

SECURITIES AND EXCHANGE BOARD OF INDIA

WTM/GA/1/ISD/5/05

ORDER

IN THE MATTER OF UBS SECURITIES ASIA LTD. UNDER SECTION 11(4) AND 11B OF SEBI ACT, 1992, READ WITH REGULATIONS 15A, 20 AND 20 A OF SEBI (FOREIGN INSTITUTIONAL INVESTORS) REGULATION 1995 AND CLAUSES 1, 2, 5 AND 6 OF CODE OF CONDUCT AS SPECIFIED IN REGULATION 7 A OF SEBI (FOREIGN INSTITUTIONAL INVESTORS) REGULATION 1995

1.0. BACKGROUND

1.1. On May 17, 2004, there was steep fall in the Indian stock market (Sensex fell by 567.74 points; NIFTY fell by 196.90 points; Intraday Sensex fell by 842 points). Such a steep fall in the stock market resulted in temporary stoppage of trading twice on major stock exchanges viz. BSE and NSE, during the day. It was unprecedented in the recent history. In view of the crash in the Indian securities market on May 17, 2004, Securities and Exchange Board of India (hereinafter referred to as 'SEBI' or 'the Board') examined the dealings in securities by various entities on May 17, 2004 duly taking into account the developments in the Asian market.

1.2. It was found that on May 17, 2004, UBS Securities Asia Ltd. (hereinafter referred to as 'UBS') which is a SEBI registered Foreign Institutional Investor (FII) (Registration No. INHKFA060600) dealing through its SEBI registered proprietary sub-account Swiss Finance Corporation (Mauritius) Ltd. (hereinafter referred to as 'SFCML') sold in the Cash Market segment to the extent of Rs.188.35 crores (gross). As on May 14, 2004, the equity portfolio of UBS was to the tune of Rs. 2956 crores.

As on May 14, 2004, it had built up NIFTY Futures short positions to the tune of Rs.434 crores and stock Futures short positions to the tune of Rs.292 crores. Thus, UBS was a significant participant in the cash as well as the derivatives (F&O) segment of the Indian securities market during May 2004.

1.3. Information was called for from UBS, which was amongst the largest sellers in the cash segment on May 17, 2004. While initially, UBS informed SEBI on May 27, 2004 that all the transactions were on their proprietary account, subsequently UBS revealed that it had also sold large value of securities on May 17, 2004 on behalf of various entities to which its affiliate, namely, UBS AG, London had issued Off-shore Derivative Instruments (ODIs) with underlying Indian securities. It was suspected that the steep market fall on May 17, 2004 could have been triggered as a result of UBS playing ducks and drakes with the market, accentuating the selling pressure for no reason linked to the fundamentals of scrips or their performance. SEBI decided to ascertain the details of ultimate beneficiaries to whom the ODIs were issued by UBS / its affiliate and whose transactions resulted in the large scale sale by UBS on May 17, 2004. Accordingly, SEBI decided to investigate whether the gravitas of happenings on May 17, 2004 and the conduct of players on that day, including UBS resulting in the market literally keeling over gave rise to violation of SEBI (Prohibition of Fraudulent and Unfair Trade Practices Relating to Securities Market) Regulations, 2003 and other regulatory requirements.

1.4. During the course of investigation, SEBI called for further information from UBS relating to its major ODI clients in terms of their addresses, the names of their directors, fund managers, major shareholders, top five investors etc. UBS initially did not furnish the information citing reasons such as client confidentiality etc. Subsequent to repeated follow-ups by SEBI, UBS started furnishing bits and pieces of information relating to some of its ODI clients. These details were furnished by UBS over a period of many months and subsequent to repeated requests / reminders by SEBI on pain of regulatory consequences. Even then the information furnished was found to be incomplete and despite repeated requests, SEBI was unable to obtain the

requisite information, with UBS remaining parsimonious in providing the information sought.

1.5. By indulging in the putative transactions UBS might have earned substantial gains. Further it was suspected that the said gains might have accrued to UBS due to unprecedented wave of sale in the cash market with its cascading effect of depressing the cash as well as futures market, with the concomitant favourable impact on the short positions in the futures segment held by it. The data obtained from UBS reveals that, while UBS incurred a loss of Rs.17.54 crores on May 17, 2004 on account of its sale in the cash segment, its short positions in Futures (derivative) segment earned it a mark to market credit (amounting to the profits earned on account of the short positions in the futures segment) of Rs.59.37 crores resulting in a net gain of Rs.41.83 crores.

1.6. In such a context of suspected interference with the market equilibrium by UBS, it was felt that the repeated failure of UBS to give the complete information as sought for, raised serious regulatory concerns besides hampering investigation. In the above background, SEBI issued a show-cause notice to UBS.

2.0. SHOW CAUSE NOTICE

A detailed show-cause notice dated November 24, 2004 was issued to UBS, inter-alia alleging the following:

2.1. Investigations found that the dealings of UBS in Cash and F&O Segment at BSE/NSE were done on behalf of its clients which were mostly Hedge Funds as well as in the proprietary account of UBS. During the course of investigations, SEBI, inter alia, sought the names of major shareholders and names of top 5 investors in respect of the major clients of UBS. They were also advised to confirm that none of the major investors of its clients are Indian nationals, persons of Indian origin or overseas

corporate bodies (which are majority owned or controlled by non resident Indians).

2.2. In reply, UBS vide e-mail dated August 7, 2004 stated that they had written to each of the investment managers for the investment funds that were identified in SEBI's e-mail dated 30 July 2004; and have requested to provide UBS Securities with information in relation to their trading during the relevant days in May 2004 and whether the investment funds have "major shareholders"; they have classified a major shareholder as any one person or entity that owns in excess of 20% of the shares in the fund. Alternatively, they have advised that responses may be sent directly to SEBI.

2.3. UBS sought an extension of time for their response to be submitted to SEBI to Wednesday, 11 August 2004 stating that the majority of investment managers are located in North America and Europe, who must review this matter and seek their own internal approvals wherever necessary.

2.4. They further stated that some of the investment managers may not be able to respond due to confidentiality constraints. They assured that UBS was using its best endeavors to ensure that responses are received from the investment managers where possible.

2.5. However, in respect of many of the clients, UBS has failed to furnish the above information sought by SEBI citing reasons like confidentiality provisions in the client agreements. I note that the show-cause notice has alleged that, despite SEBI seeking the information, the following information has not been received from UBS with respect to its clients, at the time when the show-cause notice was issued.

Sl No	Counterparty Name	Information not provided by UBS.
1	Caxton International Limited	Specific details of the shareholders

Sl No	Counterparty Name	Information not provided by UBS.
2	Indus Asia Pacific Fund Ltd	Expressed inability to disclose the name and addresses of the top 5 investors for investments in Indian securities during May 2004, directors and major shareholders pursuant to the fund's organisational documents.
3	ROHATYN	Declined to reveal information on the investors and shareholding.
4	Indea Capital Pte Ltd.	Did not release the names of top 5 investors to SEBI.
5	PMA Prospect Fund	Declined to furnish the names and addresses of top 5 largest investors in the funds citing reasons of confidentiality.
6	Sattva Asia Opportunities Master Fund	Declined to provide the names of investors of the fund.

2.6. Further, UBS vide their earlier email dated September 09, 2004 in response to a query by SEBI, inter alia stated as below:

“In relation to your request to provide a confirmation that none of the entities referred to in your note have investors that are *"...Indian nationals, Persons of Indian origin or Overseas Corporate Bodies (which are majority owned or controlled by Non-Resident Indians)"*, such a request seems to be inconsistent in the context of the scope of the FII Regulations. By requesting UBS Securities to provide such a confirmation there is the assumption that you are relying on a regulation that restricts an FII from entering into an 'Offshore Derivative Transaction' with a fund that may have a shareholder who is an Indian National, NRI, PIO or OCB. We would appreciate your clarification that the FII regulations prohibit an FII from entering into an 'Offshore

Derivative Transaction' with a fund that may have a shareholder who is an Indian National, NRI, PIO or OCB?

In relation to your request to provide the names of "*...major shareholders / investors of the said 5 clients*" - apart from Swiss Finance Corporation (Mauritius) Limited, our clients are extremely unlikely to provide this information to UBS Securities due to client confidentiality. Furthermore, the entities you have listed have relationships with multiple FIIs and it seems that a request for the same information should come from a central source. Whilst UBS Securities seeks at all times to comply with requests from our regulators, in our view, on this occasion it may be appropriate for SEBI to solicit such information directly from these entities rather than through UBS Securities. Alternatively, it may be appropriate to solicit details of shareholders through SEBI's relationships with regulators in the location that the fund operates."

2.7. Further to the above, SEBI vide e-mail dated September 14, 2004, once again advised UBS to obtain from the three clients viz. Sattva Asia Opportunities Master Fund, PMA Capital Mgmt Ltd.A/c PMA Prospect Fund and Indea Capital Pte Ltd. A/c Indea Absolute Return Fund, details of the names and addresses of their major investors / shareholders, the names and addresses of their top 5 investors (in terms of value invested) and a confirmation that none of the major shareholders of the said clients are Indian national, Non-resident Indian or Overseas Corporate bodies (majority controlled by NRIs) or persons of Indian Origin. (In respect of Aman Capital Global Fund Ltd., UBS informed SEBI that the said client did not have any dealings through UBS during May 2004 and accordingly, no further information was sought regarding major investors / shareholders etc. of the client). In response, UBS vide e-mail dated September 24, 2004 furnished the replies of Sattva Asia Opportunities Master Fund, PMA Prospect Fund and Indea Absolute return Fund. (These have been dealt with later under the head narration of facts).

2.8. In view of partial replies/ unsatisfactory replies, SEBI, vide email dated October 01, 2004, sought further information in respect of the major shareholders, top 5 investors

etc. in respect of 12 of the major clients of UBS. The information sought by SEBI vide the aforesaid e-mail inter-alia include the following:

Sr. No.	Name of Client	Information Required
1.	Caxton International Ltd.	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. reason for sale on May 17, 2004 4. value of portfolio with underlying Indian securities held on May 14, 2004
2.	Moore Global Fixed Income Fund Ltd.	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
3.	Indus Asia Pacific Fund Ltd.	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders
4.	Discovery Global Opportunities Master Fund Ltd.	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
5.	Moore Macro Fund LP	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
6.	ROHATYN / TRG Global	<ol style="list-style-type: none"> 1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004

Sr. No.	Name of Client	Information Required
	Opportunity Master Fund	2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
7.	SAC Capital Associates LLC	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
8.	DKR Soundshore	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
9.	Indea Capital Pte Ltd.	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
10.	Sattva Asia Opportunities Master Fund	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders
11.	Lehman Brothers Finance SA	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004 2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004
12.	PMA Capital Management	1. Name and addresses of the top 5 investors for investments in Indian securities during May 2004

Sr. No.	Name of Client	Information Required
	Ltd. A/c PMA Prospect Fund	2. Names and addresses of directors, major shareholders 3. value of portfolio with underlying Indian securities held on May 14, 2004

2.9. The charges contained in the show-cause notice include that UBS has failed to furnish the complete information in respect of its clients as sought by SEBI. The information so far furnished by UBS was obtained after repeated follow-ups involving a great deal of regulatory persuasion. In that view, the show-cause notice alleges that UBS has failed to comply with the Regulation 20 and 20 A of SEBI (Foreign Institutional Investors) Regulation 1995 (hereinafter referred to as 'FII Regulations') besides violating clauses 1, 2, 5 and 6 of Code of Conduct as specified in Regulation 7 A of FII Regulations.

