REPORT

JOINT COMMITTEE
TO
ENQUIRE INTO
IRREGULARITIES IN SECURITIES
AND
BANKING TRANSACTIONS

(TENTH LOK SABHA)

(VOLUME-I — REPORT)

Presented to Lok Sabha on 21st December, 1993

Laid on the Table of Rajya Sabha on 21st December, 1993

LOK SABHA SECRETARIAT
NEW DELHI

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COMPOSITION OF THE JOINT COMMITTEE TO ENQUIRE INTO IRREGULARITIES IN SECURITIES AND BANKING TRANSACTIONS

SHRI RAM NIWAS MIRDHA — *Chairman*

MEMBERS

Lok Sabha

*2. Shri A. Charles
3. Shri Mani Shankar Aiyar
4. Shri Vijaya Kumar Raju Bhupathiraju
5. Shri P.C. Chacko
6. Shri Nirmal Kanti Chatterjee
7. Sqn. Ldr. Kamal Chaudhry
8. Shri Murli S. Deora
*9. Shri M.O.H. Farook
10. Shri George Fernandes
11. Shri Jaswant Singh
12. Shri Ram Naik
13. Shri P.G. Narayanan
14. Dr. Debi Prosad Pal
15. Shri Sriballav Panigrahi
16. Shri Shravan Kumar Patel
17. Shri Harin Pathak
18. Shri Rabi Ray
19. Shri K.P. Unnikrishnan
20. Shri Sushil Chandra Varma

Rajya Sabha

21. Shri S. S. Ahluwalia
22. Shri Triloki Nath Chaturvedi
23. Shri Jagesh Desai
24. Shri Gurudas Das Gupta

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*Appointed with effect from 5 March, 1993 *vice* Shrimati Basava Rajeswari and Shri P.M. Sayeed resigned with effect from 19 January and 17 February, 1993, respectively.

25. Shri H. Hanumanthappa

26. Shri Murasoli Maran

27. Shri S. Jaipal Reddy

* 28. Shri Sukomal Sen

** 29. Shri Digvijay Singh

30. Shri Ram Naresh Yadav

SECRETARIAT

1. Shri G.L. Batra	—	*Additional Secretary*
2. Shri S.C. Gupta	—	*Joint Secretary*
3. Smt. Ganga Murthy	—	*Deputy Secretary*
4. Shri K.L. Narang	—	*Under Secretary*
5. Shri P. Sreedharan	—	*Under Secretary*

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* Appointed with effect from 6 August, 1993 *vice* Shri Dipen Ghosh ceased to be a Member of the Committee on his retirement from Rajya Sabha.

** Appointed with effect from 7 December, 1993 *vice* Shri Yashwant Sinha ceased to be a Member of the Committee on his resignation from Rajya Sabha on 14 November, 1993.

List of Abbreviations used in the Report

ABFSL	—	Andhra Bank Financial Services Ltd.
ADN	—	A.D. Narotam
AFR	—	Annual Financial Review
AI	—	Air India
BCD	—	Bhupen C. Dalal
BoA	—	Bank of America
BoK	—	Bank of Karad
BPL	—	Bharat Petroleum Ltd.
BR	—	Bank Receipt
BSE	—	Bombay Stock Exchange
C&AG	—	Comptroller and Auditor General of India
CANFINA	—	Canbank Financial Services Ltd.
CBDT	—	Central Board of Direct Taxes
CBI	—	Central Bureau of Investigation
CCDS	—	Corporate Cash Deployment Service
CD	—	Certificate of Deposits
CIAS	—	Corporate Investment Advisory Service
CMF	—	Canbank Mutual Fund
CONCOR	—	Container Corporation of India Ltd.
CRR	—	Cash Reserve Ratio
CVC	—	Central Vigilance Commission
CVO	—	Chief Vigilance Officer
DBOD	—	Department of Banking Operations and Development
DFHI	—	Discount and Finance House of India
DPE	—	Department of Public Enterprises
DTL	—	Demand and Time Liabilities
FERA	—	Foreign Exchange Regulation Act
FFSL	—	Fairgrowth Financial Services Ltd.
FI	—	Financial Inspection
GRAM	—	Growmore Research and Assets Management Ltd.

GSAL	—	Goldstar Steel and Alloys Ltd.
HPCL	—	Hindustan Petroleum Corporation Ltd.
HPD	—	Hiten P. Dalal
HSM	—	Harshad S. Mehta
IBA	—	Indian Banks Association
IFFCO	—	Indian Farmers Fertiliser Co-operative Ltd.
IRFC	—	Indian Railways Finance Corporation
KRIBHCO	—	Krishak Bharti Co-operative Ltd.
MCB	—	Metropolitan Co-operative Bank Ltd.
NBFC	—	Non-Banking Financial Companies
NHB	—	National Housing Bank
NKA	—	Naresh K. Aggarwala
OIDB	—	Oil Industry Development Board
OIL	—	Oil India Ltd.
ONGC	—	Oil and Natural Gas Commission
PDO	—	Public Debt Office
PFC	—	Power Finance Corporation
PMS	—	Portfolio Management Scheme
PSU	—	Public Sector Undertakings
RBI	—	Reserve Bank of India
SBI	—	State Bank of India
SBI Caps	—	SBI Capital Markets Ltd.
SBS	—	State Bank of Saurashtra
SCB	—	Standard Chartered Bank
SEBI	—	Securities and Exchange Board of India
SGL	—	Subsidiary General Ledger
SLR	—	Statutory Liquidity Ratio
SR	—	Security Receipt
UCO Bank	—	United Commercial Bank
UTI	—	Unit Trust of India

INTRODUCTION

I, the Chairman of the Joint Committee to enquire into irregularities in securities and banking transactions, having been authorised by the Committee to submit the Report on their behalf, present the Report of the Committee.

2. The Committee were constituted on a Motion adopted by Lok Sabha on 6th August, 1992 and concurred in by Rajya Sabha on 7th August, 1992. The Chairman of the Committee was appointed by the Hon'ble Speaker on 10th August, 1992. The terms of reference of the Committee are given in Appendix-V.

3. The Committee were instructed to make a Report to the House by the end of Winter Session, 1992. As the Committee could not complete their work by the scheduled date they sought four extensions, the last extension being upto the last day of the Winter Session, 1993.

4. Two Members of the Committee *viz.*, Smt. Basava Rajeswari and Shri P.M. Sayeed resigned on their induction in the Union Council of Ministers. Shri A. Charles and Shri M.O.H. Farook were appointed in their places to serve on the Committee with effect from 5th March, 1993.

Shri Dipen Ghosh, M.P. retired from the membership of Rajya Sabha on 9th July, 1993 and ceased to be a member of the Committee. Shri Sukomal Sen was appointed in his place with effect from 6th August, 1993.

Another Member of the Committee *viz.*, Shri Yashwant Sinha ceased to be a Member of the Committee consequent upon his resignation from the membership of Rajya Sabha with effect from 14th November, 1993. Shri Digvijay Singh was appointed in his place with effect from 7th December, 1993 to serve on the Committee.

The Committee place on record their appreciation of the valuable contribution made by Smt. Basava Rajeswari, S/Shri P.M. Sayeed, Dipen Ghosh and Yashwant Sinha to the deliberations of the Committee.

5. The Committee constituted three Study Groups for detailed examination of the various aspects relating to the irregularities in securities and banking transactions as indicated below:

Study Group I	Government of India including Ministry of Finance and Reserve Bank of India.
Study Group II	Banks, Financial Institutions and Finance Companies.
Study Group III	Public Sector Undertakings, Stock Exchanges, Securities and Exchange Board of India (SEBI) and Brokers.

A Working Group on Procedure and Programme was also constituted. The composition of Study Groups and the Working Group is given in Appendix-VII.

6. A Sub-Committee of the Joint Committee consisting of — Chairman S/Shri Jaswant Singh, Rabi Ray, Jagesh Desai and Dipen Ghosh were appointed on the 28th April, 1993 to draft the Report of the Joint Committee.

7. The Committee held ninety-six sittings in all. Of these, 4 sittings were held for technical briefing, 55 sittings were devoted for recording of evidence and 37 sittings for in-house deliberations. The total duration of the sittings of the Committee was 410 hours. The Committee took evidence of two Ministers, one Ex-Minister, officials/ex-officials of Banks,

Non-Banking Finance Companies, both in public and private sector, Public Sector Undertakings, RBI, SEBI, Investigating Agencies — CBI, CBDT and Enforcement Directorate, Ministries/Departments of the Government of India, Presidents and Executive Directors of selected Stock Exchanges and other individuals. The list of individuals and organisations whose representatives gave evidence before the Committee, is given in Annexure. A verbatim record of the oral evidence before the Committee running into about 5400 pages, was kept.

8. The Study Groups, Working Group and the Drafting Sub-Committee held 13, 9 and 20 sittings respectively. The total duration of these sittings was 96 hours.

9. The Committee undertook tour to Bombay from 4th to 6th November, 1992 and visited Bombay Stock Exchange and held informal discussions with the representatives of the Indian Banks Association, All India Workmen Union, All India Officers Association in Banking Industries and All India Bank Depositor's Association, etc.

10. The Committee considered the final draft of the Report and adopted the same unanimously at their sitting held on 8th December, 1993.

11. The Minutes of the sittings of the Committee form Part II of the Report.

12. For facility of reference and convenience, the observations, conclusions and recommendations of the Committee are also given separately at the end of the Report.

13. The Committee wish to express their thanks to the Ministers, ex-Ministers, representatives of various other Ministries/Departments, Organisations and individuals for placing before them the material and information asked for by them in connection with the examination of the subject and for giving evidence before them.

14. To assist the Committee in their work a Special Cell under the overall charge of Shri G.L. Batra, Additional Secretary and headed by Shri S.C. Gupta, Joint Secretary was created. The other officers in the Cell included Smt. Ganga Murthy, Deputy Secretary; S/Shri K.L. Narang, P. Sreedharan, Under Secretaries; late S.S. Malhi, Assistant Director; Shri Dilip K. Singh, Executive Officer. S/Shri P.C. Koul, N.S. Hooda, N.C. Gupta, Reporting Officers and other supporting staff, S/Shri Satish Loomba, Deputy Secretary; S.A. Venkataraman, ex-Principal, Staff Training College, R.B.I. and Dr. Dharmendra Bhandari, Assistant Professor, University of Rajasthan also assisted the Committee for sometime. The Committee place on record their deep appreciation for the hard work, dedication and valuable assistance rendered to them by all the officers and staff.

NEW DELHI;
December 11, 1993
Agrahayana 20, 1915 (Saka)

RAM NIWAS MIRDHA
Chairman,
Joint Committee to enquire into Irregularities in Securities and Banking Transactions.

ANNEXURE

[Para 7 of Introduction]

List of individuals and organisations whose representatives gave evidence before the Committee

1. Governor, Reserve Bank of India.
2. Public Debt Office (PDO), RBI.
3. Department of Banking Operations and Development (DBOD), RBI.
4. State Bank of India.
5. Andhra Bank.
6. UCO Bank.
7. Canara Bank.
8. Vijaya Bank.
9. Bank of Madura.
10. Allahabad Bank.
11. Bank of Karad (In Liquidation).
12. Metropolitan Cooperative Bank Ltd. (In Liquidation).
13. Standard Chartered Bank.
14. Citibank.
15. Bank of America.
16. ANZ Grindlays Bank.
17. SBI Capital Markets Limited.
18. National Housing Bank.
19. Andhra Bank Financial Services Ltd. (ABFSL).
20. Canfina
21. Canbank Mutual Fund.
22. Allbank Finance Ltd.
23. Fairgrowth Financial Services Ltd.
24. Ministry of Finance.
25. Ministry of Industry, Department of Public Enterprises (DPE) and Department of Heavy Industry.
26. Ministry of Petroleum and Natural Gas.
27. Ministry of Commerce.
28. Ministry of Railways (Railway Board).
29. Department of Atomic Energy.
30. Department of Fertilizers.
31. Central Bureau of Investigation.
32. Central Board of Direct Taxes.
33. Enforcement Directorate.

34. Securities and Exchange Board of India.
35. Air India.
36. Indian Airlines.
37. Vayudoot.
38. Oil Industry Development Board.
39. Oil & Natural Gas Commission.
40. Power Finance Corporation Limited.
41. Indian Railway Finance Corporation Limited.
42. Maruti Udyog Limited.
43. Bharat Heavy Electricals Limited.
44. Oil India Limited.
45. Gas Authority of India Ltd.
46. Hindustan Petroleum Corporation Limited.
47. Indian Oil Corporation.
48. IBP Co. Ltd.
49. Bharat Petroleum Corporation Ltd.
50. Nuclear Power Corporation of India Ltd.
51. Indian Farmers' Fertilizer Cooperative Limited.
52. Krishak Bharati Cooperative Limited.
53. Rashtriya Chemicals & Fertilizers Ltd.
54. State Trading Corporation.
55. Minerals and Metals Trading Corporation of India Limited.
56. Export Credit Guarantee Corporation of India Ltd.
57. India Trade Promotion Organisation.
58. Container Corporation of India Ltd.
59. Presidents and Executive Directors of Stock Exchanges, Bombay, Calcutta, Madras and Delhi.
60. Shri Harshad S. Mehta — Broker.
61. Shri Pallav Sheth — Broker.
62. Shri Ajay Kayan — Broker.
63. Shri Bhupen C. Dalal — Broker.
64. Shri Hiten P. Dalal — Broker.
65. Shri Abhay D. Narotam — Broker.
66. Shri J.P. Gandhi — Broker.
67. Shri J.R. Shroff — Partner M/s. V.B. Desai, Broking firm.
68. Shri Naresh K. Aggarwala — Broker.
69. Shri T.B. Ruia, Shareholder, MCB Ltd.
70. Shri S.L. Khosla, Ex. Chairman, ONGC.
71. Shri K. Margabanthu, Ex. CMD, UCO Bank.

72. Shri M.N. Goiporia, Ex. Chairman, SBI.
73. Shri Amitava Ghosh, Ex. Deputy Governor, RBI.
74. Shri K.R. Nayak, Ex. CMD, Andhra Bank.
75. Shri N.D. Prabhu, Ex. CMD, Canara Bank.
76. Shri K. Madhavan, Ex. Joint Director, CBI.
77. Dr. V. Krishnamurthy, Ex. Member, Planning Commission.
78. Shri R. Kannan, Ex. Executive Director, Merchant Banking Division of Standard Chartered Bank.
79. Shri P.S. Nat, Ex. Chief Executive of Standard Chartered Bank.
80. Shri C.V. Siva Prasad, Managing Director, Andhra Bank Financial Services Ltd.
81. Shri Y. Sunder Babu, Ex. Managing Director, Andhra Bank Financial Services Ltd.
82. Shri N. Krishna Mohan, Managing Director, Goldstar Steel & Alloys Limited, Hyderabad.
83. Shri Kalyanaraman, Senior Vice-President, ABFSL, Bombay.
84. Dr. Manmohan Singh, Minister of Finance.
85. Shri B. Shankaranand, Minister of Health and Family Welfare and the then Minister of Petroleum and Natural Gas and Chairman, OIDB.
86. Prof. Madhu Dandavate, Former Minister of Finance.

CHAPTER - I

JOINT COMMITTEE — ITS CONSTITUTION

1.1 The capital market recorded a phenomenal growth since 1980s and the share prices in the stock market touched the peak levels in the years 1991 and 1992. The All India Index Number of share prices computed by the Reserve Bank of India (RBI) on a weekly basis, with the base year 1980-81 equal to 100, recorded an increase from 554.9 in April 1991 to 571.3 in June 1991. The prices continued to rise further and the RBI Index moved further to 771.9 in September, 1991. By end December 1991, the index touched a level of 805.1. During the same period the Bombay Stock Exchange (BSE) sensitive index with the base year 1978-79 equal to 100 recorded an increase from 1193.61 on 1 April, 1991 to 1361.72 on 21 June, 1991 and moved up further to 1912.35 on 16 September 1991. By end December, 1991, the index reached 1915.12. Commenting on this increase, the Economic survey of 1991-92 presented by the Ministry of Finance in February 1992 reflected, "The market sentiments gathered further bullishness following the new fiscal measures announced in the Union Budget for 1991-92 and the new policy initiatives of far-reaching consequences announced in the Industrial Policy Statement in July 1991, and the Trade Policy Statement in August, 1991."

1.2 Though the share prices in the stock Market registered a slow rate of growth in the months of November and December 1991, the prices started once again booming from early January, 1992. The RBI index rose from 840.7 in January, 1992, to 991.2 in February and touched an all time high of 1324.9 in March 1992. The rise in the BSE sensitive index was much more significant in the first quarter of 1992 when the index moved up from 2302.5 in January, 1992, to 3047.68 in February and 4285 in March 1992 touching a peak of 4467.32 by 22.4.1992. A graphic presentation of the movement of BSE sensitive index during the period 1.4.1991 to 21.8.1992 is given in Appendix I.

1.3 Parliament meanwhile was exercised over the abnormal spurt in share prices and members expressed their concern both in the Lok Sabha and the Rajya Sabha. In reply to Unstarred Question No. 4969 in the Lok Sabha on 27.3.92, the Minister of State in the Ministry of Finance, stated, "The share prices have shown rising trend during the last nine months due to market factors including the recent liberalised policies of the Government". Attention of the Government was also drawn by the members to the impact such abnormal rise in the prices of shares had on the economy. The matter came in the form of a Starred Question (No. 484) in the Rajya Sabha on 31.3.1992. The Minister of State in the Ministry of Finance informed the House: " Government have taken note of the general increase in the prices of shares of companies including the prices of shares of multi-national companies operating in India. The increase was mainly on account of expectations of investors generated by the rise in the level of foreign exchange reserves and the improvement of overall economic environment. The low floating stock in the market and excess of funds flowing into the stock market also contributed significantly to this increase. While the holding of shares with the financial institutions is sizeable, there is no indication to suggest that the spurt in prices of shares was due to withholding of shares in huge blocks by these institutions".

1.4 The Finance Minister held a meeting with the Presidents of the Stock Exchanges and the Chairman, Securities and Exchange Board of India (SEBI) on 28.3.92 regarding the functioning of Stock Exchanges. A copy of the record of discussions of the meeting is given in Appendix II. SEBI addressed a letter on 10th of April, 1992 to the Stock Exchanges regarding implementing the provisions under the SEBI Act, particularly Section 12(1), where

registration by the stock brokers had become obligatory. As a measure of protest, a strike call was given by the stock brokers and members of most Exchanges in the country refrained from trading between 16th and 24th April, 1992.

1.5 The irregularities in the conduct of banking and securities transactions however surfaced on 23rd April, 1992 in the press highlighting that the State Bank of India (SBI) is making frantic efforts to reconcile the books of its securities and investment department in the wake of the discovery that several hundred crores had been advanced without following due procedure and possibly without collateral securities.

1.6 The subject relating to the behaviour of the share market and the irregular diversion of funds from banks to the stock market came up for detailed discussion in the Rajya Sabha on the 29th of April, 1992. Describing the boom in the share market as artificial and speculative in nature and being fuelled by the investments being made by a number of nationalised banks, the members urged the Government to take prompt corrective action. The members demanded a commission of inquiry to go into shortfall in the securities held by the SBI and the irregular diversion of funds from SBI to the stock market through select brokers. The working of the Public Debt Office (PDO) in the RBI in this context also engaged the attention of the House.

1.7 The situation arising out of the strike by share brokers resulting in the closure of stock exchanges, over the implementation of the provisions regarding registration under the Securities and Exchange Board of India (SEBI) Act and the steps taken by the Government in regard thereto came up for discussion in the Lok Sabha on a Calling Attention Motion on 30th April, 1992. A copy of the statement made by the Finance Minister is shown as Appendix III.

1.8 While responding to the Motion, the Finance Minister stated in Parliament that he did not have a fool-proof answer as to what determines the stock market prices. Recounting the steps initiated in this regard, he informed the House about his meeting with the Presidents of Stock Exchanges on 28th March, 1992, at which he impressed upon them the need to maintain efficiency and orderly stock market behaviour to promote the confidence of investors, directing the RBI to regulate bank credit for share transactions, and conduct of searches and raids on business and residential premises of a group of brokers. He also informed the House that simultaneously, RBI had been asked to set up a Group to look into the system and procedure from the point of view of strengthening, monitoring, supervision and detection and to take suitable remedial and preventive action. As regards securities transactions, acknowledging the occurrence of malpractices, he informed the House that he had asked RBI to look into the whole matter not only relating to SBI but of all other banks. This enquiry would be conducted under the overall supervision of a Deputy Governor, RBI (Shri R. Janakiraman). Referring to the irregularities, the Finance Minister indicated that there had been a systems failure and "The Government will go into the causes as to why such things have happened and also what needs to be done to tone up the system". As regards the brokers strike, the Finance Minister expressed the view that the strike will be dealt with sternly and that with the statutory backing accorded, SEBI will "act as a watchdog, as a guardian of what happens in the stock market".

1.9 In the Rajya Sabha, the Finance Minister in his statement on 4th May, 1992 (Appendix IV), regarding the buoyancy in the stock market stated, "the increase in prices of shares of companies listed on the stock exchanges was on account of several factors including the expectations of the investors generated by the improvement of overall economic environment and the rise in the level of the foreign exchange reserves". However, after detailing the measures initiated including according statutory status to SEBI, tightening of credit

margins to discourage use of bank credit for speculative activity, the Minister expressed the view, "the Indian economy and the capital market are quite large and capable of absorbing fluctuations in prices on the stock market. There is no cause for undue alarm. Government is keeping a close watch on the situation. It is true that in recent weeks, there has been an excessive bout of speculative activity in the stock market. Apart from expectation about the overall economic health of the economy, the relatively low level of floating stock in the market and the excess of funds flowing into the market also contributed to the increase in share prices until 26 April, 1992. Unfortunately it appears that to a certain extent, bank funds have also been used for this purpose". Commenting on the RBI, he stated : "I must compliment the RBI that they became cautious that something was wrong. Right from January onwards, they started investigating the problem, reconciliation of the SGL". Through a special mention in the Rajya Sabha on 14 May, 1992 the question of having a Parliamentary probe into the role of the RBI in the scandal relating to the funds of the banks being diverted to the stock market and the lack of effective monitoring of the securities transactions by the Public Debt Office (PDO) and the Department of Banking Operations and Development (DBOD) of the RBI came up for discussion. Discussion also centred round the collusion of bank officials and brokers.

1.10 The Government on June 6, 1992, promulgated an ordinance providing for the establishment of a Special Court for the trial of offences relating to transactions in securities and for matters connected therewith or incidental thereto. Justice Shri S.N. Variava, a sitting Judge of the High Court at Bombay, was nominated to head the Special Court and Shri A.K. Menon, Additional Deputy Comptroller and Auditor General as Custodian under Section 3 of the Ordinance. The Custodian notified the names of forty one persons and institutions under the provisions of the Ordinance in order to prevent the diversion of the property of the offenders.

1.11 In his statement on the irregularities and fraudulent transactions in banks and other financial institutions in the Rajya Sabha on 8th July, 1992, the Finance Minister referred to the findings of the Janakiraman Committee Report submitted in May 1992 and confirmed that "unscrupulous brokers" in collusion with certain bank officials had manipulated securities transactions of banks and financial institutions for their own purposes in a variety of ways and in clear violation of the established rules, guidelines and prudent business practices. Referring to the action taken he informed the House that the matter based on preliminary investigations, had been referred to CBI, administrative action taken against officials involved in these irregularities, a special court for trying offences established and searches and raids by income-tax authorities continued. This had been followed up by investigations into Foreign Exchange Regulation Act (FERA) violations by the Enforcement Directorate and suspension of the main share brokers involved. He also informed the House that the RBI was looking into the Securities transactions of all the major banks to further tighten up the systems of monitoring and supervision. RBI had in fact introduced concurrent audit in respect of treasury transactions and measures were taken up for gearing up internal control machinery and streamlining of fund management operations. The members demanded an enquiry by a Joint Committee of Parliament into the whole matter. The matter was further discussed in the Rajya Sabha on 9th, 21st and 29th July, 1992.

1.12 Reacting to the deliberations in both the Houses of Parliament, the Prime Minister in a statement on 9th July, 1992, stated : "I feel that there is need for a comprehensive inquiry through the instrument of Parliament which not only fully establishes Parliamentary Supremacy but also provides an effective safeguard to protect the country's interests. I am therefore requesting the Hon'ble Speaker to proceed with the formation of a Joint Parliamentary Committee and entrust it with the task ..... I would like to assure this august

House that my desire and purpose remain, as they have been so far, to unveil the truth and ensure the smooth transformation to a vibrant economy in the larger interest of the nation". The matter was discussed further in the Lok Sabha on 9th, 14th and 31st July and 3rd and 4th August, 1992.

1.13 The motion regarding appointment of a Joint Committee to enquire into the irregularities in securities and banking transactions was moved and adopted in the Lok Sabha on 6th August, 1992 (Appendix V), and concurred in by the Rajya Sabha on 7th August, 1992 (Appendix VI).

The motion moved in the Lok Sabha *inter-alia* stated that the Rules of Procedure of the House relating to Parliamentary Committee shall apply. It, however, added : "The Committee may if need arises in certain matters adopt a different procedure with the concurrence of the Speaker". During the discussion in the House on the motion regarding the appointment of JPC, the Leader of the Opposition specifically mentioned that the above procedure had been provided to enable the Committee if it felt necessary, to summon a Minister with the concurrence of the Speaker. Some other Members also expressed the hope that the Committee would have the fullest cooperation from the Ministers. The Joint Parliamentary Committee was constituted on 10th August, 1992, with Speaker, Lok Sabha, appointing Shri Ram Niwas Mirdha from amongst the Members as the Chairman of the Joint Committee.

1.14 The Committee immediately after its constitution held its first sitting on 12th August, 1992, the broad procedure to be adopted by the Committee for its working was deliberated upon. While some members pleaded for the entire proceedings to be thrown open to the media, the consensus was that the proceedings should be kept strictly confidential. However, in view of widespread public interest, it would be desirable for the Chairman to brief the press after each meeting of the JPC. At the same time, it was agreed that no member of the JPC would reveal the proceedings outside the precincts of the Committee. Accordingly, making a departure from the existing conventions and practices, the Committee empowered the Chairman to brief the Press for which the necessary approval was given by the Speaker.

1.15 For facilitating a comprehensive examination of the complex subject, three Study Groups were constituted as indicated below :

Study Group I	-	Government of India including Ministry of Finance and RBI.
Study Group II	-	Banks, Financial Institutions and Finance Companies.
Study Group III	-	Public Sector Undertakings, Stock Exchanges, Securities & Exchange Board of India and Brokers.

The composition of the Study Groups is given in Appendix VII.

1.16 Direction 99 of the Directions by the Speaker provides: "A Minister shall not be called before the Committee either to give evidence or for consultation in connection with the examination of estimates or accounts by the Committee. The Chairman of the Committee may, however, when considered necessary but after its deliberations are concluded, have an informal talk with a Minister, the estimates or accounts of whose Ministry or undertaking were under consideration by the Committee...." However, as the motion adopted by the House for the JPC provided that the Committee might if need arises in certain matters adopt a different procedure with the concurrence of the Speaker, a specific request was made to

the Hon'ble Speaker, Lok Sabha, by the Chairman on 22nd February, 1993, as decided by the Committee for permitting the Committee to call written information on certain points from Ministers/ex-Ministers and to call them for evidence before the Joint Committee, if considered necessary on account of the wide ramifications of the subject under examination.

1.17 Hon'ble Speaker, Lok Sabha accorded the necessary approval on 4th March, 1993. While granting approval, he stated that this was being done in view of the uncommon nature of the case and the views expressed by the leaders of all parties at the time of constituting the Committee and also later.

1.18 The Committee accordingly called information in writing on certain points from the following Ministers/ex-Ministers:

(1) Shri Manmohan Singh
(2) Shri B. Shankaranand
(3) Shri V.P. Singh
(4) Shri Yashwant Sinha
(5) Shri S.P. Malaviya
(6) Prof. Madhu Dandavate
(7) Shri Chinta Mohan
(8) Shri Madhavrao Scindia
(9) Shri N.D. Tewari
(10) Shri P. Chidambaram

1.19 The Committee also took evidence of

(1) Shri Manmohan Singh, Finance Minister

(2) Shri B. Shankaranand, Minister of Health and Family Welfare and the then Minister of Petroleum & Natural Gas

(3) Prof. Madhu Dandavate, ex-Minister of Finance.

CHAPTER - II

SCAM — AN OVERVIEW

2.1 A principal task before the Committee was to knit together the various strands relating to banking and securities transactions into such shape as would lead itself to proper investigation. Progressively, as the dimensions of the scam became known, various isolated and unconnected enquires were commissioned: the banks concerned undertook departmental enquiries; vigilance investigations were also set in motion. The SEBI undertook its own efforts, as did the BSE. The RBI, as the principal regulatory body took serious note of the matter and constituted a Committee under the Chairmanship of Shri R. Janakiraman, Deputy Governor, RBI on 30.4.1992. Its terms of reference, were to:

(a) enquire into the extent of non-compliance by banks and financial institutions with the guidelines of the RBI regarding securities transactions including transactions in PSU bonds, units, etc.;

(b) enquire into the inadequacies in systems and procedures in force in these institutions generally and the extent of use of Bank Receipts (BRs) which have been in vogue in regard to the transactions in Government securities and other instruments;

(c) suggest such corrective steps as may be necessary to have a more efficient and accountable system in the future;

(d) examine and determine the extent of malpractices, if any, indulged in by officials of banks and financial institutions, where their funds have been allowed to be used for speculative transactions by brokers and other intermediaries and whether undue benefits have been thereby derived by brokers and others through unauthorised access to borrowed funds of the banks/financial institutions and fix responsibility thereof and recommend the action to be taken; and

(e) scrutinise the procedure adopted by Public Debt Offices (PDOs) of the RBI in regard to the maintenance of SGL accounts and other related matters and suggest remedial measures to tone up the responsiveness of the system.

The Committee submitted six reports during May 1992 to April 1993.

2.2 For possible violations of FERA and exchange control regulations the enforcement directorate was energised. The CBDT began looking at possible tax violations. For suspected criminal acts the CBI was commissioned. PSUs and their activities began to be scrutinised by their Boards and the administrative ministries concerned. Various special audits of banks, foreign, private and nationalised, were conducted. Non Banking Financial Companies (NBFCs) too became an area of close scrutiny. In all this, however, the Government, Ministry of Finance or other ministries involved played no coordinating role. There was no channelising this display of energy by Governmental organisations into any recognisable directions.

2.3 But before any of this, there had to be that triggering mechanism which would bring to forefront all these many questionable activities and turn on them the full glare of public cconcern. The first report about irregularities in securities transactions by the SBI appeared in the Press on 23 April 1992. This failure on the part of the premier bank of the country jangled the financial nerves of our commercial capital, Bombay. When voices of concern were raised in Parliament, Government reaction was not prompt. The crisis did not resolve itself,

rather obstinately persisted and deepened. Just about that time, the BSE stopped operations, the brokers went on a sudden strike. In hind-sight it is ironic to reflect that had this strike not occurred the irregular transactions in shares and securities would have continued for some time. This strike of the brokers of BSE was the reaction to a directive of the Securities and Exchange Board of India, to the brokers, to re-register themselves and to pay higher registration fees. As this new regulation was not acceptable, protest by stopping of work was resorted to . An unintended consequence of SEBI's otherwise wholly laudable scheme of bringing order into the ranks of brokers was the closure of BSE which in turn, stopped flow of money. And as this volume of accumulated, un-settled transactions travelled backwards through the drains of questionable practices, the entire system clogged, then ceased working altogether. It is at this juncture that the enormity of what was happening finally struck home. An agitated Parliament demanded the constitution of a Joint Parliamentary Committee which the Government readily accepted.

2.4 When this Committee was appointed already in existence was the Janakiraman Committee which was seized only of the securities transactions aspect of the scam in banks and their subsidiaries. However, there was no in depth enquiry into the possibility of malfunctioning of various ministries including of the Ministry of Finance or the RBI. It had also uptill then, not been found necessary to institute a comprehensive inquiry into irregularities by either the non-banking financial companies or any of the PSU.

2.5 The Committee, in the early weeks of its endeavours, collected all these various diversely functioning strands. In the very establishment of the Study Groups by the Committee (Appendix - VII) was a recognition of the principle that it was seized with three overlapping layers: The decision makers, i.e. the Government of India, Ministry of Finance etc.; the implementors i.e. the banks, PSU etc.; and thirdly, the field executors i.e. the brokers, officials etc; The Committee were seized of the responsibility to identify the full dimension of the banking and securities transactions matter; the direction and destination of the fund flows thus released; the identification of the various wrongs that had taken place, the consequences of them, the needed remedial action. Where it could, the Committee were to identify the guilty.

2.6 The Committee knit all these together. The table of contents of this Report identifies the principal constituents of the scam. The Committee worked under considerable constraints of time and expertise. It sought assistance from and received it in varying degrees from various quarters.

2.7 The scam is basically a deliberate and criminal misuse of Public funds through various types of securities transactions with the aim of illegally siphoning of funds of banks and PSUs to select brokers for speculative returns. The latest irregularities in the securities and banking transactions, are manifestations of this chronic disorder since they involved not only the Banks but also the stock market, financial institutions, PSU, the central bank of the country and even the Ministry of Finance, other economic ministries in varying degrees. The most unfortunate aspect has been the emergence of a culture of non-accountability which permeated all sections of the Government and Banking system over the years. The state of the country's system of governance, the persistence of non-adherence to rules, regulations and guidelines, the alarming decay over time in the banking systems has been fully exposed. These grave and numerous irregularities persisted for so long that eventually it was not the observance of regulations but their breach that came to be regarded and defended as "market practice". Through all these years the ability of the concerned authorities to efectively address themselves to the problems has been tested and found wanting. The consequence of these iregularities in securities and banking transactions are both financial and moral. During the period from

July, 1991 to May, 1992 the most glaring proof of the nexus between the irregularities in banks and the overheating of stock market which came to light is explained by the graphic representations of the BSE Index and the fact that there was a sharp increase in securities transactions during the corresponding period of the banks involved in serious irregularities related with the scam. What is more apparent is the systematic and deliberate abuse of the system by certain unscrupulous elements. It is abundantly clear that the scam was the result of failure to check irregularities in the banking system and also liberlisation without adequate safeguards. There is also some evidence of collusion of big industrial houses playing an important role. It is because of these elements that the economy of the country had to suffer and while some gained thousands of crores, millions of investors lost their savings. The criminality of the perpetrators of the scam becomes all the more despicable as it was during this period that the country was passing through most trying times, economically and financially. An observation that the Committee has been constrained to make at a number of places in the succeeding chapters is that for all these not many have yet been identified and effectively punished.

2.8 It is the view of the Committee, as detailed in subsequent chapters, that there are several dimensions of this entire episode : the functional one concerns the banks, brokers, PSUs and ministries, etc. Here accountability was largely absent, punishment for a wrong committed was rare, an ethos of non-implementation prevailed all around. The second aspect about which the Committee express its grave concern is the supervisory role and responsibility. That supervision failed from top to bottom is both self-evident and is detailed in subsequent chapters. What is extremely worrisome to the Committee, however, is an unhappy side effect. Amongst all the witnesses that appeared before the Committee, in all the many hours of evidence taken, the Committee seldom came across an instance where responsibility for wrong was forthrightly accepted. Further, and more worrisomely, the Committee found that as of routine, through the entire apparatus of Governmental machinery, a very damaging approach seems to pervade, that of transferring responsibility downwards. This distressing lack of fibre in the apparatus of governance can only debilitate the state. This persuades the Committee to briefly comment upon the third dimension of this entire matter, which is moral. No system can work through regulations alone, of course, it cannot work if they be flouted; but much more than that, if a system be devoid of the moral quotient, of a commonsense appreciation of right from wrong, of a sense of public duty particularly when entrusted with public funds, then it cannot work.

2.9 Subsequent chapters amplify and illustrate these overview observations of the Committee.

CHAPTER - III

FINANCIAL SYSTEM — A BROAD FRAMEWORK

3.1 A good vibrant financial system is essential to provide an effective means for implementing monetary and other economic policies to achieve the desired socio-economic objectives. The financial system comprises financial institutions, financial instruments and financial markets which provide an effective payment and credit system and thereby facilitate the channelising of funds from the savers to the investors in the economy. The institutional structure of the organised Indian Financial System is stewn with a plethora of organisations of various sizes, functions, shapes and structures. These can be broadly classified as under:

(a) Commercial banks in public and private sector, including Indian branches of foreign banks.

(b) The three-tiered structure of cooperative banks catering to the need of rural credit and agricultural sector.

(c) Urban cooperative banks functioning in urban/metropolitan areas and providing credit for non-agricultural sectors.

(d) Regional Rural banks sponsored by the commercial banks in public sector in participation with Central/State governments for meeting the rural credit need in an intensive manner as supplement to credit through cooperative agencies and commercial banks.

(e) Developmental Financial Institutions providing term lending facilities at All India Levels such as Industrial Development Bank of India (IDBI), Industrial Financial Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) and Industrial Reconstruction Bank of India (IRBI) besides National Bank for Agriculture and Rural Development (NABARD) and National Housing Bank (NHB) , Exim Bank, Small Industries Development Bank of India (SIDBI) and the 18 State Level Financial Corporations and other specialised corporations set up by various state Governments, for promotion and development of Small Scale Industrial Sector.

(f) NBFC in private sector as well as in public sector incorporated as subsidiaries of certain public sector banks (e.g. SBI Capital Markets Ltd. (SBI CAPS), Canbank Financial Service Ltd (CANFINA), Andhra Bank Financial Service Ltd (ABFSL), Allbank Financial Services etc. engaged in multifarious para-banking activities such as hire purchase/ lease financing, merchant banking, underwriting, floatation of mutual funds, venture capital funds besides running chits/kuries, nidhis and dealing in shares/stocks.

3.2 A recent addition to the institutional structure is the setting up of the Discount and Finance House of India (DFHI) as a wholly owned subsidiary of RBI. Besides the above, the Unit Trust of India (UTI), Life Insurance Corporation of India (LIC), and the General Insurance Corporation (GIC) also play an important role in the financial market. Of late, the PSUs especially the large sized ones have also come to play a significant role on account of sizeable surplus funds generated by them from time to time through bond issues or other means.

3.3 The commercial banking sector occupies a place of pride in the financial system of the country and it has undergone a sea-change in its geographical coverage and nature of activities. At present it comprises the SBI along with its seven subsidiaries, the 20 nationalised

banks, 23 private sector banks besides the 24 foreign banks having their head offices abroad. The public sector banks comprising SBI group together with the nationalised banks account for over 90% of the total banking business. Even though no fresh banking company had been licenced and allowed to operate ever since 1949 when the Banking Regulation Act came into force (apart from the two joint sector companies viz., the Poorbanchal Bank and Bharat Overseas Bank), the present Government has taken a conscious decision to permit entry of new banks in the private sector provided they satisfy certain specified norms. The other financial institutions have also made much progress in recent years in extending its geographical spread and functional reach. Many new financial institutions such as merchant banks, leasing companies, mutual funds and venture capital companies have come on the scene; there is a growing institutional continuum - a process which has been aided by commercial banks entering into capital market activity by floating subsidiaries for the purpose. A number of fresh financial instruments such as 182 days Treasury Bills, Commercial paper, Certificate of Deposits (CD) and convertible Debentures have been introduced or come into operation.

3.4 Money Market activity, though still centered on inter-bank call money transaction has been broadening and a beginning made to develop a secondary market. The last dcentered on inter-bank call money transaction has been broadening and a beginning made to develop a secondary market. The last decade has witnessed the capital market growing in strength and diversity. India has the distinction of having the oldest Stock Exchange in Asia established in Bombay in 1875. The stock market operations were till the last decade, on a limited scale, but the decade of 80s witnessed tremendous growth in the capital market. There are at present 22 recognised Stock Exchanges spread all over the country, including the Over The Counter Exchange of India (OTCEI) at Bombay. While most of these are corporate bodies limited by shares or guarantees, three stock exchanges namely those at Bombay, Ahmedabad and Indore are Association of individuals. The qualification and procedure relating to admission of members to Stock Exchange are governed by the rules of respective exchanges. The number of listed companies has gone up to 6,500 from 220 a decade back. Against an annual average of about Rs.90 crores raised from the primary market in the Seventies, Rs.5749 crores were raised during 1991-92, the number of shareholders (investors) has also risen sharply from about 20 lakhs to over 1.4 crores during the period and is expected to touch 4 crores shortly. The daily turnover of the stock markets has risen from a mere Rs.15 crores in 1979-80 to Rs.332 crores by 1991-92. The number of active stock brokers have also increased three fold from 1000 to about 3000 in the past decade. The BSE accounts for more than two-thirds of the total turnover in securities all over India.

3.5 The SEBI was constituted on 12.4.1988 to deal with all matters relating to the development and regulation of securities market and to protect the interests of investors. Earlier, such functions were being discharged by the Ministry of Finance. SEBI was accorded statutory status in February 1992.

3.6 The Ministry of Finance, Banking Division oversee and generally monitor the financial system as a whole to ensure that it subserves the National goals and priorities. The RBI of India (RBI) - the Central Banking and Monetary Authority of the country - which is at the apex of the banking system, controls and regulates the functioning of the banks. It is entrusted with the responsibility for providing a sound banking system to the country, and is vested with wide powers of supervision over the commercial banks and urban cooperative banks in terms of the Banking Regulation Act, 1949. The power vested in RBI under the said Act are exercised by it through its DBOD insofar as commercial banks are concerned. The administration of the Act as applicable to Urban Cooperative Banks is vested in another Department of RBI viz., Urban Banks Department (UBD). A number of other Departments in RBI also broadly concern themselves with certain aspects of working of banks.

CHAPTER - IV

IRREGULARITIES IN SECURITIES TRANSACTIONS — BANKS

A. Factors leading to Scam — Banks

4.1 Deposits accepted by commercial banks constitute a major chunk of their resources. These are deployed by way of credit to various sectors of economy in accordance with the socio-economic policies of the country. The banks are also required to keep a large portion of deposits mobilised by them in Government and other approved securities to comply with statutory requirements of maintaining Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) which had gradually gone up and were till recently at a rate of 16% and 38.5% of the net Demand and Time Liabilities (DTL) of the banks respectively.

4.2 The SLR & CRR requirements are the instruments of monetary/credit control for the Central Banking Authority (RBI). Of late, however, SLR has come to be utilised for investment in Government Loans and thereby provide finance to the Central/State Governments for implementing their various projects and programmes. Thus there has been a steady increase in these ratios which together accounted for nearly 55% of the Deposits. As the coupon rates of Government securities were low, the banks had been voicing their grievances and attributing this as one of the causes of their low profitability. Banks generally subscribe to New Loans or purchase securities in the market to meet SLR requirements. A few transactions are also undertaken to have a proper maturity pattern of the investment portfolio and obtain optimum current yield. However, as the quantum of the portfolio increased, some banks started indulging in purchase/sale of securities on a significant scale to improve their earnings. Again whenever CRR is increased some of the banks who keep over-extended positions in their credit portfolio, had to borrow to ensure compliance. This has the tendency to shoot up the call money rates but Indian Banks Association (IBA) and RBI had earlier imposed ceilings on rates of interest on inter-bank borrowings during the last decade. To bypass this stipulation banks devised even a decade back the scheme of "buy-back" or `Ready-Forward' sales of securities to raise funds for their maintaining the required balances with RBI. These transactions involved the banks in need of cash "selling" some of the securities in its portfolio and "buying" it back after the stipulated interval of few days so that it could maintain the balance with RBI on the Friday and comply with CRR requirements. The rates for purchase/sale were so negotiated that the lender gets his stipulated return which was always higher than the Call Money rate which till 1988 was pegged at 10%. The rates for sale/purchase of securities were totally unrelated to the market rates and these involved an element of "Forward trading".

4.3 The buy-back or ready forward transactions which came into play in the context of the ceilings on inter-bank borrowings continued even after lifting of the ceiling. Even though RBI in its guidelings of 15.4.1987 and 1.12.1987 (Appendix-VIII) had prohibited Ready-forward transaction with non-bank clients and in securities other than Government securities the practice appears to have continued mainly to pass on a higher rate of return than permissible on "deposits" of their non-bank clients. It is also pertinent to point out here that a process of disintermediation had set in the second-half of the eighties. In other words, the `users' of funds viz., industrial and commercial units started obtaining funds direct from the savers/investors without intervention of banks. Such units both in private/public sector whenever they had surplus funds desired to invest in avenues which would give them better return than on deposits with banks. These gave opportunities for the banks to intervene as

"portfolio managers" and conduct Ready-Forward deals for them for a commission. The foregoing factors combined with emphasis of exploring new avenues of business, improvement in volume of business and profitability to cover the estimated loan losses by banks vide RBI's Action Plan - 1990-91 for scheduled commercial banks *inter alia* contributed to the security operations by banks gaining momentum. Further the removal of interest ceiling on floatation of debentures and public sector bonds in August 1991 led to the devaluation of the earlier instruments in the market and added to the spurt in the trading of these instruments. The coupon rate hikes of October 1991 and March 1992 on securities created a flutter in the market and gave a further fillip to intense trading in bonds and securities. With the banks running helter skeltor to minimise their losses, the brokers took the fullest advantage of the situation and fished merrily in the troubled waters.

4.4 The diversion of funds from the banking sector in the scam had been largely facilitated by the practice of banks executing a large number of "ready-forward" and "double ready forward" transactions. According to Janakiraman Committee only 5.38% of the total transactions during 1.4.1991 to 23.5.1992 were conducted on "outright" purchases or sales basis. These transactions had been mainly between banks and brokers and under portfolio management and other similar schemes.There was large diversion of ostensible surplus funds of a large number of PSUs through these schemes. These were purely financing transactions though they took the form of purchase and sale of investments and appeared to be an attempt to bypass RBI directives to banks governing direct advances by banks to brokers. Additionally a broker got access to banks funds without complying with margin requirements as would be the case where direct loans are given. Being basically fund management exercise and not security transactions proper, the rates agreed upon in these ready forward transactions had no relevance to market rates. The difference between the two rates was treated as cost of use of funds for the user. These transactions provided funds to the brokers at rates which were lower than the "byaj-badla" rates in the market.

Early warning signals

4.5 In the course of investigation, the Committee found that most of the irregularities in securities transactions that took place in 1991 and 1992, had been indulged in by various banks even much earlier. Certain earlier inspection/scrutiny reports of RBI called by the Committee revealed the following types of irregularities in securities transactions by various banks. The irregularities noticed were:

i) Large percentage of transactions through ready forward deals;

ii) entering into ready forward deals by some banks;

iii) entering into transactions at rates which had no relevance to the market rates for the purpose of window dressing/ for facilitating compliance of SLR requirement;

iv) extensive use of BRs for ready forward transactions;

v) issue of a number of further BRs on the basis of one out-standing BR, issue of BRs having no backing of securities; and

vi) facilitating the brokers to take temporary position in Government securities without involvement of their funds by putting the transactions through brokers account and issuing BRs on behalf of the brokers.

4.6 The three instruments widely misused in the irregular transactions were 1)Bank Receipts (BRs); 2) Subsidiary General Ledger (SGL) transfer forms; and 3) Bankers cheques. BR is a non-transferable unstamped trust receipt issued by a bank selling securities when

it is not able to effect physical delivery of the securities sold even after the receipt of the purchase consideration for reasons such as the securities are lying at another centre. In terms of the B.R., the seller bank undertakes to hold the security on trust for the purchaser for the short period till delivery and it is generally considered valid for 90 days or till delivery is effected whichever is earlier. In the inter bank market, a large number of transactions in securities were being concluded by means of BR deliveries (instead of physical delivery of securities sold); however, there was no uniformity in the format of the BR and there were also no set guidelines for its usage. B.R. does not find a place in the Banking Regulation Act, 1949. It was only on the 6th May, 1991 that IBA issued a circular prescribing a format and laying down certain broad guidelines and recommending its adoption by member banks and other financial institutions like IDBI/IFCI/ICICI/NABARD etc. The RBI for the first time *inter-alia* issued instructions to banks in this regard in their Circular of 26-7-1991- (Appendix-IX). A similar receipt issued by a non-banking financial company is termed "Security Receipt" (SR) and such receipts also came to be freely used in security transactions.

4.7 Government securities are issued in any of the three forms:

a) Government Promissory note which is negotiable by endorsement and delivery and having on the reverse instructions for collection of interest from the PDO of RBI by presentation by the holder in due course.

b) Stock Certificates - which are bonds registered in the books of PDOs and transferable only with notice to PDO who will effect the transfer.

c) Subsidiary General Ledger Account (SGL).

4.8 Generally banks and select financial institutions who are the main holders of the Government securities are allowed to maintain an account of their holding of securities. Inter-bank or inter institutional transfer of securities can be effected by mere advice to PDO of RBI in the prescribed SGL transfer form. Thus SGL is a running account with RBI which gets debited/credited accordingly as the holding bank/institution sells/purchases the securities under advise to RBI. This facility was also extended to select/recognised brokers.

4.9 To give some specific instances of the irregularities noticed earlier, one of the inspection reports of RBI as early as October 1986 in respect of Andhra Bank and Syndicate Bank clearly indicated that the BRs were greatly misused by the Banks. It had been observed that BRs were issued irregularly by Andhra Bank to the tune of Rs. 150 Lakhs for Government securities without having sufficient balance of those securities. Bank of Karad and Allahabad Bank had purchased these non-existent securities and the purchasing banks, as is normal, included these securities in their SLR position. Undue favours were shown by Andhra Bank to one of the brokers firm viz. M/s. V.B. Desai. The deals of broker were being dealt as if they were deals of the banks by issuing its own BRs. The Bank was even indulging in fraudulent practice of issuing BRs. on behalf of brokers without having adequate balance of the underlying securities in the brokers account.

4.10 Both Andhra Bank and Syndicate Bank had also issued SGL transfer forms although they were only holding BRs for relevant securities and had either nil or inadequate balance in SGL Accounts indicating that they were only accommodating certain brokers. Andhra Bank had undertaken transactions in securities mostly on behalf of brokers - constituents like V.B. Desai, R.P. Shroff and Sons, B.C. Devidas, S.D. Jhaveri, A.D. Narottam etc., it was observed that in several cases SGLs issued against securities represented by BRs had bounced. SGL transfer forms were issued without adequate balance of Security in the account of the brokers firms and the banks had relied upon them in regard to the balance for the securities rather than their own account. The Bank had no proper records to monitor SGL

transfers. The scrutiny report of 1986 also revealed that both Andhra Bank and Syndicate Bank were entering into pure fund deals in the garb of security deals through buy-back arrangement thereby circumventing the ceiling on call money rate which was 10% at that time. Certain deals in securities were indulged in by the banks with a view to showing inflated profits. Syndicate Bank had sold Government securities to Andhra Bank for Rs. 1500 Lakhs @ 97.75 on 31.12.1985 and repurchased the same on the same day @ 91.30 thus making a profit of Rs. 96.75 Lakhs on the date of balance sheet. The deal was reversed on 6.1.1986 and the bank suffered loss of the same amount. The Syndicate Bank had also resorted to artificial inflation of securities for the purposes of SLR. This was done by conducting the transactions under buy-back arrangements at rates higher than the prevailing market rates on the same day or within a few days through exchange of BRs.

4.11 A number of irregularities were also noticed during scrutiny of various other banks like Bank of Madura, BOK , UCO Bank, Canara Bank and Vijaya Bank etc. In UCO Bank, it was revealed that apart from the official transactions the bank's Bombay (Hamam Street) Branch unauthorisedly indulged in investment transaction of large magnitude with daily turnover varying between Rs.100 crores and Rs.1000 crores at the behest of certain brokers by issuing its own BRs, thereby exposing the bank to serious risks.

4.12 In the case of Bank of Madura Ltd. it was noticed as early as 1987 that in many transactions two rates were advised by the broker- one in the contract note and another in the delivery note where the margin widened to accommodate the brokerage/brokers profits, while delivery rates were taken for vouching, contract rates were entered in the purchase/ sale/holding registers. Similarly in Canara Bank the following irregularities were brought out in the inspection Reports:—

i) Short sale of securities;

ii) Rates of deals not in conformity with market rates;

iii) holding of unapproved securities in excess of permitted limit; and

iv) irregularities in buy-back transactions.

4.13 It is thus evident that many of the irregularities in securities transactions that took place in 1991 and 1992 had been building up since the mid-80's, if not earlier, and could have been minimised if the authorities concerned had heeded to the early warning signals. The RBI issued several circulars, including the one in July, 1991, prohibiting these misdeeds and yet everything that was sought to be prevented in fact, accelerated and assumed uncontrolled dimensions.

B. Dimension of the Scam

4.14 The irregularities in securities transactions of the banks and financial companies known as securities scam, which came to light in the second quarter of 1992 is unprecedented in many respects. Both the volume and the involvement of individuals and the institutions were various and stupendous. It embraces among others foreign banks, financial and other companies in the public/private sectors, the principal stock exchanges, select brokers, public sector and private sector corporations, and persons occupying high offices. The Janakiraman Committee have highlighted the various irregularities and fraudulent transactions undertaken by the banks and financial institutions etc. in the six reports submitted during May, 1992 to April, 1993. As per these reports value of securities transactions undertaken during the period from 1 April 1991 to 23 May, 1992 totalled upto Rs. 12,85,549 crores. About 80% of these transactions were undertaken by only 12 banks and financial institutions. Another

noteworthy feature is that the five foreign banks namely Citibank, SCB ,BOA, ANZ Grindlays bank and American Express accounted for about 56% of the total transactions. A bankwise analysis of the transactions as per the sixth report of the Janakiraman Committee is in Appendix X.

4.15 A broad analysis of the information obtained by the Committee from various sources reveals that apart from a direct flow of funds to the stock market through sanction of authorised/ unauthorised credit facilities to some brokers by some banks by way of overdraft and discounting of bills covering shares/debentures, there had been fraudulent manipulations of the "Investment Portfolio" in some banks (including their subsidiary financial companies) to divert the funds to certain brokers to fuel the unprecedented rise in share prices.

4.16 According to the Janakiraman Committee the total problem exposure of various banks/financial companies was as much as Rs. 4024.45 crores. This was mainly due to the reason that they were either not holding any securities or holding forged securities etc. for investment made by them or were having only BRs/SGL transfer forms issued by two small banks namely, BOK and Metropolitan Cooperative Bank Ltd. which were of no intrinsic value. The banks and financial companies which have mainly suffered losses are NHB, SBS, SCB, SBI Caps, CANFINA, ABFSL, CMF. The details are given below:

Sl.No.	Bank	Amount (Rs.in crores)
1.	National Housing Bank	1,271.20
2.	State Bank of Saurashtra	174.93
3.	SBI Capital Markets Ltd.	121.36
4.	Standard Chartered Bank	1,482.14
5.	Canbank Financial Services Ltd.	666.73
6.	Canbank Mutual Fund	102.97
7.	Andhra Bank Financial Services Ltd.	205.12
		4,024.45

4.17 A more detailed analysis of the exposure is given below:

(Rs. in crores)

(A)	Total value of investments made by banks and institutions for which they do not hold any securities, SGL transfer forms or BRs:		
i)	National Housing Bank		1271.20
ii)	State Bank of Saurashtra		174.93
iii)	SBI Capital Markets Ltd.		121.36
iv)	Standard Chartered Bank	510.61	
	Less: Recovery	4.00	506.61
v)	Canbank Financial Services Ltd.		188.47
			2262.57

		(Rs. in crores)
(B)	Total exposures against BRs/SGL transfer forms issued by BOK Ltd. or Metropolitan Cooperative Bank Ltd.	
i)	Canbank Financial Services Ltd.	438.66
ii)	Canbank Mutual Fund	102.97
iii)	Standard Chartered Bank	931.84
		1473.47
(C)	Other items:	
i)	Standard Chartered Bank; (Non-receipt of Securities against BRs etc.)	43.69
ii)	Canfina; (Securities held in the name of other organisations)	39.60
iii)	Andhra Bank Financial Services Ltd.; (Securities found to be forged/fabricated)	205.12
		288.41
	Gross problem exposure	4024.45

4.18 The gross problem exposure mentioned above represent banks' investments which are difficult to recover because, as against the money already paid out by them, either they do not hold any security or they hold BRs/SGL transfer forms of doubtful value and because of imperfect contracts/ documents they may not be in a position to enforce the contracts and recover the money.

4.19 While in the case of NHB, SBI and SBI Caps the ultimate exposures will be on Shri Harshad S. Mehta (HSM), in the case of Stanchart, Canfina and CMF, it will be mostly on Shri Hiten P. Dalal (HPD) / Shri A.D. Narottam (ADN) and in case of ABFSL, it will be on Fairgrowth Financial Services Ltd. (FFSL).

4.20 The amount mentioned above does not include the depreciation/loss suffered by several banks/institutions by reasons of the fact that they were left holding securities/bonds which had depreciated in value as also losses which may occur in settlement of matters which are in dispute. It has been estimated that there is a depreciation of about Rs. 804 crores in the value of bonds held by banks in their own account and in PMS and other schemes. It does not also include the claims and counter-claims of brokers, banks and other parties. It also does not take into account the undue benefits extended to the brokers, permitting them to earn huge profits from public funds made available to them. The loss occasioned to the PSUs on account of their holding on BRs/SGL forms of no intrinsic value and the loss to the host of investors on account of the sharp fall in the market price of shares held by them which had been artificially jacked up earlier is anybody's guess. The impact on the economy of the scam has been rather wide and the precise loss to the various institutions/parties still remains to be determined. The scam has raised serious questions about the functioning of the financial system as a whole. It has exposed the gross inadequacies of internal control and quality management, within the banks/institutions external auditing, supervisory mechanism of RBI and the Ministry of Finance as well as serious deficiencies in the working of financial markets.

4.21 On the question of exposure there are varying figures. Janakiraman Committee speaks of this as Rs. 4024 crores where as Central Bureau of Investigation have assessed these at Rs. 8383.31 crores on the basis of cases registered by them. In addition, the Committee examined the figure provided by the office of the Custodian which assessed the amount on the basis of various claims and counter claims preferred by various aggrieved parties. The statements furnished by the custodian as on 16 November, 1993 showing assets of notified persons as intimated to the custodian and claims against the notified persons are given in Appendix XI. This figure comes to Rs. 3650.60 crores. The Committee enquired about the reasons for the variations in the figures of the Janakiraman Committee and those of the custodian. A statement indicating the reasons for the variations in the figures as furnished by the Office of the Custodian is shown as Appendix-XII.

4.22 The Committee are of the opinion that it is difficult to estimate the huge sums of money which were illegally utilised by various scamsters for their personal gains during this period because the monies were repaid and the transactions completed. The monies 'Lost' represent the deals which could not be completed because either the monies were swindled or BRs/SGL transfer forms held by bank are of doubtful value. Further, because of imperfect contracts/documents, it may not be possible to enforce the contract and recover the money.

4.23 The Committee did not independently attempt this exercise as three separate specialists bodies had already attempted it. The Committee are of the view that it is the duty of the Ministry of Finance to undertake this responsibility by either instituting a separate Committee for the purpose, or through the same Committee as has been specified in para 18.37.

C. Irregularities committed by banks in the use of BRs

4.24 The examination of securities transactions by the Committee revealed serious irregularities. One of these was the gross and widespread misuse of BRs. It was observed that the guidelines of IBA and the circular of RBI dated 26.7.1991 for the use of BRs has been observed more in their breach than in their adherence. In many cases the BRS issued were not even in the "format" prescribed, nor serially numbered and executed by two authorised officials; these were not also printed on special security paper. In many case these were routine casual cyclostyled or typed receipts and their content, and execution were not in tune with the importance and value of the transaction they represented.

4.25 A major chunk of transactions during April 1991-March 1992 particularly at the four leading foreign banks viz. Citibank, ANZ Grindlays Bank, SCB and BOA and the SBI had been undertaken by them on the "Ready-Forward" basis. There had been an indiscriminate resort to use of BRs to evidence delivery of securities sold. In bulk of the security transactions only BRs were exchanged between the banks without movement of any security. Thus use of BRs which was intended as an "exceptional method" of delivery of security in certain special circumstances became a popular/common method for securities transactions. Further, as already stated, the inter bank transactions were invariably routed through brokers. Gradually, the banks omitted to mention in the BR even the name of the "counter party" bank with whom the deal was struck so that the BR could be utilised by the broker towards sale to bank. In many cases BRs issued favouring one bank, came to be discharged by it and passed on for further use in respect of another bank for a transaction named by the brokers. Thus BRs which were "non-transferable" receipts became quasi-negotiable, bearer bonds representing the value of securities mentioned therein. This facilitated a large volume of transactions being put through by tendering BR against BR which is prohibited

as a BR transaction requires to be completed only by delivery of those securities. Banks issued BRs even where SGL securities are involved which is gross violation of rules. Such was the tempo created in the use of BRs that a number of banks issued BRs for securities which were not in their portfolio at all. The purchasing banks receiving the BRs seldom cared to check with counter parties and satisfy themselves on their ability to deliver the securities in due course. Thus BRs became almost a legal tender. Citibank representative stated before the Committee that they had kept "exposure limit" for acceptance of BRs of different banks indicating that these were considered as "credit" transactions and not "sale" transactions. In the case of two small banks having very limited resources of their own and dominated by brokers, viz., the BOK and MCB (now in liquidation) BRs had been issued representing sale of securities which were several times the value of their entire investment portfolio. The banks had allowed their names to be utilised in the market by their broker clients as banks alone are entitled to issue BRs. In fact MCB was not even authorised to issue BRs and even then it unauthorisedly issued 30 BRs on behalf of its two clients who were dealing in shares and securities etc. viz. Dhanraj Mills Pvt. Ltd, and Excel & Co. aggregating Rs.1944.52 crores without backing of securities. Institutions like NHB which is not a member of IBA and which has not been specifically mentioned as an eligible institution by IBA for issue of BRs had also indulged in the misuse of BRs. So was the case with subsidiaries of nationalised banks like SBI Caps, Canfina etc. Due to the close nexus established among certain brokers and the banks "kite-flying" in BRs came to be engineered by some brokers and the funds were generated i.e cheques obtained by brokers against BRs which did not represent genuine sale transactions. Some of the BRs generated by the unscrupulous brokers for their share transaction in the stock exchange has no intrinsic value at all. Such was the nexus between some of the brokers and banks, some banks had issued BRs to cover the security transactions of their broker clients in gross violation of RBI instructions issued in July, 1991. In several cases the BRs were outstanding for considerably long period beyond the stipulated time without assigning any reason and ultimately got cancelled/returned indicating these were intended only for providing accommodation. That many of these security transactions were not genuine but were "accommodation" provided to the brokers is also evidenced by the fact that the BRs issued has been cancelled eventually by payments received by the banks from "undisclosed sources" or several outstanding BR transactions were netted and settled by the broker ultimately. Despite the volume of outstanding BRs being large and their period of outstanding unreasonably long, most banks failed to take steps to reconcile the oustanding BRs and insist on delivery of scrips within reasonable time; on the contrary, it has been observed that there had been a conscious slowing down of the reconciliation.

Irregularities in the use of SGL transfer form

4.26 As already explained above, banks and other financial institutions who hold sizeable volume of Government Securities in their investment in the form of a running account titled SGL A/c by the regional PDO of RBI, transfers from the account of one institution to another, on account of mutual sale/purchase in the same region can, therefore, be effected by sending a SGL transfer form duly signed by authorised officials of the banks. RBI(PDO) effects the transfers and advises the banks concerned. It also submits periodical statement of holdings to the banks for their reconciliation. As already stated BRs are not to be issued in respect of securities held in SGL account even then a number of banks had been irregularly issuing BRs in respect of securities held in SGL A/c. Similarly, the scrutinies had revealed that in a number of cases banks had issued SGL transfer forms (evidencing sale of securities without mentioning the names of counter party banks) to help broker clients raising money thereagainst. Banks had also not adhered to the stipulation that SGL transfer forms should be signed by two authorised officials. There had been several instances of banks issuing SGL transfer forms knowingly that they do not hold the relative scrips in their SGL/A/c with

PDO. As in the case of BRs, SGLs had been issued against receipt of SGLs of other banks which is grossly irregular. In some banks there were no SGL mirror register and this also resulted in their issuing SGL transfer forms without holding the specific securities in their portfolio. In other words, SGL transfer forms had also been allowed to float to raise money by the broker-clients and these were not presented to PDO for long. In a number of cases SGLs presented to PDO for effecting transfer had bounced for reasons that there was inadequate balance to put through the transactions.

4.27 The total number of SGL forms which bounced from July, 1991 to May, 1992 due to insufficient balance in the accounts of the account holders which included banks/ subsidiaries/financial institutions, broker (V.B. Desai) and one Public Sector Undertaking (Indian Oil Corporation) were as high as 1039. The banks whose SGL transfer forms which frequently got bounced during the period April, 1991 to May, 1992 due to insufficient funds were (number of SGLs bounced in bracket), Citibank (126), SCB (229), ANZ Grindlays Bank (40), BOA (97), Canfina (26), SBI (34), Andhra Bank (170), Bank of Madura (157) and BOK (116) etc.

4.28 Thus, it is evident from the above that the tendency of banks to issue SGL transfer forms without sufficient balance in their account resulting in their bouncing continued on a large scale till May, 1992 when the manipulations had got exposed. What is further distressing is that none of the banks other than a solitary instance of Karur Vysya Bank Ltd. reported to DBOD (RBI) about bouncing although the RBI circular dated 26-7-1991, specifically required the Chairmen of banks to personally report about bouncing. Far from complying with the instructions, banks had resorted to several other ways of misusing the SGL operations. It has been observed that banks had been putting through transactions, particularly buy-back deals wherein SGL transfer forms issued at the time of undertaking the first leg of deal were returned to the issuing bank at the time of reversal of deal without lodging with PDO. The shortfall of securities worth about Rs.650 crores in the SBI illustrates a glaring instance of the extent to which SGL operations were misused and manipulated. In SBI, transactions in securities exceeding over 30% and valuing more than Rs.17.000 crores during 1991-92 were conducted through HSM. The debits and credits in respect of the transactions appeared in the investment Account maintained at the Bombay (Main) Branch. However, in a large number of cases the relative debits and credits did not appear in the SGL account of the bank maintained at PDO. Blank SGL transfer forms were allegedly handed over to the broker whereby the SGL account of SBI with PDO was unauthorisedly operated without any transactions entered into by SBI eventually leading to an accumulated shortage of securities worth Rs.650 crores over a period. In the case of BOK, maintenance of brokers security ledger was found most unsatisfactory. Posting of transactions in the ledger was done to suit the interests of brokers. A lot of manipulations in posting of transactions in the ledger of ADN had been noticed.

4.29 It was observed that even though bouncing of SGL is comparable to bouncing of "cheques" in clearing, serious notice had not been taken of such instances as arrangements used to be made for 'payment' thereagainst and eventual cancellation and return of the SGLs. Even the normal banking precaution of not accepting cheques of parties whose instruments bounce frequently, had not been taken in respect of SGL bouncing. Yet another peculiar feature of transactions in SGLs is that even after "bouncing" these forms are utilised for deliveries to other banks. RBI also did not take any serious note of large scale bouncing of SGLs of certain banks. The role of RBI in this regard has been discussed later in this Report. Yet another interesting feature observed in respect of these irregular transactions especially in SBI was that their settlement was arranged before the "due date of interest" of the scrips concerned.

In certain banks for e.g. Andhra Bank, their SGL account were allowed to be operated by brokers as if they were their own investment account. Thus as in the case of BRs, SGL transfer forms were also misutilised, to enable brokers to spin off funds from the banking system. In short, a large volume of BRs/SGLs having inadequate or no backing of securities started floating in the security market and the relative funds covered thereunder enjoyed by the brokers. No periodical reconciliations were made to ensure that the outstandings are genuine. Thus the investment portfolio of the banking system got inflated and the difference between the real holding and inflated figures were enjoyed by certain brokers.

4.30 After examination of the type of transaction by the banks, the Committee regret to note that the banks had in blatant violation of the RBI guidelines relevant thereto entered into a large number of ready-forward/buy-back transactions and indulged in irregularities like misuse of BRs/SGLs/Bankers Cheque etc. A large number of the banks were found having flouted the RBI guidelines issued in 1987 and 1988 regarding entering into such deals. The most disturbing aspect is that top management of the banks concerned had miserably failed to implement the guidelines of RBI particularly the one issued on 11.4.1988 (Appendix XIII) which had emphasised that the top executives in banks should bestow their special attention to inter-bank buy-back arrangements to ensure that the guidelines on the subject were strictly complied with in letter and spirit and any deviations viewed seriously and accountability fixed at all levels. The top management of the RBI appear to have treated the blatant violations of its own guidelines prohibiting ready forward and buy back transaction issued over the years in 1987, 1988 and subsequently in 1991 with as much callousness as the top managements of the banks violating the guidelines.

4.31 The RBI vide their Circular dated 20 June, 1992 (Appendix XIV) prohibited all new inter-bank ready forward deals in Government securities except in Treasury bills. Subsequently, however, ready forward transactions have been permitted in Specified Government securities. The Committee are of the view that continuance of Ready Forward transactions in their present form in government securities inclusive of PSU bonds and units of UTI is detrimental to the system.

4.32 The Committee are led to the conclusion that the BR system has been considerably misused. Every step should, therefore, be taken to prevent recurrence of such things in future. There is need for reforms of the BR system, for example, by way of reduction in the period of its validity and imposing of severe penalties for its misuse.

4.33 The SGL form, can be compared to cheques whose bouncing is now a penal offence. Government may examine whether similar provisions can be made with regard to bouncing of SGL transfer forms, or any other suitable measures need to be taken to punish those who are responsible for the misuse of SGL transfer forms.

CHAPTER-V

IRREGULARITIES IN SECURITIES TRANSACTIONS — PRIVATE/CO-OPERATIVE SECTOR BANKS

5.1 The scrutiny of security transactions revealed that not only public sector banks and their subsidiaries and foreign banks but some banks in private and cooperative sector were also involved in irregular transactions. The two banks examined by the Committee were Bank of Karad Ltd. and Metropolitan Cooperative Bank. It was noticed that these banks had undertaken transactions in securities heavily on behalf of the brokers acting as a conduit.

5.2 The RBI circular dated 26.7.1991 had, in fact, cautioned banks that they should be circumspect while acting as agents of their broker clients for carrying out transactions in securities, on behalf of brokers. Despite the RBI instructions, certain banks, continued to act on behalf of the brokers and certain others fell in line on a larger scale where the banks were used as "conduits" eventually resulting in jeopardising interests of the bank and its genuine investors. Some of such cases are dealt with in the succeeding paragraphs.

Bank of Karad (in liquidation)

5.3 The BOK Ltd. was incorporated in 1946. The Bank has 43 branches, all in Maharashtra except one in Belgaum (Karnataka). The deposits of the Bank as on 31.3.1992 were about Rs. 78 crores. The advances were about Rs. 34 crores and investments in SLR securities about Rs. 27 crores. The paid up capital of the bank as on 31 March 1992 was Rs. 30.72 lakhs.

5.4 The securities department of the Bank which functioned as Funds Management department was attached to the Hamam Street (Fort) Bombay Branch and located a little distance away from the main branch. It handled all the treasury operations of the bank, viz., borrowing/lending in call money market, bills re-discounting, purchase/sale of securities of banks own as well as on behalf of its broker-clients.

5.5 The trading in securities by the bank was almost confined to its broker clients. The bank had 23 broker clients of whom only a few like Bhupendra Champaklal Devidas, ADN, Excel & Co., Darshaw & Co. were active. Shri Bhupen Dalal has been director of the bank on many occasions, his son Shri M.C. Dalal became a director from July 91. Shri Abhay Narottam retired as director in December 1991. The account of Shri Narottam was beset with most of the irregularities. BOK entered into 534 transactions involving various securities of the aggregate face value of Rs. 7,186 crores during the period 1.4.1991 to 23.5.1992 on behalf of or on the instructions of ADN.

5.6 As pointed out in its successive inspection reports of RBI since 1986, BOK had been guilty of several irregularities and malpratices. In violaton of RBI instructions, sales were effected on behalf of the broker by issue of banks BRs and no entries were reflected in BOK books. The bank has issued on brokers accounts BRs against non-existent securities or in anticipation of the broker procuring as backing BRs of other banks for relative securities. BRs had also been issued by the bank against BRs issued by Metropolitan Co-operative Bank which was not authorised to issue BRs and which had no backing. The funds so raised had been credited to the account of the broker. The BRs had been used mainly to put through transactions with SCB, Canfina and CMF. The bank also used its own SGL in selling and buying Government Securities on behalf of brokers which frequently bounced at PDO of RBI. Instances where the Bank borrowed from call money market for accommodating the broker

have been narratted elsewhere in the Report. It is regrettable to note that the supervising authorities did not take any effective action during all these years to prevent the irregularities.

5.7 The transactions conducted by the Bank in the manner explained above facilitated creation of huge deposits in the current account of ADN.

5.8 In his evidence, Shri Narottam contended that most of the business was routed through his account by Shri T.B. Ruia (Dhanraj Mills), HPD and on a few occasions by Shri Bhupen Dalal. According to him, the transactions were being conducted by Shri J.P. Gandhi. It has been reported that ADN had formed a nexus with Excel & Co. and Dhanraj Mills Pvt. Ltd. all broker clients of the bank and obtained false BRs of MCB, which were deposited with BOK with the request to sell the securities underlying the BRs to counterparty banks under its own BRs. The funds so raised were apparently utilised by them to play in the stock market.

5.9 The issue of large number of BRs by the Bank for huge amounts without the backing up of underlying securities led to its exposure which was disproportionate to its asset base. It had undertaken responsibility without proper verification of the ability of the brokers to deliver the securities to honour banks's commitment under the BRs issued by it. Such outstanding BRs issued by the Bank without any backing of securities amounted to Rs. 894.22 crores. In the RBI's perception, the above action of the Bank was fraught with grave danger to the interest of the bank, its depositors and shareholders. Therefore, in the public interest and for securing proper management of the BOK Ltd., RBI issued belatedly a show-cause notice and an order on 20.5.1992 under Section 36 AA(2) of the Banking Regulation Act 1949 directing Shri C.R. Kanade not to act as Chairman and as Director of the BOK and not to take part in the management of the Bank from 20.5.1992. Two of the Directors of the bank viz., S/Shri Bhupendra C. Dalal and Milan B. Dalal were also removed simultaneously, as their continuance on the board of the bank was considered inimical to the interest of the Bank. Subsequently, on 27.5.1992, the Bank was put under liquidation under Section 38 of the Banking Regulation Act.

Metropolitan Co-operative Bank Ltd. (in Liquidation)

5.10 MCB Bombay is a licensed non-scheduled small urban Co-operative bank with less than Rs. 10 crores of assets with only one office located at Bombay. The bank was established in the year 1972 and the same was issued a licence to conduct banking business on 28 September 1972. The paid up capital of the Bank as on 27.5.1992 was Rs. 17.65 lakhs. MCB was not authorised to issued BRs. It did not have a SGL Account. It is not a member of IBA.

5.11 MCB had unauthorisedly issued 30 BRs on behalf of its two clients who were dealing in shares/securities viz. Dhanraj Mills Pvt. Ltd. and Excel & Co. aggregating Rs. 1944.52 crores between 25.3.1991 and 2.5.1992. The two constituents viz., Dhanraj Mills Pvt. Ltd. and M/s. Excel & Co. on whose behalf the BRs were issued and the transactions put through, had opened current accounts with the bank on 15.3.1991 and 13.12.1990 respectively. Before opening the accounts and before agreeing to issue BRs on their behalf, the bank had not even cared to ascertain as to how long they were in business, who were there bankers, what was nature of their business, resources and standing etc.

5.12 BRs were issued in exchange of Pay Order received from BOK and Stanchart for equivalent amount which was followed by issue of Pay Order by MCB for equal or nearabout money. However, out of the 30 cases, no consideration whatsoever was received in respect of 14 cases. The bank had no record nor the officials were aware as to the constitutent-wise break-up of BRs issued without consideration. Out of 30 BRs, valuing Rs. 1245.71 crores

(BOK-4 BRs valuing Rs. 592.30 crores and Stanchart 7 BRs valuing Rs. 653.41 crores) and 3 BRs in which value has not been indicated and only face value of the securities is known as Rs. 70 crores, are still outstanding.

5.13 Commenting on the irregularities, Shri Hemant B. Vyas, Ex-Chairman, MCB, in his written submission to the Committee stated :-

> "These transactions have been done unauthorisedly by some members and officials of the bank, outside the bank premises. They also signed BRs without any authority from the Board and without any Board resolution."

5.14 In their submission, the Chief Executive Officers of the Bank at the relevant time maintained that they were acting under the orders of Shri K.K. Kapadia, Vice-Chairman of the Bank. Tracing the origin of the nexus between MCB and the brokers, Shri K.K. Kapadia deposed before the Committee :-

> "We came into contact with Shri T.B. Ruia and other brokers because my nephew got married to the daughter of one of the executives of Killicks. Normally when such relations develop, it is common to talk about each other's business interests. I am in yarn business. Naturally somebody must have told them that I am also a board member of this bank. Then that group started taking interest in the bank and they told me so."

Shri Kapadia further deposed:-

> "When they came to know that I am also a Director of this bank, I was invited to Killicks office and I was told to bring the balance sheet along. I had given them our balance sheet. They said that it is a small bank and with their association they can lead it to achieve higher position. Naturally I was tempted. It is my intention to bring the bank to a higher pedestal. Moreover we were facing the threat of liquidity. Because of this and other reasons, I was listening to them. The BRs were issued on their account to BOK and then payments were also received and simultaneously payments of lesser amounts were made to BOK. So, in each transaction, some surplus was left in our bank which helped to improve our liquidity... For the past one year, we had about Rs. 25 lakhs to Rs. 30 lakhs in their accounts."

5.15 Shri Kapadia identified the brokers group as "Persons like Abhay Narottam, J.P. Gandhi, Hiten Dalal etc." and said that it had taken place in February-March, 1991. In fact, in a written submission made by Shri Kapadia and other MCB officials to the RBI inspectors, it was stated that the entire exercise was done at the premises of the Security Department of BOK or at the office of the broker, Hiten P Dalal on the basis of an informal arrangement with the BOK/SCB and some constituents of the Bank. The persons who were generally present at such meetings included Sarvashri S. Ramaswamy (Excel & Co.), T.B. Ruia (Dhanraj Mills Pvt. Ltd.), J.P. Gandhi (Share broker), Manubhai (Share broker), Abhay Narottam (Director BOK and share broker), C.S. Raje and Sudhakar (BOK officials).

5.16 The facts stated in the above paragraph clearly establish the nexus between MCB and brokers. In fact, Shri Kapadia in his evidence also stated:

> "When we were interrogated by the CBI, when I was confronted before Mr. T.B. Ruia in the hospital, he admitted before the concerned officers that these people were absolutely innocent. Whatever is done is done on my instructions and on our behalf. That was the admission made by him."

5.17 Shri Kapadia admitted that he had been made a Director in one of the companies associated with Shri Ruia and that two directors were co-opted in the MCB Board at the instance of Shri Ruia. Shri Kapadia also stated that one of the meetings of the Board of MCB was held in the premises of one of the companies of Shri Ruia.

5.18 Shri Ruia in his deposition before the Committee had denied his involvement. In his written submission, he stated that any statement of or relating to matters connected with the FIRs that he made as a witness before JPC might adversely affect his defence and/or offer to the prosecution undue advantage against him.

5.19 In their depositions made before the Committee, Shri Hemant B. Vyas, Ex-Chairman of the Bank and Shri K.K. Kapadia, Ex-Vice-President maintained that MCB had a maximum clearing house limit of only Rs. 50 lakhs per day (10% of the deposit liabilities of the Bank). However, cheques for very large value were got cleared by RBI through the clearing houses without raising any objection. When the Committee pointed out this to RBI, they admitted that clearing houses did not focus on the value of gross inter-bank clearings as the net value was usually small. Further, the limit of 10% was not applied to inter-bank clearings as cheques in this clearing were issued by banks on themselves favouring other banks. However, RBI assured the Committee that in the light of the experience of MCB, it was proposed to instal a purposive analysis of inter-bank clearances.

5.20 A special study was carried out of the position of the Bank with reference to its financial position as at the close of [the business on 27.5.1992. The report submitted disclosed deterioration in the bank's financial position. The total erosion in the value of the assets as on May 27, 1992 amounted to Rs. 251.39 lakhs. This had not only completely eroded the paid-up capital and reserves of the bank, but also affected deposits to the extent of Rs. 104.10 lakhs. Besides, several deficiencies were revealed in the matter of violation of directives relating to interest rates on advances, maximum limit on advances to director/single borrower, unsecured loans, interest rates on deposits, defaults in the maintenance of CRR and SLR and issue of gurantees. In addition, 11 BRs for Rs. 1245.71 crores and 3 BRs with no value but stated to cover securities worth Rs. 70 crores still continued to remain outstanding. The Divisional Joint Registrar of Cooperative Societies, Bombay Division in his letter dated June 5, 1992 had also advised that the special audit for the period ended June 30, 1991 of the bank had brought out serious irregularities and deficiencies in its working and the bank had been classified as 'D' class and accordingly requested RBI to accord its sanction for issuing order of liquidation of the MCB, Bombay.

