

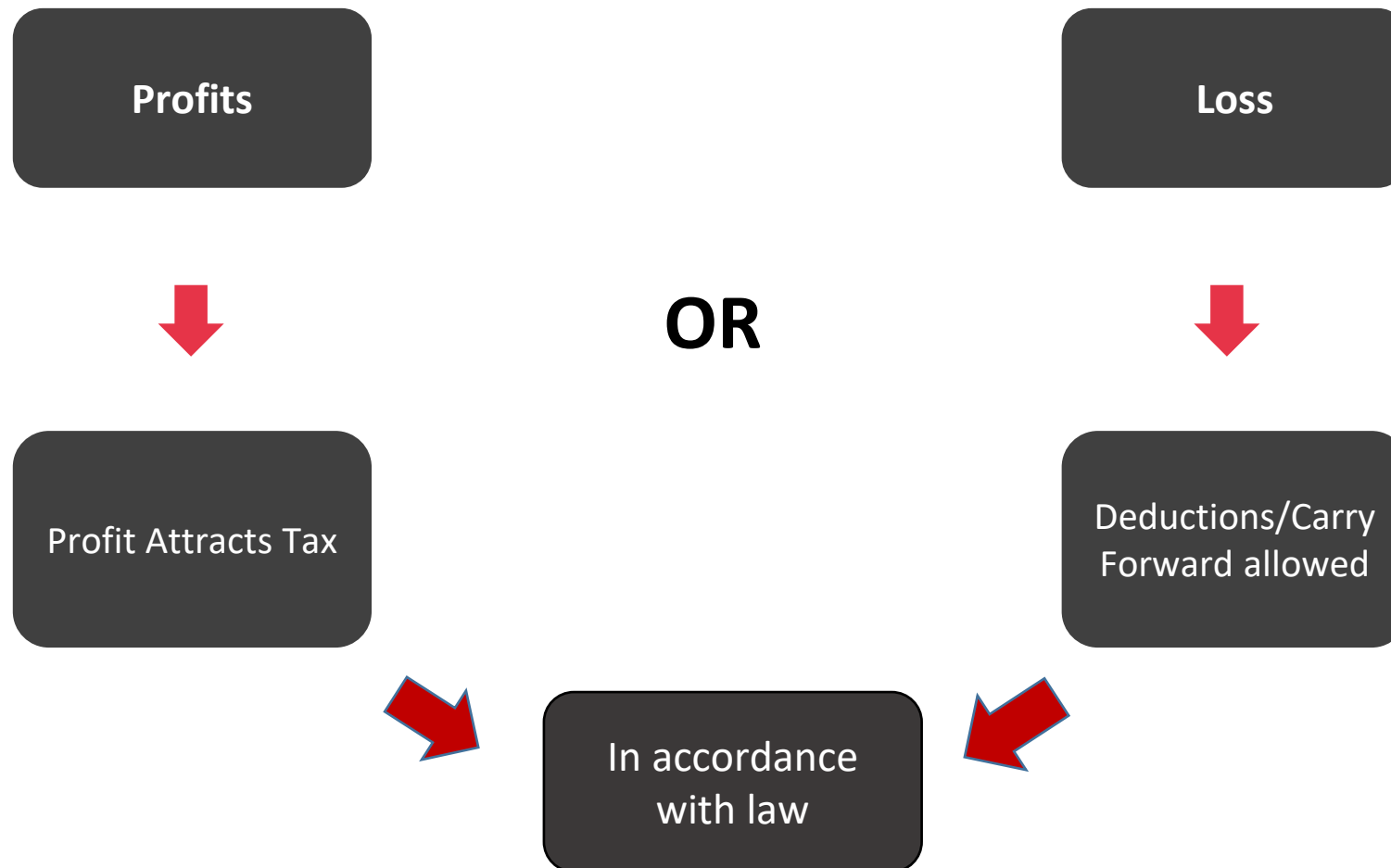


SEBI's SETTLEMENT SCHEME- 2020 REVERSAL TRADING IN ILLIQUID STOCK OPTIONS

Pavan Kumar Vijay

Founder, Corporate Professionals &
Past President, ICSI

Any Economic Activity Results Into Either Of The Following



Disclaimer

This disclaimer informs the participants that the views, thoughts and opinions expressed in the presentation are mine and do not belong to any other person.



Legitimate Tax Planning is Allowed Under Law

**A few Legitimate ways
of Tax Planning that the
law recognizes**



Law Punishes Illegal Tax Planning (i.e. Avoidance)

a few examples of Tax avoidance are given below:

Bogus
Expenses

Sales
Skimming

Booking
fictitious losses

Non-Genuine Trading in Securities Market

PAST CASES

Booking illegal
Long Term
Capital gains

Fictitious Trading
at SME Platform

Trading in
Penny Stocks
having no
strong
fundamentals

NEW METHOD

Trading in illiquid
stock options





What happened in Illiquid Stock options matters?



Trading Pattern in Illiquid Stock Options

Illiquid Stock
Option

Reversal trades

Artificial
Volume

Substantial Price
difference without
any significant basis

Same Counter
Party

Same day/time

Let's understand.. How?



How does Anonymous Trading is executed in the market?

1

Buyer and Seller does not know each other

2

Buyer and Seller enters the **Price, Quantity** in the system.

3

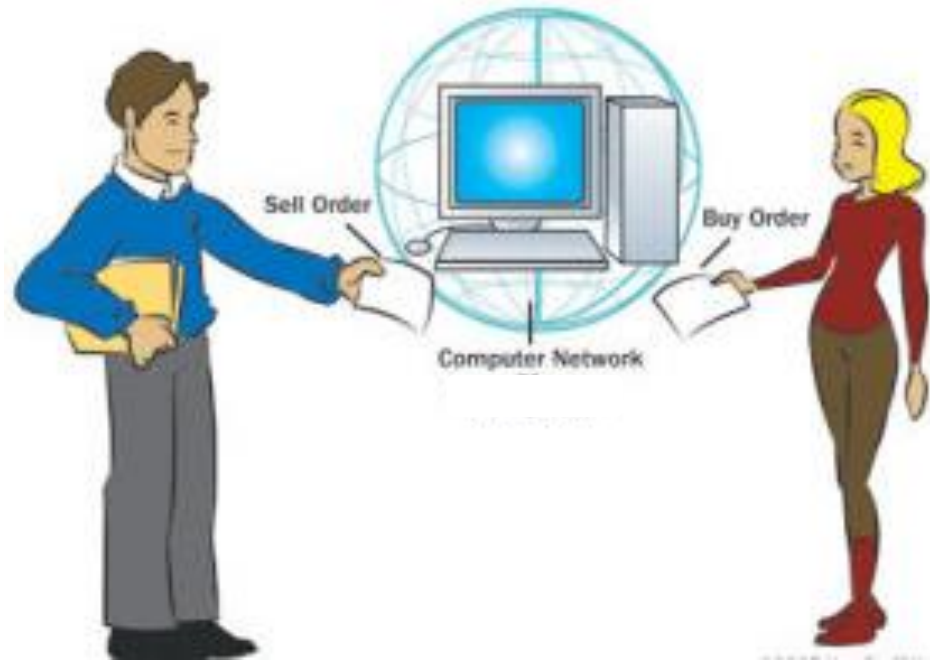
The System matches the orders having same quantity, price and the trade is executed on FIFO bases.