2.10. The show-cause notice stated that despite repeated requests/reminders by SEBI, UBS did not furnish the details regarding the names of the major investors of its clients namely Caxton International Ltd. (hereinafter referred to as 'Caxton' or 'CIL'), Indus Asia Pacific Fund Ltd., ROHATYN, Indea Capital Pte. Ltd., PMA Prospect Fund and Sattva Asia Opportunities Master Fund citing reasons such as confidentiality provisions in the client agreement for its refusal to furnish the above information. Thus, it was alleged that UBS had failed to comply with the KYC (Know your client) requirements as specified in Regulation 15A of FII Regulations read with Circular No.IMD/CUST/8/2003 dated August 8 2003. The show-cause notice further stated that the reasons furnished by UBS for not furnishing the above information was not satisfactory as Regulations 20A of FII Regulations clearly states that FIIs are required to fully disclose information concerning the terms of and parties to off-shore derivative instruments such as Participatory Notes etc., by whatever names they are called, entered into by it or its sub-accounts or affiliates relating to any securities listed in any stock exchange in India, as and when and in such form as SEBI may require.

- 2.11. The show-cause notice stated that the aforesaid conduct of UBS was detrimental to the orderly development of securities market and the interest of investors and consequently, SEBI is empowered to issue appropriate directions under Section 11 B and take any of the measures provided under Section 11(4) of the SEBI Act 1992 against it, besides other actions, if any.
- 2.12. In view of the above, UBS was required to show cause as to why directions under Section 11(4) and 11B of the SEBI Act, 1992 including directions to prohibit it from dealing in securities on behalf of its clients in respect of whom it did not have information on its underlying investors, should not be issued against UBS.
- 2.13. UBS was advised to furnish its reply within 15 days from the date of receipt of this notice, failing which, UBS was informed that it shall be construed that it had no explanation to offer and SEBI might proceed to pass suitable orders as may be deemed necessary in terms of SEBI Act 1992 and the Regulations made thereunder. UBS was also advised to indicate whether it desired to avail an opportunity of personal hearing.

3.0. REPLY TO SHOW CAUSE NOTICE AND ORAL AND WRITTEN SUBMISSIONS

In response to the aforesaid show-cause notice UBS vide letter dated December 7, 2004, sought inspection of documents relied upon by SEBI. UBS also sought further time to provide its written reply to the show-cause notice. I note that UBS was afforded an opportunity of inspection of documents and copies of documents sought were provided to UBS. Subsequently, vide letter dated December 22, 2004, UBS furnished its reply to the said show-cause notice. In addition, vide letter dated January 14, 2005 UBS gave certain of the information in a well calibrated and measured response, which were originally sought during the course of investigations. Subsequently, as sought by UBS,

an opportunity of personal hearing was granted by me to it on February 1, 2005 wherein UBS was represented through its senior officials and its Advocates. During the course of personal hearing some information / clarifications were sought by me from UBS and the same was subsequently furnished by UBS. Further to the same, another opportunity of personal hearing was granted by me to UBS on May 5, 2005 wherein UBS was once again represented through its senior officials and its Advocates. Though the personal hearing concluded on May 5, 2005, UBS furnished a confidential letter on May 13, 2005 seeking to clarify a particular query relating to Caxton, a client of UBS / its affiliate.

4.0. NARRATION OF FACTS

Before proceeding to consider the issues involved, it is essential to recapitulate the facts relating to the subject matter of the instant proceedings.

4.1. During the course of investigations into the dealings of UBS during May 2004, SEBI had sought various information relating to twelve major clients, on behalf of which UBS had dealt in Indian securities market. While UBS furnished the requisite information regarding six of its clients (the information is being examined by SEBI, for collating with the rest for better appreciation of the events), in respect of the remaining six clients, namely Caxton, Indus Asia Pacific Fund Ltd., ROHATYN, Indea Capital Pte. Ltd., PMA Prospect Fund and Sattva Asia Opportunities Master Fund, UBS has not furnished the complete details sought by SEBI. I note that the details of information sought from UBS during the course of investigations and its replies are narrated in detail in the afore-said show-cause notice.

4.2. The facts of the matter relating to the details of information sought by SEBI in respect of each of the six clients and the replies of UBS to the same are elaborated in the show-cause notice. I note that these facts as detailed in the show-cause notice have not been disputed by UBS in its reply to the show-cause notice. Accordingly, I take it that the facts as detailed in the show-cause notice are not under dispute.

4.3. Subsequent to the issue of show-cause, UBS furnished to SEBI certain information, in respect of the six entities, which were actually sought by SEBI during the course of investigations i.e. prior to the issue of show-cause notice. Further to the above submissions of UBS, I had sought further information / clarification from UBS during the course of personal hearing and the same were submitted by UBS on February 24, 2005 and April 29, 2005. In the interests of equity and natural justice, I have considered all these submissions made by UBS even though these have been received subsequent to the issue of show-cause notice and hence were not originally available to SEBI at the time of issue of show-cause notice.

4.4. The details of information sought from UBS in respect of each of the aforesaid six clients and the replies of UBS as brought out in the show-cause notice are set out below in a chronological sequence. For the sake of convenience, the details of information submitted / received subsequent to the issue of show-cause notice are also narrated chronologically for the respective clients.

4.4.1. Caxton International Ltd.:

Caxton, the largest selling client of UBS on May 17, 2004 had sold securities valuing Rs. 99.05 crores on May 17, 2004. UBS has informed that the above client declined to respond to request for information by UBS. In the light of the above, with a view to obtain the information directly from the above client, SEBI, vide e-mail dated September 1, 2004 advised UBS to furnish the complete contact details of the said client. In response, UBS assured SEBI that they are liaising with their US office to obtain the contact information sought by SEBI and they would furnish the information in a day or two. After repeated follow-ups and in view of the delay / non-cooperation of the above client, on September 6, 2004, SEBI forwarded to UBS a letter addressed to the said client seeking information including the names and addresses of directors, major shareholders/unit-holders/investors (holding 20% or more of units / shares of your fund) and fund managers.

UBS was advised to forward the letter to Caxton and follow-up with the client to obtain response expeditiously. The letter was also sent by SEBI directly to Caxton International Ltd. C/o Caxton Corporation, 500, Park Avenue #8, NEW YORK NY 10022 USA i.e. the address furnished by UBS.

In response, a brief letter dated September 9, 2004 by Caxton Associates LLC was forwarded to SEBI through UBS. In the said letter, Caxton Associates LLC has inter-alia stated that "... Confirm that Caxton International Ltd., a British Virgin Island company, entered into a Price Return Equity Swap on the NSE S&P CNX Nifty Index (the "SWAP") with UBS Securities AG London on January 6th, 2004. ON May 17th, 2004, the parties closed out this SWAP. Caxton's reason for closing out this transaction was to prevent further losses on a position that was incurring losses."

Since Caxton did not furnish information regarding their major shareholders/investors etc., SEBI, vide e-mail dated September 14, 2004, again reminded UBS to obtain from the said client the names and addresses of their major shareholders / investors, the names and addresses of their top 5 investors (in terms of value invested) and also to confirm whether any of the major investors of the above client are Indian national, Non-resident Indian or Overseas Corporate bodies (majority controlled by NRIs) or persons of Indian Origin. UBS was advised to obtain the information from the said client on or before September 22, 2004. Since UBS did not furnish the information, vide email dated October 01, 2004 SEBI once again sought the above information from UBS.

In response to information sought by SEBI, UBS vide its e-mail dated October 27, 2004 forwarded the letter of Caxton Associates LLC dated October 26, 2004 inter alia stating that Caxton Associates, LLC ("Caxron") is a Delaware USA limited liability company and the trading advisor to Caxton International Ltd ("the Fund"). Under the terms of its trading advisory agreement with the Fund, Caxton has full trading authority on behalf of the Fund i.e. Caxton will enter into purchase and sales transactions without any obligation to seek the advice or approval of either the Fund

or any of its shareholders. Caxton represented that they do not consult with the shareholders of the Fund prior to entering into Trades or liquidating trades, and they do not have any agreements (whether in writing or informal) to following any instructions or suggestions from either the Fund or its shareholders in any of their trading on behalf of the Fund. In addition, while they are unable to make any representations as to the nationalities of the underlying investors in the Fund, Caxton represented that to their knowledge no Non-Resident Indian or Person of Indian origin is a beneficial owner of Caxton.

Further to the above UBS vide its Fax message dated November 2, 2004 submitted a copy of letter from Caxton dated November 1, 2004. Vide this letter Caxton stated that Caxton Associates LLC is the trading advisor to Caxton International Ltd (CIL). They furnished the names of the the sole share holder of CIL is Caxton Global Investments Ltd. (Caxton Global). They also stated that as per their understanding as of June 30, 2004 the sole direct shareholders of Caxton Global with more than 10% holdings are qualifying institutional holders which are not Non-Resident Indians or Persons of Indian Origin. They also furnished the names of the directors of CIL. But they have not provided the information with respect to the names/ holding details of these qualified institutional investors.

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Copies of ISDA Master agreement between UBS AG and Caxton International Ltd. were received through SEC, USA on SEBI's initiative during January 2005. As directed by me, SEBI, vide letter dated April 20, 2005, forwarded the copies of the above agreement to UBS for its comments. I note that UBS has not furnished any comments on the same.

4.4.2. Indus Asia Pacific Fund Ltd.:

In respect of Indus Asia Pacific Fund Ltd., SEBI vide e-mail dated October 1, 2004 sought details regarding the names of major shareholders, top five investors and the value of the portfolio with underlying Indian securities held by Indus Asia Pacific Fund Ltd on May 14, 2004. In reply UBS vide its e-mail dated October 28, 2004, informed SEBI that Indus Capital Partners LLC (the fund manager of Indus Asia Pacific Fund Ltd) is a company incorporated in the United States (New York). UBS informed SEBI that Indus Capital Partners LLC have expressed their inability to disclose the Name and addresses of the top 5 investors for investments in Indian securities during May 2004, directors and major shareholders pursuant to the fund's organisational documents.

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Vide e-mail dated Dec. 6, 2004, UBS furnished the names of directors of Indus Asia Pacific Fund. Subsequently vide letter dated Jan. 14, 2005, UBS furnished further information as under:

Indus has advised that the five largest investors in the Indus Asia Pacific Fund are:

- A USA based global fund of funds organization
- A major Northeastern USA university
- A major Southwestern USA university
- A European based bank and investment organization
- A European based fund of funds organization.

Indus has advised that to the best of its knowledge and belief none of the major investors are Indian nationals, Persons of Indian Origin or Overseas Corporate Bodies, which are majority owned or controlled by NRIs.

In view of the vague descriptions relating to the top five investors, as narrated above, during the personal hearing granted to UBS on Feb. 1, 2005, I advised UBS to furnish

specific names of investors of Indus Asia Pacific Fund rather than vague descriptions of the nature of these investors. In response vide e-mail dated Feb. 25, 2005, UBS furnished the names of investors of Indus Asia Pacific Fund.

4.4.3. **ROHATYN:**

With regard to ROHATYN, vide e-mail dated September 9, 2004, SEBI advised UBS to obtain the complete details of long positions held by TRG Global Opportunity Master Fund through all FIIs/brokers indicating the name of the broker, type of instrument held, name of underlying Indian security, quantity of underlying Indian security and the value (in Indian Rupees) as on May 14, 2004. UBS vide e-mail dated September 21, 2004, has informed SEBI that they have sought the above information from the client.

UBS Securities Asia Ltd vide their e-mail dated 28 October 2004 informed SEBI that their client TRG Management LP (“TRG”) has expressed their inability to disclose information regarding the name and addresses of the top 5 investors for investments in Indian securities during May 2004, the details of value of portfolio with underlying Indian securities held on May 14, 2004 as well as confirm whether any of their major shareholders/ investors are Indians, NRIs or OCBs citing confidentiality constraints.

