How did a spot exchange become a futures one?

Given that the Mumbai police has arrested Jignesh Shah, presumably it feels it has enough on his role in the R5,600 crore National Spot Exchange Limited (NSEL) scam. Apart from the Grant Thornton forensic report that suggested Shah was fully aware of the goings on in NSEL, former CEO Anjani Sinha has also said as much repeatedly, after he recanted his statement that he and his team alone were responsible for the scam—apart from Sinha, 8 others were arrested before Shah, and many more interrogated over several months. And given how, though an exchange cannot possibly be selling financial products to investors, various brokers were marketing NSEL products to their clients, the Mumbai police has said it is also investigating the role of brokers. Since most of the trades on NSEL were synchronised ones, the role of the brokers is critical.

COUNTDOWN TO SHAH'S ARREST

July 12, 2013: NSEL told to stop all new contracts

July 31: NSEL puts off settlement by15 days

August 20: NSEL sacks CEO Anjani Sinha

October 1: EOW files FIR in NSEL case

October 5: FMC questions FTIL 'fit and proper' status

October 17: NSEL ex-CEO Anjani Sinha arrested

October 20: Shreekant Javalgekar quits MCX

October 31: Jignesh Shah resigns from MCX board

December 18: FMC deems Shah/FTIL not fit & proper

January 6, 2014: Police file NSEL charge sheet

March 13: CBI files case against NSEL

March 20: Sebi strips FTIL of 'fit and proper' status

THE EVIDENCE

While Shah blamed the ₹5,600-cr NSEL scam on ex-CEO Sinha, Grant Thornton report found Shah was complicit

- Shah at board meetings of March and August, 2010 where NSEL got credit facilities for NK Proteins to cover trading shortfall
- Shah at May board meeting when same thing done for IBMA
- Settlement fund used for NSEL's business
- Back-to-back trades suggested para-banking — illegal for an exchange
- Key risk committees never set up. Manual reporting helped to alter transaction details
- Internal audit of 2011 by Mukesh P Shah given to NSEL board confirmed para-banking activity
- PwC found NSEL-type manual reporting on MCX, critical alerts disabled
- Paired-trades of NSEL type also found on MCX

What is important, however, is to also focus on the events that led to NSEL being able to convert from a simple commodity exchange—and a spot exchange at that—to one where financial products were on offer. The way it worked was simple. Trader A sold wheat, say, to trader B; trader B, in turn, sold this wheat back to trader A, but to be delivered at some time in the future—the difference in the price was the interest rate. All contracts were executed simultaneously, to ensure all parties had legal paperwork to protect their interests.

The obvious question, of course, just as in the case of Sahara and Saradha, is how NSEL managed to fly under the radar for so long. This is where the role of the ministry of consumer affairs comes in. As long as clients couldn't sell 'futures', and you can't on a spot exchange, there was no problem. But in June 2007, the ministry came up with an exemption under the Forwards Contract Regulation Act and allowed NSEL what it called 'forward contracts of one-day duration'. This is what allowed a spot exchange to convert into a futures one; and since a spot exchange is not regulated by the Forwards Markets Commission, this allowed NSEL to remain unregulated. How was this allowed to happen and why did no one pay any attention?