5

Settlement is done and beneficial ownership of shares gets changed.

4

Investors execute trades that are visible in an order book but they don't know who is the counterparty



What is 1-2-3 Transactions i.e. Synchronized Trades?

1

Buyer and Seller known to each other

2

Parties punch Price, quantity in a synchronized manner at a pre-determined time.

3

The chances for executing the trades with each other increases to 90%.

4

The Trades are pre-meditated.



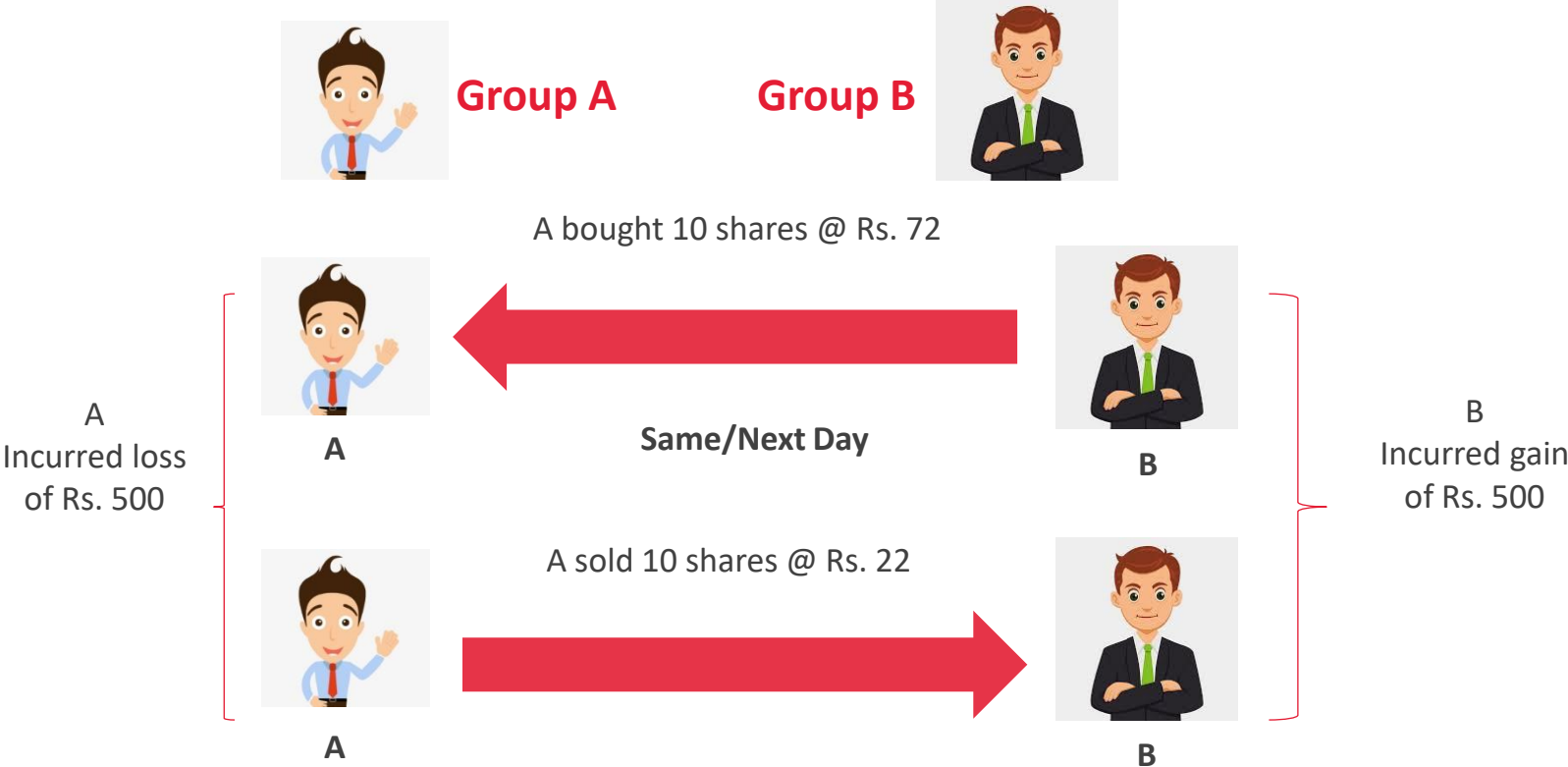
6

To create artificial price/volume of a particular security.