UBS has further informed SEBI that Nicholas Rohatyn, Brian Lippey, Guido Mosca, Jorge Mariscal and David Lee furnished are the directors of the fund.

It is seen that UBS has provided only limited information with respect to TRG even after repeated SEBI requests for information. They have not disclosed the value of their client’s portfolio as on May 17, 2004 and the details of top investors/ shareholders citing confidentiality constraint

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Vide letter dated Jan. 14, 2005, UBS furnished further information regarding the investors in the TRG Global Opportunity Master Fund Ltd.

4.4.4. **Indea Capital Pte Ltd.:**

Regarding Indea Capital Pte Ltd, vide e-mail dated September 14, 2004, SEBI advised UBS to obtain from Indea Capital Pte Ltd. details of the names and addresses of their major investors / shareholders, the names and addresses of their top 5 investors (in terms of value invested) and a confirmation that none of the major shareholders of the said clients are Indian national, Non-resident Indian or Overseas Corporate bodies (majority controlled by NRIs) or persons of Indian Origin. UBS vide e-mail dated September 24, 2004 has informed SEBI that the client has furnished their response as below:

“

1. The fund has no shareholder who holds more than 20% interest.
2. The investors are qualified investors, principally from Europe and USA.
3. We are unable to release the names of top 5 investors to SEBI.”

Indea Capital Pte Ltd. A/c Indea Absolute Return Fund has declined to furnish the names of top 5 investors. They have confirmed that the investors are qualified investors, principally from Europe and USA and have further confirmed that the fund has no shareholder who holds more than 20% interest.

Further to the above SEBI vide e-mail dated October 1, 2004 once again sought details regarding the names of major shareholders, top five investors and the value of the portfolio with underlying Indian securities held by Indea Capital Pte Ltd. In response UBS vide their e-mail dated October 28, 2004 cited the earlier e-mail of Indea Capital Pte Ltd dated September 14, 2004 and thus did not furnish the above information sought by SEBI.

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Vide e-mail dated Dec. 6, 2004, UBS furnished the NAV of the fund (Indea Capital Pte Ltd. A/c Absolute Return Fund). Vide letter dated Jan. 14, 2005, UBS furnished the names of the largest investors in the Absolute Return Fund as on May 31, 2004.

During the course of personal hearing on Feb. 1, 2005, I advised UBS to furnish copy of its client agreement with Indea Capital Pte Ltd. In response vide letter dated Feb. 24, 2005, UBS furnished only the 'Terms and Conditions' contained in its pro-forma agreement. In view of the above, as directed by me, SEBI vide letter dated April 20, 2005 once again advised UBS to furnish the information sought by me during the personal hearing on Feb. 1, 2005. In response vide letter dated April 29, 2005, UBS furnished copies of ISDA master agreement between UBS AG and Indea Absolute Return Fund.

4.4.5. PMA Prospect Fund:

PMA Prospect Fund in their reply as forwarded by UBS stated as below:

“

1. No single underlying investor holds more than 20% in PMA Prospect Fund

.....

5. In relation to the request for the list of names and addresses of the top five (5) largest investors in the fund, for reasons of confidentiality this information cannot be disclosed unless those investors' prior consent is obtained (which is unlikely to be easily forthcoming) or the fund or PMA is under an obligation to disclose this information under applicable law or regulation (which I understand is not the case here).”

Thus it is seen that the above client of UBS has declined to furnish the names and addresses of top 5 largest investors in the funds citing reasons of confidentiality.

Further to the above SEBI vide e-mail dated October 1, 2004 once again sought details regarding the names of major shareholders, top five investors and the value of the portfolio with underlying Indian securities held by PMA Capital Management Ltd A/C PMA Prospect Fund. In response UBS vide their e-mail dated October 28, 2004 cited their earlier e-mail to SEBI dated September 23, 2004 (as narrated in the earlier paragraph) and thus did not furnish the above information sought by SEBI.

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Vide letter dated Jan. 14, 2005, UBS furnished the names of the five largest investors in the PMA Prospect Fund

4.4.6. Sattva Asia Opportunities Master Fund:

Regarding Sattva Asia Opportunities Master Fund, UBS vide e-mail dated September 24, 2004 has informed SEBI that the client has agreed to provide a response directly to SEBI. Vide e-mail dated September 27, 2004; the reply of the client was received stating that due to confidentiality restrictions in their prospectus and agreements with investors, they are not in a position to release the names of the investors in the fund. However, they confirmed that there are no Indian nationals or OCBs among their top five investors and that their investor base consists of financial institutions from the US and Europe.

Further to the above SEBI vide e-mail dated October 1, 2004 sought details regarding the names of major shareholders, directors and top five investors of Sattva Asia Opportunities Master Fund. In response UBS vide their e-mail dated 28 October 2004 informed SEBI that Sattva Investment Advisors Ltd (the fund Manager) has during

September 2004 responded directly to SEBI. The information furnished by Sattva did not contain the names of their major shareholders and top five investors. Thus UBS has not furnished the above information sought by SEBI.

Information received by SEBI / furnished by UBS subsequent to issue of SCN:

Vide letter dated Jan. 14, 2005, UBS furnished the names of the largest investors in the Sattva Asia Opportunities Master Fund as at May 17, 2004.

In the light of the above, I now proceed to consider the issues that form the subject matter of instant proceedings.

5.0. CONSIDERATION OF ISSUES

5.1. I have carefully considered the findings of investigation as detailed in the show cause notice dated November 24, 2004, the replies to the show-cause notice with annexures, material on record and the oral and written submissions made by UBS / its advocates including its submissions on May 13, 2005 made after the conclusion of the final hearing.

5.2. The following issues arise for consideration:

- Whether UBS has failed to comply with the 'Know Your Client' requirements as laid down in Regulation 15A of the FII Regulations?
- Whether UBS has failed to furnish complete information as sought by SEBI during the course of investigation?
- Whether the information furnished thus far by UBS was furnished by it only after repeated follow-ups by SEBI thereby scuttling the investigations by SEBI?

- Whether UBS has failed to comply with the clauses of Code of Conduct as prescribed under the Third Schedule of the FII Regulations?
- Whether the above acts of omission and commission by UBS render it guilty of non-compliance of Regulations 15A, 20 and 20A of FII Regulations as well as the various clauses of Code of Conduct applicable to Foreign Institutional Investors?
- Whether the aforesaid conduct of UBS is detrimental to the orderly development of securities market and the interests of investors, thereby inviting directions under Sections 11B and 11(4) of the SEBI Act, 1992 against UBS.

6.0. WHETHER UBS HAS FAILED TO COMPLY WITH REGULATION 15 A OF FII REGULATIONS

6.1. Regulation 15A of FII Regulations states

“(1) A Foreign Institutional Investor or sub-account may issue, deal in or hold, off-shore derivative instruments such as Participator Notes, Equity Linked Notes or any other similar instruments against underlying securities, listed or proposed to be listed on any stock exchange in India, only in favour of those entities which are regulated by any relevant regulatory authority in the countries of their incorporation or establishment, subject to compliance of ‘know your client’ requirement.”

6.2. The above regulation was inserted in the FII Regulations with effect from February 3, 2004. An insight into the rationale of the above regulation based upon certain preceding developments in the Indian capital market would enable better appreciation of the following discussion.

6.3. SEBI examined the issue of FIIs issuing derivative instruments through a multi-layered structure and more particularly the need for identifying the ultimate

beneficiary of these ODIs. It was felt that only known and regulated entities should be allowed to invest in Indian securities market through the FIIs and non verifiable sources should not be allowed. The relevant excerpts specifically on Participatory Notes (PNs) / ODIs by the Hon'ble Joint Parliamentary Committee on Stock Market Scam (2001) are quoted below:

“8.66 According to SEBI, four Sub accounts of FIIs namely, Coral Reef Investments Co. Ltd. (Sub-account of RP&C International), CAL FP (Mauritius) Ltd. (Sub-account of Credit Agricole Lazard Finance Prod.), DBMG of Mauritius Ltd. (Sub account of Deutsche International Trust Corpn. CI Ltd.), Kallar Kahar Investment Ltd. (Sub-account of Credit Suisse First Boston) had transacted in scrips associated with Ketan Parekh in a substantial way. Total trading of these sub-accounts was to the tune of Rs. 14000 crore approx. during the period from January 1999 to March 2001. Investigations have shown that entities connected with some of the Sub-Accounts issue Participatory Notes (PNs) as derivative Instruments outside India. It is suspected that these instruments enabled entities, which may not be eligible to get registered as FII to transact in Indian capital market. This instrument enables the holders to hide their identities. Through PNs, various layers are created which make it easier for the holders to keep their identities undisclosed and at the same time purchase shares in Indian Market. It is suspected that some of the Indian promoters have purchased shares of their own companies in this way. It appears that shares purchased through this route were shifted to Ketan Parekh entities through OCBs. SEBI has now asked FIIs to report about the details of the PNs as and when issued by them.

8.67 Participatory Notes are derivative instruments issued against underlying securities of investments in shares. Primarily, the Participatory Notes are one of the methods to raise funds by large investors. An investor wishing to raise resources may collect funds from various investors (retail investor) to pool in the funds against security of underlying investments in shares. Normally, the return of the retail investors are linked to an equity index. PN is issued outside

India and represents transaction between two non residents, who are not subject to the Indian laws. PNs are extra territorial instruments and SEBI has no regulatory jurisdiction over them.

8.81 SEBI has expressed suspicion that some of the Indian promoters have purchased shares of their own companies through Participatory Notes issued by sub-accounts of FIIs. This mechanism enables the holders to hide their identities and enables them to transact in Indian Capital Market. The Committee note that SEBI has since directed FIIs to report about details of the Participatory Notes as and when issued by them. The Committee suggest that failure on the part of FIIs to report about issue of PNs should be viewed seriously and should entail stringent punitive action. It should also be ensured that this instrument is not misused in any way to manipulate the Indian Securities Market.”

6.4. Thus, it is seen that the thrust of the Hon’ble JPC recommendations was to prevent undesirable entities from dealing in Indian securities market using the back door entry provided by the anonymity of Off-shore derivative instruments.

6.5. The rationale for the above insertion of Regulation 15A, include the following considerations as well:

- Besides disclosure of names of the beneficiary owners of PNs, FIIs may be allowed to issue only in favour of regulated entities, while not permitting any further down stream issue of PNs or any other synthetic product.
- The source of external funds would necessarily be a matter of relevance and therefore it should be transparent or verifiable. The same makes it imperative that the names of ultimate beneficiaries of FII investments are known.
- It would be in the interest of the market and the investors not to allow any unregistered and unregulated entities to invest in our market and that the

names of the ultimate beneficiaries of the investments in India are known / verifiable.

- The requirement of all sub accounts to be regulated entities would unambiguously keep the hedge funds out because at present they are unregulated.
- To discharge its regulatory responsibilities, SEBI would need to be in a position to ascertain, if circumstances so warrant, the details of ultimate investors in the Indian market, based on “Know your client” principle enforced in other jurisdictions.

Thus, it is clear that SEBI with a view to prevent undesirable elements from utilizing the anonymity provided by the PN / ODI route, moved a regulation to regulate the issuance of PNs / ODIs and also to know the ultimate beneficiaries of such PNs / ODIs. This is the background and the thrust of regulation 15A which has an immediate nexus with JPC recommendations and SEBI’s follow-up initiative thereof.

6.6. It is clear that the said Regulation 15A while requiring the FIIs / sub-account to issue, deal or hold off-shore derivative instruments with underlying Indian (listed) securities only in favour of regulated entities simultaneously imposes an obligation on the FII to comply with ‘know your client’ requirement. The information sought for by SEBI directly stems from the requirement to comply with KYC norms and both are complementary. The charges in the show-cause notice against UBS in this regard and the replies of UBS should be appraised in the context of the developments as above which are precursors to the insertion of Regulation 15A.