5.21 For the reasons stated in the foregoing, and after bringing the proposed liquidation of the bank to the notice of the Government of Maharashtra on June 8, 1992 the RBI India in exercise of the powers conferred under clause (i) of Section 110A of the Maharashtra Co-operative Societies Act, 1960 read with Section 13D of the Deposit Insurance and Credit Guarantee Corporation Act, 1961 conveyed its sanction for the winding up of the MCB to the Divisional Joint Registrar of the Co-operative Societies, Bombay Division on June 19, 1992. The District Deputy Registrar of Co-operative Societies, Bombay issued interim orders vide his order under Section 102/92 of Maharashtra Co-operative Societies Act, 1960 on July 21, 1992. The Administrator already appointed by the Cooperation Department on 27.5.1992 was designated as Liquidator who took over charge on June 20, 1992.

5.22 The Committee are led to the conclusion that both BOK and MCB had allowed themselves to be used as conduits by the brokers in violation of all regulations, norms and practices over the years thus endangering the interests of the banks, their depositors and the share holders. It is also strange that the banks including foreign banks accepted BRs of huge amounts from these small sized banks. The serious irregularaties indulged

in by the banks eventually resulted in their liquidation. The Committee, therefore, recommend that the Board members and the principal executives should be prosecuted and suitably punished.

5.23 One fall out of the liquidation of these two banks is the sad plight of thousands of depositors and the employees. In this connection, the Committee note that the maximum amount of Rs. 30,000/- payable under the Deposit Insurance Scheme was fixed as far back as 1980. This limit has now been raised to Rs. 1 lakh per depositor w.e.f. 1.5.1993. However, it would be applicable only in respect of those insured banks taken into liquidation/amalgamation etc. on or after 1.5.1993 and would not, therefore, be applicable to the depositors of both the banks under discussion. The Committee recommend that the proposals for taking over or merger of these banks with some existing banks should be considered expeditiously in a manner that will protect the interests of depositors and the employees.

CHAPTER-VI

IRREGULARITIES IN SECURITIES TRANSACTIONS — NON-BANKING FINANCIAL COMPANIES AND MUTUAL FUNDS

6.1 Non banking Financial Companies (NBFCs) mostly in the private sector and largely located in Metro cities, because of their small numbers and low volume of business did not have any major impact on the economy uptill the eighties. This changed when industrial concerns and others floated their own equipment leasing companies. As leasing and hire-purchase business proved to be beneficial, banks were also enabled by an amendment in the Banking Regulation Act, 1949, to engage in these and other similar activities principally to augment their earnings. These however, were permitted only as subsidiary companies, being an activity distinctly apart from traditional banking. In the second half of eighties therefore, a number of public sector banks led by the SBI, set up subsidiaries for undertaking a number of other activities such as merchant banking, hire purchase and equipment leasing financing, venture capital, mutual fund etc. These activities were subject to the specific approval of RBI under Section 6(1) (a) to (n) of the Banking Regulation Act, 1949. Such subsidiary companies being independent legal entities, the resources mobilised by them were free from the SLR and CRR requirements, their deployment was also not hampered by the requirements of flow to priority sectors, productive purposes etc. Besides, within the RBI as two different departments, DBOD and Department of Finance Companies were exercising supervision over banking and non-banking companies, there was a lack of coordination as to who should supervise these non-banking subsidiaries of banking companies. This resulted in loss of control, absence of monitoring of the activities of these subsidiaries and insufficient adherence to such regulations as were meant to inculcate prudence in monetary activities.

Irregularities in Securities Transactions of NBFCs

(a) Operational Irregularities

6.2 Scrutiny of Security transactions in various banks has revealed that the non-banking subsidiaries of major public sector banks such as SBI Capital Markets Limited, Canbank Financial Services Limited, Andhra Bank Financial Services Limited, Allbank Finance Limited etc. indulged in irregular transactions and in imprudent investment of funds into the securities market under the Portfolio Management Scheme and in unauthorised investments on the stock exchanges through brokers. Even though these companies were incorporated essentially for undertaking Merchant Banking and such other activities in a large measure they adopted portfolio management of temporary surplus funds of PSUs and other larger corporate clients of their parent banks. These subsidiary companies violated PMS guidelines of the RBI in various ways and almost as of routine. The funds so deployed became one of the principal sources for fuelling the stock market. Large volumes of unauthorised 'investment' transactions were undertaken by these NBFCs through repos, BRs etc. All these investment operations of public funds were not supervised adequately and were in the absence of suitable policies (of the NBFCs) for investment. The transactions also reveal various nexus with select brokers through whom sizeable transactions were put through. In many cases brokerage was also not being paid, as the deals were at the instance of the brokers and for their benefit. These NBFCs had the advantage of the names of their parent banks to attract deposits funds and at the same time offered high returns. Each company devised its own schemes to attract funds.

Competitive and wholly unverifiable claims about returns were advertised to attract investments. This gross irresponsibility was not checked either by the parent banks, who in fact encouraged it or by the government, who in the ultimate are the trustees of this public asset.

(b) Monitoring and supervision of affairs of NBFCs - Lapses observed

6.3 As the subsidiary Non-banking companies were mostly staffed by personnel from the parent banks, RBI expected that they would discharge their responsibilities with diligence and prudence, and that the parent bank would monitor their affairs suitably. However, there were no separate book of instructions/Manual nor was there any internal inspection machinery set up. No regular system of external supervision was introduced. Strangely enough, the Committee learnt during its deliberations that these subsidiaries were not even examined by the RBI at the time of inspections of the parent bank. The subsidiary companies, on the other hand, felt that as they were independent legal entities they were free from the regulatory provisions governing their parent banks. During interrogation by the Committee, the Chairmen of parent banks routinely averred that they were unaware of the happenings/transactions in their subsidiaries; conversely officials of the subsidiary companies submitted that they were unaware of any guidelines issued by RBI in respect of investment policy, they also held that these applied only to the parent banking companies. This situation was not simply of omissions particularly as Chairmen of the banks are also Chairmen of the subsidiaries. The Committee observe that to avoid falling within the purview of RBI guidelines, the parent banks knowingly shifted such transactions as they were specifically debarred from undertaking to their subsidiaries. What is worse is that even though the RBI had in one of its circular dated 2.5.1989 stated that transactions prohibited for parent banks could not be put through or carried out by their subsidiaries. This advise was neither followed nor enforced.

SBI Capital Markets Ltd.

6.4 SBI CAPS was established in 1986 as a wholly owned Merchant Banking Subsidiary of SBI and is mostly staffed by deputationists from the parent bank. The resources/sources of funds of the company comprised besides its equity and reserves (aggregating to Rs. 94.31 crores as on 31.3.1991) short term deposits from private and public sector companies. It also accepted funds under PMS. It has two broad divisions "Merchant Banking" and "Mutual Fund". In the former, the company mainly manages issues of shares/debentures of public limited companies including Equity support and venture capital, provides finance through Equipment Leasing/hire purchase transactions besides arranging credit syndications and accepts funds for investing in money-market instruments. It is in the third category of activity that serious irregularities have come to light resulting in even sizeable loss. SBI CAPS has four Regional Offices at Madras, Calcutta, New Delhi and Bangalore apart from its corporate office in Bombay. However, only the offices at Madras and Delhi were allowed to accept deposit of corporate clients. While investments are generally made by the corporate office at Bombay, the Madras Regional office has been permitted to invest when rates at Bombay are not that favourable. It is reported that as per corporate policy, the subsidiary shall invest only with reputed banks and financial institutions. This, however, has not been adhered to.

Major Irregularities observed in Deposit/Investment Transactions

6.5 The company had accepted sizeable volumes of deposit as inter-corporate placements, from private and public sector companies, at various rates of interests and for varying periods. Deviating from the normal practice of issuing Deposit Receipts for these funds, the

company had entered into "ready forward" sale deals with these corporate bodies purporting to cover sale of its long term investments. Only letters were exchanged setting out terms and conditions of sale and the actual transaction of securities not just not undertaken, it was never originally intended to either. SEBI inspectors during their scrutiny in June-July, 1992 have stated that this company has camouflaged the real nature of its transactions which are in reality loans taken by the company and are in violation of their guidelines. The Company sought to explain that these were PMS transactions and that RBI guidelines (which stipulate minimum lock-in-period etc.) would not be applicable to them. It had argued that the company is a separate legal entity independent of the parent bank and not bound by RBI guidelines. However, after receipt of the specific and a repeat instruction from RBI in June, 1992 that their guidelines/instructions would apply *mutatis mutandis* to the subsidiaries of bank it issued instructions for discontinuance of such transactions. The contention of the Company is not tenable as the RBI guidelines dated 2.5.1989 had clearly specified the very same instructions. It is regrettable that the subsidiary of a premier bank (almost wholly owned by RBI) have flouted guidelines of the RBI and SEBI which are but prudent parameters to safeguard the interests of depositors/clients.

6.6 The volume of securities transactions of SBI Caps, Bombay during the years 1990-91 and 1991-92 was as follows:-

Period	Purchase (Rs. in crores)	Sales Total (Rs. in crores)	Transaction (Nos.)	(Rs. in crores)
1.4.1990 to 31.3.1991	7200	6730	13930	1250
1.4.1991 to 31.3.1992	18844	16114	34953	3440

6.7 At the Madras Regional Office, funds received had been passed on mostly to Growmore Research and Asset Management Ltd. (GRAM) a company belonging to Shri Harshad S. Mehta. The Regional Office had pleaded that the funds were parted against BRs of Citibank, Madras. SEBI and internal auditors had however repeatedly ponted out that "there is no evidence of receipt of securities purchased". Between April, 1991 and April, 1992 Rs. 1,148.61 crores were placed with GRAM and remitted by telegraphic transfers to Shri Harshad Mehta and his group accounts at Bombay with SBI. The maximum outstanding at any one time was about Rs.150 crores, this is almost twice the normal level of exposure of Rs. 80 crores to individual brokers as stipulated in the company's own instructions dated 17.12.1991. Further, there is no evidence to suggest that the company made any critical appraisal of the activities of GRAM or its credit worthiness. Similar transactions have also taken place, in gross violation of the company's own guidelines and all canons of prudence, and safety with Kotak Mahindra (Rs. 75.25 crores) and Somayujulu & Co. (Rs. 25 crores). Even though this gross irregularity of placing funds with brokers was taking place for long the corporate office is stated to have come to know of it only in May, 1992 - when shortage was detected. The company has not been able to submit a reconciliation. It has suffered a loss on this account. Wholly inexplicable is that even as late as end of April, 1992, when transactions with HSM had been warned against, an amount of Rs. 16.25 crores was placed with GRAM.

6.8 SBI CAPS have admitted these irregularities. Further, the accounting practices and procedures adopted in respect of receipt of funds from clients was also unsatisfactory. The

company operated a current account with its parent bank in which the funds received from constituents were collected and disbursed either by way of inter-corporate deposits, or under ready forward deals made directly therefrom without bringing the transactions into the books-of-prime entry in the company. The explanation that these were considered "off-balance sheet" items is evasive and unconvincing especially as funds were made available directly to brokers. The Company was not able to reconcile the transactions only because it did not maintain any control records. Accountancy procedures adopted by SBI Caps were not in keeping with the probity and prudence expected of a banking organisation.

6.9 The Committee are led to the conclusion that SBI CAPS violated all established norms, that this was in the knowledge of the parent bank, that the company parted with substantial funds in favour of broker (HSM), and that it did so without any security.

Internal Control/Management

6.10 The company has stated that internal audit is conducted by a Chartered Accountant firm every quarter at its corporate office as well as at its four Regional Offices. They admitted that as far back as June, 1991 the auditors had stated that there was no evidence of securities having been purchased by the Madras Regional Office and that there was need for fixing broker-wise limits. It was, conceded to the Committee during their deliberations that the irregularities pointed out in the internal audit reports were not discussed at the Board meetings. The Managing Director of SBI CAPS stated to the Committee in this context :-

> "Madras office gave a certificate that BRs were being accepted whereas for majority of transactions they did not accept BRs and for minority they did accept BRs."

6.11 As a specimen instance of misleading corporate office, they had forwarded to the Committee a copy of the Madras Regional Office letter dated 11th March, 1992 in connection with 'private placement of funds'. It has been stated therein that as the corporate office was not interested in the offer of Neyveli Lignite Corporation (NLC) for private placement of their bonds, they were entering into a Ready forward deal with GRAM (belonging to HSM covering Rs. 200 crores of these bonds to be issued by NLC in three lots carrying net interest of 12%, 13% and 13.5% for 3, 6 and 7 months. As per the terms of the deal the Bonds would be arranged to be issued in favour of SBI CAPS. However, at the end of the letter it has been stated "We feel that deployment of funds with Growmore would be acceptable inasmuch as they are backed up by BRs of major banks". This has been referred to as a false certificate of Madras Regional Office. When the scrips are arranged to be issued to SBI Caps and they are required to sell these to GRAM as per terms, it is not understood, how BRs of other banks would be relevant or acceptable for the transactions. A reading of the letter clearly indicates that it is a clear accommodation, at a highly concessional rate to GRAM, arranged by the broker through their nexus with the PSUs viz. Neyveli Lignite Corporation Ltd. The Committee are unable to accept the contention that Corporate Office was unaware of what was happening in branches. Further, if it was unaware even then it was derelict in the discharge of its responsibilities and the Committee take a serious view of this tendency to avoid accepting responsibility on ground of ignorance.

6.12 The Statutory Auditors had failed to report on the irregularities committed at the Corporate and Regional Offices. While the auditors were required to carry out physical verification of securities, they failed to do so with reference to stock as on 31.3.1991, but accepted the company's records and also failed to verify with SBI Bombay Main Branch which had been authorised to act as custodian of the securities on behalf of SBI CAPS.

There was no periodical physical verification of the securities held either by SBI CAPS itself or on its behalf, by SBI Inspectors, as per normal banking practice. The parent bank, which submits half yearly review on the functioning of subsidiaries to its Board failed to report on the irregularities. It was thus, in addition to other failures, guilty also of not discharging its own direct responsibilities, towards its own subsidiary and its proper functioning.

Collusion between Officials and Broker

6.13 More than 82% of the business of Madras Regional office where irregularities were the maximum, had been put through GRAM/HSM. Even in the company as a whole, transactions of SBI Caps through this broker was the highest. Instructions relating to maximum exposure to a single broker were not simply not adhered to, they were wilfully flouted. During evidence before the Committee various instances of SBI officials being lured away and employed by the HSM group were cited. In fact, this tendency has been witnessed elsewhere also and is the single largest contributor to collusive practices proliferating.

Canbank Financial Services Ltd.

6.14 Canfina was set up as a wholly owned subsidiary of Canara Bank and it commenced its operations with its Head Office at Bangalore on Ist June, 1987. Its authorised and paid up capital are Rs. 50 crores and Rs. 10 crores respectively. It was staffed mostly by personnel from Canara Bank and has branches at Ahmedabad, Bombay, Calcutta, Hyderabad, Madras and New Delhi besides Bangalore. As the Board comprised mostly of senior executives of Canara Bank and its Chief Executive is also a senior official of that bank (on deputation) the company functioned under the umbrella of the parent bank; besides it submits periodical returns on its functioning to the Board of Canara Bank for information.

6.15 The activities authorised to be conducted by the Company are equipment leasing, merchant-banking, venture capital and consultancy services. The Company, initially deployed a major portion of its owned funds and deposits in equipment leasing business and obtained the classification of an 'Equipment leasing company' from the Department of Finance Companies of RBI; this classification entitles the company to mobilise public deposits to the extent of ten time its owned funds.

Irregularities in Transactions

6.16 In the context of a number of PSUs raising resources by way of floatation of bonds in the market, the company took the role of "market maker" and handled 75% of the total PSU bonds issued. It also shifted its activities to 'Portfolio Management' and 'Corporate Investment Advisory Services'. The method adopted by this Company for handling bond issues is explained in the subsequent paragraphs.

6.17 When commissioned by a Public Sector Undertaking (PSU) to raise resources by way of bonds, Canfina would agree to an initial subscription of a substantial portion of the Bonds with the stipulation that the amount subscribed by it was to be kept with Canfina itself, under portfolio management services, CIAS. At times, the rate of interest offered on the investment was lower than the coupon rate of the bonds itself. Some illustrations of this kind have been given in the Chapter on PSUs. The general question of the operation of the Public Sector Bonds Schemes has been discussed in the Chapter on Ministry of Finance.

6.18 The outstanding amounts under PMS/CIAS/ICDS as on 31.12.1992, and total value of Bonds of PSUs held by CANFINA/Canara Bank given below will give an idea of the business handled by the company as also of its liabilities:

Sl.No.	Name of PSUs	Total Outstandings by Canfina as on 31.12.1992	Total Bond of respective PSUs by Canfina & Can Bank (including reversals)
		(Rs. in crores)	(Rs. in crores)
1.	IRFC	425.17	748.06
2.	HUDCO	297.00	278.86
3.	MTNL	150.00	260.13
4.	NPC	248.25	426.58
5.	NPTC	94.00	40.00
6.	NTPC	165.00	350.69
7.	PFC	8.00	287.09
8.	CIL	5.31	76.84
9.	OIDB	275.42	NIL
10.	NALCO	60.00	NIL
11.	BRPL	27.57	NIL
12.	EXIM BANK	40.00	NIL
13.	KRIBHCO	36.00	NIL
14.	OTHERS	23.75	NIL
		1,855.47	2,468.25

6.19 CANFINA, however, does not account for these funds in its books on the plea that these are off balance-sheet transactions. The company has stated in one of its replies "since the PMS funds and investments were not considered as part of company's liability and asset they were not brought to the balance sheet ...." About utilisation of these funds for BR operations and their proper accounting the company has stated that the "requirement that all deliveries must be against payment is not practicable on account of market practices". In other words CANFINA issued BRs covering these bonds to brokers, at their instance, without deliveries. Brokers, were thus enabled to get cheques, mostly for banks specified by them and then to rotate the funds at will. Without any doubt CANFINA indulged in unethical risky operation colliding with the PSUs through the medium of brokers supposedly for PMS transactions. As, however, there was no actual transfer of funds by PSUs to CANFINA, as admitted by them in their written replies to the Committee, these transactions cannot be termed as "Portfolio Management Service" at all. In any event the company has not also admittedly complied with other requirements of the PMS such as minimum lock-in period, prohibition of guaranteed return, risk to investor etc. The company has stated in one of its replies to the Committee; "Under the CIAS activity, the company was accepting funds for generally less than one year. Under this activity, conceptually the securities were sold to the party on receiving funds for investment. Similarly, it was bought back from the party when repayment was made. These transactions were treated as buying and selling of securities for clients. It was presumed at that time that the guidelines of RBI are not applicable."

6.20 Apart from this the company had also indulged in a large volume of investment transactions by way of purchase of units of UTI and in certain cases Government securities, even though dealing in investments is not one of its authorised activities. These transactions had been mostly by way of Ready forward or Double Ready Forward deals at the instance of brokers ostensibly with other banks but essentially with the latter's broker clients. Some of these transactions have been commented upon by the Janakiraman Committee as illustrative examples.

6.21 The Committee have observed that CANFINA had been violating the guidelines of RBI in regard to PMS for long. It had been pointed out by the RBI who inspected it in March, 1991, that the Managing Director of the company had given a false assurance to RBI in terms of his letter CANFINA - RBI INS: 1619: 89 dt. 22.9.1989 that the company had been accepting funds with lock in periods of one year and over only. In many cases, it was observed during inspection that funds for a shorter duration had been accepted and further, funds were allowed to be withdrawn as and when the parties desired. The RBI had, *inter alia*, pointed out several other irregularities.

6.22 It is obvious that the management of CANFINA was well aware of the affairs being conducted irregularly. The company has pleaded in justification of its action and condonation of not having followed PMS guidelines : "We would not have been able to do either market making of PSU Bonds or manage the PSU funds since these guidelines were generally not followed by other competitors, mainly foreign banks who entered this arena in early 1991 as a result of Government's liberalised policy and started offering high yields."

Inter Corporate Placement of Funds

6.23 The company also arranged for placement of funds received from some of its corporate clients with other corporate clients who were in need of funds retaining a rate of return for it in the process. It has been observed during the inspection by RBI, conducted as far back as in 1988 that funds had been placed by 'borrowers' of Canara Bank at a rate of interest even slightly lower than that charged by that bank and in gross violation of credit discipline. Here again the funds received/placed were treated as 'off-balance' sheet items. However, the letters issued/received do not appear to establish any privity of contract between the 'lender' of the funds and the 'taker' of the funds and hence, the liability of CANFINA is not ruled out in case the latter does not refund.

Claims by and against CANFINA

6.24 It is observed that an aggregate amount of Rs. 778.17 crores is due to CANFINA and the possibility of recovering bulk of these funds is remote. Besides, the company is contingently liable in respect of claims against it for Rs. 223.81 crores. Thus, the company could lose to the extent of about Rs. 1000 crores on its speculative and reckless dealings. This is in addition to facing an extreme liquidity crisis. It is understood that the parent bank has so far accommodated it on a "no profit no loss" basis to the extent of over Rs. 2600 crores against available securities with it. In this context the Chairman of the Canara Bank has stated :

> **" While the involvement of our two subsidiaries in the infamous episode has had an unsettling effect on the bank, the decision to be taken in its aftermath, especially concerning Canfina was quite crucial. Legally there was no compulsion for the bank to rescue CANFINA. However, the fact remains that it is a wholly owned subsidiary of Canara Bank which itself is owned by the Government....."**

6.25 The Committee hope that the nature and extent of the financial assistance being provided by Canara Bank to its subsidiaries are such as could be justified on prudent commercial norms. Further the parent bank cannot be absolved of the responsibility for various irregularities of its subsidiary.

Monitoring and Management Information System

6.26 The deliberations and evidence before the Committee clearly indicated that there was practically no internal control machinery to check irregularities. The machinery of audit was perfunctory and superficial. It is observed that the parent bank had not conducted any inspection or periodical scrutiny of the affairs of Canfina. To a specific query as to whether it was lack of reporting system or lack of internal inspections due to which these irregularities occured and why did these things not come to the notice of higher management, the Chairman of Canara Bank replied : "In fact the reporting system was violated.... it was not placed before the Board of the Canfina. At the top level they were not aware of the violations that have taken place...."

6.27 To a query whether the irregularities were at anytime discussed with - RBI, the Chairman of Canara Bank replied that "only the working of the Canara Bank was discussed and not its subsidiaries".

6.28 The Committee consider it necessary to underline such self admitted dereliction of duty on the part of those concerned.

Andhra Bank Financial Services Ltd.

6.29 ABFSL was incorporated as a wholly owned subsidiary of Andhra Bank, a comparatively smaller sized public sector bank taken over in the second round of nationalisation with a paid up capital of Rs. 5 crores. While the Chairman of the Andhra Bank is the ex-officio, Chairman of the subsidiary, its affairs are managed by the Managing Director under the supervision of the Board. Shri K.R. Nayak an ex-senior official of Canara Bank was the Chairman while Shri Y. Sundara Babu was the Managing Director at the time of its incorporation in February, 1991. The Board included among others late Shri M.J. Pherwani. Like all the other bank subsidiaries it was authorised to transact merchant banking, equipment - leasing and hire/purchase as well as other business "Incidental" thereto. It was not to do other business such as trading in securities, discounting of bills etc., covered by Section 6(1) (a) to (n) of Banking Regulation Act, unless these were incidental to the activities authorised. The company, however, did precisely that in which it was not supposed to and engaged in such activities on a large scale, of course without the necessary approval of the RBI. As per the balance sheet of the company as on 30 June, 1992 the leased assets and stock-on-hires amounted to Rs. 5 crores as against its total assets exceeding Rs. 500 crores. The company was classified as a "Loan company" only by the Department of Financial Companies of RBI, Bangalore. As such it was not entitled to invite deposits in excess of 25% of its own funds, as per the Directions of Department of Finance Companies of RBI in respect of NBFCs. The company contravened this provision. The bulk of its outside liabilities comprised "inter-corporate deposits", amounting to Rs. 387.46 crores and "security transactions" (buy-back) to Rs. 119.32 crores, besides other public deposits which stood at Rs. 7.85 crores.

Functioning as a Conduit

6.30 The bulk of the funds collected by ABFSL had been from PSUs. Thus as on 31.3.1992 out of total deposits collected by way of "inter corporate" and "security transactions" at

over Rs. 500 crores - an amount of Rs. 350 crores were from PSU clients. A substantial portion of these funds raised, had been passed on by it to three parties viz. Fairgrowth Financial Services Ltd. (FFSL), Shri H.P. Dalal (HPD) and SCB ostensibly under ready-forward transactions and without complying with the guidelines of RBI in this respect. Thus the company has merely acted as a conduit for diversion of funds from public sector enterprises to private sector companies and foreign bank thus circumventing the investment guidelines for PSUs which prohibit their investing/depositing moneys with private sector finance companies. Similarly, the readyforward transactions with counter-parties by this company were in reality deposits at pre-determined rates. During the period 31 August, 1991 to 26 May, 1992 ABFSL deployed through 229 transactions, an aggregate sum of around Rs. 1732 crores. Of these for Rs. 1255 crores, 178 transactions accounting for 73% in value were with FFSL and Shri H P Dalal. The Bangalore branch had deployed nearly Rs. 1,000 crores in contracts with FFSL. For this there was no exchange of securities and the payments were only supported by "SRs" an innovative illegality as issued by FFSL. Upon insistance for delivery of securities, FFSL had delivered securities of a face value of a mere Rs. 205.12 crores. These too, were forged. The statutory auditors of the company helped matters by not even visiting the branches of the company and never verifying the investment.

6.31 The Janakiraman Committee enquiring into the affairs of this company have concluded:

> " This debasement of the true role of ABFSL appears to have been done with the full knowledge of and under the direction of the bank's top management.
>
> In fact the manner in which ABFSL has functioned since its inception would almost seem to suggest that ever since the subsidiary was formed, it has acted only for the benefit of FGFSL and Hiten P. Dalal."

6.32 It is relevant to report, as deposed before the Committee that even before the incorporation of the company on 25 February 1991, the then Managing Director Shri Sundara Babu had been negotiating with FFSL for assistance in the matter of availing of "Start of Service" and had paid Rs. 25,000 for the purpose. In fact, three officers of ABFSL were deputed to that private company for being trained in the business.

6.33 In addition to the inter-corporate deposits and 'Security transactions deposits' referred to earlier and reflected in the balance sheet of the company, the company has also been granting 'Bridge loans' to favoured customers pending their issuing of right shares etc. Apart from these the company had been indulging in transactions in securities in the guise of 'investment service' to its clients. The total funds so collected and outstanding on 31 March, 1992 were Rs. 310.91 crores. These funds reportedly placed by ABFSL for investment on behalf of its clients have not been reflected in its financial statements. However, correspondence with the investors, form of receipts issued and other documentations make it clear that these are in fact 'deposits' accepted for portfolio management. This was in gross violation of PMS guidelines issued by RBI. It is also observed that there had been no transfer of securities to the clients on whose behalf investment service had been rendered.

Collusion with Broker H.P. Dalal and ABFSL

6.34 Apart from having large number of transactions with FFSL for which it was patently acting as a conduit, the company, had significant transactions with Shri H.P. Dalal. These amounted to Rs. 361.55 crores or 21% of the total during the period 31 August, 1991 to 26 May, 1992. The company could not give any convincing reasons for such a concentration

with one broker. During interrogation by members of the Committee the Chairman of the Bank initially denied having any knowledge of HPD . Subsequently he admitted having met him. To repeated queries as to how or why he was appointed as the principal broker of Andhra Bank and allowed to operate a separate SGL Account through them, the Chairman gave evasive or no replies.

6.35 The Committee find the conduct of ABFSL and its officials, censurable and recommend early and prompt action against all found guilty.

Estimated loss on account of involvement in irregular security transactions

6.36 As on 30.6.1992 the total liabilities of the company aggregated around Rs. 514.63 crores. As against this it had only the assets of face value of Rs. 30.22 crores.

6.37 In addition, the company holds certain securities of the book value of Rs. 308.33 crores. Claims and counterclaims of ownership and the depreciated value of these securities make these holdings as of little countervailing value to ABFSL.

6.38 The Committee seriously view the heavy losses sustained by ABFSL for which the parent Bank cannot be absolved of responsibility.

AllBank Finance Ltd. (Allbank)

6.39 AllBank Finance Ltd. is a wholly owned non-banking subsidiary of Allahabad Bank incorporated in February, 1991 by converting the erstwhile subsidiary Allahabad Bank Nominees Ltd. originally incorporated in September, 1951. It has its registered office at Calcutta and an active branch at Bombay. As in the case of other subsidiaries the Chairman of the parent bank is Chairman of the Company. However, in this company, even though there is a full time Managing Director, the Chairman had been authorised by a special resolution of the Board to exercise "full" executive powers thereby creating an anomalous situation of two full time Managing Directors. Further, the Board comprises eight Directors of which, five are employees of Allahabad Bank, thus subordinate to the Chairman, the remaining three being his nominees picked up from the parent bank. The principal activity of the company, which has a paid up capital of Rs. 5 crores and classified as an "Investment Company" by the RBI had been raising funds by way of inter-corporate deposits and deploying them in stocks and shares by way of ready forward with brokers etc., besides direct lending. The latter constituted mainly "bridge loans" to companies for whose public issue the company was a lead manager or a co-manager. The principal broker for the company is M/s. V.B. Desai and Co., the others having significant dealing being M/s. Baijnath Khandelwal & Co., Calcutta. During the period 31.7.1991 to 31.3.1992 the company entered into 29 ready forward deals with M/s. V.B. Desai aggregating Rs. 46.52 crores. A major portion of these contracts related to ready purchase/forward sales of shares of limited companies from the principal broker. These transactions, in the opinion of the Committee, were simply a device to facilitate the brokers business interests.

6.40 It is seen that the subsidiary company had functioned mostly for the benefit of M/s. V.B. Desai and had in contravention of all principles of safety of funds passed on its customers deposits to the broker for investment and speculative deals in share market.

6.41 When during evidence, the Committee brought to the notice of the representative of the Company that in several cases the names of counter party were not indicated the witness expressed his inability to explain the reason for not knowing the name of the counter-party and stated "There are a few entries where we are not able to trace". Another disquieting

feature observed by the Committee was that most of the funds deployed by Oil India under PMS with AllBank finance were utilised for investments in the equities of private sector companies. During evidence the representative of the company stated that the public sector enterprise had authorised them to invest their funds in private sector companies also and it was done as per contract.

6.42 Apart from PMS, AllBank Finance Ltd. had also mobilised substantial amounts of money from other corporate entities including PSU, 'inter-corporate deposits'. During 1991-92, the company had mobilised Rs. 58.09 crores as inter-corporate deposits and Rs. 259 crores till November, 1992. In this connection, the Committee also found certain discrepancies in the manner in which funds were shown in the books of PSUs and the company. For example, OIDB, whose deployment of funds was also examined by the Committee, has shown an amount of Rs. 39.56 crores as investment under PMS on 24.4.1992 in their books. However, the Company has shown it as Inter-Corporate Deposit. During evidence the Committee enquired as to how the amount could be shown as inter-corporate deposit by AllBank since OIDB was not a company under the Companies Act. The representative of the company deposed "we did not take into consideration that thing".

6.43 There was no regular inspection of the affairs of the subsidiary company by the inspectors of parent bank and it was stated that RBI also had not conducted any inspection except a scrutiny in May, 1992 of the one transaction with HUDCO.

Fairgrowth Financial Services Ltd.

6.44 The FFSL was set up on 9th July, 1990 with a paid up capital Rs. 700 only. The paid up capital of the Company as on 31.3.1992 is Rs. 8.60 crores. The total number of shareholders of FFSL is 2611. These included some public servants - which includes Government Officers and Ministers and their family members who were allotted shares from promoters' quota. The main objective of the Company is to undertake the business of equipment leasing, hire purchase, merchant banking in all its aspects, portfolio management service, investment in stocks/securities and also to deal with real estate.

6.45 Money Market turnover (sales) gross figures as furnished by FFSL for the period 1.8.1990 to 30.6.1992 were as follows:-

(Rs.in crores)

Party	10.8.90 to 31.3.91	1.4.91 to 30.6.92	Total
*ABFSL (Equity)	46.46	—	46.46
*ABFSL (Bonds/Units)	1008.48	913.50	1921.98
BOI Finance	792.16	528.79	1320.95
BSES	103.37	35.50	138.87
NHB	1672.79	254.69	1927.48
Parag Bosimi Ltd.	27.25	23.12	50.37

* ABFSL have stated that they commenced business only from 1.7.1991. According to them, therefore, the Fair Growth Financial Services Ltd. Money Market turnover (sales) gross figure furnished for the period 10.8.90 to 31.3.91 do not relate to ABFSL Ltd.

6.46 It has been reported that FFSL deployed/lent funds to various private firms/ individuals apart from deployments in stock market operations. The Company earned a profit (after tax) Rs. 1.11 crores as on 31.3.1991. This went up to Rs. 45.34 crores as on 31.6.1992. The main business of the Company was with ABFSL whose share in total volume of business was 30.86%.

6.47 The contacts with the ABFSL started even before ABFSL commenced its business operations in July, 1991. A letter was sent by FFSL on 4.2.1991 addressed to the Chairman, Andhra Bank (marked for the attention of Shri Y. Sundara Babu, DGM who after the formation of ABFSL became its M.D.).

6.48 The letter after referring to a discussion with Shri. Y. Sundara Babu, stated "as we propose to mobilize surplus funds from public/private corporate sector, we reckon that we may encounter situations wherein the client may be willing to provide in funds for management but may be prevented by the restrictive covenants of their investment guidelines. To overcome such procedural difficulties, we hereby propose that your bank act as our Bankers for carrying out the money market operations on our behalf. The letter while going into the details of the *modus-operandi* to be adopted for the purpose also mentions as follows:

a) To receive Bank/Money Receipts in your name, in respect of Securities purchased by us. Payment will be made by you to the debit of our account with you.

b) To issue your BR in respect of securities sold by us. Sale proceeds received will be credited by you to our account with you.

c) To make offers of Purchase/Sale to our clients in your own name, on our behalf.

d) To make offers to manage surplus funds of our clients in your own name, on our behalf.

e) To extend quotations and to respond to tenders in respect of Private Placement Issues of Public Sector Bonds and/or investment proposals, in your own name on our behalf."

6.49 The back up commitments proposed by FFSL were as follows:

> "In respect of match-making proposals, we undertake to square off the transactions on the same day where offers of Purchase/Sales have been made by you on our behalf, reverse tie-up will be extended by us. For example, where an offer on purchase has been made by your on our behalf to X Ltd., we shall make an offer of purchase from you at a rate which is equal to the rate quoted by you to X Ltd.
>
> Where offers to manage the surplus funds of our clients have been made by you, on our behalf, we shall provide you reverse tie-up for such transactions.
>
> Where quotations have been extended or tenders responded to by you on our behalf, back up quotation will be provided by us to you."

6.50 The remuneration proposed was 25% of the realised spread in respect of purchase/ sale offers and quotations/tenders, and a minimum spread of 0.10% per annum for offer to manage surplus funds. The actual dealings between ABFSL and FGFSL were on the lines contemplated in the above letter.

6.51 The close nexus between ABFSL and FFSL can also be seen from the discussion for the tie-up between FFSL and Andhra Bank. On 15th May, 1991 Shri Sundara Babu (DGM,

Andhra Bank) submitted a note to the Head Office for entering into start-up services with FFSL. The initial demand by FFSL of Rs. 60,000 was later negotiated and settled at Rs. 25,000 and three officers of ABFSL were sent for training at FFSL.

6.52 The Committee were informed by the Company that they had 232 transactions with ABFSL under ready forward on the basis of SRs without physical delivery of any securities. During evidence FFSL admitted to have carried out transactions to the tune of Rs. 6,000 crores including roll overs, out of which 90% was in SRs without the backing of security. They were also informed that when the scam broke out, upon an enquiry by RBI, ABFSL maintained that all their securities transactions with FFSL were backed by physical delivery of securities. In order to maintain the stand ABFSL pressurised FFSL for delivery of securities. According to FFSL this pressure forced their money market personnel at Bangalore to give forged securities. The two officers of ABFSL and FFSL came to an "understanding", and 4 to 5 units certificates which were genuine and whose original value was about Rs. 1000 crore was altered to around Rs. 155.00 crores. These were then handed over around 16.5.1992 in a closed cover to ABFSL. The representatives of FFSL confessed to the fraudulent method adopted by the Company from the beginning.

6.53 It was also noted that Bombay Suburban Electricity Supply Company (BSES) had been transacting with FFSL through ABFSL. In case of two transactions amounting to Rs. 49.91 crores, ABFSL representatives informed the Committee that it was BSES which had made it a pre-condition that the ABFSL had to buy securities only from Fairgrowth against the deposits of BSES. ABFSL was provided a Commission of half per cent in the transaction. A dispute arose when BSES claimed the outstanding amount from ABFSL but ABFSL maintained that FFSL should be held liable. As the routing transaction was put through by ABFSL, BSES was insisting that ABFSL should acknowledge the liability and not FFSL.

6.54 FFSL had also obtained accommodation contracts for sale and purchase of securities from two brokers viz. Shri Pallav Seth and Shri Shrenik Javeri. The total amount of sale contract is Rs. 615.87 crores and the purchase contract amount Rs. 799.26 crores. According to the FFSL there was no diversion or out flow of funds on the basis of these contracts. These contracts were obtained only for audit purposes. It was also revealed during evidence that the balance sheet as on 31 March, 1992 which had been approved by the Board of Directors and audited by the statutory auditors was nullified and a new balance sheet was drawn. As to the reasons for it, it was stated that in the earlier balance sheet there were many adjustments and the Company had violated Section 370 of the Companies Act. After the Scam broke out the Auditors, on being approached by the Directors of the Company suggested on 4 July, 1992 that a new balance sheet should be drawn. In the new balance sheet the contracts with Shri Pallav Seth and Shri Shrinik Javeri were removed from the books of accounts. Further, the transactions which were earlier shown as borrowings and lendings were, in the new balance sheet, shown as amount receivable and payable.

6.55 The amount due from FFSL as on 29.1.1993 is as under :-

Present Position	(Rs.in crores)
ABFSL	237.42
BOI Finance	99.69
NHB	2.32
BSES	48.91
Other Corporate	31.00
	419.34

6.56 FFSL has, however, maintained that the liability exists in its books and they are prepared to pay either BSES or ABFSL as the case may be. BSES has thereafter gone to the Special Court in this regard and the Special Court has subsequently asked the CBI to enquire into the matter. There is evidence to show that payments of large amounts have been made to Director, Finance of BSES.

6.57 The Committee were informed that CBI has registered a case on 25.7.1992 against some officers of FFSL in regard to forging of documents, obtaining of bogus contracts from the brokers and the transactions with BSES. It has also been stated that CBI investigations have revealed that FFSL apart from deployment of funds in stock markets deployed/lent funds to various private sector companies individuals. The possibility of these deployments being used as conduits for paying bribes was being investigated.

6.58 The Registrar of Companies has also filed several complaints against the company in the Special Court for economic offences in Bangalore. All these cases were at the trial stage.

6.59 FFSL with an incorporation of Rs. 700/- earned a profit of Rs. 47 crores within two years of its operation.

6.60 The Committee wish to underline that FFSL seem to have perfected systems to circumvent all the rules and regulations. It sought to influence public servants - which includes Government Officers and Ministers through inducement including that of offering its high value shares at face value. FFSL provided the perfect conduit for collusive activities between broker and banker.

6.61 The Committee conclude that some Non Banking Financial Companies played a dubious role in the scam. In this connection they note that the powers of the RBI to supervise and monitor the working of NBFCs are derived from chapter IIIB of the RBI Act. However, the control exercised by RBI in terms of the said provisions is not adequate, being confined only to deposit taking activities. It is astonishing that no authority, either in the Government of India or in the RBI, appears to have taken stock of the possible role of NBFCs in securities and banking transactions nor of the limitations in the RBI Act to deal with such contingencies. Over a period of several years, an entirely new sector of financial activity was allowed to grow and flourish without giving any thought to the deleterious consequences of the activities of this new sector. In the light of the role of the NBFCs in the current scam the Committee are of the considered view that there is an imperative need to ensure that the financial companies follow prudent practices for inculcating healthy financial discipline and, therefore, their overall functioning, particularly the deployment of funds has to be brought within the purview of some guidelines. The Committee, therefore, recommend that Government should examine whether the provisions in Chapter IIIB of the RBI Act are sufficiently wide to cover the necessary regulation. If not, the question of reinforcing the existing legislation or to enact a separate legislation for the NBFCs be examined so as to ensure proper functioning of NBFCs and also to protect the interest of the depositors.

Mutual Funds

6.62 Mutual Funds have played an important role in the capital market. The working of the mutual funds is governed by the guidelines issued by Ministry of Finance, RBI and SEBI. A scrutiny of securities transactions by the Committee has disclosed involvement of the Mutual Funds also in irregular transactions. The Committee examined in particular the involvement of Canbank Mutual Fund (CMF).

6.63 CMF had violated some of the critical provisions in the guidelines issued by RBI on 7.7.1989 and Controller of Capital Issues (28.6.1990) relating to secondary and money market operations, investments in the primary market, arms length relationship between the sponsors, its subsidiaries and the mutual fund. The violations had been in respect of the provision requiring mutual funds to take delivery of scrips purchased and give delivery of scrips sold, provision prohibiting mutual funds making short sale/purchase of securities or carrying over transactions from one settlement to the next, provisions prohibiting mutual fund to enter into any transactions of speculative nature, provision prohibiting mutual funds to invest in any other unit trust/mutual fund, barring exceptional circumstances and then for a temporary period and within a ceiling of 5% of its assets; and, provision prohibiting mutual funds undertaking direct or indirect lending, portfolio/funds management, underwriting, bills discounting, money market operations etc.

6.64 The Committee regret to note that CMF has violated almost all the guidelines and regulations. The sponsor and its subsidiary have derived benefit through the operations of CMF at the cost of the investors.

6.65 A majority of the secondary market operations of CMF has been carried out through just a few brokers. 42% of the turnover of 8 schemes of CMF was transacted through 4 brokers. These brokers had defaulted in delivering the scrips, and instances were noticed where prior approval of the sanctioning authority was not obtained for the purchase of large quantity of shares. Instances have been revealed where CMF had incurred considerable loss for no plausible reasons in their secondary market transactions. Besides, there were also instances where large numbers of shares were sold by CMF at prices lower than the market prices. These remain unexplained. The Special Audit Report also pointed out several instances in which CMF used the mechanism of wrong credit to divert funds from the CMF schemes to brokers, apparently under advice of Canfina, though these were not in writing.

6.66 CMF also resorted to placement of short, medium and long term deposits of Public and private limited companies ranging from three months to three years categorising all such placements as short term deposits. They had also entered into private placements of Non-Convertible Debentures, suescription to promoters quota and standby arrangements. The irregularities observed in this connection included, investment decisions for private placements made without proper analysis, investment decisions influenced by factors concerning the business of Canara Bank or Canfina, funds placed with several corporate clients of the Canara Bank with the understanding that they should reduce their advance with the bank, investments made which had the effect of transferring underwriting developments of Canara Bank/Canfina to the CMF etc.

6.67 Transactions of CMF in non-SLR securities in one case entailed a loss of Rs. 103 crores to the Fund and ran the risk of potential loss of Rs. 30 crores in another. While the former related to a deal with BOK through a SGL/BR without the backing of securities the latter related to a ready forward transaction with NHB who failed to honour the commitment on the reversal transactions.

6.68 Net Assets Value (NAV) basically reflects the economic value of the fund at a given date on the assumption that the fund needs to be redeemed. The actual NAV can be reflected by determining the market value of all the investments deducting the liabilities arising therefrom divided by the number of units. The SEBI inspection revealed that the NAVs arrived at by the Fund Managers were inaccurate. They were thus defrauding investors.

6.69 Other irregularities/inadequacies have been observed in respect of maintenance/ authenticity of accounts, records and in respect of the Systems and internal control of CMF.

6.70 The manner in which CMF had invested the funds of the schemes indicates that it had not exercised sufficient care, prudence and diligence in the interest of investors of the schemes and in several instances had exposed the investors in the schemes to high degree of risks without disclosure of it to the investors. This in the view of the Committee, is a serious breach of trust.

6.71 When asked to comment on the repeated defaults, the representative of CMF said:-

> **"it is true that in some areas the violations continued to take place."**

6.72 Yet again the Committee do find it necessary to underline the self-admitted or the self-evident. Officials managing this fund were negligent, derelict in the discharge of their responsibility and committed breach of trust with investors.

6.73 Apart from CMF, irregularities were also observed in the working of other mutual funds, viz. Bank of India Mutual Fund, SBI Mutual Fund, LIC Mutual Fund, PNB Mutual Fund, GIC Mutual Fund and Indian Bank Mutual Fund. The irregularities revealed during the course of inspection conducted by SEBI from August, 1991 onwards were mainly as follows :-

i) Sale of units after the closure of schemes;

ii) Loans to brokers thereby exposing investors to avoidable risk;

iii) Poor maintenance of books of accounts and other records;

iv) Deliveries for purchase and sale of securities outstanding for long period;

v) Investments were made without any records of the basis of the investment decisions; and

vi) Concealed lending to the companies by way of advance subscriptions to be adjusted later against allotment of debenture.

6.74 The Committee regret to note that several Mutual Funds indulged in serious malpractices/irregularities detrimental to the interest of investors. Failure to exercise adequate control by the authorities concerned resulted in recurrence of the same and regrettably, the irregularities came to be regarded as market practice. It is systemic failure of this order that set the stage for the scam. The system is as much in need of rectification as culpable individuals are in need of punishment.

6.75 The question of enforcement of the regulations for the operations of Mutual Funds is dealt with in another Chapter.

CHAPTER - VII

PORTFOLIO MANAGEMENT SCHEME — MISUSE

7.1 The Portfolio Management Service (PMS) in a broader sense meant aiding for a fee in the deployment of surplus funds in profitable channels at the risk and responsibility of the owners of the funds.

7.2 Traditionally, such surplus funds used to be kept in 'deposit' with banks which carried low rate of returns. While this provided a good source of funds for the banks it assured safety to the depositor. However, in recent times as the moneys came to be raised at considerable cost by the enterprises, it was felt, that these should be deployed profitably till they were utilized in the projects. Hence the advent of Portfolio Management Service in banks which formulated "Special schemes" bearing different names in different banks for the purpose mainly to attract their corporate clientele. As these activities which started in the second half of 80s increased in momentum and several irregularities and misuse of funds noticed, RBI issued certain guidelines, initially in May, 1989, to be observed by banks and their subsidiaries for rendering such services to their bigger corporate clients. These were further amplified in January 1991. The substance of these guidelines is as follows:

(a) PMS services were to be provided at the customer's risk, without guaranteeing them a pre-determined return;

(b) The services were to be provided to parties in respect of their long term investible funds;

(c) The minimum period for which funds were to be placed by clients should be one year;

(d) The transactions should be booked at market rates only;

(e) proper accounting and documentation had to be ensured;

(f) Funds accepted for portfolio management should not be entrusted to another bank for management;

(g) A definite fee was to be charged for such services independent of the return to the client;

(h) The funds were expected to be deployed essentially in capital market instruments such as shares, debentures, bonds, securities, etc. and were not to be employed for lending in call money/bill market and lending to/placement with corporate bodies;

(i) Transactions between the bank's investment account and portfolio account were to be strictly at market rates;

(j) While putting through transactions on behalf of a portfolio account, a clear indication had to be given that the transactions pertained to the "portfolio account";

(k) The undeployed funds had to be treated as outside borrowings of the bank and CRR/SLR had to be maintained on such funds; and

(l) The banks' liability to its clients in respect of funds accepted for portfolio management had to be properly reflected, in the published accounts.

7.3 As many of the large sized PSUs had vast funds pending their utilisation in the projects concerned there was a rush from banks, to capture these funds. These were invested in PMS operations, which were treated as off balance sheet items. Banks formulated their own

schemes for management of funds to bypass RBI guidelines. Thus, for example, Stanchart introduced their "Corporate Cash Deployment Scheme" in terms of which the funds received from the clients were returned after the stipulated period which could vary from a few days to few months with assured return. As these funds, by whatever scheme attracted, were not accounted for in the banks' balance sheet, some banks claimed that RBI guidelines such as those relating to minimum lock in period etc,, were not applicable as they claimed that these are 'inter-party' transactions only. The subsidiaries of public sector banks like SBI Caps, CANFINA, ABFSL also felt that RBI guidelines on PMS were not applicable to them and did not care to adhere to it. In short, the guidelines only remained in the circulars of RBI and never practised nor did RBI care to have a serious look into their adherence. Some of the grave violations observed are:

(a) The minimum lock-in-period of one year had not been observed; funds had been accepted for few days to few months and in certain cases 'foreclosed' earlier to suit the convenience of the parties;

(b) Funds obtained had been utilised in some cases in call money market, sometimes for discounting of bills or financing share brokers;

(c) Banks had indulged in short sales in respect of PMS clients and most of the deals are not at market related rates; and

(d) The banks had invariably paid a fixed rate of return ranging from 12% to even 38% in some cases; in certain cases, the excess earnings had not been passed on to the clients but taken to P&L A/c of the banks.

7.4 The principal suppliers of funds for operating the schemes by the banks are the PSUs whose role in the securities transactions are dealt with at length in another chapter. Misuse of the scheme for entering into Ready Forward deals with non-bank clients had been rampant besides diverting funds to call money market or breaking the credit discipline sought to be imposed by RBI by pumping additional funds to borrowers through these channels.

7.5 One disturbing feature noticed by the Committee was that the irregularities in PMS operations had surfaced even as early as 1986 when it was also operated in the form of buy back deals. But regrettably no corrective measures were taken by authorities concerned to stop them. For instance, a RBI scrutiny undertaken in 1986 indicated that the Syndicate Bank, Bombay had been receiving funds from its New Delhi Branch for investment in securities/units etc. on behalf of institutions like HUDCO, Oil Industry Development Board (OIDB), Rural Electrification Corporation (REC) and Army Group Insurance Fund (Society) (AGIF). The bank was found undertaking funds management on behalf of them by utilising the funds in Government securities/units/debentures on short term basis and paying them minimum fixed returns irrespective of the bank's high earnings from management of funds in securities.

7.6 In May-July 1988, scrutinies were held by RBI in respect of New Bank of India, Bank of India, Central Bank of India, Punjab National Bank, Vijaya Bank and UCO Bank. The scrutinies revealed that the banks had violated RBI guidelines while providing Portfolio Management Service to their corporate clients. In some cases the fund entrusted was for short periods of 30 days and investment transactions were notional than real, with a view to providing a particular yield to investors. In many cases, the sale and repurchase prices were not in alignment with the prevailing market rate, as the prices were after agreeing with the predetermined cost of funds borrowed.

7.7 Again, scrutinies of PMS operations of five banks viz., Canara Bank, Citibank, Vijaya Bank, American Express and ANZ Grindlays during August-September 1989 and also the scrutiny of the bills portfolio of Vijaya Bank undertaken during January-February 1990 revealed widespread irregularities. The scrutinies, in fact, showed *inter-alia* that:-

i) Banks had been accepting short term funds, i.e for a period less than one year, for portfolio management;

ii) Instead of managing such funds themselves, banks placed such funds with other banks for management;

iii) Banks had been deploying portfolio funds in call money markets and bills market;

iv) Banks had not been maintaining client-wise records of funds accepted for portfolio management and investments made thereagainst. They have been using portfolio funds for their own purposes, and mixing their own investments with those of their clients.

7.8 According to the sixth report of Janakiraman Committee, large sums of money have been received by the banks and their subsidiaries under the portfolio management scheme and other schemes. The magnitude of the funds made available under these schemes can be seen from the following summary :

(Rs. in crores)

Name of the bank	Aggregate funds accepted 1.1.1991 to 31.12.1991	1.1.1992 to 30.6.1992	Funds out-standing as on 30.6.1992	Percentage
Canbank Financial Services Ltd.	7282.34	7638.81	2095.20	36.46
Stanchart	4259.61	9201.99	166.81	2.90
Hongkong Bank	1559.10	792.85	90.38	1.57
Andhra Bank Financial Services Ltd.	1135.91	1569.23	506.79	8.82
Citibank	843.06	676.97	1334.59	23.22
BOI Finance	517.72	641.85	195.90	3.41
Indbank Merchant Banking Services Ltd.	505.70	489.60	489.60	8.52
Others	619.54	942.68	867.43	15.10
	16722.98	21953.98	5746.70	100.00

7.9 The figures of funds outstanding on 30.6.1992 shows that two banks alone viz., Canfina and Citibank accounted for almost 60% of the oustanding amounts.

Vijaya Bank

7.10 The Committee discussed at length the various facets of PMS with officials of RBI, banks, PSUs, etc. As a sample study, the transactions by the Vijaya Bank and irregularities noticed therein are described in the following paragraphs.

7.11 The operations of PMS by Vijaya Bank is a glaring example of a bank acting as a 'Conduit' to pass on the funds of PSUs to a foreign bank in violation of RBI and Government guidelines.

7.12 The bank started rendering PMS services (earlier called Cash Management Scheme) since January 1987 mainly to cater to the needs of public sector corporations, e.g. National Airports Authority of India and Pawan Hans Ltd. etc. The Bank's Investment Department placed the funds with Citibank, for a brokerage ranging from 1/4% to 3/4% per annum.

7.13 The following Table indicates the details of portfolio funds entrusted to Citibank on behalf of PSUs and others:

Year	PSUs (Rs. in crores)	Others (Rs. in crores)	Total (Rs. in crores)
1988-89	361.45	116.25	477.70
1989-90	341.47	9.02	350.49
1990-91	172.75	10.30	183.05
	875.67	135.57	1011.24

7.14 Pertinently, the PSUs were permitted to undertake normal banking operations with foreign banks with effect from 3.1.1992 only. Therefore, by deploying PSU moneys with Citibank, Vijaya Bank acted as an intermediary for PSUs to invest with foreign banks. When the Committee brought this to the notice of the representative of Vijaya Bank, he stated in evidence, "nobody had informed about this to us. We were not aware of this". The witness further stated that the PSUs were aware of the arrangements of Vijaya Bank with the Citibank although they (PSUs) were not informed in writing. It also came out in evidence that funds deployed by certain PSUs like Pawan Hans had been invested in private companies equities in violation of the guidelines.

7.15 On 31st March, 1989, Vijaya bank under 'Cash Management Scheme' (nomenclature of PMS at that time) received an amount of Rs. 25 crores received from Reliance Petrochemicals Ltd., and provided it to 22 different borrowers who had credit facilities with Vijaya Bank. Under this arrangement Reliance Petrochemicals Ltd., received a return of about 15% and the bank a return of 2%. These operations of lending to select borrowers and providing an implicit guarantee of the bank, violated the principles of portfolio management as well as other directives of RBI. Admitting the violations, the representative of the bank stated in evidence:-

"Inter-corporate deposit was a wrong thing we have done".

7.16 The PMS operations of Vijaya Bank, in general, involved several other violation/non-compliance of RBI guidelines. The bank did not conduct PMS in the nature of consultancy/ management for a fee at customer's risk. The same was conducted with an assured, pre-determined return to the client. Though, funds were accepted for periods exceeding a year, the bank agreed to disinvest the funds in durations of less than one year, e.g. in the case of Bharat Aluminium Co. Ltd. and International Airports Authority of India. Although the bank was maintaining a client-wise record of PMS funds accepted and investments made thereagainst, particulars of credits on account of realised interest, dividend, etc., and debits relating to the portfolio account were not reflected in the individual clients' accounts. Periodical statements of accounts were generally not furnished to PMS clients. Transactions

between the bank's Investment Account and PMS clients' account were not put through at market rates. The bank did not have an approved list of brokers. Most of the PMS transactions were put through the Kotak group; the bank's exposure to this group was to the tune of Rs.53.64 crores (66.6%) out of the total PMS funds of Rs.80.50 crores as on 31st March 1992. Certain further specific instances of irregularities noteworthy are also discussed in the succeeding paragraphs.

7.17 Kotak Mahindra Finance Ltd. alongwith its associate company Komaf Financial Services Ltd. had been acting as a conduit for diverting funds accepted by Vijaya Bank under its PMS service, into 'badla' financing. As on 19.6.1992, PMS funds of Vijaya Bank so routed by KMFL in badla financing stood at about Rs. 36 crores. The *modus operandi* followed was similar to that in Ready Forward transactions.

7.18 In another instance of deployment of PMS funds, Vijaya Bank tried to window dress its profit as at end-March 1992 by putting through transactions in convertible debentures/ shares of Reliance Petrochemicals Ltd. (RPL) between its own Investment Account and clients's portfolio account at off-market rates. It has been observed that the bank sold debentures to PMS clients at above market rates and subsequently repurchased them at rates below market prices and deprived the PMS clients of their rightful dues. The deal resulted in a net surplus of over Rs. 12 crores to the bank. The Committee consider it relevant to point out here that all the PMS clients of the banks at that time were PSUs, viz., Pawan Hans, Indian Railway Finance Corporation and Central Warehousing Corporation.

7.19 The bank's liabilities to its clients in respect of funds accepted under PMS as on 30.12.1992 is Rs. 40.21 crores.

7.20 The merchant banking subsidiaries of public sector banks like SBI Caps, CANFINA, ABFSL received large sums as inter-corporate deposits and under PMS and similar Schemes and these funds have been made available to the brokers under ready forward deals. In many cases these deals are in respect of transactions in shares and often the funds have been made available by public sector companies and public sector corporations. The irregularities noticed in operations of PMS and inter-corporate deposits by these subsidiaries of the banks and by foreign banks have been dealt with in the respective Chapters.

7.21 The foregoing paragraphs make it abundantly clear that the misuse of PMS began in the mid eightees and progressively increased to climactic proportions in 1991-92. In order to circumvent the RBI guidelines, schemes under various nomenclatures were devised. The schemes have been operated as a "deposit substitute" by banks and clients so as to avoid RBI restrictions on interest rates and SLR/CRR requirements. The irregularities recounted after the sample studies of banks and the subsidiaries clearly indicate violations in respect of the guidelines issued by RBI and also show that the misuse was deliberate and wide-spread. The Committee deplore the impudent flouting by the banks of the guidelines issued by RBI. For instance, banks accepted deposits for less than one year, sometimes even for a day. Similarly, although the portfolio investment is supposed to be at the cost and risk of PMS clients and the banks claimed that no guaranteed returns were offered, in actual practice the returns were indicated. By an ingenious juggling of transactions, the banks paid only the indicated returns and excess profits were skimmed off to their Profit and Loss accounts. The Committee are unhappy to note that the senior management of the banks failed to implement the schemes in consonance with RBI guidelines and were responsible for the serious irregularities noticed and recommend that steps be taken to remove these Officers immediately and launch prosecution against them, as per law.

7.22 The Committee also deplore the gross negligence and persistent failure of RBI to ensure effective compliance with its guidelines. Evidence led before the Committee makes it abundantly clear that these irregularities were a matter of common and general knowledge, in fact, this was defended as a normal market practice by banks. It was primarily for the senior management of RBI to have taken note of these irregularities, examined their implications and taken rectificatory action under the RBI Act and in consultation with Government. Little or none of this was done. Red alerts were ignored, reports consigned to the backburner, and market intelligence treated with disdain.

7.23 The Committee recommend that an indepth study be made of the whole system of PMS operation, so as to identify the weakness and remove the flaws.

7.24 PMS operations envisage deposit of money for one year. It will be very unusual that PSUs would have large funds which are surplus to their requirements for a period of one year. There is a speculative element in all PMS transactions. The Committee are, therefore, of the view that PMS is not the proper mode of investment for deployment of surplus funds by PSUs. The banks should be instructed not to accept funds for PMS and other similar scheme from PSUs.

CHAPTER-VIII

FOREIGN BANKS — THEIR ROLE

8.1 Foreign banks have a significant place in the Indian Banking System and some of them have been operating in India for over a century. They are generally operating in main cities only and they have an insignificant numerical presence with 45 banks having 140 branches and 23 representative offices (21 banks having representative offices only) as on 31 March, 1991 as compared to that of Indian Banks (about 65000 branches).

8.2 The net profit of these banks has grown by more than six times during less than five years from a mere Rs. 66.59 crores in December, 1987 to a hefty Rs. 433.09 crores on March, 1992.

8.3 The profits in March, 1992 are to be viewed in the context of the fact that their total presence in the banking system is hardly 0.4% and the profits made by the entire banking industry during the period were Rs. 1299 crores. On the other hand the performance of the foreign banks in meeting priority sector lending targets has not been satisfactory. Their lending to the priority sector (the target for which due to the concessions enjoyed by the foreign banks are much lower than the target stipulated for nationalised banks), has during the last four years been 7.67%, 9.84%, 9.45% and 7.86% against the targets of 10%, 12%, 12% and 15% respectively.

8.4 Foreign banks are governed by the law and regulations of the country of their operation and conform to the rules of the country of origin to the extent they do not conflict with the former. None-the-less, in recent years, in the context of foreign exchange problems experienced by the country, the foreign banks came to enjoy more indulgence of the regulatory/monetary authorities, even though theoretically they continued to be governed by the same control measures as applicable to their Indian counterparts.

8.5 The examination by the Committee of securities transactions in banks has, revealed that some of the foreign banks have been deeply involved in the irregularities in securities transactions, they have acted in an unbecoming manner, indulged in large scale security deals, highly disproportionate to their normal requirements and in the process not only violated RBI guidelines, but also, their own set procedures and *prima facie* the laws of the countries of their origin. In the process they have thrown over-board all principles of prudence and safety in management of funds of constituents who had reposed faith and confidence in them. The Committee examined in particular the securities transactions of four foreign banks viz. **SCB Chartered Bank, (SCB) ANZ Grindlays Banks, BOA (BOA) and Citibank.**

Securities Transactions

8.6 The aggregate value of the transactions undertaken by the foreign banks for the period 1 April, 1991 to 23 May, 1992 is estimated at Rs. 6,82,427 crores or 56% of all such transactions. Another fact to be noticed is that amongst top six institutions which have undertaken largest number of transactions, five are foreign banks, the remaining one being Canfina a non- banking subsidiary of Canara Bank. A massive spurt in their volume of securities transactions during 1991-92 has been observed.

8.7 For instance, in SCB the figures went up to Rs. 1,67,014 crores during April, 1991-June, 1992 from a mere Rs. 12,485 crores in the previous year (1990).

8.8 In the case of ANZ Grindlays the figures more than doubled to Rs. 99,439 crore (April, 1991-June, 1992) from Rs. 41,174.50 crore during the corresponding period in the previous year.

8.9 In the case of BoA the figure went up to Rs. 1,51,646 crores from Rs. 55,555 crores.

8.10 These banks also indulged in issue of BRs without receipt of money or securities, exchanged BRs, issued consolidated BRs, indulged in issue of BRs even where SGL facilities were provided etc. Similarly, they have also grossly misutilised the SGL facilities and permitted large scale bouncing of SGLs. During the period October, 1990 to June, 1992 a total 612 SGLs of these banks bounced. The banks hardly cared to verify the abilities of counterparty banks issuing BRs of high value to perform, despite the fact that some of them were known to have very small resources like BOK and MCB (both now in liquidation).

8.11 During the course of evidence the officials of Citibank had asserted before the Committee that their bank had fixed credit exposure limits for various banks for acceptance of their BRs to minimise its risks; it could not, however, sustain its stand as it was proved that it had exposures ranging from Rs. 3 crores to Rs. 332 crores in several cases of transactions with small institutions.

8.12 Citibank had issued SGLs signed by a single authorised signatory instead of two as required. It had continued to accept SGLs of same banks whose previous SGLs had bounced. Not only that, Citibank during the period under review issued 42 SGLs and repurchased them from the counterparty without these being lodged with PDO of RBI. Even though its system and procedures are wholly computerised, including SGLs, it had issued cyclostyled SGL forms in cases where the SGL balance was less than the transaction amount and the computer would not have issued an SGL form without the required balance. It had also resorted to issue of BRs whenever it was aware that its balances in SGL A/c were not adequate.

8.13 In the case of SCB its operations have left the bank holding BRs/SGL transfer forms of BoK and MCB worth over Rs. 930 crores which are of doubtful value.

8.14 No SGL register was maintained by the bank to ensure before issuing SGL forms that there was sufficient balance in the SGL Account. Seventy Eight SGL transfer forms issued by the bank during 13.12.1991 to 2.5.1992 bounced on lodging with PDO. A curious aspect of SGLs issued by SCB is that it even repurchased the bounced SGLs from the counterparty banks like BoA and Citibank. It is rather astonishing that the local management of these banks had not taken any serious note of the bouncing of BRs/SGLs of SCB covering sale/purchase of securities worth hundreds of crores of rupees.

8.15 In response to the Committee's questions about the irregularities in securities transactions the replies of the witnesses of these banks were evasive. For instance, all the four foreign banks examined by the Committee have entered into a large number of ready forward deals with non-bank clients in non-SLR securities. When asked about the reasons for resorting to this irregular practice the representative of ANZ Grindlays Bank sought to explain it by saying that the 'funds management activities required a short term interest rate instrument which could equilibriate demand and supply pressures in the money market'.

8.16 The Chief Executive of ANZ Grindlays Bank also stated before the Committee:

> "When this fact (R.F. transactions with non-banking counterparties and non-SLR securities) was brought found that it included every bank, every PSU and every major corporation. So it seems to me that it was a part of the financial

system even though it was outside the line of RBI. It occurred to me that RBI was turning a Nelson's eye to this undertaking."

8.17 Such transactions were also sought to be justified on the ground of market practice by SCB. In the case of BoA the ready/forward deals were disguised by recording the forward leg in the name of a different party although the settlement was made with the same counterparty. The transactions were sought to be justified by stating before the Committee:

> "After consultation with our own people, with our legal counsel we came up with a manner in which these transactions should be done which we believed was legitimate and was according to the letter of the law."

8.18 To the query as to why the bank relied on its own legal counsel and did not approach the RBI for clarification the witness said:

> "I fully agree with you. In retrospect we should have gone to the RBI. I admit that."

8.19 It was also noticed that these ready forward transactions of the bank were also adversely commented upon by the RBI in its review of the foreign banks for the period ending March, 1990. About the action taken by the bank on this review, the witness informed the Committee:

> "We did our best to resolve the issue within the framework of the guidelines of the RBI."

Portfolio Management Scheme and Foreign Banks

8.20 All the four banks referred to above, whose officials deposed before the Committee, have operated Portfolio Management Schemes nomenclatured differently in different banks. Some banks had more than one scheme to attract different types of clientele and to suit different circumstances.

ANZ Grindlays was the first bank to introduce PMS in August, 1986 with guidelines received from their Head Office. By the end of December, 1990 there were 523 PMS clients and the amount outstanding therein was Rs. 211.12 crores. The inspection of the bank by RBI in May 1990, however, pointed out several irregularities in the implementation of the scheme such as:

(i) indicating expected returns.

(ii) investing parts of funds in promissory notes discounted by the banks, etc.

8.21 No steps were taken to avoid these irregularities for a long time. It was only in 1991 that a deliberate step was taken to market PMS in accordance with RBI guidelines of 1989. This however, led to substantial run-offs of the PMS. By the end of December, 1991 the number of PMS clients fell to 337 and the amount outstanding was reduced to Rs. 69.04 crores. It was reported to the Committee that the bank has discontinued the scheme since September, 1992.

8.22 BoA introduced PMS formally in September, 1990. Previous to this, the bank's transactions under portfolio management (though not termed as PMS) were adversely commented upon by the RBI in September, 1989 for non-compliance of norms pertaining to indicative yields and the lock-in period. For instance, in the case of funds of UTI, one of the clauses in the agreement read as:

> "If the yield on fund is over 14% p.a the bank will be entitled to keep appropriate amount towards fees commission, etc. out of the same."

8.23 Similarly, in the case of deposit by corporate bodies *viz.* TISCO, PD Hinduja National Hospital and Indian Vaccine Corporation, the bank accepted the fund for a period of less than one year. The relevant clause of the agreement read as:

"The money may be deposited with you and withdrawn from time to time."

8.24 During the period April, 1991 to July, 1992 the bank had only three PMS customers, namely, UTI, IRFC and Peerless General Finance and Investment Limited. In regard to the guaranteed rate of returns for these PMS clients, it has been observed that there has been a conscious attempt on the part of the bank to give a minimum rate of return and the final pay outs have been more or less in line with the indicated return.

8.25 Citibank also had a large number of clients who had placed large funds with the bank under PMS. The aggregate of funds collected by the bank under the scheme amounted to Rs. 1275.73 crores. A category-wise summary of fiduciary funds as on 28.5.1992 is as under:

	Category No.	No. of Accounts	No. of Companies	Total (Rs. in crores)
*1.	Public Sector Units	14	13	395.07
*2.	Financial Institutions	11	3	269.99
3.	Private Sector Companies	35	23	610.42
4.	Others (Individual)	4	4	0.25
		64	43	1275.73

*The list of clients category-wise is given in Appendix-XV.

8.26 The practice to be followed by the bank in regard to Portfolio Management funds is codified in the internal manual prescribed by its Head Office *viz.* International Fiduciary Standards Manual, June, 1987. The Manual prescribed clear cut segregation between the assets of the bank and that of its clients. However, it was observed by RBI in inspection in August, 1989 that this procedure was not being followed by Citibank in India. The funds received from clients under Protfolio Management and their deployment in various investments did not form part of the normal accounting of the bank. All these liabilities and assets were off balance sheet items. The bank did not pass vouchers even under contingent items. The bank indicated the expected return on the clients portfolio after consultation with the clients.

8.27 Thus the bank was guaranteeing a pre-determined return. It has also accepted funds for less than one year in violation of the RBI guidelines.

8.28 The Financial Inspection of City bank by RBI on 25.5.90 also pointed out that the funds placed by the clients with the bank have been mostly utilised among others for placing in the call money market. The bank also did not obtain RBI approval for its holding of public sector bonds in excess of 1.5% as on 31 March, 1990. It also entered into buy back deals in public sector bonds with non-bank clients in disregard of RBI instructions.

8.29 A warning was given to the bank by RBI *vide* letter dated 18 January, 1991 that in case of recurrence of irregularities RBI may be constrained to review the position in regard to bank's continuing undertaking such business. The bank *vide* their letter dated 1.2.1991 conveyed that they will ensure adherence to RBI guidelines. However, as subsequent events have disclosed, these serious irregularities continued with no action from RBI.

8.30 The total transactions undertaken in the PMS customers accounts by the Citibank during the period April, 1991 to May, 1992 aggregated to Rs. 1,26,160 crores. Most of the transactions undertaken in PMS clients accounts are on ready forward basis and the securities used for transactions include non-SLR securities, Units of UTI and Mutual Funds, PSU Bonds, Debentures and even equity shares in some cases. As per the guidelines of RBI, ready forward transactions in PSU Bonds, Units of UTI are clearly banned. The bank, however, contends that such transactions are banned only for banks and not amongst customers. The bank has claimed that the legal opinion obtained by it on this issue has supported its contention. The witness of Citibank admitted during his second deposition before the Committee:

> "In the course of the audits, it has been established that some ready forward transactions have been undertaken in the 14 month period April, 1991 to May, 1992 by the bank with approved parties but in securities that were not approved for RFs *viz.*, Units of UTI."

8.31 Another contentious issue is that while the fiduciary PSUs have been categorising the amounts placed with the bank as deposits, the bank has shown these as investments. In support of its action the bank contends that since BRs were issued to the PSU clients the placement of funds was in the nature of investments. However, in many cases it has been observed that BRs have not been issued to counterparties and such undischarged BRs are still in the possession of the bank. In fact, in case of Air India out of 20 odd ready forward transactions undertaken by the bank on its behalf, BRs were not issued in 17 cases and it was only on 24 December, 1992 that these BRs were forwarded to Air India and discharge obtained. It is apparently an afterthought to cover the earlier lapses. There are instances wherein purchases and sales in same securities on the same day and with same counterparty have been undertaken and this has resulted in substantial profits/losses in the PMS clients accounts. The bank claimed that it has not guaranteed any pre-determined returns to the PMS customers. But the examination of relevant records indicated that it is not so. For instance several customers at the time of opening of PMS account have clearly indicated the annual yield. Secondly, various letters received from PMS clients have indicated the amounts of return accruing in their PMS accounts on the basis of so-called indicative yields and the bank has paid the same to them. Thirdly, the bank had retained partly or wholly the earnings in excess of indicated return and justified it on the basis of the legal opinion obtained by it. Subsequently, the witness also admitted :

> "It is possible that the manner in which these benchmark expectations were communicated to our customers may in some cases have led them to believe that these were guaranteed."

8.32 A number of PMS accounts have been opened by the bank by accepting units of UTI from these customers by offering them a return of about one per cent over the Unit dividend. These units have remained in the custody of the bank and it has on their basis indulged in ready forward transactions by issuance of BRs as no Units have changed hands.

8.33 An interesting feature about certain PMS accounts managed by the bank is that out of the total portfolio funds deployed with the bank almost 30 per cent have indirectly come from Citibank itself or through deals engineered by Citibank on account of its PMS customers. For example:

i) PFC 17% bonds to the extent of Rs. 150 crores subscribed by the bank on the condition that the money would be placed back by PFC in PMS at an interest rate of 14.25%.

ii) The bank subscribed to GIC Rise II units from the GIC Mutual Fund for Rs. 75 crores on behalf of one of its fiduciary customers and on its part the Fund placed Rs.25 crores with the bank under PMS.

8.34 The Bank has regularly used PMS customers accounts for skimming profits over and above the benchmarks indicated to the customers. Further the losses of certain customers as also in the bank's own portfolio have been also passed on to some of the fiduciary clients.

8.35 The bank has also confirmed that there were prodedural lapses and failure to comply with internal policies of the bank in PMS operations. During the second deposition before the Committee, the witness of the bank informed that three senior most officers and the senior most dealer in the securities and PMS area were no longer in the employment of Citicorps/Citibank.

8.36 SCB offered a non-discretional corporate service to deploy short term corporate funds in PSU bonds, debentures, etc. From January, 1991 this service was named as Corporate Cash Deployment Service (CCDS) and was meant for deployment of funds for short term periods of less than one year at the risk and instructions of the clients. The CCDS clients included corporate bodies both in public and private sectors, banks/financial institutions and subsidiaries of nationalised banks. The scheme was continued by the bank under the pretext that the legal opinion obtained by it in November, 1990 had confirmed that it was not violative of RBI guidelines. However, RBI was never approached for clarification of the guidelines.

8.37 The bank collected huge amounts (Rs. 695.86 crores at Bombay) under the scheme in total violation of RBI regulations both on interest rates on deposits and on PMS. The manner in which the scheme has been operated shows that funds collected under the scheme were in the nature of deposits on which interest was paid at rates which exceeded the maximum rates specified in RBI guidelines. For funds obtained in this manner the bank also paid brokerages to parties which was in violation of RBI directives. The funds obtained were also deployed under ready forward deals with non-bank clients including brokers, corporate entities etc. which was also in violation of RBI directives.

8.38 The Committee were amazed to note that even in fairly large sized banks of international standing like SCB the demarcation of responsibilities between the "front" office and "back" office got diffused and controls totally weakened. There has been a complete abdication of responsibilities by the back office which had acted on the oral commands of the `dealer' and released cheques even without obtaining securities or receipts thereof. This bank had indulged in several `dummy transactions' to transfer profit or conceal the true extent of depreciation in securities.

8.39 The irregularities in this scheme were observed by RBI in its inspection of the bank in May-June, 1992 and due to prohibition of such transactions by RBI circular dated 20th June, 1992 these have since been wound up. All funds deployed by the customers under this scheme have been returned.

Dummy Customers

8.40 The scrutiny of the documents submitted by the Citibank to the Committee has revealed that the bank was using the word 'dummy customers' in a large number of cases involving huge amounts in the statement of transactions on account of PMS clients. During the course of the evidence when the representative of the bank was asked to clarify these transactions, he informed the Committee:

> "Suppose we have to buy Rs. 50 crores of MTNL bonds in one lot. But that belongs to five customers of Rs. 10 crores each. Then at that time when you

issue the cheque, the contra entry is made to the dummy customer's name and put back into the customer's name."

When asked further as to why five separate cheques could not be issued for these transactions, the witness clarified:

"It is because the other bank wants only one cheque."

8.41 This practice, however, has led to several incongruities in the dealings of Citibank with its PMS clients like for instance, when PFC, a PMS client of the bank, asked for the details of the securities that were transacted on behalf of their portfolio account by the Citibank, the bank expressed its inability to provide the requisite information under the plea that the securities purchased or sold on behalf of PFC were transacted in a basket of similar securities of other PMS clients and thus it was difficult to segregate transactions for individual clients. This is in contravention of the relevant guidelines which provide that the PMS customer can obtain the particulars of transactions undertaken on its behalf in its PMS account by the banks concerned.

8.42 It will be seen from the foregoing that Citibank as also the other banks mentioned above are guilty of serious malpractices.

Foreign banks' reliance on brokers

8.43 The scrutinies of the security transactions of the foreign banks have also revealed that there has been extensive reliance on deals through/with stock brokers. Thus Citibank out of its total of 17,838 transactions worth Rs. 2,15,842 crores carried out as many as 7,560 or 42% of the transactions worth Rs. 92,501 crores through brokers as per its computer output sheets. However, it is felt that transactions through brokers must in reality be much more as it is noticed that in many cases the names of the brokers have not been recorded in the computer system even though these are observed as mentioned in the relative "deal slips" and contract notes held in some cases.

8.44 According to a random estimate such transactions constitute about 30% of the transactions. Amongst various brokers empanelled by this bank HPD, Shri D.S. Prabhoodas and M/s. C. Mackertich along with M/s. Stewart & Co. have respectively transacted about 30%, 12% and 10% of the transactions. This bank has allowed its favourite brokers to take positions. In several instances the bank has received difference cheques from brokers and to facilitate the brokers in this game the bank has also gone to the extent of issuing cost memos to counterparty, different from their control register copies, in order to enable the counterparty to record transactions at a rate other than bank's buying/selling rate. When asked as to whether such differential rate transactions were approved by its Central Bank and the Head office, the witness of Citibank stated, "No."

When told about the wrongful nature of such transactions, the witness stated:

"The practice was not correct. I apologise for that."

8.45 Some instances of favouring brokers are:

On 12 August, 1991 Citibank purchased on account of PMS customer Vijaya Bank from broker HPD debentures worth Rs. 9.21 crores. These debentures were finally sold to Andhra Bank on 24 April, 1992 through broker HPD at the same rate. Thus the broker was funded to the tune of Rs. 9.21 crores for the period 12 August, 1991 to 24 April, 1992 that is approximately 9 months. Similarly in another set of transactions which started with Citibank purchasing Can Stock of the face value of Rs. 5 crores for a total value of Rs. 6 crores

on 14.5.1991 and ended with their ultimate sale to ABFSL for a total consideration of Rs. 6 crores on 31.3.1992. HPD who was the broker in this case was funded by Citibank for an amount of Rs.6 crores for almost an entire year through a chain of ready forward transactions. In another case Citibank purchased on account of PMS customer Grasim - 15 lakh equity shares of Reliance Industries Ltd. in a private deal from Grindlays Bank at Rs. 400 per share through broker HPD on 10 April, 1992. The proceeds of Rs. 60 crores were credited by Grindlays Bank to HSM's account. On 13 April, 1992 the entire lot of these 15 lakh shares was sold to HPD in a private deal for the same consideration of Rs. 60 crores, thus accommodating broker HSM with this money for four days.

8.46 During the course of special audit of the Citibank it was observed that in many cases broker names have not been fed in the computer system though the concerned dealer (officer of the bank) indicated the name of the broker in the deal slip. Obviously the procedure had been adopted to conce/al the turnover/brokerage paid etc. This requires also to be viewed in the context of compensatory payments/receipts of brokers in respect of loss in transactions. This practice had also resulted in the correct turnover in various securities transactions undertaken through brokers not being ascertainable. The information originally submitted by the bank to the Committee in this regard was not correct. The bank had, therefore, to submit revised figures of securities turnover through brokers to the Committee in January, 1993 after the above lacuna was pointed out by special auditors appointed by RBI.

8.47 BoA has routed 65% of its total transactions aggregating Rs. 1,14,056 crores through brokers and 58% of the transactions are accounted for by three brokers *viz.* Shri D.S. Prabhoodas, NKA and M/s. Somayajulu and Co. The bank had violated its own guidelines regarding fixing ceiling of monthly gross turnover and contract limits for each broker. During the period February, 1991 to December, 1991 the bank allowed credits ranging between Rs. 31.5 lakhs to Rs. 20 crores in the current account of HSM without any specific authorisation for the purpose on five occasions.