5

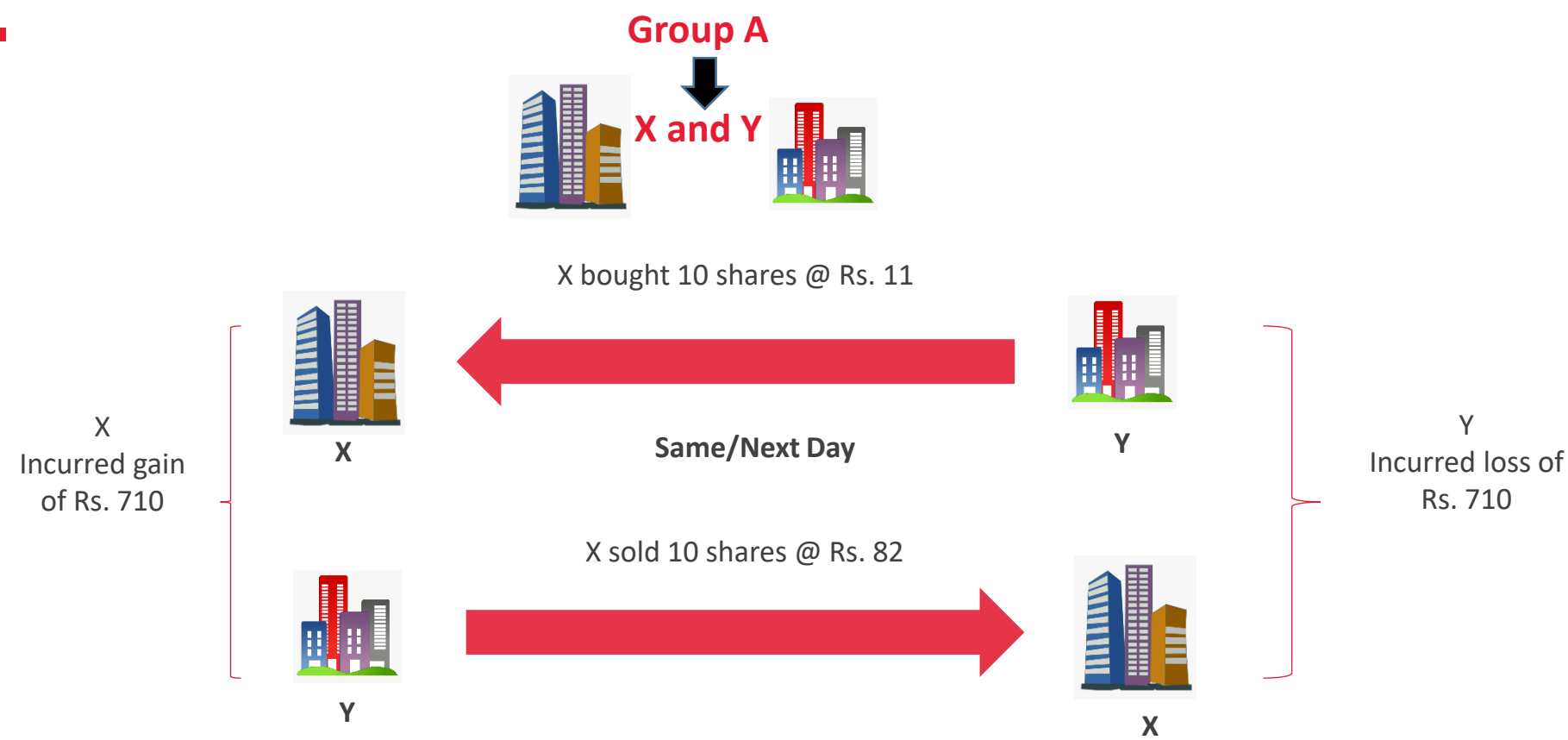
Through these trades, Parties breach the anonymous trading system.

How Reversal trades executed in Different Groups?



The above-said trades are done repetitively by the parties

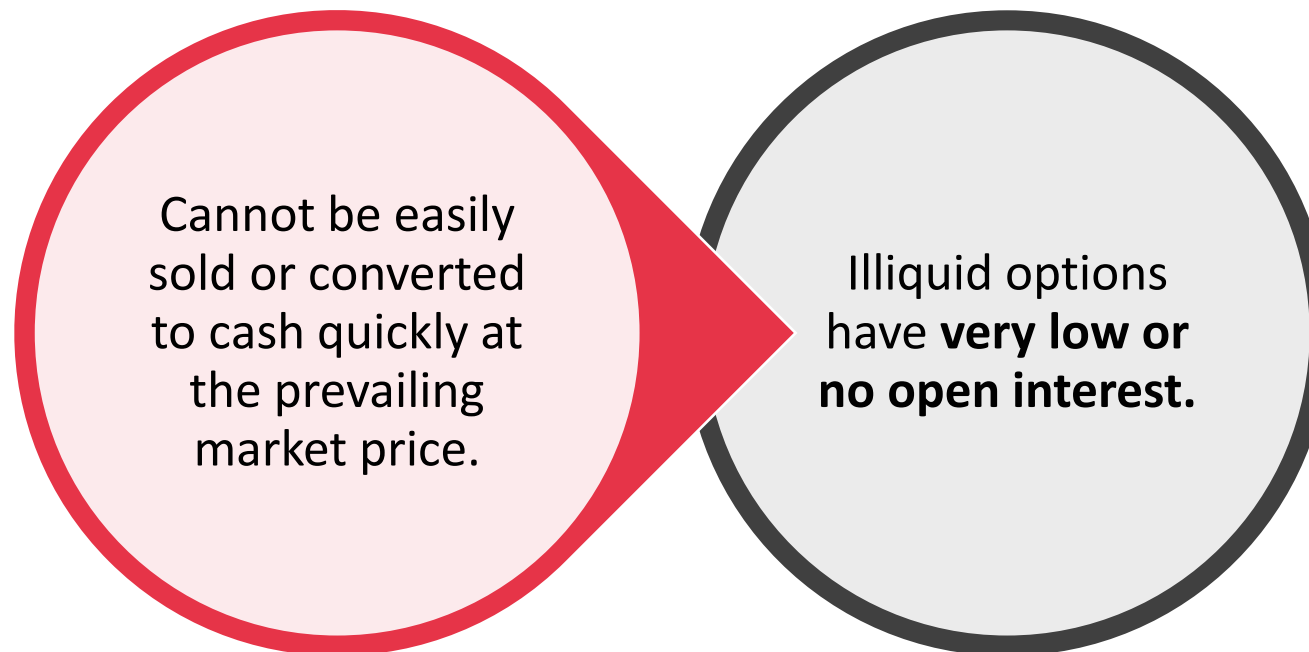
How Reversal trades executed within the Group?



The above-said trades are done repetitively by the parties

What Are Illiquid Stock Options?

An Illiquid Stock option is an option contract i.e. derivative, that—



What Are Reversal Trades?



In illiquid options matter- SEBI alleges that parties did non-genuine reversal trades to make notional/ fictitious gains and/or losses.

The Apex Court in Securities and Exchange Board of India versus **Rakhi Trading Private Ltd. (Civil Appeal no. 1969 of 2011, dated 8th February, 2018)** quoted:

*“Trading is always with the aim to make profits. **But if one party consistently makes loss and that too in pre-planned and rapid reverse trades, it is not genuine, it is an unfair trade practice.**”*

What Is Creation of Artificial Volume Of Trading?

It means enhancing volume of trading in a scrip or derivative via non-genuine trades.

In illiquid options matter- SEBI has alleged that the Parties have executed non-genuine Reversal trades in a synchronized manner to create artificial volume in illiquid stock options to make notional/ fictitious gains and/or losses.



What SEBI has observed in Illiquid options matter?

(Investigation period: April 1, 2014 to September 30, 2015)

- SEBI has observed the following w.r.t. illiquid stock options matter—
 - ◆ Parties misused the anonymous trading system which is the hallmark of Securities Market.
 - ◆ Parties acted abnormally i.e. made consistent losses. No economic rationale behind such transactions.
 - ◆ Trades reversed with pre-arrangement with the Counter party. Minimal time difference between order placement by buyer and seller.
 - ◆ Trades reversed within very short period of time i.e. either on same day or next day.
 - ◆ Trades reversed at differential pricing without having any basis of such increase/decrease.
 - ◆ Trades are non-genuine and aimed at creating fictitious losses and/or gains.