6.7. UBS, in its reply dated December 22, 2004, has contended that all offshore derivative instruments issued to the clients satisfies all legal and regulatory requirements under both the FII Regulations in relation to ‘know your client’ requirements and the ‘know your client’ requirements in the

relevant jurisdiction where such offshore derivative instruments were issued. UBS has further stated that the offshore derivative instruments were issued to the clients by UBS AG London branch, which is regulated by the Financial Services Authority ('FSA') and complied with all applicable 'know your client' requirements in the United Kingdom as prescribed by the FSA. In its letter dated May 13, 2005, UBS has reiterated that "The 'know your client' procedures are compliant with the standards of the relevant regulator, the Financial Services Authority of United Kingdom."

6.8. UBS has submitted that UBS Investment Bank (UBS-IB) which includes the operations of UBS, SFC (a SEBI registered sub-account of UBS) and UBS AG London branch has implemented comprehensive policies and procedures to ensure that its 'know your client' requirements meet or exceed international regulatory requirements and industry best practice standards. UBS has submitted that such policies have been applied in the absence of substantive guidance being provided to FIIs as to the required standards to satisfy 'know your client' requirements under the FII regulations. UBS has summarized the key policies that define its approach to 'know your client' and furnished the same as 'Annexure 2' of its reply dated December 22, 2004. In addition to the above, UBS has furnished a copy of Customer Identification and Know Your Customer Due Diligence Programme (Annexure 3), Know Your Customer policy and Prevention of Money Laundering and Terrorist Financing policy (Annexure 4) as annexures to its aforesaid reply.

6.9. UBS, in its reply dated December 22, 2004, has further contended that neither UBS nor SFCML (i.e. Swiss Finance Corporation Mauritius Ltd., a SEBI registered sub-account of UBS) entered into offshore derivative transactions with external clients. All such transactions over Indian underlying securities were entered into by UBS AG London branch. Since UBS and SFCML do not undertake the activities referred to in Regulation 15A(1), the 'know your client' requirements under Regulation 15A(1) does not apply to

either UBS or SFCML.

6.10. At Point 26 of the aforesaid reply, UBS has stated that “In issuing equity linked notes (i.e. ODIs / PNs), UBS AG London has provided for in the terms and conditions of such offshore derivatives which require the clients to undertake / represent and warrant that:

- a) The Notes not be offered or sold, directly or indirectly, (a) in India or (b) for the account of any resident Indian or c) Non-Resident Indians, Overseas Corporate Bodies and Persons of Indian Origin (all as defined in the Indian Foreign Exchange Management Act); or (d) to any other person in violation of the India exchange control regulations and / or any applicable laws and regulations in India.
- b) “...by purchasing the Notes, each purchaser shall be deemed to have confirmed that (a) the purchase or sale or offer to purchase and sell by it or its clients of the Notes and any related action in connection with the exercise of any rights under the Notes by any of them will not cause or result in violation of any provision of applicable law and regulation and (b) the purchase or sale or offer to purchase and sell by it or its clients of the Notes will only be made to “entities which are regulated by any relevant regulatory authority in the countries of their incorporation or establishment” as permitted from time to time by The Securities and Exchange Board of India.”
- c) “Each purchaser of the Notes confirms that the purchase or sale or offer to purchase and sell by it or its clients of the Notes and any related action in connection with the exercise of any rights under the Notes by any of them will not cause or result in violation of any provision of applicable law and regulation. Each purchaser further confirms that the purchase or sale or offer to purchase and sell by it or its clients of the Notes will only be made

to “entities which are regulated by any relevant regulatory authority in the countries of their incorporation or establishment” as permitted from time to time by the Securities and Exchange Board of India.”

6.11. Further during the course of personal hearing on May 5, 2005, the counsel for UBS cited SEBI circular no.IMD/CUST/13/2004 dated February 19, 2004 wherein SEBI has clarified the entities which would be deemed to be regulated entities for the purpose of Regulation 15A.

6.12. Regarding the contention of UBS that the off-shore derivative instruments with underlying Indian securities are not issued by it or its proprietary sub-account (SFCML) and hence the requirement of ‘know your client’ specified in Regulation 15A is not applicable to it, it is an admitted fact that SFCML is a proprietary sub-account of UBS and it is also admitted fact that UBS is routing all its investments in Indian securities through its proprietary sub-account viz. SFCML. It is also noted from point 3 of its reply dated December 22, 2004 that “SFCML originates transactions and holds positions in the Indian securities markets in order to take a fundamental view, or to hedge derivative instruments over Indian underlying securities that are transacted by an affiliate company, UBS AG London branch.” It is noted from the records that UBS AG, London has issued ODIs against underlying Indian securities to several entities situated outside India. UBS has clearly stated that UBS AG, London is their affiliate. From the above it emerges that UBS AG, which is an affiliate of UBS, has issued ODIs to its clients on the basis of underlying Indian securities held by UBS. In the materiality of circumstances and in the scheme of internal arrangements among the group, it stands to reason that UBS should be in a position to know the ultimate client for whom the ODIs have been issued by UBS AG, London, more so when the issue of PN by UBS AG, London is directly contingent upon the positions held by UBS in the Indian securities market thereby creating a close nexus between the two operations.

6.13. When UBS is aware of the regulatory requirement of informing the details of the

ultimate client and when UBS is also aware that its affiliate is issuing ODIs on the basis of underlying securities held by it, it is more so relevant for UBS to ascertain from UBS AG, London and inform the regulator about the ultimate clients.

6.14. UBS has stated that SFCML deals in Indian securities on its own account as well as to hedge the derivative instruments over Indian underlying securities transacted by UBS AG, London. Thus, it is an admitted position that a part of the transactions by UBS / its sub-account SFCML in the Indian securities market are attributable to the ODIs issued by its affiliate UBS AG, London. I also note that UBS has been submitting monthly statements on the ODIs issued by its affiliate as required under regulation 20A of FII Regulations and in the format prescribed by SEBI circular IMD/CUST/8/2003 dated August 8, 2003. I note that in the monthly ODI statements submitted by UBS to SEBI, the names and locations of the ultimate clients are indicated as recipients of ODIs issued by UBS AG, London. Further, at Point 26 of its reply dated December 22, 2004 (as narrated above), UBS / its affiliate have clearly subjected themselves to the applicability of Indian regulations. I also note that UBS AG is also registered with SEBI as an FII and accordingly, all the relevant regulations are applicable to it. Further, the issue relating to scope of Regulation 15A was neither raised during the course of investigation nor during the personal hearings before me. On the contrary, UBS has submitted itself to the jurisdiction of SEBI for purposes of regulation 15A as well while furnishing information as sought for by SEBI from time to time.

6.15. If SEBI were to accept the contention of UBS that the ODIs have been issued by an affiliate (i.e. UBS AG) of the FII (i.e. UBS Securities Asia Ltd.) and accordingly the requirements specified in Regulation 15A of FII Regulations are not applicable in this case, it would defeat the very objective (as elaborated earlier) for which Regulation 15A has been introduced. UBS has provided access to the off-shore clients to Indian securities market and accordingly verifying the antecedents of these entities and ensuring compliance to KYC norms specified in Regulation 15A is the primary responsibility of UBS. In the light of the above, I do not find the contention

of UBS that the 'know your client' requirements as laid down in Regulation 15A are not applicable to it, tenable.

6.16. **The requirements under Regulation 15A**

I now propose to examine in depth what are the requirements under regulation 15A of FII Regulations. Two basic requirements with regard to issuance of ODIs against underlying Indian securities as laid down in Regulation 15A of FII Regulations are:

- (i) the ODIs be issued only in favour of those entities which are regulated by any relevant regulatory authority in the countries of their incorporation / establishment;
- (ii) subject to KYC requirement

6.17. With regard to requirement (i) above, UBS has cited SEBI circular dated February 19, 2004 and has argued that the clients are deemed regulated entities as they are regulated by the relevant authority in the countries of their incorporation / establishment. The above circular clarifies the entities that would be deemed to be regulated entities. Any way, the circular dated February 19, 2004 should be read in conjunction with Regulation 15(A)(1) of FII Regulations. It is clear that mere issue of ODIs to entities that are deemed to be regulated entities is not adequate even under the said circular. The circular did not make any reference to KYC. Hence, the requirement 'subject to 'know your clients'' as laid down in the aforesaid regulation would be applicable notwithstanding that the ODIs have been issued to said entities which UBS claims to be regulated entities.

6.18. As noted earlier, UBS has furnished as Annexure 3 and Annexure 4 of its reply dated December 22, 2004, Customer Identification and Know Your Customer Due Diligence Programme (CIP) and Know Your Customer policy and Prevention of Money Laundering and Terrorist Financing policy, respectively. Admittedly, these internal guidelines are applicable to UBS and SFCML as well as to UBS AG, London. Upon perusal of the same, I find that in the preamble to the CIP it is

explicitly mentioned that

“Knowing who our customers are includes knowing the people and the entities we deal with as well as knowing the ultimate beneficiary of the transactions we undertake.....

The fundamental question to keep in mind through the process is simply this, are we certain that we know the true identity of those with whom we are doing business?”

Further at Page 7 of the aforesaid CIP / CDD of UBS-IB, it is laid down that

‘Beneficial Ownerships (Not applicable to the Americas)

It is important to be aware that individuals and entities are not always acting on their own Account but may be acting on behalf of someone else. A key aspect of identification under the CIP (Customer Identification Programme) is ascertaining for whose ultimate benefit an Account is being operated or opened i.e. ascertaining the identity of the ultimate Beneficial Owner.

Ownership Chains

Money launderers may use a complicated ownership structure to conceal the origin of funds and the identity/ies of the Beneficial Owner/s. from the individual or entity who is the apparent Customer there may be a chain of ownership, leading back to the Beneficial Owner. It is therefore necessary to look through the various entities in the ownership chain to determine the identity of the Beneficial Owner so as to establish their legitimacy. For example, if a potential Customer is a company whose shares are held by another company then the ownership chain should be followed to the Beneficial Owners of the second entity and so on until the identity of the ultimate Beneficial Owner is established.”

At Page 8 of the aforesaid CIP / CDD of UBS-IB, it is mentioned that

“Customers acting as Agent

The concept of identifying the Beneficial Owner/s also extends to Customers who are acting as Agent on behalf of any underlying Principals. As a consequence, the identity of both the Agent and the underlying Principal should be verified (unless reliance can be placed on an Approved Agent).”

At Page 9 of the aforesaid CIP / CDD of UBS-IB, it is mentioned that “..... The KYC Policy at Clause 5.1 provides that UBS – IB (IBS Investment Bank) must complete the vetting process before it enters into a business relationship with a customer...”

6.19. Thus, it is clear that its own internal guidelines clearly lay down the need to identify the ultimate beneficiaries of the entities on whose behalf UBS / its affiliates transact. The contentions of UBS that it does not know the beneficiaries of the entities on whose behalf ODIs against underlying Indian securities have been issued indicates that it has failed to comply with the minimum requirements of its own internal guidelines. Also, while its internal guidelines require it to know the ultimate beneficiaries of these transactions, UBS has claimed that it does not even know the beneficiaries who are at the first level since the fundamental question is to know the true identity of those with whom they are doing business. This is a basic requirement in any commercial sense.

6.20. In the light of failure on the part of UBS to furnish the required information as sought for by SEBI before the issue of show-cause, only two inferences are possible having regard to the observations supra that compliance of KYC requirements are applicable to UBS:

6.21. The first inference would be that UBS did not comply with the KYC requirements as laid down in regulation 15A of FII Regulations which would tantamount to

violation of the said regulation. The second inference would be that UBS had the necessary information in its possession as per KYC norms or had access to such information but did not furnish the information in time which would tantamount to non-compliance with regulation 20 / 20A of FII Regulations.