8.48 ANZ Grindlays Bank has routed more than 50% of its total transactions worth Rs. 99.439 crores through brokers. HPD appears to be the most favoured broker of this bank having cornered 31% of the transactions. The others having significant volume of transactions are M/s. Somayajulu and Co., HSM and Shri Asit Mehta. Apart from the volume, the manner and style of the operations and surrounding circumstances clearly establish that the major consideration for routing transactions through select brokers was that they alongwith the banks have played mutually serving roles in irregularities and malpractices observed in the transactions. Instances have also come to light where some of these banks have suffered apparent losses in certain transactions for the benefit of select brokers and the possibility therefore of compensatory benefit being arranged elsewhere cannot be ruled out. In the case of ANZ Grindlays Bank, from the available material before them it is not difficult for the Committee to conclude that HSM and his group of companies alongwith HPD have been enjoying a lot of undue facilities. HSM and his group had 19 overdraft accounts besides 33 other current accounts in various branches of the bank and enjoyed lot of credit facilities against shares in violation of RBI directives. Further the bank had given him the facility of getting cheques in the bank's name itself, credited to his account. He had also been enjoying concessionary and interest free credit facilities. HPD and Shri NKA have also enjoyed undue facilities from the bank. The former had been allowed to make huge profits on several occasions and the latter provided badla financing to the extent of Rs. 2 crores by way of ready forward of funds of its subsidiary Esanda Finance & Leasing Ltd. The bank had provided rollover to the broker from 14 November, 1991 to 7 April, 1992. It had also provided accommodation to the broker to the extent of Rs. 24 lakhs by ready forward in shares of Reinz Talbros in February, 1991.

8.49 Even though the foreign banks examined by the Committee claimed that they had entered into deals only with other banks or their subsidiaries, there is no gainsaying that these were intended to be only with brokers as counterparties. Thus, in the purchase of Citibank from Andhra Bank aggregating about Rs. 2,000 crores, nearly 60% of the cost memos of the latter have been marked being on account of any one or other of the 3 brokers, HPD, VBD or Shri Mukesh Babu. The nexus between brokers and the banks is best illustrated in the relationship between SCB and broker HPD. In this bank in a majority of transactions, though these purport to be with institutions like Andhra Bank, BOK, ABFSL, etc., the payments and receipts had been effected through HPD's account in Andhra Bank and ADN's account in BOK. In fact, it is observed that there was an informal arrangement between the bank and HPD whereby HPD had assured to SCB a return of 15 per cent in respect of transactions in SLR securities and at call money rates or better rates in respect of non-SLR securities. The relationship between the broker and bank's dealer was such that the bank kept on buying securities from counterparties under the directions of HPD totally surrendering its discretion regarding the deals. In the process the bank had used its own funds to carry the 'broker's position in forward contracts. A similar type of arrangement also existed between the bank and another broker VBD earlier.

8.50 In consequence, the safeguards customarily used in securities transactions were abandoned. Thus payment were made in advance of receipt of securities, SGL transfer forms or BRs, discharged receipts were returned without receipt of securities and delivery was accepted of securities other than those contracted for and of BRs issued in favour of other banks. Inevitably this led to a widening gap in SCB portfolio. To cover this gap, the dealers entered into wholly fictitious transactions mainly involving the BOK and the MCB which were not backed by securities or were backed by BRs of doubtful value.

8.51 SCB's investment and accounting records have been manipulated to camouflage the arrangement with HPD and later to record the fictitious transaction to bridge the gap in SCB's investment portfolio. Thus, a number of dummy transactions have been recorded, transactions have been recorded at rates different from the rates at which transactions have actually taken place and transactions have been recorded to hold back or book profits, which profits have been later reversed. There is good reason to believe that senior management of SCB was aware of the arrangements with HPD and earlier with CVB.

Internal Control and Audit

8.52 All the four banks examined by the Committee have well laid out procedures for internal control. However, the moot point is that all these rules and regulations seem to have been followed more in breach than in observance. Some of these banks like ANZ Grindlays and SCB have even violated the guidelines of their Head Offices in certain instances.

8.53 About the Internal Audit the Committee were informed that though these banks have their own internal audit but none of these irregularities were pointed out by them previously. In so far as statutory audit is concerned the common refrain of these banks before the Committee has again been that the irregularities that have taken place during the recent scam were not pointed out by their respective statutory auditors. It has been observed that in case of BoA the statutory auditors for the year ending March, 1991 had made the following observations in their management letter to the bank:

> "The Bank enters into forward contracts in securities including *inter-alia* government, securities, which is prohibited under Securities Control Regulation Act."

8.54 Similarly, the audit of ANZ Grindlays Bank carried out in March, 1991 pointed out certain irregularities which included:

1. Non-updating of BR exposure records.
2. Non-maintenance of list of authorised signatories.
3. Limit excesses on dealer limits and BR exposure limits.
4. Monitoring of positions by dealers not wholly accurate.

Violation of Laws of their own countries

8.55 Out of the four foreign banks examined by the Committee, two of them, namely, Citibank and BoA have their headquarters in United States of America and the remaining two, SCB and ANZ Grindlays are headquartered in United Kingdom. Both these countries have very strict banking and treasury laws and very comprehensive machinery to enforce them. Some of the activities of these banks in India may also have been violation of relevant laws of their respective countries.

8.56 During the course of examination when the Citibank was asked as to whether some of its activities were in violation of the Federal Laws, its reply was that certain provisions of the Glass Steagall Act appeared to be applicable to the Indian scenario.

8.57 Government of India has requested RBI to take up this matter with the concerned authorities, however, RBI has not formally taken up this matter. In the information submitted to the Committee, RBI has stated that the foreign banks involved in the security scam have been asked to offer their comments on the subject matter. The Committee have also been informed that the Securities and Exchange Commission (SEC) of USA had written to SEBI of India (SEBI) on the possible violation of US banking laws, by the US based banks operating in India and the Commission as well as the Federal Reserves System, Washington have been furnished copies of Janakiraman Committee Report by Indian authorities. The SEC had also written to SEBI suggesting investigation in securities transaction of the US banks.

8.58 A team of Federal Reserve Bank of New York had come to India on 11 January, 1993 to look into the recent developments in securities market in India including specific allegations to the effect that Citibank had engaged in improper activities. Besides having consultations with Indian authorities, the team also met representatives of Citibank, as well as BoA.

8.59 The Committee have been finally informed that the RBI has obtained the comments of the foreign banks on the irregularities committed by them and forwarded their explanations to the concerned authorities of the countries of their origin so as to find out whether any of these bank's operations in India were violative of the rules and regulations of the country where it is headquartered.

Accountability

8.60 The Committee enquired about the steps taken by the banks to fix responsibility and to take action against persons responsible for various irregularities. The response of these banks in this regard bordered on two extremes. While BoA and ANZ Grindlays Bank accepted some of the irregularities committed by them and also expressed regrets, in case of Citibank it started with outright denials of existence of any irregularity and gradually veered around to acceptance of most of them.

8.61 During the first evidence, the witness of the bank categorically stated:

> "There is no evidence of employee fraud."

Even during the subsequent hearing the witness initially stuck to the same view point and stated:

> "There is also no reason to suspect employee fraud."
>
> However, in the same breath he added:
>
> "Swift action has been initiated. The three senior most officers and the senior most dealer in the securities and PMS areas are no longer in the employ of Citicorp/Citibank. The RBI has been kept informed."

8.62 The SCB has admitted the existence of irregularities in its operations but has apportioned the blame to two very junior officers working in one of its smaller units.

8.63 A common refrain of the top management of these banks has been their unawareness of what was happening in their banks. Evidence before the Committee points to the fact that the top management of the foreign banks examined by the Committee was aware of the goings on in their banks.

8.64 For example in case of SCB these irregularities were in the knowledge of the top management of the bank when these were conveyed to its London, Head Office by one of its officer's namely, Shri Prakash Yardi, Assistant Manager as early as on 10 September, 1990. The bank did not take cue from this warning.

8.65 In regard to the action taken against the guilty officers the Committee have been informed that senior level changes have taken place in all the four banks in the aftermath of these irregularities. In the case of ANZ Grindlays, BoA and SCB the respective country chiefs have been replaced. Significantly these actions took place only after the oral evidence of the representatives of banks was taken by the Committee.

8.66 SCB has taken a veriety of actions ranging from reprimand to removal from services against its 19 employees. these include two junior officers who have been named as accused in the FIR filed with the CBI.

8.67 In the case of Citibank it has been a complete *volte-face* Initially it made assertions before the Committee that it had committed no irregularities. Later on during the second deposition before the Committee its witness stated:

> "However, lapses in implementation have come to light. These have resulted in actions counter to internal policies as well as in some cases counter to all spirit of RBI guidelines."

8.68 The information available with the Committee, however, belies the spontaneity of action as claimed by Citibank with regards to removal of some of its officers. In the case of Shri. A.S. Thiagrajan, Senior Vice- President, who was looking after Investment and Corporate areas of the bank, he was relocated outside India at the instance of the RBI when it came to its notice that Shri Thiagrajan was interfering with the ongoing investigations of the bank.

Profitability and Repatriation of Profits

8.69 The following statement gives the investment income earned by these banks during the last few years:

(Rs. in crores)

Bank	1990-91	1991-92
ANZ Grindlays Bank	92.34	144.94
BOA	22.91	66.94
Citibank	50.38	128.27
Stanchart	43.93	81.24

8.70 Evidently all these banks have shown a spurt in profit from the year 1990-91 onwards. The quantum rise in the profits from securities transactions besides being attributable to the sharp rise in the volume of these transactions has also been due to the irregularities committed during the process.

8.71 In fact, the gross violations of RBI instructions on security transactions by BoA lead the Inspecting Officer of the special scrutiny team to seek orders from RBI regarding disallowing the Bank to remit to its Head Office profits earned from securities transactions during 1991-92.

8.72 **The Committee desire that special scrutiny may be carried out by the RBI in all the foreign banks involved in the recent irregularities and the question of disallowing repatriation of profits through irregular securities transactions and other malpractices be considered. It is necessary that stringent penalties, including suspension of their licences are imposed on these banks keeping in view the extent of irregularities indulged into by each of them. Legal action should be pursued both in India and the foreign country concerned.**

CHAPTER-IX

MONITORING AND INTERNAL CONTROL — BANKS/SUBSIDIARIES

9.1 Internal control is an essential prerequisite for an effective management of any organisation. Internal control means the plan of organisation and all the methods and procedures adopted by the management to assist in achieving the managements objective of ensuring the efficient conduct of its business, including adherence to management policies, safeguarding of assets, prevention and detection of errors and frauds, the accuracy and completeness of the accounting records etc. Apart from the overall supervision and control exercised by RBI on the banking system every bank theoretically has an elaborate internal inspection/audit machinery to periodically inspect the various Departments/Division/Branches. The internal inspection Department in banks are headed by very senior Executives in the rank of General Managers who are required to report directly to the respective Chairman of the bank. These Executives also function as Chief Vigilance Officers. The Committee, however, find that the internal inspection machinery had not been updated to suit the growing needs in the new areas in which banks are venturing. While powers had been delegated, responsibility had not been assigned and accountability of staff for mistakes and irregularities seldom pursued. Information systems vital to banking industry are noteworthy only for their near universal dysfunction. No senior official appearing before the Committee ever admitted to knowing what was happening in their banks, all wrongs were invariably transferred to the misconduct of an official lower in the rung.

9.2 Besides the internal inspection carried out generally by the officers of the bank itself, banks annual accounts are also required to be audited by firms of Chartered Accountants appointed by the banks with prior approval of RBI. These statutory auditors are required to report whether the financial statements reflect a true and fair view of the financial position and operating results. They are also required to physically verify stocks and securities and reconcile wherever such items are held outside by third parties on behalf of the bank. The operations in a bank, which are required to be conducted as per instructions laid down in its own book of Instructions/Manual are periodically checked by its internal inspectors, overseen/monitored by RBI inspectors and final accounts are statutorily audited. Even though *prima-facie* the overall structure for monitoring and supervising the activities of the banks appears to be comprehensive and sound, the Committee have observed during its deliberations several short-comings. Many of these have already been dealt with in earlier Chapters. Various other deficiencies observed by them, in general, in internal control etc. are briefly outlined below.

9.3 The Committee have observed during the course of inquiry that for investments made by several banks in securities, the deal tickets indicating the dates relating to the nature of the deal, counterparty, broker's name, if any, details of security, amount, price, contract date and time etc. were not available. Further the contract notes did not mention the names of the counterparty. In several banks/institutions even the fundamental safeguard of providing double/multiple custody of sensitive assets, system of cross/counter checking were found to be conspicuous by their absence. The scrips in the investment portfolio had not been physically checked or verified with certificates of holding.

9.4 There were no records of BRs received and on hand, nor was there any evidence that those were periodically verified by persons other than the custodians. In certain

banks/institutions, the persons preparing cheques for purchases were not different from the persons delivering/receiving the scrips, SGL transfer forms or BRs. The procedures for issue and recording of BRs/SGLs in many banks were weak. Many banks and institutions did not have an up-to-date record of authorised signatories for acceptance of SGL transfer forms, BRs. etc. Even where such records were available verification of signatures was not often done. As mentioned elsewhere, many banks did not have any proper system for reconciliation of the balance in the SGL account maintained with the PDO. In some banks/ institutions, their own investment dealings and investment dealings under the PMS were made by the same persons and in several cases, the persons had custody of both the banks/ institutions own investment and investments held under PMS. In most banks in the name of market practice, "account payee" cheques issued by one bank in favour of another were being credited to the brokers accounts, a practice which cannot be considered as legally valid. Citibank reported that they issued cross cheques and not account payee cheques - a highly illegal practice. Neither internal auditors nor any other monitoring agency ever pointed out this.

9.5 Another disquieting feature observed by the Committee was that most of the banks did not have any proper system of reporting to top management about the details of transactions in securities, details of bouncing of SGL transfer forms issued by other banks, BRS outstanding, review of investment transactions etc. Banks had also defaulted in submitting to the Board certain returns which they were required in terms of RBI instructions like quarterly statement on buy-back arrangements indicating *inter-alia* profitability of transactions etc.

9.6 Further, many banks had not formulated and got approved internal exposure limits for transactions including exposure limits on the volume of transactions through individual broker, and the maximum amount of outstanding BRs or SGLs issued by other banks which can be accepted by the bank. Even where exposure limits were fixed, they were conveniently breached with impunity, a fact which did not attract the attention of external or internal audit or RBI inspectors.

9.7 In this context, the Committee's attention has also been drawn to certain irregularities in the approval of investment transactions in SBI. As per the scheme of Delegation of Powers in SBI the Deputy Managing Director concerned was empowered to approve all transactions involving sale and purchase of securities upto Rs.100 crores. Transactions exceeding Rs.100 crores each were required to be approved by the Managing Director concerned. From the materials made available to the Committee it is seen that there were 171 transactions involving amount of Rs. 100 crores and above between 1.3.91 and 31.3.92. Of the 171 transactions, 40 transactions of Rs.100 crores each were approved by the Deputy Managing Director (Treasury and Investment Management) as authorised in terms of the Scheme of Delegation of Powers. Of the remaining 131 transactions each exceeding Rs. 100 crores, 91 transactions (60%) had been put up to the Managing Director for *ex-post-facto* approval. 22 transations of more than Rs.100 crores each were stated to have not been put up at all to the Managing director for approval. According to the SBI, copies of notes in respect of the remaining 18 transactions were not even available with them.

9.8 The Committee are astonished to note that no specific instructions had been laid down in the SBI Manual about investment operations. In this connection the observations of a Deputy General Manager, SBI in a note submitted to the Committee are pertinent:

> "Even if a Trust of Rs.100 crores is created, some rules and regulations are invariably laid down for its operations. It is rather strange that for handling securities for over Rs.20,000 crores in respect of Bank's Investments, no laid

down instructions are available. No prescribed procedure in regard to handling of such transactions has been even laid down in the Banks Book of Instructions. No such written instructions have also been received from Central Office or the L.H.O."

9.9 Certain other officers of SBI also in their depositions before the Committee maintained that they had not received any written instructions about the nature of the job to be handled at their desk and that there were no manuals describing the nature of their job. Absence of guidelines/manuals were also observed in other banks/institutions like BOK, SBI CAPS etc. Further, in SBI, all investment decisions were communicated over the telephone which was followed by written confirmations. The Deputy General Manager and other officers of SBI in their submissions to the Committee stated that the instructions conveyed over the telephone were many a times changed. It is evident from the above that the absence of laid down instructions in the manual and the oral way of communicating investment decisions clearly lent scope for manipulations in operations.

9.10 An on-site examination of SBI by way of Management Audit, with reference to the position as on 31.3.1991 had been conducted by RBI during the period 3.6.91 to 10.9.91. In the process, a sample check of various aspects relating to the different portfolio of the Bank had been undertaken to see (a) whether the management system, processes and contracts were adequate, (b) whether the systems were operating as desired by the top management or whether there were divergencies and (c) whether management styles and capabilities were effective and adequate.

9.11 Pertinently, the Management Audit had inter-alia **observed the following in respect of Funds Management:**

> **"At present the investment decisions are taken by the Investment Committee and there is no back up support, independent of the operating functionaries to scrutinise the transactions. It is desirable to have a relook into the functioning of the Funds Management Department and the Investment Committee may be entrusted with formulation of policy guidelines/exposure limits and actual transaction decisions may be delegated to other functionaries with the rank of DGM/GM, with a back up cell for concurrent post-scrutiny of the transactions, the cell directly reporting to DMD (Treasury and Funds Management).**
>
> **Besides the transactions reported to the Board or Executive Committee, the bank is also undertaking buy/sale back deals essentially as a CRR/SLR drill, the buy back deal to procure funds and the sale-back deals to secure SLR securities at below call money rates. However, while determining the holding rates on the balance sheet date the buy/sale back deals are excluded from turn over in order to ensure that the non-alignment of buy/sale back rates do not distort the holding rate."**

9.12 The Committee regret to note that the comments of the Chairman, SBI on the draft report had been received and the report as finalised by the Inspecting Officer was submitted to the Deputy Governor on 30.11.1991 and to the Governor on 4.2.1992. The report was, however, finalised and issued to the S.B.I. only on 13.11.1992 and this too only after the matter was raised by the Committee during evidence on 18.9.1992. Thus there was an inordinate delay on the part of RBI in finalising the report and issuing it to the SBI. The Governor, RBI admitted the lapse during evidence.

9.13 The Committee find that investment operations of certain banks were computerised.

However, in the one case, it was observed that the computer generated information sent to the Central Office was not verified by the controlling authorities with the actual transactions. Similarly, vouchers were also stated to have been passed by them without looking into the instructions received from the central office.

9.14 Deficiencies observed in the internal control in some other banks examined by the Committee are further outlined below.

Andhra Bank/ABFSL

9.15 In one of the outstanding instances of failure of internal control at ABFSL's Fort Branch at Bombay it has been reported that the Funds Manager did not follow the guidelines laid down by the Central Office and these violations relate to purchase and sale of transactions on behalf of brokers, entertained through oral/telephonic instructions, etc. In a note put up to the top management by the CVO, it was stated that "It appears that Central Office treated the Funds Department as a part of Fort Branch while the Chief Manager, Fort Branch considered Funds Department as an extended arm of Central Accounts Departments since the Funds Manager was receiving instructions directly from Central Accounts Department". It was admitted that "taking advantage of this, the Funds Manager has misused his powers...."

9.16 Further ABFSL had made a total investment of Rs. 1717.52 crores with the FFSL Ltd. which formed about 43% of its total investment. This disproportionate share of business going to FFSL was only detected on 16 June, 1992, *i.e.* well after the scam had broken out. The reason for this as stated before the Committee was that "there was no day to day reporting system or day to day consultation."

Canara Bank, CANFINA and CMF

9.17 A major device by which the transfer of funds to brokers' accounts have been achieved has been through the issue of BRs which were not supported by underlying securities and by payments being diverted to broker's accounts either directly or through counterparties named in the transactions. This appears to have been made possible by a significant lack of internal Control in the Banks as indeed also by collusion between the concerned officials and the concerned brokers. The bank has still not conducted any internal inquiry to find out the factors which facilitated such malpractices.

9.18 In the case of Canfina there are certain transactions which were beyond the powers delegated to the dealer. There was neither a prior sanction obtained from the M.D. nor a separate note placed for ratification immediately after the deal was concluded. In the routine monthly report these transactions were included without furnishing detail of the amounts involved. No specific mention was made in the report seeking ratifications of transactions beyond the dealers power. All these instances only go to establish a total lack of monitoring and internal control in Canfina.

9.19 The representatives of Canfina stated during evidence that "the flow of information upward was not what it should have been due to dilution in implementation of reporting system.... the regular reporting was not coming. It was not placed before the Board of the Canfina. At the top level they were not aware of the violations that have taken place...." However, the RBI inspection reports and evidence of discussions that the RBI officials had with senior officials of Canara Bank and Canfina pointed out the continued gross irregularities and the lack of internal control. The Shankar Aiyar Audit Report has also pointed out the lack of internal control by way of reporting. This, however, hardly absolved

the top management of its supervisory role and responsibilities.

9.20 The CMF reporting system includes sending various reports to Canara Bank, RBI, SEBI besides sending performance reports to the Ministry of Finance and to the Public Trustee Equity Holding every month. However, it has been admitted by the representatives of CMF that "the reporting system was not effectively made use of".

9.21 Transactions in shares and debentures were normally done after getting the prior permission from the appropriate authorities. There also exists on paper a system of review/ monitoring. Decisions regarding security, transactions in money market operations were being taken at the level of Chief Dealer (AGM). A note is put up by him to GM (Operation) Bombay if the transactions are upto Rs. 25 crores and to the Chief Executive if it exceeded Rs. 25 crores.

9.22 The representative of Canfund, however, stated that there was no formal back-up support system to review and monitor the transactions. As a result, irregularities were not coming to the notice of top management. Neither were they seeking them. Monitoring and review system was introduced with effect from 1.7.1991 but this was not implemented effectively. The irregularities came to the knowledge of top management only when a claim was received from SCB. Again, not an absolvement of the management.

9.23 Although the internal reporting system failed to bring out the irregularities before the top management the reports of RBI/SEBI have repeatedly pointed out serious violation of the guidelines of mutual funds committed during 1991. Later in 1992 still more irregularities were pointed out. The August, 1991 report was reportedly placed before the Board of Trustees. All these clearly show that the Board did not take seriously the report of RBI and SEBI and allowed the irregularities to continue.

National Housing Bank

9.24 The irregularities committed by Shri C. Ravi Kumar who was incharge of the Funds Management Board is one of the examples of a failure of the reporting system in the NHB. During the course of evidence the acting CMD and Chief General Manager pleaded that they did not know that Shri Ravi Kumar was indulging in illegal or unauthorised activities. It has come to the notice of the Committee that the DGM, Shri Manoj Rakshit had put up a note to the Chief General Manager stating that all functions should not be centralised in one or two persons like Shri Ravi Kumar. It was suggested that the writing of cheques, reconciliation of accounts and other activities connected with it and other normal functions of the Accounts department should be as per normal rules and there should be better checks and balances. It is, therefore, clear that although the management was aware, no corrective action was taken. Astonishingly, the confidential note was marked to Shri Ravi Kumar himself for discussion by the Chief General Manager, Shri Hoshangadi on the plea that it merely related "to change of procedure, change of formats etc. pertaining to funds management". No wonder, the confidential note ended up with Shri Ravi Kumar and went unresponded. The Chief General Manager, Shri Hoshangadi did not also bring this to the notice of the Chairman or the Executive Director. During evidence the Acting Chairman, Shri R.V. Gupta admitted that, "Had they followed these steps, we should perhaps not have been in this trouble". It is astonishing that no inspection of the department was carried out nor anything was done to ensure compliance of the note.

9.25 At the NHB there was system of putting up periodic reports including weekly and monthly reports on investment transactions. There was a system of getting every deal either approved or ratified at the Chief General Manager's level. The practice was discontinued from October, 1991. The Executive Director Shri P.K. Parthasarathy was not even aware of this breakdown in communications till December 1991. This lapse was admitted by the

Shri Parthasarathy during oral evidence.

9.26 Further, the practice of getting the approval of daily vouchers from the Chief G.M. continued only till September, 1991 after which no regular day to day approval was obtained. Even the weekly report in this regard was also discontinued, the reason cited being the frequent absence of Chief G.M. from the station. As a result, there was delay in posting of voucher and consequential dislocation and later these were returned to the accounts section and were posted in the day book. Surprisingly nobody enquired in this regard and the matter also was not reported to the Executive Director or the Chairman. All this evidence only goes to prove the near complete breakdown of the reporting system in the NHB.

9.27 To sum up; deficiencies were observed in internal control and supervision in the following areas in banks/institutions in general:

a) **the segregation of duties between (i) persons responsible for entering into deals, (ii) persons having custody of investments, and (iii) persons responsible for recording the transactions in the books of accounts and other records;**

b) **the periodic reconciliation of investment account and the independent verification thereof;**

c) **controls over the issue of SGL forms and BRs and record keeping in respect thereof;**

d) **controls for verification of the authenticity of BRs and SGL forms and confirmation of authorised signatories;**

e) **procedures for confirmation with counterparties, brokers' contracts as also of overdue BRs;**

f) **the segregation of responsibilities of persons handling the bank's own investments and those dealing on clients' accounts;**

g) **fixation of exposure limits;**

h) **reporting system; and**

i) **laying down of instructions relating to investment in securities in the Manual.**

Vigilance

9.28 The Committee note that the Vigilance Departments both at Head Office and at controlling office levels of all public sector banks/FIs, are functioning under the overall supervision of CVO. The C.V.O. is of the rank of General Manager and is selected by the Government in consultation with the Central Vigilance Commission (CVC) from the panels received from the banks. The CVO for a bank is from another bank or from RBI.

9.29 The CVOs in the public sector banks/financial institutions are required to submit quarterly Action Plan Reports on anti-corruption measures, on vigilance cases in respect of the various officials working in their respective banks other than the chief executive. The RBI is required to furnish to the Government of India, on a quarterly basis, reports on major frauds (involving amounts of Rs. 1 crore and above) in all the public sector banks.

9.30 Vigilance surveillance over public sector banks/financial institutions is done through Vigilance Officers in each bank/FI and Vigilance Section in the Banking Division of the

Ministry of Finance functioning under the supervision of the Joint Secretary in charge of personnel relations and vigilance. The RBI has special Investigation Cell under the head of a Joint Chief Officer. The Vigilance Cell of RBI as well as the Vigilance Section of the Banking Division work closely together.

9.31 Instructions were issued by RBI on 5.9.1991 to the Chairmen/Managing Directors of all public sector banks imposing upon the banks to structurally strengthen and revitalise the internal control and vigilance machinery (Appendix XVI).

9.32 The Committee attempted to look into the role exercised, if any, by the Vigilance Departments in some of the banks in the matter under examination. As would be seen, regrettably, they had not performed the duties that they were required to do. Neither the top management of the banks nor the boards paid sufficient attention to vigilance matters.

9.33 The SBI has got a Vigilance Department in each of the 13 circles. It also has got a Vigilance Department at the apex level in Bombay. Unfortunately, the Bank Vigilance failed miserably in detecting the irregularities being continuously committed at a large scale at the apex level in Bombay itself. The CVO, SBI, in fact, deposed before the Committee that he started investigating these irregularities in securities transactions after he was asked to do so on finding the discrepancies in the statement of SGL. On being enquired by the Committee whether the Vigilance could not have acted on their own in the light of the unprecedented spurt in the transactions observed in the relevant period, the witness stated:

> "As the records show, I did not, in this particular case. And I do not want to hold any brief for that."

9.34 In extenuation, the witness stated that his department was a small one for a bank of the size and network of SBI and that at present, there was no information system whereby his department could get the information about transactions of a particular case, no such information, at any stage, had reached him. While the Committee cannot accept this as a valid explanation for the total failure of the bank vigilance in this case, they trust that the shortcomings in the functioning of the department will be taken due care of so as to improve the efficacy of the system.

9.35 In Andhra Bank, officials involved in the irregularities are being investigated by the Vigilance Department and reports are still awaited.

9.36 In the case ABFSL, it has come to the notice of the Committee that apart from CBI inquiry, no departmental action like vigilance inquiry have been undertaken by the bank against the erring officials. The irregularities that have occurred have not been thoroughly examined nor any comprehensive reports have been prepared. Initially the Vigilance Department had sent some teams to Bombay, Hyderabad and Bangalore for scrutiny but this was subsequently abandoned and the task was handed over to a firm of Chartered Accountants.

9.37 Although, 90% of the securities transactions were carried out by the Bombay Branch, the internal audit and annual inspection reports failed to detect these irregularities. There was also no surprise inspection by the Vigilance Department. Surprisingly, the reason adduced by the CVO was that "in the Bombay office we have Chartered accountants" which only goes to show the misconception of the officials regarding the role of Vigilance Department. The representatives, however, admitted the "negligence on the part of the Vigilance Department" and further accepted the failure of the management in controlling/ detecting the irregularities.

9.38 The Committee note that in the wake of the scam, the Banking Division, Ministry of Finance held a meeting of the Chief Vigilance Officers on 8.7.1992 in which certain action points were discussed and finalised for implementation. The points included initiating administrative and punitive follow-up action on the irregularities of the respective banks raised in the reports of the Janakiraman Committee, preventive measures to be taken, special enquiry into the conduct of the subsidiary companies, CVO to utilise reports of RBI's annual financial review, internal and statutory auditors on PMS in banks/subsidiaries, to study the extent of brokers margin in securities transactions. It is further seen that decision had also been taken to constitute investigating teams in banks involved for assisting the CBI, that it was desirable for CVOs to attend the Board meetings and also to go into the report of the Ghosh Committee on prevention of frauds.

9.39 The Committee find it relevant to quote a RBI circular issued on 5.9.1991 to the Chairmen/Managing Directors of banks which had described the functioning of the Vigilance Departments in the banks as... . "While the preventive role was generally confined to issue of circulars and reiteration of standing instructions regarding acceptance of gifts, hospitality from clients etc., the detective role arose mainly when complaints were received or the internal inspections revealed adverse features in any particular account or an area which involved vigilance angle. It is our assessment that absence of a regular system of preventive vigilance and looking into vigilance angle only on receipt of complaints or source information, had to a large extent, resulted in the detection of frauds, malpractices, irregularities etc., at a very late stage." In this connection, the Committee's attention has also been drawn to the finding of the Committee set up to enquire into various aspects relating to frauds and malpractices, in banks (Ghosh Committee). The Ghosh Committee in their report had dealt with the inadequacies/shortcomings in the working of the Vigilance departments in the banks etc. and have made recommendations so as to ensure that CVOs function as preventive, detective and punitive agencies.

9.40 The failure of the CVOs of the public sector banks/financial institutions to perform their preventive as well as detective roles clearly indicate that the functioning of the vigilance system in the banks/financial institutions has been found to be totally unsatisfactory. The Committee trust that the recommendations contained in the Ghosh Committee report will be updated and implemented urgently. The action plan finalised at the meeting of the Ministry of Finance on 8.7.92 should also be implemented urgently. The Committee further recommend that the Board of Directors of each bank should periodically review the functioning of vigilance set up including the reports of CVOs and the follow up action thereon.

Internal Audit

9.41 Apart from the system of statutory audit by external auditors, banks have their own internal audit/inspection machinery. Some of the banks have also a system of concurrent audit. The role of the internal auditor is essentially to verify that the books and records are being maintained in accordance with the practices and procedures prescribed by the management, reflecting a correct record of the assets and liabilities, that advances shown in the books have been authorised by the competent authority and that they are realisable and enforceable at law, that other assets really exist, that all income accruing has been brought into account, that all expenditures are appropriately charged and where necessary, has been duly authorised, and generally that all instructions issued by the management are being duly complied with. It is also the responsibility of the Internal Audit and Inspection Departments of Banks to verify that all directives and instructions/guidelines of the RBI are being complied with and these have properly percolated to and are clearly understood by, the operating officials.

9.42 According to the RBI generally banks are expected to cover all their branches under internal inspection at least once during a period of 12-18 months. The inspection report format is evolved by the individual banks themselves. Such of the banks as do not have adequate staff to inspect branches, engage the services of Chartered Accountants for branch inspections. These branch inspection reports are duly required to be perused by RBI Inspectors during the course of their periodical inspections. Any deficiency in scope and coverage of inspection reports or the follow-up of inspection findings are duly required to be incorporated in RBI inspection report. RBI vide their Circular dated 5.9.1991 advised that internal auditors should critically examine the investment transaction in order to ensure that they are undertaken in accordance with laid down procedures and these transactions are undertaken only on business considerations and not intended to pass on undue benefits to brokers.

9.43 The Committee find that the system of internal audit/inspection varied from bank to bank. According to the system of internal audit prevailing in the SBI, inspections of branches were conducted by the Inspection and Audit Department of Central Office once in 18 months. Similarly, SBI had a concurrent Auditor in all the branches. In SBI Caps, internal audit was conducted by a Chartered Accountant firm every year at Corporate Office and the four Regional Offices. The UCO Bank represented a distinct type where the bank did not have a system of either concurrent or internal audit either at its Hamam Street Bombay Branch which was the hub of irregularities or at the Head Office.

9.44 Andhra Bank did not have any system of Internal Audit but had only Inspection group. Canara Bank, on the other hand, had the system of inspection by in house teams at periodical intervals (periodicity varying between 18-24 months) and Quarterly Income Audit conducting 100% transaction. The Committee are dismayed to note that neither the internal audit/inspection groups nor the concurrent audit in any of the banks examined by the Committee, with the exception of SBI Caps had pointed out the irregularities in securities transactions. The banks have admitted to this failure. In SBI Caps, the internal audit had pointed out in June, 1991, as well as September, 1991, that there was no evidence of securities having been purchased by the Madras Regional Office of SBI Caps from its brokers. They had in June, 1991 also pointed out about the need for fixing limits in respect of the amount of transactions to be conducted through a single broker. The report and the comments of the Madras Office were forwarded to the Corporate Office. However, it was not placed before the Board of Directors. The Committee find that the inadequacies/shortcomings of the internal audit/inspection groups had also been brought out by the Committee set up to enquire into various aspects relating to frauds and malpractices in banks (Ghosh Committee). The RBI have stated that the shortcomings pointed out by the Ghosh Committee have been taken note of and banks advised on 25.8.1992 to take steps in the light of the recommendations of the Ghosh Committee. It may be repeated that the Ghosh Committee submitted its report on 30.6.1992.

9.45 **The Committee regret to note the serious weaknesses in the internal control systems of the banks especially on the treasury and investment side. Not only there was lack of effective control systems, there was also laxity in enforcing strictly even the existing inadequate systems. The Committee strongly feel that a proper and effective system of internal controls in banks whereby irregularities can be obviated and detected immediately, is of utmost importance. They, therefore, suggest that the banks should urgently review their internal control mechanism in the light of the deficiencies noticed to ensure that there are adequate safeguards in the systems.**

9.46 **It is noticed that there is no comprehensive document containing all directives, guidelines, circulars etc. issued by the RBI, which is readily accessible for reference by**

all concerned. This creates the possibility of banks and/or other officers, by omission or design, claiming ignorance of specific directives, etc. The Committee, therefore, suggest that such a compendium should be brought out expeditiously and kept up-to-date.

9.47 The Committee find that there is no satisfactory mechanism in most of the banks to examine and follow up the observations/suggestions made in the reports by the internal inspection department, Vigilance Cell and Internal Auditor etc. There is also need for proper follow-up action on the inspection reports, guidelines, circulars etc. issued by RBI. They suggest that a Committee of Board of Directors, which may include the Chairman, nominees of RBI and Government of India as also, where available, a professional such as Chartered Accountant or a management/ financial consultant, should be entrusted with the task of overseeing the follow up action on the above mentioned reports.

CHAPTER-X

STATUTORY AUDIT

10.1 The objective of an independent audit of financial statements, prepared within the framework of recognised accounting policies and practices and relevant statutory requirements is to enable the auditor to express an opinion on such financial statements. The auditor's opinion helps determination of the 'true and fair view' of the financial position and operating results of an enterprise. Detection of material frauds and errors as an incidental objective of independent financial auditing flows automatically from the main objective of determining whether or not the financial statements give a true and fair view. The report of statutory auditor is an important public document and is of great significance.

10.2 While performing the audit, the auditor is required to use his skill and judgement keeping in view that the audited accounts should clearly disclose the results of the working of the entity for the year as also every material feature and transactions of an exceptional or non-recurring nature. Since the financial statements are based on books of accounts, the auditor has necessarily to satisfy himself that the books are properly maintained and can be relied upon. If certain information is vital for showing a true and fair view, the financial statements have to disclose it. The financial statements should also disclose all "material" items, i.e. items the knowledge of which might influence the decisions of the user of the financial statements.

10.3 The statement on Standard Auditing Practices issued by the Institute of Chartered Accountants of India states that the auditor should obtain sufficient appropriate audit evidence through the performance of compliance and substantive procedures to enable him to draw reasonable conclusions. The auditor should review and assess the conclusions drawn from the audit evidence obtained and from his knowledge of business of the entity as the basis for the expression of his opinion on the financial information. This review and assessment involves forming an overall conclusion as to whether the financial information has been prepared using acceptable accounting policies, which have been consistently applied, the financial information complies with relevant regulations and statutory requirements; there is adequate disclosure of all material matters relevant to the proper presentation of the financial information, subject to statutory requirements, where applicable. Thus in forming his opinion on the financial statements, the auditor follows procedures designed to satisfy himself that the financial statements reflect a true and fair view of the financial position and operating results of the enterprise.

Statutory Audit of Banks

10.4 Section 30 of the Banking Regulation Act, 1949 provides that the balance sheet and profit and loss account of a bank is required to be audited. This section provides that the auditor "shall have the powers of, exercise the functions vested in, and discharge the duties and be subject to the liabilities and penalties imposed on, auditors of companies by Section 227 of the Companies Act, 1956". The section further provides that "in addition to the matters which under the aforesaid Act the auditor is required to state in his report, he shall, in the case of a banking company incorporated in India, state in his report —

a) Whether or not the information and explanations required by him have been found to be satisfactory;

b) Whether or not the transactions of the company which come to his notice have been within the powers of the company;

c) Whether or not the returns received from branch offices of the company have been found adequate for the purpose of his audit;

d) Whether the profit and loss account shows a true balance of profit or loss for the period covered by such account; and

e) Any other matter which he considers should be brought to the notice of the shareholders of the company".

10.5 The 'Study on Audit of Banks' brought out in 1985 by the Institute of Chartered Accountants of India specifically mentions *inter-alia* that the auditor should review the internal control procedures of the bank to identify areas which would require a closer examination. The auditor should obtain an understanding of the nature of books and records maintained and the terminology used by the bank to describe various types of transactions and operations. In addition, the auditor should also obtain relevant circular instructions, particularly those relating to closing of yearly accounts, inspection reports, etc. The most important part of the audit is the Auditors' Report as it is through this report that the observations/comments of the auditors on the accounts are conveyed.

10.6 The RBI as supervisory authority gives directions or issues guidelines/instructions to banking companies to prevent the affairs of any banking company being conducted in a manner detrimental to the interests of the depositors or in a manner prejudicial to the interests of the banking company, or to secure the proper management of any banking company.

10.7 On the issue of Directives, guidelines and instructions, the RBI stated :

> "In respect of the directives issued by RBI banks have no maneuverability in the implementation as these are to be implemented both in letter and spirit. On a number of other policies or operations of banks, the Reserve Bank issues appropriate guidelines or instructions. In this context, it is relevant to point out that whether a particular advice to banks is in the form of guidelines or instructions, to the extent it is issued by the regulatory authority it has all the sanctity of a directive issued under the provisions of the Banking Regulation Act/RBI India Act and banks are expected to follow these guidelines and instructions, without any deviation."

10.8 The various directives, instructions, etc. are binding on the banks and it is the duty of the auditors to report on the non-compliance of these directives, circulars, instructions etc. which have an impact on the business activity of the bank and the disclosure of true and fair view.

10.9 Section 30(3)(e) of the Banking Regulation Act specifically states that the auditor is also required to state in his report:

> **"Any other matter which he considers should be brought to the notice of the shareholders of the company."**

10.10 The Committee have not come across any report where the auditors have reported under this clause even on the weaknesses in internal control, violation of RBI guidelines etc.

Verification of Securities

10.11 The 'Study on Audit of Banks' issued by the Institute of Chartered Accountants of India states *inter-alia*:

> "The auditor should inspect the investments physically on the date of balance sheet. He will have to take particular care to see that only genuine investments are produced to him, and that securities held by the bank against loans and advances are not shown to him as the banks own investments. To ensure this the auditor should see all the investments and securities simultaneously and should keep them under his control until he completes his checking ...When investments are held by any other person on behalf of the Bank, the auditor should examine the certificate from him. The certificate should state the reason for holding the investment. The receipt originally issued by such person when taking delivery of the investment is not considered adequate for audit purposes."

10.12 The auditors clearly had a duty to verify the existence and quality of investments held by the banks on their own account as well as of their PMS clients. This also required a reconciliation of the investment account, physical inspection of securities on hand, confirmations of counterparty banks for BRs issued by such banks and on hand, confirmation of SGL balances with the PDO, and control and reconciliation of BRs issued by the banks. The irregularities regarding the existence and quality of investments had existed since long and had not been detected by the external auditors for which they must accept responsibility.

Sale and/or Purchase of Securities

10.13 The 'Study on Audit of Banks' further states that:

> "Transactions which may have taken place in investments since the date of the last balance sheet should be vouched, either in full or on a test basis depending upon the number of transactions. Proper adjustment of interest should be made in the cost or sale value of government securities purchased or sold."

10.14 It was thus incumbent on the auditor to examine in detail at least on test check basis the sale and/or purchase of the securities with the relevant vouchers such as contract notes, bills, receipt etc. as evidence for sale and/or purchase of securities. The auditor should have examined whether payments on account of sale and/or purchase of securities are duly accounted for and correct entries are made in the ledger. It is surprising that the irregularities in securities transactions on such a massive scale were not noticed by the auditors. In a large number of cases, the payments for the sale and/or purchase of the securities were routed through the brokers account which should have aroused the suspicion to have more in-depth check. A vigilant and conscientious auditor could have detected the irregularities and an early reporting of them would have prevented their large scale recurrence.

10.15 The Committee have come across many examples in RBI Inspection Reports of the last few years which have highlighted the irregular purchase and/or sale of securities, deals in units and bonds of PSUs; gross violation of RBI circulars, instructions, directives etc.; circumvention of CRR/SLR requirements; irregular 'borrowings' and 'lending' by banks in the guise of securities transactions; booking profits on bogus securities transactions; weaknesses in the system of internal control etc. The Committee are pained

to note that the auditors did not take into consideration the serious irregularities pointed out in the Inspection Reports of RBI. The highlighting of these irregularities in the auditors' report would have assisted in curbing the proliferation of the irregularities in future. It clearly indicates that the auditors were negligent in the performance of their duties. The Committee suggest that the RBI and the Institute of Chartered Accountants of India should scrutinies the audit reports of the banks involved in the irregularities and initiate suitable action against the defaulting auditors.

Portfolio Management Scheme

10.16 Portfolio management is a permitted activity for the banks to engage in, under section 6(1) of the Banking Regulation Act. However, with a view to regulating the above activity, the RBI has issued circulars/guidelines in April 1987, May 1989 and January, 1991 (Appendix-XVII).

10.17 The auditor is required to satisfy himself that the income on PMS funds is duly accounted to fund owners and the service charges/fees for management of the funds is correctly accounted for in the books of the fund manager. The auditor has also to satisfy himself that the profits of the fund manager are not inflated by accounting the income of fund owner as income of fund manager; losses of fund owner are not absorbed as losses of the fund manager etc. The Auditors should have examined whether the banks maintained clientwise portfolio Account, whether the liability of the banks in respect of PMS funds was properly reflected in the accounts and how the funds undeployed were treated for the purpose of CRR/SLR.

10.18 The Committee have come across only one Audit Report for the year ended 31.3.1991 of BOI Finance Ltd. where the auditors have highlighted the gross irregularities, violation of RBI guidelines and gave a qualified audit report in relation to management of portfolio funds. If one of the auditors could highlight the various irregularities being committed in PMS transactions, the Committee are led to enquire as to how other auditors in similar circumstances continued to certify without qualifications that the financial statements showed a true and fair view. The Committee desire that all these financial irregularities should be examined in detail for all the banks/institutions involved and should be rectified and correctly reflected in their accounts. The auditors while auditing the accounts for the year in which these rectifications are made should also report on their accuracy or should qualify their report in case no such corrective actions are taken by the bank/institutions involved.

Foreign Banks

10.19 The special scrutiny conducted by RBI in 1989 and 1990 revealed gross irregularities in the PMS operations by the foreign banks and non compliance of RBI circulars etc. RBI vide their letter dated 18 January 1991 warned the four foreign banks viz., American Express Bank, BOA, Citibank and ANZ Grindlays Bank that if the adverse features recur, RBI would be constrained to prohibit them from undertaking PMS transactions in future.

10.20 The Committee are unable to appreciate how the auditors of the foreign banks certified that the financial statements for 1990 and 1991 gave a true and fair view when the RBI Inspection Report itself established that the banks were indulging in gross irregularities, violating RBI guidelines etc., which have a material impact on the true and fair view of the financial statements. The Committee suggest that the Institute of Chartered Accountants of India and RBI should initiate necessary action.

CANFINA

10.21 CANFINA was set up as a wholly owned subsidiary of Canara Bank and commenced its operation on 1 June, 1987. On the basis of the examination by the Committee of RBI inspection report from 1988 onwards, it is amply clear that CANFINA indulged in gross irregular financial activities since its inception in 1987. The Inspection Report of RBI dated 9 September, 1988 highlighted several irregular activities of the company. The report states, *inter-alia*:

> "Both under inter-corporate placement of funds scheme and portfolio management, huge funds are made available to Canara Bank. This had enabled Canara Bank to depress the credit-deposit ratio and has also distorted the DTL of the bank. The clients are big corporate institutions coming under CAS purview. Providing funds outside this control system vitiates CAS discipline. Thus, the whole arrangement cuts across the monetary and credit disciplines envisaged for the banking system, by diverting huge funds outside the system."

10.22 The subsequent inspection of CANFINA conducted by RBI between 5 March, 1991 and 23 March, 1991 with particular reference to the position as on 31 January, 1991 also indicates serious irregularities on PMS operation. The report also specifically states:

> "Published accounts of CANFINA do not reflect its liability to its clients in respect of funds accepted by it for portfolio Management."

10.23 The scrutiny of investment transactions of CANFINA in 1992 revealed that maintenance of records is barely adequate as could be seen from the following instance :

> "Out of 324 purchase transactions put through during April to June, 1991 scrutinised by us, in 67 cases both contract notes and cost memos, in 152 cases contract notes and in 48 cases cost memos were not made available for scrutiny. Similarly out of 376 sale transactions, in 19 cases both contract notes and sale memos, in 142 cases contract notes and in 7 cases sale memos were not made available. We have also come across many purchases/sale contracts, as also cost/sale memos, against which no transactions were put through as per the Register of Purchases/Sales and physical ledger. A few cases were noticed where contract notes were not stamped/cost memos were not signed, however, transactions were put through against them. Even though physical securities ledger showed an oversold position, further sales were undertaken on many occasions. On certain days even though sales were put through, balances were not struck as it was already in debit."

10.24 Far from taking note of the above deficiencies and reporting on the irregularities, the auditors had the audacity of observing in their report dated 23 April, 1992 for the year ending 31 March, 1992 stating *inter-alia*:

a) **"The company has an internal audit system commensurate with the size and nature of its business;"**

b) **"The maintenance of records by the company for the transactions relating to dealing in shares, securities, debentures and other investments is found satisfactory. Investments on hand are in the name of the company or in the process of transfer to the company."**

The Committee regret to note that the audit report of CANFINA is unworthy of any reliance and it is obvious that the auditors failed in discharging their duties. The Committee suggest that the RBI and the Institute of Chartered Accountants of India should scrutinies all such audit reports and initiate suitable action against defaulting auditors.

Role of Auditors in FFSL

10.25 The role of audit in Fairgrowth Financial Services Ltd. (FFSL) is particularly relevant as it illustrates all the many wrongs that are permitted to happen simply because the statutory auditors failed to discharge their duty adequately. The auditors after examining the books of accounts and other records of the company for the year ended 31st March, 1992 reported on 29 April, 1992 that the Balance Sheet reflects a true and fair view of the state of affairs of the company and the Profit and Loss Account also give a true and fair view of the profit of Rs. 43.29 crores (previous year Rs. 1.11 crores) for the year. The Auditors Report further states *inter-alia*:

> "In our opinion and according to the information and explanations given to us, the Company has maintained proper records of transactions and contracts as to dealings in shares, securities, debentures and other investments and timely entries have been made therein. The same have been held by the Company in its own name or in the process of transfer to its name, except to the extent of the exemption, if any, granted under Section 49 of the Companies Act, 1956."

10.26 The Company is required to disclose the details of investments company-wise and quantity-wise including the stock in trade in terms of Part I and II of the Schedule VI of the Companies Act, 1956. The management in its Notes on Accounts clarified that they have applied to the Central Government for exemption from the disclosure requirement. However, the approval was not granted or received on the date of signing the auditors report. In such circumstances, the auditor ought to have qualified the report giving the necessary details. Non-disclosure of the information was a deliberate attempt to hide the real state of affairs.

10.27 To the queries of the Committee as to why the Balance Sheet is changed, the Managing Director of FFSL in his evidence stated:

> "It was because we removed all these contracts which we took for SR purposes and audit purposes. Then the new Balance Sheet is drawn .... This is also inflated profits of the company. That is the reason why Mr. Bansi Mehta had given the opinion that the company should nullify the account... After the scam our Directors approached him. Then he gave an opinion saying that the account should be nullified and that all these contracts should be removed and new Balance Sheet should be drawn... It was an oral advice... It was on 4th July, 1992 after the scam broke out... If the scam would not have been there he would not have been advised to nullify."

10.28 In reply to a question by the Committee, the Managing Director, FFSL admitted that some entries were missing in the Balance Sheet. He also stated:

> "Mr. Bansi Mehta has invested on 6.4.1991 for five thousand shares and on 21.9.1991 for another five thousand shares."

10.29 The evidence of the Managing Director of FFSL clearly indicates that the accounts for the year ended 31.3.1992 were manipulated. The auditors, it appears, aided and abetted in manipulation of the accounts of the company. The Committee recommend enquiry into the role of the auditors of FFSL and taking of further necessary action.

Action Against Statutory Auditors

10.30 The Committee are pained to note that the statutory auditors, with rare exception, failed to report the large scale irregularities continuing in the banks, PSUs, companies etc. in the securities transactions, portfolio management scheme, gross violation of guidelines/circulars etc. The entire irregularities discussed in the report are mainly of financial nature, continuing for a long time and the auditors cannot absolve themselves of the responsibilities of not detecting or reporting the same. Many of the audit reports were in the nature of collusive cover up operation.

10.31 To the query of the Committee to indicate the action taken against statutory auditors, RBI stated that in the light of the serious irregularities observed in securities transactions of some banks and their subsidiaries/mutual funds in the year 1991-1992, it has been decided on 12 December, 1992 that bank audit assignment for 1992-93 should not be given to any of the audit firms who had audited securities transactions of these banks in 1991-1992. The names of such firms are given in Appendix XVIII. RBI, however, admits that some of these auditors as shown in Appendix XVIII had already been approved for appointment in 1992-93. The Committee are surprised to find that RBI did not consider it necessary to withdraw the approval in respect of these auditors and to review the matter after the decision of 12 December, 1992. To the specific query of the Committee about action against auditors of bank negligent in their professional duties for the accounts of 1990-91, RBI stated in August, 1993 that the matter is being separately examined by them. **The Committee feel that the action of RBI is wholly inadequate considering the continued serious lapses on the part of the auditors. Necessary action should be initiated by the RBI against all auditors who failed to discharge their duty properly. The Institute of Chartered Accountants of India should also be informed about such auditors so that they may take necessary disciplinary action.**

Audit of PSUs

10.32 A large number of Public Sector Undertakings and subsidiaries of nationalised banks are registered as companies under the companies Act, 1956. The audit of government companies and deemed government companies is conducted by professional chartered accountants, who are appointed or reappointed by the Central Government on the advice of the C&AG. The statutes governing some corporations and authorities require their accounts to be audited by the C&AG and reports given by him. In respect of AI, Indian Airlines the International Airports Authority of India, National Airports Authority of India, Inland Waterways Authority of India, ONGC, Damodar Valley Corporation and Delhi Transport Corporation, the C&AG of India is the sole auditor under the relevant statutes. In respect of Central Warehousing Corporation, Delhi Financial Corporation and the Food Corporation of India, the CAG has the right to conduct audit independently of the audit conducted by the Chartered Accountants appointed under the statues governing the three corporations.

10.33 **The Committee have come across serious irregularities in investment transactions by PSUs which have been discussed extensively elsewhere in the report. For instance, as against the Government instructions to make investments only in Government Securities, public sector bonds, treasury bills, PSUs in the guise of PMS entered into ready forward**

deals without taking physical possession of securities or at least the details thereof from banks/financial companies. It has also come to the notice of the Committee that in several cases, the investments were made in contravention of the relevant statue, guidelines, memorandum and articles of association etc. Most of the deals were struck on phone and no record was maintained to substantiate reasons for the decision taken. In most cases, funds of the PSUs were exposed to great risk and some of the PSUs may lose heavily because of default in payment by non banking financial companies.

10.34 In regard to audit, the Statement on Auditing Practices brought out by the Institute of Chartered Accountants of India states *inter-alia*:

> "When an investment is made, it should be ascertained whether the company has power under its Memorandum of Association to make such investment. It is essential to ensure that on purchase of investments, the requirements of Section 292, 293(1)(c) and 372 of the Companies Act, whenever applicable are complied with. The power to invest the funds of a company has to be exercised at Board Meetings or by persons to whom power has been delegated by the Board in accordance with the provisions of Section 292. It should be noted that the persons to whom power has been delegated act within the limits of authority delegated to them.... Ordinarily, the purchase of an investment is vouched with a broker's contract note, bill of costs and stamped receipt."

10.35 The Committee have come across only one Audit Report of Bharat Heavy Electricals Ltd. for the year ending 31.3.1991 where the auditors have qualified the report stating inter alia that these 'deposits' should have been shown under the head 'investment' under 'Portfolio Management Scheme' as these were utilised by CANFINA for purchase and sale of securities etc.

10.36 It was the duty of the auditors to obtain details of the investments made under PMS and to report whether the investments made were within the powers of the PSUs and whether the same are correctly reflected in the Balance Sheet. The auditor of a government company is required not only to verify whether the financial statements give a true and fair view, but has also to look into the efficacy of the system. The Committee regret to note that the auditors failed in performing their professional duties and this failure permitted the officials to play with the funds of the PSUs by irregularly investing/ lending them in contravention of the statutes, government guidelines/decisions etc. The Committee suggest that the Department of Company Affairs, the C&AG should examine the audit reports of PSUs etc., involved in the irregularities and take appropriate action against auditors who were negligent in the performance of their duties.

Supplementary or Test Audit

10.37 The C&AG has the power to conduct a test or supplementary audit of company's accounts where he finds it necessary to do so. Apart from this, the C&AG also conducts an efficiency-cum-propriety audit of selected companies. The supplementary audit by the C&AG broadly covers financial statements, systems and performance. As far as audit of financial statement is concerned, broad checks are applied on the financial statement as reported upon by chartered accountants. The areas specially covered under the audit of systems and performance relate to investment decisions, project formulation, project management, delegation of powers etc.

10.38 The Committee are constrained to observe that none of the Reports of the C&AG except Report Nos. 1 and 3 of 1993, Union Government (Commercial) have pointed out the

serious irregularities in the investment and other related transactions by PSUs. There are obviously some shortcomings in the methodology of audit which deserve to be examined.

Suggestions for Reforms in Audit

10.39 The Committee feel that there are grave shortcomings in the objective and methodology of audit as practised now at present. The Committee addressed itself to some of the aspects of reforms in the system of audit. The Committee are of the view that the present method of appointment of auditors, their actual conduct of audit, their involvement with the bank in other professional assignments and various other practices as highly unsatisfactory. The Committee find that the term of the auditor is only one year. They are sometimes appointed as late as in March and are required to submit their report latest by June. The Committee feel that the auditors should be appointed well in time and for reasonably long period. Various other improvements are needed in conducting of audit and reporting by the auditors. Rather than detailing a charter of reforms, the Committee suggest that the Government should address itself to the various shortcomings in audit and take necessary corrective measures. The Committee also suggest that with a view to achieving the objective of effective audit, statutory amendments be made wherever considered necessary. The Committee are of the view that the setting up of an independent Central Audit Authority instead of the fragmented system adopted by individual banks, as at present, may be seriously considered.

CHAPTER-XI

ACCOUNTABILITY — BANKS

11.1 At the very outset the Committee would wish to observe that the most noteworthy and unexplained aspect of the accountability of officials has been the absence of prompt and deterrent action against the guilty. Action initiated or taken has been selective, has varied from the reasonably prompt to extremely lethargic and lackadaisical. Thereafter, the disciplinary or punitive aspect of it has traversed the entire spectrum of procrastinatory bureaucratic option : from the evasive and wholly ineffective, "sent on leave", "transfer", "suspension" etc. The Committee have been hard pressed to find instances of immediate corrective action, initiation of legal proceedings, leave alone conviction proper or the actual sentencing of identified perpetrator of this gross abuse of public responsibility. The Committee are not convinced by the standard explanatory arguments advanced about our sluggish legal system. The Committee do wish to place on record their observation that the will to uniformly, and without fear or favour punish the guilty seems to have been absent through the entire sorry episode. And, this observation is being recorded more than one year after the Scam came to light.

11.2 The above observation is based on the Committee's enquiries about the role of top management/officials/staff of various banks/financial institutions in the irregularities in securities and banking transactions. A list indicating the names of the Chairmen and Managing Directors or other high ranking officials of the banks and their subsidiaries etc. who were proceeded against variously is at Appendix XIX. In this connection, the Committee further wish to note that the CBI have till date filed only 12 cases and 33 off-shoot cases arising therefrom. Of the 12 original cases, 10 related to banks/financial companies. The names of the accused figuring in the cases relating to banks are given in Appendix XX. Some of the more important points emerging from this aspect of the Committee's enquiry are dealt with in the succeeding paragraphs.

State Bank of India

11.3 Irregularities in the securities transactions in the SBI have already been mentioned at different places in this report. The CBI, Janakiraman Committee Report and others have listed various defaults resulting in wrongful loss to the SBI. The CBI has made available to the Committee a list of officials that they hold as wrong doers who have been named in the FIR. This is at Appendix XX.

11.4 During enquiry by this Committee, top officers of SBI including Ex-Chairman and the Managing Directors deposed. They claimed, uniformly, that they were all totally unaware of any and all of the irregularities committed. Various different procedures adopted in passing and making entries in HSM's account in SBI, were, it was asserted done without any administrative approval of any higher authority. Only Shri R. Sitaraman, a Desk Officer at SBI Bombay Main Branch was held by them, as committing all the irregularities. According to them he alone was also responsible for the fudging of records. These senior officials of SBI did, however, also accuse some others also like Shri A.N. Bavadekar, Deputy Manager and Shri K. Kailasam, Assistant General Manager for their failure to exercise suitable control and supervision. These were charged by their superiors of negligence in submitting and signing the reports/confirmations without verifying the facts which they were required to do. According to the SBI:

> "Since confirmations were ostensibly in conformity with instructions, due to negligence of the Deputy Manager (Securities), fraud committed by the Desk

Officer (Shri R. Sitaraman) was not detected. The manager of the Division did not also scrutinise the vouchers which led to the non-detection of the fraud."

11.5 During his evidence, Shri C.L. Khemani, Deputy Managing Director, however, asserted that the Corporate Office, including Chairman, were fully aware of the investment transactions. As per the procedure, all transactions involving Rs. 100 crores and above were got approved by the Managing Director concerned regularly.

11.6 Shri Sitaraman, during his evidence asserted differently. He stated that as a matter of routine, the Central Office used to convey orders over the phone. The daily report of all executed transactions would then go to the Central Office whereafter, instructions in writing were issued, on several occasions, subsequent to the transactions after the submission of the branch reports. According to him, this delay is the lacunae, on the strength of which he is being made to appear as solely responsible for all actions and for the entire blame. He further asserted that all transactions with brokers were contracted at the Central Office. The following observation by him in regard to the then existing collusion between top officials of SBI and HSM is revealing. When asked as to why he, as an official of the SBI, did not complain about HSM, Shri Sitaraman responded:

"At that time his stature was like that had I opened my mouth they would have simply thrown me into the Arabian sea and that too would have been alright in those days."

11.7 It was found that in several transactions involving Rs. 100 crores or more approval of the M.D. as required had not been obtained. Then, despite orders of the Chairman, SBI on 16.3.1992 to not conclude any further transactions or allow any roll over to HSM without his prior approval, Shri Khemani allowed precisely that, a roll over involving Rs. 360 crores. Not content, he also concluded a fresh transaction with HSM for Rs. 275 crores on 18.4.1992. These transactions were cleared by the Investment Committee, but without the approval of the M.D./Chairman. When his attention was drawn to this blatant disregard of instructions, Shri M.N. Goiporia the then Chairman, SBI, stated in evidence:

"I am not aware of this. It is something else done behind my back. Those were not approved by me at all. I heard the April transaction just now."

Surprisingly, the only action taken against Shri. Khemani is to ask him to proceed on leave.

11.8 The S.B.I. has taken the below mentioned action against other officers:

S. No.	Name	Action
1.	Shri M.M. Sharma, Dy. General Manager, Bombay Main Branch	Explanation called for
2.	Shri K. Kailasam, Manager (Securities Division)	Suspended *w.e.f.* 11.5.1992
3.	Shri A.N. Bavadekar, Dy. Manager (Securities Division)	- do -
4.	Shri R. Sitaraman, Desk Officer (Investment Cell)	- do -
5.	Shri R.R. Koppikar, Concurrent Auditor	Explanation called for
6.	Shri A.D. Padhye, Manager (Personal Banking Division)	- do -
7.	Shri A.J. Gokhale, Computer Operator (Investment Cell)	- do -
8.	Shri D.M. Shah, Head clerk	- do -

In addition, according to SBI, explanation had been called for from a few other officials who had handled the collection of bankers cheques in the name of the bank brought by HSM and issue of bankers cheques to different banks and financial institutions at his request.

11.9 The SBI is the premier retail bank of the country. Its very name confirms its status and standing. The Committee, however, find that its officers have done everything to rob it of the status. Worse, they do not even have a residual sense of belonging to accept responsibility for this great wrong that they permitted to happen. The SBI hierarchy from top to bottom was casual in its approach, negligent in the performance of its duties and unpardonable in their collusion with brokers. The Committee feel that the whole matter requires to be enquired into with a view to punishing the guilty.

SBI Capital Markets Ltd.

11.10 SBI Caps maintains a current account at the Bombay Main Branch of SBI through which its security transactions are executed. Not surprisingly, the Committee have found that payments were made through a debit of this account for transactions which had not been authorised. Not only were funds diverted into unauthorised transactions, in consequence, SBI Caps was left as not holding any securities/BR etc. to the extent of Rs. 105.11 crores. Similarly, the Madras Regional Office of the Company also carries an exposure of Rs. 16.25 crores due to direct deployment of money with a concern connected with HSM.

11.11 Numerous instances of collusive action whilst in service, of employment by HSM Group as a reward after service, of diversion of SBI Caps funds have come to light. Details of some of these are listed below:

a) Shri Ashok Aggarwal, Sr. Project Executive of SBI Caps, who was one of the dealers and whose role in a few of the transactions is under investigation, resigned from SBI Caps on 31.3.1992 and joined M/s. Harsh Estate, a company of HSM.

b) Other officers of SBI Caps *viz.*, Shri S.R. Iyer, Shri Anil Sharma and others figured in computer print outs of HSM. They are shown to have had financial transactions with HSM Group. Of particular concern is the report of CBI, that bankers cheques issued by Shri Ravi Kumar, NHB for an amount of Rs. 24.98 lakhs in February, 1992 favouring SBI Caps was diverted to the account of one Shri Deepak Mehta, out of which shares were purchased in favour of and for late Shri M.J. Pherwani, former Chairman, NHB. This was done as per the instructions of HSM Group.

c) An officer of the AGM level (Shri L.V. Sharma) left SBI Caps three years back and joined as an employee in HSM group as a liaison officer.

11.12 The Committee are of the view that its observations about SBI hold for SBI Caps as well. The Committee believe that the Corporate office was aware of what was happening in Regional offices and is thus not absolved of its responsibility on grounds of ignorance. SBI Caps has till date taken no meaningful disciplinary action against errant officials. This further proves the fact that everyone concerned in SBI Caps was acting in collusion with each other. The top management of SBI Caps also needs to be proceeded against for dereliction of duty.

State Bank of Saurashtra

11.13 In two months, September-October, 1991, SBS had four securities transactions with HSM Group. It invested through actual payment interbank adjustment etc. a total of

Rs. 174.95 crores. These were fraudulent transactions entered into with SBI and NHB to accommodate HSM Group. For this fraud the Bank received no securities, not even BR. In the process it lost the entire sum of money — Rs. 174.95 crores of public money. Not one official of SBS had been punished for this; just one official suspended.

11.14 The Committee offer no further comments to this recital of basic facts of the case.

National Housing Bank

11.15 The NHB was set up in July 1988 under the NHB Act, 1987 primarily for promoting, establishing, supporting or aiding in the promotion, establishment and support of housing finance institutions.

11.16 During the period October, 1991 to April, 1992 through 18 cheques issued by NHB, and one issued on behalf of it (NHB) by the State Bank of Patiala, ostensibly for the purchase of Units, Treasury Bills and other securities by the NHB from ANZ Grindlays Bank and the SBI a total amount of Rs. 1214.30 crores was fraudulently taken away from the NHB. In fact, those transactions were never entered into. Cheques for the entire amount involved drawn in favour of SBI and ANZ Grindlays Bank were handed over to the representative of HSM Group. These were then credited to the account of HSM by the ANZ Grindlays Bank and the SBI. The total through the alchemy of BR and SGLS became Rs. 1271.20 crores. Yet, for this entire amount NHB held nothing, neither securities nor even receipts.

11.17 Besides HSM, the other involved in this are late Shri M.J. Pherwani, Chairman, NHB and S/Shri C. Ravi Kumar, AGM, NHB, S. Suresh Babu, Assistant Manager, NHB, Bombay, R. Sitaraman, JMG-I Officer, SBI, Main Branch, Bombay.

11.18 Uptil 20th of June, 1992 not even departmental action was taken against the erring officers or staff. On that date, the acting Chairman Shri R.V. Gupta appointed a Deputy General Manager along with two other senior officers to go into the question of lapses. A report was then submitted on 9 October, 1992. Departmental action initiated is mainly as under:

(i) Shri C. Ravi Kumar, Assistant General Manager and Shri Suresh Babu, Assistant Manager have been placed under suspension and CBI has also filed charges against these 2 officials on 4th June, 1992. NHB has filed a complaint (FIR) with CBI on 10th July, 1992 in which these 2 officers were implicated.

(ii) Besides, this, it has been reported by NHB to the Committee that there are 3 other officers against whom departmental actions have been initiated whose signatures have figured in the disputed cheques.

United Commercial Bank

11.19 The Committee noticed *inter-alia* the following irregularities indulged in by the UCO Bank:

(a) discounting of two accommodation Bills of Exchange for Rs. 50.36 crores of the group of companies of HSM;

(b) illegally diverting a sum of Rs. 40 crores taken by UCO Bank as call money to the account of HSM; and

(c) unauthorised diversion of funds amounting to Rs. 837.45 crores obtained under portfolio Management from Power Finance Corporation to HSM.

11.20 Briefly, as regards (a) above, it has been revealed that the bills discounted were bogus. The shares shown in the Bills were actually not available with the concerned firms and no actual transactions ever took place. Further, the shares purchased by UCO Bank of Gujarat Ambuja Cements and Castrol were to give pecuniary advantage to HSM. These purchases were made without an authorization of the Board of Directors and was without proper verification of the average market price. In this, there was collusion between Shri K. Margabanthu, Ex-CMD and HSM. It is also found that Shri Margabanthu used to visit Bombay frequently and meet HSM regularly.

11.21 In respect of the second irregularity, it has been observed that HSM, having an account at UCO Bank Hamam Street Branch, Bombay was required to maintain a steady credit balance of Rs. 1 crore. However, on 6.4.1992, this account showed a debit balance of Rs. 39.07 crores. To make up this debit, officers of the UCO Bank borrowed call money amounting to Rs. 40 crores from NHB and then diverted this amount to the account of HSM. This money has not been recovered.

11.22 The third case related to the PMS transactions of UCO Bank with the Power Finance Corporation. During the period 1990-91 transactions purportedly between PFC and UCO Bank for investment of PFC funds on a short term basis or under PMS were diverted to the accounts of HSM. Various cheques of the PFC instead of being issued directly in favour of UCO Bank were issued in favour of ANZ Grindlays Bank. This Bank then credited the proceeds to the account of HSM in Bombay Main Branch from where these were then transferred to his (HSM) account with UCO Bank, Hamam Street Branch, Bombay. BRs were then issued by officials of UCO Bank acknowledging receipt of these sums. The total amount invested by PFC with the UCO Bank which unauthorisedly found its way to the account of HSM is Rs. 837.45 crores including roll-overs.

11.23 Most of these irregularities pertaining to the Hamam Street Branch of UCO Bank were committed during the tenure of Shri V.N. Deosthali, Scale I Officer who was handling securities transactions. This officer unauthorisedly issued a large number of BRs and equally unauthorisedly offered Portfolio Management to the Power Finance Corporation. Shri Deosthali's links with HSM have since been established, during CBI inquiries. As punishment Shri Deosthali's services were terminated on 19 October, 1992. No one in PFC has even been departmentally questioned. The Committee's endeavours in this regard are contained in a separate Chapter. It needs, however, to be placed on record that this entire episode starting with the placement of funds of the Power Finance Corporation with UCO Bank and its diversion to the account of HSM is one of the sorrier examples of collusive greed, resulting in loss of public money.

11.24 During oral evidence it was submitted by the CMD and Executive Director, UCO Bank: "We have moved the persons accused out from the positions they were holding previously and put them in other places which are not operationally dealing with the official transactions. Apart from that we have also ascertained through our inspection teams the correct position of the deals so that we can take follow-up action". Strangely, the bank had not initiated any departmental action earlier on the plea that the Vigilance Manual specifically provides that "when an investigation is already taken up by the CBI a parallel investigation should not be taken up". When the Committee clarified that there was no such ban, only the Bank initiated independent internal investigations. This was on 29th October, 1992 long after perpetration of this fraud.

11.25 The Committee were also astonished to note that Shri Venkatakrishnan of the Treasury and Investment Department of this bank, who actually figures in the CBI's FIR, was transferred as the G.M. of the Inspection Department. During evidence the reason

tendered for this, by the CMD and Executive Director of the bank, was that he was transferred "as no financial decision was involved in the Inspection Department". Admitting "inappropriateness" under the Committees questioning they offered to transfer him yet again.

11.26 Amongst the many instances of questionable activity is that of Shri Sunil Gorwara who arranged "regular fund transfers from Parliament Street Branch to the account of HSM, although the cheque was received in favour of UCO Bank, but the money was transferred to the broker's accounts". The Bank has suspended him on 29.10.1992.

11.27 During the course of oral evidence, it has come to the notice of the Committee that the former CMD, UCO Bank, Shri Margabanthu on 26 November 1991 had initiated a move to withdraw the CBI case lodged by the Vigilance Officer on 24th October, 1991 relating to Power Finance Corporation's claim on certain outstanding BRs. The initial move of Shri Margabanthu was unsuccessful due to the reservations expressed by the Executive Director on the file. The attempt was renewed again on 21st of December, 1991, which led to the withdrawl of the case. The Committee, however, noted that the proposal was not signed by the General Manager, Vigilance and also it was not referred to the Executive Director on the plea that they were away from the station for a long time.

11.28 In fact, when the matter was put up to the former CMD by the Assistant General Manager Vigilance, he had pleaded that the relations of the brokers with the bank will be spoiled, "who are doing a good work in getting through in the call money market" if the case against Shri Deosthali was not withdrawn. Evidently, the plea taken by the AGM, Vigilance was not tenable particularly [[as the brokers are debarred from call money operations. When this was brought to his notice, during evidence, Shri Margabanthu admitted the lapse. In the above case, it was also observed that the internal investigation report of the Bank in the matter was sought by the CBI. This was not furnished by the AGM, Vigilance until the matter was taken up by the present CMD. The AGM, Vigilance was asked only to furnish an explanation for not providing the report. Presumably as punishment, he was later shifted and given a different assignment.

Stanchart/Canfund/Canfina and BOK/MCB

11.29 As pointed out elsewhere, the total exposure against BRs/SGL transfer forms issued by BOK and MCB Ltd. carried by Stanchart (Rs. 931.84 crores), CMF (Rs. 102.97 crores) and Canfina (Rs. 438.66 crores) is Rs. 1473.47 crores.

11.30 Stanchart made certain payments by cheques in favour of BOK and MCB for which BRs/SGLs were issued by BOK and MCB without any factual backing of securities. It is seen from a preliminary examination of about 3600 vouchers, in the account of Hiten Dalal, in Andhra Bank, that payments were made to Bhupen Dalal, Excel Co., Dhanraj Mills, B.S. Gandhi, C. Machertich & Co., Stewart & Co., N.K. Aggarwala, Motishah etc. According to evidence available it appears that amounts have been paid by Hiten Dalal to certain officials of Canara Bank and their family members as also to the wife of the complainant, Shri P.S. Nat. These are being enquired into by CBI. The CBI has stated that the payment made by Stanchart to the BOK were credited to the account of ADN.

Canara Bank and its Subsidiaries

11.31 During evidence it was stated by the representatives of Canara Bank and its subsidiaries that 'Stringent action is being taken against officials found responsible for lapses at various levels after investigation by the CVO of the Bank. Five officials including the

Managing Director of Canfina have been suspended against whom departmental enquiry has also been initiated. Departmental enquiries are being conducted on a time bound basis. FIRs have also been filed against persons involved in irregularities including brokers.

11.32 To a query of the Committee regarding departmental actions against officers involved in irregularities the representatives of the Bank submitted that "Canfund and Canfina put together comes to 13 persons out of which seven have been suspended and the rest are facing departmental enquiries". These seven persons include the Managing director and the Executive Director.

11.33 In one instance Shri Hiten Dalal owed Canfina a little over Rs. 25 crores on account of Ready forward transactions reversals. Towards the clearance of this liability he offered a Cancigo security valued at Rs. 33 crores, clearly not an example of "arms length". The differential amount payable on Cancigo amount was approximately Rs. 8 crores and this was remitted by the funds department at Bangalore on 11.2.92 through the Bombay Office. The decision to purchase and remit the difference was taken by the dealer Shri M.K. Ashok Kumar and Shri S. Mohan of the Funds Department. While in case of Shri Ashok Kumar a case is pending with CBI, as far as the others are concerned the CVO is still only investigating.

11.34 In another case the Chief dealer of Canfina, Shri Ashok Kumar entered in transactions with BOK which ultimately resulted in a loss of more than Rs. 43 crores to Canfina. The Bank could punish only by placing him under suspension, and filing a FIR with the CBI.

11.35 In the case of Canfund's two transactions with BOK on 27.5.91 amount to Rs. 102.97 crores, Shri Anil M. Narichania, Assistant General Manager was, as punishment, asked to go on leave and then later w.e.f. 1 Jun'92 suspended. The General Manager concerned of the CANFUND was also only suspended on being found guilty.

11.36 The Committee have extensively dealt with the role played by the BOK and the MCB in the scam and the *modus operandi* elsewhere in the report. They have also discussed about the role of officers/ex-Vice President of the MCB. Shri C.R. Kanade, Ex-Chairman, BOK deposed before the Committee that Shri C.S. Raje, Manager, Fort Bombay Branch was responsible for committing the irregularities, under the influence of ADN. In his submission, Shri Kanade also said: "the irregularities of large scale outstanding BR came to my knowledge only on 18.5.1992". Shri Raje in his evidence admitted that he had been acting under the instructions of Shri Narottam who in his capacity as Director of the Bank gave instructions. Curiously enough, he continued to do so even after Shri Narottam had retired as Director in December, 1991. However, according to Shri Raje, he had been consulting Shri Kanade regularly before acting and that Shri Kanade had told him to act as per the instruction of Shri Narottam. The contention of Shri Kanade that he had come to know about the irregularities on 18 May, 1992 only is difficult to accept as the RBI scrutinies conducted in June, 1991 and February 1992 had clearly pointed out irregularities. Shri Kanade had also himself recorded the receipt of the RBI warning letter, addressed to him, on 30.3.1992.

Andhra Bank Financial Services Ltd./Fairgrowth Financial Services Ltd.

11.37 Investigations reveal that the units certificates lodged by FFSL were forged, the original numbers of units and the names of the holders having been tampered with. According to investigations out of a total of securities worth Rs. 211.12 crores given to ABFSL by FFSL as collateral for monies borrowed by the latter securities worth Rs. 206.11 crores are forged. For committing forgeries and for accepting forgeries as collateral no one has been punished, yet. As the irregularities have occurred mostly at the Fort Branch, Bombay and

essentially related to call money operations, security transactions and dealings with Banker's cheque receivable account, Shri Sundara Babu, MD, ABFSL, was as punishment shifted to another department. The Director ABFSL, Shri Srinivasa Rao, conveniently resigned whereafter no action was taken. In this matter no vigilance action was contemplated initially on the plea that there was no evidence of their involvement in the transactions between ABFSL and FFSL. This was in itself so scandalous that subsequently Shri Sundara Babu had to be asked to proceed on leave, another example of treating leisure not actually as reward but as a punishment.

11.38 The officers of the Bombay Branch have been treated somewhat more harshly, they have been suspended by the Bank. Two of them Shri Dhan Kumar and Shri S.P. Kamath had borrowed and lent large sums of money without any permission of central office and of course, in violation of the Bank's guidelines : suspension was the salutary punishing. Another, Shri Srinivasa Rao, took long medical leave. This was such an obvious ruse that he had to be suspended, but not until 5 Nov. 1992. On 25 Nov'92, however, the court ruled that as other Directors are equally responsible why this selectivity. It was pointed out by the Court that his role as G.M. overseeing ABFSL operations had not been questioned'. Shri Srinivasa Rao, when last reports came in was free of suspension. Not so the Chief Member of the Fort Branch, who has actually been asked for an explanation. It is not known how he has responded.

11.39 In one instance the Funds Manager at Bombay Branch of Andhra Bank was found responsible for giving clean accommodation to Shri Hiten Dalal of Rs. 140 crores only. This was conveniently not reported to the Central Office. The amount involved was obtained as call money but debited to the broker's account at the local branch. This was pointed out in the bank's internal inspection report and later the officer concerned was suspended on the recommendation of the Vigilance Officer. This is perhaps the lone example of "action", even if it be suspension.

11.40 At the instance of the Committee, the Ministry of Finance have furnished a consolidated list indicating the latest position regarding departmental action initiated/ taken against officers/staff in Banks/institutions for their involvement in irregularities committed in the securities transactions. (List of officials with designation shown as Appendix XXI). It was observed that in a vast majority of cases, the action initiated so far was confined either to "explanations called for", or "explanation received, being examined". In certain other cases, the officials were stated to have been "transferred" and in a few others officials were "suspended". There are also institutions were departmental proceedings are yet to be initiated. This is clearly indicative of the lethargic and lackadaisical approach of the banks/institutions. The Committee cannot but express their strong displeasure over the tardy progress in the departmental proceedings. There is no evidence to suggest that there has been vigorous follow-up of the matter in the Ministry of Finance either. They desire that the Ministry of Finance should review the action taken departmentally by banks/institutions with a view to ensuring that the guilty officials are punished adequately without any further loss of time. Parliament should be informed of the conclusive departmental action taken against officers including top management and staff concerned for their involvement in the irregularities committed in the securities transactions, within a period of six months.

11.41 The Committee desire that the CBI should also pursue the cases lodged in all their ramifications to their logical conclusions in order to ensure that the guilty are punished.

CHAPTER-XII

BROKERS

12.1 The role of a broker in the money market transactions is mainly to act as an intermediary for bringing the seller and buyer together. There are a large number of banks and financial institutions in the money market seeking to lend their surplus funds and to borrow when in need. Similarly, in order to maintain SLR in the most economical manner, banks are required to buy, sell and switch Government securities. This exercise calls for skill and expertise in money/securities management. The main job of the brokers is to match the supply and demand thus enabling banks, etc. to obtain maximum beneficial terms. Serious irregularities were, however, noticed in the functioning of the brokers during the recent securities scam. These have been discussed in the relevant Chapters. Some important aspects are high-lighted in this Chapter.

Empanelment

12.2 The RBI has got its own panel of brokers and has fixed certain criteria for their inclusion in the approved list of brokers. It has, however, not fixed any norms for selection/empanelment of brokers by the banks. Action was left to the banks, to be taken as per their best commercial judgement. It was noticed that the banks did not have any proper policy for the selection of the brokers and providing business to them. While certain banks had formed a panel of brokers for their securities transactions other did not have any such system. Even where the banks had panels the system of selection was generally vague and undefined. Moreover, business was also given to brokers who did not figure in the panel without ascertaining their credit worthiness. For example, banks/institutions like the SBI, UCO Bank, SBI Caps, Vijaya Bank, etc. did not have any system for empanelment of brokers. The Allahabad Bank which had its own panel of brokers had also entered into major sale transactions with a broker who did not figure in its approved list of brokers without even ascertaining the financial standing of the company. The SBI claimed that it had been dealing mostly with the brokers on the approved list of the RBI, but the main broker (HSM) through whom they had conducted bulk of the business (more than 30%) in 1991-1992 did not figure in the RBI panel.