Under which provisions of Securities Laws, the Entities are charged ?



Entities charged under which provision?

Regulation 3, 4(1) and 4(2)(a) of SEBI (Prohibition of Fraudulent and Unfair Trade Practices) Regulations, 2003

The above-mentioned provisions considers any of the following as fraud—

- Buying Selling or dealing in securities in a fraudulent manner.
- Devising any manipulative or deceptive scheme.
- Employing any device, scheme or artifice to defraud in connection with securities market.
- Engaging in any act, practice, course of business which operates or would operate as fraud or deceit upon any person in connection with securities market.
- Knowingly indulging in an act which creates false or misleading appearance of trading in the securities market.

In illiquid Options Matter – SEBI observes that the trades were executed with a pre-determined manner which resulted in artificial/false/misleading appearance of trading in the stock options market. Hence, SEBI observed that such trades were fraudulent in nature and liable for penalty.



Penal provisions for violating PFUTP Regulations



Adjudication Proceedings: Chapter VI-A of SEBI Act, 1992

As per Section 15HA of SEBI Act, 1992

Minimum

Rs. 5 lakhs

Maximum

25 Crore rupees or three times the amount of profits
(Whichever is higher)

QUANTUM OF PENALTY WOULD DEPEND UPON

(As per Section 15J of SEBI Act, 1992)

- the amount of disproportionate gain or unfair advantage, wherever quantifiable, made as a result of the default;
- the amount of loss caused to an investor or group of investors as a result of the default;
- the repetitive nature of the default

Minimum penalty of Rs. 5,00,000 is prescribed for violation of PFUTP Regulations. However, lesser penalty can be imposed by AO, only in those cases where **facts and circumstances so require**.

Also, imposition of **lesser penalty is at the discretion of AO** which is guided by Section 15J of SEBI Act.

Hon'ble Supreme Court of India in the case of Adjudicating Officer vs. Bhavesh Pabari dated 28th February, 2019 (CIVIL APPEAL NO(S).11311 OF 2013)

Prosecution under Sub-section 1 of Section 24 of the SEBI Act, 1992

In addition of penalty imposed by Adjudicating Officer, SEBI may also prosecute a person for contravening the provisions of this Act/Rules/Regulations by doing non-genuine trades in securities market.

Under Section 24 (1) of SEBI Act, 1992 an offence is punishable
with imprisonment for a term which may extend to ten years,
or
with fine, which may extend to 25 crore rupees
or
with both.



Fate of Illiquid Stock Options under Ordinary Settlement Procedure



Indicative Settlement Amount as per Settlement Proceedings (Regulations), 2018

Minimum base amount (Subject to applicable factors) as per Settlement Proceedings w.r.t FUTP violations are as follows:

For Individuals: Rs. 15,00,000 (Approx.)
For Body Corporate & Firm: Rs. 1 Crore (Approx.)

KEY determinants of Settlement Amount	
• FUTP Violation	0.25
• Violation in illiquid scrip	0.3
• Financially benefited	0.25
• Reputation risk	0.25
(applicable in all settlements without admitting violation of securities law).	1.05
and <i>many more</i>	

Entities involved in alleged Reversal Trades



Total entities executed trades on BSE Stock Options Segment
21,652 entities



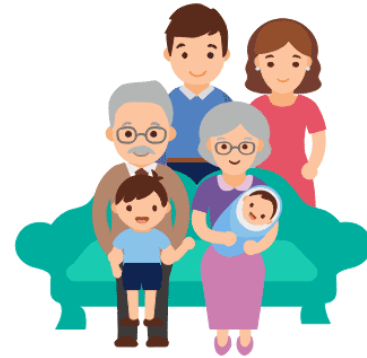
Entities involved in generation of artificial volume by executing non-genuine/reversal trades
14,720 entities
(Including Individuals, HUFs, Body Corporates, Brokers)



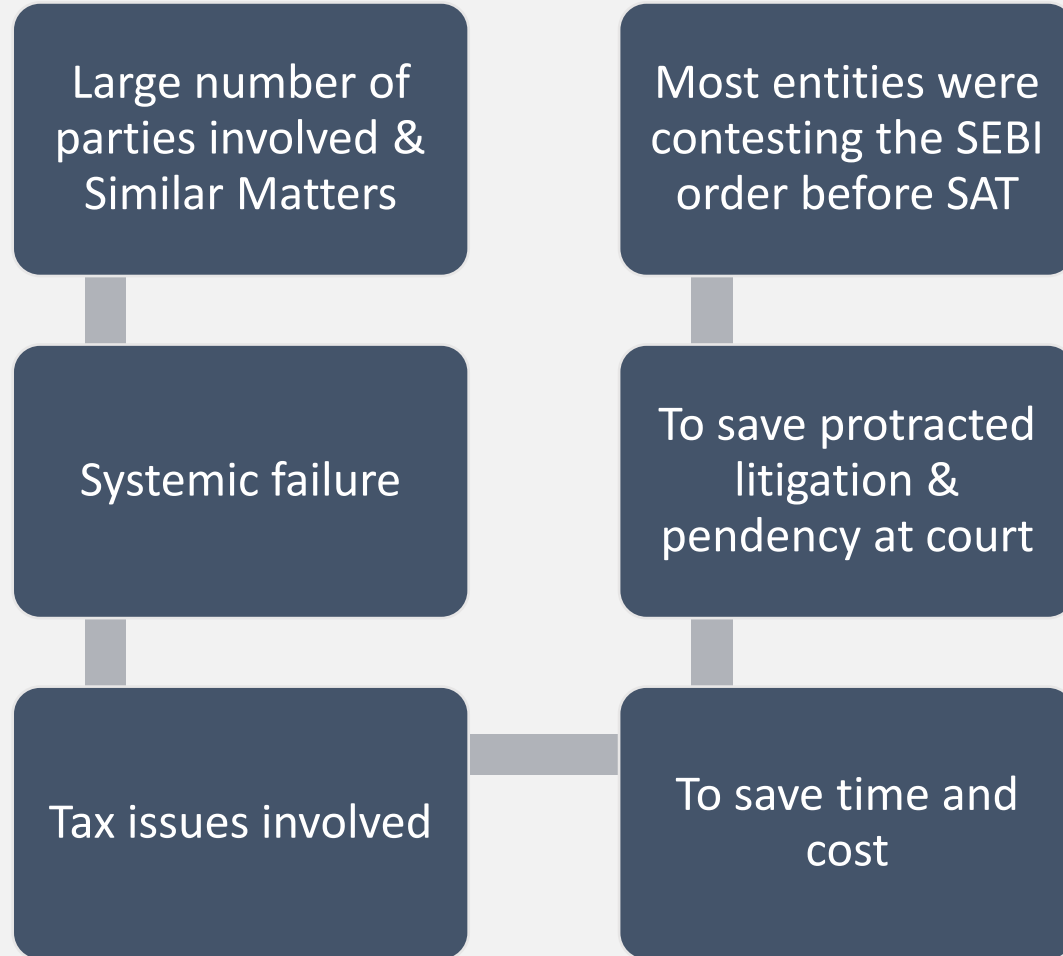
SEBI has initiated adjudication proceedings against **567 entities** and passed order against **100+ entities**.