6.22. UBS has contended that these ODIs were issued to the clients by UBS AG London branch, which is regulated by the Financial Services Authority ('FSA') and complied with all applicable 'know your client' requirements in the United Kingdom as prescribed by the FSA. In this regard, I note that the relevant portion of Regulation 15A(1) of FII Regulations reads that FIIs may issue ODIs with underlying Indian securities "only in favour of those entities which are regulated by any relevant regulatory authority in the countries of their incorporation or establishment, subject to compliance of 'know your client' requirement". Since the underlying securities are Indian securities and the transactions of UBS are executed in India, the KYC norms prevailing in India should be applicable. UBS has claimed that SEBI has not prescribed any format for KYC norms to be followed by FIIs. "Know your client" is a very basic commercial requirement which does not require a formal prescription and UBS either should have followed its own internal guidelines as already highlighted or what is required under regulation 15A in the light of rev-up to regulation 15A with a strong rationale to keep out undesirable elements from entering Indian securities market through back door namely ODIs. Thus, the KYC requirement specified in regulation 15A of FII Regulations should be construed in the context of insertion of regulation 15A effective February 3, 2004.

6.23. It is the duty of UBS / its affiliate that prior to issue of ODIs against underlying Indian securities, it should have completed the 'know your client' requirements by asking its clients all the questions that the regulations required. Instead UBS claims to have approached its respective clients after SEBI sought information regarding these clients. This clearly demonstrates that UBS with a view to evading the obligation under KYC requirements is seeking to give a convoluted meaning out of sync with the context in regulation 15A. It is a cardinal principle that any law or regulation

should be understood in the context in which it was enacted and to ascribe a different construction to the requirements of such law / regulation would be totally out of place and inconsistent with the very letter and spirit of the regulation, thereby defeating the very objective of the regulation. A regulation seeks to advance the objective for which it was passed and to view it differently to suggest that the regulation has not prescribed the norms is not only a weird proposition but runs the risk of making the very regulation redundant and otiose. Therefore such a view can never pass muster.

6.24. UBS has claimed that it has obtained warranties from its clients relating to the requirements of regulation 15A of FII Regulations and has thereby ensured compliance with the said regulation. I note that UBS has failed to satisfy SEBI that they have ensured that the warranties have been complied with, reducing it to a brazen tokenism without a modicum of compliance in substance.

6.25. Having regard to the observations above, I hold that the conduct of UBS in providing information in trickles despite possessing the same (as will be discussed in the succeeding paragraphs), has rendered nugatory the very foundation of regulation 15A with its emphasis on disclosure based KYC norms for effective checking of market manipulations, especially by knowing who is the ultimate individual / entity responsible for it.

7.0. NON-FURNISHING OF INFORMATION

7.1. With regard to the above, I note that UBS, in its reply dated December 22, 2004, has cited Regulations 20 of FII Regulations and has argued that “The scope of Regulation 20 of the FII Regulations is limited to the information, record or documents that is in the possession of the FII in relation to its activities as an FII. However, in the present circumstances UBS does not have the information sought by SEBI. Therefore, in such circumstances it cannot be said that UBS has failed to comply with the requirements of

Regulation 20 of the FII Regulations.”

7.2. Regulation 20 of FII Regulations states that “Every Foreign Institutional Investor shall, as and when required by the Board or the Reserve Bank of India, submit to the Board or the Reserve Bank of India, as the case may be, any information, record or documents in relation to his activities as a Foreign Institutional Investor as the Board or as the Reserve Bank of India may require.”

7.3. UBS, in its reply dated December 22, 2004, has not disputed that SEBI had sought the information during the course of its investigation. A perusal of the records reveals numerous correspondences between UBS and SEBI, wherein SEBI has repeatedly sought the above information from UBS. Admittedly, the information sought by SEBI was not provided during the course of investigations. I note that the names of top five investors in respect of five clients (except in respect of Caxton International Ltd.) have been provided by UBS only subsequent to the issue of SCN. UBS has not furnished their respective addresses. In respect of its most prominent client, namely Caxton International Ltd., UBS has neither provided the names of top 5 investors of the 100% shareholder nor their addresses.

7.4. Now, the question that arises is whether UBS had in its possession the information sought by SEBI or at the very least could have accessed the information if it so desired and yet, failed to submit / obtain and submit the same to the Board. I find that the answer to the question has to be in the affirmative due to the following reasons:

7.5. I note that during the course of investigations when SEBI sought the names and addresses of ultimate clients on whose behalf UBS had bought / sold shares on May 17, 2004 as well as the details of directors and major shareholders of the entities to whom UBS / its affiliate had issued off-shore derivative instruments with underlying Indian securities. In response UBS vide e-mail dated May 27, 2004 stated that “Please note that all transactions were executed by SFC as principal.” The same was reiterated by UBS in its e-mail dated June 2, 2004. Subsequently, pursuant to

clarifications by SEBI, UBS vide e-mail dated June 14, 2004, furnished the names of ODI's clients with Indian underlying securities transacted by UBG AG (an affiliate of UBS) London branch and craftily to fend off SEBI and parry the inconvenient details stated that "Please note that all counterparties are major institutional investors that are classified as 'regulated entities' according to FII Rule 15A and on this basis information relating to Directors and major shareholders is not provided." However, SEBI did not accept the above explanation of UBS and repeatedly sought the names of addresses of all the underlying clients, their respective shareholders, directors and fund managers on whose behalf UBS had dealt in cash segment on May 17, 2004 / taken positions in Indian derivatives market on May 3, May 14 and May 20, 2004.

7.6. In response to the repeated requests by SEBI, UBS (vide its e-mail dated June 22, 2004) furnished the addresses of 21 of their clients and names of the principal directors in respect of two of its clients (namely Sattva Asia Opportunities Master Fund and Aman). UBS further stated that the majority of the clients are incorporated in Europe and the Americas and it is working with its London and New York offices to obtain the information on the principal director and shareholder for each client. UBS undertook to forward the information to SEBI as soon it received the same. However, the same were not furnished by UBS in respect of six of their major clients as detailed in the show-cause notice.

7.7. I note that five of the six clients (except Caxton International Ltd.) which are the subject matter of instant proceedings appear amongst the clients covered in the e-mail reply dated June 22, 2004 of UBS as narrated above. From a plain reading of the aforesaid reply of UBS it can be inferred that the information relating to the clients of UBS which were sought by SEBI was already available with the London and New York offices of UBS / its affiliate. Hence, UBS assured SEBI that the same would be obtained from the respective offices and furnished to SEBI. As already pointed out in the course of discussion on the compliance of requirements of regulation 15A, the foregoing is clearly indicative of the fact that UBS had either the information or had access to the information while playing hide and seek in giving such information as

would not be prejudicial to its interests. Also sometimes it steered its course of hedging and paltering with facts by suitably employing ingenious expedients to deflect and obfuscate the process of further probe which included furnishing inappropriate information under the excuse of contrived misunderstanding of the SEBI's requirement. There are several such instances and all of them betoken a singular design to give short shrift to the requirements, unless driven by dire regulatory compulsions in terms of consequences for non-compliance, while purporting to extend co-operation.

7.8. In the light of the above, I hold that UBS did possess the information which was sought by SEBI or at the very least could have accessed the information if it so desired. From the chequered case history it is seen that UBS has given certain information after it was sought for by SEBI while for the rest it was biding the time to avoid furnishing of the information, lest the same should be inconvenient. In view of the conduct of UBS in making selective disclosure under the pretext of not having the information it is more than evident that they were not making a clean breast of the whole affair despite having the information or access to such information. Also for reasons elaborately discussed in connection with compliance with regulation 15A, only two inferences are possible and the material circumstances do not permit of a tertium quid to act in extenuation of the conduct of UBS.

7.9. UBS, in its reply dated December 22, 2004, has cited Regulation 20A of FII Regulations and has argued that "As per Regulation 20A of the FII Regulations, the obligation of UBS is to disclose only the 'terms of and parties to' off-shore derivative instruments such as participatory notes, equity linked notes entered into by it or its sub-accounts or affiliates relating to any securities listed or proposed to be listed in any stock exchange in India. pursuant to Regulation 20A of the FII Regulations there is no obligation on the part of UBS to maintain records / details of top five investors in and major shareholding of the Clients. It is submitted that in the absence of

any such obligation, it cannot under any circumstances be said that UBS has breached any obligations pursuant to Regulations 20 and 20A of FII Regulations.

In such circumstances, it cannot be said that details of major shareholders and top five investors are required to be maintained under regulation 20A of FII Regulations.”

7.10. UBS has further contended that the SEBI circular ref:IMD/CUST/8/2003 dated August 8, 2003 details the reporting requirements that FIIs are required to follow in order to disclose their offshore derivative positions and the circular also prescribes the format in which these positions are to be reported. UBS has also cited the ‘terms’ of offshore derivative instruments and the ‘parties’ to offshore derivative instruments that must be disclosed as per the formats annexed to the said circular.

7.11. UBS has in its aforesaid reply argued that

“Information in relation to the *“parties”* to offshore derivative instruments that must be disclosed is:

- a) Name and Location of the person to whom the offshore Derivative Instruments are issued;
- b) Name and Location of other person in case back to back offshore derivative instruments has been issued against the instrument mentioned in a;
- c) Type of investor (e.g. hedge funds, corporate, individual, pension fund, trust etc.)

In the light of the above, it is evident that there is no requirement in either Regulation 20A of the FII Regulations or the Circular for an FII or a sub-

account of an FII to obtain from the parties to the offshore derivative instruments details of their underlying investors and major shareholders.”

7.12. Regulation 20A of FII Regulations reads as follows:

“Foreign Institutional Investors shall fully disclose information concerning the terms of and parties to offshore derivative instruments such as participatory notes, Equity linked notes or any other such instruments, by whatever names they are called, entered into by it or its sub- accounts or affiliates relating to any securities listed or proposed to be listed in any stock exchange in India, as and when and in such forms as board may require.”

7.13. Information concerning ‘parties to offshore derivative instruments’ must include the co-ordinates of the parties. The interpretation of the terms ‘parties to’ as given by UBS is not acceptable. The term ‘information concerningparties to’ referred to in regulation 20A of FII Regulations should be interpreted in the context of enforceability of the contract i.e. the ODIs against underlying Indian securities. Thus, UBS / its affiliate should have information concerning the parties to the ODIs transactions that is adequate to enforce the agreement with their clients and it is the fundamental dictate of commercial expediency which precludes UBS from quibbling with the ‘terms of’ and ‘parties to’ to absurd lengths.

7.14. Further, I note that regulation 20 of FII Regulations is of wider amplitude than that of regulation 20A. Regulation 20 of FII Regulations casts an obligation on the FIIs to submit to the board “...any information, record or documents in relation to his activities as a Foreign Institutional Investor as the Board may require.”

7.15. In the light of the above, it is clear that, as per the Regulations 20 and 20A of FII Regulations, SEBI is indeed empowered to seek the information it actually sought from UBS and as per the FII Regulations, it is the obligation of UBS to furnish the information. The denial of such information in good time has definitely led to

violation of regulation 20 and 20A of FII Regulations besides scuppering the investigations at its very incipient stage.