12.3 Even new brokers easily got empanelled on several banks. For instance, Shri N.K. Aggarwala who resigned his job in ANZ Grindlays Bank in March, 1989 got himself empanelled on the approved list of brokers in 16 banks including RBI. When asked during evidence as to how he became a broker of RBI, Shri Aggarwala stated:

> "We applied to RBI. They have a particular format whereby we gave in the information that they required about us and we submitted the format to RBI. There was no interview and no other information was called. We received the letter by post."

12.4 Similarly, when questioned about his becoming a broker of SBI in 1989 and the procedure followed in this regard he replied:

> "There was no particular application that was required by the SBI. I just approached them verbally. They said they would have no problem in dealing with me. The policy was that they would deal with anybody who gave them the good deal. I did not make any formal application to the SBI."

12.5 What Shri Aggarwala stated is too facile to be accepted. There is obviously more to it than meets the eye. The Committee recommend that the whole system of empanelment of brokers by banks specially the public sector banks needs to be examined in detail.

Disproportionate business to selected brokers

12.6 According to Janakiraman Committee Report about 58% of the transactions during April, 1991 to May, 1992 of the value of Rs. 7,43,604 crores were conducted by the banks/ institutions through the Brokers. A statement showing broker-wise analysis of the transactions during 1 April, 1991 to 23 May, 1992 is shown as Appendix XIX. It will be seen therefrom that 50% of the transactions conducted through brokers were undertaken by only half-a-dozen *viz.*, HPD, HSM Somayajulu & Co., Batliwala & Karani, NKA and VBD & Associates.

12.7 There were no prudential norms/exposure limits fixed for each broker. The banks/ institutions were found to have developed close nexus and diverted disproportionate business to selected brokers. A list showing the names of brokers accounting for more than 20% or more business of securities transactions in Banks/Financial Companies during April 1991 to May 1992 is given in Appendix XXI.

12.8 Illustratively in SBI, HSM along with NKA had more than 50% of the business. In the case of SBI Caps it was found that more than 82% of the business of its Madras Regional Office where irregularities on a large scale took place, was conducted through GRAM/HSM. HSM also had close nexus with NHB, ANZ Grindlays Bank and UCO Bank. HPD had a close nexus with Stanchart and Citibank and through broker ADN with BOK. He also played a major role in the transactions of Andhra Bank and its subsidiary, ABFSL. NKA also had a nexus with Hongkong and Shanghai Banking Corporation Ltd.

12.9 Different reasons have been attributed by banks for allocation of investment transactions only to a few brokers. Managing Director, SBI admitted in evidence that the volume of business transacted through HSM was " ostensibly high". According to SBI, HSM and NKA (who had also accounted for about 20% of the business) were active in the market and their proposals were found attractive. When Shri C.L. Khemani, Deputy Managing Director who was in charge of the Investment Committee at that time was asked about the disproportionate business given by SBI to HSM, his reply was, "whoever gave the best deal to SBI got the business. In security dealings one cannot behave like a ration shop to distribute business." Shri Mahadevan, MD, SBI however, conceded that the corporate office had never enquired whether the deals were competitive.

12.10 The SBI also admitted that they had not fixed any limits for the brokers. However, according to SBI, as the transactions routed through HSM and NKA were on the increase, it was decided by the bank to fix limits for those two brokers in November, 1991. When the Committee called for the relevant details, it was however seen that an abnormally high limit of Rs. 1,000 crores was fixed for deals outstanding at any one time for putting through ready forward deals through HSM. Similar limit was also stated to have been fixed in respect of the broker NKA, but the relevant papers were not traceable in the bank.

12.11 In the case of SBI Caps also, no limit had been formally imposed for the aggregate business to be undertaken through one single broker. In December, 1991, a circular was issued fixing a maximum limit of exposure of Rs. 80 crores to one broker on an experimental basis which was to be followed by fixing of suitable limit for aggregate business. This was, however, not done.

12.12 The Allahabad Bank also had not fixed any limit for the volume of transactions to be put through each broker. So, was the case with various other banks.

12.13 A note furnished by RBI to the Committee indicated that the RBI inspections of several banks had, in fact, on several occasions in the past pointed out the non-existence of panel of brokers in banks, failure to review panels where it existed, disproportionate business to selected brokers, failure to maintain brokerwise records of deals entered into, brokerage paid, according business to brokers who did not figure in the panel and other inadequacies. Such objections had been raised by RBI in respect of Canara Bank (31.12.86), Syndicate Bank (31.12.86), United Bank of India (31.3.90), Punjab & Sind Bank (31.3.89), Punjab National Bank (30.6.88), Bank of Maharashtra (31.3.91), Shanghai Bank (30.6.87, 30.9.88), Central Bank of India (31.3.91), Bank of Madura (30.6.86) and several other banks.

Manipulations to Favour Brokers

Crediting of Cheques to Brokers Accounts

12.14 The scrutiny of securities transactions in a number of banks revealed that some banks were even handing over Account payee cheques drawn in favour of other banks to the brokers who got them credited to their account ostensibly to assist the latter in transferring funds quickly to meet their obligations. As per informal understanding and in the name of market practice the payee-bank used to credit the proceeds to the account of the broker constituent who brought the cheque to it for collection. These practices were in gross violation of the instruction that the accounts of banks with RBI, should be utilised only for genuine interbank transactions and not for transfer of funds to their clients. The total amount diverted to the brokers accounts and the ultimate disposal of funds has not been determined. Some instances are however, given below.

12.15 In respect of investment transactions between PFC and UCO Bank during the period July 1990 May 1991, 16 bankers cheques totalling Rs. 394.23 crores were unauthorisedly issued in favour of ANZ Grindlays which were irregularly credited to the account of HSM.

12.16 The Committee have come across another securities transaction in 1990 between Allahabad Bank and LIC Mutual Fund involving serious irregularities and making available of funds by LIC Mutual Fund to the brokers. According to RBI, they received a complaint dated 1.2.1992 addressed to the Finance Minister from Shri Ashok Nath Verma, MP alleging that BOK was used as a conduit for cornering the shares of Larsen & Toubro Ltd. and Reliance Industries Ltd. through a broker firm M/s. Dhanraj Mills (Pvt.) Ltd. for which finance to the extent of Rs. 50 crores was stated to have been arranged through LIC Mutual Fund. Complaint was also received in this connection from Shri Shantilal Purushottamdas Patel, ex-MP vide his letter dated June, 2, 1992 enclosing copies of his earlier letters dated October 1, and 9, 1990 addressed to the then Finance Minister. Another complaint dated June 17, 1992 from Shri Chimanbhai Mehta, MP was received by RBI. Shri Digvijaya Singh, MP in his representation dated July 23, 1992 to the Prime Minister on the same subject had also desired that Government should investigate the matter through the C&AG, SEBI, BSE, CBI and the Ministry of Finance.

12.17 RBI in a note stated that the matter was investigated by them at BOK, Allahabad Bank and Central Bank of India to examine the transactions in securities of LIC Mutual Fund during June September 1990. On the request of RBI, SEBI also investigated the records of LIC Mutual Fund.

12.18 From the information made available to the Committee, it is seen that large amounts were received by Allahabad Bank through bankers' cheques from the account of LIC Mutual

Fund maintained with Central Bank of India (Churchgate Branch) reportedly representing the cost of purchase of Government securities by the LIC Mutual Fund from Allahabad Bank during June-August 1990. These were then credited to the account of M/s. Dhanraj Mills Pvt. Ltd. (of Shri T.B. Ruia) maintained in Allahabad Bank. The transactions, 10 in all, amounting to a total of about Rs. 174 crores during June-August 1990 were stated to be the Mutual Fund's ready forward transactions with Allahabad Bank undertake through their broker - ADN. The SGL transfer forms given to LIC Mutual Fund by the broker were, in fact, stated to have not been issued by Allahabad Bank.

12.19 RBI is of the view that Allahabad Bank appeared as a fictitious counter party in the transactions of initial purchase and subsequent resale of securities by LIC Mutual Fund through ADN/Dhanraj Mills (Pvt.) Ltd. and the funds represented by the banker's cheques of Central Bank of India on account of LIC Mutual Fund have been used by the broker(s) during the interregnum. The CBI has registered a case on the subject on 30.3.1993 against ADN broker, unknown officials of LIC Mutual Fund, Allahabad Bank, Dhanraj Mills (Pvt.) Ltd. and Others.

12.20 Similarly, during the period 1991-92, SBI had issued RBI cheques in favour of NHB and had received from NHB, RBI cheques in favour of SBI at the instance of the broker HSM. These debits/credits were accounted through the current account of HSM, maintained at the Main Branch, Bombay. NHB made claims for different amounts during May, 1992 for certain transactions for which 'Account Payee' cheques were issued by SBI but which were not completed. The cheques were issued ostensibly for the purchase of Units, Treasury Bills and other securities by NHB from SBI. In fact, these transactions were stated to have been never entered into by SBI.

12.21 In the meantime, RBI *vide* their letter dated 26.5.92, expressed the view that SBI would be liable to repay the amount aggregating to Rs. 707.56 crores to NHB. RBI stated that they trusted that SBI will meet its liability without any further delay. They also directed SBI to make adequate provisions to meet such liabilities. SBI vide their letter dated 10.6.92 denied their liability in respect of the claim made by NHB on 3.6.92. In their letter dated 29.5.92, to RBI,SBI contested the claim of NHB on legal considerations and stated that they were not constrained to make the payments as suggested by RBI. On 10.6.92, RBI replied to SBI stating that they were unable to agree to the SBI stand and asked SBI to account to NHB for the amounts.

12.22 The matter was considered by the Central Board of SBI at their meeting held on 11.6.1992. The Board resolved that in compliance with the direction of the RBI, payment not exceeding Rs. 707.56 crores be made to NHB on the clear understanding that payment is made under protest and without prejudice to SBI's rights and remedies against NHB or any other person/persons through legal action or otherwise and on the understanding that when the above payment is made, it shall not mean that SBI accepted the liability to NHB and that the same shall not prejudice the rights of the SBI to proceed against NHB and or any other person/persons. On 13.6.92 a cheque for Rs. 707.56 crores was issued by SBI to NHB. SBI debited the same to the current account of HSM maintained in their Bombay Main Branch.

12.23 Similarly, the dispute between NHB and ANZ Grindlays Bank is yet another instance arising out of credit of interbank cheques to brokers account. NHB made a claim of Rs. 520.70 crores (subsequently reduced to Rs. 506 crores) on ANZ Grindlays Bank *vide* their letter dated 12 May, 1992, their contention being that the bankers cheques issued by NHB favouring ANZ Bank as a consideration for certain transactions were wrongly credited by the bank to the account of HSM without any written instruction from NHB in this regard. The matter was

a subject of protracted correspondence between the bank and NHB. Finally, on 26 May, 1992, RBI addressed a communication to the Chief Executive of Grindlays Bank intimating that it was not in order for the bank to have credited the proceeds of the cheques issued by NHB to the account of HSM in the absence of any such instructions. In the light of the above, the RBI maintained that the bank was liable to repay the amount claimed by NHB. Eventually, in consonance with the direction issued by the RBI, ANZ Grindlays Bank made a payment of Rs. 506 crores to NHB 'without prejudice'. As of date the matter has been referred to Arbitration for adjudication.

Routing of Transactions

12.24 Many brokers *e.g.* HSM, HPD, ADN, Excel & Co., NKA etc. used some of the banks as 'routing' banks which carried large volume of securities transactions for them. Thus Andhra Bank, UCO Bank, BOK, Bank of Madura and ABFSL carried transactions of the value of over Rs. 77,000 crores for brokers and others during April, 1991 to May, 1992. These banks, thus, provided special privilege to a select few brokers by lending their names to the transactions of these brokers totally disproportionate to the income derived and exposed themselves to great risk by irregularly issuing their own BR or SGL transfer forms against BR received or to be received in their favour.

12.25 The operations in the current account of ADN with BOK indicated huge debits and credits. A probe into the transactions conducted by the RBI revealed that this account was used as conduit for diversion of funds in the guise of securities transactions by some of the brokers. Most of the debits and credits in the account represented receipt and payment of funds on behalf of HPD. Funds raised by ADN through BR issued by BOK (and outstanding on date) were reported to have been used to the extent of Rs. 559 crores to fund HPD and to the extent of Rs. 74 crores to fund other brokers.

12.26 Similarly, in the case of MCB, all cheques/payorders received by the bank against its own BR account were credited to the accounts of the Dhanraj Mills Pvt. Ltd. and Excel & Co. In the case of Andhra Bank also certain cheques drawn on the bank had been credited to the account of HPD. It is reported that the analysis of HPD' account with Andhra Bank on the basis of verification made at six banks and subsidiaries has shown that over Rs. 433 crores had been used for purchase of shares, debentures, Units of Mutual Funds and approximately Rs. 408 crores had been used to fund losses of banks in securities transactions.

Netting

12.27 Another unhealthy accounting practice observed by the Committee was the practice of netting to camouflage the true nature of various transactions. Thus if the bank had put through several purchases/sales of different securities during the day the net position was only reflected in the account. This system conceals the details of various transactions, the loss, if any, incurred in individual deals and reasons therefor. In short it prevented a scrutiny of the judiciousness and genuineness of the deals.

Single point clearance

12.28 In the case of SBI, it was noticed that HSM had been unauthorisedly given the facility of collection and credit of the Bankers cheques by SBI as per his instructions. The Bombay Main Branch of SBI acting as the agent of SBI Caps had debited SBI Caps account and unauthorisedly credited funds to the account of HSM instead of making payments to named banks/institutions. Cheques drawn on UCO Bank had been credited to the current account of the same broker.

12.29 The Committee noticed in this connection that HSM had requested the Bombay Main Branch twice by his letter dated 19.8.91 and 10.1.92 for acceptance of bankers cheques from banks/organisations brought by him or his representative and issuance of bankers cheques thereagainst. In fact, the broker wanted that the facility of "single point clearance" whereby the activities of issuance and acceptance of bankers cheques in their account may be conducted through the Securities Division of the SBI Main Branch Bombay instead of the Personal Banking Division in the same branch where he had the account. This facility had enabled HSM to put through his transactions through the Securities Division itself and also to get bankers cheques in favour of SBI credited to his account and issue of cheques against the credits. The SBI in a note furnished to the Committee stated that the letter dated 19.8.1991 was not traceable but the letter dated 10.1.1992 did make a reference of the same. The Committee, however, obtained a copy of the letter dated 19.8.91 from HSM. In this letter HSM while requesting for the facility of obtaining bankers cheques against presentation of bankers cheques in bank's favour argued that there would be no outlay of any funds by the bank. On the contrary a good amount of sum will be left in current account for the bank to enjoy the float.

12.30 In his letter dated 10.1.92, the broker repeated his request and stated:

> "to facilitate a single point clearance, we have to request you to let the activities of issuance and acceptance of Banker's Cheques be conducted by the Securities Division. This will facilitate us to meet the deadlines of inter-bank clearing timings."

12.31 Shri M.M. Sharma, Deputy General Manager, SBI, Bombay Main Branch informed the Committee that the letter dated 10.1.1992 in respect of the current account of HSM was referred to him by Shri A.D. Padhye, Manager, Personal Banking Division. The stand taken by him (Shri Sharma) was that Bank cannot approve the recommendations on the letter unless sufficient deposits and adequate security was made available. There is however, no record to substantiate the contention of the DGM except the letter written by him on 10.6.1992 to Shri G. Kathuria, CGM, i.e. after the scam broke out.

12.32 Commenting on the manner in which the issue was dealt with by the Bombay Main Branch, SBI in a note stated:

> "The Bombay Main Branch did not look at these requests in depth and thus overlooked the danger signals in the letter. Instead, the Dy. General Manager of Bombay Main Branch took a view that the Bank did not specifically approve of the request made in the letter. The matter was not referred by Bombay Main Branch to their Controlling Authorities i.e. Bombay Local Head Office. The investigations have revealed that HSM was, however, enjoying the facility even prior to the date of his request and continued to do as no internal checks were carried out in Bombay Main Branch even at this stage."

12.33 In his evidence, Shri V. Mahadevan, MD, SBI stated that the facility was not authorised by the Head Office. In another note, SBI further stated as follows:

> "At no point of time, the Desk Officer or his immediate superiors referred the matter to Central Office for approval of such facilities. Central Office was not aware of this position till investigations which commenced in 2nd week of April revealed irregularities."

12.34 From the facts stated in the foregoing paragraphs it is sufficiently clear that none of the officials concerned of SBI, Bombay Main Branch had considered the impact of the request of the broker and the irregular practice continued.

Payment of brokerage

12.35 Even though there were specific instructions that brokerage paid should be segregated and accounted for separately, yet this has not been implemented in most cases. The amount of brokerage paid to each broker was also not available. There was also no uniformity in the system of payment of brokerage. Many transactions had been accounted for "net of brokerage" basis for concealing the amount of brokerage. In SBI in respect of transactions put through the broker HSM (who was the principal broker) no brokerage had been paid. In such deals the broker got a cut by way of price differential between the rates quoted by him to the two parties, he did not charge separately his brokerage and the concerned bank officers while approaching their top management for sanction for putting through the deals represent to them that the bank was not paying any brokerage in the deal. To facilitate the above type of deals a third bank acted as conduit of the broker by maintaining the broker's account and collecting and paying on behalf of the broker. There were wide variations between the rates at which transactions were recorded by the purchasing banks and the selling banks and the amounts representing the difference in rates running sometimes into crores of rupees were transferred to the brokers account.

Borrowing from Call Money Market for accommodating Broker-clients.

12.36 In the case of BOK, it was seen that the bank had been accommodating the broker-clients out of the way and meeting their requirements for funds even by borrowing from the call money markets. Although the transactions were camouflaged as purchases and sales of debentures, these, in fact, were nothing but short-term lending to the broker-clients. The bank had invested huge funds in the purchase of debentures of a few public limited companies like Essar Gujarat (Rs. 15 crores), Essar Shipping (Rs. 15 crores) in December, 1991 and Shakti Sugar (Rs. 7 crores) in November/December,1991 from ADN. The debentures were sold back within two-three days again purchased and re-sold thereby making funds available to the brokers. In the first two cases, the purchases were made from the broker on the basis of allotment letters issued by the companies to the brokers. The debentures which do not qualify for SLR purposes, were purchased out of funds raised through borrowing in the call money market.

12.37 Instances were also observed where the funds borrowed in the Call Money Market were credited to the broker-clients account without showing them as borrowings of the bank for the purpose of maintenance of SLR. For example, the call money borrowing register of the bank showed a borrowing of Rs. 20.00 crores from Maharashtra State Co-operative Bank on 30 December, 1991 and the interest of Rs. 1,42,465 accrued thereon. The cheque received from MSCB was credited to the account of ADN and amount paid back on 1 January, 1992 with interest by debit to his account. Similarly, it borrowed Rs. 10.00 crores on 21 May, 1991 from Tamil Mercantile Bank which was credited directly to ADN account and paid back on 23 May, 1991 with interest by debit to his account. Both these borrowing were not shown as call money borrowings to avoid maintenance of SLR thereon.

12.38 Thus the bank was not only going out of the way to help the broker, but it was also violating the statutory requirements regarding maintenance of SLR by not including the borrowings in its Demand and Time Liability.

Accommodation through bill discounting

12.39 Certain banks have made massive funds available to their favoured brokers through irregular discounting of bills. An illustrative case is that of bill discounting done by UCO Bank for an amount of Rs. 50.37 crores. The bills discounted were not for genuine

commercial/trade transactions but for purchase/sale of shares among the Group concerns of HSM. Thus not only the RBI guidelines were contravened, substantial losses to the bank also took place because the shares were purchased at an inflated price and their values depreciated considerably subsequently. This aspect has also been discussed in another chapter.

Overdraft Facility

12.40 The brokers also enjoyed unauthorised overdraft facilities. For instance, during the period April, 1991 to April, 1992 debit balance totalling Rs. 28.6 crores were permitted on 130 occasions in the account of HSM at Bombay Branch of ANZ Grindlays Bank without charging even interest thereon.

12.41 In another innovative facility to HSM the bank permitted him to open 19 overdrafts in his own name and in the name of his associates in Adayar Branch, Madras. The limits sanctioned to these accounts were kept a little less than Rs. 3 lakhs each to avoid operative restrictions for overdraft against shares. Significantly, only HSM's wife's account was issued a cheque book and the entire amount of other 18 accounts was transferred to her account. Similarly, the BOA during the period February, 1991 to December, 1991 allowed on 5 occasions unauthorised credits ranging between Rs. 31.5 lakhs to Rs. 20 crores in the current account of HSM without any specific authorisation for the purpose.

'Badla' Financing

12.42 Brokers managed to get finances from banks for there badla transactions in flagrant violation of RBI guidelines. For instance ANZ Grindlays Bank placed in one known case an amount of Rs. 2 crores with broker NKA for a period of about 5 months and in another a sum of Rs. 24 lakhs was placed under similar arrangements for 40 days.

12.43 During the course of his deposition before the Committee NKA was asked as to how he indulged in these irregular arrangements as besides being a broker, he was also an erstwhile banker. To this he replied:

> "It is not illegal. It may be irregular. We must draw a distinction between RBI regulation and law of the land. RBI regulations are binding upon the banks not on the brokers. If Grindlays Bank approached us to do *badla*, we did *badla* for them. It is under law that they were approaching. I wish that I had not taken that transaction. I did not break any law on doing that *badla* transaction."

12.44 When told *badla* was not permitted by the banks and becoming a party to such deals amounted to getting involved in irregular deals, the witness admitted:

> "To that extent I am guilty."

HPD and M/s Batliwala and Karani also managed to get finances for badla transactions from ANZ Grindlays Bank.

Trading of securities with brokers

12.45 In some cases the banks parted with their own securities for the benefit of broker clients. For instance, in the case of Bank of Madura, it adopted the method of selling its securities directly to broker clients or route the securities to them through the intermediation of another bank at such rates that the broker clients could trade in them on terms more favourable than those on which the bank was trading. In several cases the securities routed

to the broker clients had been acquired by bank under ready forward transactions and the brokers were then allowed to close these transactions with the counter-party/other banks at wide differentials resulting in large accrual of funds to them.

Misuse of official position

12.46 In certain cases the brokers or their associates have managed to get into official positions in smaller banks either rural or co-operative and then misused their official positions for irregular securities transactions to the detriment of the interests of these banks. One such case is of BOK. As detailed in earlier Chapter BCD and ADN who were on the Board of Directors of BOK for long misused their position to enter into irregular securities transactions in the name of the bank. ADN's account with BOK was used as a routing account for transactions of other brokers. Similarly, Shri T.B. Ruia, a shareholder of MCB who had connections with the Vice-Chairman of MCB, Shri K.K. Kapadia was primarily responsible for carrying out massive irregularities in the bank. The misdeeds of these brokers have finally landed the two banks into liquidation affecting a large number of small depositors. In this connection it is worth mentioning that in a Circular of March 1992, RBI stated "Do's and Don'ts" for Directors in private banks on the basis of some reports at that time (Appendix XX).

FERA and other violations

12.47 The involvement of certain brokers in FERA violations, havala business, drug trafficking, income-tax violations etc. has also been noticed. These matters are under examination of various investigative agencies.

12.48 For instance, it is reported that HSM had extensive dealings with Shri Nirajan J. Shah a confirmed *havala* dealer. HSM has been siphoning off substantial amounts of funds abroad and later on bringing them under the Foreign Exchange Immunities Scheme. Three such instances of his relations receiving substantial amounts of remittances from abroad have come to notice till date. The total amount remitted through these three cheques amounts to Rs. 2.73 crores and according to end-use statement furnished by the ANZ Grindlays Bank in this regard all these funds have been utilised for purchasing shares and debentures of various companies.

12.49 Similarly, Shri B.R. Ruia father of Shri T.B. Ruia received a sum of US dollars 400948 from Citibank, New York during 1991 under the Foreign Exchange Immunity Scheme. However, searches by Income Tax authorities of three brokers/*hawala* dealers namely M/s. T. H. Vakil, M/s. V. Krishnakant and M/s. S.N. Shah have revealed that these three parties were given cheques of M/s Dhanraj Mills Private Limited (DMPL), a family concern of Shri Ruia, worth Rs. 6.30 crores between June and December, 1991 by a broker Shri Suresh K. Jajoo with the request that the money may be paid back in cash after deducting their commission of 1% as this amount was required for remittance purposes. Shri Jajoo has admitted to having done such jobs for Shri Ruia because he and his family had taken a loan of Rs. 1.66 crores from M/s. DMPL.

12.50 In case of BCD the Directorate of Enforcement has gathered intelligence about various foreign companies associated with the Dalal family in order to probe the involvement of BCD and his family in large scale violation by way of conversion of Rupee assets into clandestine foreign exchange.

12.51 CBI on the basis of investigations on the role of BCD in siphoning of funds from Indian Banks/Financial Institutions had moved the Special Court, Bombay and obtained

letters rotatory requesting assistance of Courts in UK, Channel Island and Isle of Man for obtaining evidence connected with the illegal transactions.

Influence of brokers on officials in high position

12.52 The Committee came across instances of easy accessibility and influence of brokers on officials in high positions. For instance, HSM was known to Shri S.N. Chaturvedi, an industrialist and through him met Dr. V. Krishnamurthy, former Member, Planning Commission. The latter arranged for HSM to meet the then Finance Secretary briefly on 19.2.1992 for a presentation on "alternate strategy for economic reforms". He also met the then Governor, RBI on 1.4.1992, again with the help of Dr. V. Krishnamurthy. At the meeting, according to the then Governor, HSM "explained to me various aspects of solving the balance of payment problem, which was through invitation of foreign capital to India. At the end of the meeting he told me that he had a problem with the SBI and that the SBI India was not treating him properly." The Governor, RBI spoke about it to the Chairman, SBI and then to the Chief of DBOD. The latter then spoke about it to the MD of SBI also. It is worth mentioning that certain transactions of huge amounts were noticed there-after in the account of HSM with the SBI which was being monitored by the bank and in which there were virtually no transactions for about a fortnight during March, 1992. There were also instances of the brokers wielding influence on the top management of the banks. For instance, the CBI filed a case against Shri V. N. Deosthali of UCO Bank during 1991 for fraudulently crediting to the account of HSM a sum of Rs. 100 crores given by PFC to UCO Bank. This case was got withdrawn by HSM using his influence with Shri Margabanthu, Chairman, UCO Bank.

12.53 In this regard HSM during his evidence before the Committee admitted that he had met Shri Margabanthu in Bombay in connection with this case after he took as CMD of UCO Bank and pleaded with him for the withdrawl of the CBI case. Asked further whether he had told the CMD that if the case continued it will result in the bank losing business he stated "the wordings may be different but it will bring that effect".

12.54 The close links between bank officials and the brokers are also evident from the fact that several senior officials of the banks were employed by the brokers in their companies. For instance, the ex-Chairman of Canara Bank (Shri N.D. Prabhu) and ex-CMD, Punjab National Bank (Shri J.J. Varshney) who was also in the Advisory Committee of NHB were taken in the Board of Directors of HSM Group of companies. Several officers of SBI were also given employment by HSM in his various companies.

12.55 The foregoing paragraphs make it abundantly clear that the banks in general, colluded with certain unscrupulous brokers in a big way. They failed to evolve any clear-cut policy regarding the role of brokers in conducting transactions in securities, including their selection, fixing limit over the quantum of business to be given to each one, nature of transactions and system of reporting etc. Regrettably, this had not been done even after the matter was raised by RBI during the course of inspections conducted in several cases in the past at least since 1986. Equally regrettable is the fact that, RBI, despite having been seized of the problem for long did not take any action nor deem it fit to lay down any guidelines for regulating this aspect of the investment function till June, 1992. No wonder, brokers even totally new to the field were able to exploit the lacunae to their advantage resulting in occurrence of various irregularities on a large scale. The close nexus between certain PSUs, banks, and brokers enabled them to have unauthorised access to funds leading to diversion of huge public funds from the banking sector to the brokers to enable them to channelise these funds into the stock market as also the call money market. It was only in the aftermath of the scam that the RBI issued detailed guidelines on 20.6.1992 regarding the role of brokers. It is only after the matter was highlighted by

the Committee during the course of taking evidences that RBI further tightened the instructions to banks/institutions.

12.56 In the context of large scale diversion of funds to brokers, huge amount of money paid to them as brokerage as well as price differential and various other malpractices indulged in by the brokers in the securities transactions, the Committee considered the question whether it is necessary for banks to use the services of brokers for inter bank securities transactions. The banks need to trade in securities mainly for SLR purposes. The short term requirements of banks in this regard can be met by D.F.H.I. which has developed secondary market in Treasury bills for different maturity periods. The R.B.I. has also announced in April, 1993 the proposal to set up a Securities Trading Corporation of India for the development of a secondary market in Government securities and public sector bonds. Further, the number of players who hold Government Securities to any appreciable extent (RBI, Commercial Banks and LIC reportedly holding 88% of the Government Securities) and who are required to trade in them are a few in number. The Committee, therefore, recommend that Government and RBI should seriously consider whether there is any need for brokers for inter-bank securities transactions which is expensive in terms of commission and offers opportunity for various malpractices and frauds as seen in the securities scam.

CHAPTER-XIII

STOCK EXCHANGES AND SECURITIES AND EXCHANGE BOARD OF INDIA — AN OVERVIEW

A. Stock Exchanges

13.1 Although stock exchanges have been functioning in India for several decades, the BSE being the oldest stock exchange in Asia, substantial growth in the stock markets as such, and in their operations took place only during the decade of the 1980s. The number of recognised stock exchanges in India registered an increase from just 5 in 1957 to 13 in 1984; at present their number stands at 23. Most of them are corporate bodies, three, however, namely those at Bombay, Ahmedabad and Indore are Associations of individuals. In tune with the growth in stock exchanges the capital raised increased from Rs. 87.60 crores in 1960 to Rs. 195.90 crores in 1980. This market capitalisation gained further momentum moving upto Rs. 561.40 crores in 1981-82 and Rs. 2770.20 crores in 1986-87. The next significant spurt was noticed in 1988-89 when the capital raised moved upto Rs. 3500 crores and in the very next year 1989-90 it became Rs. 6473.10 crores. The number of listed companies also grew significantly during 1980s and increased from 2200 to over 6500, the daily turnover on the Indian Stock Markets increasing from Rs. 15 crores in 1979-80, to about Rs. 400 crores at the end of 1991-92. The number of shareholders also rose sharply during this period from about 20 lakhs to over 1.4 crores.

Membership of Stock Exchanges

13.2 A Stock Exchange is a market for dealing in securities. An investor has to employ the services of a registered stock broker — a member of the stock exchange for buying or selling of his securities in the stock market.

Relation between the brokers and his clients are governed by the bye-laws of the Stock Exchange and also by the custom of the trade.

In some of the Stock Exchanges like Bombay, Ahmedabad, etc. brokers for execution of their orders, deal with another class of stock exchange professionals called jobbers. A jobber is a member of a Stock Exchange or his authorised representative who gives two way quotes *i.e.* buy as well as sell quotes. Jobbers known as market makers or specialists ensure liquidity for the shares in which they trade by constantly purchasing and selling them.

The Stock Exchange have adequate powers under their Rules, Bye-laws and Regulations to take disciplinary action against erring members ranging from warnings, censures, fines and suspension to expulsions depending upon the gravity of the offence.

With the increase in the number of stock exchanges, the number of active stock brokers has also increased. Today there are over 3,000 active stock brokers all over the country.

13.3 The amendment to the statute also provides for admission of financial institutions and their subsidiaries and subsidiaries of banks in the public sector to be admitted as members of stock exchanges on their being so recommended by the Government of India.

Governing Boards of Stock Exchanges

13.4 The Governing Boards of Stock Exchanges comprise elected stock brokers Directors and non-elected Directors. The non-elected Directors comprise Government nominees, public Representatives and Executive Director.

Presently 50% of the Directors on the Governing Boards are from the members of the Stock Exchange and 50% from non-members.

The day-to-day administration of Stock Exchanges is entrusted to Executive Directors who are appointed with the prior approval of Government.

Powers of the Governing Board

13.5 The Governing body of a recognised Stock Exchange has wide powers of governance and administration. It has the powers, for example, subject to Government approval, to make, amend and suspend the operation of the Rules, Bye-Laws and Regulations of the Exchange. It also has complete jurisdiction over all members and in practice its powers of management and control are almost absolute.

Powers of the Executive Director

13.6 Under the bye-laws of Stock Exchange, the Executive Director is generally vested with administrative powers to run the day-to-day administration and to enforce the provisions embodied in the Rules, Bye-laws and Regulations of the Exchange and to exercise all such other powers, rights, duties and functions as may be entrusted or delegated to him by the Governing Board from time to time. The Executive Director of the Exchange has been vested by the Governing Board of the Exchange to exercise any of the powers and authorities of the Governing Board of the Exchange except the power to make, add to, vary and rescind the Rules and Bye-laws of the Exchange.

SEBI *vide* their guidelines issued on 20th November, 1992, have asked stock exchanges to *inter alia* amend their Rules/Articles of Association to provide that the appointment/removal of the Executive Director will be with the prior approval of SEBI. The Executive Director has also been directed to implement all the directives/guidelines and orders of the Central Government/SEBI and to implement any provisions of law or rules, bye-laws and regulations of the Exchange.

Deviation from Rules, Bye-laws and Regulations of Stock Exchanges

13.7 Pointing out non-implementation of their own rules and bye-laws by the Stock Exchanges, the Chairman, SEBI during his evidence before the Committee stated:

> "Under regulation 4.2 of the BSE Exchange Regulation related to Form 21, it is prescribed that the broker has to say how much he has transacted as a principal and how much as a broker. I do not think that it is enforced at all. There are examples of lack of administration in stock exchanges. It is non-implementation of their own Regulations."

In the course of evidence it was discovered that some of the funds of the Stock Exchanges themselves were invested irregularly as in some banks.

13.8 The BSE has stated that strict adherence to certain provisions of Rules, Bye-laws and Regulations of Stock Exchange has become impracticable, at least in certain areas like payment of admission fee, entrance fee and annual subscription within one month from the

date of election, deposit of margin money, declaration of a member as defaulter, arbitration award, issue of letters of offer; acceptance of application monies in case of Rights Issues; Further Issues; letters of allotment in Market Lots; Closure of Transfer Books; publication of Half-yearly Results; payment of dividend/interest at par at certain specified centres; closing out of transactions and auction.

Delhi Stock Exchange has also informed that deviations have also been made in most of the above areas while Calcutta Stock Exchange has made deviation in respect of declaration of members as defaulter and the Arbitration Award.

13.9 Pointing out the consequences in regard to declaration of a member as defaulter, BSE has observed:

> "If these Bye-laws are to be strictly enforced in letter, then there would be a continuous spate of defaults in all the Exchanges in the country. Hence these Bye-laws are enforced in spirit taking duly into account the interest of the entire market and investing public at large."

13.10 The Presidents and the Executive Directors of the Stock Exchanges by their own admission before the Committee have said that they are not following Rules, Bye-laws and Regulations as some of them are impracticable.

The Committee, however, note that alongwith routine violations of rules and regulations, some of them are said to be difficult to implement in the present circumstances. In that case they should have been amended to make them administrable. The Committee expect the SEBI to examine these difficulties and to take remedial action.

SEBI should also ensure that Executive Directors function according to their legislative mandate.

Other Irregular Practices in the Stock Exchanges

13.11 Some of the irregular practices noticed in the Stock Market relate to non-payment of margin money, violations of carry forward limits, violations of trading restrictions, over trading by members, kerb trading, reluctance to publish data on the prices and volume of trading in a more open manner, insider trading, ineffective at times merely notional inspection of books of brokers, insufficient and inefficient income tax surveys of stock exchange operations and actually non-existent punitive action on detection of irregularities, ineffective or no redressal of investors grievances, etc.

Violation of trading restrictions is a rule rather than an exception. In the effective imposition of this essential disciplining measure BSE even during the hypervolatile period, for example has failed signally. Inspection by every agency has revealed that virtually every member inspected had violated these trading restrictions. This fact, therefore, that there was rampant violation of them was within the knowledge of Exchange authorities, yet while on the one hand in the hyper-volatile months of 1991-92 various trading restrictions were being imposed, on the other their effectiveness was being completely nullified by allowing concessions relaxing the rigid restrictions, not penalising defaulters, etc.

13.12 The Committee's study of this problem area in BSE reveals a very unsatisfactory state of affairs. The Committee expect the SEBI to pursue this matter with Bombay and with other Stock Exchanges inspected by them with a view to ensuring greater adherence to regulations. It is axiomatic that action be taken against those who contravene the rules, bye-laws and regulations. That this is not done has been stated earlier. The fact that the

Committee have to restate such a self evident principle as that the guilty must be punished, is tellingly conclusive of the extent of irresponsibility in stock exchanges.

Insider Trading

13.13 Given the totality of the banking and securities transactions and inevitable scandal, the volume of monies involved, the close inter-relationship between banks, brokers and industrialists the Committee addressed itself to examining the aspect of insider trading. With a view to establishing a legal frame work for taking action against the practice of insider trading SEBI has now framed regulations on insider trading, which have been approved by the Government, and notified on 19.11.1992. Under the regulations, an Insider has been prohibited from dealing in securities on the basis of any unpublished price-sensitive information communicating such unpublished price sensitive information to any one except, as required, in the ordinary course of business and counselling any person to deal in securities on the basis of unpublished price-sensitive information. Under the regulations, SEBI is vested with the power to investigate any matter having a bearing on the allegation of insider trading and to prohibit the insider from disposing of any of the securities acquired in violation of these regulations. Any person contravening these provisions under the SEBI Act is punishable with imprisonment for a term which may extend to one year or with fine or both.

13.14 The Committee observed that until late in 1992 there existed no legal sanction against insider trading. The Committee have come across some instances raising suspicion about such trading. It was as a result of the Committee's observations during investigations that SEBI was empowered to take necessary action.

Disciplinary action against Erring/ Defaulting Member Brokers

13.15 The Committee have perused the details of disciplinary action taken and penalties imposed against member brokers by the Disciplinary Action Committee of BSE and other Exchanges during the year 1989, 1990, 1991 and 1992. The nature of violations covers the entire gamut of their activities.

As regards action taken during the recent period i.e. since 1989, the Committee have been informed that the Governing Board of BSE has awarded suspensions for certain periods; one each in 1990 and 1991 and on seven members including S/Shri Harshad S. Mehta, ADN, M/s. V.B. Desai and Bhupendra Champak Lal Devidas in May and June, 1992. But these examples of 1992 can hardly be counted as examples of the BSE's punctilious observation of rules. Madras Stock Exchange declared three members as defaulters in 1989, and one in 1992.

13.16 Looking at the small number of cases in which punishment was awarded, it is apparent that the Boards of the Stock Exchanges are reluctant in taking action against their fellow brokers. Not unnaturally, therefore, even when action is taken the penalties imposed are minimal and hardly of any consequence. The Committee are of the view that brokers over-representation on the governing boards is a contributory factor for this malaise.

Reforms in Stock Exchanges

13.17 The Committee note that SEBI has also issued the following guidelines in order to bring reforms in the Stock Exchanges:

(i) to publish data regarding prices and volume of trade in more open manner;

(ii) Member brokers should indicate to the clients the brokerage and the prices separately in the contract note issued to them;

(iii) to inspect the books of brokers;

(iv) amendment to relevant bye-laws and regulations so as to make specific provision for issue of contract note by the broker to the client mandatory;

(v) to enforce margin requirements strictly;

(vi) to review and redress investor grievances promptly;

(vii) to enforce capital adequacy norm for stock exchange brokers to base minimum capital and additional capital related to volume of business; and

(viii) amendment to bye-laws of the stock exchanges to make it necessary for the member brokers to inform the exchange when they reach 80% of trading limits as determined under the capital adequacy norms.

13.18 The Committee hope that the enforcement of the guidelines to bring reforms in the stock exchanges will not just be closely monitored by SEBI, but strictly enforced.

13.19 At present, the Securities Contracts (Regulation) Act, 1956 does not prohibit trading by a member of the stock exchange on his own account. This gives rise to several malpractices. The Committee are of the view that brokers should conduct business as a broker and not take positions. Till such time that SEBI implements the above, they should ensure that brokers maintain separate accounts in respect of their business and that which they conduct on behalf of their clients.

13.20 Apart from other agencies, Income Tax authorities should study in depth taxation aspects of the operation of the broker members of Stock Exchanges.

Redressal of Investors' Grievances

13.21 Investors protection and an efficient and prompt redressal of their grievances is amongst the primary duties of the Stock Exchanges. Complaints from investors relate mainly to non-receipt of refund/allotment of advice, delay and or nonreceipt of securities, shares bought, delay in transfer of such securities, shares, non-receipt of interest, dividend, non-receipt of brokerage and under-writing Commissions, undue delay in settlement of accounts, etc. The Committee have been informed that a Investor Service Cell exists in almost all exchanges to resolve such grievances.

A perusal, however, of the Inspection reports of some of the major Stock Exchanges like Bombay, Calcutta, Delhi and Madras indicates that there are inordinate delays in resolving the complaints of investors. There are very few cases in which disciplinary action has been taken against the erring broker. In the case of BSE Exchange there have been only 2 cases in the past when the Stock Exchange had imposed a one day suspension, each, on one member-broker in February 1990, and an another in November, 1991.

13.22 The Committee feel that an effective system to handle complaints and taking of follow-up action within a specified time frame should be evolved and both the receipt of complaints and the action taken thereon should be regularly reviewed by the Governing Board of Stock Exchanges and deterrent action taken against persistently defaulting members. SEBI should also call for periodic reports from the Stock Exchanges

to monitor action taken by the stock exchanges in investors grievances to discharge its responsibility in this regard.

13.23 Many of the investor's grievances can, however, only be redressed under the relevant provisions of Company Law. The matter was taken up by the Ministry of Finance with the Department of Company Affairs for delegating to SEBI the powers and functions of the Central Government under Section 187D, 209A, 247 as well as empowering an officer of SEBI to take action against companies under the provisions of Sections 56 (3), 59 (1), 63 (1), 68, 73 (2), 73 (2A), 73 (2B), 113 (2), 118 (2), 133 (2), 207 and 209A of the Companies Act, 1956. The Department of Company Affairs on 4.11.1993 has agreed to delegate powers to SEBI in respect of offences under Section 56 (3), 59 (1), 73 (2), 73 (2B), 113 (2) and 207. The Committee believe that with the delegation of these provisions to SEBI there would be better redressal of investors grievances. The Committee further recommend that the machinery under the Companies Act for the compliance of the remaining provisions be so strengthened that the investor's interest are further safeguarded. The Committee are of the view that the small investor is the most neglected entity. Looking into the large number of such investors due protection of their interests assumes great importance.

Carry Forward of Deals

13.24 Trading in securities "for clearing" popularly known as forward trading in securities, was banned by the Government through a Notification dated 27th June, 1969. This ban is still in force. However, in 1983, the Bye-laws of major Stock Exchanges at Bombay, Calcutta, Delhi, Ahmedabad and Madras were amended, by the Government in order to facilitate the performance of contracts with carry forward facilities in respect of "specified shares". Under this system transactions are conducted as hand delivery contracts, for delivery and payment within the stipulated period *i.e.* not more than 14 days following the date of the contract. This, however, may be permitted to be extended by a further period of 14 days each so that the overall period does not exceed 90 days from the date of the contract. The contracts can also be closed during the settlement period by purchase or sale, as the case may be, and only those contracts which are not so closed and which do not result in delivery and payment need to be extended or postponed.

13.25 The practice actually followed varies among different stock exchanges. While in the case of Bombay and Delhi Stock Exchanges, transactions are settled on the basis of delivery and payment every fortnight, with carry over from one settlement period of 14 days to another settlement period of 14 days; in the case of Madras, trading in shares is only on 'cash terms' Further transactions are required to be completed by delivery and payment within 14 days from the date of it, there being no carry over of a transaction from one settlement to another settlement.

13.26 It may be recalled that even as early as 1982, a payment crisis into which the BSE had been thrown had been brought to the notice of the then Government by a Member of Parliament - Shri R.N. Mirdha, presently Chairman, JPC. In his letter dated 22 July, 1982 (Appendix-XXV) he had then pointed out that despite the machinery that existed for a proper functioning of Stock Exchanges, including the representation by Government nominees on the governing boards, it had been ineffective in discharging its responsibilities. Even the mild restraints imposed from time to time under the existing systems were being flouted with impunity. Margins imposed for trading were not enforced, huge transactions were not even recorded and illegal trading outside the stock exchange was regularly reported in newspapers as 'Kerb' rates. In response to the letter, the then Minister of Finance acknowledged vide his letter dated 26 August, 1982 (Appendix-XXVI) that the BSE had

developed payment crisis on account of excessive speculative activities and that efforts would be made to streamline its functioning inclusive of regular inspection of books of accounts and other documents of the parties, and that deterrent disciplinary action against erring members would be taken.

As regards carry forward of transactions, it was indicated that steps to strengthen regulatory capacity of Stock Exchange Authority and to curb speculative activities would be examined. The Minister had also expressed the view that the stock exchange would be regarded as a public institution rather than as a private body of brokers.

13.27 The Committee are actually not the least surprised to find that even after a decade, functioning of Stock Exchanges are still characterised by the very same malpractices that had been prevalent earlier. Indeed, it has been observed by SEBI, in an extra ordinary coincidence of phraseology, "that the BSE Exchange is functioning as a private club of member brokers", and is characterised by "lack of financial management, non-enforcement of market regulations, chaotic market operations and absence of proper marketing control." The evidence before the Committee clearly indicates that the successive Finance Ministers and other supervisory/regulatory authorities have done little in the last decade to bring about the orderliness in the operations in the exchange held out as an objective to the present Chairman of JPC more than ten years ago.

13.28 On a query from the Committee as to the thinking of Government on banning of carry forward of transactions the representative of the Ministry stated:

> "I don't think one can say without consulting SEBI, that one should only allow settlement on the cash basis. Mere banning of carry forward without replacing it by something else would not help. Every body would agree that a certain volume of speculation is essential for the functioning of the Stock market. Speculation is a part of system. We are against unhealthy speculation."

13.29 When asked by the Committee as to what was unhealthy speculation, the representative stated:

> "It is difficult to distinguish healthy speculation and unhealthy speculation."

13.30 Clarifying the position, he further stated as follow:

> "If you have to sustain liquidity in the share market and you do not want carry forward, then you must allow credit to go direct into the share market..... In every country, all banks give credit direct. It would not be appropriate to close the carry forward arrangement, and to insist that no credit be given to the market. This is the point. It is no good saying that we can do this piecemeal."

13.31 The Committee have been informed by the Ministry that trading in specified shares, though speculative in nature, is not necessarily unhealthy as it can have some economic functions and benefits. It provides liquidity in the market and prevents violent fluctuations in share market prices, though these speculative transactions will require to be properly regulated and monitored.

13.32 However the views expressed by SEBI are at variance with those of the Ministry of Finance.

SEBI is currently examining the trading practices prevalent in the Indian Stock Exchanges particularly carry forward of transactions and badla system. SEBI is of the view that the carry

forward/badla transactions should be disallowed and transactions conducted strictly on a delivery basis and trading in future and options be permitted in a separate market. According to SEBI, a notice of 6 months to the Stock Exchanges may be given to evolve the structure and the rules for operating trading in future and options and the relevant section under the Securities Contracts (Regulation) Act be suitably amended. As an intervening measure, SEBI has suggested that badla can be prohibited on the exchange by allowing transactions to be carried forward at making up prices only subject to carry forward margins.

13.33 The Committee would expect the SEBI, in consultation with the Ministry of Finance, to at least now enforce suitable and effective measures.

Meetings - Attendance by Government Nominees

13.34 Under provision of Section 4 of the Securities Contracts (Regulation) Act, 1956, the Central Government can have three nominee Directors on each of the Stock Exchange. It has been noticed that the same nominee director is represented on the Governing Boards of several stock exchanges. Further, from the records of the meetings of the Governing Board of the Stock Exchange, Bombay, it has been noticed that the Government nominees have attended very few meetings during the past five years. Self explanatory details are at Appendix XXVII but some instances have to be cited.

In 1988-89 out of 28 meetings, the Officers of Ministry of Finance attended only 6. In 1989-90 of a total of 36 meetings, Officers of the Ministry of Finance could attend only 3 meetings and in the case of one particular Officer, of the 17 meetings held during his tenure not a single meeting was found as convenient for being attended by him. In 1990-91, the representatives of the Ministry of Finance could attend only 4 meetings out of 65 held. Even at the height of scam in 1991-92, the representative of the Ministry of Finance could attend only 2 meetings out of 40.

13.35 Considering the very low level of attendance leave alone participation and contribution to deliberations the Committee are of the view that such nominees have contributed precious little in arresting the various malpractices in stock exchanges. The Ministry of Finance and the Government directors cannot be absolved of their responsibility in this regard. The Committee hold that the need for having such Government nominees on the Stock Exchanges needs to be reviewed with the constitution and transfer of regulatory power to SEBI.

Inspection of Stock Exchanges

13.36 SEBI was asked to conduct annual inspections of Stock Exchanges by the Ministry of Finance in July, 1991. Accordingly, SEBI commenced their inspections in July, 1991. They have so far conducted inspections of 13 stock exchanges upto February, 1993. Of these, inspections of 7 small exchanges was carried out upto January, 1992, and the remaining 6 stock exchanges namely, Madras, Saurashtra, Calcutta, Hyderabad, Vadodara and Bombay were inspected during February, 1992 to February, 1993. The general short comings noticed in these Stock Exchanges are largely the same as have been commented upon by the Committee earlier.

13.37 The Committee are constrained, however, to note that the BSE, which accounts for more than 2/3rds of the total turnover in securities all over the country, is clearly the market leader in all irregularities noticed in the Stock Exchanges at large. It is also noticed that this Stock Exchange was inspected for the very first time, by a regulatory authority, after more than a century of its coming into existence, and that too only in February, 1993, almost a year after the major banking and securities transactions scam had taken place.

What has been revealed is that irregularities have been committed not just by the member-brokers but also by the members of the Governing Board themselves.

13.38 The Committee are also disturbed to note the following observation from the Inspection Report of BSE:

> "The Stock Exchange, Bombay, is governed by a Board which presently consists of 24 members including an Executive Director. From the list of names of the members on the Board, it is noticed that, the Exchange has virtually been under the administrative control and supervision of three persons during the last five years, viz., Shri G.B.Desai, Shri Hemendra Kothari, and Shri M.R. Mayya (Executive Director). Shri Mayya has been with the Exchange for the last almost 10 years."

13.39 Before according statutory status to SEBI in February, 1992, the Ministry of Finance was the only authority having vast powers under the Securities Contracts (Regulation) Act, 1956. Not once were these powers exercised, not by way of punitive or corrective action, not even by reprimand, caution or calling for explanation. It is only after SEBI was accorded statutory powers an authority really capable of bringing order into Stock Exchanges came into existence.

13.40 The Committee note that irregularities in the Stock Exchanges are not of recent origin, they have been prevalent for quite sometime now. Regrettably, while the major stock exchanges in the country lent themselves to illegal activities abetted by the controlling authorities of the respective Stock Exchanges, the Ministry of Finance failed miserably to exercise its regulatory authority by neglecting the responsibilities entrusted to it. Despite the fact the Government had promised to initiate all necessary action, the Ministry of Finance over the years failed not only to discharge its responsibility but also to act on its own assurances. The Committee expect that the Ministry of Finance and SEBI will now address themselves to this responsibility.

Audit of Accounts of Members of Stock Exchanges

13.41 It is only in January, 1983 that the Central Government directed that accounts of members of stock exchanges be audited by chartered accountants. This audit now made mandatory, covers books of accounts and other documents as specified under Rule 15 of the Securities Contracts (Regulation) Rules, 1957.

13.42 The Committee must observe that it is only after a lapse of 10 years, that the Ministry of Finance have now issued another Circular in March, 1993 on the subject of audit of books of accounts of Members of stock exchanges. This is yet another instance of the Ministry of Finance taking no follow up action on a subject of importance and in an area of its direct responsibility.

It is also pertinent to mention that the BSE have also finally issued a notice in May, 1993 "directing all the concerned members to submit all pending audit reports for the year upto 1991-92 positively by 30th June, 1993 failing which they have been informed, "they would automatically stand suspended from Ist July, 1993." What the other stock exchanges have, done is not known to the Committee. It is however Committee's apprehension that somnolent indifference prevails.

Mutual Funds and SEBI

13.43 In the past seven years Public Sector Banks and Financial Institutions have been permitted to set up Mutual Funds. At present Mutual Funds unit holders in the country have

grown to 20 millions. Very recently, Government have announced their decision to promote the further development of mutual funds by throwing the field open to the private sector and joint sector mutual funds.

13.44 Mutual Funds Guidelines dated 28th June, 1990 required all Mutual Funds to register with SEBI. Government authorised SEBI on July 9, 1991 to inspect records and books of accounts of all Mutual Funds. However, Guidelines necessary to govern the establishment and operation of Mutual Funds were laid down by the Ministry of Finance on the 14th February, 1992.

13.45 The inspection of Mutual Funds by SEBI revealed the following major deficiencies:

i) Sale of units after the closure of schemes;

ii) Loans to brokers thereby exposing investors to avoidable risk;

iii) Poor maintenance of books of accounts and other records;

iv) Deliveries for purchase and sale of securities outstanding for long period; and

v) Investments were made without any records of the basis of the investment decisions.

13.46 SEBI has made the following recommendations to overcome the deficiencies noticed in the working of Mutual Funds:

i) Reconstitution of Board of Trustees and formation of Asset Management Companies;

ii) Submission of monthly progress report on the operations of the existing schemes;

iii) Overhauling of internal control systems of the Mutual Funds; and

iv) Complying with Mutual Funds guidelines before being allowed to launch new schemes.

13.47 The guidelines framed by SEBI under provisions of Section 12 of the SEBI Act, 1992 which has the force of law only came into effect with the notification of the general frame work of guidelines for Mutual Funds on 20 January, 1993.

13.48 It is the expectation of the Committee that the deficiencies identified in the working of Mutual Funds would be set right early.

Inspection of UTI Mutual Fund Operations by SEBI

13.49 The issue of examination of the Mutual Fund operations of UTI by SEBI also came up before the Committee. In this connection, the Committee was informed that no formal procedures for inspection of financial institutions including UTI have been laid down by the Government. While SEBI is inclined to inspect the Mutual Fund activities of UTI, Chairman, UTI holds the view that as UTI is not a Mutual Fund in the classical sense of the term, Further, that as they have been set up under a separate Act of Parliament, they cannot be subjected to inspection by SEBI.

13.50 In his evidence before the Committee, Chairman, SEBI pointed out as follows:

> "While we have the responsibility to regulate the mutual fund industry where a very large number of small investors are involved, 85 per cent of the mutual fund industry is with the UTI. And the Government have not yet authorised

SEBI to look into the activities of the UTI. We hope that they will give us the authority to look into the UTI also which will then enable us to service a very large number of investors, who are investors in the UTI schemes, When that comes, we will be more effective in the mutual fund area."

13.51 In this connection, the Ministry of Finance in their written reply have stated as follows:

"UTI was established under a separate Act of Parliament. UTI functions not only as a Mutual Fund but also as a Financial institution which distinguished it from other Mutual Funds. Because of these special characteristics of UTI, the issue needs to be examined from a legal angle as well as institutional angle,

Due to persistent differences in approaches over the subject between SEBI and UTI, Government has decided to seek the opinion of Law Ministry whether UTI operations are automatically covered by SEBI Act.

If the Law Ministry confirms that UTI is not covered by SEBI Act, it is proposed to constitute a Group with the representatives of UTI and SEBI to suggest appropriate legal provisions in the UTI Act itself to ensure investor protection.

If the Ministry of Law Confirms that SEBI Act covers the operations of UTI, it is proposed to request UTI to provide the Ministry with an action plan including time frame through which UTI will be in position to conform to SEBI Regulations. In case there are any inconsistencies in the UTI Act, UTI will be requested to propose necessary amendment to ensure effective supervision of UTI by SEBI.

The case has already been referred to Law Ministry on 2nd January, 1993."

13.52 UTI had set up in July, 1993 a Committee under the Chairmanship of Shri N. Vaghul, Chairman, ICICI to consider, inter alia, whether UTI should be subjected to SEBI regulations and if so, what practical considerations would need to be built into regulations to reflect UTI's special status. The Committee had submitted its report in September, 1993. The Committee has recommended that UTI may form one or more Asset Management Companies (AMCs) to undertake the functions of management of mutual funds. The Committee has also recommended the transfer of management of closed ended schemes to the proposed Asset Management Company. The Government has written to UTI in October, 1993 to set up an Asset Management Company and to begin with transfer the management of closed ended schemes to the AMC inaccordance SEBI regulations. It has been clearly indicated that SEBI will exercise full regulatory powers over the operation and business of the AMC and the schemes managed by it.

13.53 The Committee have in their study and investigation of Mutual Funds observed serious irregularities in their operations. Some guidelines for regulation of their operations have been recommended by SEBI in January, 1993. The Committee expect that these would be enforced properly.

13.54 The Committee are also in agreement with the views of the Ministry of Finance that the Mutual Fund operations aspect of UTI functioning ought to be brought under the purview of SEBI. If necessary, the UTI Act may be amended accordingly.

13.55 Despite market operations of Rs. 35,000 crores it is relevant, however, to record that no inspection of any kind, has ever been done about the activities and operations of UTI.

To this lacunae, it is the expectation of the Committee, the Ministry of Finance would address itself with despatch.

13.56 SEBI has granted approval to the sponsors of Mutual Funds in the private sector also. The Committee desire that SEBI would not only lay down stringent norms for Mutual Funds but also effectively and closely monitor operations of the Mutual Funds.

B. Securities and Exchange Board of India

13.57 Uptil 1988, the Finance Ministry was responsible for the monitoring of the Stock Markets and their orderly functioning. However, recognising the enormous growth in capital markets, and the need for protection of investors rights, to prevent trading mal-practices, the Government decided to set up a separate board for the regulation and orderly functioning of the stock exchanges and the securities industry. SEBI was thus constituted, in April, 1988, through a government resolution under the overall administrative control of the Ministry of Finance. As per this resolution, SEBI has three functions:

i) to deal with all matters relating to the development and regulations of securities market, investor protection and advise Government on these matters;

ii) prepare comprehensive legislation for regulation and development of securities market; and

iii) Carry out such functions as may be delegated by the Central Government for the development and regulation of securities market.

13.58 Immediately after its constitution in July 1991, SEBI was entrusted with the inspection of stock exchanges and of the inspection of mutual funds.

Irregularities noticed in these were reported to the Government. Apart from this SEBI inspected the SBI Mutual Fund, the CMF and BOI Mutual Fund. Here too irregularities noticed were conveyed to the Government. SEBI had also recommended that CMF should be allowed to launch new schemes only after the defects noticed were corrected. In October 1991 SEBI also brought out an abridged prospectus, suitably re-designing the format for providing all information required from companies and their promoters. Apart from the above SEBI also reformed tardy compliance of statutory provision of Section 73 of the Companies Act, 1956 relating to payment of interest for delay in refund of moneys. It introduced a scheme of 'Stock Invest', in March, 1992, providing for a specific mode of payment whereby the issuer company can encash the instrument only after the allotment has been finalised.

13.59 SEBI was accorded statutory status through an Ordinance promulgated on 30 January 1992. The SEBI Board was constituted on 21 February, 1992. With the enactment of the SEBI Act 1992 on 4 April, 1992, SEBI became a statutory body.

13.60 To protect the investor's interest SEBI entertained investors complaints against companies, brokers and other intermediaries from August 1990. It also issued press releases to enhance general awareness. The number of investor complaints received is around 3.36 lakhs during the period August, 1990 to 15 Oct. 1992. SEBI undertakes a periodical follow up of complaints with major defaulting companies. During the year 1991-92 out of the 1.1 lakh complaints received SEBI was able to resolve 35.974. SEBI has also introduced a system of registering representatives and active investors/shareholders associations to strengthen the interests of investors. Investor guidelines series and publications like Investor Grievances — Rights and Remedies were also being brought out to ensure proper and

adequate disclosures with effect from coming out with new issues. SEBI has taken up the job of authorisation and registration of merchant bankers since April, 1990.

Delay in according statutory status to SEBI

13.61 As regards delay in according statutory status, deposing before the Committee, the representative of the Ministry of Finance stated:

> "Board was constituted initially as a non-statutory body in 1988. It was intended to give SEBI statutory power and to shift the functions of the Controller of Capital Issues to SEBI in order to have one regulatory authority responsible for the healthy development of the capital markets. The government gave top priority to implementing the decision and SEBI was given a statutory basis by the Ordinance promulgated on 30th January, 1992."

13.62 The Committee regret to note that the Ministry of Finance took $3^1/_2$ years to give the needed statutory backing to SEBI. The Ministry have attributed this inordinate delay to "consultations with the Department of Company Affairs", "Ministry of Law" and with SEBI itself, in view of the complex issues involved. The Committee are not impressed by this feeble explanation. It is unable to appreciate the time lags of Ministry of Finance between decision and implementation.

13.63 The Committee are informed that consequent upon becoming statutory body in February, 1992, SEBI framed rules and regulations under Section 12 of the SEBI Act, 1992 for stock brokers and various other financial intermediaries laying down norms and guidelines for their operations in the capital market and forwarded them to the Government for approval and notifications. While some of them have since been approved and notified. The following are pending finalisation since October, 1992:

1. Rules and Regulations for Bankers to an Issue.
2. Regulations on Substantial Acquisition of Shares and Takeovers.
3. Rules and Regulations for Debenture Trustee.
4. General Regulations.
5. Rules and Regulations for Investment Adviser.

13.64 The Committee expect that these will be finalised and notified expeditiously.

CHAPTER-XIV

PSUs — CONTRIBUTIONS TO SCAM

14.1 Public Sector Undertakings (PSUs) have had and continue to have a role to play in our economy especially in some of the core sectors. While some of the PSUs came into existence through special enactments, a large number of them were incorporated as companies under the Companies Act with the entire or majority of their shares being held by Government or Government bodies. PSUs by their very nature of operations have large financial outlays and obtain their resources through various means. The funds which were temporarily surplus before their utilisation by PSUs for the intended purposes used to be kept in deposit with banks. With the introduction of PMS and other similar schemes by banks and NBFCs which offered high return PSUs were attracted towards these schemes and invested huge amounts therein. The Committee, therefore, examined the *modus-operandi* of investments made by the PSUs to satisfy themselves on their prudence, propriety and legality and whether these conformed to the guidelines issued by the Government. Such temporary surplus funds of PSUs are monies meant for a different purpose, temporarily floating and requiring safe lodgement. It is in this background that as far back as 1964 the Department of Economic Affairs had issued a circular (Appendix-XXVIII) which *inter-alia* mentioned:

> "Corporations and Companies which are wholly owned by Government or in which Government own more than fifty per cent of the capital should ordinarily maintain their accounts with the State Bank of India or any of its subsidiaries. Any surplus funds which are required to be invested with banks" should also be invested in these banks."

14.2 This was modified in 1973 (Appendix-XXIX) and again in 1987 consequent upon nationalisation of major banks, the Bureau of Public Enterprises (BPE) permitted PSUs to have banking arrangements with any of the nationalised banks. On 3 January, 1992 DPE issued further guidelines (Appendix-XXX) allowing the PSUs to undertake "normal banking transactions with any banks of their choice including foreign/private sector banks."

14.3 In December, 1987 Government also issued instructions (Appendix-XXXI) to PSUs that they should invest their surplus funds in Public Sector Bonds, Government Treasury Bills or as deposits with Government. In February, 1988 it was clarified that the instructions applied only to funds which were not required for period exceeding six months. The background for issue of this circular was that owing to drought conditions, the Government's financial position had weakened and to strengthen the budgetary position of the Government, PSUs were advised to invest their surplus funds in the public sector bonds and treasury bills.

Investment made by PSUs

14.4 To examine investments made by PSUs, the Committee called for details of volume and nature of investments and operations of some select PSUs. An exhaustive and detailed examination and analysis of all PSUs investments was not practicable for the Committee. They also took evidence of the representatives of DPE and eight nodal Ministries/ Departments *viz*. Ministries of Petroleum and Natural Gas, Railways, Commerce, Industry, Tourism and Civil Aviation, Power and Departments of Fertilizers and Atomic Energy and select PSUs under them. The examination by the Committee has revealed that a large number of PSUs had placed funds with banks and financial institutions in PMS and as "short term

deposits, inter-corporate deposits" etc. From the information furnished to the Committee in respect of 96 PSUs it was noticed that the total funds provided by these PSUs during 1991-92 and 1992-93 (upto December, 1992) alone through various modes amounted to Rs. 24666.47 crores and Rs. 10811.53 crores respectively as given in Appendix-XXXII.

14.5 The examination of various PSUs by the Committee revealed serious irregularities in their investment transactions. For instance as against the Government instructions to make investments only in Government securities, public sector bonds treasury bills, PSUs through banks/finance companies in the guise of PMS entered into ready forward deals without taking physical possession of securities or at least the details thereof with banks/ financial companies at market driven rates. In many cases, the funds of PSUs have been diverted to brokers and used for purchase of shares of private sector companies in violation of Government guidelines. PSUs had also entered into such transactions with foreign banks prior to January, 1992 i.e. before they were permitted to have even normal banking transactions with them.

Monitoring by DPE

14.6 BPE was set up in 1965 as a part of Ministry of Finance. In 1985 it was brought under the administrative control of Ministry of Industry. In May, 1990, BPE became a full fledged Department known as DPE.

14.7 The role and functions of the DPE as redefined on 14 April, 1978, *inter-alia*, included:

(a) To compile the annual financial and physical performance of each central public sector undertaking to submit to the Government a combined annual performance appraisal of the public enterprises.

(b) To undertake jointly with the administrative Ministries continuous in-depth studies of individual public enterprises as also groups of enterprises so as to make useful contribution towards the better functioning of public enterprises.

14.8 Though continuous in-depth study of public enterprises for their better functioning were the stated objectives of DPE, the Committee noted that no clear and specific instructions had been issued by DPE to PSUs regarding investment of surplus funds. The Committee enquired from DPE as to whether any instructions were issued by it to PSUs pertaining to investment of surplus funds. In reply DPE surprisingly stated that:

> "DPE was not concerned with investment/deployment of funds by PSUs. Hence no instruction was issued by the Department either to the administrative Ministries or to the PSUs in regard to these subjects."

14.9 The Committee further enquired as to whether DPE had prescribed any system of reporting by the PSUs regarding deployment of funds. The DPE stated that they had never prescribed any format or system of reporting by the PSUs as the DPE was not the concerned authority in the subject matter of investment/deployment of funds by PSUs. The PSUs/ Administrative Ministries also did not interact with the DPE over the subject of utilisation of surplus funds.

14.10 The above statement by DPE is to be seen in the context that it was DPE itself which entertained the representation of Bharat Earth Movers Limited and ANZ Grindlays Bank in August, 1991 to allow the PSUs to deal with foreign banks as well. The representatives of ANZ Grindlays Bank also met Secretary, DPE on 26.8.1991. The DPE examined their proposal and the Secretary, DPE held the view that "in view of the announcement made in regard to the new industrial policy where efficiency has a premium, choice of banks should be left

to the Central Public Sector Enterprises for dealing with". The proposal was sent by DPE to the Ministry of Finance (Department of Economic Affairs) for their consideration which communicated to DPE their decision that "the PSUs can undertake normal banking transaction with any bank of their choice including foreign/private sector banks". Again it was DPE which issued instructions in the matter to all PSUs on 3.1.1992.

14.11 The Committee asked DPE to give the reasons for reviewing the prevailing instructions and issuing of Circular No. DPE/14(19)/90-Fin. dated 3.1.1992 which allowed the undertakings to have normal banking transactions with any bank of their choice including foreign/private sector banks. In reply DPE stated that these instructions were mainly confined to keeping accounts with nationalised banks and raising loans for working capital requirements and these were conveyed to PSUs in accordance with the decision of the Department of Economic Affairs, Banking Division.

14.12 It is strange that while DPE played an active part in permitting PSUs to have banking transactions with foreign banks they did not consider it their duty to monitor them. Asked as to why the DPE was not monitoring the compliance of various Circulars issued by it, Secretary DPE during evidence stated:

> "Our position is clear. We don't interfere in day to day working of PSUs and we have not done it."

14.13 Asked further as to why DPE had issued various Circulars when it did not consider its duty to monitor their implementation. Secretary, DPE further stated:

> "....The point is, it facilitates. We are a part of the Government. Our object is to facilitate."

Monitoring by Ministries

14.14 The Committee noted that the Administrative Ministries were also not reviewing/monitoring the procedure of investment of surplus funds by PSUs under them. During the evidence the Committee asked Secretary, Ministry of Industry to explain as to what type of review/monitoring was done by the Ministry in respect of PSUs under it. In reply, Secretary, Industry stated:

> "As a Ministry, when we monitor the performance of the PSUs with which we are associated, we lay particular emphasis on the profitability of the company and likewise reduction of losses wherever they are being made either in the company as a whole or in certain operations of a particular company which might otherwise not be loss-making. This is one of our primary concerns...."

14.15 As regard the monitoring done by Ministry of Petroleum of PSUs under its Ministry, during evidence Secretary, Petroleum stated:

> "There are two formal ways in which any Ministry is expected to supervise; one is quarterly performance review. Quarterly performance reviews are held by the Secretary concerned meeting of which also includes at times other agencies of the Government including Planning Commission, etc. Now it is more or less confined to the Ministry but at times the Planning Commission also comes in the picture depending on the subject involved. A review is undertaken of specific items which are indicated in the MOU and with that as base they will submit material to the Ministry and the review is undertaken which includes their functional performance as well as financial

performance.... . Second one is the review by Government officers, Joint Secretaries and Directors who are on the Boards of various PSUs."

14.16 It is noted in this connection that the Ministry of Petroleum called a review meeting of all PSUs under its control on 11.5.1990 on the subject of investment of surplus funds. In this meeting Secretary, Ministry of Petroleum and Natural Gas (PNG) *inter-alia* stated:

> "It was to be noted that deposits with other Public Sector Undertakings need not always be presumed to be in best interest of the depositing company. It was necessary to be careful in considering requests from PSUs for funds as investment. On some of the concessions offered by some organisations and banks seeking surplus funds, there have been CBI enquiries and it was necessary for all management boards to be careful in this regard and to monitor the investment decision in these organisations carefully. There was need for great vigilance in this regard and Finance Director should be held personally responsible for regularity of all investment decisions in order to ensure that they were fully above board".

14.17 It was agreed that the Chief Executives of all the PSUs of Oil Companies would review the arrangements in their organisations and make improvements in the arrangements and write to the Secretary (PNG) on the action taken within six weeks. Of a total of 13 companies however, only six sent their written replies in 1990. Others did not and the Ministry also did not bother to pursue their own initiative.

14.18 The Ministry called for further information from all the PSUs in March 1991, August 1991, January 1992, and August 1992 on all these occasions a review/analysis was made by the Ministry.

14.19 It is however seen by the Committee that the entire exercise conducted by the Ministry was perfunctory for long since major irregularities in OIDB, ONGC, OIL, GAIL etc. remained unchecked as discussed in detail later.

14.20 The Committee noted that even after the breaking out of the scam not many Ministries made departmental review to examine the manner of investments made by PSUs under them.

14.21 The Committee note that the PSUs were the single largest source of surplus investible funds around Rs. 36,000 crores between April 1990 and December 1992 only. In the investment of these funds guidelines and instructions were routinely flouted and no norms were observed. Neither DPE nor the Ministries concerned took any steps to ensure the compliance of their guidelines. Even the Ministry of Petroleum and Natural Gas which had made a review of investment of surplus funds by the PSUs under its administrative control in May, 1990, closed its eyes knowing fully well that PSUs were investing with the foreign banks despite the guidelines of DPE that PSUs could have normal banking transactions only with nationalised banks.

14.22 The Committee are of the view that it is the duty and responsibility of Ministries who issue guidelines to ensure their implementation. Further, nodal Ministries who have been entrusted with the overall supervision of the various agencies under it are also expected to monitor the guidelines/instructions issued through them. The Committee feel that both DPE and the Administrative Ministries have failed in their duties and this failure permitted certain individuals to play with the funds of PSUs by irregularly investing them with foreign banks etc. in contravention of all Government guidelines/ decisions.

14.23 The Committee suggest that policy and procedure for investments should be clear cut and transparent. The Committee expect the Administrative Ministries to apply their mind to this question and in consultation with the Ministry of Finance and the DPE lay down a clearly defined investment policy for PSUs.

Sources of Funds

14.24 Serious irregularities were noticed by the Committee in the utilisation of funds generated or obtained by the PSUs from various sources. Sanctity of the purpose for which funds were raised was completely disregarded in several cases. In others, the practices and procedures followed, were a mockery of the guidelines and instructions. Some illustrative cases examined by the Committee explain the position better.

Abuse of Cash Credit Facility

14.25 The Committee noted that many PSUs misused the cash-credit facilities with the banks to pass on the funds to the banks instead of utilising it for their operational expenses, for instance:

(i) Hindustan Petroleum Corporation Ltd. (HPCL) availed of an overdraft (OD) facility of Rs. 35 crore from SBI and instead of utilising the money for working capital requirement made investment of Rs. 30 crores and that too with a foreign Bank (SCB) on 18.5.1991. From a note furnished by the Corporation to the Committee it is noted that representative of the Corporation learnt from the market that Government were planning to freeze the O.D. limits suddenly at the level of its utilisation on a particular day and that in order to circumvent this move the Corporation decided to utilise its O.D. facility to the full.

(ii) To enable BHEL to meet its operational expenses, BHEL was allowed cash credit facility of Rs. 229 crores by a consortium of nationalised banks led by SBI, but it was found that BHEL used moneys from the cash credit account for depositing/ investing with financial companies. In all 23 withdrawals were made for investing with CANFINA (11 deposits), ILFS (11 deposits) and PNB CAPS (one investment) of amounts ranging from Rs. 4 crores to Rs. 105 crores and the yields obtained on these deposits ranged from 20 to 38.5 per cent per annum. In 8 cases the funds were not surplus with the Company but represented moneys drawn from the credit facility available. The directions of the Board permitted only investment/deposit of surplus funds and not moneys from cash credit facility.

14.26 The Cash credit agreement stipulated that any surplus moneys with BHEL can be deposited by it only with the members of the consortium. BHEL violated this condition by making 23 deposits with financial companies which were not members of the consortium. It is questionable what net benefit accrued to the company.

Budgetary Support

14.27 Several PSUs invested their funds, while they continued to receive budgetary support. Total funds received by some of the PSUs for the last 3 years were as given on the following page:

Rs. in Crores

Name of PSU	1990-91	1991-92	1992-93
IBP	-	-	26.39
NPCIL	185.00	130.57	138.05
CONCOR	15.00	14.00	-
ITPO	13.81	16.10	15.00

Their investments during the corresponding period are given below:

Rs. in Crores

Name of PSU	1991-92	1992-93
IBP	20.87	20.71
NPCIL	867.24	178.06
CONCOR	266.46	9.49
ITPO	46.14	34.43

14.28 The Committee regret to note that all the above PSUs instead of utilising the funds for their operational requirements have made huge investments with banks/finance companies. Thus while on the one hand budgetary support was sought from the Ministries on the other, funds were invested thus depriving the PSUs of these funds for considerable periods.

Inter Corporate Loans

14.29 Some PSUs invested moneys as intercorporate loans. In a meeting taken by the then Minister of State for Civil Aviation on 6.2.1992 it was decided to provide to Vayudoot Ltd. Rs. 10 crores each from AI and Indian Airlines to take care of its pressing funds requirements and to liquidate its most urgent liabilities. Vayudoot promptly invested this money in short terms deposits. Certainly not a liquidation of its "most urgent" liability.

External Borrowings

14.30 Some of the companies like State Trading Corporation (STC), Minerals and Metals Trading Corporation (MMTC), Indian Oil Corporation (IOC), ONGC resorted to external borrowings to meet their business operation requirements. Funds which became available as a result of availing foreign currency borrowing, were often lured into PMS and such other questionable activities.

Floating of Bonds

14.31 The Administrative Ministries concerned accord approval for issue of bonds both taxable and non-taxable after clearance of the overall quantum and breakup by the

Department of Economic Affairs which invariably obtained the views of the Planning Commission before giving such clearance. PSUs were earlier also required to obtain the approval for subscription. Total amount of bonds issued both taxable and non-taxable by 19 PSUs were of the order of over Rs. 20,000 crores with interest rates varying from 9% (tax free) to 17.5% (taxable). It was noticed that PSUs floated bonds beyond their actual needs. The authorities concerned never seriously examined the quantum of bonds to be floated and their phasing.

14.32 PFC floated 17% taxable secured redeemable bonds for Rs. 300 crores. These were allotted to Citibank and UCO Bank on private placement basis. Both the banks subscribed to these bonds to the extent of Rs. 150 crores each on 10.2.1992 and 28.3.92. The amount received by sale of bonds were deposited in the PMS with the same banks on the same dates for one year. The Committee are left wondering as to why the bond was allowed to be issued at all in this manner.

14.33 It is pertinent to note that the placement of funds with the banks was at rates, lower than the interest payable on the bonds. Thus the company deposited funds with Citibank and UCO Bank on which yields of 14.25% and 13.50% per annum respectively were agreed upon, resulting in lower return of Rs. 9.40 crores in one year.

14.34 The Controller of Capital issues (CCI) while according consent for issue of bonds had stipulated that at least 20% of the bonds were to be offered to the public over the counter. The Company asked UCO Bank to offer bonds worth Rs. 60 crores over the counter, (40 per cent of the bonds issued to them) but did not ask Citibank to do so. In May, 1992 the Company learnt that UCO Bank had sold all the bonds to Punjab National Bank and thereby the condition of sale of 20% bonds to the public had been violated. This attracts penalty under Section 13 of the Capital Issues (Control) Act, 1947. No one till date has been penalised.

14.35 Similarly IRFC entered into an agreement with CANFINA, by which the sale proceeds of 9 per cent (Tax free) Railway Bonds amounting to Rs. 700 crores sold to CANFINA were invested on 30th November, 1991 by the IRFC with CANFINA for six months at an yield of 11%. Rs. 350 crores more were deposited for one year at the yield of 11 per cent for first six months and 18 per cent for next six months.

14.36 The Nuclear Power Corporation of India Limited (NPCIL) floated 13% taxable bonds worth Rs. 562.18 crores during 1990-91 and placed them back with banks/financial companies as per details given below:

Name of Institution	Amount	Date of investment	Details of schemes	Period	Rate of interest
Canfina	250 crores	23.8.90	Short Term	3 months	13.50%
SBI Caps	100 crores	26.9.90	Short Term	3 months	13.50%
Vijaya Bank	50 crores	3.9.90	P.M.S	12 months	13.25%
Canfina	150 crores	4.4.91	P.M.S	12 months	13.25%

14.37 During 1991-92 also NPCIL, floated 9% tax free bonds worth Rs. 100 crores, 17.0% taxable bonds worth Rs. 300 crores and 17.5% taxable bonds worth Rs. 150 crores. The proceeds of these bonds were invested as per details given on the following page:

Name of Institution	Amount	Date of investment	Details of schemes	Period	Rate of interest
ABFSL (9% Tax free bonds)	25 crores	26.2.90	Short Term	12 months	12.00%
ABFSL (17% Taxable bonds)	25 crores	26.2.90	Short Term	12 months	12.00%
Citibank (9% Tax free bonds)	30 crores	28.2.90	PMS	12 months	12.00%
CANFINA (17% Taxable bonds)	150 crores	31.3.92	Short Term	4-12 months	17.50%

14.38 The Committee noted that NPCIL gave a total discount of Rs. 9.5 crores to ABFSL for subscribing to Rs. 100 crores bonds in February, 1992. Discount of Rs. 6.525 crores was given to Citibank for subscribing to bonds worth Rs. 45 crores in February, 1992. A commission of 3% was given to Canfina for subscribing to bonds of Rs. 200 crores in March, 1992.

14.39 It is further noted that subsidiaries of nationalised banks with whom the funds were placed defaulted in making payments on due dates. The details of some of the defaults are as under:

Name of the PSUs	Name of the Financial Companies who defaulted	Amount Outstandings
NPCIL	Canfina	Rs.256 crores
NPCIL	ABFSL	Rs.110 crores
IRFC	Canfina	Rs.515 crores
OIDB	Canfina	Rs.70.86 crores
MDNL (Mishra Dhatu Nigam Ltd.)	ABFSL	Rs. 4.20 crores

14.40 Efforts have been made by these PSUs to realise the outstandings but without any success so far.

14.41 The purpose of floating of bonds by PSUs to raise resources to meet their operational requirements was completely defeated as the monies realised through floating of bonds were invested with the banks/financial companies. Thus, these funds remained blocked for considerable period. Many companies gave concessions and invested monies

at rates lower than the interest rates of the bonds thereby incurring losses in the process. Their losses were compounded further as some of the subsidiaries of banks did not return the funds of PSUs which became due on maturity. This aspect has been dealt with in another chapter.

Irregularities in Procedure for Investment.

Authorisation for Investment

14.42 The investment policy of PSUs are governed either by the Companies Act, 1956 or special statutes governing PSUs under which they are incorporated or the Memorandum and Articles of Association depending upon the nature of the organisation. It was seen that in many cases the investments were made in contravention of the relevant provisions by PSUs. For example statutes of many statutory corporations expressly prohibited investment of funds without permission of Government. Such permission was never taken. In other cases investments were made much before the grant of requisite permission.