Approximately 70-80 entities approached SAT challenging the SEBI Order.



Why the Settlement Scheme 2020 ?



The Hon'ble SAT vide its order dated 14th October, 2019 in the matter of **R S Ispat Ltd** vs SEBI directed:

"We are adjourning this matter today, so that SEBI may consider holding a Lok Adalat or adopting other alternative dispute resolution process with regard to the illiquid stock options"

Hence, to settle the proceedings initiated for such entities, SEBI introduced a scheme to settle the matter.

Types of Transactions Involved in Illiquid Options Matter

Non Genuine Transactions

Fictitious Loss

Fictitious Gains

- Trades will be adjudged as non-genuine.
- Will attract face legal actions as well as punishment.

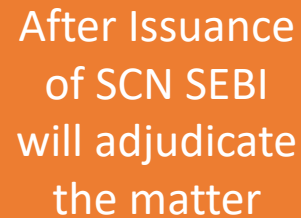
Genuine Transactions (If it is)

- Burden of proof on the party.
- If Date, Time, Price and Quantity of order placement not matching with counterparty, the parties can take the benefit.

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- A. No, the entities who do not avail the one time settlement opportunity shall be liable for action as per law.
- B. Although, the genuine entities can represent their case before Adjudicating Officer in an effective manner and may get relief.



Why there is 'No Option'?



Because Hon'ble Supreme Court and SAT have already observed in cases dealing with illiquid options that trading is non-genuine and is an unfair trade practice under the provisions of securities law.

RS ISPAT LTD. Vs SEBI

Vide order dated 14.09.2020, SAT held that the appeals have no merits and hence dismissed.

Key observations of SAT :

- Buying and selling of equivalent quantities within the day may not be illegal but if the trades were done with ulterior purposes then the same are non-genuine.
- That one party is making a profit and the other party is making a loss.
- There is proximity in the time of sell orders at a higher price and the same quantity is being reversed to the same party in a lower price within a fraction of seconds or few minutes.
- Contracts got matched between the same parties.
- That the trades only had misleading appearance of trading in the securities market without intending to transfer the beneficial ownership.

Relevant portion of Hon'ble SAT's order:

"In our opinion, the trades were non-genuine trades and even though direct evidence is not available in the instant case but in the peculiar facts and circumstances of the present case there is an irresistible inference that can be drawn that there was meeting of minds between the Appellants and the counter parties, and collusion with a view to trade at a predetermined price."

Why there is 'No Option'?

SUPREME COURT OBSERVATIONS

The Apex Court in Securities and Exchange Board of India versus Rakhi Trading Private Ltd. (Civil Appeal no. 1969 of 2011, dated 8th February, 2018) quoted:

“Trading is always with the aim to make profits. But if one party consistently makes loss and that too in pre-planned and rapid reverse trades, it is not genuine, it is an unfair trade practice.”

Supreme Court quashed the SAT Order and upheld the penalty of Rs. 1.8 Crores imposed by SEBI on Rakhi Trading under Section 15HA of SEBI Act, 1992.



The Apex Court in **SEBI v. Kishore R. Ajmera** in Civil Appeal No. 2818 of 2008 observed *SEBI can penalize Securities fraud/ Manipulation in cases where direct/clinching evidence is not available, by applying the test of preponderance of probabilities i.e. taking into account the surrounding facts and circumstances of the case including but not limiting to the conduct of the person concerned.*



SETTLEMENT VS. ADJUDICATION



Comparison of Penalty Imposed and Settlement Amount

PARAMETRES FOR CALCULATION OF SETTLEMENT AMOUNT

- Number of contracts
- Number of non-genuine trades
- Quantum of artificial volume created
- Settlement factor of 0.55 is applicable

Minimum Settlement Amount Rs. 5,00,000
(As observed from the trend of Scheme)

FACTORS FOR ADJUDGING QUANTUM OF PENALTY

- Number of contracts
- Number of alleged non-genuine trades.
- Quantum of artificial volume created and Frequency of trades.
- Rationale behind the transaction.
- Unlawful profit incurred or loss avoided.
- Impact on the market.
- Conduct of the Noticee.

Minimum Penalty Amount: Rs. 5,00,000 subject to AO discretion*

Maximum can go upto 25 Crores or 3 times the profit earned
(As prescribed under SEBI Act)

*Decided in civil appeal no(s).11311 of 2013 Adjudicating Officer Vs. Bhavesh Pabri

Settlement Amount as Calculated under the Scheme

S.No.	No. of contracts reversed	No. of non-genuine trades executed	Artificial volume of trades	Settlement amount
1.	83	492	2,75,50,000	33,57,500
2.	210	512	1,21,77,000	39,77,500
3.	165	612	2,55,25,750	39,77,500
4.	1672	4968	30,70,27,560	83,17,500



Comparison of Penalty Imposed and Settlement Amount

Entity Name	AO Order Date	No. of Contracts	Number of non-trades	Artificial Volume	AO Penalty	Settlement Amount
Greencrest Financial Services Limited	27.08.2019	4	8	8,70,000	5,00,000	6,97,500
Blackcherry Commosale Pvt Ltd	21.12.2018	26	86	1,45,05,000	5,50,000	20,92,500
Rector Investments Private Limited	13.06.2019	118	2319	21555500	19,50,000	39,52,500
R.S. ISPAT Limited	27.11.2018	105	220	1,78,71,514	25,00,000	31,77,500
Matri Mangal Trading Private Limited	29.03.2019	133	1792	1,56,33,250	50,00,000	37,97,500

