities market regulator, SEBI cannot remain irresponsive in the light of such preliminary findings. In the case where the preliminary findings have pointed out to the role of numerous entities, each having a specific role to play, SEBI cannot split the activities of the entity from the other entities. The directions issued vide the Order are interim in nature and were issued on the basis of *prima facie* observations. The investigation would bring out the actual role of each of the entities which would then be considered in accordance with law. Needless to say, if the investigation is not able to find out anything adverse against the entity, appropriate directions would be issued immediately thereafter. It is to be noted that the entity has not been responding properly to the summons issued by SEBI to them. It has been seeking extension repeatedly and whatever information provided by it is insignificant and not complete. As a matter of fact, SEBI is yet to receive full information sought in the summons dated November 28, 2011 from the entity. Such act of the entity is hampering the process of investigation. On the one hand, the entity is seeking relief from SEBI in respect of the Order and on the other hand it is not co-operating in the investigation. The same cannot be justified. The activities of the sub-

accounts including the entity were found to be *prima facie* in violation of the provisions of the Securities and Exchange Board of India Act, 1992, the Securities and Exchange Board of India (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market), Regulations, 2003 and the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995, as mentioned in the Order.

3. Now, I deal with the arguments preferred by the entity. As regards the alleged connection of the entity with Mr. Arun Panchariya, it was submitted that, even at the point of time when Mr. Arun Panchariya was a director, the investment decisions of the entity were taken collectively by its Board of Directors and accordingly the orders for the trades were placed with the stock brokers. It was also submitted that Mr. Arun Pancharia was neither the whole time director nor the managing director of the entity. As the said submission needs to be tested with the findings of the investigations, I am unable at this stage to draw any conclusions. With respect to the submission that there is no allegation of matching of trades in the shares of K Sera Sera Limited at NSE, it is to be noted that the examination by SEBI was carried only for the trades at BSE and therefore, it cannot be inferred that there was no matching/structuring of trades at NSE. I also note that SEBI has provided the trade log with time, order quantity and order rate for each trades between the entity and the group and therefore, the submission that SEBI had not given the details of the trades is incorrect. It is also noted that during the inspection held on November 28, 2011 the print outs of trade logs of the relevant scrips along with order time, quantity and rates, for each trade were provided to the representative of the entity. Further, only in the case of CAT Technologies Limited, the trade log was not having the order time, quantity and rate. With respect to the submission that the entity has different schemes of investments which were referred to as classes and that its strategy of buying GDRs converting the same and selling has been objected to in the Order, it is to be noted that as mentioned in paragraph 40 of the Order, majority of the entity's trading was in GDRs only and in most of the scrips were Pan Asia had been the arranger/lead

manager. Further, examination of the trading activity of the entity revealed that it had purchased shares worth ₹55,29,567/- (3 scrips) and sold shares worth ₹1,96,98,66,428.96/- (19 scrips) during the examination period. Out of this, sale of shares worth ₹2,95,30,96,755.06/- (16 scrips) consisted of scrips where GDRs were issued and the issue was managed by Pan Asia. This would *prima facie* lead to an inference that the entity has been trading in scrips which have been managed by Pan Asia. Trading in other classes of investment by the entity, during the period of examination, were insignificant as compared to its trading activity in GDRs. The entity has also contended that if there was any pre-arrangement for matching of trades between itself and the group then, the matching should be for 100% and not less than that. In this regard, I find that in the Order, the definition of the term 'group' is not exhaustive. There could be others who had purchased shares from the entity/sub accounts and could be part of the group. Only the investigation would identify such persons, if any.

4. As observed in the Order, the entities of the Group have purchased 60% of the shares of Asahi Infrastructure & Projects Limited; 58.7% shares of Avon Corporation Limited; almost 100% of CAT Technologies Limited; 75.66% of shares of IKF Technologies Limited; 59.14% of shares of K Sera Sera Limited and 50.72% of shares of Maars Software international Limited, out of the total shares of those companies sold by the entity. As stated hereinabove, the Group entities have purchased substantial quantities of the shares of the six companies when sold by the entity. The preliminary findings have observed that the said six companies do not have such financial fundamentals to support any investor interest. The entity while referring to Annexure A of the Order submitted that the alleged matching out of 65 instances was less than 10% in 44 instances and went as low as 0.87%. In this regard, it is to be noted that in the Order all the entities of the alleged group were taken as a whole for calculating the percentages of matching of trades with the entity. In a case like this where the observations are that various entities *prima facie* connived with each other, SEBI cannot segregate the role of the entity from the others and on the other hand the case has to be