Charter Violation

14.43 In the case of National Airport Authority (NAA) investments are to be made as per the provisions of Section 19(3) and 22 of NAA Act. Section 19(3) states that all moneys standing to the credit of the Authority shall be deposited as may be specified by the Central Government. Section 22 states that the Authority may invest its funds (including Reserve Fund) in the securities of the Centre or in such other manner as may be prescribed.

14.44 In contravention of the above provisions the Authority made investments of its funds during the period 1988-89 to 1992-93 under PMS, Schemes of Mutual Funds etc. without the prior approval of the Board and Government. Total investments made by National Airport Authority during 1988-89, 1989-90 and 1990-91 were as under :

Year	(Rs. in Crores)
1988-89	197.00
1989-90	154.00
1990-91	91.00

14.45 Similarly, AI violated section 12(2) of the Air Corporations Act, 1953 where permission for investment of moneys is required from the Central Government as discussed in detail elsewhere.

14.46 Krishak Bharti Cooperative Limited (KRIBHCO) and Indian Farmers Fertiliser Cooperative Limited (IFFCO) which are Cooperative Societies and governed under Multi-State Cooperative Societies Act, 1984 are required to take permission of Central Registrar of Cooperative Societies before making any investment. It was, however, noted that KRIBHCO did not seek at all the permission of Central Registrar for making investments, IFFCO did approach the Registrar for seeking its approval but made investments to the tune of Rs. 159.05 crores even before getting the permission.

14.47 In the case of KRIBHCO which had taken loan from Government, permission of Government of India was also required for making investments. However, KRIBHCO pending such approval made investments to the tune of Rs. 249.63 crores.

Delegation of Authority

14.48 The Board of Directors of some PSUs have delegated power to CMD/Director (Finance) upto a certain limit to make investments/disinvestments in a year and at one time. It was, however, noted that in some cases excessive powers have been delegated to an individual. For instance, in the case of STC which had a total turnover of Rs. 1500 crores during 1991-92, the Director (Finance) was delegated with powers for investments not exceeding Rs. 700 crores at any point of time.

14.49 In reply to a question by the Committee whether the powers delegated were not excessive, the Secretary, Commerce stated:

> "It is undoubtedly very excessive. This kind of delegation of powers to one individual and that he should be the sole authority to invest and the Board is informed at a later stage is absolutely an excessive delegation of powers."

14.50 When asked as to whether nominee of Ministry of Commerce on the Board of Directors of PSUs were present at the time of delegation of financial powers and if so, whether they raised any objection in this regard, the Secretary, Commerce stated:

> "This has been going on from 1986 onwards. I will check up and let you know. Frankly speaking, it has come to my notice only because of this JPC meeting."

14.51 He further added:

> "I propose to advise, through my Additional Secretary (Finance), that at the next meeting of the Board, all the PSUs under the control of the Ministry of Commerce should thoroughly discuss these powers delegated for investment and see that a proper delegated structure is there — there has to be delegation and there is no doubt about it in my mind and to what extent the powers should be delegated."

14.52 It was also noted that the Chairman of Indian Oil Corporation also had excessive powers to make investments upto Rs. 5000 crores in a year.

Inviting of quotations and their scrutiny

14.53 The Committee noted that different public sector companies were following different procedures of inviting quotations and recording them. For instance:

(i) Companies like Hindustan Petroleum Corporation Limited (HPCL), Indian Oil Corporation (IOC), Bharat Petroleum Corporation Limited (BPCL), Oil India Limited (OIL) were receiving quotation on telephone, recording them and placing funds with banks after obtaining approval of the competent authorities. Oil India Limited had a practice of obtaining confirmatory letter from the banks who quoted the highest rate of return.

(ii) Gas Authority of India Limited (GAIL), Container Corporation of India Limited (CONCOR), AI, Vayudoot, ONGC obtained quotations on telephone but these were not recorded and decision of investment was taken only on the basis of verbal approval of the competent authorities.

(iii) OIDB was inviting quotations invariably in writing, however, glaring irregularities were noted in the system of inviting quotations and processing which has been dealt with separately.

(iv) STC recorded only the best offers received on telephone from the banks and did not record detailed notes indicating rates of quotations received from various other banks and finance companies.

(v) Some of companies like NPCIL and Rashtriya Chemicals and Fertilisers Limited (RCF) had placed funds merely on the basis of requests received from banks without undergoing the proper procedure of calling quotation from other banks, to ensure that the investments were made in the best interest of the company.

14.54 Thus it is noted that most of the deals were struck on phone and no record was maintained to substantiate reasons for the decision taken. The Committee find that inevitably such dubious practices lent themselves to misuse.

14.55 While most of the companies were issuing instructions and getting confirmatory letters periodically from banks/finance companies with regard to investment of funds in many cases instructions to banks were not given at the time of placement of funds. The Committee noted that in the case of PSUs like STC, MMTC, OIL, NPCIL and KRIBHCO, funds were invested without issuing specific instructions to banks/finance companies as to how these funds should be invested by them. Thus the funds of these organisations were exposed to risk by leaving the discretion with banks about the manner of investment of these funds.

14.56 The Committee have to, therefore, conclude that the mechanism for decision making in such an important area was most unsatisfactory. It is obvious that this needs to be reformed immediately.

Physical delivery of Securities

14.57 The PSUs invested their surplus funds with banks/finance companies in various securities. It was, however, noted that the companies did not take physical delivery of the securities, instead they were issued receipts from various banks/finance companies, which indicated that the securities would be delivered when ready in exchange for such receipts and in the mean time the same will be held in their account. On maturity of investment periods the companies got their monies back by simply exchanging the receipts. Without any physical possession of securities, funds of the companies were exposed to great risk indeed and inevitably some of the companies have lost heavily in consequence because of default in payment by subsidiaries of nationalised banks.

14.58 The Committee noted that many companies/organisations like OIDB/ A I did not possess even receipts in respect of some of the investments made by them under PMS/short term investments with banks/ their subsidiaries. OIDB went further and did not have even any confirmation in regard to safe custody of the securities. It did not ask for them either even though these investments were invariably in hundreds of crores.

14.59 In the case of A I out of 20 Ready Forward transactions with Citibank, the bank did not deliver any securities, it issued BRs in only two cases. The remaining 18 BRs were submitted to AI by Citibank for discharge only on 24.9.1992 although all the ready forward transactions were completed by February, 1992. One BR was not discharged by AI as the security mentioned in the BR did not agree with the security mentioned in the letter to Citibank at the time of placement of funds. SBI Caps too neither delivered securities purchased by the Corporation nor were BRs issued to the Corporation. In both the cases of Citibank as well as SBI Caps., no action was taken by AI to obtain the securities/BRs.

14.60 In the case of BHEL, statutory auditors reported that the deposits shown by the company for the year 1989-90, 1990-91 were not infact deposits and should have been shown under the head "investments" under PMS. The Report further stated :

> "All these investments were unsecured and were not backed up by any security.... There is no documentary proof of particulars of Corporate Bodies/ Institutions alongwith amount of short term deposits and rate of interest offered by them for taking BHEL short term surplus funds... The Company was borrowing heavy funds and investing similar heavy funds on the same day/next day... In many cases initially funds were invested for short periods at higher rate of interest. But these investments were renewed at lower rate of interest resulting in loss of interest. Hence there was no proper planning of assessing surplus funds initially."

14.61 It is strange that the Board of Directors and even Administrative Ministries which received annual report alongwith the comment of the statutory auditors also turned a Nelson's eye in the matter.

14.62 In the case of NPCIL the Company did not take possession of its securities held by ABFSL despite the fact that ABFSL defaulted to the tune of Rs. 110 crores. Only when the Committee asked during evidence on 14.1.93 as to why physical delivery of securities was not taken, the representatives of NPCIL stated that they would now take physical delivery of securities held by ABFSL on behalf of the company. It is not known whether this has been done or whether indeed ABFSL have any securities to deliver.

14.63 The PSUs also did not take any letter or undertaking from banks/finance companies indicating the securities obtained by them on behalf of the companies.

14.64 In the case of MMTC, the Company did not receive physical delivery of securities, nor were they aware of the nature of securities obtained by the institutions in respect of investment made by the Corporation.

Reporting system to Board of Directors/CMD/Director (Finance)

14.65 Different PSUs have followed different procedures of reporting investment decisions to their Boards. While some of the PSUs have developed a system of periodical reporting to the Board, others have not done so on the ground that there was no requirement for placement of individual investments before the Board regularly. The Committee have noted that in some of the PSUs, the Board has either not been apprised about the investment of surplus funds at all, or informed much later. In some PSUs, specific directives of the Board as also CMD/Director (Finance) who were authorised to make investment had also been flouted. The general picture that emerged on examination of PSUs was that there was an absence of monitoring of huge investments made by PSUs at the Board level. Some specific cases are as follows:

1. In the case of GAIL, the Board was apprised of the investments made by the Company from April, 1988 to June, 1990 only in July, 1990, i.e. after a gap of 2 year and 2 months. Until May, 1990, there was no regular system of reporting to the Board, after which also reporting on yearly basis alone was done.

2. In the case of KRIBHCO, an investment of Rs. 52 crores had already been made before the proposal for making short term investment was placed in the Board meeting on 15.12.1989. Further, it was seen that specific directive of Board of Directors for not making any investment without the approval of the Department

of Fertilizer was flouted. It was noted that KRIBHCO had made 40 transactions relating to investment of funds aggregating to Rs. 197.63 crores between 15.12.1989 and 23.7.1990 before the permission of Department of Fertilizer was received on 23.7.1990. Further the Board of Directors of KRIBHCO authorised the Managing Director to make investment of surplus funds. With effect from 1.4.90 the M.D. authorised the Finance Director of the company to review the funds position from time to time and to make investment of surplus funds. This delegation of power by MD to Finance Director was done without approval of Board. The matter was ratified by Board after a period of 2 years only in the meeting held on 7.3.1992.

14.66 Some of the companies, which were regularly reporting to the Board on investment, dispensed with this practice. For example NPCIL was placing information relating to investment of surplus funds on monthly/bi-monthly basis, before the Board upto 1989. After 1989, this information was given to the Board only through AGM/Annual Accounts. No reasons were recorded for this change of practice.

14.67 In some companies junior officers made investments without taking prior approval of competent authorities. The Board of Directors of MMTC authorised CMD/Director (Finance) and Chief General Manager (Finance) to make investment of surplus funds up to Rs. 80 crores, Rs. 50 crores and Rs. 5 crores respectively with an over all limit of Rs. 250 crores outstanding at any point of time. However, a junior officer of the company invested on 5.9.89 Rs. 20 crores each with SAIL and Indian Bank without the prior approval of CGM, Director (Finance) and the CMD.

14.68 The Board of Directors of Container Corporation of India authorised the Managing Director and Director (Finance) to invest the funds. From the notes of the Company regarding sale/purchase of securities it is noted that investments were made by a junior officer and *ex-post-facto* sanction of Director (Finance)/M.D. was taken. However, during evidence Director (Finance) stated that all the investments were made by the junior officer with his prior approval.

14.69 In the case of GAIL also a junior officer made 10 investment worth Rs. 10.9 crores without the approval (in writing) of Director (Finance) who was the competent authority to make these investments. GAIL has maintained that all the investment were made with the prior verbal approval of Director (Finance). However, there are no records to substantiate this . During evidence when the Committee pointed out to the Director (Finance), GAIL that there were no records to show that the junior officer took his approval before making investment the Director (Finance) stated:

"that is what they do, there was no time".

14.70 In another case of Oil India Limited the specific advice of the Director (Finance) made on 3.7.1990 that no investment be made with certain banks like Vijaya Bank, UCO Bank, New Bank of India and United Bank of India in view of their bad financial position was flouted and an investment of Rs. 15. crores was made with Vijaya Bank on 28.10.1991. No action against the officers who made investments in violation of these instructions was taken by the Company.

14.71 Some of the companies started placing information of short term deposits made only after the specific directives of the Boards. Thus, in the case of BHEL, it was only after the Board directed the Company to make a review of deposits made in 1991-92 such a review was submitted to it on 27 October, 1992.

14.72 In the case of Indo-Burma Petroleum, an investment policy indicating guidelines for short term investment was formulated by the Board on 10 July, 1990 and all such investments

made between April, 1988 and July, 1990 were ratified by the Board in its meeting held on 10 July, 1990. In this meeting the Board directed that it be apprised of the investments made on a quarterly basis.

14.73 Some of the companies made investments in modes/with institutions other than those for which approval was granted to them. Thus for instance Bharat Dynamics Limited invested surplus funds with Andhra Bank, CMF, Indian Bank, etc. since June, 1988, even though it was accorded permission of Ministry of Defence (Department of Defence Production) to make investments with PSUs only.

14.74 Similarly, Mishra Dhatu Nigam Limited invested its surplus funds from April, 1989 in mutual funds such as CMF whereas the Government of India prescribed investment in other PSUs only. The investments in mutual funds and in banks were irregular.

14.75 Contrary to the instructions issued by Government of India in December, 1987 that PSUs should invest their surplus funds in Public Sector Bonds, Government Treasury Bills, or keep them as deposits with the Government for a period exceeding 6 months the National Film Development Corporation invested Rs. 13.31 crores from 20.9.1991 to 25.10.1991 under PMS with various banks including foreign banks for periods ranging from 15-180 days.

14.76 The Board of the Directors of National Aluminium Company Limited (NALCO) at their 50th meeting held on 21st December, 1988 authorised its CMD subject to the approval of the President of India to invest the surplus funds in the following items:

a) Government of India securities

b) Treasury bills

c) Units of UTI

d) Selected State Government Securities

e) Deposits with selected PSUs

It also provided that the total funds thus invested shall not be exceeding Rs. 130 crores at any time.

The Board of Directors at 52nd meeting held on 29.5.1989 increased the amount from Rs. 130 crores to 260 crores while authorising the CMD to invest surplus funds in Government Securities/deposits etc. This amount of Rs. 260 crores was subsequently raised to Rs. 400 crores *vide* resolution of the Board adopted at 54th meeting held on 30.12.1989.

14.77 Government of India, Deptt. of Mines *vide* its letter dated 16.12.1988 conveyed the approval of the President to invest surplus funds of NALCO in the State Government Securities/State Govt. Public Sector companies as a short term arrangement. This approval was modified through the corrigendum dated 2nd January, 1989 conveying the authorisation for investment in following securities/deposits :

a) Government of India Securities

b) Treasury Bills

c) Units of UTI

d) Selected State Government Securities

e) Deposit with selected PSUs

The Clause 'short term arrangement' was modified to `it shall be resorted to as a short term arrangement.'

14.78 NALCO invested huge funds of which the details are as follows:

1988-89	Rs. 104.69 crores
1989-90	Rs. 288.15 crores
1990-91	Rs. 210.68 crores
1991-92	Rs. 220.28 crores
1992-93 (Upto August, 1992)	Rs. 195.00 crores

14.79 The Board of NALCO has never authorised CMD to make investments/deposits through/with foreign banks whereas the Company did make investments through/with American Express Bank, BOA, Citibank and Hongkong Bank which is a clear violation of the resolution of the Board of Directors as well as the approval of the Government of India.

The Company had also invested funds during all these years under Portfolio Management Scheme through Indian Banks as well as foreign Banks. It did not abide by the directive of the RBI that the investment under Portfolio Management Scheme cannot be for less than one year. Again the Board did not authorise CMD, nor did the Government give its approval to Company to make investment under PMS.

14.80 It is thus noted from the above stated cases that the general control and direction which the Boards were expected to exercise was absent. There was neither a proper system of reporting such transactions to the Board nor the Board's directives implemented in letter and spirit. The Committee recommend appropriate rules and regulations be prescribed for regular reporting of financial transactions to the Board and sanctioning powers so delegated amongst different authorities to prevent abuse of powers by vested interests.

14.81 The Committee find that there have been large scale contravention of statutory provisions and rules/regulations regarding financial matters. It is regrettable that these contraventions were not detected in time by the top management and the Government nominees on the Boards. At least now an enquiry should be held and responsibility fixed on officers who indulged in these malpractices and irregularities.

Role of Government nominees on Board of Directors

14.82 The Committee noted that role of Government Directors on the Boards of PSUs was not defined in writing. Asked to give his views to make the role of Government Directors effective, the Secretary, Ministry of Industry stated:

> "I would say, the instructions should be in two parts. One is purely procedural part that they will obtain guidelines and instructions whenever necessary from appropriately high authorities, may be Secretary or Minister or in certain cases, may be even other Ministries where they might be involved to see how Government's point of view should be presented. Likewise, after the meeting they will submit a report to somebody, usually head of the Ministry about all the main items or any item which they feel worth of bringing notice to the Secretary. They should bring it to the notice at the earliest along with comments, if necessary."

14.83 The Secretary of the Ministry of Petroleum stated:

> "So far as the investment policy for the Department is concerned, it is approved in the presence of the Government Directors and the PSUs are right

in saying that the policies as approved by the Board are expected to be in conformity with the Government instructions and guidelines. In a specific transaction, if it is wrong, it is for the Government Director to point it out. It is not a question of the Government being privy to wrong decisions.....If anything wrong is noticed in these, the Government nominees are bound to point it out and ask for explanation."

14.84 The Committee noted that in many cases nominees of Ministries did not attend the meetings of Board regularly. To cite an example in the case of Export Credit Guarantee Corporation (ECGC) during 1991-92 out of a total of five meetings of Board only two were attended by the Government Directors. Similarly, in the case of MMTC, on two occasions none of the representatives of Ministry of Commerce attended the meeting of the Board. Asked to give the reasons for non attendance of Board meetings by Government Directors, Secretary Commerce during evidence stated:

"What happens, is that for some intervening periods, sometimes there is a gap between an outgoing Government Director and the incoming Government Director."

14.85 It was thus seen that the Government Directors who were appointed as nominees of the Government for overseeing the work of PSUs in accordance with stated policies did not discharge their responsibilities as expected and remained passive witnesses to irregularities. The Committee were also dismayed to see that attendance in Board meetings was taken by the Government Directors in a casual manner. In sum, the scheme of appointment of Government Directors does not appear to have worked as envisaged.

Investment under PMS

14.86 DBOD of RBI on 2 May, 1989 issued guidelines to banks, merchant banking subsidiaries of banks wherein it was stated that PMS may be offered by banks/bank subsidiaries to their clients in respect of their long term investible funds and that the minimum period for which the funds could be accepted for management by the banks/bank subsidiaries from their clients should be one year. It was also stated that PMS should be provided by banks on suitable management fee for enabling their clients who had long term investible resources to build up a Portfolio of Securities at their own risk and without making any commitments with regard to minimum yield to their clients. It was further envisaged that banks providing such services will keep the identity of funds accepted from their clients for Portfolio management distinct by maintaining clients-wise record of funds received and investments made there against and earnings thereon. Thus the account holder was entitled to get a statement of account of his portfolio account. The banks were also asked not to mix their own investments with those of client's portfolios and likewise not utilise portfolio funds for their own investments or otherwise.

14.87 As per Government instructions, PSUs could invest their surplus funds in PSU bonds, treasury bills and Government securities only. It was, however, noticed that in many cases. PSUs had placed funds with banks/banks subsidiaries under PMS or other similar schemes only with instructions to invest in Government securities etc. without taking physical delivery. PSUs also did not even keep a tab on how the funds made available by them were invested and it was noticed in large number of cases that funds of PSUs given under PMS had been used for purchase of shares of private companies. For instance, Rs. 159.63 crores collected by Syndicate Bank from Oil India Limited, OIDB and Pawan Hans Ltd. as on 30.6.1992 were invested substantially in shares of private sector companies.

14.88 Similarly, Vijaya Bank had purchased shares of private sector companies from the funds placed under PMS with them by certain PSUs like Pawan Hans Limited, NAA etc. The representative of Vijaya Bank during their evidence before the Committee stated that these PSUs were aware of the manner of investment of funds by the bank.

14.89 Oil India Limited placed funds worth Rs. 10 crores with Allahabad Bank from 25.7.91 to 24.7.92 at rate of 16% per annum. These funds were similarly utilised by the subsidiary of Allahabad Bank i.e. All Bank Finance Limited in the purchase of shares of some private sector companies like Appolo Tyres, Grasim, etc. According to All Bank Finance Limited this was done as per the contract entered into between Oil India Limited and Allahabad Bank at the time of placement of funds. The Oil India Limited had given full discretion to bank to utilise the money in their own manner. These are only illustrative cases and Committee have every reasons to believe that funds of many other PSUs might have been utilised for the purchases of shares of private companies.

14.90 Some other irregularities noticed with regard to investment of funds in PMS by some of the PSUs were as under:

> "HPCL invested Rs. 55 crores under Portfolio Management Scheme with two subsidiary companies of nationlised banks - Rs. 20 crores with Canara Bank Financial Services Limited (CANFINA) in October, 1989 and Rs. 35 crores with BOI Finance Ltd. (BOIFIN) in December, 1989. The Board of Directors, while approving investment of funds in January, 1989 had directed that the investment under Portfolio Management Scheme should be made only in approved securities like units of UTI, Public Sector Bonds, Central/State Government Securities Government Treasury Bills, Deposits with Government etc."

14.91 It was, however, observed that out of Rs. 35 crores provided to BOI Finance Limited under PMS, bulk of the funds were invested in inter-corporate deposits (ICDs) and shares and debentures of various Public Limited Companies. The Company also did not take steps to have the physical delivery of securities or at least the details of securities purchased by the Finance Company.

14.92 According to records of BOI Finance Limited, the income generated on the entire portfolio of Rs. 35 crores worked out to Rs. 7.19 crores of which Rs. 4.79 crores only were passed on to the HPCL. Apart from deducting Rs. 0.51 crores towards 'tax deducted at source', BOI Finance Limited charged Rs. 1.89 crores as management fee and out of pocket expenses (OPE), which worked out to 5.40 percent of the entire investment. By not insisting on periodic statement of their portfolio account the Company allowed BOI Finance Limited to charge a much higher fees than the agreed rate of 2 per cent and thus lost substantially in the deal.

14.93 At the time of investment of surplus funds under the PMS the Company had availed cash credit facilities from various banks (Rs. 181.56 crores as on 31 March, 1990) at an interest rate of 17 per cent per annum. But the Company earned only a return of 13.07 per cent on its investments. The investments in PMS thus resulted in substantial loss to the Company.

14.94 The funds under PMS by HPCL with Canfina were placed for 290 days (i.e. from 20.10.1980 to 6.8.1990) which was contrary to the RBI guidelines that PMS investments should be made atleast for a minimum period of one year.

14.95 Oil India Limited had also placed funds under PMS with Grindlays Bank on 20.8.1991, 4.10.1991 and 26.11.1991 for a period of less than one year.

14.96 Maruti Udyog Ltd. (MUL) on 1.4.1990 placed Rs. 5 crores under the Portfolio Management Scheme with Grindlays Bank for investment in money market assets for a period of six months. It was intended that the assets would include bonds, units, Government securities, etc. The Bank assured a composite yield of 16% to MUL. These funds were passed on to Brisk Financial Consultants Pvt. Ltd. (BFC) on a clean basis at 15.5.% for first 6 months and 16% thereafter. BFC engaged in investment in shares, debentures and making loans and advances to companies, is managed by Shri Chanderkant and his son, Naresh K. Aggarwala. The amount of Rs. 5 crores was rolled over further upto 5.9.1991.

14.97 The irregularities in PMS indulged in by some other PSUs like ONGC, AI, OIDB and Vayudoot have been dealt with in detail separately. The desirability of PSUs deploying funds in PMS has been commented upon in another chapter of the report.

Placement of funds for short periods

14.98 The PSUs have placed funds with banks and finance companies for very short periods, sometimes for only a few days and even for one day implying supply of funds for speculative purposes to earn higher return. These banks/finance companies issued BRs for the amount received. The PSUs after the maturity of investments returned the BRs and got their moneys along with the yield which was agreed to at the time of placement of funds. Thus these transactions were in the nature of ready forward deals instead of genuine investment transactions which was in contravention of RBI guidelines issued on 11.4.1988 which stated that sale and purchase of securities with the same party and for identical or similar amounts were construed as tacit arrangements which was in contravention of the instructions prohibiting buy back arrangements with non-bank clients.

14.99 The Committee noted that the yield obtained by PSUs on short term investment was very high in comparison to the rates fixed by RBI on term deposits for similar durations. The average yield ranged from 20-30%. However, in one case of short term deposit made by Cochin Refineries Ltd. on 22.10.1991 with SBI Caps for 4 days the yield was as high as 90%.

14.100 There was also a marked variation in the rates of return obtained by the companies on the investments made on same day or almost near about. Like in case of Maruti Udyog Limited, BHEL following variations were noted:

Maruti Udyog Limited

Date of Investment	No. of Days	Yield Obtained
29.7.1991	30	17.25%
29.7.1991	15	17.00%
27.9.1991	90	18.05%
28.9.1991	30	23.05%
12.11.1991	07	22.00%
13.11.1991	30	27.00%

BHEL

Date of Investment	No. of Days	Yield Obtained
22.4.1992	15	27.25%
23.4.1992	15	38.00%
27.4.1992	15	38.50%
29.4.1992	15	31.50%

14.101 The yields obtained were suggestive of the fact that the funds of PSUs were irregularly used in call money market through banks or passed on to the brokers for speculative purposes.

Placing of funds with Foreign Banks

14.102 It was noticed that many PSUs were making investments with foreign banks long before they were allowed to have even normal banking transactions on 3.1.1992. When asked by the Committee to give the reasons for such investments PSUs have stated that the DPE circulars which stipulated that PSUs should have normal banking transactions with nationalised banks only did not prohibit them from making investment with foreign banks even before 3.1.1992.

14.103 The Committee have noted that this interpretation of term 'normal banking transaction' was made by the Boards of the PSUs themselves without approaching Administrative Ministries/DPE. Asked by the Committee as to how the Board decided on transaction and whether this differentiation was reflected in any circulars/guidelines, the Chairman of Export Credit Guarantee Corporation of India Limited replied:

> "There is no circular. It was a decision of the Board."

14.104 Asked further as to whether the nodal Ministry was consulted on this aspect, the Chairman, ECGC further stated:

> "I have not come across any correspondence in this regard."

14.105 Asked as to whether the PSUs under the Ministry of Petroleum informed the Ministry that investment of funds with foreign banks was not incontravention of guidelines and whether the term 'normal banking transactions' did not include 'investment' Petroleum Secretary during evidence stated:

> "Their investment policy which they submitted to the Government, which we reviewed, and the statement which they have made before the Secretary, all those things reveal that they have treated investment different from having banking arrangement."

14.106 When questioned by the Committee whether investment with foreign banks prior to 3.1.1992 were against the DPE guidelines, Petroleum Secretary stated:

> "There is a difference in perception. This has not been the perception in the Ministry and the PSUs."

14.107 However, an ex- Chairman of ONGC, a PSU under the Ministry of Petroleum and Natural Gas admitted that PSUs were violating DPE guidelines and the Ministry was aware of it, during evidence he stated :

> "Most of the Companies completely breached BPE guidelines. No objection was also raised to it when a review meeting of all PSUs and Ministry of Petroleum was held on 11.5.1990 with Chief Executives of all PSUs under it."

14.108 When the PSUs were not even permitted to undertake normal banking transaction with foreign banks it is ironical as to how they could be permitted to make investments with foreign banks.

Investment with Non-Banking Financial Companies

14.109 PSUs have also made investments with Non Banking Financial Companies like Canfina, PNB Caps, SBI Caps, etc. and justified it on the contention that these companies are subsidiaries of nationalised banks. Many PSUs have also shown in their books the funds given to NBFCs as inter-corporate deposits. These are covered under Section 370 of the Companies Act. The provisions of Section 370 do not apply to a Government company of which the entire share capital is held by the Central Government. However, approval of the administrative ministry is required to be obtained. Many PSUs made inter-corporate deposits with NBFCs in violation of these provisions. Further, different companies had been investing funds under schemes like PMS etc. under different terms of contract and have described these transactions by different names. However, if the monies so invested are utilised for purchasing of shares and securities in the name of an investing company (whether actually transferred to the investing company or not) the provisions of Section 372 of the Companies Act apply, which also appear to have been violated by many PSUs.

14.110 In this connection the Committee note that the Department of Company Affairs is responsible for the enforcement of the provisions of the Companies Act, 1956 in respect of the companies registered thereunder. Section 209A of the Act empowers the Department in this behalf to conduct inspection of books of accounts of the companies. The Committee are surprised to note that as per the existing practice, inspection of books of accounts of Government Companies (PSU) is not being conducted by the Department of Company Affairs at all. The reasons adduced are that the PSUs were subjected to audit by C&AG and that they were under the administrative control of the Ministries concerned. What is further surprising is that during the years 1991-92 and 1992-93 inspection of books of accounts of NBFCs were also not conducted with regard to irregularities committed under PMS and other similar schemes except in a few cases. In fact, none of the subsidiary companies of nationalised banks which prominently figured in the scam were subjected to any scrutiny at all. The reasons advanced by the Department are that NBFCs were subjected to RBI guidelines, they were also inspected by SEBI and there was paucity of staff etc. The reasons adduced by the Department of Company Affairs for non-inspection of books of accounts of Government companies and NBFCs are untenable and cannot be accepted as valid explanations for the failure of the Department in the discharge of the statutory obligations cast upon it. It is only now, after the matter was pursued by the Committee with the Department of Company Affairs, that the Department has decided to conduct limited inspection of books of accounts of PSUs which have entered into PMS transaction for ensuring compliance of provisions of Section 370/372 of the Act. The Committee would like the inspections to be expedited. The Department of Company Affairs should also inspect the books of accounts of all the NBFCs including subsidiaries of banks involved in the scam. Necessary prosecution proceedings should also be initiated

against PSUs & NBFCs, wherever violations of the provisions of the Companies Act are detected. It should also ensure that the provisions of Sections 370 and 372 of the Companies Act are scrupulously followed in future by PSUs and NBFC with a view to obviating recurrence of the irregularities committed in the scam.

Investment in the Units of UTI

14.111 The Committee have noted that PSU made investments in the Units of UTI which was not a security approved by Government as per the guidelines issued on 1.12.1987. A statement indicating the amount of investment made be some PSUs in the units of UTI is enclosed in the Appendix-XXXII.

14.112 It was noticed that in the case of several PSUs, the Board of Directors had approved investment in the units of UTI. The Committee asked during evidence as to whether purchase of Units of UTI by PSUs even with the approval of the Boards was regular. In reply, the Secretary, Ministry of Commerce stated:

> "I would only respectfully submit that all the PSUs under the charge of this Ministry and I presume other Ministries have been investing in UTI for the following reasons: The first and fore most is they think that UTI is a public sector institution and is not in the private sector."

14.113 Asked further as to whether investments in Units of UTI by PSUs was in conformity with the guidelines for investments, the Commerce Secretary stated:

> "Strictly speaking it does not conform to the guidelines."

Diversion of funds to brokers

14.114 While most of the PSUs/Organisations denied before the Committee about utilising the services of brokers, the Committee found that in some cases inquiries/investigations by CBI/internal auditors clearly established nexus between brokers, officers of PSUs/banks resulting in syphoning of funds of PSUs to brokers. It is reported that 22 PSUs had placed funds to the extent of over Rs. 12,000 crores through Harshad S. Mehta which were syphoned of to him and his groups of Companies. Some instances are given below:

(i) In case of PFC, it has been alleged that in respect of certain investment transactions between PFC and UCO Bank during the period July, 1990 — May, 1991 16 Bankers' cheques for a sum of Rs. 394.34 crores were unauthorisedly issued in favour of ANZ Grindlays Bank instead of UCO Bank with whom transactions were held. The Committee were informed by CBI that total number of such transactions was 20 and the total amount which unauthorisedly found its way in the account of broker HSM was Rs. 483 crores. In addition, PFC reinvested their funds of Rs. 354 crores on maturity with the UCO Bank in 9 cases so far. It was reported that these amounts were also credited to the account of HSM. In this way, the total amount invested by PFC with UCO Bank which unauthorisedly found its way to the account of HSM was Rs. 837.45 crores. During the course of his examination by the Committee HSM confessed that PFC deployed funds through him in money market.

(ii) In the case of Maruti Udyog Limited, it was found, that funds of MUL meant for purchase of units from UCO Bank were credited into the individual accounts of HSM . There is a financial involvement of Rs. 33.63 crores.

(iii) From the information furnished by Ministry of Petroleum and Natural Gas, the Committee find that CBI investigated some of the investments made by IBP

Company Limited with Banks during 1986 and 1987 and found that some officials of IBP Co. entered into a criminal conspiracy with each other and with Shri Manoj Dhupelia, broker. The nature of allegations indicated that cheques drawn in favour of some banks were actually handed over to employees of broker firm Manoj Dhupelia & Co. for investment in the banks in whose favour the cheques were drawn. Although the purpose of investment was for purchase of Government bonds, during the entire process neither the banks nor the broker firm physically possessed the scrips and the entire transactions took place through BRs. While IBP issued cheques in favour of some banks, the receipts received from the broker were from other banks. Investigations have further revealed that the interest accrued on the investment made by IBP was credited in the bank account of the broker firm which kept a portion of the money towards brokerage charges while returning the amount to IBP. The amount retained by the broker was stated to be Rs. 7.77 Lakhs. The Committee were further informed that following the unearthing of the security scam, the CBI was again investigating the links between HSM and the broker named above, namely, Manoj Dhupelia.

(iv) In respect of one case of term deposit made by Rashtriya Chemicals and Fertilisers, Bombay, although the Company had intimated in their replies to the Committee in January, 1993 that no broker was employed by the Company for any of their short term investments/deposits, the Committee were subsequently informed by Department of Fertilizer that in one case of short term deposit made by the Company with Canfina in November, 1988, one broker of Delhi, namely, M/s. Sikanderlal and Co. was employed and one per cent brokerage was paid to him. Investigation into this matter have held the then CMD of the Company (Shri R. Venkateshan) responsible for this act.

14.115 The Committee found that funds of PSUs/Cooperative Societies were deployed by the subsidiaries of nationalised bank with broker/private sector finance companies. Thus ABFSL Limited during 1991-92 deployed the funds of MUL, PFC, KRIBHCO, IFFCO, RCF with broker HPD and FFSL as per details given below:

Year 1991-92

Funds accepted from	Amount (Rs. in crores)	Deployed with
MUL	22	HPD
	32	FFSL
	20	HPD & FFSL
Power Finance Corporation Ltd.	223.31	HPD
	91.41	FFSL
	19.978	HPD & FFSL
KRIBHCO	70.00	HPD
	107.00	FFSL
IFFCO	9.00	HPD
	3.00	FFSL
RCF	107.00	HPD
	55.50	FFSL

14.116 While the above funds of PSUs/Societies were diverted to brokers/private sector companies through subsidiaries of nationalised banks, the Committee noted that the Tourism Finance Corporation of India invested its surplus funds to the tune of Rs. 141.20 crores out of a total of Rs. 240.49 crores during 1.4.1991 to 31.8.1992 with finance companies like Classic Financial Services, Fairgrowth Financial Services Ltd., Fairgrowth Investment Ltd., Escorts Financial Services Ltd., Industrial Credit and Development Syndicate, Lloyds Finance Ltd., Shriram Financial Services Ltd., Finance Capital Services (P) Ltd.,

14.117 Risk Capital and Technology Corporation (RCTC) deployed funds with Housing Development Finance Corporation (HDFC) a private sector company through brokers M/s Shah Investments and SJ Financial Investment Consultants. Funds deployed by RCTC through brokers during 1991-92 were to the tune of Rs. 3.91 and 1.40 crores respectively.

14.118 Asked to give reasons for excessive interaction with the above organisation, RCTC stated that these brokers were on the panel of HDFC. They provided good services to RCTC by passing on to RCTC a substantial portion of the commissions received by them from HDFC thus raising the effective return to RCTC.

14.119 The details of the commissions received by RCTC from the brokers, which was 80% of the commission received by the brokers from HDFC were as under:

Financial Year	Amount in Rupees
1988-89	27,280
1989-90	25,861
1990-91	69,585
1991-92	17,660

14.120 RCTC has contended that no brokerage was paid by it to brokers rather it got commission from brokers which were credited to profit and loss account of RCTC. The Committee however find that, rate of return on the funds deployed by RCTC with HDFC, wherein brokers were also engaged was 10-11% whereas in cases where in funds were deployed with banks/financial companies other than HDFC the rate of return was even upto 23%.

In this background the Committee are unable to understand as to why RCTC chose to place its funds with HDFC at a lower rate of return. The Committee would like that a detailed enquiry be made to ascertain as to why funds were placed with HDFC at a lesser rate of return.

14.121 After examining these cases, the Committee have been driven to the conclusion that these irregularities were not an occasional aberrations but had become an integral part of the system. The irregularities were known to the authorities and yet not corrected. Inevitably and not surprisingly the unscrupulous elements exploited the situation for their illegal enrichment. In the process it was the common man and the economy of the nation that have paid an enormous price.

14.122 The Committee also examined investments made by some of the major PSUs where serious irregularities were noticed, as detailed in the following pages.

Oil and Natural Gas Commission (ONGC)

Investment of surplus funds

14.123 ONGC is a statutory corporation incorporated under the ONGC Act 1959. According to Section 19(3) of the Act, all monies of the Commission shall be deposited in the RBI or with the agents of that Bank or in a corresponding new bank constituted under the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or in such other banks as may be prescribed or in a Government Treasury or invested in such securities as may be approved by the Central Government. As per Government instructions dated 8.12.1987, ONGC was asked to invest funds available with them which were surplus to their immediate requirements in PSU bonds, Government Treasury Bills or as deposits with Government of India.

14.124 ONGC's investment of surplus funds as on 25.8.92 was as under:

		(Rs. in crores)
(i)	Mutual Funds/Financial institutions	279.32
(ii)	PMS	NIL
(iii)	PSU Bonds	1,662.06
(iv)	Units of UTI	159.97
(v)	Inter-Corporate Loans	842.73
(vi)	Equity share Capital of PSUs	54.52
(vii)	Public Deposit A/c with Govt. of India	496.19
	Total:	3494.79

Approval of the Commission

14.125 All investment recommendations are finally approved by the Member (Finance), ONGC who has been delegated with powers under ONGC Payment, Deposit, Custody and Investment of Monies Regulation. It has been stated that the Commission was periodically apprised of the deployments of funds with details.

Source of surplus funds

14.126 According to ONGC, revenue realisation from refineries for crude oil and in respect of supply of gas to Public Undertakings as well as private consumers comes on specific dates as prescribed by the Government and/or in accordance with the individual agreement. The credit period generally being from 3 weeks to 1 month, with a system of billing for weekly/ fortnightly supplies at different places. The outflow of money, particularly for payment of statutory charges, which is a heavy amount falls on different dates in accordance with the relevant Act/Regulation and/or as prescribed by respective State Governments. This situation results in certain cash surpluses for short periods ranging from 15 days to 6 months.

14.127 Further, as per directives of the Government, ONGC undertook external commercial borrowings for meeting its requirements of foreign exchange for purchase of material and services. Such a borrowing of foreign exchange resulted in equivalent rupee fund surplus. According to ONGC, with the twin objectives of creating liquid asset for repayment of loan in time and to reduce the burden of interest payment on such borrowings, such rupee surplus funds were required to be invested in long-term as well as in short-term instruments.

Irregularities in short term investments

14.128 Upto April, 1987, short-term Investments were made by ONGC only in Term Deposit with banks. From May 1987 they started making short-term investments with banks/subsidiaries in schemes but for periods less than a year. In fact, there were several cases where investments had been made for even periods ranging between 1 to 7 days. According to ONGC, since the amounts involved were very large it became necessary to invest such funds even for shorter periods to earn substantial amounts. Evidently, these transactions were ready forward in nature and violative of Government guidelines.

System of inviting offers for investment

14.129 There was no proper system of inviting offers of investments from different banks in writing. All negotiations and deals were fixed over telephone. The Member (Finance) stated during evidence that while placing funds with banks for short-term investments, oral instructions had been given. It has been observed that while nationalised banks/subsidiaries had been mostly issuing simple letters acknowledging receipt of the amount of investment indicating the rate of returns etc., the foreign banks were issuing BRs acknowledging receipt of money and indicating that the securities viz. Bonds, Treasury Bills etc. will be delivered when ready in exchange of the receipt duly discharged and in the meantime the same will be held in the account of ONGC. There was however, no physical delivery of securities even subsequently.

Transactions with Foreign Banks

14.130 PSUs were permitted to undertake normal banking operations with foreign banks vide DPE circular dated 3.1.92. However, ONGC had undertaken transactions with foreign banks even prior to the issue of the said circular. In fact, out of the 196 transactions in 1990-91, 50 transactions were conducted with foreign banks. Similarly, out of 91 such transactions undertaken in 1991-92, 18 transactions were with foreign banks.

14.131 The first investment in a foreign bank was made in March, 1989 and thereafter transactions were conducted on a continuous basis till these were discontinued in February, 1992. Foreign banks with whom transactions made were, BOA, American Express, Citibank, ANZ Grindlays Bank, Hongkong & Shanghai Bank, Oman International Bank and SCB.

14.132 Though ONGC admitted that deposit of funds in foreign banks was not permissible under the provisions of ONGC Act, they however, felt that there was no prohibition for making investment in approved securities through foreign banks, who were also authorised dealers to do such transactions.

14.133 The Committee enquired as to who in the ONGC made the distinction between "short-term investment" and "short-term deposit". Shri M.C. Nawalkha, Member (Finance) stated in evidence :

> "This decision was arrived at during our in-house discussion. This interpretation was arrived at in the Finance Department headed by me and it was endorsed by the Chairman in August, 1990."

14.134 Asked whether ONGC had sought any legal advice on the above in the context of the investments made by them in foreign banks prior to January, 1992, the witness replied:

> "No. I did not seek legal advice either from our Legal Office or from the Ministry of Law."

14.135 To a question of the Committee, the witness replied that the securities purchased out of the funds made available on short-term investments were retained by the bank. On being asked whether ONGC had been aware as to what the banks did with these securities, the witness said in evidence :

> "We were not knowing earlier,. After the scam broke out, we could ..... But, admittedly, before the scam broke out, nothing came to light."

14.136 The argument advanced above for having transactions with foreign banks is hardly tenable. In fact, such transactions were in the nature of Ready Forward with no securities ever having actually been purchased or sold at the risk of ONGC and were not permissible.

Investments under PMS

14.137 The Commission invested Rs. 100 crores with two nationalised banks under 'portfolio management scheme' for twelve months. It was not ensured that the funds were invested by the banks only in approved Government Securities. No periodical returns indicating the details of investments made were obtained from the banks. The rate of return or yield was guaranteed or assured by the banks at the time of placement of funds in violation of rules. They were shown as 'short-term investments' in the books of the Commission.

Transactions with Banks/Subsidiaries

14.138 The Commission invested Rs. 1728.64 crores against 'special deposit receipts' in nationalised banks and their subsidiary companies for period ranging from 7 days to 243 days at rates of interest varying from 6.1 per cent to 32 per cent. Out of the above, an amount of Rs. 786.37 crores was invested in 'Investment Advisory Services' of Canbank Financial Services Limited. In a few cases the Commission obtained commitment that these amounts would be invested in Government securities but details of the securities was on behalf of the Commission were not obtained from this. In majority of the cases, the manner in which the funds were to be deployed by the banks and their subsidiary companies was neither indicated by the Commission nor by the banks or subsidiaries.

14.139 A sum of Rs. 118 crores was invested in four mutual funds of public sector banks which was against Government instructions permitting only investments in Government approved securities.

Transaction with Oman International Bank (OIB)

14.140 ONGC had placed Rs. 30 crores with Oman International Bank (OIB) @ 17% for 94 days on 6.5.91. In the offer letter received on 7.5.91, it was mentioned by OIB that the funds will be invested in approved securities only. However, according to information received from RBI the internal auditors of OIB in their memorandum dated 5.10.91 pointed out that the transaction was undertaken by the branch at the instance of Reliance Industries Ltd. The funds were passed on to in house brokers of RIL for acquiring RIL shares. OIB had not issued any statement of securities in which investment was made. The letter addressed by ONGC to OIB on 27.7.91, requesting for the same was not replied by OIB Later, ONGC obtained refund of the amount on 8.8.1991.

14.141 From the copy of the note recorded after the deployment of the above mentioned funds, it was seen that the 'investment' had been made after the prior approval of Member (Finance). It may also be interesting to note that although ONGC had obtained back the funds

from OIB since they were in need of it, they had placed Rs. 156.58 crores with different banks between the period 2.8.91 and 19.8.91.

14.142 In another instance ONGC made investment of Rs. 20 crores with State Bank of Hyderabad (SBH) for 234 days on 26.6.91 @ 16.75%. According to the internal auditor of OIB these funds were transferred to Oman International Bank on 26.6.91 purportedly for investment in Government securities on behalf of SBH. These funds too were passed on by OIB to the brokers of RIL. The action of the bank was in violation of its Head Office directive which prohibited the branch from dealing in securities for any third party. As per the letter sent by SBH to ONGC on 26.6.91 and 14.3.91, the funds were deployed in securities. An error of ONGC compounded by falsehoods of banks-beneficiary a private Company.

Investments in UTI

14.143 As on 25.8.92, ONGC had invested an amount of Rs. 159.97 crores in Units of UTI. The investments in units were not regular in terms of the provisions of ONGC Act and also are not covered by the Government instructions dated 8.12.1987.

Role of Brokers

14.144 According to ONGC, brokers were never engaged in the deployment of funds. However, it was admitted by Shri M.C. Nawalkha, Member (Finance) in evidence that certain brokers like V.B. Desai and D.S. Prabhudas had approached him to know about the availability of funds. Shri V.K. Joshi, Sr. Dy. Director (Finance & Accounts) also admitted that he had at times received telephone calls from certain brokers. Asked whether anybody from 'Mehta' group or 'Dalal' group had contacted him, Shri Nawalkha replied "not to our knowledge."

Accountability

14.145 Shri M.C. Nawalkha has been holding the position of Member (Finance) since 3.11.1988. Recommendations for making investments were made after obtaining offers from various banks by Shri V.K. Joshi, Sr. Dy. Director (F&A), New Delhi. Availability of surplus funds were worked out by Shri Gopal Krishna Additional Director (F&A) Corporate Accounts Section, Dehradun, in consultation with Shri K.L. Aneya, General Manager (F&A), Corporate Budget Section, Dehradun.

14.146 CBI has registered a case vide RC.3(A)/92-ACU(1) belatedly on 16.11.1992 against Shri M.C. Nawalkha alongwith others in connection with the investment of surplus funds of ONGC amounting to Rs. 730.52 crores with the UCO Bank in 30 installments during 4.7.89 to 2.4.91. It has been alleged that the concerned cheques of ONGC for the purpose of investments were handed over to HSM or his representative as per the instructions of Shri Nawalkha and these were diverted into the account of HSM. It is understood that Shri Nawalkha has since been suspended.

14.147 It was brought to the notice of the Committee that Shri S.L. Khosla, who retired as Chairman, in September 1992 had taken an assignment in Reliance Industries Ltd. after his retirement. Rule 23 of the Terms and Conditions of Appointment and Services Regulations, 1975 made under ONGC Act, 1959 prohibited appointment or posting for retired persons from ONGC in any firm or company whether Indian or foreign with which the Commission has or had business relations within two years from the date of his retirement, without prior approval of the Commission.

14.148 ONGC has reported that the Commission signed a contract on 29.7.1988 and 7.1.1991 with Reliance Industries for supply of gas to the Company's units at Ahmedabad and Hazira and the supplies commenced on 22.4.1989 and 24.5.91 respectively. To the extent that ONGC have supplied gas to Reliance Industries, they have had business relations with the firm.

14.149 Shri S.L. Khosla was appointed as Chairman, ONGC with effect from 3.6.1990 and relinquished the post on 30.9.1992. As per the terms and conditions of his appointment letter, Shri Khosla was governed by the rules of ONGC in this regard. The Committee were initially informed that there was no information on record of the Commission from Shri S.L. Khosla regarding his intention of taking employment with Reliance Industries Ltd. after his retirement.

14.150 After the matter was raised by the Committee, ONGC sought the information from Shri Khosla. In his reply to ONGC on 19.4.1993, Shri Khosla stated that he had joined RIL w.e.f. 15.10.1992 (he had, in fact, deposed before the Committee on 14.10.1992), as one of their advisors and maintained that his employment after retirement did not involve violation of any law.

14.151 Meanwhile, ONGC had made a reference to the Additional Solicitor General of India whether Regulation 28 of ONGC (Terms and Conditions of Appointment and Service), Regulations, 1975, are applicable uniformly to the appointment by the President or otherwise and in particular to ex-Chairman, ONGC. The Additional Solicitor General opined on 11.4.1993 that Regulation 28 would be applicable only to the employees/staff of the Commission and not to the Members including the Chairman. The Ministry of Petroleum & Natural Gas in a communication to the Committee on 19.4.1993 stated that the opinion is yet to be examined by Government.

Meeting of the Ministry held on 11.5.1990

14.152 In a meeting taken by Secretary (Petroleum and Natural Gas) on 11.5.1990, the need for exercising great vigilance in investment of surplus funds was impressed upon all PSUs and it was advised that the Finance Directors of the PSUs should be held personally responsible for regularity of all investment decisions in order to ensure that they were fully above board. This issue has been dealt with elsewhere in the report. The minutes of the said meeting revealed that in the discussion, some of the PSUs had stated that they were making short term investments in banks including foreign banks and also that investments were made in the subsidiaries of banks and in UTI.

14.153 In his deposition, Shri S.L. Khosla, former Chairman, ONGC maintained that the then Secretary, PNG had not taken any objection to it at that time. Referring to the CBI enquiries which the Secretary had mentioned at the meeting, Shri Khosla stated:

> "I spoke to Mr. Godbole. He did not agree to divulge details."

14.154 The witness further stated:

> "If I could guess, what he had in mind, was, I think some brokerage passed and that became the subject matter of CBI inquiry."

14.155 The Committee are constrained to note that despite the caution given by the Secretary, PNG as far back as May 1990, no effort was made by ONGC to ensure regularity in deployment of surplus funds, "Unfortunately, the Ministry had also not followed up the matter. In fact, no system of informing availability of surplus funds, their deployment and the investment decision of the Commission at specified intervals had been prescribed by the Ministry.

14.156 The facts stated in the foregoing paragraphs clearly bring out the irregularities committed by ONGC in the deployment of large surplus funds as also the shortcomings in the system. Evidently, in order to circumvent the Government restrictions in regard to the placement of funds with foreign banks, ONGC has sought to make an unsustainable distinction between "short term investment" and "short term deposit." No one at the level of senior officials of the Ministry or in the top management of ONGC or in the legal department of ONGC seems to have bothered to check whether or not such action was compatible with the provisions of the ONGC Act. Cupidity appears to have overcome all considerations of propriety or legality.

14.157 Another disquieting feature observed by the Committee was that the funds deployed by ONGC with banks in two transactions one to the Oman International Bank (Rs. 30 crores) and the other to the State Bank of Hyderabad (Rs. 20 crores) had been passed on to the brokers who used them to purchase shares of Reliance Industries Ltd. While in the first case, ONGC authorities had failed to obtain from the bank even a statement of securities in which investments had been made, in the second case, the letters issued by the bank to the Commission did not reflect the correct position of the deployment of funds.

14.158 The representatives of ONGC maintained before the Committee that brokers were never engaged by the Commission in the deployment of funds. However, they had admitted that certain brokers, in fact, had approached them. The Member (Finance) ONGC who is currently under suspension has also in a subsequent note furnished to the Committee stated that he had since learnt that some of the cheques were delivered by officers of ONGC to the representatives of the brokers. This clearly suggests that brokers had played a vital role in the deployment of surplus funds of ONGC. The Committee expect that subsequent investigations will take note of the facts narrated above and make further inquiries so as to find out the persons responsible for irregularities.

14.159 The ex-Chairman of ONGC had taken appointment with Reliance Industries after his retirement from ONGC which appears to be in contravention of ONGC Rules. The Committee desire that the matter should be enquired into and further necessary action taken including amendments to ONGC Rules to remove lacunae, if any.

14.160 The Committee also desire that ONGC should enquire into the irregularities as well as the shortcomings in the procedures dealt with in this report with a view to streamlining procedures/systems for deployment of funds so that the irregularities do not recur in future. Action should also be taken expeditiously against the officers found guilty of indulging in malpractices.

Oil Industry Development Board (OIDB)

Deployment of surplus funds by OIDB

14.161 The OIDB was set up on 18 January, 1975, under the Oil Industry (Development) Act, 1974 to provide financial assistance for the development of Oil Industry. For that stated purpose under the Act a cess on crude oil and natural gas began to be levied. All proceeds of the cess are credited to the Consolidated Fund of India. Out of such proceeds, however, such sums of money as the Central Government thinks fit for being utilised exclusively for the purpose of the Act, are made available to the Board after due appropriation by the Parliament.

14.162 According to Rule 32 of the Oil Industry Development Rules, 1975 the Board has been authorised to invest its surplus funds with the SBI, the nationalised banks or their wholly owned subsidiaries. According to OIDB, funds were deployed with the banks/ subsidiary giving the highest guaranteed return and were put in safe instruments like Certificate of Deposit or under other schemes with the mandate that these would be deployed in Government securities, Public sector bonds, Units of UTI etc.

14.163 In his deposition before the Committee, the Secretary, OIDB stated:

> "These investible surplus funds are only those which are not readily required by the Oil companies for various purposes as laid down under the Oil Industry Development Act. These funds are invested keeping in view three principles, the principle of security, liquidity and maximum return."

14.164 As on 18.9.1992 after deploying an amount of Rs. 1745 crores with Oil companies for capital project and other approved activities, the Board had invested an amount of Rs. 592.82 crores — Rs. 209.53 crores with nationalised banks, Rs. 334.98 crores with wholly-owned subsidiaries of nationalised banks and Rs. 48.31 crores as inter-corporate deposits with oil companies.

Disproportionate investments in selected Banks

14.165 OIDB Rules were amended in September, 1990, permitting banking operations with wholly owned subsidiaries of SBI/nationalised banks. Prior to 31.3.1992, OIDB had been making investments in instruments like Fixed Deposit Receipt and Certificate of Deposit only. However, 28 transactions of investments were made under PMS and other similar schemes during the period 31 March to 27 May, 1992. Details of this are shown in Appendix-XXXIII. It will be seen therefrom that out of 28 such transactions, with nationalised banks and their subsidiaries involving a total amount of Rs. 544.51 crores, 17 transactions involving Rs. 295.42 crores were undertaken with CANFINA and 8 transactions, involving an investment of Rs. 198.88 crores were conducted through Syndicate Bank. Thus these two institutions alone accounted for more than 90% of the investment, in a period of less than two months. The dates and the period are significant because it was during those days that the scam was at its peak, the Government claimed it was seized of the matter in all earnest; the Parliament had debated it; Stock exchange operations were at a stand still, banks were facing liquidity crisis, brokers were desperate and funds were not to be found.

14.166 When the Committee enquired about the disproportionate investment made with Canfina, the Secretary OIDB deposed:

> "As the facts show, the offers of Canfina happened to be the highest. It is a wholly owned subsidiary of a nationalised bank. Therefore, we were sure that it is a safe and secure investment. Then, it was the highest rate so the other principle of maximum return was also fulfilled."

14.167 The Committee asked Shri B. Shankaranand currently Minister of Health and Family Welfare, who was the Chairman of OIDB at the relevant time as to how he explained investment of 91% of funds in the two institutions. In a written note, he stated:

> "Since the rates of interest/yield by the bank/financial institutions in question were highest during the relevant period, funds were invested with them."

14.168 It needs to be pointed out that the Minister of Petroleum is *ex-officio* Chairman of OIDB. This is as per charter.

System of inviting offers

14.169 According to OIDB, the process of inviting offers, was initiated by the Accountant 10 to 15 days in advance of the dates when the surplus funds were expected to be available. The OIDB letters inviting fresh offers for investment of funds in CDs did not specify any time limit for submission of the offers by the banks. However, from March, 1992 onwards OIDB letters calling for offers from the banks and their wholly owned subsidiaries for investment of funds in the PMS/Investment Advisory Services/Investment Services/ Certificate of Deposit started indicating the dates by which offers should be submitted. Nevertheless, offers received after the stipulated dates were also entertained. Surprisingly, the offers were not required to be submitted to any particular officer and were not required to be sent in sealed covers. Furthermore, there were no office orders/instructions in regard to inviting of offers and their processing.

Irregularities in processing of offers for PMS etc.

14.170 The Committee have found several deficiencies in the processing of offers received from different banks/subsidiaries for investment of funds in PMS and other similar modes of investment. These deficiencies were particularly observed in the manner in which revised offers from Canfina and Syndicate Bank were received, processed and ultimately investments made during March-May, 1992. Details are dealt with in subsequent paragraphs.

14.171 OIDB had funds of about Rs. 160 crores for investment between 31.3.1992 and 10.4.1992. The Board's Secretariat had invited offers from different banks/subsidiaries to be furnished positively by 23.3.1992. Canfina had initially furnished an offer of 17% per annum on 23.3.1992 which was revised on the same day by another letter offering 18.20% p.a. When the file containing different offers was put up to the Secretary, OIDB, the offers received for investment under PMS for one year from Syndicate Bank for Rs. 140 crores @ 18.25 % and from Canfina @ 18.20% were the most competitive rates. However, another revised offer guaranteeing a rate of 18.30% was made by Canfina three days later, *i.e.* vide their letter dated 26.3.1992. This was received at the Secretary's office and taken into account by him in his note put up to the Chairman on the same day *i.e.* 26 March, 1992.

14.172 In reply to a question by the Committee, the OIDB in a written note furnished after evidence stated that the Private Secretary to the Secretary, OIDB was requested to clarify various aspects of the receipt of letter No. DCAN:OIDB:92 dated 26.3.1992 from Canfina received on 25.3.1992. In his statement, the PS to Secretary OIDB stated that certain statements as desired by Secretary were received from the office of the OIDB on 25.3.1992.

He further stated:

"One other Letter was received from Canbank Financial Services. As the letter and documents from OIDB, were received by the peon in my absence in the late evening hours, it is difficult to name the person who brought these letters. I placed the letter alongwith the statements received from OIDB, in file and gave a running serial number to these receipts.

After having added these letters to the case file, I took this to JS&FA around 7.00 p.m. that very day (25.3.1992) for dictation. There is mention of all the documents so filed and serialised by me in the dictation of the JS&FA.

It is true that the date marked on the letter delivered by the Canfina went unnoticed. In fact even the statements from the OIDB were also not dated. But all these documents were filed by me in a serial order giving them enclosures Nos. 36-43 and the same got reflected in the dictation of the

Secretary OIDB taken by me in the late evening hours on 25.3.1992 for submission to the Chairman, OIDB."

14.173 Even granting that a letter dated 26.3.1992 could be received a day earlier that is on 25.3.1992, the fact remains that the revised offers were received by the Secretary, OIDB and were taken into consideration by him after the last date prescribed, which was 23.3.1992.

14.174 In another case, a file containing letters of quotations from different banks was submitted to Chairman, OIDB on 27.4.1992 itself. This file was received back for putting up a self contained note alongwith two additional letters from Syndicate Bank, one from Bombay, and the other from the Delhi Office of this bank, both, however were dated 27.4.1992. Seeking orders for the investment of the amount of Rs. 114.72 crores, Secretary, OIDB indicated that as of then, the offers of Corporation Bank (19.50%) and Syndicate Bank (19.51%) were better. the Chairman, OIDB gave the following orders on 27.4.1992:

"All the funds available upto 30th April, *i.e.* Rs. 114.72 crores be invested at the best offer of 19.51% of Syndicate Bank."

14.175 The Committee find it strange as to how a letter dated 27.4.1992 from the Bombay Branch reached the Chairman's office in Delhi on the same date. From the letter it is apparent that Delhi letter was written in furtherance of the Bombay letter. There is another inexplicable aspect of this entire transaction. Letter from Syndicate Bank, Bombay, had obvious enough over writing to make it up to an offer of 19.51% p.a. Uptill then the highest offer had been 19.50% p.a. This leads to doubts about the breach of confidentiality of offers, and about overwriting. It is also relevant to point out that in their letter issued to banks/subsidiaries inviting offers for investments in the above case, OIDB had stated that the offers should reach them by 16.4.1992 positively.

14.176 In yet another case, a file was initiated on 24.4.1992 in connection with investment of Rs. 63.89 crores which would become available between 1.5.1992 and 4.5.1992. OIDB vide their communication to banks/subsidiaries had prescribed 23.4.1992 as the last date for submission of offers for investment. When the file was finally submitted to the Secretary, OIDB indicating the offers and proposals, he stated on 30.4.1992 that an offer received from Syndicate Bank dated 30.4.1992 @20.05% at the Chairman's office might also be considered alongwith others and the file was put up to the Chairman, OIDB. The Chairman, OIDB passed orders on the same day for investment of Rs. 63.89 crores in Syndicate Bank.

14.177 Apart from Syndicate Bank, Canfina had also been found repeatedly furnishing revised offers. All these investments let it be repeated have to be viewed in the context that the irregularities in securities and banking transactions had come to light in the last week of April, 1992. The involvement of various banks/subsidiaries had started unraveling since then but still, investments of substantial amounts were made with them as shown below.

14.178 A file was initiated on 7.5.1992 seeking orders for the investible surplus of Rs. 120.53 crores which would have become due between 12.5.1992 and 20.5.1992. The last date for submission of offers by various banks/subsidiaries was 5.5.1992. The file was marked by Secretary, OIDB to Chairman on 8.5.1992. On 11.5.1992 revised offer from Canfina at the rate of 20.10% p.a. was received. Indicating that the file had been received back from Chairman's office for a self contained proposal, the Secretary sought orders of Chairman on 11.5.1992 for investment of Rs. 69.83 crores in Canfina and the balance of Rs. 50.70 crores in Syndicate Bank which was approved by the Chairman on the same day. Similarly, a file was initiated on 15.5.1992 for deployment of investible surplus of Rs. 87.01 crores between 21.5.1992 and 27.5.1992. The offers for investment were to be furnished to OIDB office by banks/subsidiaries by 13.5.1992. The file was submitted to the Chairman, OIDB on 15.5.1992 with

the available best proposals for investment in Indbank Merchant Banking Services Ltd. (18.50%) for short term investment and with PNB (17.50%) under CD. The Chairman was out of town and the file was desired to be resubmitted on 20.5.1992. The file was resubmitted on 19.5.1992 stating that a higher offer from Canfina had since been received on 18.5.1992 offering yield of 18.6% for 91 days and proposal for investment in Canfina was approved by Chairman, OIDB on 20.5.1992.

14.179 The Committee enquired about the delivery of letters involving offers for investment from the banks/subsidiaries at the office of the Chairman. OIDB in a note replied:

> "A number of letters, representations, applications etc. pertaining to various subjects of the Ministry are received from the people in the office of the Minister for Petroleum & Natural Gas. Information about the particulars of these people is never maintained as it is not feasible and practical."

14.180 When asked further whether such letters were received at the Chairman's office as a matter of practice, OIDB replied that the letters received pertaining to various subjects were sent to the officer concerned for appropriate action. They also maintained that there were instances in the past also when such letters had been received at the Minister's office.

14.181 The Committee asked Shri B. Shankaranand to cite the instances where he as Chairman directly received offers from banks/institutions for placement of funds either at his office or at his residence and the details of the subsequent action taken thereupon by him. In his written note, he stated:

> "Besides being Chairman of OIDB, I was also Minister of Petroleum and Natural Gas. It is common knowledge that numerous letters, representations, applications, etc. from people are received through dak or otherwise in the office/residence of the Minister as a routine affair and they are passed on to the concerned officers for examination and necessary action. Amongst them if there were any letters from the nationalised banks or their wholly owned subsidiaries for placement of funds they were sent to the concerned officer *i.e.* the Secretary, OIDB and they were all considered alongwith other offers and the investments were always made on the basis of highest rate of interest-yield."

14.182 When asked for his comments on the manner in which the letters from banks received at his office were added to the file after the cases have been processed and decision taken in favour of the banks from which revised offers were received, Shri B. Shankaranand, the then Chairman, OIDB in a note stated:

> "If the letters in question were received in my office while the concerned file was under process, it was but necessary to send them back to the Secretary, OIDB to examine the offers alongwith others before actual investment."

14.183 Enquired as to why Canfina was found placing revised offers of investment repeatedly, OIDB in a note stated:

> "The procedure for investment of funds followed by OIDB did not bar submission of revised offers by any nationalised bank or its wholly-owned subsidiary."

14.184 The Committee pointed out that the manner in which Canfina and Syndicate Bank had been furnishing revised offers repeatedly in the case under examination during the final stages of the processing of the offers would seem to give an impression that they were able

to garner inside information about the rates offered by other banks/subsidiaries. Reacting to the above, OIDB stated:

> "It is denied that the Canfina & Syndicate Bank were able to garner inside information about the rates offered by other banks/subsidiaries. As already stated, the OIDB's extant policy did not bar submission of revised offer."

Short-term Investment

14.185 Out of the 17 transactions with Canfina involving Rs. 295.42 crores, seven transactions of investments valuing Rs. 106.21 crores were undertaken for a period of 30/91 days. The rates of returns indicated on those transactions were higher than the rates prescribed by RBI for term deposits. The investments were, therefore, akin to PMS, but violative of the RBI condition on banks regarding its duration etc.. In fact, the transactions were ready forward in nature, violative of RBI guidelines.

Sanctions for placement of funds

14.186 The office of the Chairman, OIDB is held by the Minister holding charge of the Ministry of Petroleum and Natural Gas. Prior to March, 1991, investment decisions were approved at the level of Secretary in OIDB. In March, 1991, the then Chairman, OIDB expressed his desire to review the system of deployment of funds prevailing in the organisation and issued orders that till the system was reviewed, further deployment of funds might be made with his prior approval. In pursuance of the said order, all investment decisions came to be approved at the level of Chairman, OIDB since then.

Utilisation of money

14.187 The Committee are astonished to note that OIDB did not possess either the securities or any stamped receipts in respect of the investments made by them under PMS/short term investment with the banks/their subsidiaries. It has also been revealed that they did not even have any confirmation in regard to the safe custody of the securities.

14.188 Asked whether he was aware of the above position, the then Chairman, OIDB, in a note furnished to the Committee stated:

> "I was given to understand that all such investments were made by cheques and pay orders and receipts obtained and that while making such investments the OIDB had mandated that the amount be invested only in PSU Bonds, Government securities and units."

14.189 What has further dismayed the Committee is that funds of OIDB were used by Syndicate Bank without the knowledge of the Board in making investments in equities of private sector companies.

Amount outstanding from Canfina

14.190 Out of the seven transactions referred to above with Canfina for a period of thirty/ninety days, in respect of six transactions, out of Rs. 90.86 crores matured during the period, Canfina had repaid an amount of Rs. 20 crores only and this too on 7.9.1992. The Company had requested for continuation of the funds which was not agreed to by OIDB. However, the money is yet to be realised from Canfina. The Secretary, OIDB stated in evidence that Canfina could not pay it because of their "bad ways and means position".

14.191 Significantly, all the six transactions were conducted between 21.5.1992 and 27.5.1992 when the ramifications of scam were well known. In fact, in all, 12 transactions were conducted in May, 1992 involving a total amount of Rs. 158 crores. The Committee asked why the ramifications of scam were overlooked while taking investment decisions after the last week of April, 1992. In a written note, OIDB replied:

> "The involvement of Canfina in the irregularities in the securities and banking transactions came out only in the second interim report of the Janakiraman Committee submitted to the RBI Governor on June 2, 1992. No investment with Canfina had been made after May 27, 1992."

Irregularities in investments under Certificate of Deposit Scheme (CDs)

14.192 The OIDB started investing in the instrument of 'Certificate of Deposit' from February, 1990 onwards. All investments made by OIDB till 21.3.1992 with nationalised banks/subsidiaries were under the scheme of Certificate of Deposit or as Fixed Deposits. A test check of files relating to 26 transactions relating to the period 30.4.1991 to 22.6.1991 under the scheme of Certificates of Deposit by the Committee revealed several irregularities. Some of such irregularities were :

(i) in certain cases, revised offers received from some banks after the processing of offers initiated were included and decisions taken in their favour;

(ii) absence of clear cut criteria in selecting the banks for investments/renewals, particularly when they had offered the same rates;

(iii) investments in institutions at rates in variance with the rates as indicated in the approval notes;

(iv) discrepancies in respect of the names of banks with whom investments have actually been made *vis-a-vis* the names of banks with whom investment had been approved, etc.

14.193 In all the files containing investment decisions under the scheme of CDs, a condition had been added that any better offer received prior to investment was also proposed to be availed of. OIDB has quoted this condition to justify when some of the discrepancies mentioned above were brought to their notice.

14.194 The Committee regret to note that under the cover of the said condition, revised offers received from banks even after the approval of the proposals by the Chairman, OIDB were entertained and investments made with them. Evidently, this made a mockery of the orders of the then Chairman, OIDB that the deployment of funds should be made with his approval as in the above cases, the said orders were not observed.

Inter-Corporate deposits with Oil Companies

14.195 Out of the total investments of surplus funds amounting to Rs. 592.82 crores as on 18.9.1992, OIDB had deployed Rs. 48.31 crores as inter-corporate deposits with oil companies. Commenting on the reasons for deposits with oil companies the Secretary, OIDB deposed in evidence:

> "Actually, when the investible funds became available to us on the 4th of June, we did not give to any of the banks because we did not know which banks were involved in it. We had some requests from the oil companies. These were not for loan but for investment. So, we put the money between 4th of June

and 14th of September, 1992 only with IBP, Balmer Lawrie and Indian Additives Ltd. which are companies in oil sector. We did not put any money with any of the banks."

14.196 These investments were made with six such companies between 4.6.1992 and 14.9.1992.

14.197 However, in its meeting held on 18.9.1992, OIDB observed that the rules permitted investments with nationalised banks and their wholly-owned subsidiaries. In view of this, the Board directed that the funds entrusted to the oil companies in the nature of investment be recalled. During evidence, the representative of the OIDB admitted that deployment of money with oil companies "was not strictly as per the rules". According to him:

> "but this we did, so that nobody could raise a finger at us that some banks were in the scam and we made investments with them."

14.198 As per the decision taken by OIDB at their 28th meeting held on 24.10.1990, deposits with the subsidiary companies can be made if it was under-written by the parent bank and that too on a selective basis as and when necessary. Out of the total investments of Rs. 544.51 crores with banks/subsidiaries between 31.3.1992 and 27.5.1992 an amount of Rs. 334.96 crores was deployed with subsidiary companies of nationalised banks (Canfina Rs. 298.82 crores, Allbank Finance Rs. 36.56 crores). Since the parent banks had not under-written the deposits as was required in terms of the Board's decision on 24.10.1990, the Committee asked as to how the then Chairman justified investments of such a large amount in subsidiary companies of nationalised banks. In a note Shri Shankaranand stated:

> "I am given to understand that the Board's decision was with regard to parent bank's guarantee for the deposit with the subsidiary companies and not with regard to investments in instruments. OIDB had been mandating that their funds be invested in PSU Bonds, Government securities and Units of UTI. Thus, the said investments of the OIDB were not deposits and therefore, the question of parent bank's guarantee did not arise. The OIDB in its meeting held on 18.9.1992 found all the investments with the nationalised banks and their wholly owned subsidiaries to be in order."

14.199 The contention of the then Chairman, OIDB that the transactions of deployment of funds in question were investments in instruments is not acceptable. Though OIDB had been mandating that their funds be invested in specified securities, the banks/institutions had never transferred any securities in the Board's favour. In fact, the banks/institutions had failed to give any confirmation in regard to the safe custody of the securities and even to provide stamped receipts in respect of the transactions. Therefore, in the absence of proof of purchase of securities and their transfer to the Board, the Committee cannot accept the transactions as investments in instruments.

14.200 Significantly, the ramifications of scam were widely known by September, 1992 and it was common knowledge that the type of transactions in question hardly involved any genuine investment in instruments. The Committee are, therefore, surprised as to how the Board at its meeting held on 18.9.1992, chaired by Shri Shankaranand himself, arrived at the conclusion that the investments made with the subsidiaries of nationalised banks in 1992 were in order in terms of the Board's decision dated 24.10.1990.

14.201 After OIDB started making investments in PMS and other schemes from March, 1992 and till 27.5.1992, OIDB had made disproportionate investments in two institutions, viz., Canfina and Syndicate Bank. The manner in which these two institutions had been chosen repeatedly for investment, on several occasions, has indeed exposed the system

of processing of offers prevalent in the organisation. It had become a usual practice to entertain revised offers after the last date of submission of quotations and after the files had been submitted to the Chairman, OIDB for final orders. Such practices make a mockery of the tender system and violate the norms of prudent financial management. Unavoidably, such actions have created doubts that some institutions had received preferential treatment at the hands of OIDB. Unfortunately, the explanations offered by both the then Chairman and others from OIDB have in no way helped in dispelling these suspicions.

14.202 What has caused considerable concern to the Committee is that OIDB did not possess either the securities or any stamped receipts in respect of the investments made by them, and did not even have any confirmation in regard to safe custody of the securities. Apparently, investments were continued to be made with such banks even after they had failed in submitting the necessary documents. More astonishingly, these funds of OIDB were widely used in making investments in equities of private sector companies. Had OIDB obtained the statements from the banks concerned periodically regarding the manner of deployment of money, the senior officers who were responsible for the management of finances had followed up by obtaining the securities or stamped receipts for the payments made, these facts would have come to light. Unfortunately, the officers failed. The Committee are of the view that the Secretary, OIDB, Financial Adviser and other officers responsible for fund management were negligent in the discharge of their duties, and the responsibilities should be fixed for the lapses.

14.203 The Committee note that Canfina has already defaulted in repaying the money to the extent of Rs. 70.86 crores which became due in August, 1992, and also Rs. 137.28 crores which matured till 16.4.1993. The recovery of Rs. 71.31 crores which became due in May, 1993 is also doubtful. The efforts made by OIDB so far to retrieve the money back from Canfina have not succeeded. Chairman, OIDB when asked to explain what action had been initiated for recovery of sums replied:

> "With regard to Canfina's default in meeting its repayment obligations, it was discussed in the Board's meeting. And I quote from Annexure-II of the proceedings. The Board took note of Canfina's default in meeting its repayment obligations and directed that the Department of Banking be approached for advice as to what possible measures could be taken to retrieve OIDB's funds. The legal position regarding the responsibility and accountability of Canara Bank for the repayment obligations of Canfina was also asked to be examined."

14.204 The Committee find it necessary to observe that OIDB has mentioned the security of investment as one of the criteria. How, when this is found wanting, the Ministry of Finance is to advise about remedial action. The Committee feel that it is an evasion of responsibility on the part of OIDB to approach the Department of Banking now for advice on how to recover the money.

14.205 The Committee are of the view that assumption of responsibility for placement of funds by Chairman of OIDB was uncalled for. The Committee are also of the view that Ministers acting as ex-officio Chairmen of such organisations is not a healthy practice. In the light of these observations, the Committee consider it a sad duty to conclude that the two Chairmen, OIDB during the relevant period did not discharge their responsibilities in consonance with the high office held by them. Further it is the expectation of the Committee that Government will take necessary corrective action.

AIR INDIA

Irregular Deployment of Funds

14.206 Section 12(2) of the Air Corporations Act, 1953, permits AI to keep an account with any scheduled bank and to invest any money in such manner as may be approved by the Central Government. In 1987-88, AI made some investments, in PMS, with nationalised banks. A *post-facto* approval was accorded by the Government in March, 1988, for PMS with the SBI only. On 20.7.1990 AI sought permission of Government to invest funds with nationalised banks in Ready Forward purchase and sale of securities. Although no permission was received, investments were made in April, 1991 with Citibank, and with SBI Caps in June, 1991 in Ready Forward Deals. The total amount invested in Ready Forward transactions in Citibank and SBI Caps during 1991-92 amounted to Rs. 96.77 crores and Rs. 147.86 crores respectively (excluding amounts reinvested or roll over). Investments made in Citibank were for periods ranging from 7 to 52 days at rates of returns varying from 17% to 22%.

14.207 Further, investments were also made with Indbank Merchant Services Ltd. in January, 1992 which was not a scheduled bank but a subsidiary of a bank, without the approval of the Central Government. Funds invested in Indbank Merchant Services amounted to Rs. 35 crores. In February and May, 1992 AI placed funds under PMS in Citibank again without the approval of the Government. Amounts of Rs. 49.28 crores and Rs. 10 crores were invested with Citibank in two accounts on 10.2.1992 and 7.5.1992 respectively. During evidence, the CMD, AI, Shri Y.C. Deveshwar admitted that the investments in these three areas were not in conformity with the provisions of the Air Corporations Act.

Failure to obtain securities/BRs

14.208 Out of the 20 Ready Forward transactions of AI, Citibank issued BRs in two cases. The remaining BRs were submitted to AI by Citibank only for discharge and that too on 24.9.1992, though all the Ready Forward transactions had been completed by February, 1992. One BR was not discharged by AI as the security mentioned in the BR did not agree with the security mentioned in the letter to Citibank at the time of placement of funds. Citibank did not deliver any securities in any of the transactions. SBI Caps however, neither delivered the securities purchased by the Corporation nor were any BRs issued to the Corporation. In this questionable investment with SBI Caps in June, 1991, AI had placed Rs. 147.86 crores.

Tampering with Records

14.209 All investments in Ready Forward with Citibank were described in the books of accounts of AI as with the SBI Fixed Deposit Account. This continued upto January, 1992. Shri Sidhwa, Deputy Director (Finance), AI, while admitting this in evidence stated that the then Acting CMD, Shri Gupte, knew about it as there was a footnote in hand, in the weekly statements furnished to the CMD stating that the amounts shown as deposit in SBI, included amounts deposited in Citibank as well as in SBI Caps. It came to the notice of the Committee that these handwritten footnotes also showed the break up of such amounts invested in Citibank and SBI Caps alongwith the rate of interest thereon. Shri Sidhwa also said in evidence:

> "I was advised that we should go about these transactions discreetly..... I had to carry out sometime certain directions."

Investment in Equities of Listed Companies

14.210 AI permitted Citibank, on 7.2.1992, to invest their funds even in equities and stocks of listed companies. As on 31.3.1992, out of Rs. 49.28 crores kept in PMS Rs. 48.15 crores was invested in *equity shares*. Though Citibank advised AI of details of these investments from February 1992 onwards, no action was taken to stop such placement of public funds in private equities. It was only on 20.6.1992 that AI instructed Citibank to liquidate them. This was confirmed by Citibank on 22.7.1992. It was also revealed during evidence, that in the office copy in AI of the schedule of Citibank's PMS agreement, the columns regarding investment in equities and stocks had not been tick marked whereas it has been done so in the original copy submitted to the bank. This omission in office records cannot be attributed to the inefficiency or sloppiness but appears to be the outcome of a more sinister design.

System of Inviting Offers

14.211 AI did not have any standard system for inviting quotations of rates of returns from various banks either in respect of the investments of funds or for deposits under schemes like CDs. It was admitted in evidence that in respect of investments made with Citibank, SBI Caps and Indbank, best rate was not sought. All this was done orally and the terms offered by different banks were neither documented nor tabulated.

Bank Statements not Scrutinised

14.212 The AI Management had not perused or scrutinised the "Customer Transaction Statements" and the "statements of Portfolio Holdings" submitted periodically by Citibank. The lapse was admitted in evidence. During evidence the CMD deposed:

> "AI officers have tick-marked and practically all natures of securities including shares have been tick-marked. AI officers were given periodic state of health of their portfolio, it went unattended. It went to the Cash Section and nobody acted on it. A number of statements were coming. These original statements are with us. Many of them are not even signed by anybody and the explanation given to me and to the Investigating team is that we were not concerned with what they were doing so long as they at the end of the year received this rate of return of 19%."

Submission of weekly statements

14.213 It was stated during evidence that weekly statements were being submitted to the office of Director of Finance, superscribing on those reports, the investments placed with Citibank and SBI Caps. These weekly statements of money deployment continued to be submitted to Shri S.R. Gupte who was Acting-CMD till 4.11.91 and Deputy Managing Director thereafter till his voluntary retirement on 21.3.92. Shri J.A. Sidhwa, Deputy Director, Finance and Shri K. Raghunathan, Deputy Financial Controller did not submit such reports after Shri Gupte's retirement.

Role of Present CMD, AI

14.214 Shri Y.C. Deveshwar took over as CMD, AI on 13.11.91. He stated that he had come to know about the irregularities in investments on 24.7.92. He admitted that although a statement used to come to the CMD's office showing the income and cash position, he never discussed with the concerned officers the details of investment of surplus funds of the Corporation till these irregularities were pointed out by the Auditors of AI.

14.215 Asked whether he had enquired about the investments by the Corporation from

Shri Sidhwa after Shri Gupte had left, Shri Deveshwar replied in the negative and added:

> "I never conceived that the investment could be made in an unauthorised manner."

Role of AI Vigilance

14.216 The Director, Vigilance and Security, AI conceded during evidence that he had not been able to detect the irregularities.