Source: <https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html>

Conclusion

Parameters	Settlement Scheme	Adjudication proceedings
Monetary liability	Ranging from: 5 lakhs to 80 lakhs	Minimum INR 5 Lakhs Maximum – Upto INR 25 Crores or 3 times the amount of profits (Penalty imposition will depend on merits of each case)
Filings	<ul style="list-style-type: none"> • Payment of Settlement Amount • Filing of application with prescribed documents. 	<ul style="list-style-type: none"> • Detailed reply and corroborating material and evidence. • Representation before AO.
Timely Completion	Proceedings will be concluded in a timely manner.	Not determined; generally SEBI takes 6-7 months in concluding the proceedings.
Cost	High One time monetary cost.	Lower monetary cost than Settlement. But may pose graver consequences in the longer run.
Penalty/SA paid will be allowed as business Expenditure under Income Tax?	May be	No

Trend Analysis of Settlement Amount under the Scheme

Total
14,720 entities

Approx. 13,248 entities
(90% of 14, 720)
SA Range- 5 to 10 lakhs

Approx. 6624 entities
(50% of 13,248 entities)
SA Range- Rs. 5,50,000

FUTURE CONSEQUENCES

SETTLEMENT

- No finding of fault by SEBI, since the Application can be filed without acceptance of guilt.
- Entities may face action from other regulatory authorities, but they have to investigate independently since, there would be no finding of SEBI against the party.

ADJUDICATION

- In case of penalty imposed by SEBI, Parties will be adjudged violating FUTP regulations and Trades will be considered as **non genuine**.
- This may result into initiation of various proceedings by SEBI under Section 24 of SEBI Act.
- Parties may also face legal action from other authorities.

FICTITIOUS PROFIT/LOSS AND ITS REVERSAL

Prevention of Money Laundering Issues

**SECURITIES FRAUD IS A
SCHEDULED OFFENCE
UNDER PMLA, 2002**

CONCLUSION



THANK YOU

Pavan Kumar Vijay

Founder, Corporate Professionals &
Past President, ICSI
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Procedural Aspects of the Scheme



What is the new Settlement Scheme of SEBI ?



- **One time Settlement Scheme** under Regulation 26* of Settlement Proceedings Regulations, 2018.
- First of its kind scheme made by SEBI under Settlement Regulations.
- Available to the entities involved in **“trading in illiquid stock options”** segment at BSE.

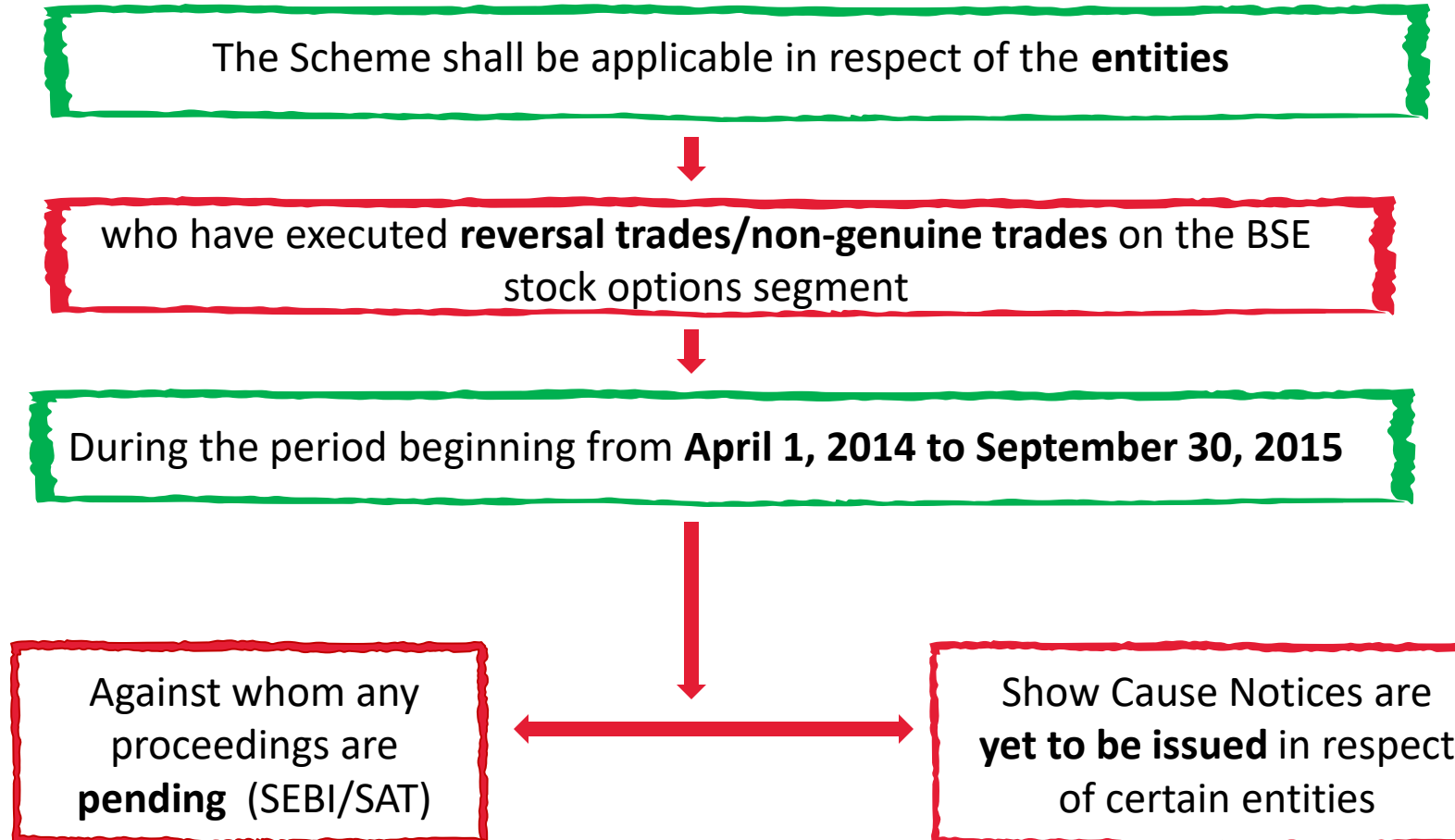
**Regulation 26 is the empowering Regulation under SEBI Regulations which enables SEBI to come out with Schemes, similar to above-said, from time-to-time.*