8.0. HOW INVESTIGATIONS WERE HAMPERED BY THE CONTUMACIOUS CONDUCT OF UBS

8.1. As already noted, the stock markets in India witnessed a major fall on May 17, 2004 resulting in stoppage of trading twice on major stock exchanges during the day. SEBI found that on May 17, 2004, UBS was a major seller in the Cash Market segment having sold securities to the extent of Rs.188.35 crores (gross). On May 14, 2004, UBS had sold securities valuing Rs.42.65 crores (gross) in the cash segment. As on May 14, 2004, UBS had built up short positions of Rs.434 crores in NIFTY Futures and Rs.292 crores in Stock Futures. As on May 14, 2004, the equity portfolio of UBS was to the tune of Rs. 2956 crores. Thus, UBS was a major trading client in the Cash and F&O segment during May 2004.

8.2. By indulging in transactions of the nature cited above UBS has earned substantial profits. The strategy of UBS appears to be that while its large scale sale in cash market would depress the market and thereby result in likely losses in the securities sold in cash segment, simultaneously the short positions in the Futures segment held by UBS would turn profitable. The data obtained from UBS reveals that, while UBS incurred a loss of Rs.17.54 crores on May 17, 2004 on account of its sale in the cash segment, its short positions in Futures (derivative) segment earned it a mark to market credit (amounting to the profits earned on account of the short positions in the futures segment) of Rs.59.37 crores. Thus, the profits earned by UBS on account of its transactions on May 17, 2004 works out to Rs.41.83 crores.

8.3. Investigations found that the dealings of UBS in Cash and F&O Segment at BSE/NSE were done on behalf of its clients which were mostly Hedge Funds as well as in its proprietary account. During the course of investigations, SEBI, inter alia, sought the names of major shareholders and names of top 5 investors in respect of the

major clients of UBS. It was also advised to confirm that none of the major investors of its clients are Indian nationals, persons of Indian origin or overseas corporate bodies (which are majority owned or controlled by non resident Indians).

8.4. I have noted in this regard that this information was not forthcoming. A perusal of the records relating to investigations reveals that various information, including the above, were sought from UBS and many of the information were received after repeated follow-ups over a period of many months. As narrated in earlier paragraphs, some of the information sought by SEBI was not furnished by UBS even after repeated follow-ups / reminders.

8.5. To throw further light on this matter, I narrate below the attempts made by SEBI to obtain information in respect of Caxton International Ltd., the largest client on whose behalf UBS had dealt on May 17, 2004.

During the course of investigations it was noticed that, on May 17, 2004, UBS had sold securities valuing Rs.99.05 crores in the cash segment on behalf of one of their clients viz. Caxton International Ltd., to whom Offshore Derivative Instruments were issued by UBS AG, London, a group entity of UBS. SEBI had sought information from UBS regarding the address, names of major shareholders, major investors for the said transaction and fund managers of Caxton International Ltd. Also, UBS was advised to furnish the securities holdings of Caxton (name of scrip, number of shares and value in Indian Rupees) as on May 14, 2004 as also the reasons for effecting such large sales particularly on May 17, 2004 from the above client. In response UBS, inter alia, furnished the following information from the said client.

Counterparty Name	Fund Manager	Counterparty Address	Major Shareholders/ Investors
Caxton International	Waiting for response from	C/O Caxton Corporation 500 Park Avenue #8	Declined to respond

Limited	counterparty	NEW YORK NY 10022 USA	
---------	--------------	--------------------------	--

8.6. After repeated follow-ups and in view of the delay / non-cooperation of UBS / its client, on September 6, 2004, SEBI forwarded to UBS a letter addressed to the said client seeking further information. UBS was advised to forward the letter to Caxton International and follow-up with the client to obtain response expeditiously. The said letter was also sent by SEBI directly to Caxton International Ltd. C/o Caxton Corporation, 500, Park Avenue #8, NEW YORK NY 10022 USA i.e. the address furnished by UBS.

8.7. In response, a brief letter dated September 9, 2004 by Caxton Associates LLC was forwarded to SEBI through UBS. In the said letter, Caxton Associates LLC has inter-alia stated that “.... Confirm that Caxton International Ltd., a British Virgin Island company, entered into a Price Return Equity Swap on the NSE S&P CNX Nifty Index (the “SWAP”) with UBS Securities AG London on January 6th, 2004. ON May 17th, 2004, the parties closed out this SWAP. Caxton’s reason for closing out this transaction was to prevent further losses on a position that was incurring losses.”

8.8. Since Caxton did not furnish information regarding their major shareholders/investors etc., SEBI, vide e-mail dated September 14, 2004, again reminded UBS to obtain from the said client the names and addresses of their major shareholders / investors, the names and addresses of their top 5 investors (in terms of value invested) and also to confirm whether any of the major investors of the above client are Indian national, Non-resident Indian or Overseas Corporate bodies (majority controlled by NRIs) or persons of Indian Origin. UBS was advised to obtain the information from the said client on or before September 22, 2004. However, no reply was received till the end of the month of September 2004. In view of the non-cooperation of UBS / its client Caxton International Ltd. SEBI wrote to Securities and Exchange Commission, USA to obtain the above information from the said entities

and forward the same to SEBI. In response, during January 2005, SEC, USA furnished the requisite information to SEBI including the copies of client agreement entered into by UBS AG (an associate of UBS) with Caxton International Ltd. through SEC, USA. As directed by me, SEBI forwarded the above agreement to UBS for its comments (No comments have been received from UBS in this regard). Also, SEBI vide letter dated April 20, 2005 once again advised UBS to furnish the client agreements as sought by me during the personal hearing on February 1, 2005. This was finally submitted by UBS vide its letter dated April 29, 2005 after the usual detour of mistaken understanding of the requirement giving way to clarity in the fullness of time which ensured the necessary leeway in time for reporting.

8.9. Thereafter, during the course of the personal hearing on May 5, 2005, I pointed out to UBS that SEBI had, on October 18, 2004 recorded the statement of Shri Keith Stoddart, Managing Director, Legal and Compliance, Regional Head of Compliance at UBS. He is stationed at Hong Kong. Admittedly, his responsibilities include compliance matters for the above legal entity with regard to its activities in Asia. I pointed out during the course of the personal hearing on May 5, 2005 that SEBI had sought from UBS copies of KYCs (know your client) and Client agreements with Caxton International Ltd., Discovery Capital and Indea Capital Ltd. I pointed out that UBS agreed to revert with this information by November 5, 2004 stating that this information was held by its overseas offices. I noted that UBS failed to furnish the same till the commencement of instant proceedings.

8.10. In response, it was submitted on behalf of UBS that the client agreements sought by SEBI were understood by UBS to mean the terms and conditions of the agreement with the clients. Subsequent to the personal hearing on May 5, 2005, a letter was received from UBS on May 13, 2005. In the said letter UBS has stated that “UBS was requested to submit its ‘know your client’ procedures and agreements with the three clients, we had understood the agreements with clients to mean the business Terms and Conditions of UBS AG London Branch and not the ISDA agreements and there was no request at that time to produce such agreements.....It may be noted that

ISDA agreements are industry standard transactional documents prepared under the auspices of the International Swaps and Derivatives Association and are not considered as client specific agreements.”

- 8.11. I note that during the course of investigations SEBI sought copies of KYCs (know your client) and Client agreements with Caxton International Ltd., Discovery Capital and Indea Capital Ltd. SEBI was investigating the dealings of UBS during May 2004 and in view of the dealings of UBS on behalf of the aforesaid clients during May 2004, client agreements of UBS with the aforesaid three clients were sought from UBS. Thus, the client agreements sought from UBS were transaction specific. Business Terms and Conditions furnished by UBS is an unsigned document and is of no interest to SEBI. The ‘Terms and Conditions’ merely defines the terms and conditions subject to which UBS is willing to enter into business relationship with its prospective clients. The client relation gets formalized only when the client agreement is signed / executed by the parties to the agreement i.e. UBS / its affiliate on the one hand and its client on the other.
- 8.12. It is queer and fanciful that a client agreement which is normally understood to be the one executed by the client with the intermediary and accordingly duly signed by the parties to the agreement could be misconstrued to mean ‘terms and conditions’ of a pro-forma agreement, unsigned generic document. It does not accord with normal human conduct in a commercial parlance where things are understood consistent with the meaning in the déjà vu of commercialese.
- 8.13. I note that even this information, as misunderstood by UBS was not furnished to SEBI till the commencement of the instant proceedings. It was pointed out by the counsel for UBS there is no charge in this regard in the show-cause notice issued by SEBI. While it may be right, I note that the above sequence of events clearly shows a deliberate attempt by UBS to obstruct the due process of investigations by giving certain non-descript documents under the veneer of seeming compliance. It is noted that even my requests during the course of personal hearing were not promptly and

properly complied with by UBS. In this context I note that the information was sought by me during the course of personal hearing when UBS was being represented through an experienced counsel.

8.14. If UBS had any doubts in regard to the information that is being sought by SEBI, it could have furnished both the 'Terms and Conditions' as well as the client agreements duly executed by the parties to the agreement. At the very least, UBS could have sought clarifications from SEBI regarding what is the actual requirement of SEBI. I find that UBS did neither, and the reasons are not far to seek, having regard to the case history replete with reporting lapses, misstatements mired in a welter of contradictions.

8.15. During the course of personal hearing on May 5, 2005 it was argued on behalf of UBS that UBS has no reason not to comply with the regulatory requests and the lapses as cited above occurred only due to misunderstanding of SEBI's requirements. In a quasi-judicial proceeding, it is not essential to go into the aspect of 'mens rea'. The conduct of UBS as narrated above speaks for itself and for the purpose of determining the contumacious conduct of UBS, I do not find it necessary to go into the motives of UBS for not co-operating with the requests of the regulator. The egregious conduct of UBS is evident from the circumstances as narrated above.

8.16. The records incontrovertibly show recalcitrant attitude of UBS in furnishing various information as sought by SEBI during the course of investigation. During the course of personal hearing on May 5, 2005, it was fairly conceded by the counsel for UBS that UBS indeed failed to furnish the information sought by SEBI in a timely manner. The counsel pleaded in a manner of speaking for condonation stating the failure was unintentional and was caused due to improper understanding of the requests for information made by SEBI. Also it was explained at pains that there was no attempt at suppression. I do not accept this contention of UBS. I find that misunderstanding is a contrived posture to avoid furnishing what is specifically required by SEBI for investigations.

8.17. One of the objectives of the investigation was to ascertain whether any Indian nationals, persons of Indian origin or overseas corporate bodies have dealt in the Indian securities market in a surreptitious manner hiding their identity behind the entities to whom off-shore derivative instruments were issued by Foreign Institutional Investors including UBS. It is reasonable to presume that UBS was also aware of this objective of SEBI as it was specifically asked to obtain confirmations from its clients that none of the directors, major shareholders etc. were Indian nationals, persons of Indian origin or overseas corporate bodies.

8.18. As noted earlier, the agreement between UBS AG and Caxton International Ltd. was received by SEBI through SEC, USA during January 2005 i.e. subsequent to the issue of show-cause notice. At my direction, SEBI vide letter dated April 20, 2005, forwarded the agreement to UBS for its comments. UBS has not provided any comments regarding the same. During the course of personal hearing granted to UBS on February 1, 2005, I had sought copies of the client agreement which UBS / its associates had entered into with two of its clients, namely, Discover Global Opportunity Master Fund Ltd. and Indea Absolute Return Fund. The same were furnished by UBS vide their letter dated April 29, 2005.

8.19. It is seen that in respect of two of the aforesaid clients namely, Caxton International Ltd. and Indea Absolute Return Fund the client agreements with UBS have been executed by certain persons (whose names I prefer not to disclose for the sake of confidentiality) which needs further investigation by SEBI. This information if received by SEBI earlier i.e. when the investigation were in progress, could have enabled SEBI to investigate the antecedents of these persons with Indian sounding names. But the measured move of UBS in making convenient disclosures has effectively frustrated SEBI's efforts to conduct a meaningful investigation in or about real time.