Role of AI Staff

14.217 AI has apportioned the blame for the irregular investments to Shri S.R. Gupte, former Deputy Managing Director who was also discharging the functions of Director Finance, Shri J.A. Sidhwa, Deputy Director (Finance) and Shri K. Raghunathan, Asstt. Financial Controller. Shri Sidhwa and Shri Raghunathan have maintained that they were acting in pursuance of the oral instructions of Shri Gupte.

14.218 In his deposition before the Committee, Shri Deveshwar, stated:

> "On the first document that was given to Citibank to start this arrangement, it has been superscribed by the Head of the Cash Section that this investment is being made at the behest of the Managing Director. These weekly statements were coming to the then Director of Finance and acting CMD and were seen by the Executive Assistant and sent back with notings that Mr. Gupte has seen it. There is one document on which his signatures are available, having seen that document."

14.219 The Committee asked Shri Sidhwa whether he had recorded his views while making the controversial investments which according to him was done at Shri Gupte's instance. The witness replied:

> "Unfortunately no. I admit that. I did not record. As far as I am concerned, I took all the instructions from my senior in good faith and acted according to his instruction."

14.220 On being further asked whether he had reported about the investments after the new CMD took over, the witness replied:

> "I was supposed to have informed him but I have not done it. It was a lapse on my part."

14.221 Shri S.R. Gupte, denied having issued oral instructions. In his note furnished to the Committee Shri Gupte stated that he had passed an office order consequent upon his taking over charge as Acting Chairman & Managing Director giving authority on matters pertaining to the Finance and Accounts Departments to Shri J. Sidhwa. The Committee, however, found that in fact, no such office order was issued, but only a D.O. letter to Shri Sidhwa by Shri Gupte in which Shri Sidhwa was also requested to keep him apprised of any major developments on a periodical basis. The Committee also observed that weekly statements were being sent to Shri Gupte about deployment of funds even after he assumed charge as Deputy Managing Director on 4.11.1991.

14.222 Consequent to the investigations conducted by the Vigilance Division of AI, a report was submitted to the Management and as a follow-up, two officers of the Finance & Accounts Department *viz.*, Shri J.A. Sidhwa, Deputy Director, Finance and Shri K. Raghunathan,

Deputy Financial Controller have been placed under suspension on 30.10.1992. The Committee are relieved to learn about this cooperative attitude.

Special Audit of AI's Investments

14.223 An audit of AI's investments from April 1991 and the financial status of these investments as on 30.9.92 was conducted by S.B. Bilimoria & Co., Chartered Accountants. This is with particular reference to details of all such transactions to determine gains/losses, outstandings and examine the existing systems/procedures and recommend improvements. The Audit Report has revealed several other irregularities like non-compliance of the limit laid down in AI Accounts Manual regarding signing of payment voucher for the Ready Forward transaction with Citibank, permission of roll over of the Ready Forward transaction to Citibank and SBI Caps without issuing any letter, modifying the conditions of Ready Forward transactions before the date so as to meet Citibank's requirement; differences in the rates of returns of Citibank for transaction on the same day for the same maturity, wide discrepancies in the rates of equities indicated by the Citibank from those quoted in the BSE, discrepancies in the description and number of securities sold by AI and purchased by Citibank, procedural shortcomings in the transactions with SBI Caps etc. This Report has identified several shortcomings in the existing procedures followed by AI and have suggested suitable changes. All this is however, now an internal exercise by AI and hardly rectifies all the earlier wrongs. It is for the Government to ascertain why these wrongs took place and how many continue even now.

Outstandings

14.224 All investments made by AI with the exception of a PMS account with Citibank made on 7.5.1992 for Rs. 10 crores (which was due to mature on 7.5.1993) have matured. According to AI, no loss has been incurred on these investments.

Monitoring by the Ministry

14.225 It has been observed that there was no system at all of monitoring by the Ministry of Civil Aviation in respect of the deployment of funds by the public enterprises under their control. A system for obtaining a quarterly report of the position of investments from the PSUs was introduced *vide* the Ministry's letter dated 20.8.1992. This was four months after the scam had surfaced.

14.226 To conclude this sorry episode, investments made by AI India with Citibank in April, 1991, (Rs. 96.77 crores), SBI Caps, in June, 1991, (Rs. 147.86 crores), both in Ready Forward deals; deposit of Rs. 35 crores, in January, 1992, with Indbank Merchant Services Ltd., and Rs. 49.28 crores, in February 1992, and Rs. 10 crores, under PMS with Citibank, in May, 1992 were highly irregular and totally violative of the provisions of Air Corporations Act. The manner in which the agreements were signed by the representatives of AI with Citibank authorising the bank to invest in private equities concealing the said conditions in records of the Corporation and also the manner in which the books of AI were tampered with so as to show the investments in question as deposits with the SBI, clearly establishes that these actions were malafide. **The failure of AI officials to obtain securities, BRs from Citibank/SBI Caps in time, and the complete negligence demonstrated in perusing the periodical statements emanating from Citibank, indicating investments in the equities of Private Sector Companies only reinforces the above observation. It is also demonstrative of the total failure of the officers higher up in the hierarchy to exercise proper control and supervision.**

14.227 The Committee find that AI has apportioned the blame for the irregular

investments on Shri S.R. Gupte, former Deputy Managing Director who was also discharging the functions of Director, Finance, on Shri J.A. Sidhwa, Deputy Director (Finance) and Shri K. Raghunathan, Asstt. Financial Controller. The last two have been suspended pursuant to a departmental inquiry. Both of them have maintained that they were acting in pursuance of the verbal instructions of Shri Gupte who voluntarily retired on 21.3.1992. Shri Gupte denied having issued oral instructions. However, considering the fact that the weekly statements showing deployment of funds with various banks were stated to have been sent by Shri Sidhwa, Shri Gupte could not have remained unaware.

14.228 The Committee want the matter to be thoroughly inquired into, if necessary with the assistance of CBI with a view to punishing the guilty. The Committee feel that the Chief Executive of AI should have kept himself informed of the manner of investment of sizeable surplus funds of the Corporation. If that had been done, irregularities could have been detected earlier. The Committee trust that the shortcomings in the existing procedures pointed out in this report, as also by the report of the Special Audit will be set right. It needs, however, to be stated here that overall responsibility remains that of the Ministry. This was not satisfactorily performed.

VAYUDOOT

Deployment of Funds by Vayudoot

14.229 Vayudoot was incorporated in 1981 as a Company under the Companies Act, with AI and Indian Airlines holding its entire issued share capital in equal proportions. The present paid up share capital is Rs. 36.17 crores. Both AI and Indian Airlines in their capacity as promoters and shareholders of Vayudoot Ltd. have been providing from time to time essential funds required by Vayudoot to meet its operational requirements and for discharging its liabilities. Such funds have been contributed either in the form of equity or as loan. Since inception, Vayudoot has received financial assistance aggregating to Rs. 91.54 crores from AI, Indian Airlines, ONGC, International Airports Authority of India and Ministry of Civil Aviation. The total outstanding liability of the company is about Rs. 170 crores; and this against a share capital of 36.17 crores.

14.230 The state of operations of Vayudoot was discussed at a meeting taken by the then Minister of State for Civil Aviation on 6.2.1992 followed by another meeting on 8/2/92 taken by the then Minister of Civil Aviation & Tourism. At these meetings it was decided to provide to Vayudoot working funds not exceeding Rs. 20 crores to enable it to carry out operations for six months. The amount was to be provided equally by AI and Indian Airlines. AI was to provide, apart from its own share of Rs. 10 crores, the equivalent share of Indian Airlines as well, the amount being treated as an advance from AI to Indian Airlines. It was decided that the actual release of funds from time to time within the ceiling of Rs. 20 crores will have to be justified further to AI by CMD, Vayudoot. Accordingly, AI had released the amount in two instalments @ 10% rate of interest in March, 1992 and Indian Airlines in April-May 1992 @ 16% interest rate. (AI had earlier in July-December, 1991 had also provided Rs. 5 crores in three instalments). According to a communication of the Ministry of Civil Aviation, the objective of this was to enable it to take care of its pressing fund requirements, *i.e.* to liquidate the most urgent liabilities out of a list of liabilities totalling Rs. 35.64 crores. This was also the ground on which Vayudoot itself had sought immediate funds. According to the Ministry, Vayudoot had also referred to the "precarious financial position" at a meeting of the CMDs of AI, IA and Vayudoot on 16.3.1992.

14.231 Explaining the purpose for which the funds were required, Captain V.K. Trehan, CMD, Vayudoot deposed before the Committee:

> "Vayudoot needed these funds not only to negotiate for settlement with the suppliers of spares of engines but also to pay for the past liabilities, and also to induce the suppliers that it was essential for the continuity of the operation of Vayudoot and for this purpose, it was necessary to establish that Vayudoot has funds with it."

14.232 However, during the period 26.3.1992 to 10.6.1992, it was noticed that Vayudoot deployed the funds in what is termed as "short term deposits", in 18 transactions, for periods ranging from 15 to 30 days at interest rates varying from 19.5% to 37.5%. The amounts deposited in each transaction varied from Rs. 70 lakhs to Rs. 13.50 crores. The deposits were made with Canara Bank (14 transactions), Grindlays Bank (3 transactions) and SCB (one transaction). In fact all these were Ready Forward transactions in violation of RBI guidelines, they were only euphemistically "short term deposits".

14.233 When the Committee asked about the reasons for doing so, the CMD stated in evidence:

> "There was a time lag between negotiations and the settlement. It was felt that if the money is put in the short term deposits not only will it earn revenue for Vayudoot but also it will help us to negotiate with the creditors which we have achieved. "

14.234 The witness also stated that it was he, who at his level decided about the controversial short term investments. He said, "it was my decision".

System of Inviting Offers

14.235 There was no proper system of inviting offers for deployment of funds by Vayudoot. Rates were ascertained telephonically which were entered in a register and investments made. The CMD, in fact, explained the system as follows:

> "We use to ring up three-four banks and whichever bank was offering the highest rate of interest, we used to go to them".

Transactions with Canfina

14.236 It has been observed that in 14 out of the 18 transactions mentioned earlier, funds were purportedly placed with Canara Bank, but the receipts were issued by Canfina which was not a scheduled bank, but a subsidiary company of the same. Apart from the fact that making investments in a subsidiary of a nationalised bank was not specifically authorised by the Articles of Association of the company, Vayudoot had also never brought the discrepancy to the notice of Canara Bank.

14.237 Commenting on the same CMD, Vayudoot stated in evidence:

> "I had made the deposits in Canara Bank. The receipts they gave were of Canfina. Whatever is the internal arrangement of theirs is not known to me. If it is a mistake, it is a mistake."

Investment in Canfina and Stanchart even after Involvement in SCAM was known

14.238 Vayudoot continued to invest in Canfina through Canara Bank from 26 March, 1992 to 10 June, 1992, that is when the matter of scam was in the forefront of public consciousness.

Similarly, money was also deployed with Stanchart on 30.5.1992. Thus even after the irregularities in securities and banking transactions and the involvement of Canfina and Stanchart in the same was revealed, Vayudoot had continued deployment of funds with them. During evidence, CMD, Vayudoot sought to explain it by saying that he realised that the company had been doing wrong only when it came in the newspapers that Canfina and other banks had been involved in the securities scam.

Interest on overdraft

14.239 The company had drawn overdraft from Vijaya Bank, State Bank of Patiala and Bank of India. Having defaulted in servicing its debts, Vayudoot was being called upon to pay penal interest @ 26.5% by Vijaya Bank. Significantly, in 9 out of the 18 transactions involving a total amount of Rs. 31 crores, Vayudoot had got interest at rates considerably lower than 26.5% i.e. from 19.5% to 24.5%. This, at best, is curious financial management of borrowed funds.

Role of Directors of Ministry/AI

14.240 There are two representatives of the Ministry of Civil Aviation in the Board of Vayudoot. The representative of the Ministry of Civil Aviation was present at the meeting of the Board held on 7.7.1992 when the Board considered the question of short term investment. However, according to CMD, Vayudoot, he (the Ministry's nominee) had not raised any objection about the short term investments made. It is strange that no enquiries were made by the Government Director particularly in view of the fact that by July, 1992 the ramifications of the scam and the involvement of PSUs was well known. The nominee of AI from whom Vayudoot had borrowed the money, in the Board meeting had also apparently, not made any protests.

14.241 Articles of Association of Vayudoot Ltd. *inter-alia* authorised the company to invest in the R.B.I., S.B.I. or any of its subsidiaries or any Nationalised Banks or in such securities as may be approved by the Government. It also authorised that account may also be opened with any of the other scheduled banks with the approval of the Government if it was necessary to do so for the proper functioning of the company.

14.242 It was contended by Vayudoot that the resolutions passed by the Board of Vayudoot in its meeting held on 20.10.1988 and 27.8.1992 authorised the Chairman/CMD/ED/General Manager to make short and/or long term deposits.

14.243 The resolution of 20.10.1988 *inter-alia* stated as follows:

> "Resolved that the Chairman and the General Manager be and are hereby empowered, severally or jointly to open/close and/or operate any account of Vayudoot Limited whether it is cash credit, collection, disbursement, current, safe custody, short and/or long term deposits, loan against exchange accounts."

14.244 Similarly, the Resolution of 27.3.1992 *inter-alia* read as under:

> "Resolved that Chairman/Managing Director or Chairman & Managing Director be and are hereby authorised to open/or close bank accounts in the name of Vayudoot Limited whether it is cash credit, collection, disbursement, current, safe custody, short and/or long term deposits, loan against short and/or long term deposits or foreign exchange Accounts with any of the Banks."

14.245 It will be seen from the above that the Board resolutions were really in the nature of authorising the officer(s) designated therein to sign on behalf of Vayudoot to open/close, operate Vayudoot's account in Cash Credit, collection, short term, long term deposits and foreign exchange accounts with any of the banks etc. and not an authorisation for making investments.

14.246 The meeting of the Board of Vayudoot which took note of the transactions was held on 7.7.1992, i.e. after the completion of all the 18 transactions. During evidence the Committee were informed by the CMD that the Board had ratified the making of "short term deposits."

14.247 On scrutiny of the relevant papers, the Committee however, found that while reporting to the Board, the exact nature of the transactions was not indicated and the Memorandum prepared for the said meeting of the Board also did not contain any mention about the short term deposits made. The Minutes of the Board meeting simply stated:-

> "Instead of keeping the money idle, a conscious decision was taken to make a judicious utilisation of funds by depositing it in the banks for short term duration. The Board noted the same".

14.248 In other words, neither the Board was furnished the nature and details of the investments/deposits made by the Management/nor did the Board ratify at the meeting the specific investments/deposits made. Surprisingly, no one in the Board also called for any details.

14.249 From the facts stated in the foregoing paragraphs it is abundantly clear that after getting financial assistance, for different purposes from AI/Indian Airlines, Vayudoot invested the funds with banks/Finance Company. This was certainly not in consonance with the objective for which financial support was provided by AI and Indian Airlines. Pertinently, having defaulted in serving its past debts particularly to banks, Vayudoot at the relevant time was being called upon to pay penal rate of interest at 26.5%. On the loan from AI/IA it was paying 10 and 16%. Astonishingly, instead of meeting these heavy interest carrying liabilities, the Company chose to make several new investments which offered a return lower than this said 26.5%. Further, the manner in which Vayudoot had been issuing pay orders for 14 out of the 18 deposits in favour of Canara Bank but obtaining receipts from Canfina is a singular lapse.

14.250 In this connection, the Committee note that on 14.12.1992 it was decided at the level of the Minister of Civil Aviation and Tourism to seek explanation from the CMD, Vayudoot. However, the formal letter in pursuance of the said decision was issued only on 5.3.1993. The Committee find it inexcusable that there should be so much delay in an important matter like this. The Committee hope that the Ministry of Civil Aviation will at least in the future ensure a proper system of monitoring with a view to ensuring that funds are deployed by the PSUs under their administrative control strictly in terms of the policy and laid down procedures.

14.251 The Committee feel that the role played by the CMD, Vayudoot and all other officers concerned in the entire episode should be thoroughly inquired into with a view to fixing the responsibility.

Power Finance Corporation Limited

14.252 The Power Finance Corporation Limited (PFC) was established in July, 1986 as a Public Limited Company under the administrative control of Department of Power, Ministry of Energy.

14.253 The main objects of the Corporation are to provide term-finance to Power Sector and to play a catalytic role in bringing about a quick and balanced development of the power sector in India.

Short Term Investments in Government Securities/PSU Bonds

14.254 As would have been observed from details of funds placed by PFC in short term investments, it placed funds with banks and financial institutions for periods ranging from 5 days to 184 days. According to the Corporation, neither the Companies Act nor PFC's Memorandum and Articles of Association debar it from making such investments.

It is, however, noted that the funds placed with banks and financial institutions by the Corporation were in the nature of ready forward deals, and were not investments in Government Securities and PSU Bonds as claimed by it.

14.255 There is no evidence to show that any securities were made available to the Corporation for its investments. The Corporation has offered as explanation that it was receiving BR instead, for these short term funds placed with the banks/ financial institutions. These BR were returned to the banks, duly discharged, on the date of maturity of investment. At the end of each financial year, the Corporation was only obtaining a certificate from the banks in regard to the funds placed, plus outstandings, in Government Securities/PSU Bonds. This too was only for being furnished to the Statutory Auditors in connection with the finalisation of the annual accounts of PFC. The Corporation has, however, not mentioned whether any details of the Government Securities/PSU Bonds purchased by the banks/ financial institutions, on behalf of the Corporation, were detailed in the certificate received from the Banks. Apparently everyone played this game of make believe quite cheerfully, the banks, PFC and even the auditors.

Exceeding Delegated Powers

14.256 The Board of Directors of PFC in its 6th Meeting held on 27 January, 1988 delegated powers to CMD for investment of funds upto Rs. 100 crores at any one time. The Board in its 38th meeting held on 30 May, 1991 enhanced the limit to Rs. 300 crores. However, on six occasions between July 1990 and May 1991, the total investment made, in each case, exceeded Rs. 100 crores in contravention of even these delegated powers.

Details are given hereunder:

Date of Approval by CMD	Amounts (Rs. in Crores)	Institutions with whom Investments made
30-7-90	176.50	Andhra Banks, Canfina, PNB Caps, IL&FS (through BOA), BOI Finance and UCO (through Grindlays Bank).
01-01-91	246.35	PNB Caps, IL&FS, UCO and SBI Caps.
07-03-91	125.01	CBI, PNB Caps, IL&FS and UCO
03-04-91	103.45	IL&FS, BOA, SBI Caps and PNB Caps.
01-05-91	263.78	PNB Caps, IL&FS, SBI Caps, UCO, Hongkong Bank, ANZ Grindlays Bank and Canfina.
27-05-91	117.49	BOA, SBI Caps, IL&FS, PNB Caps and HDFC.

14.257 The two CMDs, who approved these proposals, retired from service on 30-9-1990 and 30-6-1991, respectively. Even a post-facto approval of the Board of Directors having not been obtained, these erring CMDs have not yet been asked to explain why the authorisation was flouted.

Irregularities in Issue of Cheques for Investments

14.258 Certain Banks/ Financial Institutions (FIs) (mentioned below) with whom investments were made had given mandates to issue cheques in favour of another Bank for the invested amounts. These mandates according to PFC were sometimes written, at others apparently oral. In all these cases, PFC had issued the cheques alongwith written directions (issued through a letter) to the payee bank to remit the funds to the concerned bank/FIs with whom investment was made.

Name of the Bank/FI with whom Investment was made	Name of the Bank on whose favour cheques were issued
SBI Capital Market Services Limited	SBI
PNB Capital Market Services Limited	Punjab National Bank
Canbank Financial Services Limited	Canara Bank
BOI Financial Services	Bank of India
UCO Bank	Grindlays Bank
Infrastructure Leasing & Financial Services Limited	BOA
Housing Development & Finance	Indian Overseas Bank Corporation.

14.259 However, in the following instances, these banks/FIs desired to have the RBI cheques issued in favour of banks other than those specified above. The details of these transactions are as under:

Date	Amount (Rs. in crores)	Institution with whom investment was made	Cheque issued in favour of
20-2-1991	4.50	IL&FS	Central Bank of India
5-4-1991	5.00	IL&FS	Central Bank of India
1-10-1990	20.95	SBI Caps	BOA
16-4-1991	2.96	SBI Caps	American Express
20-2-1991	4.50	Central Bank	BOA
31-7-1990* to 26-4-1991	397.24 (in 16 cheques)	UCO Bank	ANZ Grindlays Bank

* C & AG Report - Commercial (No 3 of 1993)

14.260 The only action that PFC has taken is to call for explanations of the concerned officers of their Finance Department in this regard and that too after the Committee's examination. The Committee have been informed that appropriate action would be taken by the PFC on receipt of these explanations. The Committee find this manner of dealing with financial irregularity as unsatisfactory and would like very urgent punitive and rectificatory action to be taken.

Crediting of Cheques to the Account of the Broker

14.261 On 31-7-1990 a decision was taken by the Board to invest a sum of Rs. 30.03 crores and Rs. 55.96 crores for a period of 91 days with UCO Bank. Instead of issuing cheques in favour of UCO Bank, a cheque for Rs. 85.99 crores was issued in favour of ANZ Grindlays Bank in pursuance of UCO Bank letter of 30 July, 1990. This cheque was then irregularly credited to the account of HSM in ANZ Grindlays Bank. This however is not the only instance of cheques being irregularly credited to the account of the broker.

14.262 In respect of investment transactions between PFC and UCO Bank during the period July, 1990—May 1991 some 16 Bankers' cheques totalling Rs. 394.23 crores were unauthorisedly issued in favour of ANZ Grindlays Bank instead of to UCO Bank with whom the transactions had been sanctioned.

14.263 Investigations have revealed that the total number of such transactions was 20, total amount which thus unauthorisedly found its way to the account of HSM being Rs. 483 crores. In addition, mostly during the same period on 9 occasions PFC reinvested their funds on maturity, totalling Rs. 354 crores with the UCO Bank. It is reported that these amounts were also credited to the account of HSM.

14.264 In this manner, the total amount invested by PFC, with UCO Bank which then unauthorisedly found its way to the account of HSM comes to a gross total of Rs. 837 crores.

14.265 The Committee need hardly underline the blatant misuse of public funds and of total violation of investment norms. These monies did not fund power projects, they financed brokers, banks and financial scams. That till date, no one has been punished for this swindle, is in the view of the Committee, a reflection of the tardiness with which the matter has been dealt with.

Investments in Foreign Banks

14.266 In March, 1991, CMD, PFC decided to deal with a few foreign banks but without taking prior approval of the Board. PFC Board in its meeting of 30-5-1991 accorded post facto approval to two such transactions of investment with ANZ Grindlays Bank. The then CMD, however, continued to deal with foreign banks on a regular basis.

14.267 PFC have justified mistakenly the above investments in foreign banks in terms of Ministry of Finance (Department of Economic Affairs) guidelines of 5 Feb., 1988 for investment of surplus funds in PSU Bonds, etc.

14.268 The transactions carried out with the foreign banks being however of the nature of ready forward, with no securities made available to PFC these could not be termed as investments in PSU Bonds and Government Securities. The Committee regret to note that the Board of PFC also did not apply its mind to this matter and remained a passive spectator.

Floating of Bonds

14.269 During 1990-91, PFC raised funds through issue of 9% Tax Free Bonds, for Rs. 600 crores, and Rs. 60 crores through 11.5% Government Guaranteed Bonds. These amounts were then placed as 'term deposits' with Canfina Rs. 280 crores at 12.5% and the balance with other banks/Financial Institutions at 8% an interest or return rate *lower* than that payable on the Bonds themselves.

14.270 Banks with whom funds were mainly placed, besides CANFINA, are as follows:

Amount	(in Rupees)
P.N.B.	250 crores
Vijaya Bank	20 crores
Canara Bank	50 crores

14.271 The Corporation also placed funds raised through 17% Taxable Bonds in February and March, 1992 with Citibank and with UCO Bank as detailed below :

Sl. No.	Date of investment	Name of Bank	Amount (Rs. Cr.)	Period (Year)	Yield
1.	10-02-92	Citibank	150.00	1	14.25%
2.	28-03-92	UCO Bank	150.00	1	13.50%

14.272 Explaining this curious method of resource mobilisation, the PFC informed the Committee that following Controller of Capital Issues's necessary approval on 24-10-91, CMD, PFC on 30-10-1991 wrote to Heads of 22 nationalised banks (including SBI), their subsidiaries, and also IDBI, UTI, LIC and IFCI, seeking their subscription to Rs. 300 crores worth of bonds, of a maturity period of 7 years, at an interest rate to be mutually settled between the Corporation and the prospective subscribers.

14.273 Only Infrastructure Leasing and Financial Services Limited (ILFS) offered a subscription of Rs. 20 crores worth of bonds at an interest rate of 18% with 0.5% brokerage, but with a condition of deposit of this entire amount for a period of six months, at the same rate i.e. 18% rate of interest. Despite such a patently poor response to PFC's efforts at marketing its projected bond issue, its Board, in its meeting held on 3-12-1991, approved the proposal to issue Bonds worth Rs. 300 crores by way of public issue, or offer of sale through banks. The Board also authorised negotiations with banks for the purpose.

14.274 Strangely enough even the Ministry of Power did not also stop. Instead *vide* its letter dated 18-12-1991 it sanctioned private placement of these bonds, with financial institutions, banks and their subsidiaries with a stipulation that atleast 20% of the bonds (say 60 crores) must be offered, over the counter, to the general public.

14.275 PFC placed bonds worth Rs. 150 crores with Citibank in February, 1992, and the balance Rs. 150 crores worth of Bonds with UCO Bank in March, 1992. The 20% public subscription was completely neglected.

14.276 As regards placement of funds under PMS it was explained that the overriding condition of locking of funds for a period of one year, at not less than 14.25% p.a. with

Citibank and at 13.5% p.a. with UCO Bank was a prior condition of their agreeing to subscribe to the offered Bonds of the PFC. The funds (Rs. 300 crores) would thus not be available for power projects until at least a year later. For this one year the PFC would be a net loser by around 7% of the total amount.

Transaction with Canfina in Exchange Risk Fund-Escrow Accounts

14.277 A Committee had been set up under agreements dated 15th November, 1990, signed between PFC and the Andhra Pradesh State Electricity Board and Tamil Nadu Electricity Board, for onlending the proceeds of a loan from the Asian Development Bank to these State Electricity Boards (SEBs) for certain specified power projects. This Committee comprised of Director (Finance), PFC, and representatives of the two SEBs. It was meant to manage the loan funds be placed in an Escrow account, started under the above cited agreements, and to invest these funds in Government Securities, etc.

14.278 Almost predictably, an amount of Rs. 17.87 crores was provided to CANFINA by PFC on 19 May, 1992 theoretically for investment in Government Securities and Public Sector Bonds. This was a violation of the principle of escrow accounts, of agreements contracted, of so many other norms and standards.

14.279 When asked to explain as to why this investment was made with Canfina on 19 May, 1992 when all Newspapers were full of Canfina's financial problems the CVO of PFC, who had enquired into the matter, stated that Canfina's involvement with the scam came to PFC's notice for the first time on 27-5-1992, when it was carried in newspapers, such as "The Economic Times".

14.280 Out of an amount of Rs. 17.87 crores, plus yield thereon, due from Canfina under the said transaction, only Rs. 9.87 crores has so far been recovered. Efforts to recover the balance amount are stated to be continuing, so the Committee was informed. The Committee would like to emphasize that these as yet, unrecovered dues, were funds originally received from Asian Development Bank and were meant for power projects in Andhra Pradesh and Tamil Nadu.

Action by PFC against Officers

14.281 Three officers of the PFC S/Shri M. Prasad, P. Rao and M. Ravi have only been placed under suspension. The Ministry has taken this action in the months of October and November, 1992 after the Committee's examination. Advice from the CVC was sought whether, pending finalisation of investigations by the CBI, any Departmental action against the officers involved could be taken. The CVC advised on 9-12-1992 that no formal disciplinary action either by the Ministry of Power or by the PFC should be taken pending CBI investigation. Further, CBI's Investigation Report, when received, may be referred to the Commission, yet again, for advice.

14.282 The Committee find this as completely unsatisfactory. In the face of all the many documented and established misdeeds and gross violations by the PFC, not one single person has been punished so far by the Government. The past and present Boards of the PFC, and the various concerned officials and others of the Ministry of Power have shown little sense of concern or urgency in meeting out punishment to the guilty.

Indian Railway Finance Corporation Limited

14.283 The IRFC incorporated under the Companies Act of 1956 was established in December, 1986. It is under the administrative control of the Ministry of Railways. The entire paid up capital of Rs. 232 crores has been provided by the Ministry of Railways.

14.284 IRFC has been incorporated primarily to mobilise funds from Public by issue of Bonds and to use the funds to finance/purchase of rolling stocks and lease the same to the Railways to meet their expansion and modernisation needs.

Board of Directors

14.285 The Chairman of the Corporation is usually the Financial Commissioner of the Railways. In that capacity he acts as a part-time Chairman of the IRFC Board. The post of Director (Finance) of IRFC has not been filled since inception.

Investment Committee

14.286 As per its Articles of Association the Board of Directors of IRFC are empowered to invest surplus funds of the Company with RBI, SBI, any nationalised banks or in such securities as may be approved.

14.287 An Investment Committee comprising of 3 Directors of the Company has been formed and powers delegated to it to invest funds in banks and their subsidiaries, financial institutions, Government securities and Government companies, etc. The Committee is authorised to invest Rs. 1500 crores in any one financial year.

Investment Procedure

14.288 Quotations are obtained on phone from banks/financial institutions and on the basis of these funds are then deployed with the banks/financial institutions quoting the highest rate. A summary of all such investments is periodically made out and signed jointly by all members of the Investment Committee. The Board of IRFC is also periodically apprised of this. There is, however, no fixed periodicity for it.

Market borrowings through Issue of Bonds

14.289 The borrowings of the Corporation till-date is Rs. 5341 crores as per Appendix XXXIV.

14.290 The Corporation borrows funds from the market through the issue of bonds. IRFC has a special dispensation from Ministry of Finance of 9% Tax-Free ten years bonds. In all, bonds worth about Rs. 5341 crores including Rs. 111 crores for Konkan Railway Corporation have so far been issued by IRFC since April, 1987.

Reference to the Ministry of Railways (Railway Board) for Investments.

14.291 On 3rd October, 1988, IRFC made a reference to the Railway Board stating *inter alia* as follows:

"IRFC will have to redeem the Bonds raised in 10 years from the date of issue by generating adequate funds by investment of surplus of lease rental over interest and other commitment service charges.

As per the understanding with the Ministry of Railways, IRFC will receive on the assets leased to the latter, lease rental @ 16% per annum. After payment of interest of 9%/10% per annum and service charges of 0.5% (average), the balance funds of 6.5% would be available with IRFC. It is necessary that such funds are invested in such a manner so as to generate the requisite funds at the end of ten years when the Bonds issued have to be redeemed".

14.292 If IRFC had to be financially viable and to enable them to redeem the bonds on maturity, they might be permitted to invest IRFC surplus funds in investments yielding 13% per annum interest (gross) other than in the following securities as laid down by the Ministry of Finance in December, 1987:

i) Government Treasury Bills (average yield 9% per annum)

ii) Public Sector Bonds (yielding 13% interest)

iii) Public Deposit Account with RBI (yield 10% per annum)

Such investments (yielding 13% gross interest) can be made in Mutual Funds/UTI/Inter-Corporate deposits, etc. It was, therefore, requested that the Ministry of Finance might be approached for relaxing the applicability of the above directive so far as it concerned IRFC.

14.293 Without approaching the Ministry of Finance, the Ministry of Railways replied to IRFC on 15 November, 1988 as follows:

> "Informal enquiries made with the Ministry of Finance indicate that the orders of that Ministry contained in Secretary (Expenditure)'s DO. No. 2(232) (CDN)/87 dated 1.12.87, a part of which relating to investment of surplus funds by the PSU was forwarded to IRFC under this Ministry's letter of even number dated 29th December 1987, were issued in the light of the drought situation prevailing in the country during 1987-88.
>
> In his D.O. letter No. F.16(9)-B(CDN)/88 dated 24.3.88 followed by another D.O. letter of same number dated 13.9.88, the Secretary (Expenditure) while reiterating measures to effect economy in Government expenditure, has stated that so far as public sector enterprises are concerned, they will follow their own economy measures as per their own requirements. Since that Ministry (Ministry of Finance) have not now reiterated their earlier instructions in respect of investment of surplus funds of the PSU Undertakings, they may invest their surplus funds in such a manner so as to achieve optimum profits. In view of this, the IRFC may draw up a suitable plan for investment of its surplus funds with the approval of its Board of Directors."

14.294 During evidence the Committee referring to informal enquiries made with the Ministry of Finance enquired whether the informal consultation had any particular meaning. The Advisor (Budget), Railway Board and Managing Director, IRFC stated:

> "In this case, he (Executive Director) had discussed the matter with the concerned officer of the Ministry of Finance. It is with a value."

14.295 The Committee are constrained to observe that in such a serious matter as investment of funds raised through Bonds, the Ministry of Railways instead of obtaining formal approval of the Ministry of Finance for investing in securities not covered by Government instructions, chose to act on its own after the so called 'informal enquiries'. This resulted in a reversal of the established policy of the Ministry of Finance. The Committee find no justification for the conclusions drawn and the instructions issued by the Ministry of Railways. The Committee also find no evidence to indicate whether even the approval of the Board of IRFC was obtained for this purpose.

14.296 The Ministry of Railways is also guilty of firstly of not obtaining formal clearance from the Ministry of Finance for what amounted to total reversal of well established policy. Thereafter, it is guilty of issuing vague instructions to IRFC and finally it failed

even to monitor these instructions. In consequence IRFC has virtually lost over Rs. 866 crores. The Committee recommend that the whole matter should be thoroughly enquired into and responsibility fixed.

Deployment of Funds with Canfina

14.297 IRFC raised Rs. 700 crores in November, 1991 through an issue of 9% Tax Free Bonds on private placement basis. As per an agreement with Canfina, the entire sale proceeds of Rs. 700 crores were deposited with Canfina instead of utilising it for the purchase of assets. Of this sum Rs. 350 crores were deposited for a period of 4 months *i.e.* upto 30 March, 1992, under a Scheme styled as 'Investment Advisory Services'. On this an indicative yield of 11% per annum was advised to IRFC. The balance of Rs. 350 crores were placed under PMS with an indicative return of 11% p.a. for the first six months and 18% for the balance of the year. The funds were to be deployed in any of the approved securities in accordance with Government guidelines. The Corporation, however, did not obtain any securities or any details of them to satisfy itself that the investment had actually been made in the approved securities.

14.298 Besides these funds raised through the issue of bonds IRFC also placed with Canfina additional funds even after the scam had broken out. This was done during the period April to June, 1992 for a total of Rs. 116.97 crores. This was also the period when there was a maximum demand for funds.

14.299 Canfina has defaulted in making payments on the due* dates. The entire capital amount invested *i.e.* Rs. 445.37 crores total plus accrued interest and advised returns is outstanding without any hope of recovery.

14.300 About investing in Canfina after the scam, Managing Director-IRFC stated:

> "On 4th June and 22nd June , 1992 IRFC have put an amount of Rs. 80 lakhs in Canfina. There were paper reports about the scam. There was no directive to the Corporation that it should stop its operations. When the Canfina failed us on first July we had stopped dealing with the Canfina. There was no directive of the Government."

14.301 The Committee find as totally unsatisfactory this explanation furnished by the IRFC. The Committee must observe that IRFC engaged in questionable investments and continued to do so well after the full dimensions of the scam had surfaced.

14.302 For the loss of over Rs. 445.37 crores the IRFC and Ministry of Railways are accountable.

Investment with Foreign Banks

14.303 IRFC also placed funds with the 5 foreign banks *viz.* Stanchart Bank, ANZ Grindlays Bank, BOA, Deutsche Bank and Citibank in violation of Government guidelines.

14.304 The Corporation placed Rs. 1280.68 crores in short term investments with foreign banks for periods ranging from 12 days to one year between 3.4.89 and 1.1.92.

14.305 It has been reported that in respect of investment made with Deutsche Bank, the letter issued by IRFC permitted the bank to invest in market securities other than

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* As on 8.6.1993.

Government Securities, Public Sector Bonds, UTI Units, Mutual Funds investments also. The bank used the amount for the purpose of bill discounting on behalf of various private clients of the bank is violation of RBI directions. The IRFC also accepted a definite yield for its investment which was also in violation of RBI guidelines.

14.306 In respect of investment with SCB, IRFC did not take care to ensure that their money was invested as per their own directions. They agreed to a fixed rate of return which was in violation of RBI guidelines. It is reported that SCB Chartered Bank utilised these deposits of IRFC for making various investments in money market instruments and capital market instruments of Indian Companies/Corporate bodies and other authorities. These transactions are under investigation by CBI.

14.307 The Committee regret to note that IRFC made investments with foreign banks when not authorised to do so. Further IRFC permitted the Banks to invest their funds in securities other than those approved. This was in violation of Government guidelines for investment.

Investment by Cooperative Societies (KRIBHCO and IFFCO)

14.308 KRIBHCO and IFFCO which are Cooperative Societies are authorised to invest their surplus funds under the provision of Multi-State Cooperative Societies (MSCS) Act, 1984. As per Section 62 of MSCS Act of 1984, a multi-state cooperative society may invest or deposit its funds as under:

(a) In a co-operative bank, State co-operative bank, co-operative land mortgage bank, co-operative land development bank or central co-operative bank; or

(b) in any shares or securities specified in Section 20 of the Indian Trusts Act, 1882; or

(c) in any shares or securities of any other multi-State cooperative society or any co-operative society; or

(d) in the shares, securities or assets of any other institution, with the previous approval of the Central Registrar; or

(e) with any bank; or

(f) in such other mode as may be prescribed.

Explanation — in clause (e), "bank" means any banking company as defined in clause (c) of section 5 of the Banking Regulation Act, 1949, and includes, -

(i) the SBI constituted under the SBI Act, 1955;

(ii) a subsidiary bank as defined in clause (k) of Section I of the SBI (Subsidiary Banks) Act, 1959;

(iii) a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings) Act, 1970 or a corresponding new bank constituted under Section 3 of the Banking Companies (Acquisition and Transfer of Undertakings)

Investment of Surplus funds by KRIBHCO

14.309 As per section 62(d) of MSCS Act for making investment in the shares, securities or assets of any other institution permission of Central Registrar of Cooperative Societies is required.

14.310 The Committee, however, noted that KRIBHCO made investment in 9% tax free bonds/securities/units of UTI, with subsidiaries of nationalised banks, Indian branches of foreign banks without taking any such approval.

14.311 Asked by the Committee as to why permission of Central Registrar of Cooperative Societies was not taken , KRIBHCO in a written note furnished to the Committee, stated:

> "KRIBHCO had invested its surplus funds in short term deposits schemes and in deposits against bonds/units offered by the banks with an assured rate of return. Since the funds were placed as deposits with various banks, it was our understanding that approval of the Central Registrar was not required. In view of this, no approval of Central Registrar was obtained."

14.312 The above contention is not justified as permission of Central Registrar is required for deposit of surplus funds as well. KRIBHCO thus violated the provisions of the MSCS Act.

Approval of Department of Fertilizer

14.313 KRIBHCO had drawn a total loan of Rs. 342.50 crores from Government of India and Rs. 79.75 crores from financial institutions for setting up the Fertilizer Complex at Hazira. As per subsidiary loan agreement entered by the society with the Government of India the Society is required to take the approval of Government of India for making any investment of its surplus funds in the Units of UTI, tax free bonds or securities or PSUs investment in other cooperative societies, which are permitted as per the provision of MSCS Act. In a meeting held on 15.12.1989 the Board of Directors of KRIBHCO approved the proposal to invest its surplus funds that may be available from time to time in short term deposits permitted as per the MSCS Act. The Board also desired that necessary approval of Government of India for period not exceeding one year may be obtained.

14.314 The Committee noted that the Society made investments of funds worth Rs. 249.63 crores even pending receipt of such an authorisation from the Department of Fertiliser. This was finally accorded on 23.7.1990. The Committee also noted that the Society had also made an investment of Rs. 52 crores. This was done even before the approval was given by Board of Directors.

Investment with Indian Branches of Foreign Banks

14.315 KRIBHCO sought permission of Department of Fertilizer to make investments *inter alia* with the subsidiaries of nationalised banks such as Canfina, SBI Caps, PNB Caps, in 9% tax free bonds issued by PSUs, Units of UTI, investment with other cooperative societies and any other investment as per the provisions of MSCS Act, 1984. The above proposal of KRIBHCO was considered by Department of Fertiliser. The permission of Department was given to the Society to make short term deposits in nationalised banks, cooperative societies, Public Sector Bonds, UTI, etc. subject to certain conditions which *inter alia* included that investment should conform to provisions of MSCS Act, 1984. It is strange that the Department allowed the society to make investment with foreign banks although the Society did not seek any such permission. From the notings in the relevant file of the Department of Fertilisers, it is seen that the issue of investment with Indian branches of foreign banks was not deliberated upon at all. It is only at the stage of the issue of letter on 23.7.1990, which was signed by an Under Secretary of the Department that the permission to make short-term deposits in foreign banks was also granted. The Committee would like the matter to be thoroughly examined as to how such a permission deemed to be granted when the matter was not deliberated upon.

Investment with the Subsidiaries of Nationalised Banks

14.316 The Committee noted that KRIBHCO made huge investments with subsidiaries of nationalised banks *viz.* Canfina, ABFSL, SBI CAPS etc. For making investment with subsidiaries of nationalised banks, permission of Central Registrar of Cooperative Societies was required, which was not taken. The question of investments made with the subsidiaries of nationalised banks was reviewed by the Department of Fertilizer wherein it was noted that investments with subsidiaries of nationalised banks was open to risk not only just on return but also on the aspect of security of the principal amount. Wholly inexplicably, investments by KRIBHCO with ABFSL and Canfina were made and as late as June & July 1992 to the extent of Rs. 59 crores after the scam broke out. Canfina and ABFSL defaulted in making payments to the tune of Rs. 47 and 92 crores respectively, thus causing a total potential loss to KRIBHCO of Rs. 139 crores.

Delegation of Power

14.317 On 15.12.1989 the Board of Directors of KRIBHCO authorised the MD to make investment of surplus funds. With effect from 1.4.1990 the MD delegated his powers to the Finance Director of the Company without seeking approval of the Board. The Board ratified this delegation of power in its meeting held on 9.3.1992, after 2 years.

Manner of Utilisation of Funds

14.318 The Society did not issue instructions in writing to banks/finance companies with regard to manner of utilisation of funds thereby exposing its funds to risk of being misused. The MD, KRIBHCO during his evidence stated that in some cases advice was given in writing and in other oral instructions were given as to how the banks should utilise the funds of the Society.

Physical delivery of Securities

14.319 The Society did not even take care of obtaining details or physical delivery of Securities. All the investments were made on the basis of BR only.

Revised Guidelines for Investments

14.320 Four months after the Scam became public the Board of Directors of KRIBHCO on 11.8.92 issued the following revised guide lines for investment of surplus funds of the Society:

1. The Society should stop making investments with nationalised banks which are reported to be involved/ having excessive exposure in the recent security scam and those who are reported to be not very sound.

2. The Society should also stop making investments with :

   a) Indian branches of all foreign banks;

   b) Subsidiaries of nationalised banks like Canbank Financial Services, A.B. Financial Services, Indbank Merchant Banking Services, PNB Caps Services etc.

3. The Society should restrict its investments only in the following :

   a) Nationalised banks excluding those whose financial position is reported to be not sound or who are reported to be deeply involved in the recent security scam:

   b) State level cooperative banks ; and

c) Subsidiary banks like State Bank of Patiala, State Bank of Travancore, State Bank of Hyderabad, State Bank of Mysore etc., which are subsidiaries of SBI.

4. The banks mentioned at 3(a), 3(b) above need not necessarily be members of the consortium of banks of Society. However, all other things being equal, preference could be given to the members of the Society's consortium of banks within the above guidelines.

5. In bonds, securities floated by financial institutions like ICICI, IFCI, IDBI, UTI and Public Sector Bonds etc. after obtaining necessary approvals, if required, from the Government of India or Central Registrar of Cooperative Societies.

6. The maximum amount of investment with any single bank, whether nationalised or cooperative or institution mentioned at (5) above, should not exceed Rs. 30 crores in each case.

14.321 The Committee consider such action as tantamount to a belated bolting of stable doors.

14.322 KRIBHCO which is a Society registered under Multi-state Cooperative Societies Act, 1984 can make investments as per the provisions contained in Section 62 of the Act. Accordingly, the society was required to take permission of Central Registrar of Cooperative Societies before making investment/deposit of surplus funds. The Society however, made all investments without seeking the permission of Central Registrar. The Committee also found that on the one hand KRIBHCO had taken loan from Department of Fertilizer and other financial institutions and on the other it made investments also. The Board of Directors of the Society authorised the M.D. to make investments, however the M.D. in turn delegated this power to Finance Director without the approval of the Board. Department of Fertilizer allowed KRIBHCO to make investment with Indian branches of foreign banks even though the Society did not seek any such permission. The issue of investment by KRIBHCO with Indian branches of foreign bank was not discussed in Department of Fertilizer at all and only at the stage of issue of letter signed by an Under Secretary dated 23.7.1990, Department permitted KRIBHCO to make short term deposits in foreign banks as well. The Committee would like the matter to be thoroughly examined to ascertain as to how such permission was deemed to be granted when the matter was not deliberated upon at all. The Society made huge investments with subsidiaries of banks like Canfina, ABFSL without taking permission of Central Registrar of Cooperative Societies. Canfina & ABFSL defaulted KRIBHCO to the tune of Rs. 47 crores and Rs. 92 crores respectively. The Society exposed its funds to risk by leaving discretion with banks/finance companies with regard to utilisation of its funds. The Society did not take care to obtain the details or the physical delivery of Securities at all. Four months after the scam became public, the Board of Directors of KRIBHCO issued revised guidelines for investment of surplus funds of the society. The Committee regret that Ministry concerned which have the ultimate accountability for the observance of financial rules and regulations did not properly discharge their responsibility.

Indian Farmers and Fertiliser Cooperative Ltd. (IFFCO)

Authorisation of Registrar of Cooperative Societies

14.323 As per the provision of clause 62(d) of MSCS Act, 1984 the Society was required to take approval of Central Registrar of Cooperative Societies to make investment of surplus funds in the shares, securities or assets of any other institution. However without the approval of Board, and Registrar of Cooperative Societies, the Society made investments to the tune of Rs. 492.27 crores under short term deposits and PMS with banks and finance companies.

14.324 It was only in the 185th meeting held on 26 December, 1990, a proposal was submitted by Society to Board of Directors for according its approval for investment of surplus funds, who approved the proposal of the society subject to the approval of Central Registrar of Cooperative Societies. The Registrar of Cooperative Societies on the request of Society made on 28 February, 1991 accorded permission to society to make investment on 8 March, 1991. It is noted that pending approval of Registrar the Society made investment to the tune of Rs. 155.92 crores during 20 December, 1990 to 8 March, 1991.

14.325 Asked during evidence as to why investments were made pending approval of Registrar of Cooperative Societies, a representative of the Society stated:

> "It was so only for the first ten transactions or so."

Investments under short-term and PMS

14.326 The Society made investments under short-term deposit and Portfolio Management Schemes. However, the investments under short term as also PMS were made for identical duration but with varying yields. During 1992-93 (upto August, 1992) the yield obtained on short term deposit ranged from 10-12% whereas the yield obtained on investment under PMS ranged from 10-16%.

14.327 Asked to give the criteria for placement of funds under PMS and short term a representative of Society during evidence stated:

> "The investments were guided by the commitment on maturity. Under short term, as I explained earlier, we have the facility of withdrawing it prematurely. We have no such facility in portfolio investment."

14.328 Investments made by the society under PMS for a period of less than one year, and under guaranteed rate of return were in violation of all guidelines for PMS. That the funds of society were going in call money market is evident from the note of the society placed in the 185th meeting of the Board where in it was *inter-alia* mentioned that many foreign banks and mutual funds like SBI Capital Services, PNB Capital Services, Canbank Financial Services etc. have expressed their willingness to accept funds in their port folio investments at interest rates ranging from 12% to 19% depending on the Call Money market conditions for period ranging from 15 days and above.

14.329 It is a matter of concern that no one in IFFCO has yet been held accountable for these grave lapses.

Investments made at lower yield

14.330 During the period 1.2.91 to 23.4.91, this Society made investment to the tune of Rs. 32.93 crores as under:

Date of Invest-ment	Name of the Institution	Amount Invested (Rs.in crores)	Rate of Interest	Period of Investment -	Highest rate quoted for the period
1	2	3	4	5	6
1.2.91	BOI Finance Ltd. New Delhi	6.00	12.50%	90 days	15.25%

1	2	3	4	5	6
25.2.91	Indian Bank, New Delhi.	5.00	12.75%	91 days	14.50%
25.2.91	UCO Bank, New Delhi.	4.00	12.60%	91 days	14.50%
7.3.91	Union Bank, Hissar	2.00	8.00%	46 days	14.00%
27.3.91	Union Bank, Panipat	3.00	12.50%	91 days	14.00%
26.3.91	New Bank of India, Bahadurgarh.	1.00	13.00%	91 days	13.50%
5.4.91	Indbank Merchant Banking Services Ltd.	10.00	12.00%	91 days	14.50%
23.4.91	Union Bank, Hissar	1.93	13.50%	91 days	16.25%
	TOTAL :	32.93			

14.331 It is noted that these investments were not made at the highest rate of return even though they were made with specific approval. This resulted in an approximate loss of Rs. 15 lacs to the society. The information with regard to above investment was placed before the Board for its ex-post facto approval. The Board while giving its approval *inter-alia* directed that these investments be withdrawn as soon as their present term was over and placed with the institutions giving the highest yield.

14.332 The Board however, did not make any enquiry to ascertain as to why the deposits were made at a lower yield. The Committee would like that at least now an enquiry be made in the matter and action be taken against the officers found guilty of indulging in the acts prejudicial to the interests of the society.

Investment in excess of limit fixed for any single scheme

14.333 The Board of Directors in their 185th meeting held on 26th December, 1990 approved investment of surplus funds for short term period not exceeding one year with nationalised banks including Cooperative Banks and their subsidiaries, Public sector financial institutions, Indian branches of foreign banks and such other investment schemes which were permitted under the MSCS Act, 1984, subject to the condition that Investment in each of the scheme did not exceed Rs. 35.00 crores and the total investment be limited to Rs. 150.00 crores. The Central Registrar of Cooperative Societies also approved this proposal. However in violation of above guidelines investments were made in excess of Rs. 35 crores in any single scheme. The information with regard to these investments was given to board in its 186th meeting held on 26.2.1991. The approval to these investment was given on an-ex-post-facto basis, by board in its 188th meeting held on 8.5.1991. No explanation was called for, none was offered. The Committee do not find this a proper conduct on the part of the Board.

Physical delivery of Securities

14.334 The Society did not take physical delivery of the securities in which investments were made by it. Rather receipts issued by banks/finance companies conforming that they were holding the Securities/Units/Bonds on account of IFFCO were taken.

Review by the Ministry

14.335 A perusal of the file called by the Committee regarding approval accorded by the Ministry for investments of surplus funds by KRIBHCO, revealed that the policy regarding investment of surplus funds by the PSUs/Societies under the Department of Fertiliser had been reviewed several times from October, 1991 onwards. However despite several deficiencies notified in this regard no instructions were issued by the Department.

14.336 The Department of Fertiliser directed in October, 1991 to the Companies/Societies under it that they should set up a group of responsible people in their Organisations to make recommendations so that deposits were made to earn the highest rate of interest available at any time, and called for information from all PSUs/Cooperatives to intimate the procedure followed by them in respect of short term investments. The information received was reviewed and Secretary Fertilizer in March, 1992 suggested that suitable instructions may be given to PSU/Cooperative Societies to stream-line the procedure for short term investment. No such instructions were however issued. Another review was made in July, 1992 and Department suggested that instruction/guidelines be issued to PSUs/Societies which prohibit them from (i) making investment in subsidiaries of nationalised/scheduled banks, (ii) utilising the service of brokers etc. This was also not acted upon.

14.337 In November, 1992 another review was carried out which *inter-alia* revealed as under:

(1) RCF, IFFCO and KRIBHCO have made investments in the subsidiaries of nationalised banks which carried risk not only as regards the return but also as regards the security of the principal. Whatever be the internal procedure the companies/the societies have been following, the exposure of such large surplus funds to risk connected with such investments in institutions which eventually failed to provide no security as regards principal is indicative of inadequacies in assessment of credit worthiness and security of the institutions in which investments were made.

(2) There is also need to impress on the companies/societies not to invest their short term funds in securities/investments/deposits which carry on risk as regard the security of the principal as well as on the return on the principal. One aspect of the investments made by KRIBHCO and IFFCO is as to how the two cooperative societies made short term investments in CANFINA & ABFSL which are non banking financial companies when the Multistate Cooperative Societies Act perhaps did not allow such investments.

14.338 In pursuance of certain information called for by the Committee the Department of Fertiliser in a note furnished in January, 1993 stated that a quick review of the information collected from the PSUs and cooperatives show that in general the deposits/investments were made in accordance with the procedures laid down for this purpose by the organisation concerned, there were, however, some departure. In the case of KRIBHCO for instance, investment were initially made even pending receipt of authorisation that had been asked for from this Department. Another irregularity was that the delegation of power given by the Board to the MD for investment of funds had, in turn, been sub delegated to the Finance Director without intimation to the Board. The matter was, however subsequently ratified by the Board on 7.3.1992. Similarly deposits had been made by IFFCO & KRIBHCO in Indian branches of foreign banks even prior to the specific permission given to PSUs in January, 1992 by the Government, on the ground that as Cooperative Societies there were no such restrictions on them.

14.339 It is only in March, 1993 that Department of Fertiliser issued guidelines for streamlining of the system of short-term deposits by Public/Cooperative Sector Undertakings. These guidelines *inter-alia* stated the importance of a more systematic and

critical assessment of the risk factor while investing funds particularly of a large magnitude and not merely on the incentive of a marginally higher return particularly in institutions which do not have a proper track record or offer sufficient security.

14.340 It was also suggested that Investment decision need to be institutionalised in the respective Companies/Societies through Committees rather than being taken at the discretion of an individual officer or director.

14.341 It further mentioned that above guidelines would be in addition to the observance of formal external and internal regulations/instructions overseeing such investments issued by the Government from time to time. In this connection, special attention was invited to Ministry of Finance's instructions issued vide the D.O. Letter Nos. F.4(14)-W&M/87 dated 19/12.6.1987 and F.16(12)-B(CDN)/87 dated 8.2.1988, under which the PSUs were advised to invest their surplus funds in Government treasury bills or public sector bonds.

14.342 As regards the irregularities noticed in IFFCO and KRIBHCO the Committee were informed that the respective Boards of IFFCO & KRIBHCO had in the light of the report about the scam reviewed the position in regard to investments of surplus funds. IFFCO discontinued the investments in units of UTI/Government Securities with effect from 1st June, 1992.

14.343 In the case of KRIBHCO a Sub Group of the Board was constituted to examine the matter relating to investment of surplus funds of the Society. The Sub Group submitted its report on 24.11.1992 which has been accepted by the Board on 14th December, 1992. The Sub Group held that Finance Director and General Manager (F&A) were prima-facie responsible for short-term investments and found particularly objectionable investments made as late as June-July, 1992 in ABFSL after the scam report had become public. The Board resolved that the Government may be approached for approving the suspension of Finance Director.

14.344 Both GM(F&A) and Director Finance have since been suspended.

14.345 The Committee would wish to comment that this narration of events amply establishes the failure of the Department of Fertiliser to initiate timely action and ensure that its instructions be implemented.

14.346 As per provisions of section 62 of Multi-state Cooperative Societies Act, 1984, this Society was required to take approval of Central Registrar of Cooperative Societies to make investments of surplus funds. However, pending approval of the Central Registrar the Society had already invested funds to the tune of Rs. 155.92 crores. There was no systematic pattern of investment made by the Society under short-term and Portfolio Management Scheme. The Society invested funds under Portfolio Management Scheme for a very short duration which was in contravention of RBI guidelines, according to which funds under PMS could be placed only for a minimum period of one year. Further, return of funds placed under the PMS was guaranteed. The Committee also noted that the Society placed funds for utilisation in call-money market.

14.347 During the period 1.2.1991 to 22.4.1991 the Society made investments at a lower rate of interest although higher rates were available for these investments. Such a practice led to a loss of Rs. 15 lakhs to the Society. The Board of Directors gave their ex-post facto approval to these investments. Surprisingly no action was initiated against the officers who committed this lapse. The Society also made investment in excess of Rs. 35 crores which was the limit granted to it for making investments in any one single scheme. These

investments were approved by the Board of Directors of the Society on ex-post facto basis. However, no action was taken by the Board against erring officials.

14.348 The Committee would like that at least now an enquiry be made in the matter and action taken against the officers found guilty of indulging in the acts prejudicial to the interests of the Society. The Committee also suggest that the Govt. should enquire the role and responsibility of the Registrar of the Cooperative societies in regard to functioning of the two important cooperative societies (KRIBHCO & IFFCO).

14.349 One important fact which emerges from the foregoing and from the replies of various heads of PSUs is that non-financial PSUs were indulging in financial transactions of such an order that interest income quite often was more than interest expenditure and in some cases the profit of the enterprises were more due to such financial transactions rather than from productive activities. This formed part of profit and was regarded as an index of success.

CHAPTER-XV

RBI — FUNCTIONS AND RESPONSIBILITIES

15.1 The RBI was established on April 1, 1935, in consequence of the enactment of the RBI Act, 1934. The Preamble of the RBI sets out the objectives of the Bank as 'to regulate the issue of Bank notes and the keeping of reserve with a view to securing monetary stability in India and generally to operate the currency and credit system of the country to its advantage'. Within these overall objectives, this Central Bank of the country also performs a wide range of other functions aimed at a proper fiscal management of the nation's economy.

15.2 To ensure a sound, efficient and adequate banking and credit structure, the RBI has been vested with extensive powers of supervision and control over the banking industry in the country. These powers were initially conferred upon the RBI by the Banking Regulation Act, 1949. From time to time the scope of these powers have been enlarged with the growing requirements in the banking sector. To bring about a greater spread of banking facilities and to effect certain changes in the pattern of banking, nationalisation of banks was effected in July, 1969. The objective of nationalisation was 'to control the heights of the economy and to meet progressively and serve better, the needs of development of economy in conformity with national policy and objectives'. Over the last two decades the promotional efforts of the Bank have come into greater focus and the Bank has been increasingly channelising credit to the preferred sector and borrowers of small means termed as the Priority Sector.

Internal Organisation and Management

15.3 The Governor of RBI is the chief executive authority of the Bank. He has powers of superintendence and direction of the affairs and business of the bank and exercises all such powers as may be exercised by the Bank unless otherwise provided under the regulation made by the Central Board. At present the Governor is assisted in the performance of his duties by 4 Deputy Governors and 6 Executive Directors.

The present set-up of the Bank comprises:

(i) Banking Department and

(ii) Central Office Departments

The Organisational set-up of the Bank is placed at *Appendix-XXXIV*.

Banking Department

15.4 The Banking Department of the Bank is entrusted with the handling of transactions arising from the Bank's duties as in regard to the Government and to the banks. This Department is organised activity-wise under four heads:

(a) Public Accounts Department

(b) Public Debt Office

(c) Deposit Accounts Department

(d) Securities Departments

Central Office Departments

15.5 The Central Office comprises the following 18 Departments out of which 17 are located in Bombay and one in Calcutta :

(a) Secretary's Department;

(b) Department of Banking Operations and Development ;

(c) Industrial Credit Department;

(d) Rural Planning and Credit Department;

(e) Exchange Control Department;

(f) Department of Currency Management;

(g) Department of Expenditure and Budgetary Control;

(h) Department of Government and Bank Accounts;

(i) Department of Non-banking Companies;

(j) Department of Economic Analysis and Policy;

(k) Department of Statistical Analysis and Computer Services;

(l) Credit Planning Cell;

(m) Department of Administration;

(n) Personnel Policy Department;

(o) Management Services Department;

(p) Legal Department;

(q) Inspection Department;

(r) Premises Department.

15.6 As the irregularities in securities transactions are mainly the concern of the PDO and the DBOD the Committee's examination was focussed mainly on the functioning of these two organisations alongwith of course top management of the Bank.

Central Board

15.7 The general superintendence and directions of the Bank's affairs is vested in the Central Board of Directors which comprises :

(i) A Governor and not more than four Deputy Governors appointed by the Central Government under Section 8(1)(a) of the Act.

(ii) Four Directors nominated by the Central Government, one from each of the four Local Boards, in terms of Section 8(1)(b).

(iii) Ten Directors nominated by the Central Government under Section 8(1)(c).

(iv) One Government official nominated as Director by the Central Government under Section 8(1)(d).

15.8 The Governor and Deputy Governors hold office for such periods as may be fixed by the Central Government at the time of their appointment but not exceeding five years. They are eligible for reappointment. The Directors nominated under Section 8(1)(c) hold office for four years but may continue thereafter till their successors have been nominated; the term of office of those nominated under Section 8(1)(b) is related to the membership of the Local

Boards. The Government official nominated under section 8(1) (d) holds office during the pleasure of the Central Government. The Governor and in his absence a Deputy Governor nominated by him is the Chairman of the Central Board. Government's official nominee is not entitled to vote at the meetings of the Board.

15.9 The meetings of the Central Board are required to be held not less than six times in each calendar year and at least once in a quarter. For purposes of administrative convenience, the Board has delegated some of its functions by means of statutory regulations made under Section 58(2) of the Act to a Committee called the Committee of the Central Board consisting of the Governor, the Deputy Governor and other Directors. At present there are 8 non-official Directors on the Board of RBI. 7 of these Directors were appointed on the Board in March, 1983 and one Director in January, 1986. The Committee are astonished to note that a Board overloaded with representatives of industries and business is still continuing well beyond its normal term of four years and a decision on its replacement is still to be taken. The Committee were informed that 49 meetings of the Central Board took place during the period January, 1986 to December, 1992, out of which, the Government nominee (Secretary, Economic Affairs) was present in 15 meetings only.

Functioning of the Board

15.10 Agenda for Central Board meetings normally include review of the weekly reports of Issue and Banking departments, developments in exchange and exchange control and review of the working of various departments of RBI namely the DBOD and, Rural Planning and Credit Department (RPCD), DFC, Vigilance Unit etc. Apart from these other items discussed also include economic reviews of different states, reviews of working of public sector banks/foreign banks operating in India, Annual Reports of working of RBI etc. The Committee note with concern that the irregularities in securities transactions in banks that had surfaced as early as 1986 did not engage the attention of the Board despite the fact that the scrutiny reports, the AFRs of banks as in the case of SBI, Canara Bank, Syndicate Bank, Vijaya Bank, UCO Bank and the annual reviews of 1990 and 1991 on the foreign banks had brought out serious irregularities in their operations, malpractices in securities transactions and violation of RBI guidelines. This is all the more a matter of concern as the Ministry has confirmed that the reviews of the working of public sector banks/foreign banks operating in India is a normal item of the agenda of the Central Board. In this sense, the Central Board has failed to discharge the responsibility entrusted to it.

Public Debt Office

15.11 In terms of provisions of Sections 21(2) and 21A(1)(b) of the RBI Act, 1934, the Bank has been entrusted with the management of public debt and issue of new loans of Central Government and State Governments respectively. In terms of Public Debt Act, 1944, the administration of the Public Debt of both Central and State Governments has devolved on the Bank. At present, 14 PDOs are functioning in the country. Each of them is an independent unit under the overall charge of the Manager.

Functioning of PDOs

The functions of PDOs can be broadly classified under the following categories:

(i) Issue of new loans of Central, State Governments and other Statutory Bodies.

(ii) Issue of compensation and rehabilitation grant bonds under the Land Tenure Abolition enactments of State Governments.

(iii) Payment of periodic interest.

(iv) Enfacement of securities.

(v) Renewal, consolidation and sub-division.

(vi) Payment of commutation value in respect of annuity certificates.

(vii) Repayment loans.

(viii) Registration of nominations/power of attorneys/signatures of authorised officials.

SGL Accounts

15.12 The securities pertaining to rupee loans issued by Central and State Governments are held in the following three forms :

(i) Promisory Notes;

(ii) Bearer Bonds; and

(iii) Stock or Book Debt.

15.13 The stock can be held in two forms viz. (a) in the form of a certificate (b) in the form of an account called Subsidiary General Ledger (SGL) Account. While in the case of former the name of holder thereof is registered in the books of PDO as the proprietor of the amount of the security under a specified loan, in the latter case no certificates are issued, instead the account holder is advised of the opening of an account and the balance to his credit in each such loan.

15.14 The facility to hold securities in the SGL form is available to banks, financial institutions, Provident Funds, stock exchange brokers on Bank's approved list and Government officers holding charge of Statutory Corporations.

15.15 In view of the facility of interest payment on due date without physical presentation of the security and also easy transferability from one account to another most of the investments of banks, FIs etc. are held in the form of SGL account.

15.16 As on August 18, 1992 a total of 880 SGL Accounts were operatable in 13 PDOs spread over the country. Out of these 437 i.e. 50% of the total were with PDO, Bombay. This is on account of Bombay being the main capital market in India. It is against this background that the Committee took up PDO, Bombay for detailed examination in connection with the irregularities in securities and banking transactions.

15.17 The number of SGL accounts with PDO, Bombay has steadily grown from 160 in 1987 to 455 upto June, 1992. Similarly the number of SGL transfer forms received has also grown from 3902 in 1987 to 4971 in 1988, 5778 in 1989, 6434 in 1990, 12838 in 1991 and 5623 during the first semester of 1992. It is apparent that while during the first three years the increase in the number of SGL transfer forms received is gradual between 15 to 20 percent per annum, it shows a quantum jump of almost 100 percent from 1990 to 1991 and almost the same levels are visible in one semester of 1992.

15.18 It is relevant to note that this is the period when the massive irregularities in securities and banking transactions had taken place.

15.19 About the present transactions at PDO, Bombay; the witness informed the Committee on 6 January, 1993:

"Sir the number has come down very much. We are having 25 to 40 transactions per week".

Functions of SGL Section

15.20 With a view to ensure better customer service to investors, the SGL Section was given independent status in the reorganised set up of PDO in 1987.

The salient functions of SGL Section are:

(i) open and maintain SGL accounts in the name of the eligible parties/institutions i.e., Joint Stock Banks, Provident Funds, stock exchange brokers, trusts, etc.;

(ii) to examine Government securities tendered for conversion into SGL account, applications for issue of scrips of debit to SGL accounts and SGL account transfer forms;

(iii) to prepare advices/accounting vouchers for cancellation of old securities/issue of new scrips/transfer of amounts from one PDO to another;

(iv) to prepare and issue new scrips by debit to SGL accounts and issue credit certificates;

(v) to pay half-yearly interest on amounts held in SGL accounts on due dates;

(vi) to effect inter-account transfers within the same PDO and notify the transferer or transferee in respect of the transactions;

(vii) to pay redemption value of SGL accounts pertaining to loans notified for repayment;

Bouncing of SGL Forms

15.21 A very common feature observed by the Committee in the securities transactions of the banks involved in recent irregularities is that SGL transfer forms of several banks were not honoured due to insufficient balance in their respective SGL account with PDO, Bombay.

Such dishonouring has the following ramifications:

(i) Though no credit is actually given to transferee banks, the concerned bank shows the amount of transfer under its investment in government securities for SLR purposes.

(ii) Similarly the transferor bank will show the amount under its investment in government securities for SLR purposes since no debit to its SGL account will be raised due to insufficient funds. From the aforesaid it is clear that without the transaction having materialised both the banks would continue to derive benefit for SLR purposes.

15.22 The Committee's findings on the basis of data available on the objection memos issued to various banks, etc. for their SGL forms having bounced are summarised in the statement given below:

TABLE - A

Month Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1990				69	83	60	55	64	46	85	92	77
1991	40	48	59	50	53	51	101	89	72	120	55	68
1992	130	52	139	143	76	12	1					

15.23 The number of SGL forms which bounced due to insufficient balance in the SGL account during the period October, 1990 to June, 1992 is as follows:

TABLE - B

Month Year	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1990										67	67	73
1991	71	78	109	90	100	90	111	78	56	107	52	65
1992	103	56	116	136	151	15						

Grand Total = 1791

15.24 The Committee find that the figures for corresponding months in Table A relating to issue of objection memos and in Table B relating to SGL forms returned due to insufficient balance remain unexplained.

15.25 It is further noted by the Committee that out of these a substantial number of the bouncing have taken place in the SGL accounts of the banks, etc. which are figuring prominently in the recent irregularities as shown in the statement below :

(from July 1990 to June, 1992)

Andhra Bank	:	172
UCO Bank	:	123
SCB	:	276
ANZ Grindlays	:	53
BOK	:	138
BOA	:	112
Citibank	:	171
Bank of Madura	:	110
Canfund	:	41
Canfina	:	82
Total		1278

15.26 During the course of evidence when the witness was asked as to what action was taken by PDO once this high incidence of SGL bouncing was detected, the Committee was informed:

> "It was noticed by Bombay PDO some time in September, 1990 that the number of bouncings was more than the increase; it was little more than what we expected in normal course. This was observed for some time, and when we felt that this was the trend, we informed our Central Office. They also said you observe whether it was continuing; when it was continuing, under their instructions, we wrote letters to 11 banks and drew attention of their Chairmen to this fact and asked them to see that this thing should not happen".

15.27 It may be mentioned here that the above-mentioned letter written by PDO to the Chief Accountant, RBI Bank of India on 24.1.1991 besides pointing to the irregularities in SGL accounts of certain banks and financial institutions had also proposed the following penalties against the defaulters:

(i) Debar the bank defaulting on more than three occasions during a month from operating its SGL account for a period of 3 months; or

(ii) Charge penalty rate over and above, call money rate on the amount of default, for the period of default i.e., the period between original lodgement and relodgement of the transfer form.

15.28 The Committee are informed that in the absence of any enabling provision in the Public Debt Act, 1944/Public Debt Rules, 1946 and the PDO Manual to penalise defaulting banks for such defaults, the Central Office (Department of Government and Bank Accounts) advised PDO, Bombay on 11 March, 1991 to write D.O. letters to the Chairmen of such banks and suitably advise DBOD in the matter. The Central Office also decided to assess the comparative position of default by different banks after issue of the D.O. letter to the Chairmen and for this purpose it advised PDO Bombay to submit statements in this regard on a quarterly basis. No concrete action however was taken by the Central Office on the statements pertaining to the quarters ending September '91, December '91 and March '92 under the plea that impact of the measures could not be correctly assessed for the first quarter as the D.O. letters were issued only on 22 August '91 and in so far as the two subsequent statements are concerned they were received only after the irregularities surfaced. It is significant to note that PDO functioned under Shri R. Janakiraman, Deputy Governor, during this period.

15.29 The Committee were further informed by PDO, Bombay that they had also taken up the matter with DBOD in August, 1991. DBOD in the meantime on the basis of inspections carried out in March 1991, issued a circular on 26th July, 1991 under the signatures of Shri Amitava Ghosh, the then Deputy Governor, RBI, which among other things addressed to the Chairmen of the banks that it is their personal responsibility to bring to the notice of RBI any instance of return of SGL form from the PDO for want of sufficient balance in the SGL Account. Significantly a copy of the circular was not endorsed to PDO, nor were they asked to report to DBOD the bouncing of SGLS. When Chief Officer, DBOD was asked as to why the said circular was not endorsed to PDO he replied:

> "Somehow this circular, which we issued, had not been endorsed to our Managers".

15.30 Asked as to who was responsible for this obvious lapse the witness admitted:

> "I cannot say that I am not responsible, because the overall responsibility for the department lies with me."

15.31 The Committee are unhappy to note that such an important circular like the July, 1991 circular had not even been sent to the Regional Offices of RBI which are expected to monitor the working of the banks.

15.32 It is pertinent that after the issue of July, 1991 circular in the period August, 1991 to May, 1992 the number of SGL forms which bounced due to insufficient balance actually rose further and became as high as 935. From the records available to the Committee it is apparent that PDO did not take any further follow up action after writing to the Chairmen of banks, institutions and the DBOD.

In fact, the witness informed the Committee :

> "Since there was some improvement, we had informally taken up with DBOD, and they said that they were also aware of it and they had taken care of it. As a result we could not do any further follow-up."

DBOD on its part remained content with the issue of its circular of 26th July, 1991.

15.33 Thus two important departments of the RBI headed by two Deputy Governors Shri R. Janakiraman and Shri Amitava Ghosh principally concerned with SGL displayed insufficient concern in the matter contributing greatly to subsequent damage to the system. It is this gross derelication of duty in PDO and DBOD which greatly contributed to the scam.

Computerisation of P.D.O.

15.34 A high powered Committee was appointed by Governor, RBI in consultation with Government of India in April, 1985 to revise Public Debt. Act, 1944 and Public Debt Rules 1946, etc. The Committee headed by Shri T.N.A. Iyer, Executive Director, RBI consisted of representatives of Central Government, State Governments and the RBI. It was assigned the task of undertaking a comprehensive review of the Act, Rules, Manuals of Instruction, etc. and make suitable recommendations with the main objective of rendering prompt and efficient customer service. The Committee submitted its report on 5 February, 1986. The Committee among its various other recommendations had also suggested that the SGL accounts may also be opened and operated through a computerised system.

15.35 This computerisation did indeed take place but in June, 92 only, after a lapse of almost six and a half years and that too in the aftermath of the scam.

When asked during the course of evidence as to why it was not taken up earlier, the witness stated:

> "In 1988 the matter was reviewed. But at that time the review was not restricted to computerisation of SGL Section as such. But it was reviewed to see whether the transactions in PDO can be computerised . There are a number of other sections also in the PDO. The Committee decided that because some other priorities are there, the computerisation could be done a little later, after the priority items are taken care of. At that time, the computerisation in PDO was not undertaken".

15.36 When asked what was the perception of PDO, Bombay, when there was a quantum jump in the transactions in SGL Accounts, the witness stated:

> "The increase in transactions was noted as an increase in workload. It was not depicted as something sinister or something that might be happening behind the screen. The effort of the Bombay Office was to make the proper adjustments in the staff so that the additional workload could be taken care of".

15.37 When asked as to who was to take notice of this spurt and whether the spurt was brought to the notice of senior officials, the witness informed the Committee:

> "The fact that there were transactions would have been noticed by the Bombay Office. Bombay Office did not advise any higher agency and higher agency would not per se come to know about it".

15.38 The Bank has finally informed the Committee that the SGL accounts operations in PDO Bombay in respect of both Central and State Government Loans have been computerised. Computerisation of SGL accounts in PDOs at New Delhi and Madras has been completed and the system is also on parallel run at these offices. Further, necessary action has been initiated to computerise the SGL operations at the PDOs at Calcutta, Hyderabad, Ahmedabad, Bangalore, Kanpur and this process is at an advanced stage.

Inspection of P.D.O.

15.39 As regards periodic inspection of PDO, Bombay, the witness stated:

> "I can say it is generally supposed to be done once a year, but it is sometimes taking more than a year".

It may be mentioned here that the last two inspections of PDO were held in 1990 and 1992 respectively, and the latter was subsequent to the surfacing of the scam.

15.40 The Committee are of the opinion that a set procedure of inspections at regular intervals of the PDOs should be evolved and strictly followed so that any shortcomings/ irregularities which are observed are rectified within the shortest possible time.

Action against guilty officers

15.41 It has come to the notice of the Committee that in some cases there had been undue delay in preparation and despatch of Objection Memos. Further no statement of SGL account transactions were furnished to the banks. There had been several instances of wrong postings which had been corrected subsequently indicating that due care had not been exercised in the postings.

15.42 A Study of PDO, Bombay was conducted in May, 1992 'by the Inspection Department of the RBI. The study revealed the following irregularities:

(i) Certain entries not authenticated;

(ii) Certain corrections, cancellations; deletions, etc., not authenticated;

(iii) Entries made under incorrect accounts;

(iv) Arithmetical inaccuracies;

(v) Delay in furnishing particulars of transactions/objection memos to the banks concerned in some cases.

15.43 When the witness was asked about the action taken against the erring officers, he informed the Committee:

> "Since we did not know whether the mistakes were intentional, we put four Grade A officers under suspension on May 18, 1992. Then we conducted one more enquiry. Then charge-sheets were ordered. So far they have not come across any evidence of their getting any pecuniary benefit and doing anything to help any party. But there were a number of procedural irregularities committed by them and they were charge-sheeted".

15.44 Subsequently the Committee have been informed that the Enquiry Officer had submitted his report and on the basis of that the Competent Authority has proposed tentative punishment. This has been conveyed to the four officers. Simultaneously their

suspension orders have been withdrawn and they have joined duties. These officers have made written representations on 10 April, 1993 and have appeared for personal hearing on 8th and 11th May, 1993. Their submissions are under consideration of the Competent Authority. The Committee urge that as it is already more than a year since the offences were noticed, the authorities concerned proceed with all deliberate speed to secure prosecution/punishment of the guilty at all levels. The Committee are not satisfied that the necessary speed consistent with the gravity of the situation has been demonstrated.

Amendments to Public Debt Act

15.45 During the course of evidence when the witness was asked as to whether the Public Debt Act, 1944 was adequate, he replied:

> "We are aware that the Public Debt Act, 1944 has become obsolete".

15.46 A Committee to revise Public Debt Act, 1944 and Public Debt Rules, 1946, etc. was set-up by Governor, RBI in 1985. The Committee gave its report in February, 1986 The Committee have examined this report and found that some of the recommendations relating to flotation of loans, switch over to Government Stocks only in book entry form (i.e. SGL Accounts), management of public debt, management information system, servicing of Government loans, payment of interest, etc. will have far reaching effects not only on the functioning of PDOs but will improve customer services perceptibly.

15.47 When the witness was asked about the action taken on the said report, he informed the Committee on 6 January, 1993:

> "We had discussions with Ministry of Finance which looks after the amendments, etc. We have already submitted a proposal to the Ministry of Finance by amending the Public Debt Act and we thought that it would come-up in the last session of Parliament. Soon that will come up and wholesale changes are being made in the Public Debt Act, so that some provisions of the Act which are deterrent or which do not allow us to improve our customer service etc. should be removed."

15.48 Asked as to when were these proposals submitted to the Government, it has been stated that the draft of the Public Debt Bill was submitted alongwith a note for Cabinet to the Ministry of Finance in August, 1992. This is under consideration of the Government.

15.49 The draft amendment to the Public Debt Act was submitted to the Government after a delay of 6-1/2 years in August, 1992. This draft amendment also became unavoidable in the wake of the malfunctioning of PDO becoming public knowledge. There is something terribly wrong with a system of governance which recognises, as far back as 1985, that the Public Debt Act, 1944 has been rendered "obsolete" but requires such a long period to rectify obsolescence. In the view of the Committee this alongwith the delay in computerisation highlight the importance of timely decision making. If delays and such delays 6-1/2 years are permitted between a decision taken and its implementation then malfunctioning of systems is inevitable, it will spread as it has done; ultimately robbing the institutions of the ability to take and implement any decisions at all. The paralytic reaction time of governmental institutions is another major contributory factor to this scam, and the Committee would wish to emphasize it.

Functions of DBOD

15.50 The principal supervisory function of the DBOD is Inspection. It is detailed in subsequent paragraphs.

Inspection of Banks

15.51 The most significant supervisory function exercised by the RBI relates to inspection of banks. This is to safeguard the interest of the depositors and to build up and maintain a sound banking system in the country. Inspection is vital for an overall appraisal of the financial and managerial systems and the actual performance of banks.

15.52 The power to conduct inspections is vested with the RBI under Section 35 of the Banking Regulation Act, 1949. To enable RBI officers to properly carry out such inspection of banks, a detailed inspection manual was prepared in 1962 and revised in 1976 and again in 1987. The manual is supplemented by periodic instructions on various aspects of a bank's functioning, for example the guidelines of 1987 from the DBOD specify aspects to be critically looked into while conducting scrutiny of investment portfolio, buy back arrangements in Government and other approved securities, portfolio management on behalf of clients of banks etc. The Committee has also been informed that the DBOD has given further instructions on the working of banks including securities transactions. Two kinds of inspections namely the Financial, and the Annual Financial Review are presently in vogue. The Financial Inspections (FI) of banks is an elaborate exercise with focus on the determination of the real exchangeable value of the banks owned funds through a detailed scrutiny and evaluation of assets and determination of liabilities, including contingent liabilities which may turn out to be actual liabilities. The inspection is carried out at the Head Office and controlling offices (Zonal/Regional Office) as also at a sufficient number of branches so as to cover at least 60% of the advances of the banks, with a suitable mix of rural, semi urban and metropolitan branches including loss-making branches. The periodicity of FI is as under:

Public Sector Banks	-	once in 4 years.
Public sector banks with unsatisfactory financial position	-	once in 3 years.
Private sector banks	-	once in 2 years.
Private sector banks with unsatisfactory financial position	-	every year.
Foreign banks operating in India	-	once in 2 years.

15.53 AFR, introduced by RBI in 1985, is a rapid scrutiny of the working of public sector banks based on secondary records of the banks (i.e. records other than those at branches which are referred to generally as primary records, like audited accounts, long form audit reports submitted by the statutory auditors, Management Information System (MIS) available at the Head Office, internal Inspection Reports and Reviews put up to the Board. Under this inspection only the Head Office and 25% of the controlling offices are visited by the Inspection team.