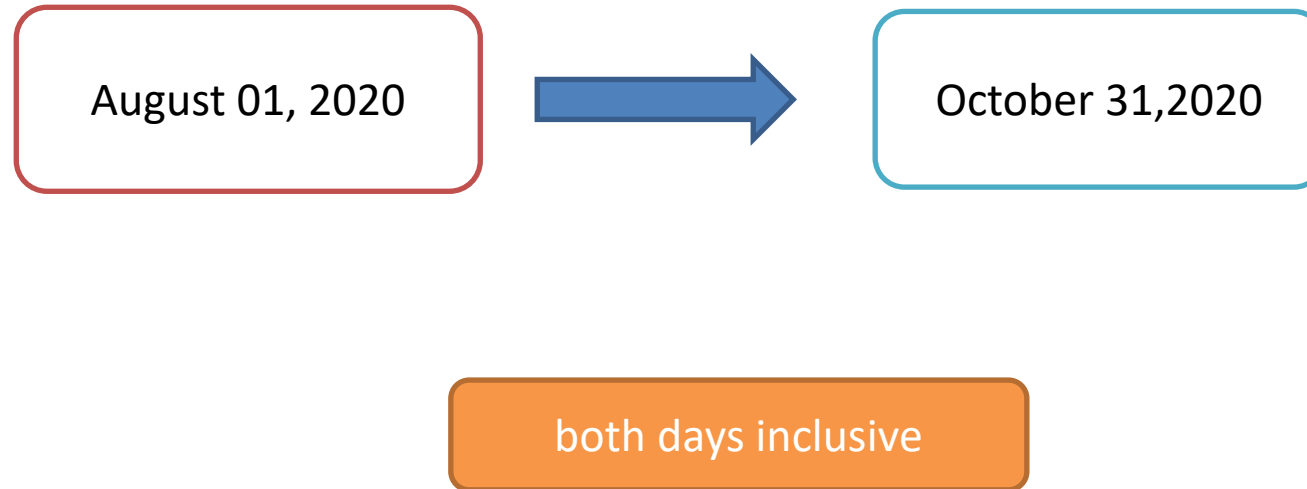
Salient features of Settlement Scheme



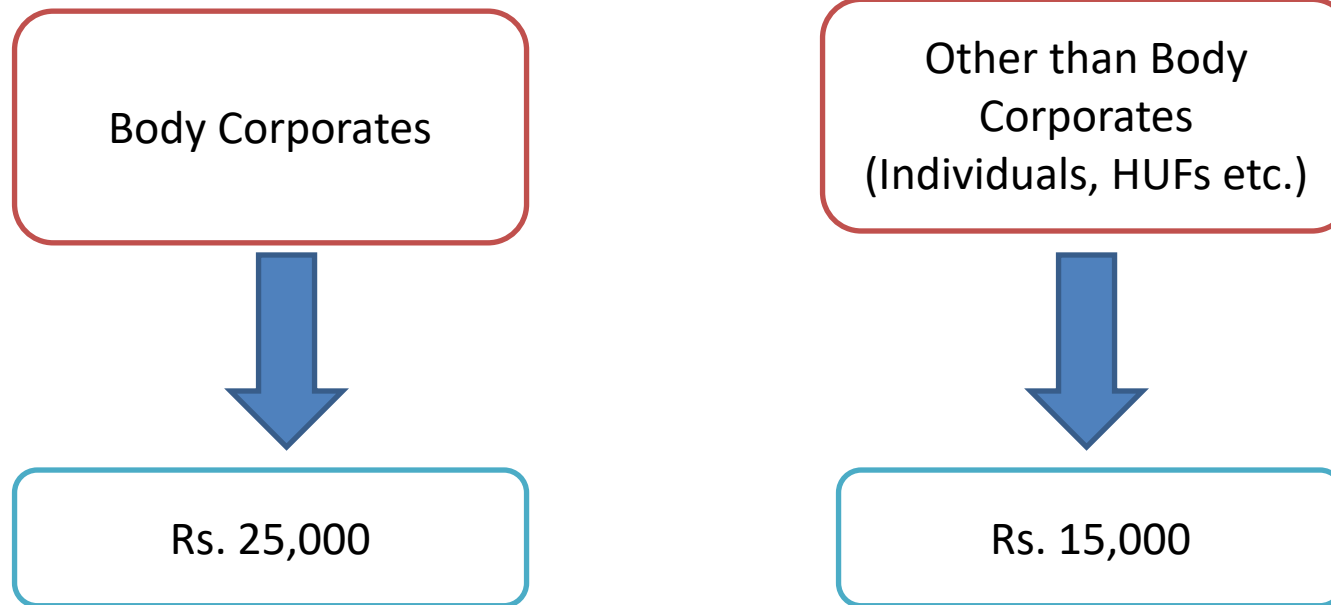
Eligibility



Validity of the Scheme



Application Fees as applicable



SEBI **may collect legal charges** in addition to the aforesaid amount in respect of the cases which are before the Hon'ble Securities Appellate Tribunal or before any other Court.

Determinants of Settlement Amount

Settlement Parameters

- Number of contracts,
- Number of non-genuine trades
- Artificial volume created

Settlement Factor

- A uniform consolidated **Settlement factor of 0.55** in all cases wherein the entities had executed reversal trades.

Parameter	Settlement Factor
Violation in Illiquid Scrip	0.3
Reputation Risk (Non-admission of guilt)	0.25

Procedure of availing Settlement

1

Access the Sebi online portal

<https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html>

2

Check your Settlement amount

Continued



Screenshot of Portal

Entity Name:

Entity Type:

Body Corporate

Number of contacts reversed:

528

Number of non genuine trades:

1151

Artificial volume of trades:

28713000

☒ I agree to the general terms and conditions, the terms and conditions of the scheme, the undertakings and waivers (standard format) and also agree to conform to the SEBI (Settlement Proceedings) Regulations, 2018.

Undertaking and Waivers:

Choose File

No file chosen

PAN Card:

Choose File

No file chosen

ITR for last 3 Years:

Choose File

No file chosen

ADD ATTACHMENT

Settlement Amount:

4727500

☐ Payment Due

Registration Fee:

25000

☐ Payment Due

Total Amount:

4752500

Continued



Procedure of availing Settlement

3

Submit following documents Online

<https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html>

PAN Card

- Scanned Copy
- Self Attested

Income Tax Returns

- Scanned Copy
- for the last 3 financial years.
- Self Attested

Undertaking and Waivers

- Format to be as specified in Part-C of Schedule I of SEBI (Settlement Proceedings) Regulations, 2018.
- Scanned Copy
- Non- Judicial Stamp paper of Rs. 200.
- Duly notarized and Stamped
- Can be filed **“without admission of guilt”**.

Continued



Undertakings and Waivers

I/We,, the applicant(s) herein, as a condition for making the enclosed application to the Board for examining and consideration of the application, hereby declare that I/we agree and undertake that:

- (1) I/We admit the jurisdiction and right of the Securities and Exchange Board of India to initiate appropriate proceedings in respect of the alleged default.
- (2) I/We further agree and undertake that the time spent during the settlement proceedings shall be excluded for computing the limitation period or laches, if any, for initiating or continuing or restoring any legal proceedings, if any, against me/us, and waive any objections in this regard.
- (3) The Securities and Exchange Board of India may enforce any claims against me/us arising from or/in relation to any violation of the settlement order passed pursuant to this application.
- (4) Nothing in the settlement order shall preclude any other person from pursuing any other legal remedy to which such person may be entitled against me/us as per law.
- (5) The settlement proposed by me/us does not limit or create any private rights or remedies for any person who is not a party to these proceedings, against me/us.