8.20. SEBI relies on the intermediaries registered and regulated by it to ensure that the

Indian securities market is developed in an orderly manner and any mischief mongers are kept out of the market and thereby protect the interests of investors in Indian securities market. The claim of UBS that it misunderstood the requests for information made by SEBI taxes my credence. Considering the fact that UBS is registered with SEBI since the year 2000, operates in multiple jurisdictions, would be in all likelihood regularly processing requests for information from regulators situated in various countries and the fact that it has a dedicated regional compliance team to process such requests makes the claim of UBS sound hollow. It may be one of expediency / convenience; and to boot, a self-serving statement, too facile and facetious to be believed.

8.21. I hold that since UBS did not give the information in a timely manner, investigations stand virtually thwarted. While, UBS may argue now, as it indeed did during the course of personal hearing on May 5, 2005, that SEBI is free to investigate the matter even now, with the data made available I find that it is almost a year since the commencement of investigations into the matter and during the period with great difficulty SEBI could collect only the first level information from UBS, while a meaningful investigation is a far cry from this stage.

8.22. SEBI would have been well within its rights to ask for information upto the ultimate beneficiary in terms of Regulation 15A; but what was sought for was the first level information i.e. the identity and details of the entity with whom UBS was directly engaged in business. The failure to furnish such a basic information, in time, not involving any third party enquiry or elaborate due diligence in the form of detailed KYC enquiry to ferret out the ultimate beneficiary is indefensible by any account. The several excuses that have been trotted out in not complying with this basic requirement are devoid of any merit, since they were meant to beguile the underlying and felt need not to divulge the information, as such a disclosure would be prejudicial to their interests. Equally specious is the argument that they took time to collect information from a cornucopia of sources through e-mail or visits to clients, when the nature of information at first level should be on call, exclusively in their

domain of immediate control not entailing any such “beyond-the-ken” global initiatives. Additionally, it should not have been a matter of insuperable difficulty for UBS to give the full and complete information with proper documentation at the first level of its business relationship, since admittedly as per applicable FSA norms, not in dispute, UBS is required to have the necessary due diligence and client verification at the first level. In such a context, the delay of one year has something more to it than what is made out in terms of touted difficulties, which peter out to be imaginary in the ultimate analysis.

8.23. I hold that the quality of information and its evidentiary value has suffered due to efflux of time. It is a moot point whether further enquiry now will lead to any useful results. To that extent the scope and utility of enquiry has been vastly undermined, frustrating the finding of fact which is the summum bonum of any enquiry / investigation. UBS by its contumaciousness and recalcitrance has struck at the very root of investigation before it could really take off in a meaningful way.

8.24. Instances of reporting lapses, Misstatements etc.

a) I note that UBS has cited confidentiality provisions in its client agreements as a reason for non-furnishing / failure to furnish in a timely manner, the information sought by SEBI. UBS vide its letter dated February 24, 2005 has furnished the terms and conditions of its client agreement stating that these are “the terms and conditions for investment business entered into between UBS AG, London branch and their respective clients.” Thus it is clear that UBS / its affiliate have entered into agreements with similar terms and conditions with its various clients. The very fact that UBS was able to provide the information sought by SEBI in respect of many of its clients whereas it did not provide similar information in respect of its other clients shows that client confidentiality provisions was not a constraining factor. Some of the clients of UBS also directly furnished the requisite information to SEBI. Thus, it is clear that the reluctance of UBS to provide the information to SEBI was the cause of failure to furnish the information sought by

SEBI in a timely manner and reasons such as client confidentiality, as claimed by UBS, were not the cause of such failure. Making a fetish of client confidentiality for not providing information sought by the regulator is untenable as there can be no claim of confidentiality as far as the regulator is concerned, more so when the entities are registered with SEBI.

- b) This reluctance of UBS to provide specific information to SEBI is brought out by the fact that even the information furnished by UBS vide its letter dated January 14, 2005 i.e. subsequent to the issue of show-cause notice, was found to be vague. For instance, while furnishing the names of top five investors of Indus Asia Pacific Fund Ltd., UBS stated that these are a USA based global fund of funds organization, a major Northeastern USA university, a major Southwestern USA university, a European based bank and investment organization and a European based fund of funds organization. Obviously, UBS had in its possession the names of the top five investors of Indus Asia Pacific Fund Ltd. as without possessing the names, it could not have described the entities as above. Thus, UBS was giving vague descriptions when it was in possession of the actual names of the top five investors. Since UBS did not give the specific names of the top five investors of Indus Asia Pacific Fund Ltd. which was obviously in its possession, I, during the personal hearing on February 1, 2005 advised UBS to furnish the same. Specific names of these investors were furnished by UBS vide email dated February 25, 2005, clearly evidencing that UBS had this information / was in position to access this information but attempted to delay providing the same by giving vague descriptions regarding the top five investors of the said client. This conduct of UBS shows that it was attempting to thwart the investigations by SEBI by providing bits and pieces of vague information despite being in possession of specific information.

Despite the cant and protestations by UBS that it has co-operated with SEBI and whatever information that was available with it, as required by SEBI was furnished to SEBI, the fact remains that in the real time a true and fair compliance

remained a desideratum.

- c) UBS originally (in its e-mails dated May 27, 2004 and June 2, 2004) claimed that all its transactions during May 2004 were its proprietary transactions i.e. they were not executed on behalf of any clients. subsequently, vide e-mail dated June 14, 2004, UBS furnished the names of the clients on account of whom it had dealt in the Indian securities market during May 2004.

- d) When SEBI sought copies of its client agreements with three of its clients namely, Caxton International Ltd., Discovery Capital and Indea Capital Ltd., UBS did not furnish the same. Being a party to the agreement, it is obvious that UBS / its affiliate were in possession of these agreements. When I sought the same again during the personal hearing on February 1, 2005, vide letter dated February 24, 2005, UBS furnished the 'terms and conditions' of a proforma agreement. SEBI was forced to obtain the client agreement between UBS AG and Caxton International Ltd. through SEC, USA and the same was forwarded to UBS for comments. Subsequent to the above, UBS vide letter dated April 29, 2005 furnished the client agreements with the other two clients viz. Discovery Capital and Indea Capital Ltd. These agreements contain certain information that would have proved immensely useful to SEBI, had it been provided as soon as sought for.

- e) During the personal hearing on May 5, 2005, UBS contended that all the information sought by SEBI have been provided albeit in a belated manner. When issue of information regarding the ultimate investors of Caxton which had been sought earlier by SEBI was raised, UBS contended that the same had been furnished to the Investigating Officer. I advised UBS to once again furnish the same directly to me. In response, UBS vide letter dated May 13, 2005 has admitted that it does not possess this information thereby rendering its claim of having provided the same earlier to the Investigating Officer false and misleading.

f) Further in the ODI statements furnished by UBS on a monthly basis to SEBI the name of Caxton did not figure in the first instance amongst the entities to whom UBS / its affiliate has issued ODIs. When pointed out by SEBI during investigation, UBS admitted the lapse and furnished a revised ODI statement on June 25, 2004 including the name of Caxton. In the backdrop of what has been discussed on the conduct of UBS the omission becomes serious and is of a piece with the conduct of suppressio veri suggestio falsi. This particular instance, though not strictly arising from the show cause, has been cited as a relevant antecedent in a continuum of what permeates the case history to make a telling point that cocking a snook at the regulatory requirements is the staple of the conduct of UBS.

8.25. In the light of the conduct of UBS as narrated above, I hold that there has been a systematically misled the Board besides a lot of cover-up in the matter of furnishing information.

9.0. **NON-ADHERENCE TO THE CODE OF CONDUCT**

9.1. In the show-cause notice dated November 24, 2004, UBS was charged with violation of clauses 1, 2, 5 and 6 of Code of Conduct as specified in Regulation 7 A of FII Regulations. Regulation 7A of FII Regulations states “A foreign institutional investor holding a certificate shall, at all times, abide by the Code of Conduct as specified in Third Schedule.”

9.2. Clause 1 of Code of Code of Conduct states “A Foreign Institutional Investor and its key personnel shall observe high standards of integrity, fairness and professionalism in all dealings in the Indian securities market with inter-mediaries, regulatory and other government authorities.”

9.3. Clause 2 of Code of Code of Conduct states “A Foreign Institutional Investor shall, at all times, render high standards of service, exercise high due diligence and

independent professional judgement.”

9.4. Clause 5 of Code of Code of Conduct states “A Foreign Institutional Investor shall maintain an appropriate level of knowledge and competency and abide by the provisions of the Act, regulations made thereunder and the circulars and guidelines, which may be applicable and relevant to the activities carried on by it. Every Foreign Institutional Investor shall also comply with award of the Ombudsman and decision of the Board under the SEBI (Ombudsman) Regulations, 2003.”

9.5. Clause 6 of Code of Code of Conduct states “A Foreign Institutional Investor shall not make any untrue statement or suppress any material fact in any documents, reports or information furnished to the Board.”

9.6. UBS in its reply dated December 22, 2004, has submitted that it has exercised all possible due diligence in and undertaken necessary effort in obtaining the information as requested by SEBI. UBS has further submitted that “.....despite there being no obligation under the FII regulations for UBS to obtain from the holders of off-shore derivative instruments such as participatory notes, equity linked notes or any other similar instruments against underlying securities, listed or proposed to be listed on any stock exchange in India, the details of their major shareholders or top five investors, UBS made all necessary efforts to procure the relevant information from the clients to SEBI. UBS corresponded promptly with the relevant clients and even proposed that the clients provide the information directly to SEBI, if they were prevented from disclosing the required information to UBS for confidentiality purposes.”

9.7. UBS has summarized the correspondence exchanged by it with its clients as well as with SEBI. UBS has stated that certain clients (Indus Asia Pacific Fund, TRG Global Opportunity Master Fund and PMA Prospect Fund) informed that confidentiality requirements did not allow these clients to

disclose the names of the major shareholder or details of top 5 investors. UBS has stated that under FII Regulations it is not obliged to obtain the above information from the holders of ODIs. Hence UBS has contended that it has acted diligently and exercised proper care.

9.8. Further, UBS has stated that it has not failed to maintain appropriate level of knowledge and competence and abide by the provision of Act etc. UBS has stated that it has not made any untrue statement or suppressed any material fact in any document, reports or information furnished to SEBI and accordingly it has not breached clauses 1, 2, 5 and 6 of the code of conduct.

9.9. UBS has further contended that the information requested by SEBI was not within the control or power of UBS to provide as such information was exclusively in the domain third parties. In such circumstances, it cannot be held liable for failures, which arise for no fault of its and which are as a result of factors beyond its control.

9.10. It is an admitted fact that SFCML is a proprietary sub-account of UBS and it is also admitted fact that UBS is routing all its investment in Indian securities through its proprietary sub-account viz. SFCML. It is also admitted that SFCML originates transactions and holds positions in the Indian securities markets in order to take a fundamental view, or to hedge derivative instruments over Indian underlying securities that are transacted by an affiliate company, UBS AG London branch. It is noted from the records that UBS AG, London has issued ODIs against underlying Indian securities to several entities situated outside India. From the above it emerges that UBS AG, which is an affiliate of UBS, has issued ODIs to its clients on the basis of underlying Indian securities held by UBS. Therefore UBS in all likelihood should be in a position to know the ultimate client for whom the ODIs have been issued by UBS AG, London. When UBS is aware of the regulatory requirement of informing the details of the ultimate client and when UBS is also aware that its affiliate is issuing ODIs on the basis of underlying securities held by it, it is more so relevant for

UBS to ascertain from UBS AG, London and inform the regulator about the ultimate client.