15.54 During the course of evidence, the representative from RBI mentioned that the AFR is not basically a detailed inspection as no branches of the public sector banks are inspected under this method. He also held the view that in contrast the financial inspections though comprehensive, were time consuming. In order to correct this inherent flaw in the AFR System, inspections have extended beyond the public sector banks to cover select branches of these banks.

15.55 The number of major branches (having advances of above Rs. 5 crores) and controlling offices that have been inspected under the modified scheme during 1991 and upto August, 1992, are as follows:

	1991	August 1992
Branches	1545	1323
Controlling Offices	293	208

Elaborating further, the representative informed the Committee that in order to make the inspection system a more purposeful and effective instrument of supervision and control over the crucial areas of working of banks, the RBI in May 1991 set up an Informal Working Group under the Chairmanship of Shri S. Padmanabhan, former Chairman, Indian Overseas Bank. The Group was asked to look into the present system of RBI inspection of commercial banks and to make recommendations with a view to making it more timely and effective. This Group in its Report submitted in September, 1991, proposed two types of inspection, namely , (i) Annual Financial Inspection with the main accent on an assessment of a bank's financial position; (ii) The Biennial Management Audit.

15.56 Apart from the financial inspections and the Annual Financial Reviews, the RBI also carries out scrutiny of specific areas as and when considered necessary such as scrutiny of larger group advances, bill discounting, security transactions, PMS transactions etc. In addition, it also carries out inspection for certain specific purposes as provided in the Banking Regulation Act of 1949. The findings of the inspection are communicated to the bank's CEO, focussing the attention of the bank's top management to the irregularities observed by the RBI. In response, the written comments of the bank indicating specific measures taken or proposed to be taken for rectification of various irregularities/deficiencies noticed during the inspection are obtained. The Inspection Report is also required to be placed before the Board and the RBI nominee is expected to discuss these aspects with the bank's Chairman and generally ascertain the progress in this regard. Within the RBI, the inspection findings are discussed by the Deputy Governor/Executive Director with the bank's top management, within a month of receipt of detailed comments with a view to ensuring that the bank's management pay personal attention to setting right the identified irregularities, as also help in judging the adequacy of the action initiated by the bank on the inspection findings. Further, periodic Action Plan meetings are also held where again deficiencies are discussed.

15.57 In the case of foreign banks, apart from financial inspections, the working of these banks are also annually reviewed and the review is then placed before the Central Board. The RBI has informed the Committee that the irregularities featuring in the Inspection Reports and Scrutinies are followed up with the Chief Executives of the banks concerned until the rectification of the irregularities has been ensured. Besides, when a copy of RBI Inspection Report is forwarded to the Indian Office of the foreign banks operating in India, the concerned Chief Executive Officer is advised to forward a copy of it to their Head Office and obtain on it their observations as well. The Indian Office is also advised to place the Inspection Report, observations of the Head Office and the RBI forwarding letter addressed to the Chief Executive Officer in India before the Local Advisory Board of the bank alongwith the action taken/proposed to be taken to rectify the features observed in the bank's working.

Inspection Reports — Follow up

15.58 A scrutiny of AFRs inspection reports and special scrutiny reports from 1986 onwards of various banks have revealed that most of the irregularities that have surfaced recently have been time and again referred to in various reports and the prime players were the same

that are now involved. The irregularities noticed have been discussed elsewhere in this Report. The table given below summarises the data furnished to the Committee by the RBI relating to inspection and follow-up by the banks on the Inspection Reports on a sample basis of 11 Indian Banks and 4 Foreign Banks:

Statement Showing Follow-up of Inspection Reports by the RBI

Name of the Bank	Date/period of Inspection	Date, when Report forwarded to Bank	When reply received from Bank	Date of discussion with Management of Bank
State Bank of India	31.12.86 (FI)	3.6.88	21.1.89	12.2.90
-do-	1986 (AFR)	11.2.88	11.5.88	
-do-	1987 (AFR)	10.3.89	-	12.2.90
State Bank of Bikaner & Jaipur	1986 (FI)	21.7.88	-	22.6.89
Andhra Bank	31.12.87 (AFR)	11.1.89	6.7.89	19.4.90
Bank of Baroda	31.12.87 (AFR)	28.10.88	-	Discussion not yet held
Bank of India	31.3.90 (AFR)	25.3.91	-	-
Canara Bank	31.12.86 (FI)	25.10.88	-	29.6.89
-do-	31.12.86 (AFR)	26.4.88	-	Discussion could not take place
-do-	31.12.87 (AFR)	16.3.89	-	-
-do-	31.12.87	5.7.90	-	Discussion not held
Syndicate Bank	1986 (AFR)	22.2.88	-	-
-do-	1987 (AFR)	5.1.89		
Vijaya Bank	31.12.86 (AFR)	17.3.88	9.5.88 as some replies were evasive advised to offer specific commented on 7.11.88	Discussion not held

Name of the Bank	Date/period of Inspection	Date, when Report forwarded to Bank	When reply received from Bank	Date of discussion with Management of Bank
Vijaya Bank	31.12.87 (AFR)	29.10.88	2.3.89 replies evasive asked on 11.6.89 to give specific replies	Discussion not held
-do-	31.12.89 (AFR)	26.7.90	Comments not satisfactory asked on 30.12.90 to give specific replies	-do-
-do-	31.03.90	14.1.91	26.3.91 Asked on 8.9.91 to submit specific replies	Some of the irregularities discussed in Action plan meeting held on 2.7.91 between Governor, RBI and CMD
Bank of Karad	30.6.86 (FI)	17.1.87		9.3.87
-do-	25.3.88 (FI)	27.3.89		15.6.89
-do-	29.6.90 (FI)	3.5.91		22.8.91
Bank of Madura	30.6.86	18.4.87		23.9.87
-do-	25.9.87	18.7.88		15.12.88
-do-	30.9.88	12.12.89		12.4.90
Citibank	30.9.88 (FI)			-
-do-	25.5.90 (FI)			-
Bank of America	26.6.87 (FI)			27.9.88
-do-	30.9.89 (FI)			17.9.91
-do-	29.11.91 (FI)			-
ANZ Grindlays	29.4.88 (FI)			-
-do-	25.5.90			5.8.91
Stanchart	27.5.88			-
-do-	25.1.91			11.5.92

15.59 The Committee find that in almost all cases there have been inordinate delays in finalising and forwarding the inspection reports and pursuing them with the banks for compliance. The Committee note that in the case of SBI the Report of 1986 was finalised and forwarded to the bank almost after a lapse of one and a half years and discussed with the bank management more than three years after the inspection. The AFRs of SBI have likewise been finalised and discussed after long delays. The same kind of inordinate delays are noticeable in the case of Andhra Bank, Canara Bank, etc. In case of AFRs of certain banks like Bank of Baroda, Canara Bank, Vijaya Bank, etc., that were conducted in 1986 and 1987; the discussion between the representatives of RBI and the top management of the banks are still to take place (as on October, 92). Interestingly, delays are noticed in the case of the Foreign Banks also who have emerged alongwith certain select Indian Banks as the major players in the recent irregularities in securities and banking transactions. The RBI has indicated that discussions in quite a few cases have not been held on account of commitments on the part of the top executives of the RBI; inspection deficiencies in the case of public sector banks being generally covered in Action Plan meetings held by the Governor; and discussions having been held with the bank's management even prior to finalising of the report or sending the same for their compliance. The reasons cited by the RBI are far from convincing and hardly explain the inordinate delays that have occurred. The Committee are highly perturbed over the fact that while junior officers of the bank have been pointing out numerous irregularities in their reports, the top management of the Bank failed to act over a period of several years. Rectificatory action was relegated to a low order of priority and undertaken with great casualness, even negligence, thus contributing in significant measure to setting the stage for the scam.

While noting that the RBI set up the Padmanabhan Committee in 1991, the Committee are constrained to stress that such action should have been taken years earlier.

15.60 The Committee have noticed that the kind of irregularities that have recently surfaced can be traced back to as early as October, 1986. This had been pointed out in a letter by a Joint Chief Officer of the DBOD in RBI (Shri Augustine P. Kurias) way back in 1986 on the basis of special scrutiny of securities transactions in Andhra Bank and Syndicate Bank. The irregularities then noticed were :

1. Irregular transactions through BRs.
2. Voucher trading and tax planning.
3. Artificial revaluation of securities for the purpose of SLR.
4. Circumvention of ceiling on call money rates through sale/purchase of securities.
5. Indulging in name lending and undue favours to brokers.
6. Window-dressing in profit.
7. Acceptance of money from semi-Government Organisations without creating a proper liability.
8. Inflating/double counting of bank balances for the purposes of CRR/SLR.

15.61 Shri Kurias had suggested to the CO, DBOD for considering initiation of suitable action in the matter and the matter was referred by DBOD in January, 1987 to Directive Section, Credit Planning Cell and Secretary's Department for consideration of various issues involved in the Report.

15.62 Consequently the Secretary's Department made *inter-alia* the following suggestions for streamlining the system of banks issuing BRs for securities transactions:

(i) BR should be serially numbered and their issue entered in a separate register indicating, *inter-alia*, to whom issued, security particulars and the reasons for which the bank is compelled to issue BR.

(ii) BR could be issued by a bank only in respect of sale of securities held in its own portfolio and not in respect of any broker's transactions with other parties.

(iii) BR is only an acknowledgment and can not be transferred by a holder to any third party. In case the holder bank sells the securities covered by a BR, it should surrender the BR to the issuing bank and obtain fresh receipt in favour of the new transferee. The issuing bank should issue fresh BR on the strength of written request from the holder, if the securities in question are still not ready for delivery. Fresh entries have to be made by the issuing bank in its BR register to record the new BR and also suitable noting should be made against the old entry.

(iv) In case a BR is held by a bank which is other than the bank in whose name it is issued, it should not be counted as an investment for SLR purposes.

(v) In the case of sale of securities held in SGL account, there is no reason why the purchaser should delay lodging the transfer letter with RBI and getting the stock balance transferred. Banks should be told to lodge the SGL transfer letter with RBI within 2 days from the date of letter and not negotiate it as a scrip.

No further action was taken by DBOD in this regard. When the then Governor was asked about the reasons for this lapse, he stated:

> "Unfortunately, it got lost in the system. No action was taken thereafter. It was an institutional failure."

He further added:

> "Mr. Bhagwat's (Secretary) note said that this matter should be looked into and it was lodged at a lower level."

15.63 When asked as to whether the top management was aware of Kurias Report, the then Governor stated :

> "The file was not the file of Augustine Kurias letter. It was started on a subject relating to Indian Express's report which dealt with what is called 'a mockery of rules' or something like that, by buy-back system. On that file the letter was first referred to by an Executive Director Mr. U.K. Sharma. It went upto the Deputy Governor and it was based on the note of Mr. U.K. Sharma. At that time if Mr. Ghosh had gone into the letter of Mr. Augustine Kurias he would have set it right."

15.64 When Shri Ghosh was queried in this regard he stated, "I can tell you that during all my tenure in the RBI, except the Syndicate Bank file, I have seen not any other file". **The Committee are unable to accept this facile explanation of Shri Ghosh. Shri Ghosh was the Deputy Governor in charge of this department for 10 long years. He must be held largely responsible for turning a Nelson's eye to the continuing irregularities in the banking sector, ignoring the inspection reports prepared by the various RBI teams and being extremely casual and lackadaisical in his approach to his responsibilities. The Committee wonder how such an officer continued to occupy such a high office for such**

a long period. The Committee are even more amazed that RBI have found Shri Amitava Ghosh's services so indispensable that even after his retirement they have accorded him an important assignment.

15.65 The Governor's contention about the entire file not coming upto the top management is belied by the fact that the entire file including special scrutiny reports was put up by Shri U.K. Sharma under a note to Governor on 27 February, 1987 and the matter was also discussed by D.G. with him. **This serious inaction only highlight the manner in which the responsibilities are discharged by the senior officials in RBI. If only the then top management of RBI had taken action in 1987 on these recommendations the abuse of BR and SGLs/ Bankers Cheques which were instruments of scam could have been considerably moderated. The Kurias report had also referred to the possibilities of transactions being based on BR without underlying securities.**

15.66 **The manner in which the Augustine Kurias report had been dealt with is not an isolated instance of the way the RBI has been functioning. It is inconceivable that a relatively junior official of RBI should have been able to unearth such a long set of malpractices unless there was general knowledge in the system of the existence and persistence of these malpractices. Yet, no one at the level of the Central Board, the Governor or the Deputy Governor appears at any time between October, 1986 and March, 1991 to have addressed the problem with the seriousness it warranted. As things went, the country had to pay a heavy price in thousands of crores of rupees for the lapses on the part of the RBI top management during the crucial years.**

Scrutiny of PMS Operations

15.67 As has been commented PMS and its misuse was one of the principal contributory factors to the scam.

15.68 The RBI carried out scrutinies of PMS Operations relating to 5 banks, namely, Canara Bank, Vijaya Bank, Citibank, American Express Bank and ANZ Grindlays Bank during August-September, 1989. Also RBI undertook the bills portfolio of Vijaya Bank during January-February, 1990.

15.69 Irregularities noticed during these scrutinies related to securities transactions at off market rates, sale of securities through the medium of BR, large volume of trading in BR in Citibank, undertakings transactions through select brokers, exchange of SGLs/BRs without physical delivery of securities etc. In the case of Vijaya Bank, however, a detailed scrutiny of PMS and securities transactions was carried out.

15.70 **The scrutiny report on Vijaya Bank also disclosed serious irregularities and had pin pointed the involvement of the then CMD of the bank, Shri K. Sadanand Shetty. Based on these findings the then Governor recommended to the then Finance Secretary on 11.9.1990 that Shri Shetty's services may be discontinued in the interest of the bank. Perhaps a rare instance of punishment the then CMD of Vijaya Bank was removed upon the recommendations of the then Governor, RBI on 21 September, 1990.**

15.71 On a query as to what action had been taken on the Report on Vijaya Bank, the Chief Officer, DBOD, informed the Committee that :

> "I recorded a note on the report that we should take up the scrutiny of a few banks in three four areas: Bills, PMS, Investments including call money operations and securities transactions, also, I myself had suggested that scrutiny should be done after analysing the Vijaya Bank transactions."

15.72 However, as regards subsequent developments the witness said :

> "When this note came back it went to the section concerned to take action, but somehow this was kept in the section. Here again, as I said, although I am not trying to say that I am not responsible, ultimately I said the responsibility was mine."

15.73 This is another instance relating to PMS which has come before the Committee where virtually little action has been initiated by the DBOD on documented irregularities that had taken place. Neither was the functioning of banks in these limited areas reviewed nor any other corrective action taken after the Governor made his recommendation to the Government. The Committee would like stern action to be taken against the erring officials.

Foreign Banks and PMS

15.74 These constitute a separate entity for inspection and supervision as well. The Committee have examined this aspect closely based on findings of the regular inspections, special scrutinies of the foreign banks and the balance sheet data as on 31.3.1990. A review of working of the foreign banks as on March 1990 was placed before the Central Board of Directors of RBI in October 1990. This review clearly established that there were serious irregularities in the PMS operations of the foreign banks. The Memorandum relating to 1990 review placed before the Central Board also stipulated that further action would be taken by the RBI on the irregularities noticed. It is observed by the Committee that most of the irregularities that have surfaced in the scam had been noticed earlier in these special scrutinies and warning letters were also issued in January 1991 to these foreign banks clearly indicating that RBI would not permit them to undertake PMS operation unless they adhered to the issued guidelines.

15.75 When the Chief Officer, DBOD, was asked by the Committee about the reasons for not initiating further action beyond the warning letter issued in January 1991, the witness stated :

> "So far as action is concerned, I do not think there is any case as such. The action is generally taken taking into account the overall aspect. We have not been taking very strong action."

15.76 Exchange of correspondence between Citibank and the RBI provided an illustrative case as to the kind of response RBI gets from foreign banks in India. In the present case the Financial Inspection of Citibank was conducted on 25 May 1990 and the Report on its findings sent to the bank on 24 April, 1991. As the bank had not furnished their comments within the stipulated period of 2 months, the bank was reminded on 9 July 1991, 19 August 1991, 30 September 1991, and 23 October 1991. The bank thereafter furnished, its comments on 29 November 1991. Citibank was further reminded by RBI on 7 April 1992, 18th June 1992, and 16 July 1992 in response to which it furnished further compliance on 3 August, 1992, and the views of the bank relating to investment were furnished only on 27 August, 1992. As regards adherence to PMS guidelines, the bank had offered the revised views on 12 September, 1992.

15.77 The above instance is reflective of an attitude of indifference adopted by Citibank towards the Central Bank of this country. In fact the then Governor, RBI confessed before the Committee :

> "I find that in respect of many banks they say that their comments are expected. They have been treating us rather lightly".

15.78 He further added :

"I think we are now taking strong action and you will see the results".

15.79 While it is obvious that the Central Bank of the country has been taken lightly by the foreign banks, there are unfortunately no traces of the strong action against them.

15.80 The Committee have to comment upon the casualness with which Citibank persistently responded to the queries of RBI. It prevaricated, answered partially or inadequately, perhaps deliberately and never had a ready response to the requirements of the Central Bank of the country. Unfortunately the Committee have also to observe that this failure on the part of RBI to have its instructions obeyed is reflection of the loss of authority that the RBI has brought upon itself. The Committee have no doubt that no foreign bank would have responded with such indifference to directions/queries from the Central Bank of the country of its origin. It is the excessive accommodation shown to foreign banks by top management of RBI that imparted arrogance to these banks to describe as 'market practice' what was infact the blatant flouting of RBI directives. The foreign banks eventually emerged as the originators as also the biggest players in the scam.

Circular of July, 1991

15.81 On 20th March, 1991 the then Governor, RBI noted that "there is practice of selling Govt. securities by individual banks even when they do not have adequate stock of such scrips. The whole transaction is fictitious. All that the banks exchanged is certificates of forward sale and forward purchase, the whole process leading to considerable amount of abuse and corruption possibly the brokerage is being shared." The Governor requested the Deputy Governor to instruct the Chairmen of banks to ensure that such transactions did not take place that year. He instructed that any bank Chairman found to have indulged in such transactions will have to be dealt with severely. The message was to be conveyed to particularly Chairmen of banks in Bombay and Delhi where such transactions were reportedly taking place on a large scale. In addition, he also suggested inspection by the Inspectors of DBOD of the securities departments of some of the nationalised banks. In respect of foreign banks, however, he observed that "while foreign banks are also involved we have to take care."

15.82 In response to the Governor's note, officers from DBOD were deputed to scrutinise on a sample basis the transactions of Bank of India, Bank of Baroda, Indian Bank and the Indian Overseas Bank with a view to finding out whether banks were resorting to selling of Government securities without adequate stock of scrips and whether they were entering into transactions to provide business to the brokers so that the brokerage could be shared. The Regional Offices were also advised to depute officers to scrutinise the transactions in the investment accounts of banks with the Headquarters in their region. The Chief Officer, DBOD, in his note dated 25.3.1991 has indicated that as per the information received from the Madras and Bombay Offices of Bank of India and Bank of Baroda no instances of banks resorting to over sold position or security transactions operations have been conducted with a view to share brokerage, have been revealed by the scrutinies conducted. In fact, according to the note the above banks were holding sufficient securities when they entered into RF deals and that these were mainly in the nature of a cash management exercise. The note also stipulates that in so far as Indian banks are concerned such instances had not come to the notice of RBI as on that date though there are indications that certain foreign banks like Citibank were engaged in the above type of transactions. The note has also mentioned that as regards banks entering into buy-back deals the circular prohibiting buy back deals had

been issued in April, 1987. This note was then submitted to the Deputy Governor who marked it for the information of Governor on 28th March, 1991.

15.83 In pursuance of Governor's note RBI undertook scrutinies of transactions in securities during first quarter of 1991 by inspectors of the RBI in respect of the following banks :

1. Bank of India
2. Bank of Baroda
3. UCO Bank
4. United Bank of India
5. Indian Bank
6. Indian Overseas Bank
7. Canara Bank
8. Vijaya Bank
9. Punjab National Bank
10. Oriental Bank of Commerce
11. Punjab and Sind Bank
12. New Bank of India

15.84 The scrutinies reportedly revealed that no sale of securities without holding them in the books of the bank had been observed except in the case of UCO Bank.

15.85 Some of the other important findings of these scrutinies were:

i) Citibank had traded with Bank of India in a security not held by it, this amounting to speculative trading.

ii) Transferring of loss in securities transactions from one bank to other as tax planning measure which in reality was a tax avoiding exercise.

iii) Buy back transactions with non-bank institutions. The transactions with non-banks generally partook first purchase of SLR assets. The non-banks also kept the funds deposited with the banks, which helped in acquisition of SLR assets without depletion of funds.

iv) The bank were indulging in buy-back in securities in a typical fashion where there is no increase in the total volume of SLR assets and there is no impounding of excess liquidity, thus defeating the very objective of SLR provisions.

v) No actual transfer of securities was taking place as the transactions were being effected by transfer of BRs and making entries in the books of the concerned institutions . No entries for these transactions were being passed in the SGL account maintained with RBI except in very rare cases.

vi) Brokers were getting undue benefits from these transactions and though they were legally bound to reflect brokerage charged separately, it was never being done.

vii) Transactions in Units through exchange of BR thereby enabling brokers to take positions. This unhealthy trend made the securities market volatile and speculative to benefit unscrupulous traders.

viii) Securities transactions through current accounts of brokers resulting in fantastic profits without any outlay of funds by the players.

ix) Misuse of facility of BRs by Citibank.

15.86 The note in view of these irregularities suggested the following measures to control the same:

a) Though forward trading need not be banned but prudential ceilings on turnover of particular securities implemented through market intervention by the Central Banking authorities may curb the unhealthy speculative tendencies.

b) Abolition of brokers in the securities market as was done in the case of call money market to remove the middlemen who indulge in unhealthy practices. Role of brokers be played by RBI or DFHI.

c) As most of the swap, switch and buy-back transactions involving large amounts have the foreign banks as counterparties, their role in securities market has to be probed further, in order to curb many unhealthy practices/trends.

d) In order to curb switch, swap and buy-back arrangements (forward trading in securities) through brokers such deals involving more than Rs. one crore be effected directly between contracting banks.

15.87 This note was put up by the Special Investigation Cell of DBOD on 14 May, 1991. It was put up to the then DG Shri Amitava Ghosh by CO, DBOD on 31 May, 1991 with the suggestion that the issue of transactions in Governments securities seemed to require detailed discussion.

15.88 Subsequently another note was put up on 17 June, 1991 by a Banking Officer of DBOD which observed *inter alia* the following irregularities in securities transactions:

1. Banks indulging in ready forward deals and double ready forward deals.
2. Deals for window-dressing profitability/compliance of SLR.
3. Use of BRs.
4. Putting through transactions through brokers account and issuing BR on behalf of brokers. Undue benefits to brokers.

The note therefore recommended issue of a circular to banks advising as under:

1. Under no circumstances a bank should hold an oversold position in a security.
2. All transactions put through by a bank either ready forward or outright and whether by mechanism of BR or credit to SGL account should be reflected on the same day in its Investment Account and accordingly for SLR purposes wherever applicable.
3. Transactions between a bank and its counter party should be settled directly between the bank and the counter party bank and should not be put through brokers account.
4. Format approved and guidelines prescribed by IBA should be adopted by the banks for issue of BR.

15.89 The earlier note which had far more strident overtones was also placed below this note.

15.90 In this connection, the Deputy Governor while submitting the note to the then Governor *inter alia* stated that, "we may appoint a reputed firm of Chartered Accountant like M/s. Bansi Mehta & Co. to go into the transactions in investment accounts of few banks particularly the accounts maintained by UCO Bank on behalf of brokers. On receipt of their report we may initiate the proper action".

15.91 The then Governor recorded thereon as follows:

> "We will be inviting adverse notice if we do not issue instructions immediately to stop these malpractices. I am worried that even after I had pointed this out as early as 20 March, 1991, no deterrent action has been taken on so far. The draft instructions may be kept ready for issue on 26 July, 1991."

15.92 The circular in the form of a secret DO letter from then DG Shri Amitava Ghosh as approved by Governor was issued to Chief Executives of banks on 26th July, 1991. The Committee note the initial reluctance on the part of the then Deputy Governor to take deterrent action. The Governor had to overcome this reluctance to secure the issue of the circular and further in that very circular issued so reluctantly the two important aspects relating to (i) prohibiting buy back deals even among banks; and (ii) valuation of securities for SLR purpose, was not included. This position was seen and endorsed by both the then Deputy Governor Shri Amitava Ghosh and the then Governor. These were subsequently incorporated in the circular issued on 20th June, 1992 after the surfacing of the scam.

15.93 During the course of deposition on a query regarding the non-incorporation of these two important items in the circular, the then Governor, RBI stated:

> "I have said in the note that this may be marked to the Dy. Governor. I do not have any evidence of any follow up on that".

15.94 When reminded that the file had come back to him and it was written over it that he had seen it, the Governor replied:

> "I do not know precisely where it went. I have not seen any trace of its coming back to me".

15.95 When the Chief Officer, DBOD was asked regarding this he said:

> "Everything was put up to the Governor".

15.96 Asked further as to what was the follow up of this circular, the Governor stated:

> "We thought by issuing this circular we had put a stop on this. If it had been implemented it would have put a stop to it. But they were all flouting it".

15.97 When asked further as to whether the non-compliance by the banks was not a signal for RBI to take further action the Governor stated:

> "At that time rightly or wrongly, we had felt that we had issued instructions; and when the RBI issues the instruction banks normally obey them".

15.98 The Chief Officer, DBOD, when asked as to why no follow up action was taken by his Department on the said circular stated:

> "We had issued only a circular, we had not taken any action".

15.99 When asked further as to was it not functional failure on his part, the witness admitted:

> "I think to some extent I would agree. We could probably have written to the individual bank".

15.100 The Committee find that the first note of 14 May, 1991 on the subject matter has detailed all the irregularities which have recently surfaced in the securities transactions.

That note had also suggested certain concrete measures which if adopted would certainly have inhibited continued wrong doing. This was not done.

15.101 The Committee have highlighted this instance only to accent its earlier observation on the follow up initiated on inspection reports. They regrettably conclude that even the high office of Governor RBI did not remain unaffected by the all pervasive malaise. In retrospect, the Committee are sadly led to the view that the Governor, could have demonstrated greater decisiveness at critical moments.

July, 1991 Circular — Non-Compliance and Inaction

15.102 Regarding the response of the banks to the 26 July, 1991 circular of RBI, the Committee were informed that the response of the banks between July 1991, up to the end of the year 1991, has been as follows:

		No. of banks
(a)	Investment policy framed and copy submitted to RBI	22
(b)	In the process of formulating an investment policy	4
(c)	The letter acknowledged and confirmed that the policy followed is in accordance with/does not contravene the guidelines	9
(d)	The letter was merely acknowledged	16
(e)	* No response from the banks	27
(f)	The bank under liquidation (BCCI).	1
	TOTAL	79

* List of Banks at Annexure XXXVI.

15.103 It is observed that out of a total 78 banks who were to respond to this D.O. letter, 16 merely acknowledged the letter and there was no response from 27 others even after more than five months of the issue of the D.O. letter.

15.104 The Committee has also been informed by the Reserve Bank that "due care was, however, taken in this interregnumn (August to December, 1991) to see that major participants in the market like SBI, SCB, BOA, ANZ Grindlays Bank and Citibank confirmed compliance with the guidelines. Further, in September, 1991, when the RBI addressed the public sector banks regarding strengthening of vigilance arrangements the letter had included *inter alia*:

> "The internal auditor should critically examine the investment portfolio in order to ensure that the transactions have been undertaken on business consideration alone and are in the best interest of the bank and are not intended to pass any undue benefits to the brokers".

15.105 But even as late as July, 1992, 18 out of these 37 banks were still in the process of framing the policy in accordance with the July 1991 circular. Despite these circulars, the RBI has admitted before the Committee that though most of the key players in the recently surfaced irregularities in securities transactions like Citibank, BOA, SBI, American Express

Bank, Vijaya Bank, Syndicate Bank, etc. had admitted compliance with the D.O. letter of July, 1991, it was subsequently proved that all of them had actually ignored the instructions incorporated in this D.O. letter and had indulged in the irregularities on a massive scale. Nothing proves better, if further proof were indeed required, of the collapse of RBI's supervisory functions and the need for a thorough overhaul which will restore the position and authority of RBI at the pinnacle of our banking system.

The Committee find from the foregoing that the functioning of the departments of PDO and DBOD has been totally unsatisfactory. If the concerned Deputy Governor/senior officers in these departments had appreciated the implications of numerous reports that came before them, beginning with the Augustine Kurias Report of October, 1986, the effect of the scam would not have assumed such dimensions. Further, if Governor RBI had taken serious note of these irregularities the ambit and depth of the scam might have been moderated. As it turned out, the entire system of regulation and control over the banking system, in the very body charged statutorily to exercise regulation and control, completely broke down over a period of several years. With no one in authority, the RBI, or at the level of Governor/Deputy Governor, or in the senior echelons of PDO and DBOD taking any determined action to put a stop to irregularities, criminals and scamsters were given the run of the land. It is this failure that is the root cause of the scam.

Bill Discounting Circular

15.106 Bill discounting has developed essentially as a mechanism to enlarge credit facility to users within the parameters of financial discipline. The existence of an active bill market imparts flexibility to the money market, evens out liquidity within the banking system and enables the RBI to exercise a more effective control over the money market. With the objective of promoting a bill market, the RBI grants refinance facilities to scheduled banks under the Bills Rediscounting Scheme. The bill of exchange should be a genuine trade bill and should have arisen out of sale of goods. The Committee were further informed that in order to enlarge the scope of the scheme, the criteria for eligibility of bills has been further relaxed and some additional bills are now eligible for rediscounting.

15.107 During inspections in 1990 and special scrutinies carried out then by the inspectors of the RBI serious irregularities were observed in bill discounting operations of certain Indian and foreign banks. These irregularities *inter-alia* included:

(i) Providing additional finance to large industrial groups outside the consortium by discounting purchase and sales bills either drawn on them or drawn by them.

(ii) Discounting bills for long usance covering sale of shares/debentures.

(iii) Discounting of bills in respect of payments like electricity bills, customs charges, lease rentals.

(iv) Discounting of accommodation bills.

(v) Providing large bills discounting facililties which were disproportionate to the net worth of the beneficiary.

(vi) Obtaining excess refinance by rediscounting ineligible bills and also not maintaining proper record of bills discounted.

(vii) Placing funds received from fiduciary clients under PMS as short term working capital by way of discounting of bills.

The Chief Officer, DBOD further informed the Committee during evidence:

> ".... there is a paragraph in the bills where it is mentioned that serious irregularities were observed in the working of the foreign banks. At that time we had also carried out a scrutiny of bills, transactions, etc., not only of the foreign banks but other banks also. Apart from regular inspection, a special scrutiny was carried out of the bills transactions of a few Indian banks as well as foreign banks".

15.108 Asked about the reasons necessitating such inspections and scrutinies and the perception of the DBOD about the likely ramifications of these irregularities, the witness clarified:

> ".... in the Department we did feel that bills area is one of the areas where there could be problems. Apart from irregularities, we noticed that this could be a problem area for the bank, in the sense that we found that quite a number of bills were accommodation bills and some of these had been discounted for the purpose of enabling some groups to acquire shares in certain companies. Some of the bills were also for underlying transactions for shares etc. We were really worried about this area. In September, 1990 we had analysed the whole bills transactions area and we examined them. We felt that all genuine production activity should get the credit needed but this mechanism should not be allowed while agreeing that the manufacturing companies and others should get credit to the extent needed and we should put a curb on the bills area. In that way, we felt, the bank's interests would be safeguarded. The main reason, therefore, is that we did feel at that time that the flow of funds through the bills may not be for genuine production purposes."

15.109 The then Governor during his deposition, further informed the Committee in this regard as:

> "We found that this was a source of call money, which the foreign banks have been making".

15.110 When asked as to what action was taken by DBOD once the irregularities in bill discounting came to its notice, the Chief Officer stated:

> "We had prepared the detailed programme of action. We had put it up to the top management somewhere in October, 1990".

15.111 The Committee notice from the relevant records that a detailed note was indeed put up by DBOD on 1 October, 1990 enumerating serious irregularities in the bills discounting of certain Indian and foreign banks; the likely ramifications of such irregularities; as also the course of action to be pursued to curb this unhealthy practice. A draft circular to the banks was also appended for approval and issue. The chronology of events collated from the relevant file may be seen at Appendix-XXXVII. The Committee also note that the circular relating to bill discounting facililties was issued only on 28 July, 1992, after a characteristic delay of 22 months after the scam came to light. Some glaring examples of irregular bill discounting noticed by the Committee are at Appendix-XXXVIII.

15.112 When the Chief Officer, DBOD was asked the reasons for this delay he stated:

> "From the Department we put up the note in October, 1990. It was marked to the Governor. The Governor wanted this matter to be discussed at the meeting of top management Committee. This was discussed later".

He further added:

"The order to issue came to us only in July,1992".

15.113 Asked as to who was responsible for this decision, he informed the Committee:

"In this particular case, the circular went upto the Governor".

15.114 When the then Governor was asked to explain the reasons for such unusual delay in deciding a matter of considerable importance for the banking industry as well as the entire financial system he stated:

"I think the bill discounting circular was discussed a number of times. It was finalised sometime in September or October last year. Our credit restrictions were also severe. We thought it was not right time to do this because during credit restrictions many industries are in difficulty. We though by January we would issue. I think due to pressure of work, it could not be. Executive Director and Deputy Governor were to finalise it".

15.115 When it was suggested to the Governor that private sector companies already showed inflated income from interest and investments and that the funds arranged from bill discounting usually landed into portfolio management etc. he admitted:

"I agree with you, that is why we stopped it".

15.116 As regards not issuing the circular during 1992, RBI has informed the Committee that in the first half of 1991-92 there was a virtual cessation of credit and even in the full financial year 1991-92 the credit expansion was substantially below that of the previous year. If the measure of bill discounting/rediscounting had been implemented in 1991-92 there would have been a total disruption in the flow of credit. The Bank has further stated that though such credit drawals would be in the nature of irregular drawals, it was felt necessary to choose the appropriate time for implementing this measure. Accordingly a circular was issued after the credit policy was issued in the first half of 1992-93. After taking into account all those factors and after the Dy. Governor had reviewed the case the redrafted circular was resubmitted for approval on 15 May, 1992. The circular was approved by Governor on 26 July, 1992 and issued on the same day.

15.117 The Committee do not find as satisfactory the explanations offered by the RBI. Bill discounting was a means of finance resorted to by a number of borrowers who wished to avail of credit without going through the rigours and delays of consortium appraisal. While it is a desirable method of financing, it is important that particular groups or individuals should not get access to additional financing through this method without being eligible for additional credit. Irregularities in bill discounting had come to the notice of the RBI as early as January, 1990, if not earlier, when a detailed scrutiny of Vijaya Bank had been undertaken. The reports of the RBI also clearly pointed out the misuse of the Scheme by large industrial groups. The Study of Vijaya bank, Indian Bank, SBH, American Express Bank exposed Reliance Group as a key player in these operations through a host of financial companies — 34 in one case, 16 in another. Others included the Kotak Mahindra and the Vijay Mallya Group, These grave shortcomings in the bill discounting scheme were again highlighted by the nominee RBI Director of the Karnataka Bank in December, 1991. This note quoted several instances where industrial houses were given irregular bill discounting facilities outside the consortium arrangements. Significantly, the RBI admitted in its report in which Vijay Mallya Group and Fairgrowth were indicted that "some industrial groups shift from one bank to another as and when their dealings come to our knowledge and sort of restrictions are placed on them". With all

this information already available, RBI chose to delay even issuing a circular for a period of 22 months, despite the fact that this was the period during which there was a credit squeeze. This resulted in irregular flow of funds to large industrial houses. It is possible that the bill discounting irregularities may have been another component of the supply side of the Scam an aspect that has hitherto not been looked into. This lapse seems unpardonable and needs to be investigated.

Foreign Banks

15.118 The Committee have already discussed the role of foreign banks in the irregularities in securities and banking transactions earlier in this report. The inter-relationship between the RBI and the foreign banks are discussed in the paragraphs that follow:

15.119 Foreign banks are permitted two types of banking presence in India, *viz.*, branch operations and representative offices. All proposals for entry of foreign banks into the country are first examined in the RBI and then placed before an Inter-Departmental Committee which comprises of representatives from the Ministry of Finance (Department of Economic Affairs), Ministry of Home Affairs, RBI, etc.

15.120 Foreign banks are permitted to open representative office or enter into agency arrangement with companies in India. However, the representative offices cannot do any business in India but can act merely as a liaison office to furnish economic and trade information on India, facilitate corresponding banking arrangements and also foreign currency financing for Indian companies.

15.121 The expansion policy in the case of foreign banks is based on consideration of national advantage from the point of view of facilitating exports and foreign investments and principles of non-discriminatory reciprocal treatment and mutual benefits besides compliance with prudential and other norms are given due weightage.

Irregularities in Foreign Banks

15.122 The serious irregularities in bill discounting facilities as revealed by the special scrutinies conducted by RBI in 1989 and the irregularities in PMS operations committed by the foreign banks as contained in the Annual Reviews of 1990 and 1991, have been discussed earlier in this Chapter. The memorandum for the meeting of Central Board of RBI in October, 1990, had also indicated action being taken against the foreign banks. The irregularities noticed had been followed up with the issue of warning letters to the top management but these had merely ended with assurances stating that the foreign banks will adhere to the RBI guidelines/instructions. However, subsequent inspections have revealed the continued occurrence of the irregularities and the Committee find that ANZ Grindlays, Citibank, American Express Bank, BOA and SCB have not only been the major players in the Scam but have initiated the entire process of the Scam. During evidence, when asked about the scale of involvement of the foreign banks in the Scam. Governor, RBI, stated:

> "The foreign banks were also involved. People came and told us. They said that the principal parties to some of the transactions were foreign banks. I was generally aware that they were important culprits in this".

15.123 When further asked to clarify regarding his noting of 20.3.1991, "while foreign banks are also involved we have to take care", the Governor stated:

> "I have no valid explanation. It must have been based on the very fragile state of foreign exchange situation. We have to depend on loans and credit from foreign banks in the international market".

15.124 On the functioning of the foreign banks with regard to irregularities in PMS operations while the representative from the Ministry of Finance had stated that these were not of fraudulent nature and many of these were because of by-passing of rules, the Finance Minister however in his deposition had remarked:

> "Some of the malpractices have come to notice as early as 1986 . . . . Had proper action been taken earlier, because some of these things came to notice in 1986 and also about foreign banks in 1991, it is true that strengthening of the supervisory system would have helped."

15.125 The Committee find that because of the fragile foreign exchange situation and the BOP crisis the RBI had not been assertive enough in the action taken against foreign banks. Both the RBI and the Ministry of Finance by not taking deterrent action against them early enough enabled the foreign banks to exploit the situation and commit large scale irregularities in total violation of the guidelines laid down by the RBI. In fact, the Governor, RBI has gone on record to say that "for the past failures we have to take action against them". The Committee recommend that such deterrent action be taken without any further delay. It is also learnt that the regulatory authorities of these foreign banks in their countries of origin are examining whether any of their laws have been contravened. RBI should pursue this matter with the concerned authorities. The Committee would also recommend that in future any action taken by RBI against the branches of the foreign banks in India should be reported formally to the regulatory authority of the country of their origin. In addition the Government should take up the matter with the counter part Governments concerned.

Priority Sector Lending

15.126 Keeping in view the metropolitan status of the branches of foreign banks having limited scope for lending to priority sector activities, the targets set under priority sector lending were not applicable to foreign banks till August, 1988. Lending to priority sector was introduced in August, 1988, and foreign banks operating in India were advised to take their priority sector advances by the end of March, 1989 to the level of 10% of their net outstanding advances and to progressively increase the same to the level of 12% and 15% of their net credit by the end of March, 1990 and March, 1992 respectively.

15.127 The achievements of the foreign banks against these bench marks during the period 1989 to 1992 are given below:

Year	Target	Achievement
March, 1989	10%	7.67%
March, 1990	12%	9.84%
March, 1991	12%	9.45%
March, 1992	15%	7.86%

15.128 In a written submission, the RBI has clarified that no penal action has been taken against any bank including foreign banks for failure to achieve priority sector targets, but that this is now under consideration of the Bank. On a query from the Committee, the then Governor admitted during oral evidence:

> "I agree that action should be taken."

The Committee hope that this will be done soon.

15.129 Incidentally the Committee note that recently the Government have directed the foreign banks to use the amount representing the difference between the target laid down for priority sector lending and their actual lending for buying SIDBI bonds at 10% interest. This is however applicable from the current financial year only.

National Housing Bank

15.130 The NHB was set up in July, 1988 under a statutory Act. The Act enjoins upon the NHB the following basic mandates:

(a) promote housing finance institutions so as to generate larger reach of housing finance through branch network and also manifest larger demand for housing loans and thereby demand for ownership of houses;

(b) provide financial support for housing which will include land development & shelter projects of housing authorities, cooperative agencies and professional developers etc. to augment supply of housing to meet the demand created through (a) above; and

(c) act as regulatory agency for the housing finance institutions.

15.131 The NHB is a wholly owned subsidiary of RBI which has contributed Rs. 200 crores in the form of equity capital to the bank and a corpus of Rs. 125 crores has been received as assistance from the National Housing Credit (Long Term Operation) Fund. The other sources of funds include market borrowings through bond issues (Rs. 160 crores) and loan from LIC (Rs. 171 crores). The latter loan had been guaranteed by the Government of India. Besides, under the 9 per cent capital bond scheme NHB had collected Rs. 50 crores and it had also launched the home loan amount scheme to be marketed through banks as of April,1991. Besides the above rupee resources some external assistance has also been received by NHB from USAID to the tune of 25 million dollars (Rs. 47 crores), & OECF Y2970 million (Rs. 42 crores).

15.132 The NHB was initially headed by Shri K.S. Sastri and on his relinquishing charge late M.J. Pherwani was asked to hold the current charge of the post of CMD, NHB with effect from the 4th March,1991, in addition to his existing charge as Chairman, Stock Holding Corporation of India(SHCI) and Chairman, Infrastructure Leasing & Finance Co. Ltd. (ILFS), a joint venture of the Central Bank of India, the UTI and the Housing Development Finance Corporation. The Committee noted that though Shri Pherwani was asked to resign as Chairman, UTI in March, 1990, within days of his resignation he was appointed as Chairman, ILFS at the instance of the Ministry of Finance. Subsequently, in September,1990 he was appointed as the Chairman of SHCI also. In March, 1991, he was given the current charge of the post of CMD, NHB on temporary basis even though it was known that he had been asked to resign from the post of Chairman, UTI.

15.133 The general Superintendence, direction and management of affairs and business of NHB vests under the NHB Act in the Board of Directors. However, the Board of Directors to be constituted by the Government of India in consultation with RBI was done only in April, 1991 almost more than two and a half years after the coming into existence of the bank. Pending constitution of the Board an Informal Advisory Group was set-up in July,1989 by the then Governor, RBI to guide the activities of the bank. Shri Janakiraman, Deputy Governor, RBI was represented on this Informal Advisory Group.

15.134 During the evidence before the Committee the representatives of RBI expressed their ignorance about the functioning of NHB prior to the outbreak of the Scam. The Committee

also note that the Internal Audit Report of NHB for the period ending 31 October,1991, revealed the bank was involved in serious irregularities in call money transactions, bill rediscounting operations and public sector bonds. In the case of call money transactions, the transactions have not been executed through written agreements but on the basis of telephone calls. Also no proper books have been maintained or securities obtained except the call receipt accepted from the parties. The Audit Report also indicates that interest rates were wrongly quoted in the voucher as well as at other places. In fact the Auditor has recommended a thorough review and change in the system of maintaining call money records.

15.135 Similarly, in the case of bills rediscounted, the transactions were made through telephone calls and no agreements existed. In a few cases NHB had sold re-discounted bills to SBI on the same day for raising funds. Further more bills of BCCI discounted for a sum of Rs. 23.2 crores were still outstanding. In so far as transactions in public sector bonds are concerned, the Auditor's report has clearly indicated that NHB was purchasing 9 per cent and 13 per cent bonds from the scheduled banks for a fixed period of time and these were later being resold to the same banks at the purchased price. No fixed rate of interest existed for such bonds and NHB kept charging interest as per market demand on such bonds purchased.

15.136 As of date NHB is saddled with claims of more than Rs. 1200 crores by several banks/financial institutions including SBI etc.

15.137 The Committee find that the delay in the constitution of the Board had adversely affected the functioning of the bank and resulted in gross misuse of the funds of the Bank. In the absence of the Board of Directors the complete management was in the hands of the Chairman-cum-Managing Director of the bank. The silence of the RBI regarding its own subsidiary having violated the RBI guidelines relating to buy-back transactions and the commissions/omissions which have come to the fore are a telling commentary on the manner in which RBI through its Informal Advisory Group had taken care of the interests of its subsidiary.

Role of RBI Nominee Director

15.138 The RBI has been appointing one or more persons as Additional Directors of the banking companies in the private sector, as also its own officers as directors on the Boards of nationalised banks and those of SBI and its associate banks under the provisions of Banking Regulations Act, 1949, Nationalised Banks (Management and Miscellaneous Provisions) Scheme,1970, SBI Act, 1955 and SBI (Subsidiary Banks) Act, 1959, respectively.

15.139 There is no specific document in the RBI clearly defining the role of the directors on the Boards of nationalised banks. However, the Committee has been informed that a letter is addressed to the nominee director on his appointment which indicates that the nominee directors are "expected to see that the general management of the bank is efficient and in accordance with the guidelines and policy directions issued by the Government of India and the RBI."

15.140 The nominee directors on the Board of Nationalised Bank are required to submit a quarterly report on the working of the concerned bank. He is also advised to bring to the notice of Central Office of RBI any important issue that needs urgent attention. They are also instructed to look into specific irregularities or serious charges made against the top management.

15.141 In the case of private sector banks, there is no legal requirement for the appointment of nominee directors but RBI has been appointing as Additional Directors RBI officers

and/or other professionals in the field of banking and audit whenever considered necessary. The official nominee directors on the Board of private sector banks are required to submit to RBI half-yearly reports. The RBI has also issued detailed guidelines on the role and functions of non-official directors on the Boards of private sector banks.

15.142 When the Bank was asked as to whether any of the irregularities which have surfaced now in the securities transactions were reported to the Bank by its nominee Directors previously, the Bank has informed that no such feed back had been received barring on one occasion when the nominee Director on the Board of UCO Bank apprised RBI about the note put up to the Board on 28 August,1991 relating to issue of BR by the Hamam Street Branch of the Bank.

15.143 RBI has also maintained that the nominee directors not having reported about the irregularities to the bank management may be on account of the Board not having been informed about such matters and that generally, only matters of policy, especially in the investment portfolio, are brought to the notice of the Board of banks. The actual manner of execution of investment contracts, return of SGLs etc., do not generally get reported at the Board level.

15.144 The above position explained by RBI is not satisfactory. The Committee's examination of certain banks has revealed that the volume of transactions in securities/ statement regarding management of funds is reported, to the Board periodically. Further, as would be seen from the relevant Chapter, the RBI inspections/scrutinies of banks had in several cases indicated irregularities in securities/PMS transactions which are invariably required to be placed before the Board. In view of the above, the position that it was no where possible for the Board of Directors to know about the irregularities does not stand to reason. The reasoning is all the more untenable in cases like Andhra Bank, Vijaya Bank, BOK, Bank of Madura etc., where RBI inspection had consistently pointed out irregularities in securities/PMS transactions etc.

15.145 Shri R. Janakiraman, Deputy Governor, RBI, is the nominee of RBI on the Board of SBI. To a question of the Committee whether he had cautioned/guided SBI about the irregularities in securities and banking transactions either before the then Governor, RBI spoke to Chairman, SBI, on 10.3.1992 or after, SBI in a note replied:

> "Shri Janakiraman, in his capacity as a member of our Board, did not caution/ guide SBI about the irregularities in securities and banking transactions of the bank."

15.146 About the evaluation of the performance of its nominee Directors the Bank initially admitted that it was generally satisfied with the role played by its nominee directors on the Boards of public as well as private sector banks.

However, during the course of evidence the then Governor, RBI, shared a totally different perception in this regard with the Committee when he stated:

> "These nominee directors are not really very effective because they do it in addition to their job. I think they are not fulfilling their duty. I feel that RBI as a controlling authority should not have nominee directors."
>
> Elaborating further he informed the Committee:
>
> "The Narasimham Committee also suggested that we should not have RBI nominees."

and admitted:

> "I personally think that the system of having RBI nominee on the Board of various banks is wrong because the RBI as a controller, as a supervisor, it should not get associated with what is being supervised."

15.147 The Commitee note with surprise the fact that except in one case the RBI nominees have never reported any of the irregularities related with the present security scam previously. This is despite the fact that they are better equipped with the knowledge of monitoring and regulatory procedures and virtually have access to a mine of information available within the RBI in the form of reports of financial inspections, scrutinies, reviews etc.

15.148 In the opinion of the Committee the nominee directors of the RBI have neither noticed the irregularities nor effectively discharged their role on the Board of nationalised banks and their presence at best has been symbolic. The Committee concur with the views expressed by the previous Governor, RBI and the Narasimham Committee regarding discontinuing the practice of having RBI nominees on the Boards of nationalised banks and recommend that the RBI nominees can be dispensed with.

Accountability of Top Management of RBI

15.149 The Committee are constrained to observe that it was the top management of the RBI which was wholly responsible for the RBI's contribution to the scam. If the RBI had not turned a blind eye to the massive irregularities in the banking transactions between the period July, 1991 to April, 1992 when thousands of crores of banks funds were diverted to the stock market it would not have been possible for some brokers to play havoc with the system. Shri S. Venkitaramanan as the Governor of the Bank during this crucial period must be held no less responsible. The suggestion to treat the foreign banks differently, the delay in the issue of the circular of July, 1991, failure to incorporate all the deficiencies noticed even in this circular and the absence of any follow-up action subsequently, the delay in the issue of the bill discounting circular for 22 months, his recommendation to appoint people in top positions which proved to be a liability, subsequently, display of unusual interest in the account of HSM, his acts of omission and commission cannot be overlooked in any of their ramifications.

Similarly, the large number of SGL bouncings, the deficiencies in the functioning of the PDO and the goings-on in both SBI and NHB of which he was a director clearly indicate that there was dereliction in performing his duties by Dy. Governor, Shri R. Janakiraman.

Shri Amitava Ghosh was the Dy. Governor in-charge of DBOD for ten long years. He must be held primarily responsible for the continuing irregularities in the banking sector, ignoring the various inspection reports prepared by the teams of RBI inspectors over the years like the Augustine Kurias report, the Ranganathan report etc. and for being casual in his approach to his duties.

Shri N.D. Parameshwaran, the Chief Officer of DBOD should also be held responsible for the lapses of the DBOD. He also need not have played any role regarding the account of HSM.

Board of Financial Supervision

15.150 The Committee find that despite an elaborate machinery available with the RBI for conducting inspections, scrutinies, reviews of the banks and a detailed mechanism to

follow up shortcomings noticed in their working the RBI has signally failed as a regulatory and supervisory agency necessitating a thorough overhaul to restore the position and authority of RBI at the pinnacle of our banking system. Inspection of banks by RBI is a major instrument of supervision. The Committee find that this has become almost routinised and the documented irregularities reported by their own inspectors were not given due attention or effectively followed up. Further the AFR and inspections which have traditionally concentrated on banks' credit operations should now undertake detailed scrutiny of treasury operations following the growth in the financial market. The Committee are of the view that a separate Board of Financial Supervision should be created under the aegis of the RBI to ensure effective supervision of banks. The Finance Minister in his written submission to the Committee had indicated that a board of this kind could provide integrated supervision not only over the banking system but also over the financial institutions and NBFCS. The Board will also cross check transactions and undertake direct verification of areas like inter bank balances, assessment of the performance of banks and financial institutions in key areas such as assets liabilities management securities transaction and credit management.

15.151 The Committee recommend that the Board to be constituted for the purpose should draw on the experience of eminent persons in the spheres of banks, management, economics and related segments to provide the requisite advice as and when necessary. The annual report of the Board may be presented to the Parliament.

Takeover of BOK

15.152 BOK was placed under liquidation by the High Court, Bombay on 27th May, 1992 on an application filed by RBI. This has resulted in a lot of inconvenience to the depositors of the bank. When the Committee enquired as to what was being done to revive the bank so as to ameliorate the condition of the small depositors of the bank, they were informed that RBI had received proposals from Bank of Baroda and United Western Bank Ltd. indicating their intention to take over certain assets of BOK and for taking over its branches and offering employment to the employees of the bank.

15.153 Asked as to what was the present position of the case the RBI has informed that the banks have after going through the records of BOK submitted their offers to RBI. These are being examined and a final decision in this regard will be taken with the approval of the Bombay High Court.

Need for Legislative changes

15.154 The power to enforce penalties is contained in sections 46 and 47(a) of the Banking Regulation Act, 1949. Section 56(1) provides that information willingly furnished falsely shall be punishable with imprisonment for a term which may extend to 3 years and shall be liable to fine. Section 46(2) provides for imposition of a fine which may extend upto Rs. 2,000 for each offence if a person fails to produce any book, account or other documents. If the failure persists it may extend to Rs. 100 for every day during which the offence continues. Section 46(4) provides for the imposition of a fine of Rs. 2000 for non-compliance on the part of the banks with any requirements under the Act. RBI regularly issues circulars to be complied with by the banks. However, the irregularities in the banking sector have revealed that there has been large scale violation of RBI guidelines and instructions. For these violations it is possible to impose penalty under section 46(4).

15.155 The Committee are of the view that more deterrent and penal action should be taken in order to ensure that all banks fall in line with the guidelines/instructions of RBI.

The Committee suggest that the penal clauses in the BR Act and other relevant Acts should be reviewed with a view to enabling RBI to impose graded penalties and other types of punishments commensurate with the seriousness of the irregularities. It is also necessary to review all relevant legislations relating to banks and other financial institutions so that they keep pace with the technological changes and other developments.

Enquiries against Top Management of Banks

15.156 The Committee have been informed that the RBI has appointed special officers (retired civil servants) in respect of certain banks to enquire into the activities of the top management as these are not included in departmental enquiries and on account of the inadequacy of the CBI to look into the failure of the management function. The banks, etc. in respect of which such enquiries have been initiated are:

1. Andhra Bank;
2. Andhra Bank Financial Services Ltd.;
3. Canara Bank;
4. Canbank Financial Services Ltd.;
5. CMF;
6. Allahabad Bank;
7. Allbank Financial Services Ltd.;
8. SBI Caps;
9. Syndicate Bank.

The Committee feel that the enquiries already initiated be conducted expeditiously. Similar enquiries should also be conducted in respect of other banks/financial companies etc. involved in the scam. In the light of the findings of these enquiries, suitable action may be taken against the top management at the earliest.

CHAPTER-XVI

MINISTRY OF FINANCE

16.1 The Ministry of Finance (MoF) is vested with the overall responsibility for the entire formulation, presentation to the Cabinet, adoption and subsequent implementation of the fiscal, economic and monetary policies of the Government. As part of its implementational responsibility, it oversees the working of the country's financial systems, including the financial institutions, all NBFC companies, capital market and its health. The policy for taxation (direct and indirect), tax collection and distribution, international negotiations, exchange rates, management of balance of payments are also amongst the diverse responsibilities of this Ministry. It has the following departments:

1. Department of Economic Affairs
2. Department of Revenue
3. Department of Expenditure

The working of commercial banks, NBFCs and term lending institutions excluding LIC, GIC and UTI come under the purview of the Banking Division in the Ministry of Finance.

Banking Division - Functions and Responsibilities

16.2 Within the broad framework explained above prominent functions of the Banking Division of direct relevance to the subjects under examination of the JPC include, *inter-alia*:

- Processing of appointments of Chief Executives of banks and financial institutions and other official and non-official directors on their boards;
- Supervision and appraisal of the overall performance of all public sector banks;
- Policy relating to private banks, foreign banks and NBFCs;
- Policy matters relating to credit;
- Resolving disputes between various departments of Government, PSUs and the banks;
- Nominations of CVOs in public sector banks in consultation with the CVC;
- Vigilance Surveillance over Chief Executives of public sector banks and financial institutions; and
- Studies in Preventive intelligence.

Banking Companies

16.3 The entire gamut of operations of the banking companies is regulated under the provisions of the Banking Regulation Act, 1949. Under this Act the responsibility for regulation, supervision and control of the activities of the entire banking system including the public, private sector and foreign banks has been vested with the RBI. The RBI constituted under the RBI Act of 1934 is an independent statutory body. There is no separate institutional

mechanism within the Government to supervise the functioning of the RBI clarifying the relationship between the MoF and the RBI, the representative from the MoF deposed that:

> "There is intense consultation on all matters of policy between the Governor of the RBI and the Ministry of Finance. So policy matters are discussed and there is a continuous inter-action both in writing and as well as orally."

16.4 The Act however provides that Government can give directions to the RBI, after consultations with Governor, RBI. This provision has however, never had to be used so far.

16.5 There is a regular flow of communication between the RBI and the MoF. This normally takes the form of:

-an annual report on the operations of the Central Bank which provides a balance sheet on the entire banking system of the Government;

-a weekly statement on the aggregate advances and deposits of the banking system;

-the AFR on public sector banks and annual reports on the working of banks in India;

-action taken on frauds involving large amounts; and

-investigation of complaints and recommendatory action with respect to top management of banks.

Besides the above, a consolidated report on the working of the public sector banks on the basis of information received from the RBI is placed before the Parliament. Inter-action is also expected to take place through the Central Government nominee appointed on the Central Board of Directors of RBI, apart from the large number of official meetings on important matters.

16.6 On the aspect of governmental supervision over and the inter-relationship between the Ministry and the banking industry, the Ministry during evidence stated:

> "The statutory provisions allow for an exclusive responsibility on the part of the RBI for the supervisory side of the banking system. We ourselves in the Banking Division do not engage in that activity. The Banking Division interacts with the nationalised banks in four-five broad areas. First of all, we are responsible for the appointments that are made to the top level of the banks. We are the owners of the banks have a major responsibility in the overall operations and in this regard, we have concentrated on the developmental role of the bank. So, the deployment of credit, the expansion of credit and in particular the expansion of credit for priority sectors have been a major concern of the Banking Division. In addition, apart from obviously servicing Parliament, we undertake an annual review of each bank. This is done in the Banking Division. We make an assessment of the financial position of the banks."

16.7 Questioned whether governmental control over the banking system needs to be reviewed, the Ministry felt that the legitimate responsibility as owners of the banks could still be discharged within the confines of the existing framework. During evidence, elaborating further, the witness stated:

> "I share an honest thought the things have not been done in a right way. But the solution does not lie, I very respectfully submit, in increasing the control

of the Finance Ministry. This is not the way you will get a good banking system. It lies in having greater professionalisation of the Boards. It lies in improving the internal management of the system."

16.8 The Committee have examined this matter in depth. The Finance Minister (FM) and the Ministry during evidence have termed the scam as a "system failure". In the context, of the banking sector the Government being the owner (or trustees on behalf of the people of India) of the entire nationalised banking industry and given that there exist various methods and mechanisms of information and control, the MoF failed to:

(a) anticipate the problem;

(b) respond to it purposefully when it first surfaced;

(c) manage adequately thereafter the consequences of it;

(d) apply the needed correctives with despatch; and

(e) punish the guilty in time and resolutely.

Crisis Management

16.9 Broadly there are two dimensions of this:

Irregularities in banking practices, non-rectification of identified wrongs and non-compliance with regulations. Secondly, insufficient attention to over-heating share market. The first aspect of banking practices and regulations has been covered in other Chapters. The aspect relating to hyper volatility in the stock market and the response thereto of the MoF is discussed in the following paragraphs.

Volatility in the Stock Market

16.10 The share prices had been rising steadly since July, 1991. The BSE index which was 1361.72 (with base 1978-79 = 100) rose to 1647.00 in July, 1844.82 in August and further to 1912.35 in September, 1991. The rise continued and the year ended with the BSE index at 1915.12 The upsurge was even more sharper during the period January to March, 1992 reaching an all time high of 4285 by end March, 1992. The representative from the MoF describing this trend, stated before the Committee: "Stock market had been buoyant in the course of 1990-91 also but this was not abnormal.... This was not itself an alarming level considering that the index had fallen during 1990-91 and part of the upswing of 1991 was therefore in the nature of a recovery.....This was not abnormal given the improvement in the economic situation of the country as compared to the crisis situation prevailing earlier."

16.11 However, taking note of the increase the FM instructed Governor, RBI in September, 1991 to ensure that 'there is no increase in the outstanding level of credit to individuals against shares/debentures so that such credit is not used to finance speculative boom in shares.' With the announcement of the Credit Policy in October, 1991, the Ministry has stated that the share market remained fairly stable in the last quarter of 1991. The FM has in a written submission informed the Committee that the need to check speculation in stock exchanges was again emphasised by him to RBI Governor when the share prices rose sharply during the first quarter of 1992. The representative from the MOF deposing before the Committee stated that:

"At no stage, either RBI or Chairman, SEBI prior to mid-April gave the Finance Ministry an indication that specific things were going wrong. All that we

knew was that stock exchange market was behaving in an unreasonable manner."

Elaborating further the representative indicated:

"It is also very likely that the great deal of the speculative pressure on the stock market was a result of transactions outside the stock exchange. These transactions by definition cannot be monitored directly by SEBI." Moreover 'the fact that prices are rising does not mean that we should rush into stock market directly'. Our efforts throughout were designed to ensure that we should responded as fast as possible."

16.12 The Governor, RBI has informed the Committee that he had been in touch with both the Finance Minister as also the Chairman, SEBI. Further, though he was in close touch with the Finance Minister regarding hyper volatility market situation prior to the budget of 1992, it was a conscious decision not to make any pronouncement before the budget. When asked about this by the Committee, the Finance Minister has stated that while he and the RBI Governor had been closely interacting on this issue, the latter had not made any specific request for making a public statement on the rising share prices in the stock exchanges nor was he restrained from doing so. After the presentation of the budget in the Parliament by the Finance Minister, Governor, RBI with the consent of the Finance Minister made a statement on 9.3.1992 at Hyderabad cautioning against the speculative boom and held a meeting with the Chief Executives of the financial institutions and Chairman, SEBI on 10.3.1992 suggesting intervention by financial institutions. Similar statements had also been made by the Governor at Poona and in Madras.

16.13 The Committee were also informed that Chairman, SEBI reacting to the over heating in the stock market addressed the Ministry of Finance on 31st January, 1992 cautioning the Ministry against adverse repercussions on the capital market with the continued rise in share prices in BSE and asked the Ministry, "to have a serious look at the administration of BSE and issue necessary directives". The Ministry of Finance vide its letter dated 4th March, 1992, addressed to Chairman, SEBI, drew his attention to SEBI having become a Statutory Board with the promulgation of the SEBI ordinance on 30th January, 1992, and the establishment of the Board on 21st February, 1992, and suggested that appropriate action in regard to regulation of trading in shares in BSE be taken by SEBI and the Government kept informed. As rise in share prices continued unabated, Chairman, SEBI addressed the Ministry of Finance again on the 1st of April with the request to issue directives to major stock exchanges asking them to suspend trading and carry forward of transactions until further instructions are issued by the Government.

16.14 In the meantime, the Finance Minister addressed the Presidents of Stock Exchanges on the 28th of March, 1992 regarding better control of stock exchanges. A copy of the record of discussions of the meeting is given in Appendix-II. At this meeting, the Finance Minister had expressed the need for proper administration of exchanges to prevent price rigging and better transparency, need for maintaining capital adequacy norms, increasing corporate membership etc. However, it is sad that, the spurt in share prices or the abnormal behaviour of the stock market had not been discussed, despite the fact that he was stated to be greatly concerned about the rising share prices and had remained alert to the behaviour of the stock market from even as early as September, 1991.

16.15 While furnishing material on several questions raised in Parliament, SEBI had held a view that the rising share prices in the share market had been on account of the policy of liberalisation adopted by the Government. The replies given by the Finance Minister/ Minister of State of Finance in the Parliament also tend to share this perception. In the Lok

Sabha on 27th March, 1992 in response to an unstarred question, the Minister of State for Finance stated "the shares have shown a rising tendency during the last one month due to market factors including the recent liberalised policy." Again, while addressing the representatives of the Stock Exchange on 28.3.1992, the Finance Minister had stated "stock exchanges have been growing at a rapid pace ever since the Government assumed office because of the policy announced by the Government on trading, industry and the capital market." Elaborating further, the minutes of this meeting state "the Finance Minister wants that the efficient functioning of the Stock Exchanges was crucial if we were to guard the interests of the investors, which should be protected and the stock exchange operations should take stock of this. Keeping up the trend was also crucial and important steps should be taken very quickly to consolidate the gains and any slackness on the part of the stock exchanges can jeopardise the liberalisation process and economic reforms."

While replying to the Call Attention Motion on the strike by share brokers, the Finance Minister had stated in Lok Sabha on 30th April, 1992 that though he did not have a fool-proof answer as to what determines the stock market prices, Government was interested in a healthy functioning of the stock markets. He further said, it seems in a lighter vein, that, "But that does not mean that I should lose my sleep simply because stock market goes up one day and falls next day. Similarly the Committee would like to observe that, 'it is good to have a Finance Minister who does not lose his sleep easily but one would wish that when such cataclysmic changes take place all around some alarm would ring to disturb his slumber.'

16.16 The Committee also noticed that the FM reacting to the hyper volatility of the stock market in his statement to the Rajya Sabha on 4th May, 1992 stated, "the increase in prices of shares of companies listed on the stock exchanges was on account of several factors including the expectations of the investors generated by the improvement of overall economic environment and the rise in the level of foreign exchange reserves. The relatively low level of floating stock in the stock market, the excess of funds flowing into the market and speculative activity also contributed to this increase."

The Committee are inclined to conclude that despite MoF being aware of what was happening in the stock market did not address themselves seriously to check the unhealthy trend believing this phenomenon to be a beneficial consequence of their policy. Even after holding the market behaviour as unreasonable, the MoF did not act decisively in the matter.

RBI - Central Board

(i) Appointment of Directors

16.17 Under the provisions of the RBI Act, the Central Government has the responsibility to constitute the Central Board of RBI. This is done by appointing the Governor, Deputy Governors and nominating 10 non-official Directors on the Board of RBI. The tenure of the non-official directors is four years. In addition Government also appoints the members of the 4 local Boards of the RBI. In addition the Central Government is represented by Secretary, Economic Affairs on the Board. As per the provisions of the Act, the Central Government representative can however take part only in its deliberations, and cannot exercise voting rights.

(ii) Reconstitution of the Central Board

16.18 In terms of the provisions of the RBI Act, 1934, 10 non-official directors are to be nominated by the Central Government. The following persons were last nominated under this provision:

Sl. No.	Name of the Director	Tenure	
		From	To
1.	Shri R.P. Goenka	18.3.83	17.3.87
2.	Shri M.S. Patwardhan	16.1.86	15.1.90
3.	Shri Aditya Birla	18.3.83	17.3.87
4.	Shri Cheddi Lal (expired)	24.4.79	1.4.83
5.	Shri R. Ganesan	18.3.83	17.3.87
6.	Shri Raghu Raj	18.3.83	17.3.87
7.	Dr. A.S. Kahlon	18.3.83	17.3.87
8.	Shri P.N. Devarajan	18.3.83	17.3.87
9.	Shri Ashok Kumar Jain	18.3.83	17.3.87

At present there are 8 non-official Directors on the Board of RBI. 7 of these Directors were appointed on the Board in March, 1983 and one Director in January, 1986. The Committee note that all of them are still continuing well beyond their normal term of four years and a decision on their replacement is still to be taken. In reply to a specific query the Ministry has furnished the reasons for delay in reconstitution which are at Appendix-XXXIX. A perusal of this reply reveals inordinate delay at various levels, total indecisiveness and an utter lack of urgency in dealing with a matter of such importance. The Committee has expectations of some remedial action, even at this stage.

16.19 The Committee must also comment that this existing Board has a predominance of representatives of industrial sector.

When the Finance Minister was queried about this, he informed the Committee:

> "You cannot blame me for the present Board because I have not appointed that."

He further added:

> "I assure you that the next Board will be for more broad based, if my view prevails."

(iii) Participation by Government Nominee

16.20 The Committee were informed that out of the 49 meetings of the Central Board of RBI, held since 1st January, 1986, the Government nominee director on it has attended only 15 meetings. When this was pointed out during evidence, the witness admitted:

> "I have seen the record. I also feel that we should have been present more in the meetings. There is no doubt about it."

16.21 The Committee find it difficult to appreciate this obscure, self-condemnatory evasion. Considering that Government nominees have participated in less than a third of the meetings held since 1986, it is difficult to establish as to what they have actually contributed towards achieving the original purpose of their appointment. The Committee also note with regret that the irregularities in securities transactions brought out in the Annual Financial Reviews of individual banks like UCO Bank, Andhra Bank, Canara Bank or the Annual Reviews of select foreign banks like American Express Bank, Citibank, BOA, ANZ Grindlays etc. of 1990, and of 1991; which had adversely commented on the performance of these banks, did not even engage the attention of either the Central Board or the Government nominee on it who afterall are there to ensure adherence to policy and guidelines of the Government. The Committee holds this as one of the contributory factors for the scam.

In this regard the representative from MOF stated:

> "No such information was available to the Finance Ministry earlier as it had not surfaced in any of the AFRs received in the Banking Division nor in any of the material put up to the Boards of nationalised banks or the SBI where the Finance Ministry has official directors."

16.22 It is surprising how such assertion has been made when it is a normal practice to send the AFRs and other reports of the banks to the MOF.

Board of Directors of Nationalised Banks: Appointment

16.23 As per provisions contained in the Nationalised Banks (Management and Miscellaneous Provisions) Schemes of 1970 and 1980 the Board of Directors of a nationalised bank consists of 15 Directors of which 2 are full time including the Chairman and Managing Director, 2 employee Directors, 9 non-official Directors, 1 RBI official Director and 1 Central Government official Director. For the purposes of making recommendations to the Government for appointment to the posts of Managing Director and Executive Director there exists an Appointments Board headed by Governor, RBI. Its other members include Secretary (Economic Affairs), Deputy Governor (RBI), Chairman (SBI), Chairman (IDBI) and Additional Secretary (Banking) who functions as the member-secretary.

16.24 Recommendations received from this Appointments Board are processed in the Banking Division. After obtaining vigilance clearance from the CVC they are then approved by the FM and sent to the Appointments Committee of the Cabinet (ACC) for final approval.

16.25 From the information furnished by the MOF , the Committee note that of the 28 vacancies for the posts of Chairman cum Managing Director and Executive Directors since July 1991, only 16 have been filled up as of date. Of the remaining 12 vacancies 6 are of CMDs and 6 of EDs

16.26 The Committee find that the time consumed in processing a case for appointment is inexcusable. Further no basic qualifications for appointment have been laid down or criteria to be followed formalised. Even the convention of appointing as Chairmen only those who have put in 2 years as Executive Directors have been discarded with a routinised appointment of Indian Administrative Service officers on these technical posts. Obviously no panel is being maintained to fill up the senior level posts without delay. Equally obviously this has seriously affected a proper functioning of these nationalised banks.

As for full-time Directors a case has to be initiated three months prior to the date of occurrence of vacancy in the post of Chief Executives in any of the nationalised banks. The Department of Personnel and Training also issues instructions regarding appoint-

ment to these posts. A scrutiny of the appointment files called for by the Committee from the Banking Division of MOF has clearly established that this advance planning of three months has not been fulfilled in a number of cases. This has resulted in the granting of ad hoc extensions on several occassions.

16.27 The Committee take a serious note of such inordinate delays in appointing Chief Executives/Executive Directors of the nationalised banks. Other irregularities in the appointment of such Directors etc., has been dealt with in other Chapters/Paragraphs. The Committee have also noticed that Banking Division's processing, the case of a Chief Executive has not always been in order, for instance, the circumstances under which Chairman NHB was asked to demit the office of Chairman, UTI has not been brought on record. The system therefore requires to be thoroughly reformed.

16.28 The Committee feel that a Board on the lines of the Public Enterprises Selection Board for appointment of Chief Executives/Ex. Directors of nationalised banks be created under the aegis of the RBI to process the cases for appointment. The composition of the Board could be broad-based by including proven professionals and men of renown in it. At present the selection of CMDs/EDs is largely confined to the officers of the nationalised banks. The Committee suggest that the area of selection for the posts of CMD/EDs be widened to include persons with outstanding qualifications and experience from the financial sector.

Action taken against erring Executives of Banks

16.29 It is self-evident that Chief Executives of banks ought to be beyond reproach. The Committee observe, however, that since 1986 Chief Executives of banks whose services have been prematurely terminated include the following:

1.	Shri M.U. Kini	-	Ex-ED, Union Bank of India.
2.	Shri S.M. Chitnis	-	Ex-G.M., Bank of Maharashtra and thereafter E.D., Allahabad Bank.
3.	Shri R.C. Suneja	-	Ex-CMD, New Bank of India.
4.	Shri J. Sethi	-	Ex-E.D., New Bank of India.
5.	Shri K. Sadanand Shetty	-	Ex-CMD, Vijaya Bank.
6.	Shri Premjit Singh	-	Ex-CMD, Bank of Baroda.
8.	Shri P.S.V. Mallya	-	Ex-CMD, Syndicate Bank.
9.	Shri K. Margabanthu	-	Ex-CMD, UCO Bank.

16.30 All these nine officers have been proceeded against during the last few years and except in the case of Shri Premjit Singh, Ex-CMD Bank of Baroda, the CBI is pursuing cases against all others for serious irregularities. Some of these officers were involved in controversies even during their tenures as Chief Executives of their respective banks. Some illustrative cases are briefly cited. The first is of Shri P.S.V. Mallya, who despite not being fully exonerated by the RBI of charges was recommended for an extension on his retirement on 4 September, 1991, and allowed to continue on the post for another two months.

The case of Shri J. Sethi, Ex-ED, New Bank of India gives an insight into how the Ministry's action was not in conformity with the interest of the bank.

The RBI had through a letter informed the Ministry on 31 July,1991 about serious irregularity committed by Shri Sethi of tampering with the balance sheet of the bank. The RBI has held that "the continuation of Shri Sethi as Executive Director of the bank may not be in the bank's interest". Prior to this the RBI had also informed the MOF about instances of irregular sanctioning of advances to certain parties by Shri Sethi. This was on 7 January, 1991. Shri Sethi's services were however terminated only on 24 April, 1992 *i.e.* after more than thirteen months of the RBI bringing the irregularities committed by him to the notice of the Ministry.

Another case which the Committee examined was that of late Shri B. Ratnakar, Ex-CMD, Canara Bank. In this case charges of serious irregularities against Shri Ratnakar were taken-up for investigation by the CBI in December, 1988. The case continued to linger for more than three years till it was finally closed in February, 1992 when Shri Ratnakar, expired. Shri Ratnakar on retirement founded and became the Chairman of FFSL.

16.31 That 10 top Ex-Executives of the 20 nationalised banks have during the past few years been found involved in serious irregularities is a telling commentary on the process of selection and appointments by the Government.

16.32 Irregularities committed by this top management have not only adversely affected the functioning of their respective banks but have also contributed to the malaise spreading over the entire banking system. In fact while deposing before the Committee, Governor, RBI India stated:

> "We are not in a position to proceed against the public sector banks except with the concurrence of the Government. If we have to have a clear system perhaps we may have to amend the law in such way that RBI can take action against those Chairmen also, whether in the public sector or private sector, but after giving a notice to them.

16.33 The Government should seriously examine the suggestion of the then Governor, RBI. The Committee is of the view that if this entire system of selection and appointment of executives/directors is not totally revamped, our nationalised banking industry will not only recover it will pull our entire economy down with it. The Committee also invites attention in this connection to para 15.155 regarding enquiries against top management of banks.

Official Directors on the Boards of Nationalised Banks

16.34 Officers of the Banking Division serve as official Directors on the Boards of the nationalised banks as well as on that of the SBI, a practice based on the recommendations made by the Economic Administration Reform Commission, which felt that this would facilitate liaison and promote a channel of communication between the Government and the public enterprises. There have, however, never been any clear guidelines or directions on the actual role to be performed by the official director or their manner of reporting the deliberations of the Board to the Ministry. They have of course not done this ever. More tellingly the MOF has never felt the lack of such reporting either.

16.35 The Committee find that official Director on the Board have not given any significant feedback to the Ministry about the actual working of the banks on which they are appointed. Their presence on the Boards of the banks has also not helped in detecting any serious irregularities or malpractices.

16.36 In fact, in one case the Committee noted with surprise that the Government Director on the Board of UCO Bank, against all canons of propriety, recommended the black listing of the auditors of that bank, characterising their attitude as vindictive and

unco-operative, and amounting to harassment of the management, when they sought detailed information from branches of the bank.

16.37 The Committee also find that at present an official Director is represented on the Boards of several banks. This needs to be reviewed. The Committee were informed that this system of reporting has atlast been recently reviewed. The Committee are constrained to observe that this detailing of functions now is an abject admission of earlier defaults. This too was a contributory factor to the Scam.

Foreign Banks

16.38 Examination by the Committee have revealed that many of the foreign banks have been deeply involved in the irregularities in securities transactions and with their tremendous resources, their undoubted clout, their aggressive policies and posturing, they can if they choose, play havoc with the economy. This has been discussed earlier in the Chapter on Foreign Banks. It is also noticed that Government had fixed a target of 15% for lending to priority sector by foreign banks to be achieved by March,1992 as against 40% in the case of Indian banks. Against this target, the achievements of the banks for the last four years had range between 7.67% to 9.84%.

16.39 The very fact that such an important indicator as non-achievement of target of lending to priority sector has been taken up by the Ministry with RBI only on 18th January, 1993, clearly brings out the deliberate lack of action on the part of the Government bring the Foreign Banks in line with the policy of the Government. Even the precarious BOP position during 1990-91 and 1991-92, should not have deterred the Government from taking stern action within the policies laid down by them. Penal action should be taken against foreign banks if they do not fall in line with our banking policies as brought out earlier in the Report.

16.40 Non-compliance of governmental regulations on the part of Foreign Banks has been highlighted time and again. The MOF has failed signally in enforcing their Rules and Regulations of the country. Underplaying the whole thing, in fact while deposing before the Committee, the representative of the MOF stated, that "while he was not minimising the extent of irregularities, these were because of by-passing of Rules". The seriousness of the transgressions by the foreign banks is apparent from the observations of the representative of the Ministry who when asked whether the Government was ready to tell the foreign banks to pack-up, replied with a resounding "yes sir". The Committee hope that the Government would take necessary action in this regard.

NHB

16.41 As earlier stated in the chapter on RBI the NHB was set up in July, 1988. Its Board of Directors was, however, constituted only in April, 1992, *i.e.* after a lapse of more than three and half years. This delay was occasioned despite the recommendations of the RBI having been sent to the Ministry in February 1988, even before the enactment. In the meantime, there was only an Informal Advisory Group and all decisions were being taken by the CMD of the bank.

16.42 The Committee take serious note of the inordinate delay in the constitution of the Board which has affected the functioning of the bank and resulted in gross misuse of the funds of the bank as discussed elsewhere. As of date, NHB is saddled with claims of more than Rs. 1200 crore by several banks/financial institutions. The reasons advanced by the Ministry for the inordinate delay of almost 3 years in the constitution of Board are not convincing. This is another instance where the Ministry has displayed lack of seriousness.

The Committee find that no inspection has been conducted of NHB since its constitution. In fact it is noticed that there exists presently no system of inspection of financial institutions. Since these institutions are entrusted with huge public funds, it is imperative that a mechanism for periodic inspection of these institutions be desired by the Government.

Public Sector Bonds

16.43 Public sector bonds as a scheme was initiated in to the budget of February,1985 as a savings measure particularly rural savings, for public sector projects in the telecommunications and power sectors. In the budget of 1986 another series of public sector bonds with tax free returns were introduced. PSU could thus float two types of bonds namely 9 per cent tax free bonds and or 13 per cent taxable bonds carrying certain tax benefits. These tax benefits and other features of the public bond schemes were spelt out in the guidelines issued by the Department of Economic Affairs on 17.9.1986.

16.44 The Committee's examination of this issue has revealed that Government has been losing revenue on account of these bonds being tax free, a rough estimate being loss of income tax on Rs. 900 crores. The objective of mobilising savings to generate additional resources has not really been fulfilled as public response to the entire scheme has been poor. Though the allocation of bonds are decided at the beginning of the year in consultation with the Planning Commission Administrative Ministries and the Department of Economic Affairs, apparently during the course of implementation, distortions occur which the concerned Ministries have neither monitored nor addressed themselves to.

During the course of evidence the Committee were informed by the representative of the MOF as follows :

"....the only way the Ministry comes into picture with regard to public sector bonds is that the Ministry gives approval to raise the bonds. If it is a tax free bond, the Ministry grants it the status of tax free bond. Allocation on public sector bonds is decided by the Planning Commission as part of the plan. These bonds are a part of the internal extra budgetary resources of PSU".