seen as a whole. Further, the submission that the Order does not show the link or arrangement between the entity and the group is not sustainable. The preliminary findings and the *prima facie* observation in respect of such link/arrangement through Mr. Arun Panchariya has been mentioned in the Order itself and that the documents supporting the same has already been inspected by the authorized representatives of the entity. Thus, at this stage, the *prima facie* inference is that the subscribers to such GDR issues of the companies have been provided an exit from their investments in such illiquid companies. The companies had a common arranger in Pan Asia/Mr. Arun Panchariya for their GDR issues. Further, it has also been found that Mr. Arun Panchariya was a director of the entity and was also its investment manager. It is also pertinent to note that the entity was found to be converting GDRs of all the six select companies and selling the same in the India securities market and the counterparties were found to be the same set of entities from the alleged Group. Such group entities had absorbed majority of the shares of the said six companies sold by the sub-accounts including that of the entity. The trading activities of the entity in the select scrips are not disputed. Its submission is that it was not involved in the alleged manipulation. The Order was passed based on the preliminary findings. The investigation in the matter is in progress and therefore, at this stage, the case will not be decided on merits. The investigation in the matter shall be completed as expeditiously as possible and if the same is not able to arrive at any adverse findings against the entity, appropriate directions would be issued at the relevant point in time. Thus, at this stage, the *prima facie* observations, as detailed in the Order and the circumstances and facts therein suggests of a preponderance of probability that the entity could be part of the alleged manipulation in the matter.

5. The issue before me is to decide whether there are sufficient reasons that the Order dated September 21, 2011 may be allowed to continue. The possible modus operandi adopted by all the seven companies (identified in the Order) follows largely a common pattern; a relatively weak company issues GDRs through an arranger/lead manager in abroad and the issue size is large as

compared to their existing paid up capital (in one case it happens to be as high as 130 times). The proceeds are deposited into a relatively unknown foreign bank which has links with the arranger/lead manager. The GDRs are converted in large number and through select FIIs (including the entity), they are offloaded in the Indian market through certain clients (atleast one of which has got a connection with Mr. Arun Panchariya). Thus, on the face of it, it appears to be a strategy by which the issuing companies in connivance with certain arranger/lead manager/FIIs/counter parties in India managed to create worthless shares which are sold among Indian investors. This is an extremely serious matter involving the very integrity of the issuance process and the Secondary Market. I am also of the opinion that, while confirming the interim order it is not necessary that SEBI should prove the specific violations, at this stage. The investigations are still on. The entity has failed either to show a gross error in the interim order or any other circumstances that will make it impossible for it to be a part of the alleged manipulation.

6. I also note that in the appeal [Appeal No. 193 of 2011-India Focus Cardinal Fund vs. SEBI] filed by the entity, the Hon'ble SAT had directed SEBI to pass an order after affording an opportunity of hearing before the end of this year and to conclude the investigations before the end of February 2012. Further, the entity was also allowed to sell all the securities held by it as enlisted in Exhibits G and J to the appeal and the sale proceeds were directed to be deposited in a fixed deposit with ICICI Bank Limited earning interest. The Hon'ble SAT also observed that the entity shall not be allowed to withdraw monies from that account including interest without the prior permission of SEBI and that in case it wants to utilize any or whole of the sale proceeds, it shall seek the permission of SEBI. The direction regarding sale of securities has been given by the Hon'ble SAT in view of the falling markets to avoid further erosion in the value of the portfolio held by the entity. Therefore, at this stage, the impugned directions issued against the entity stood modified to the extent as directed by the Hon'ble SAT vide Order dated November 21, 2011 in Appeal No. 193 of 2011.

7. In view of the foregoing, I, in exercise of the powers conferred upon me under Section 19 of the Securities and Exchange Board of India Act, 1992 read with Sections 11(1), 11(4) and 11B thereof, hereby direct that the directions issued vide the ad interim ex-parte Order dated September 21, 2011 against India Focus Cardinal Fund, as modified by the Order dated November 21, 2011 (in Appeal No. 193 of 2011) of the Honourable Securities Appellate Tribunal, shall continue to remain in force against the said entity, till further directions.

PRASHANT SARAN
WHOLE TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA

PLACE: MUMBAI
DATE: DECEMBER 30, 2011