9.11. Further, UBS has stated that SFCML deals in Indian securities on its own account as well as to hedge the derivative instruments over Indian underlying securities transacted by UBS AG, London. Thus, it is an admitted position that at least a part of the transactions by UBS / its sub-account SFCML in the Indian securities market are attributable to the ODIs issued by its affiliate UBS AG, London. I also note that UBS has been submitting monthly statements on the ODIs issued by its affiliate as required under regulation 20A of FII Regulations and in the format prescribed by SEBI circular IMD/CUST/8/2003 dated August 8, 2003. UBS AG is also registered with SEBI as an FII and accordingly, all the relevant regulations are applicable to it. Hence the claim of UBS that KYC norms are not applicable to it is not tenable. Such mischievous and frivolous claim by UBS indicates that it has failed to appreciate the high standards of conduct to which it is subject to as a registered securities professional.

9.12. Such stonewalling by UBS, as referred supra, has frustrated investigations by SEBI. It is important for market participants to provide information to SEBI quickly as and when sought, as the data is time sensitive and gets time warped in the vicissitudes of a case of this magnitude, besides losing its sensitivity and evidentiary value in the ebb and flow of time.

9.13. It is the duty of UBS that prior to issue of ODIs with underlying Indian securities, it should have completed the 'know your client' requirements by asking its clients all the questions that the regulator (i.e. SEBI) is likely to ask. Instead UBS claims to have approached its respective clients after SEBI sought information regarding these clients. This shows that UBS has failed to understand the essential meaning of 'know your client' requirements.

9.14. Vide e-mail dated June 22, 2004, UBS undertook to furnish the requisite

information in respect of its clients through its London and New York office. Thus, it is apparent that these branches of UBS / its affiliate possessed / had access to the requisite information. Later, UBS changed its stance and claimed that the clients were unwilling to disclose the information citing confidentiality reasons. Such claims of client confidentiality appear to be lame excuses for not furnishing the requisite information to SEBI. The claim of UBS is not acceptable as there cannot any confidentiality claim as regards the regulator.

9.15. I find that UBS has been furnishing information misleading information to the regulator. The same is evidenced from the erroneous statements relating to Offshore Derivative Instruments (ODI statement) that were submitted by UBS to SEBI month after month. SEBI vide circular Ref:IMD/CUST/8/2003 dated August 8, 2003 has prescribed the format in which the fortnightly (later changed to monthly) statement relating to the Offshore Derivative Instruments should be furnished. Information furnished by UBS during the course of investigation revealed that out of the sales of Rs.188.35 crores (gross) made by UBS on May 17, 2004, sales valuing Rs.99.04 crores were made on account of UBS' transactions with Caxton International Ltd. When SEBI examined the ODI statements submitted by UBS it was found that the name of Caxton International Ltd. did not appear amongst the entities to whom UBS has issued ODIs. When the same was pointed out to UBS by SEBI, UBS in its letter dated June 25, 2004 admitted the error in their ODI statement. Further to the above, UBS furnished a revised ODI statement for the month of May 2004 including the name of Caxton. Subsequently, on Sep. 27, 2004, SEBI sought the details of all the ODIs issued to Caxton. UBS furnished the information vide its reply dated Sep. 30, 2004. it was notice the UBS had been issuing ODIs since January 2004. Examination of the ODI statements furnished by UBS for each of the months from January 2004 to April 2004 revealed that these statements also did not mention the fact of ODIs issued to Caxton by UBS. Thereafter UBS realised its error and consequently vide e-mail dated October 14, 2004 furnished revised ODI statements for each of the months from January 2004 to April 2004.

9.16. UBS has attempted to mislead SEBI by making false claims. During the course of personal hearing on May 5, 2005, UBS stated that they had provided all the information sought thus far by SEBI. When it was pointed out that top five investors of Caxton International Ltd. has not been provided, UBS claimed that the said information had been earlier handed over by it to the Investigating Officer. I advised them to furnish the same to me by the next day i.e. May 6, 2005. In this regard a letter was received from UBS on May 13, 2005. Upon perusal of the same, I find that UBS has stated “We wish to reiterate that we are not in possession of the names of the five major investors of Caxton.” Thus, it is clear that the claim made by the UBS before me during the course of personal hearing on May 5, 2005 of having already provided the names of the top five investors of Caxton to the Investigating Officer is false and misleading.

9.17. Another instance of the duplicity of UBS brought out by their conduct whereby they submitted the ‘terms and conditions’ of the pro-forma agreement when SEBI repeatedly sought the client agreements entered into by UBS with three of its clients. The argument of UBS that it misunderstood the requirements of SEBI stretches my credence.

9.18. The concatenation of events starting from suppression of the name of Caxton in the ODI statement as submitted to SEBI and extending upto providing of a motley pack of vague names of investors for Indus Asia Pacific Fund and further furnishing of a routine standard terms and conditions of unsigned agreement in the place of duly signed regular agreement as understood in commercial parlance gives the lie to the fact that UBS was sedulously motivated in sharing information while each such instance carries the undertones of suppressio veri suggestio falsi through self-serving statements finding its profusion in the insuppressible volubility of self-assertion running the gamut of case.

9.19. I note that on May 17, 2004, when the market fell in a significant manner (Sensex fell by 567.74 points; NIFTY fell by 196.90 points), UBS was amongst the largest

selling clients and had sold securities valuing Rs. 188.35 crores. The above sales constitutes as much as 3% of the market (BSE & NSE cash segment taken together) traded value of Rs.6092.03 crores. As on May 14, 2004, the value of securities held by UBS was about Rs.3000 crores. As on May 14, 2004, it had built up NIFTY Futures short positions to the tune of Rs.434 crores and stock Futures short positions to the tune of Rs.292 crores. Thus, it is seen that UBS was a significant participant in both the cash as well as the derivatives segment of the Indian securities market during May 2004.

9.20. Conduct is generally judged not based on single activity; but on a course of behaviour showing intentional non-cooperation with the regulator and is usually the result of acts, practices and the like approaches that are designed to give the slip to the regulator. The egregiousness of UBS' behaviour and scienter non-cooperation with the regulator is based not on a stray instance but a slew of them, neither fortuitous nor serendipitous, holding out tell-tale strands of how it was fashioned as a deliberate strategy to obfuscate the proceedings.

9.21. In the light of the above, it is evident that UBS has failed to maintain high standards of integrity, fairness and professionalism in all dealings in Indian securities market with the regulatory authority viz. SEBI. it has failed to exercise due diligence in dealing with its clients and with the regulator. It has failed to maintain appropriate level of knowledge and competency and abide by the provisions of the Act, regulations made thereunder and the circulars and guidelines applicable and relevant to the activities carried on by it. UBS has made untrue statements and suppressed material facts in the documents, reports and information furnished to SEBI, while seeking to wriggle out of the regulatory requirements imposed upon it.

9.22. Considering the above factors, I hold that UBS has failed to comply with the relevant clauses of the code of conduct as applicable to FIIs.

10.0. CONCLUSION

10.1. On a conspectus of the material particulars and the material material developments in the case, the inexorable conclusion would be that UBS has totally failed to discharge its obligations to regulatory requirements, with a design to withhold critical information for stultifying the investigation. No matter what happens to investigation, the material point is that UBS has not complied with Regulations 15A, 20 and 20A of FII Regulations and Clauses 1, 2, 5 and 6 of code of conduct applicable to FIIs as found in the course of collecting information for investigation.

10.2. SEBI is not required to prove its case with mathematical precision to a demonstrable degree; for, in all human affairs absolute certainty is a myth, and as Prof. Brett felicitously puts it – “all exactness is a fake”. El Dorado of absolute proof being unattainable, the law, accepts for it, probability as a working substitute in this work-a-day world. The law does not require SEBI to prove the impossible. All that it requires is the establishment of such a degree of probability that a prudent man may, on its basis, believe in the existence of the fact in issue. This legal proof is not necessarily perfect proof often it is nothing more than a prudent man’s estimate as to the probabilities of the case [1983(13) ELT 1546(SC)].

10.3. A catena of decisions has been cited by UBS in support of various points urged by them in their written submissions though not further pressed during the personal hearings. I have carefully considered these decisions. At the outset, I am credited with the view that though legal precedents are very important guiding factors to inform the decision making in any given case, it is equally important to know that no two cases are *pari materia*. Also it needs no emphasis that each case turns on its own facts and material circumstances which can be distinguished from the factors decided by higher courts in other cases relied upon. However, care has been taken to consider the *ratio-decidenti* of the cases cited to ensure that the findings in the instant case is in line subject to their applicability to the issues discussed and debated in the instant case in the context of its own factual matrix. None of the cases cited are of any help to UBS

in shoring up its position, in as much as enough material has been brought on record in the instant case to indicate that there has been no proper exercise of due diligence in compliance with KYC norms. Further the onus cast upon UBS in the contours of the case cannot be construed as one which seeks to impose a greater burden on UBS than what is legally required. UBS was required to give such information in relation to its clients as mandated by Regulation 15A read with 20 and 20A. There has been enough discussion on this issue elsewhere in this order how UBS failed to discharge even the limited onus cast upon it in terms of regulatory requirements. Also it is to be stressed that the present action against UBS is neither inconsistent nor palpably discriminatory in as much as the conduct and role of significant players in the market on 17th May 2004 is under scrutiny. The exercise of power under section 11B and 11(4) has been hedged in with paramount consideration for orderly development of the securities market and to further obviate any market crisis which would adversely affect the investors' interests.

10.4. Thus on an overall consideration of the various decisions, I hold that the findings in the present order has duly reckoned with all the decisions, in so far as they are applicable to the instant case.

10.5. In view of the above and in the light of the acts of omission and commission by UBS as discussed in detail earlier, I hold that UBS is guilty of non-compliance of Regulations 15A, 20 and 20A and clauses 1,2, 5 and 6 of code of conduct applicable to FIIs as laid down in the FII Regulations.

10.6. I understand that Enquiry and Adjudication proceedings have been initiated against UBS and its associate UBS Securities India P Ltd. (a SEBI registered Stock broker) in respect of certain matter which, inter alia, include some of the issues discussed above. The Enquiry and Adjudication proceedings shall proceed without being influenced in any way by the findings of this order.

11.0. ORDER

11.1. The findings in this case have highlighted serious regulatory concerns in that the PN / ODI route and its cover of anonymity is being used by certain entities without there being any real time check, control and due diligence on their credentials. Such a lapse has very grim portents as far as the market integrity and interest of investors are concerned. The mechanism of opening up the Indian securities market through PN / ODI route to entities outside India imposes a commensurate onus on the registered intermediaries (FIIs) of maintaining high standards of regulatory compliance, exercise of high due diligence and independent professional judgment and therefore any gaps in measuring up to the onus may be fraught with critical repercussions in the market.

11.2. In the light of the above and in exercise of the powers conferred on me in terms of Section 19 of the SEBI Act, 1992, read with Section 11(4) and 11B of SEBI Act, 1992, I hereby prohibit UBS / its affiliates / agents from issuing off-shore derivative instruments with underlying Indian securities against the positions held by UBS in the Indian securities market for a period of one year. I also prohibit UBS / its affiliates / agents from renewing or rolling over any of the ODIs already issued against the positions held by it in the Indian securities market for a period of one year.

11.3. I further direct UBS to establish highest standards of Customer Due Diligence process in line with the requirements of FII Regulations of SEBI.

11.4. This is without prejudice to any other action taken or to be taken by SEBI against UBS in accordance with the provisions of SEBI Act, 1992, the Regulations made thereunder or any other law as may be applicable.

This order shall come into force with immediate effect.

Place: Mumbai

Date: May 17, 2005

**G ANANTHARAMAN
WHOLE-TIME MEMBER
SECURITIES AND EXCHANGE BOARD OF INDIA**