Continued



Undertakings and Waivers

- (6) The settlement amount including legal costs, if any, shall be paid by me/us to the Board within the period stipulated by the Board.
- (7) The settlement order shall be construed and enforced in accordance with the Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018, as amended from time to time.
- (8) I/We agree that subsequent to the passing of the settlement order, I/We shall not take any action or make or permit to be made any public statement denying, directly or indirectly, any finding of the Board including that recorded in the settlement order or creating impression that the settlement order is without factual basis.
- (9) I/We hereby declare that nothing in the waiver and undertaking given by me/us shall affect my/our (i) testimonial obligations, or (ii) right to take legal or factual positions in defence of litigation or in defense of a claim or in any other legal proceeding in which the Board is not a party.

(10) I/We for the limited purpose of settlement under these regulations 'admit the findings of fact and conclusions of law' or 'neither admit nor deny the findings of fact and conclusions of law' (strike off whichever is not applicable), and agree to abide by the settlement order as may be passed in accordance with the Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018 and guidelines and circulars issued by the Board in that regard:

Provided that, in relation to defaults related to disclosures other than relating to a prospectus or a letter of offer or a similar such document required to be made in relation to an issue of securities, I/we do not deny the alleged default.

Continued



Procedure of availing Settlement

4

Payment on the online Portal

<https://siportal.sebi.gov.in/intermediary/AOPaymentGateway.html>

- **Non-refundable Settlement Application processing fees (individual or body corporate as the case may be)**
- **Payment of the settlement amounts as displayed in respect of each of the applicants**

**preserve the receipt /screenshot of online payment.*

Continued



**As per existing norms, the
online submission of
documents and payment has
to be complete by
31st October 2020**

Continued



Procedure of availing Settlement

5

Post making Online payment and submissions of documents online, **physical filing of Settlement Application** in prescribed format (*As per schedule 1 of Settlement Regulations*) is needed along with documents already submitted.

Continued



Format of Settlement Application

1. Name/Trade name of the applicant/co-applicants:

(a) Registration no., if applicable :

(b) Date of Registration, if applicable :

(c) PAN/DIN/CIN number, as available:

(d) Paid-up capital of applicant:

2. If stock broker, name of the stock exchange:

3. If sub-broker/authorised person, name of stock broker with whom affiliated and name of the stock exchange:

4. Name of the segment (Cash/derivative etc.):

5. Form of organization: corporate body/ sole proprietorship / partnership / LLP/ financial institution (if listed co., details of listing):

6. Names of promoters/directors/proprietors/partners:

Continued



Format of Settlement Application

17. Full and true disclosure of facts (including the loss caused, profit made, loss avoided, gross fees, brokerage, commissions, etc., in respect of the cause of action, with manner of calculation thereof):

[APPLICANT TO TAKE INTO ACCOUNT THE GUIDELINES PROVIDED IN SCHEDULE-II]

18. Specific charges alleged:
19. Submissions in respect of sub-regulations (2), (3) & (4) of Regulation 5:
20. Terms of settlement proposed by the Applicant:-
 - (a) Monetary terms, with manner of calculation:-
 - (b) Non-monetary terms, including manner of calculation of terms of disgorgement due:-
21. Original documents to be enclosed:
 - (a) Undertakings and waivers (as per Format specified in Part C).

Continued



Format of Settlement Application

7. Key management personnel(s):
8. Address/correspondence address, contact no./fax no. and email (any changes in aforesaid details shall be communicated to the Board promptly):
9. Name and contact details (including e-mail) of the contact person (s):
10. Other registration(s) with the Board, if applicable:
 - (a) Trade name :
 - (b) Registration type :
 - (c) Registration no. :
11. Case(s) pending with the Board/SAT/Court (Pl. specify):
12. Case(s) pending under 11B/Adjudication/Enquiry/others (pl. specify):
13. Stage at which pending:
14. Interim order(s) in the pending proceedings (gist of the orders passed), if any:
15. Other actions pending with/concluded by the Board, if any (with their details):
 - (a) Against the applicant :
 - (b) Against its associates :
 - (c) Against its key management personnel(s) :
 - (d) Against its other promoters/directors:
 - (e) Other details, if any:
16. Date of show cause notice/summons/communication indicating probable cause of action, if any, against which the settlement is sought (PLEASE ENCLOSE COPIES)*:

****Applicants can also add their defenses and mitigating factors while making submissions in the form***

Continued



Documents needed to be filled with Application Form

1. A copy of the **self-attested copy of the PAN Card** of the applicant.
2. The **undertakings and waivers** in Non-judicial stamp paper, duly notarised and stamped duty duly paid.
3. Self-attested **copies of the Income Tax Returns** of the applicant for the last **3 financial years**.
4. A self-attested **copy of the payment of Settlement Application processing fees**.
5. A self-attested **copy of the payment of the Settlement Amount**.

Continued



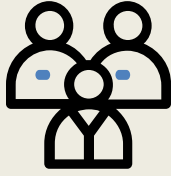
**As per existing norms, the
physical submission of
documents has to be
completed by
5th November 2020**



Post submissions of documents



What after availing Settlement Scheme?



01

A **composite settlement order** would be passed by the competent authority after reconciliation of records.



02

Settlement order shall be construed and enforced in accordance with the Securities and Exchange Board of India (Settlement Proceedings) Regulations, 2018, as amended from time to time.



Some basic queries to address



What if the one-time settlement scheme is not availed?



ENFORCEMENT ACTION

The entities who do not avail the one-time opportunity for settlement within the prescribed period, **may be subjected to enforcement actions including Adjudication proceedings and imposition of monetary penalties.**

Can I challenge the settlement Amount?



NO

The proceedings are voluntary and cannot be challenged at any appellate forum.

I do not have the details of my trades executed?



TRADE DETAILS

If trading detail is not received by you along with the Settlement Notice, the copies of the same can be asked from SEBI.

Key points to be kept in mind for the entities

- Analysis of facts and circumstances of your matter.
- Comprehend whether it is feasible to go for Adjudication or Settlement.
- Effectively represent all the mitigating factors while representing your case in Adjudication and Settlement proceedings.
- Prepare your case on the basis of the following:

Facts

Issues

Grounds

- Implication of Income Tax proceedings upon the matter.

No factors can be overlooked by the parties

THANK YOU

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