When enquired whether these bonds are meant for bulk placement with banks or for mobilisation of private resources from the public, the witness stated :

"We are conscious of the fact that the objective of raising public sector bonds is certainly to create additional funds."

As regards deploying these funds with the banks, the witness stated:

"The placement of their funds in the banks can be justified. We did not have any prohibition of how they would deploy their funds in the short run."

16.45 From the information received by the Committee regarding floatation of bonds by PSUs and the placement of funds raised thereby with banks/financial companies during 1990 to 1992, the Committee cannot but comment adversely on this practice in which everyone from the MOF to the parent Ministry of the PSU, the undertaking itself and the management, and of course the banks have engaged in a make believe exercise of raising funds from the public for meeting development requirements but did nothing of the sort. It is such systemic deficiencies that have allowed irregularities to surface, persist and remain unrectified.

16.46 This hoax was perpetrated on a number of occasions and over the years. The funds thus released became a principal source of finance for all varieties of speculative and illegal transactions in the securities market, as well as the stock market. There were then many unwholesome consequences of it. The State ended up by paying more interest on the borrowings. These were placed on inequitous terms with the banks and what is worse the schemes for which the bonds (Power, Railways etc.) were issued were delayed. The scheme thus has not resulted in the desired mobilisation of resources particularly rural savings and the resultant additionality of resources as originally envisaged for the intended purposes. The Committee find this as a serious transgression by the Government in the discharge of its supervisory responsibilities, as indeed in the fiscal management of the nation's economy. Further, the Committee have sufficient reason to believe that placement of PSU funds became the single great contributor to the Scam. What the Committee find as condemnable is that all this was public money and all who were playing with it were public servants.

Disinvestment of Shares of PSUs

16.47 The Union Budget for 1991-92 and the Industrial Policy Statement of July 1991 indicated that a part of the Government shareholdings in the public sector would be offered to Mutual Funds, Financial Institutions, general public and workers to raise resources and encourage wider public participation. The budget provided for a mobilisation of Rs. 2500 crores on this account. Of the 244 SPSUs as on 1.4.1990, 31 were selected for the purpose of disinvestment.

16.48 Based on the recommendations made by the Committee chaired by Secretary, DPE, the Government issued guidelines to identify PSUs for disinvestment by adopting different methods. The first phase was implemented in December 1991 and the second trench of disinvestment took place in February, 1992. The attendant condition *vide* clause 14 and 15, imposed by the DPE at the time of inviting bids stipulated that (i) shares of all the PSUs offered for sale shall be listed on all principal stock exchanges (Clause 14) and (ii) financial institutions/mutual funds/bank shall be free to off-load their shareholding in these PSEs through normal stock exchange transactions (Clause 15) respectively. However, Allahabad Bank and SBI Caps purchased bundles of shares of public sector companies and sold them to brokers M/s. YSN Shares and M/s. C. Mackertich (of Shri Ajay Kayan) and M/s. Stewart and Co. respectively even before their listing on stock exchange. In fact, well before making a bid on 22.2.92 for purchase of PSUs shares, Allahabad Bank had already received quotations from these 3 brokers for a re-sale of shares, for which it was yet to bid, and for which the sale was ultimately effected only on 31.3.92. The broker in turn sold one of these bundles to Citibank which had purchased them for one of its fiduciary clients namely Raheja Group of Companies. Similarly in the case of SBI Caps, the Company sold the shares acquired to two brokers on 4th and 11th March, 1992. This was as serious a transgression, as can be documented.

During evidence the Committee enquired the reasons for the sale of the shares before their listing on stock exchanges. The representative of the MOF stated that "this particular scheme itself was framed in consultation with the DPE Enterprises but the Cabinet note seeking approval was sent by the MOF. The note clearly stated that these shares must be allowed to be traded. The note however did not seek any specific approval of the Cabinet for the exact modality of the sale. The direction of the Cabinet was not that it should be 'only' through the stock exchanges".

The Cabinet's approval said that the responsibility for undertaking the sale will be that of the Department of Economic Affairs.

Elaborating further DPE informed the Committee that the condition of listing was imposed purely with the "intention of binding the Government to get the shares listed on the stock exchanges so as to assure intending institutions/buyers who earlier had expressed certain apprehensions in this regard". It was added "they no doubt are not fettered from entering into any transaction including forward trading provided they meet the provisions of SEBI and legal regulation in force."

16.49 The Committee are of the view that by disposing of the shares before their listing on stock exchanges the condition 15 imposed in the guidelines by the DPE has been violated; As these shares were not listed, it is not known whether the price obtained was the best price.

16.50 The Committee find that while seeking the approval of the Cabinet in December, 1991, the modality of sale or the guidelines to be given had never been placed before the Cabinet for its consideration. Further while the Ministry took the note for Cabinet consideration, the DPE was the executing agency for the government decision regarding sale of PSU shares. It is not clear as to how there has been no inter-action between the DPE and the MOF on such a crucial issue such as resale of these shares. It is also surprising to note that DPE considers the whole transaction as a commercial deal and is not engaged with the legality or otherwise of it. The Committee has, not examined this question of disinvestment of PSU shares at length. The Committee note that the method and procedure adopted for disinvestment of PSU shares had been adversely commented upon by the C&AG in the Report entitled "Disinvestment of government shareholding in selected public sector enterprises during 1991-92" (for the year ended 31st March, 1992) and this has been taken up for examination by the Public Accounts Committee.

Stock Exchanges

16.51 The Stock Exchanges came under regulation at the national level with effect from 28th February, 1957, when the Securities Contracts (Regulation) Act, 1956 (SCR Act) came into force. The Act was brought about with the sole aim of preventing undesirable transactions in securities by regulating the business of dealing therein, and by providing for certain other connected matters. The Act confers vast powers on the Government to exercise external control over the trading practices in stock exchanges. Under Section 5 of the Act the Government can even withdraw recognition granted to Stock Exchanges and similarly Section 10 of the Act empowers Government to make or amend bye-laws of Stock Exchanges. Prior to the establishment of SEBI, the MOF was directly looking after the functioning of Stock Exchanges through its Investment Division under the Department of Economic Affairs. The Committee find that the Stock Exchange Division, prior to the constitution of SEBI had not inspected any of the Stock Exchanges in the country despite the prevalence of serious malpractices in some of them particularly the BSE. In fact, the Ministry has stated, 'prior to the establishment of SEBI no formal assessment regarding alleged irregularities in the stock market was undertaken by the Government.' Inspite of being the only authority overlooking the functioning of Stock Exchanges and the fact that government nominees are on the Boards of all Stock Exchanges, the Committee regret to note that not even an effort was made to monitor the stock markets or ensure their orderly functioning. The abysmally low level of participation by government nominees on the Boards of Stock Exchanges have been dealt with earlier in the report. The Committee also find that after directing the accounts of members of stock exchanges to be audited by chartered accountants in 1983, the MOF made no effort to monitor the progress and it was after a decade in March, 1993 that the MOF issued another circular on the subject.

16.52 The powers to regulate supervision and control mandated in the SCR Act have since been transferred to SEBI through the SEBI Act, 1992. With the constitution of SEBI and delegation of wide powers to the SEBI, the Ministry need to closely examine the continued relevance of the Stock Exchange Division in the MOF.

Accountability to Parliament

16.53 The question of bringing the nationalised banks including the SBI and associated banks, the RBI and other public sector financial institutions like IDBI, UTI, non-banking financial institution including miscellaneous financial institution etc. within the purview of parliamentary scrutiny has been engaging the attention of Parliament and its Committees. The Ministry have, however, expressed a view that the bank should not be subjected to review like the PSUs as they are simply intermediaries between the savers and other people and they are not in the nature of taking decisions on their own. In fact deposing before the Committee, the representative from the MOF stated:

> "My understanding is, there is no country in the world where an individual commercial bank, whether publicly owned or privately owned, is subjected to a scrutiny by Parliament."

16.54 The FM is of the view that functioning of the banks particularly public sector banks come within the purview of various Committees of the House of Parliament such as Estimates Committee, Committee on Subordinate Legislation, Committee on Implementation of Official Language etc. in addition to the Consultative Committee, and as such considerable Parliamentary control over the functioning of banks already exists. He has also expressed that a separate Parliamentary Committee going into the issues relating to banking and financial institutions will have to take note of "the special features of banking activity and the need to maintain confidentiality regarding individual banking transactions within the public sector banks or in the private sector or foreign banks. It would not be desirable to have a parliamentary scrutiny which would go into these issues". On the other hand he is not averse to the idea of a forum in dealing with larger policy issues relating to banking in which the Committee could call the Finance Ministry and the RBI Governor to appear before it.

16.55 It may be pertinent at this juncture to recall what the then FM stated in response to a calling attention motion on rampant corruption, mismanagement and malpractices in the nationalised banks in Rajya Sabha on 28 August, 1990. The then FM has stated:

> "I am one of those who believe that rather than having a new banking commission, if we allow more power to the Public Accounts Committee, the Estimate Committee — I agree even to the Public Undertakings Committee..... that itself will be a very good pressure on the working of the various banking institutions. I want greater participation of these parliamentary committees so that it will be an indirect and effective parliamentary control over the banking system".

16.56 As regards secrecy provisions the relevant Acts under which the banks function the then FM stated:

> ".....one, we accept the change of format for public sector, a greater transparency and a greater defence of openness. Two, the accounting system has to be changed. There is no doubt about it. Three, there should not be the pretext of secrecy in order to see that the right of information is not denied to the clients as well as Parliament".

16.57 In the context of autonomy in the functioning of the banks, the then FM had observed, *inter-alia* as under:

> ".....functional autonomy becomes meaningless unless it is within the framework of accountability. Therefore, there should be autonomy subject to accountability. If there is autonomy and there is no accountability either to Parliament or to the customers, in that case such an autonomy is going to create anarchy".

16.58 The Committee is firmly of the view that the working of all banks — Public, Private and Foreign should be subject to scrutiny by Parliament. This task can be performed by the newly established Standing Committee on Finance or any other similar Committee to be appointed. The Committee feel that such a scrutiny will keep in view the special features of banking activity and the need to maintain confidentiality regarding individual banking transactions. The Committee suggest that Governor, RBI may be invited to appear before the Parliamentary Committee and apprise it about its monetary and fiscal policies. The secrecy clause in the B.R. Act is to be reviewed.

Ministry of Finance: Assessment and Responsibility

16.59 Asked about their assessment of the causes of the Scam MoF has stated that it had been a systems failure, inadequate internal control systems and the RBI not having been alert to the clues that became available as early as 1986.

During the course of evidence, the witness of the Ministry informed the Committee in this regard as follows:

> "I have to recognise that is really what is meant by system failure. I can only say that we should have taken decisions earlier in doing the system review. It is a pity that we did not do that. A lot of what we are doing now should have been done five years ago. If that had happened, it would have been much easier to get rid of it. The underlying problem is that we were trying to run a rickety, over-regulated and under governed system. The answer does not lie in putting yet another policeman somewhere, thinking one policeman is better than the other. The answer lies in recognising that when the financial system reaches a certain level of maturity the rules that are made for the rest of the world, we had better learn from them. I can only say that we learnt it too late".

He further added:

> "The Finance Minister never said that there was no individual failure. It is definitely our view and we have continuously said that there has been a collusion on one hand between the brokers and the other within the banking system. There is absolutely no doubt about it. I would not like to say here as to who was responsible. It is not just that the system is fine but some people were crooked and they were incompetent."

Whatever may be the view about the system the Committee urge that the guilty must be punished.

Ministry of Finance — R.B I. Inter-relationship

16.60 A proper interrelationship between the MOF and RBI is of absolutely critical importance in the proper management of national economy. Asked to comment on the RBI's role and degree of autonomy, the witness stated:

> "The RBI is an independent statutory body. There is no separate institutional mechanism for the Government to supervise the RBI. The RBI is set up under its own Act. It is an exclusive body which has exclusive responsibility for the supervision of the banking system. Therefore, there is no mechanism whereby the Department supervises the RBI. There is intense consultations on all matters of policy between the Governor of the RBI and the MOF Finance. So, policy matters are discussed and there is a continuous interaction both in writing and as well as orally".

> "But, we feel that this basic nature of interaction should not be altered. In all matters, the Central monitoring authority has a very special role. It should not be viewed as a department, as an agency subordinate to a particular department in the Government itself. The recommendations are that the degree of autonomy of the RBI should be increased".

GENERAL

Responsibility of the Ministry

16.61 All the various aspects of the holistic responsibility of MOF have been dealt with in various chapters and earlier paragraphs. This particular chapter has addressed itself specifically to the working of the MOF proper. Its vast responsibilities make it one of the most important centres of Governmental authority and decision making. It is axiomatic, therefore, that not only does this ministry have the authority to manage crisis effectively but it must also anticipate and thwart them before they arise. Every decision of the MOF directly affects the well-being, economic health of every citizen of our country. In the light of these preliminary observations, the Committee, having examined all aspects, conclude as follows:

(a) For the MOF to have asserted that the rising share prices in early 1992, was among other things, a consequence of the liberalisation policies was misplaced.

(b) Moreover for the MOF to have dealt in terms of relative unconcern with excessive speculation on stock market is not appreciated by the Committee.

(c) Effective regulation was hindered by the prevailing atmosphere in the Ministry that what was happening, far from being bad for the economy, was a reflection of the success of the new policies. Its failure to ensure adherence to its own instructions contributed significantly to irregularities in the securities and banking transactions.

(d) The Committee regret to observe that the MOF could have exercised much closer supervision of the entire securities and banking transactions. Had that been done, the subsequent disorder in our economy, could have been avoided.

(e) The Committee agree with the contention of the Ministry that the solution does not lie in increasing the control of the MOF but in having greater professionalisation of the Boards. One way of doing it would be to replace the government nominee directors, who are at present from the civil services with persons possessing professional qualifications and experience.

(f) **The Committee strongly feel that in view of their conduct and activities in the Scam, the working of foreign banks has to be strictly supervised. In a way, they have been the initiators of the Scam as well as the major players. With their tremendous resources, their undoubted clout, their aggressive policies and posturing, they can if they choose, play havoc with the economy.**

In the light of the above, the Committee feel that the responsibility and accountability of the FM to Parliament cannot be denied.

16.62 The FM has raised a point to which the Committee feel it should react. In his written submission the Minister has stated:

> **"As regards the functions of the FM, he oversees the work of the Ministry and provides overall policy guidance to the officials. Revenue and Expenditure decisions are the direct responsibility of the Finance Ministry. As such FM has more direct responsibility in these areas. He is also responsible for broad policy decisions affecting the financial system where the Finance Ministry is involved. However, FM cannot be held responsible for administrative failures or management deficiencies in the case of individual banks and other financial institutions."**

The Committee feel that such a distinction cannot be sustained by the constitutional jurisprudence under which the parliamentary system works.

16.63 The principle of constructive ministerial responsibility is equally applicable to other Departments and Ministries where acts of omission and commission have taken place in the discharge of function and duties at different levels.

16.64 The FM in reply to the general discussion on the Budget 1991-92 on 6 August, 1991 stated *inter alia*:

> **"Our strategy has been two-fold. First to release the entrepreneurial spirit and animal energy of our businessmen, industrialists and entrepreneurs to create wealth..."**

The predatory instinct inherent in a system of free enterprise does release the entrepreneurial spirit and animal energy. But to make the process of liberalisation a success it is necessary to have strategic checks and effective implementation of regulations. While the mood of the Government is upbeat on liberalisation, their orientation towards strict enforcement has yet to manifest itself. De-regulation without effective checks and balances would be an unmitigated disaster.

16.65 In the light of the developments that have taken place the relevance of continuing in its present form the Banking Division and the Stock Exchange Division needs to be examined.

CHAPTER-XVII

INVESTIGATIVE AGENCIES

Introduction

17.1 The Investigative Agencies namely the Central Bureau of Investigation, the Central Board of Direct Taxes and the Enforcement Directorate had taken up investigation of the Bank Scam cases prior to the appointment of the Joint Parliamentary Committee. The resolution passed by the Lok Sabha for constituting the JPC had stated "that the Committee shall be provided all assistance by the Government and its agencies". Besides, in the case of CBI in a clarificatory statement, the Ministry of Law opined that "there is no provision under which the CBI can refuse to comply with the directions of the JPC unless the Government may cover the case under the second proviso to Rule 270 of the Rules of Procedure and Conduct of Business in Lok Sabha and may decline to produce documents on the ground that disclosure thereof would be prejudicial to the safety or interest of the State". The Committee decided to interact with these agencies mainly with the objective of exchanging ideas and sharing of information.

Central Bureau of Investigation (CBI)

17.2 The Committee held a number of informal meetings with CBI. During the course of their interaction the Committee had given various suggestions to CBI to be pursued by them in their investigations. The Committee received 6 Status Reports besides notes on various points on which clarifications were sought from time to time. They also took oral evidence of the representatives of CBI on 25.6.1993 and on 12.10.1993.

17.3 The first Status Report received from CBI in August, 1992 indicated that they had registered 12 cases (F.I.Rs.) against banks, non-banking financial companies, Mutual Fund, PSUs and individuals. By the time the Committee received the Fourth Status Report on 30.4.1993, *i.e.* after 8 months, the number of cases registered had remained the same with the only progress reported being in the number of searches carried out, documents seized and witnesses examined. It was also noticed that out of the 12 cases, the HSM Group figured in as many as 8 cases while the Dalal Group figured in 3 cases and the remaining one case pertained to Fairgrowth Financial Services Ltd. Part-II of their Status Report dated 15.5.1993 submitted to the Committee by CBI included a fresh list of 15 off-shoot cases registered also against various Banks/PSUs/individuals/Companies involved in the scam.

17.4 In the latest Status Report of 25.11.1993 the CBI have stated that so far 35 regular cases and 10 preliminary enquiries have been registered. Out of these 45 cases, 37 cases pertain to irregular transactions in securities, 2 cases pertain to disinvestment of PSU shares while 6 cases have been registered against public servants for amassing assets disproportionate to their known sources of income, mis-appropriation of funds and obtaining illegal gratification. The total amount covered by these cases is Rs. 8383.318 crores. It may be pointed out that the total amount involved in these 9 priority cases is Rs. 4182.830 crores while in the remaining cases it is Rs. 4200.488 crores. Almost all the main scamsters figure in these cases.

17.5 The cases registered by the CBI could be broadly divided into the following three categories*:

(i) Frauds where amounts could not be reconciled :

16 cases have been registered where shortfall had accrued to the banks/ subsidiaries due to non-reconciliation/ partial reconciliation of amounts.

(ii) Frauds where amounts have been reconciled:

23 cases have been registered where amounts were irregularly siphoned off from banks/subsidiaries/public undertakings but were subsequently returned. In these cases certain losses have accrued to them due to lower rate of return, irregular and unauthorised deployments of funds etc.

(iii) Anti-corruption cases:

Six cases have been registered so far on charges of bribery, misappropriation and acquisition of disproportionate assets by some public servants.

*For details please see *Appendix-XL.*

17.6 The break up of cases brokers Group-wise are as follows:

Group	No. of Cases	Amount (Rs. in crores)
HSM Group	18#	4072.348
Dalal Group	9	2158.004
Amarchand & Hariram	2	336.071
V.B. Desai	1	141.680
Y.S.N. Shares & Securities	1	40.315
Chanderkala & Co.	1	0.275
C. Mackertich & Stewart & Co.	1	26.440
Other cases	7	1608.185
Anti-corruption	5 +(1)#	—
Total	45	8383.318

Includes RC.2(A)/92-ACU(V) (Krishnamurthy case)

17.7 As regards the progress in investigation of case, the Committee were informed by CBI that their main thrust has been the investigation in 9 high-priority cases registered by them during May to July, 1992 involving an aggregate amount of Rs. 4182.830 crores. Out of these 9 cases, chargesheets have been filed in 5 cases. The details of the stages of investigation in these 9 cases are as follows:

Details of the Stages of Investigation in Priority Cases

S. No.	Case No. & Date of Registration	Date of FR-I	Date of FR-II	SP's comments Date	Date of DLA/ALA/ LA's comments	Date of DIG's comments	Present position
1.	RC.8(A)/92-SIU-X	8.11.93	—	—	—	—	Under Legal Scrutiny
2.	RC.41(A)/92-BOM.Dt.11.6.92	31.8.92	14.11.92	16.11.92	17.11.92	18.11.92	Two charge-sheets filed on 24.6.93
3.	RC/43(A)/92-BOM.Dt.11.6.92	28.2.93	23.3.93	—	22.6.93	—	Charge-sheet filed on 10.10.93
4.	RC.44(A)/92-BOM.Dt.20.6.92	28.2.93	23.3.93	7.4.93	19.5.93	12.4.93	Charge-sheet filed on 26.10.93
5.	RC.18(S)/92-BLR.Dt.25.7.92	8.4.93	20.4.93	28.4.93	16.5.93	26.5.93	Charge-sheet filed on 12.10.93
6.	RC.51(A)/92-BOM.Dt.8.7.92	31.3.93	30.6.93	10.8.93	7.9.93	24.9.93	Charge-sheet filed on 11.10.93
7.	RC.50(A)/92-BOM.Dt.8.7.92	19.5.93	25.6.93	6.8.93	21.8.93	25.8.93	SP's report is under preparation, likely to be charge-sheeted soon
8.	RC.52(A)/92-BOM.Dt.13.7.92	7.5.93	24.6.93	15.7.93	1.9.93	23.8.93	-do-
9.	RC.11(S)/92-BOM.	—	—	—	—	—	In final stage of investigation, likely to be completed soon.

17.8 Apart from the 9 priority cases charge-sheets have been filed in the following 3 cases:

S.No.	Case No.	Department	Amount involved (in crores)	Present Position of the case
1.	RC.7(A)/93-Hyd.	ABFSL/ Solidiare	Rs. 000.405	Charge-sheet filed on 23.8.93
2.	RC.2(A)/92-ACV-V	Krishnamurthy	—	Charge-sheet filed on 04.1.93. Extradiction warrent against K. Jayakar S/o Sh. Krishnamurthy obtained and extradiction proceedings have commenced.
3.	RC.11(A)/93-Bom.	R. Sitaraman (SBI)	—	Charge-sheet filed on 27.9.93 in the Spl. judge for CBI cases in Bombay. date of next hearing not fixed as yet.

17.9 During the course of the oral evidence on 12.10.1993, the CBI stated that out of the 43 cases, they had filed charge-sheet in 7 cases so far. The remaining 36 cases would take atleast one more year for finalisation. The delay in investigation of cases was attributed to the lack of trained manpower, huge volume of material to be scrutinised and different laws and procedure followed in investigation of cases abroad. According to the CBI there are five cases involving investigations abroad which have not progressed satisfactorily. Out of these five cases four cases pertain to HSM Group and one pertain to Shri Bhupen C. Dalal and his associates.

17.10 The Committee were also informed that in order to expedite the investigation in the remaining cases and for exercising proper control & co-ordination the Bank Security Cell has recently been restructured and strengthened. All the officers investigating the Bank Scam Cases will now be working under the supervision of a Joint Director (BSC) who would be assisted by three DIGs. Many cases that were being investigated by the other branches of the CBI which resulted in problems of coordination have also been transferred to the Bank Security Cell in order to standardise, speed up and streamline the investigations. In order to speed up the prosecution, sanction has also been obtained for engagement of an additional senior counsel assisted by a junior counsel. The CBI now has two sets of Special Counsels assisted by juniors for prosecuting these cases before the Special Court at Bombay.

Non-registration of cases

17.11 The Committee have observed instances of inordinate delays in making preliminary enquiries and non-registration of regular cases by CBI in spite of enough evidence to support it. A glaring example is the case relating to late Shri B. Ratnakar, former CMD of Canara Bank. On 4 December, 1988, the CBI Bangalore Branch initiated a preliminary enquiry vide PE 2/88/CBI/BIR against Shri B. Ratnakar. The allegation against him was that during the period 1976 to 30 June, 1988, while functioning in various capacities as DGM, Executive Director and Chairman-cum-MD in Canara Bank, he had amassed huge assets in his name and/or in the name of his family members by misusing his official position. At the beginning of the check period *i.e.* 1.11.1976 his total assets were to the tune of Rs. 1,89,570/- against which he was having liability to the tune of Rs. 1,83,374/- in the nature of secured/unsecured debts. In the course of enquiry it was found that during the above mentioned period of 1976 to 1988 Shri Ratnakar acquired a number of immovable assets value of which works out to the tune of Rs. 35,86,486/-. Besides, he also had movable assets to the tune of Rs. 27,77,654/-. The enquiry reports were scrutinised at various levels in the CBI both by supervisory and legal officers and since a *prima facie* case of disproportionate assets appears to have been made out for detailed investigation, the proposal to convert the P.E. into a Regular Case was contemplated. However, the matter remained under investigation and no regular case was registered. After Shri Ratnakar expired on 2.2.1992, the case abated and had to be closed.

17.12 The Committee were informed that the Income Tax authorities have been informed about the assets possessed by late Shri B. Ratnakar and the members of his family, and the details have been passed on to them for further necessary action at their end.

17.13 Yet another instance is that of Rs. 2 crores given by Shri Hiten P. Dalal through ABFSL to GSAL in April, 1992. This issue has been dealt with in detail in Chapter 18 of the Report. It is worth mentioning here that the CBI was aware of this issue as early as 20th August, 1992, but even a PE was registered on 12.3.1993 after the matter was raised in Parliament on 4.3.1993. As regards the reasons for delay it was noticed that the Hyderabad Branch of CBI sent a proposal to the CBI, Head Office on 27.11.1992 for registration of a case. The proposal was examined in the Head Office of CBI and the Superintendent of Police, CBI,

Hyderabad, on directions of Joint Director, held discussions with the Andhra Bank officials and a formal complaint was given to the CBI on 14.12.1992. Thereafter the matter remained under examination at various levels.

17.14 The PE was ultimately registered in the Hyderabad Branch of C.B.I. on 12.3.1993. In its latest Status Report of 13.9.1993 CBI reported that the investigation in this case has been completed and it has recommended departmental action against the bank employees involved and a reference had also been made to the Company Law Board to examine the same. During the oral evidence on 12.10.1993 the representative of CBI stated that if the Company Law Board feels that there is criminality involved, "then we can proceed. But we do not have a criminal case as such". **However, when the Committee drew attention to various irregularities in advancing of loan to G.S.A.L. and its utilisation and the adverse comments in the report of SEBI on this deal, the Director, CBI, assured the Committee that in the light of the observations by the Committee, they will have the matter re-examined as the case has not been closed so far.**

Investigation of foreign Accounts

17.15 The Committee noticed that there was difference in perception within CBI about the role of CBI vis-a-vis **Enforcement Directorate in regard to investigations abroad in connection with scam cases.** The Committee were informed by Ex-Joint Director, CBI, Shri K. Madhavan, that on 25.6.1992 he received information at Bombay from a source that both HSM and Dalal Group had accounts abroad and that certain important persons of India were paid abroad through these accounts. The names of some persons of Indian origin who are staying abroad, through whom payments were made were also furnished by the source. The matter was discussed by him with the Director, CBI on 27.6.1992 and he (Shri Madhavan) was of the view that this investigation had to be done by CBI. The Director, CBI, however, wrote to Director of Enforcement on 30.6.1992 (copy of the letter is shown at *Appendix- XLI*) that CBI would confine itself at the moment in the investigation of the security scam. A separate team has to be constituted to look into FERA violations by the HSM and Dalal Group of brokers and Enforcement Directorate might like to do the needful. In case something was available of FERA violations, the scam would be furnished to the Enforcement Directorate promptly by the CBI, Bombay team.

17.16 Subsequently also on 11.7.1992 in one of the seized pocket diaries of Shri Niranjan Shah, CBDT found clue regarding a Swiss Bank account of Shri Harshad Mehta and this was communicated to the Enforcement Directorate and CBI for follow up. However, Shri Madhavan, Ex-JD, CBI after consultation with Additional Director and Director, CBI informed CBDT that according to the allocation of transactions of business between different Departments of Govt. FERA violations are to be looked into by the Enforcement Directorate and that the CBDT should therefore, write to them and they may if so desire, coordinate in the matter with the CBI.

17.17 It was only towards the end of July, 1992 that CBI decided to take up investigation of foreign bank A/cs of HSM. In a note recorded on 29.7.1992, the Director CBI observed:

> "About foreign bank A/cs, DOE has limited role as it cannot freeze such accounts. It is better that we take initiative in the matter as the money deposited was out of proceeds of crime. When I came to know about the operation of foreign accounts, I informed all concerned; let the exercise be initiated, otherwise we will face problems."

17.18 As regards the outcome of investigations abroad, CBI have reported that the investigation has revealed that Shri Niranjan J. Shah, a *hawala* dealer with narcotics links was

an associate of HSM. After the Income-tax authorities raided the residential and office premises of Shri Niranjan J. Shah at Bombay on the 30th and 31st May, 1992. Shri Shah fled to Nepal and then on to Dubai. Floppies seized during this raid indicated that he was maintaining foreign currency accounts in the name of HSM and his family members and many others.

17.19 Later a warrant of arrest was issued against Shri Niranjan Shah on 7.1.1993 *i.e.* after nearly seven months of the raid. He was declared an absconder on 22.3.1993 and on 23.3.1993 U.A.E. authorities arrested him. A team of CBI officer also visited UAE on 12.4.1993 to expedite his extradition. He was finally deported to India on 17.7.1993. On 18.7.1993 he was arrested in Bombay and produced before Hon'ble Special Court the same day. Between 18.7.1993 to 27.8.1993, he was in Police remand. Facts disclosed by him during extensive interrogation were verified both in India and abroad. Information relevant to other law enforcement agencies had been communicated to them for necessary action at their end. It was revealed that Shri Niranjan Shah was maintaining US $ account of HSM indicating payments to him and his family members on foreign currencies during 1991-92, HSM and his brothers had made payment of Rs. 2.80 crores to Shri Niranjan Shah (Rs. 35 lakhs) and his firm M/s. Romil Export (Rs. 245 lakhs).

17.20 Enquiries also revealed that a sum of US $20,020 was remitted to USA to Shri Sanjay Nawalkha, son of Shri M.C. Nawalakha (of ONGC). Shri Niranjan Shah arranged this remittance through his brother-in-law in Dubai on the instructions of HSM who made the payment of an equivalent amount in rupees to him in India.

17.21 In January, 1992 Smt. Rasila Mehta, mother of HSM and Shri Hitesh Mehta, brother of HSM received US $ 5 lakhs each from Popular Espanol, Las Palmas, Spain on the advice of Giorgia Pvt. Ltd., New York under the Immunity Scheme, 1991. Smt. Rasila Mehta also received US $ 96,331 as per advice of Morgan Guaranty Trust Co., New York also under the Immunity Scheme, 1991. As Shri Niranjan J. Shah had narcotic and hawala business links, it was suspected that the said remittances were arranged through him.

17.22 CBI's investigations also led to the discovery of various fraudulent transactions and the receipt of payments by public servants. An amount of US $ 65,000 was received by Smt. Meera Sitaraman, wife of accused Shri R. Sitaraman (of SBI) and an amount of US $ 1,95,000 was received by Shri M.G. Malgaonkar, father-in-law of Shri C. Ravi Kumar, (accused of NHB) on 29-30 January, 1992 from Bank of Baroda, Deira, Dubai. It was suspected that the amount had been arranged by HSM for bribing public servants. Shri Sitaraman admitted in his statement before Enforcement Directorate that the amount of US $ 65,000 remitted in the name of his wife was arranged by HSM who also arranged a holiday trip for him alongwith his family members.

17.23 Shri Niranjan Shah's interrogations disclosed that an amount of Rs. 6.41 crores belonging to accused Shri Harshad S. Mehta had been transferred to foreign destinations by him. The beneficiaries of these remittances to foreign countries have been found to be Shri Harshad S. Mehta and his close relatives. Further investigations into these foreign links are stated to be still continuing.

17.24 Shri Niranjan Shah has also revealed to the CBI that he was maintaining a black money account for HSM in India and that whenever Shri Mehta needed some money for which he did not want to account for he used to take the money from him. Rs. 6.10 crores are suspected to have been used for payment to public servants etc. He had at the request of Shri Mehta also sent money abroad. The total transactions by Shri Niranjan Shah in India as well as abroad on the request of Shri Mehta were of the order of about Rs. 12 crores, out of which about Rs. 6 crores had been sent abroad and Rs. 6 crores had been given in India.

17.25 He further informed the CBI that on the day he was raided by the Income-tax authorities he was in possession of shares of HSM worth Rs. 300 crores. As he was leaving the country Shri Mehta took back those shares from him. However, the location of these shares is a subject matter of verification. Shri Niranjan Shah has also explained to the CBI all the entries that he had made in his diary seized earlier.

17.26 Shri Niranjan Shah also disclosed the name of one Shri Jairaj Java during his interrogation. It is alleged that Shri Jairaj Java was trying to set up a branch of Shri Harshad Mehta's office in Dubai, and for this purpose Shri Niranjan Shah arranged 7 lakh US dollars for Shri Jairaj Java. Interpol message was sent and it was learnt that he had shifted from Bahrain to Dubai. His passport has been revoked and through Ministry of External Affairs request has been made to UAE authorities for his extradition. CBI had sent their officer with the requisite papers in this connection and are awaiting UAE Government's response.

17.27 CBI has also stated that Shri Niranjan Shah arranged from Shri Anil Pratap Harjani, a resident of Las Palmas, a loan of one million dollars for HSM which was remitted in the name of his brother and mother under the Immunity Scheme. CBI is examining the documentary evidence received in this regard.

17.28 The foreign links unearthed in this regard has also necessitated the sending of Interpol enquiries to the UAE, Switzerland, Germany, UK, Spain and the USA. These were in turn followed up with Letters Rogatory to the USA, UAE, Spain, UK, Isle of Man and the Channel Islands.

17.29 Investigation, is also being made with regard to foreign connections, Companies and transactions of accused Shri Bhupen C. Dalal. In this connection, the matter was taken up through Interpol Channels. As intimated by the Interpol Authorities in UK, the Special Court was moved to issue Letter Rogatory to UK, Channel Islands and Isle of Man. The Special Court issued the same on 30.3.1993 and have been sent to the concerned competent authorities through diplomatic channels. The Central Authority of UK have started preliminary investigations and have informed CBI that this work would be completed shortly. The Attorney Generals, Channel Islands and Isle of Man have informed that a team of CBI officers be sent to assist them in carrying out the investigation. A team of CBI officers is likely to visit these places in near future.

Siphoning of PSU funds

17.30 The CBI investigations of Bank Scam cases have also disclosed that a large number of Public Sector Undertakings had placed huge amounts with various banks under the Portfolio Management Scheme through HSM. A list of 18 Public Sector Undertakings and companies showing transactions amounting to over Rs. 12,000 crores which have come to notice of CBI so far, is given in *Appendix-XLII*.

17.31 According to CBI the banks have credited the funds placed with them by the PSUs into the accounts of HSM and his group of companies who have utilised them in their business for purchase of shares, bonds, units, loans, etc. HSM was interrogated to give his explanation with regard these transactions.

17.32 The CBI had also written to all the 18 PSUs and 4 companies to confirm the correctness of these transactions. Eighteen PSUs have informed that they had not made any investment through HSM under Portfolio Management Scheme. However, 3 of them namely (i) Engineering Export Promotion Council (ii) Life Insurance Corporation of India and (iii) UTI had informed that they had invested funds through HSM only under short term investment.

17.33 On 17.6.1993, the PSUs were again addressed to give further details of placement of their funds since 1987. Replies have been received from 5 PSUs. However, the response of following 13 PSUs is still awaited:

(i) M/s. Bharat Petroleum Corpn. Ltd., (ii) Engineering Export Promotion Council, (iii) General Insurance Corpn. of India, (iv) IFFCO Ltd., (v) Indian Oil Corporation Ltd., (vi) Industrial Finance Corpn. of India, (vii) Maruti Udyog Ltd., (viii) National Thermal Power Corpn. Ltd., (ix) Nuclear Power Corporation, (x) ONGC Videsh Ltd., (xi) Oriental Insurance Corporation Ltd., (xii) Power Finance Corporation and (xiii) Unit Trust of India.

17.34 Moreover, all the said 18 PSUs have stated that funds were placed with different banks. CBI has again addressed the concerned banks enquiring the use of funds placed with them by these public sector undertakings. It has also requested the banks to confirm whether the amounts were credited to the accounts of HSM group of companies on the direction of Shri Harshad S. Mehta/PSUs. Their replies are still awaited. A list of cases representing the funds of PSUs involved in which brokers have been identified and those in which they are yet to identified by the CBI is furnished in the *Appendix-XLIII*.

17.35 CBI have also sent letters to the Chief Vigilance Officers of PSUs, requesting them to look into these transactions relating to placement of funds. They have been also urged to examine whether funds have been utilised as per the client's advice and whether any guidelines laid down by Reserve Bank of India and Ministry of Finance have been violated. They have also been requested to send their reports for scrutiny by CBI.

17.36 The Committee recommend that the CBI may examine the cases of other brokers also who may have similarly received funds from PSUs through banks. They would also emphasise that the enquiries against the concerned officers of PSUs including the top management be expedited and necessary follow-up action taken against those who are found guilty.

17.37 The Committee were also informed that CBI is engaged in tracking of funds fraudulently obtained by the brokers in connivance with the public servants, with the assistance of teams composed from various nationalised banks of the country. As a result of this work, a very large volume of assets of the accused persons have been identified and information intimated to the Custodian appointed under the Special Court (Trial of Offences relating to the Transactions in Securities) Act, 1992, as a follow up action. The Custodian has been able to notify 41 entities (including 17 individuals) and has attached their properties.

17.38 The CBI has also been able to establish violations of the Company Law and the Stock Exchange by-laws by the brokers. These have been taken up with the Company Law Board, the concerned Stock Exchange authority and the SEBI. The Committee would like the necessary follow up action by the authorities concerned to be expedited.

Cases of coupon rate hike and disinvestment of PSU shares

17.39 At the instance of the Committee the CBI have taken up the investigation into the cases pertaining to leakage of coupon rates hike and disinvestment of P.S.U. Shares. In connection with the leakage of coupon rate hike CBI have filed a P.E. on 15.7.1993. It has been stated that during September, 1991 to April, 1992 some officials of the State Bank of India, Bombay and certain share brokers of Delhi and Bombay had prior information about the Coupon rates hike which took place on 3.10.1991 and 25.3.1992. Taking advantage of this information, they colluded with certain officials of foreign/Indian Banks by entering into forward purchase transactions prior to the hike and agreeing the delivery of the securities

after the hike, entailing a fall in the value of the securities which caused loss to State Bank of India, Bombay to the tune of Rs. 37.46 crores and corresponding gain to themselves/ brokers/banks.

17.40 CBI have registered two Preliminary Enquiries on 13.8.1993 relating to disinvestment of PSU shares by the banks and their subsidiaries to the brokers before their listing on the stock exchange and thereby failing to safeguard the financial interest of the institutions. The first P.E. involved the officials of Allahabad Bank, M/s. Y.S.N. Shares and Securities, M/s. C. Mackertich, M/s. Stewart & Co. and some other persons. The second P.E. involves officials of SBI Caps, Bombay, M/s. C. Mackertich, M/s. Steweart & Co. and officials of Canfina and Bank of America.

17.41 The Committee regret to note that the CBI has taken a long time to register a P.E. against suspected individual/officials. They would urge upon them to expedite the investigation in this regard and launch prosecution against those found guilty including the higher-ups in the decision making process.

Investigation of allotment from promoters quota shares of Fairgrowth Financial Services Limited

17.42 CBI's verifications has also revealed obtaining of favours by 513 Public servants and their relatives belonging to 42 different Government Departments, banks, Public Sector Undertakings etc. in allotment of shares under promoters quota from FFSL and its sister concerns. The list of these persons has been forwarded to the Government for taking further action in the matter.

17.43 Further, investigation was also conducted into the assets of some of the Public Servants of NHB, who played a major role in the securities transactions of NHB. Investigation revealed that Shri P. K. Parthasarthy, ED, NHB had acquired 1,000 shares of FFSL with whom the NHB had official dealings, from the promoters quota at a cost of Rs 10,000. Accused Shri C. Ravi Kumar and his family members have acquired 3,000 shares for Rs. 30,000 and accused Shri Suresh Babu had acquired 300 shares for Rs. 3,000. Similarly, Shri P.K. Parthasarthy, ED, NHB sold 1,000 master shares of UTI in his name and 1,000 SBI Magnum shares in the name of his wife, for Rs. 92,000 and Rs. 1,26,500 respectively to FFSL with whom the NHB was having official dealings. The conduct of these officers has been brought to the notice of the Banking Division, Ministry of Finance for such action as may be deemed fit.

CBI's Investigation of Cash withdrawals - HSM

17.44 The issue of cash withdrawals by certain brokers figured for the first time during the course of an informal meeting with the CBI on 7th May, 1993 when the Committee sought certain information in this regard. Later the CBI furnished to the Committee on 31.5.1993 a list of cash withdrawals made by HSM from various bank accounts maintained by him in his own name, his relatives and his group of companies. It has been reported that HSM computer floppies were seized by the Income-tax authorities when they had raided him on 28.2.1992. The process of taking over the floppies from CBI which began in June, 1992 was completed on 29th January, 1993. The final printout of the cash withdrawals amounting to over Rs. 6 crores was made out for further investigation.

17.45 During the course of the oral evidence on 25.6.1993 CBI have stated that HSM was examined for the first time regarding cash withdrawals on the 9th of February, 1993. On the 16th and 17th of March his employees were examined in this regard. Later Shri Mehta was examined again on 25th May, 2nd, 4th, 6th and 8th June 1993 on this issue.

17.46 On 9th February, 1993 when Shri Mehta was interrogated he told CBI that he would not be able to explain in isolation these withdrawals and would like to go through all the relevant papers. On 17.2.1993 HSM's counsel, Shri Mahesh Jethmalani sent a letter in which he had stated that among the cash withdrawals made and utilised were four withdrawals regarding which the CBI had asked HSM to explain which are as follows :

2.11.1991 30 lakhs from SBI, Main Branch, Bombay.
2.11.1991 10 lakhs from Grindlays Bank, M.G. Road, Bombay.
4.11.1991 25 lakhs from Grindlays Bank, Parliament Street Branch, New Delhi.
4.11.1991 20 lakhs from Grindlays Bank, Parliament Street, Branch, New Delhi.

In this letter Shri Mehta's counsel had stated that these four withdrawals and disbursement were "politically sensitive in the extreme" and details of these would be revealed if Shri Mehta was given assurance "of complete protection from political harassment or persecution". In its reply to Shri Jethmalani on 25.2.1993, the CBI stated that it is beyond their power to grant such protection. On 16th and 17th March, the employee of Shri Mehta were furnished with the required documents regarding cash withdrawals but failed to explain these withdrawals.

17.47 According to the CBI on 25th May, 1993, Shri Mehta had stated that he would be furnishing a written reply with regard to his cash withdrawals within a week's time. But when he was called again for examination on 2nd June, 1993 in this regard he expressed his inability to give reply as his advocate was abroad and therefore wanted extension upto 15th June, 1993. CBI also informed the Committee that when Harshad Mehta was examined on 2nd & 3rd June, 1993, he had maintained that with regard to four cash withdrawals, he would not reveal, but with regard to the other cash withdrawals he would explain provided he was given copies of certain documents seized by the CBI. Even after being provided with the required documents, the CBI is yet to receive the replies to their questions.

17.48 On 16th June, 1993 Shri Harshad Mehta held a press conference in which he issued a copy of an affidavit of 24th February, 1993 and briefed the press of the details of the 4 specific withdrawals of 2nd and 4th November, 1991 and its subsequent disbursement. In a press conference held on the same day he released a copy of an affidavit dated 24th February, 1993 alleging that these were in connection with payment of Rs.1 crore to the P.M on 4.11.1991.

17.49 During the oral evidence on 25.6.1993 on being querried by the Committee regarding the reasons as to why the CBI took so long to question Shri Harshad Mehta regarding the 4 cash withdrawals the representative of CBI stated that "As we had indicated in our letter to Mr. Mahesh Jethmalani that he would be examined with regard to all cash withdrawals, we wanted to equip ourselves with information with regard to all cash withdrawals". The representatives of CBI further stated that from the conditionality put forth by Shri Mehta it was evident that he "would not be answering about the 4 cash withdrawals". The CBI have reported to the Committee that Shri Harshad Mehta made no reference at any point of time that he had filed an affidavit on 16.2.1993.

17.50 The Committee are constrained to observe that although some vital information about cash withdrawal by HSM was with the CBI since February, 1993 it chose not to share the same with the Committee in either the Status Reports submitted by it to the Committee nor in the course of the informal consultation till clarifications were sought by the Committee.

Dalal Group

17.51 The CBI have informed that an analysis of cash withdrawal of more than Rs. 5,000/- made by various brokers belonging to Dalal Group has revealed cash withdrawal of Rs. 1,33,54,612/-.

17.52 Shri Hiten P. Dalal has stated to the CBI that he had purchased diamonds worth Rs.18 lakhs for his wife in March, 1992 from a jeweller introduced by Shri J.P. Gandhi as his relative. The diamond were seized by the Income-tax Department during their search & seizure operation on 16.10.92.

17.53 Shri Bhupen C. Dalal has stated to the CBI (on 9.6.1993) that "the amounts withdrawn was in between Rs.5,000 to Rs. 3 lakhs at a time and as such I presume that the same were withdrawn either for the purpose of petty cash transaction towards day to day office expenditure or for the purchase of share transfer stamps".

17.54 The CBI reported that in connection with case No.RC-2(A)/93-AC4(1) the list of cash withdrawals by M/s. V.B. Desai is also being investigated. The scrutiny of only some of the bank entries pertaining to withdrawals of above Rs.1 lakh only has been made. The purpose of these withdrawals is yet to enquired into by the CBI.

17.55 Regarding the cash withdrawals amounting to Rs.1.21 crore by HPD the CBI stated before the Committee on 12.10.1993 that "He has explained the withdrawals before us. We have verified it and it is found to be correct. The withdrawals are for day to day expenses and also for purchase of stamps. In some instance, he could not purchase the stamp and it was remitted back. We have verified it and found it to be correct. About Shri Bhupen C. Dalal, there is very negligible cash withdrawals which is less than one lakh rupees".

17.56 In this connection, it may be pointed out that during the oral evidence on 28.9.1993, the representatives of CBDT had informed the Committee that the total cash withdrawals by H.P.D. during the period 1.4.1991 to 30.6.1992 amounted to Rs.1.39 crores and out of this amount he has been able to explain the purpose of cash withdrawals for Rs.9,60,000 only. In light of this the Committee recommend that CBI may re-examine this in coordination with the CBDT.

17.57 The Committee regret to note that the investigation of Scam related cases by the CBI has been marked by inordinate delays extending up to years in some cases, in even making preliminary enquiries, non-registration of regular cases in spite of enough evidence to support it and abnormally long time taken in finalisation of cases registered by them. Even in nine cases registered by CBI more than one year ago in May-July, 1992 and which according to them were the high priority cases, the progress made in investigation has been tardy and in the first case (No. RO 41(A)/92-Bombay relating to UCO Bank) which was registered on 11.6.92, two charge-sheets have been filed only on 24.6.93 i.e. after more than one year of the registration of the case. There are 27 cases which were registered more than six months back and which are still under various stages of investigation by the CBI.

17.58 The Committee are unhappy to be informed by the CBI that it would take them at least one year more to finalise the cases already registered. They would stress the need for early finalisation of all the cases. If any strengthening of the organisation whether by way of providing additional staff or otherwise is required the same may be urgently considered by Government.

17.59 The Committee also regret to note that there was difference in perception within the CBI about the role of CBI vis-a-vis Enforcement Directorate in regard to investigations

abroad in connection with Scam related cases which led to loss of valuable time in taking up investigation of these cases. Enquiries which are still going on need to be expedited and conclusive follow up action taken.

17.60 The Committee are also unhappy that the CBI have failed to investigate the connection that the brokers had with various politically important persons and report the result to the Committee.

Central Board of Direct Taxes (CBDT)

17.61 The Committee had informal consultations with the CBDT and took their oral evidence on 24.6.1993 and on 28.9.1993 to keep themselves apprised of the action taken by the CBDT against brokers and others involved in the Scam. The CBDT furnished to the Committee 10 Status Reports and notes on various points raised by the Committee.

H.S.M. Group : Searches & Seizures

17.62 HSM Group was searched for the first time on 27.9.1990 when assets worth Rs. 4.79 crores comprising cash of Rs. 2 lakhs, jewellery of Rs.6.02 lakhs and share scrips worth Rs.4.71 crores were seized. In the course of these searches, the Group made a surrender of undisclosed income of Rs.4.25 crores under the provisions of Section 132(4) of the Income-tax Act, 1961.

17.63 Even after these searches, seizures and surrender the Group did not file returns of income or wealth for assessment year 1991-92 as provided under the Act. Earlier returns of assessment year 1990-91 had also been filed very late. In many cases negative wealth had been shown.

17.64 In a note recorded by the Member (Investigation) on 8.4.1992 he *inter-alia* mentioned about serious violations by HSM under I.T. Act 1961. He also mentioned that in view of the serious and flagrant violations, he had advised his officers to develop the case slowly and steadily for prosecutions. The above note reached the Minister of State for Revenue [MOS(R)], on the same date. He, however, signed and forwarded the same to the Finance Minister on 6.5.1992. In his note the Finance Minister recorded on 9th May, 1992 as follows:

> "This is the first time I am seeing the file. Investigations referred to in para 3 & 4 must be pursued with diligence and speed. This matter has figured in the Parliament as well and it is absolutely essential that investigations and follow-up actions in the case of Harshad Mehta should be pursued vigorously and speedily. Officers conducting investigation must be given full protection."

17.65 The Committee find that the file containing the note of the Member (Inv) was sent to the MOS (R) on 8.4.1992. However, this file remained pending with the MOS(R) for quite some time i.e. till 6.5.1992 before sending it to the Finance Minister. As regards the reasons for the delay the argument advanced by the MOS(R) was *inter-alia* that the note "was actually a routine monthly report of income tax raids for information only". The fact however is that this file also contained a couple of paragraphs on the misdoings of Shri Harshad Mehta. The Committee express their unhappiness over this delay. They find that the MOS (R) signed and forwarded this note to the Finance Minister on 6.5.1992 and the latter also recorded his note on 9.5.1992 *i.e.* only after the news of the Scam broke out in the press and was referred to in the Houses of Parliament.

17.66 The failure to take timely action against HSM is also evident from the note recorded by the Member (Investigation) CBDT on 19.5.92 as reproduced on next page:

"The Investigation Team had clearly mentioned after the defaults to maintain accounts, to get audited and to file the returns of income-tax as also the concealments detected. They had also mentioned about the prosecution potential of the case but the Assessing Officers did not pursue these deals and did not take appropriate action against the Group. Further, in such cases it is a usual procedure pursuant to searches that the connected cases are concentrated and jurisdiction over them assigned to one single officer for the purpose of coordinated and integrated investigations. It was sad to find that the cases of this Group remained scattered in the jurisdiction of three Chief Commissioners at Bombay even after the second search on 28.2.1992."

17.67 He also observed that " it is sad that a paltry penalty of Rs 6.4 lakhs has been levied for various defaults in 8 cases of the Group for various years. Not a single prosecution has been launched for various defaults, for example, for not filing income-tax and wealth tax returns."

17.68 In yet another note recorded by the Finance Minister on 30 June, 1992 he also observed:

"It does emerge that the follow up action after the searches in September, 1990 was tardy. We should find out if it was just a co-incidence or a deliberate act. In any case, we must move now with speed and make up for the lost time."

17.69 Search and seizure operations were started again in this Group on 28 February, 1992.

17.70 Details of seizures and surrender etc. made in the course of these searches are indicated below:

S.No.	Search started on	Group Name	Seizure of cash and other valuables in the course of search (Rs. in lakhs)	Income surrendered for taxation in the course of search (Rs. in lakhs)
1.	28.2.1992	Harshad Mehta	4901.95	10,000.00
2.	28.2.1992	Atul Vyas	0.60	38.14
3.	30.5.1992	Niranjan J. Shah	409.05	500.00
4.	19.6.1992	Khandwala Group	347.66	159.46
5.	19.6.1992	Mantri Banthia Group	1220.80	508.60
6.	19.6.1992	R. Sreenivasan, Madras	1101.75	Nil
7.	25.6.1992	Rajratan P. Mohta	7.35	50.00
8.	23.6.1992	Shrenik J. Shah	8.07	50.00
9.	14.8.1992	Prime Securities Ltd.	38.83	Nil
10.	23.6.1992	First Flight Courier (P)	-	-
11.	19.6.1992	M/s.Virender Saigal & Co.& Shri R. P.. Gupta	578.56	-
			8614.62	11,306.20

17.71 The Committee were also informed that all the cases of the Group had been centralised on 14.5.1992 with the CIT Central II, Bombay working under the DGIT (Inv.), provisional attachment orders u/s 281B had been issued in respect of 37 immovable properties.

17.72 The assessing officer also passed statutory orders u/s 132(5) in the cases of six members of the Group within the limitation period of 120 days ordering retention of all the seized assets. These orders are not assessment orders but are summary orders made by the assessing officer on the basis of material and explanation as available with him. In view of the fact that the liabilities so quantified (Rs. 11,381 crores) were much more than the value of seized assets, all these assets were ordered to be retained by the assessing officer for satisfaction of future tax demands arising out of regular assessments and penalties etc.

17.73 According to CBDT the pace of enquiries of the Investigation Wing were greatly hampered by total non-cooperation from HSM Group who was defiant and also recalcitrant. The Group did not maintain any regular books of account as prescribed nor got them audited. The details of transactions were in computers and hidden by pass words which were not made available. In spite of these difficulties, the officers were able to decode the data relating to final accounts in Harshad Mehta's computers showing his income from money market operations the period from 1.4.1991 to 27.2.1992 at Rs. 986 crores.

17.74 The data also indicates similar profit of Rs. 160.21 crores in the financial year 1990-91. The data so obtained has been analysed progressively and has been subsequently used in the assessment proceedings by the assessing officer.

17.75 The Investigation Wing also undertook enquiries to work out the asset position of the Group. CBDT had identified Rs. 960 crores worth of assets of HSM out of which Rs. 640 crores are shares. In addition, CBDT have came across recently shares worth Rs. 300 crores of HSM.

17.76 The Committee were also informed that searches were conducted by the Department in Bombay on 23.7.1993 and 16.8.1993 and in Calcutta on 12.8.1993. In the course of searches at Bombay, 1,02,940 shares of ACC valued at Rs. 17.03 crores and 2,96,122 shares of RIL valued at Rs. 5.65 crores were seized on 23.7.1993 from one Shri Jagdish N. Bhat. In the course of searches at Calcutta on 12.8.1993 assets of Rs. 63,10,755 including 1500 shares of ACC and 20,000 shares of Jai Prakash Industries Ltd. cumulatively valued at Rs. 54.09 lakhs were seized from one Shri Brij Mohan Sarade. 45 private limited companies and around 40 individuals were searches at Bombay on 16.8.1993 and assets valued at Rs. 32.92 lakh were seized.

17.77 The Department has stated that they suspect that all these persons are benamidars of HSM Group and they were in possession of and dealing with the assets belonging to HSM Group. The department has seized shares worth Rs. 23 crores u/s 132(1) and Rs. 80 crores worth of shares were attached by issuing prohibitory orders u/s 132(3) or attachment orders u/s 281B. However, firm conclusion in this regard can only be drawn after completion of the searches and follow up inquiries.

17.78 During the oral evidence on 28.9.1993, representatives of CBDT informed the Committee of their discovery of shareholdings of HSM in the benami account of 85 companies and 100 individuals.

17.79 According to the CBDT, HSM used to purchase the shares in the market with a blank form and these blank transfer forms were filled in the names of these dummy companies. Similarly, shares were also seized by CBDT from a Post Office at Goregaon during a search in which additional 50 packets of shares were discovered addressed to some dummy

companies and individuals. Besides survey u/s 133A conducted on 2.9.1993 in office premises of 9 brokers on the basis of information that shares registered in the name of these dummy companies were being off-loaded.

17.80 Statement of Shri Sudhir Mehta was recorded on 3.9.1993. He stated that Shri Harshad Mehta was behind the whole affair.

17.81 Smt. Vanita Mehta aunt of HSM confirmed that the shares delivered by various persons were handed over to the driver of HSM on the telephonic instructions of HSM.

17.82 HSM in his statement recorded on 6.9.1993 has denied any connection with the above scheme of transfers. However, he has subsequently said that he would be approaching the Settlement Commission in the matter.

Finalisation of assessment

17.83 The Committee were informed that in this group and connected cases 35 I.T. assessments for Assessment Year (A.Y.) 1990-91 and 20 wealth-tax assessments under the wealth-tax Act only have been completed till March, 1993. The details of assessments are indicated in *Appendix-XLIV*.

17.84 The Committee were surprised to note that CBDT had issued a notice for payment of advance tax to the HSM group under section 210(3) to pay an advance tax of only Rs. 51.71 lakhs for the assessment year 1993-94 as against tax demand of Rs. 214.70 crores for A.Y. 1990-91. In a clarification submitted to the Committee the CBDT have stated that "for the purpose of calculation of this advance tax, returns of assessment year 1990-91 were taken as the base which is in accordance with the provisions of section 210(3). Under this Section, a notice can be issued on the basis of last assessed income or the last returned income. At the time of the issuance of the notices, assessments of the assessment year 1990-91 were pending. Accordingly the advance tax payable was worked out on the basis of the returned income of assessment year 1990-91 which was only Rs. 1,12,54,688/-".

17.85 During the course of the oral evidence on 28.9.1993, the representatives of CBDT informed the Committee that they were in the process of completion of HSM's assessment for the year 1991-92 and will be completing the assessment in the next four to six weeks. The Chairman, CBDT, further stated "I am very keen to see that the 1992-93 assessment should be completed before the financial year is over. It is our desire that all Scam related cases should be completed by the end of this financial year 1993-94".

17.86 In this connection it is relevant to draw attention to the following note recorded by Chairman, CBDT on 14 October, 1992 :

> "Finance Minister desires that search cases should be monitored effectively and completed expeditiously and for this purpose the Board devise a proper system after reviewing the existing system and procedures which do not seem to be very effective".

Hiten P. Dalal, Bhupen C. Dalal, T.B. Ruia, etc.

17.87 Search operations were conducted on 16.10.1992 in the cases of 10 brokers and one industrialist. These operations were simultaneously carried out at their business and residential premises in 19 stations including Bombay, Delhi, Calcutta, Madras, Ahmedabad, Bangalore, Pune, Nasik, Surat, Baroda, Nagpur etc. The details of the groups in whose cases

action was taken by way of search and seizure of unaccounted assets made and the income surrendered in the course of these operations are narrated here under:

S. No.	Group Name	Seizure of cash and valuables in the course of search (in lakhs)				Income surrendered for taxation in the course of search in lakh/131
		Cash	Jewellery	Other	Total	
1	2	3	4	5	6	7
1.	Hiten P. Dalal	1.48	25.4	300.96	328.39	27.35
2.	Preeti N. Aggarwala	NIL	NIL	467.28	467.28	NIL
3.	Akhil K. Dalal	NIL	2.03	33.18	35.22	32.61
4.	Bhupen C. Dalal	0.50	8.94	5.51	14.95	Nil
5.	A.D. Narottam	—	—	1.29	1.29	150.00
6.	J.P. Gandhi	—	—	0.27	0.27	NIL
7.	Mahesh J. Patel	0.50	—	8.57	9.07	NIL
8.	Maheshkumar D. Shukla	1.00	2.14	40.55	43.70	98.18
9.	Haresh K.Dalal	1.00	2.42	376.37	376.79	Nil
10.	S. Ramaswamy (Prop. Excel & Co.)	1.00	NIL	NIL	1.00	1.00
11.	M/s. Dhanraj Mills Pvt. Ltd. (T.B. Ruia)	—	250.06	—	250.06	13.60
	Grand Total :				15,28.02	322.74

17.88 The following position has emerged in regard to the asset position of the members of this Group on the basis of enquiry by the Investigation Wing:

(i) HPD Group owns assets worth about Rs. 469.60 crore comprising of shares, immovable properties, bank and other credit balances etc.

(ii) ADN Group are found to have assets worth about Rs. 256.37 crores. This consists of Rs. 200 crores and Rs. 35 crores payable to him by T.B. Ruia and S. Ramaswamy respectively. However, T.B. Ruia has admitted liability to the extent of Rs. 75 crores only. The assets also include investments in Kailash Dairy Farm and Udai Dairy Farm of about Rs. 11 crores and Rs. 6 crores respectively.

(iii) T.B. Ruia Group owns assets worth about Rs. 98.42 crores. These consist of shares of about Rs. 85 crores, jewellery of about Rs. 3.35 crores and immovable properties of about Rs. 10 crores.

(iv) Bhupen Dalal Group are found to own assets worth about Rs. 25 crores comprising immovable property worth Rs. 10 crores, shareholdings worth about Rs. 10 crores and other miscellaneous items.

(v) Smt. Preeti Aggarwala has been found to own shares of the value of Rs. 82.70 lakhs in 74 companies. The asset position will be cleared on receipt of replies from the remaining companies.

17.89 The properties of this Group were provisionally attached under Section 281B to safeguard the interests of revenue in regard to the future liabilities that may arise on completion of assessments. The attachments in regard to notified persons will however be subject to the order of Special Court. Attachments in the cases of CIFCO Ltd. and Killick Nixon Ltd. were on the other hand, subject matter of writ petitions before the Bombay High Court. The High Court confirmed the provisional orders of attachment in principle but allowed partial relief in respect of current assets.

17.90 All the cases of the Group were brought together in June 1992 under one Assistant Commissioner in the Central Charge for Special Investigation and the work is overseen by Deputy Commissioner (Central) and both of them report to the Commissioner of Income-tax (Central I), Bombay. A special co-ordination cell under the control of D.G. (Inv.) North, Delhi was set-up on 23.9.1992 to assist C.B.D.T. monitoring the progress of investigation of the Scam and other related cases.

17.91 The assessment wing has been pursuing its enquiry for the purpose of making assessments in the Group. 12 I.T. assessments for the assessment year 1990-91 have been completed in March raising demands of Rs. 2.50 crores. The details of assessment are indicated in *Appendix-XLV*.

17.92 HPD had also issued cheques amounting to Rs. 78 lakhs which were dishonoured. As a result he was convicted under Section 158 of the Negotiable Instruments Act and sentenced to one year RI and a fine of Rs. 1 lakh.

17.93 Six cases of this Group were referred to compulsory audit under Section 142(2A) and therefore, time barring assessments of these cases get deferred till the receipt of the audit report. The details are as under :

S.No.	Name of the assessee	A.Y.
1.	Shri Bhupendra C. Dalal	1990-91
2.	Shri Abhay D. Narottam	1990-91
3.	Shri S. Ramaswamy (Prop. M/s. Excel & Co.)	1990-91
4.	M/s. Killick Nixon Ltd.	1990-91
5.	M/s. CIFCO Ltd.	1990-91
6.	M/s. CIFCO Finance Ltd.	1990-91

17.94 CBDT have received the Special Audit Report in August, 1993 relating to 6 cases of Shri Bhupen C. Dalal and the Committee was assured that on the basis of this report the time-barred cases would now be completed on time.

17.95 In the course of assessments it was found that the assessees had committed defaults under the various provisions of I.T. Act. Accordingly 11 notices of penalty for concealment of income under Section 271(1)(c) have been issued. These proceedings are pending.

17.96 In the course of searches as well as assessments it has been found that the Group assessees have committed a number of defaults for which they are liable to be prosecuted

under I.P.C. and the I.T. Act. Complaints have already been filed under the provisions of the I.P.C. against Shri Naresh K. Aggarwala and Smt. Preeti Aggarwala for giving false statement on oath before the authorised officers. Similar complaints have also been filed against Shri Hiten Dalal and Smt. Leena Dalal. Other offences under the I.T. Act such as wilful attempt to evade tax and wilful failure to file the return etc. are also under consideration. The details are indicated below :

S. No.	Name of the assessee	A.Y.	U/S	Office for which prosecution contemplated
1.	Shri B.C. Dalal	1989-90	35A(1)	Wilful attempt to evade wealth-tax
2.	Shri J.P. Gandhi	1991-92	276CC	Wilful failure to file return of income
3.	Shri J.P. Gandhi	1988-89	35A(1)	Wilful attempt to evade wealth-tax
4.	Shri A.D. Narotam	1989-90	276C(1)	Wilful attempt to evade income tax
5.	Shri A.D. Narotam	1991-92	276CC	Wilful failure to file return of income

17.97 The Committee regret to note that inordinate delays in investigation of the cases and lack of proper follow up action by CBDT in Scam related cases. In the case of HSM Group, searches were first carried out in September, 1990. Follow up action was, however, admittedly tardy. The Department failed to launch a single prosecution for various defaults and levied only a paltry penalty of Rs. 6.4 lakhs. No action was however taken against the officers responsible for various lapses. Even after the second raid on this Group in February, 1992 there was lack of coordinated approach and no serious efforts were made to introduce systems and procedures to ensure expeditious finalisation of assessments especially in big cases involving huge revenue. The Committee find that the assessments of various brokers for the year 1990-91 have only been completed till March, 1993 and in some cases even the assessments for this and earlier years are still pending finalisation. The Chairman, CBDT informed the Committee that it was their desire that all Scam related cases should be completed by the end of financial year 1993-94. The Committee would urge that steps should be taken to ensure that the target date is adhered to. Follow up action may also be taken expeditiously to recover the amount due and to launch prosecution proceedings wherever necessary.

17.98 The Committee would also like to point out that as the Government revenue is the first charge on the assets of the notified persons, the delay in finalisation of income-tax and wealth tax assessments and filing of claims with the Custodian would result in delays in settlement of the claims of other parties *i.e.* banks, etc. It is therefore imperative that a time bound programme is drawn up by the CBDT to finalise the cases assessments of notified persons.

17.99 The Committee have noted that CBDT have not examined the role of industrial houses with respect of Scam. The representatives of CBDT during the oral evidence stated before the Committee that although the activities of every industrial houses are scrutinised thoroughly before any assessment is made, however, they have not taken 'any specific step' regarding their involvement in the Scam. The Committee recommend that the CBDT may do so now expeditiously.

Fairgrowth Group

17.100 Fairgrowth Group consists of the following companies :

(1) Fairgrowth Financial Services Ltd. (FFSL)

(2) Fairgrowth Home Finance Ltd.

(3) Fairgrowth Investments Ltd.

(4) Fairgrowth Agencies Ltd.

(5) Fairgrowth Factors Ltd.

(6) Fairgrowth Exim Ltd.

(7) Fairgrowth Securities Pvt. Ltd. and

(8) Fairgrowth Holdings and Real Estate Pvt. Ltd.

In addition to the above the Group consists of a firm M/s. Fairgrowth Financial Services and the firm is doing the business of the share broking.

17.101 FFSL was incorporated on 9th July, 1990 as a closely held private limited company and it commenced its business on 10th August, 1990. Its shares are not listed in any stock exchange. Its paid up capital as on 31.3.1992 is Rs. 8.60 crores and consisting of 86 lakhs shares of Rs. 10 each. The entire capital has been raised by private placement and there were 2611 share-holders as on 31.3.1992.

17.102 FFSL filed its return of assessment year 1991-92 showing a loss of Rs. 36.21 lakh and in summary intimation under section 143(1)(a), this loss was determined at Rs. 34.34 lakh. Return of income for assessment year 1992-93 has been filed on 28.12.1992 and according to this return the self assessment tax liability under section 140A works out to Rs. 12.40 crores. As the amount has not been paid alongwith the return, the Special Court at Bombay has been moved for release of funds to meet this liability.

17.103 The group companies were extensively searched by the CBI on 30th July, 1992. They seized 497 documents including books of account, diaries and scrips etc. They also seized a register on 3.3.1992. There has been a constant exchange of information between the officers of the CBI and the I.T. Department in regard to seized books of account and documents and their implications for the tax investigation. These companies were earlier assessed by a number of assessing officers at Bangalore. Consequent upon the searches and the coordination between CBI and the Investigation Wing, these cases have been assigned to one Assistant Commissioner in Central Circle at Bangalore for deep and coordinated investigation.

17.104 According to CBDT the assessment Wing has been making all out efforts to complete assessments of various cases of this Group. However, it is found that the books of account of FFSL are incomplete and this is causing delay in the matter. At the same time the Group has not been responding to various statutory notices on the ground *inter-alia* that all books etc. have been seized by the CBI. The assessment Wing has also been making enquiries into

the investments made in share holdings of FFSL by various individual members, the details of which are as under :

Sl. No.	Name	Number of shares held	Amount (Rs.)
1.	Late Sh. B. Ratnakar (Individual)	8,50,010	85,00,100
2.	Late Sh. B. Ratnakar (HUF)	50,000	5,80,000
3.	Smt. Prema Ratnakar	1,57,510	15,75,100
4.	Sh. Premanand R. Shenoy	2,00,000	20,00,000
5.	Sh. Navin R. Shenoy	1,00,000	10,00,000
		13,57,520	1,35,75,200

17.105 In view of the fact that the books of account of FFSL, the leading company of the Group, were incomplete, the assessing officer had ordered special audit under section 142(2A) with the previous approval of the Commissioner (Central), Bangalore. This audit is in progress.

17.106 In the course of various enquiries it was found that the members of the Group committed various defaults which are punishable under the Income-tax Act. In particular, it was found that non-corporate assessees being the family members of Late Shri B. Ratnakar, have not filed the returns of income from assessment year 1989-90 onwards. Therefore, the proposals to prosecute Shri Premanand Shenoy, individual, Premanand Shenoy (Karta of Sh. B. Ratnakar, HUF) and Smt. Prema Ratnakar are under active consideration of the Assessment Wing.

17.107 The Committee regret to note that although the companies of the Fairgrowth Group "were earlier assessed by a number of assessing officers at Bangalore" it was only after the CBI's search on 30th July, 1992 and the scrutiny of the documents seized during this raid that it was found that the members of the FFSL Group had committed various defaults which are punishable under the Income-tax Act. The Committee recommend that prosecution proceedings to be launched expeditiously both against the corporate/non-corporate assessees of this group a matter which "is still under active consideration of the Assessment Wing".

P.M.S. Transactions of foreign banks

17.108 The Income-tax Department has reported to the Committee that they have also come across irregularities in the PMS accounts for the accounting year 1989-90 (A.Y. 1990-91) relating to three foreign banks, namely Citibank, BOA and British Bank of Middle East (BBME).

17.109 As the guidelines of RBI concerning PMS were violated the Income-tax authorities treated these funds as ordinary deposits accepted by the banks. Thus, the interest on these funds were restricted to the ordinary rate of interest payable on such deposits as approved by RBI. The interest allowed by the banks on such deposits in excess of the RBI guidelines was disallowed in the cases of BOA and BBME. In the case of Citibank also, the interest paid on PMS funds above the rate of 9% per annum was treated as bank's income. Additions made

for the A.Y. 1990-91 for Citibank was Rs. 30.98 crores, BOA Rs. 03.87 crores and the BBME Rs. 00.89 crores. The Committee recommend that the matter may be seriously pursued and CBDT may examine the cases of other banks also who had carried out similar transactions under PMS.

CBDT's investigation of foreign remittances received by the Brokers

17.110 The post search enquiries in the Group cases of Shri T.B. Ruia by the Investigation Wing at Bombay showed that Dhanraj Mills Pvt. Ltd. advanced certain moneys to 3 brokers of Bombay Stock Exchange in the financial year 1991-92 The details of advances are indicated below:

S.No.	Name	Amount in Rupees
1.	T.H. Vakil	3,44,12,538
2.	V. Krishankant	2,28,58,274
3.	Suresh Nandlal Shah	58,94,020

17.111 These brokers were examined and each one of them stated that the cheques for the respective amounts were received by them from one Shri Suresh K. Jajoo with a request that these may be deposited in their bank accounts and like amounts in cash may be returned to him. According to them, they deposited the cheques in their undisclosed bank accounts and withdrew cash. The cash so withdrawn was returned to Shri S.K. Jajoo and they were allowed commission at the rate of 1% of the cheque amount. It was also stated by them that Shri S.K. Jajoo told them that the cash was required for arranging foreign remittances under foreign exchange immunity scheme in force in the relevant period.

17.112 Scrutiny of the accounts of Shri T.B.Ruia also showed receipt of foreign remittance of US $ 400948 originating from Citibank, New York under the scheme. Therefore, a statement of Shri S.K.Jajoo was also recorded. He deposed that he had given cheques to the aforesaid brokers and the cash received *in lieu* thereof was handed over either to Shri T.B. Ruia or to the employees of Dhanraj Mills Pvt. Ltd. He is stated to have lent a helping hand in this scheme as he has taken a loan of Rs. 1.66 crore from Dhanraj Mills Pvt. Ltd. Finally Shri T.B. Ruia was examined on the issue. He denied the charges.

17.113 Enforcement Directorate has been intimated of these transactions by the Investigation Wing for necessary follow up under the FERA.

CBDT's Investigation of cash withdrawals

HSM Group

17.114 CBDT's Investigation into the cash withdrawals by the brokers was discussed at length during the oral evidence held on 24th June, 1993 with the representatives of the Department. During the course of oral evidence tendered by CBDT on 24.6.1993, the Committee were informed that on 4.1.1993 CBDT received from CBI a list of 29 cash withdrawals made by HSM during 23.8.1991 and 30.1.1992 with a request that enquiries be made by CBDT regarding the utilisation of these amounts.

17.115 After receiving the information from the CBI the assessing officer specifically questioned HSM on 18.2.1993 regarding utilisation of cash withdrawals and recorded a statement in this regard. Shri Mehta stated that answers to the questions were "extremely

sensitive in nature" and he had asked his solicitor to issue a letter to CBI on 17.2.1993 and he would await their reply before furnishing the reply to CBDT's questions. He was asked by CBDT to furnish the details by 22.2.1993. He, however, did not furnish the details inspite of show cause notices and summons issued to him. While he avoided replying to the CBDT, ignoring statutory summons, he made a public statement in the matter on 16.6.1993.

17.116 During the evidence when Committee enquired the reasons for delay, in investigation of cash withdrawals, the representatives of CBDT replied that during this period "it (cash withdrawals) was not our priority" as priority at this point of time "was the completion of time barring assessment" and on completion of which the matter of cash withdrawal was taken up again.

17.117 On 28.9.1993 when the CBDT gave further oral evidence before the Committee and they informed that besides the four cash withdrawals of 2.11.1991 and 4.11.1991 in connection with alleged pay-off of Rs. 1 crore to P.M. there were two more cash withdrawals of Rs. 5 lakhs on 10.8.1991 from ANZ Grindlays Bank, Madras and Rs. 20 lakhs from ANZ Grindlays Bank, Parliament Street, New Delhi on 4.6.1992. According to CBDT, Shri Mehta told them that these two withdrawals were also 'politically sensitive' and he would not part with the information without consulting his lawyer. HSM has also informed the Income-tax Authorities that he would go before the settlement commission with the permission of the Special Court and make a clean breast of the whole thing.

Dalal Group

17.118 CBDT have also obtained a list of bank accounts of Shri Bhupen C. Dalal and his family members which given the details of the cash withdrawals of the Dalal group. It has been stated that the matter is under further investigation.

17.119 HPD's cash withdrawals amounted to Rs.1,39,94,659 from 1.4.1991 to 30.6.1992 from his Andhra Bank account, Fort Branch, Bombay. Shri Dalal was able to explain the purpose and use of only Rs. 9,60,000. According to him Rs. 5,20,000 were paid to Shri Santosh Mane for transfer of 6,20,000 RIL shares valued at Rs. 10.40 crores. The other sum of Rs. 4,40,000 was paid to Shri Sunil Mane. This is in contravention of Section 40A(3) of the Income tax Act which required cash above Rs. 10,000 has to be paid by A/c payee cheque or draft. The matter is under further investigation.

Enforcement Directorate

17.120 The Committee had informal consultation with Enforcement Directorate and have received 6 Status Reports. The Directorate is investigating violations under FERA in respect of stock brokers and others involved in the securities Scam.

17.121 According to the Directorate, the first piece of evidence linking possible *'hawala'* operations with the bank Scam, came to their notice from the document seized during the Income-tax raids on Shri Niranjan Shah on 30-31 May, 1992 reportedly a close business associate of HSM. The Bombay Office of Enforcement Directorate was informed of the seizure of foreign currencies and documents on 2nd June, 1992 but before Directorate authorities moved in, Shri Niranjan Shah fled the country on 1.6.1992 to Nepal and then to Dubai.

17.122 Some persons like Shri Vipul J. Shah (Manager of M/s Romil Export an export firm owned by Shri Niranjan Shah); Shri Churchil Shah (brother of Shri Vipul J. Shah; Shri Satish Modi (partner of Shri Niranjan Shah in M/s Romil Builders); Shri J.K. Joshi (Partner of Shri Niranjan Shah in M/s. Ojha Leasing Co.); Shri Nagin Kothari/Atul Kothari/ Sunil Kothari; *hawaḷa* business associates of Shri Niranjan Shah have admitted that they all

entered into *hawala* transactions through Shri Niranjan Shah as mentioned in the computerised accounts.

17.123 Amongst the papers seized from Shri Niranjan Shah's house during the Income-tax raid, a diary was found which contained certain names which had corresponding entries in the computerised *hawala* accounts seized. The diary *inter-alia* contained entry of a remittance to Credit Swisse, Switzerland in favour of Shri Harshad Mehta, while another note in the diary refers to a bank account in Heidellburg, Germany.

17.124 Two major entries in the computerised accounts relate to remittances to Shri Jairaj Java (Business associate of HSM in Dubai). These were reportedly contributions towards setting up of a new company M/s. Growell International. Information has also been obtained that Shri Jairaj Java was in the past conducting his stock market operations in India through HSM. One remittance from HSM of US $ 4 lakhs in Shri Niranjan Shah's account to Jairaj Java gives a date which seems to tie-up with an investment made in large scale purchase of shares of Mazda Industries & Leasing Ltd. by Jairaj Java from his NRE account in a Bombay bank. Shri Jairaj Java's FCNR account of US $ 2.43 lakhs and the shares of Mazda Industries & Leasing Ltd. have been blocked by the RBI on the request of the Enforcement Directorate.

17.125 Enforcement Directorate has also reported that analysis of the computerised accounts of Shri Niranjan Shah, as also information obtained seems to indicate a narcotics smuggling angle. Smt. Roma Shah (Ex-wife of Shri Niranjan Shah) was arrested by the Canadian Police when a seizure of 5 tonnes of hashish was made in the warehouse of Shri Munish Shah was convicted and is still undergoing imprisonment. Smt. Roma Shah was detained for six months and then, as a result of plea bargaining, was given a suspended sentence of 1 day and thereafter repatriated to India. The computerised accounts of Shri Niranjan Shah shows that large sums of money were remitted from Shri N.J.Vadhani and Shri Niranjan Shah in Canadian dollars to Toronto in a time span which would indicate that this related to payments for the narcotics consignment. Shri Niranjan Shah had also come to the adverse notice of the US Drug Enforcement Agency.

17.126 The Directorate reported to the Committee that HSM had arranged through the *'hawala'* route to make a remittance of US $ 65,000 through a foreign exchange draft of the Bank of Baroda, Dubai in favour of Smt. Meera Sitaraman wife of Shri R.Sitaraman, former-Assistant Manager of the SBI Bombay. Smt. Meera Sitaraman/R.Sitaraman attempted to show this payment as a remittance received under the Immunity Scheme. However, detailed investigations have established that the remittance was through fabricated documents and does not constitute a valid remittance under the Immunity Scheme. In the light of this, after obtaining the advice of the Ministry of Law, show cause notices have been issued under Section 51 of FERA against HSM, Shri R. Sitaraman and Smt. Meera Sitaraman for offences under Section 8(1) of FERA. Also a show causes notice has been issued against Shri Sudhir Mehta for an offence under Section 8(1) read with Section 64(2) of FERA. Simultaneously, sanction has been issued to launch prosecution in a criminal court against these persons under Section 56 of FERA.

17.127 It has been observed by the Committee that money has also been received under the Immunity Scheme by others like for example — HSM's mother, Smt. Rasila Mehta, T.B. Ruia, etc. The Committee feel that the Scam money which may have flown out of the country have been channelised back through this Scheme. The Committee strongly urge the Enforcement Directorate that the whole matter may be thoroughly investigated.

17.128 The Committee have observed that the contribution of Directorate of Enforcement to Scam related investigation has only been marginal. The Committee are constrained to

note that Directorate has not shown the required initiative to investigate the Scam related cases independently. Their helplessness and being at the mercy of the other two investigative agencies is borne out by their own submission, during the course of the oral evidence on 29.9.1993 when the representative of the Enforcement Directorate admitted that "we are largely dependent on the clues and the evidence thrown up by other parties.....whatever evidence, they could throw up, we can follow it up. We are not able to uncover any significant lead on our own".

Lack of co-ordination among the investigating agencies

17.129 During the course of the Committee's interaction with the three investigative agencies, it had been time and again suggested to them to set up a coordination committee for timely and effective examination of the cases related to the Scam. In this context while deposing before the Committee on 24.6.1993 the representative of CBDT stated that "As far as the Central Revenue Intelligence agencies are concerned, we have a regular monthly coordination meeting at different cities." The participants are the Income-tax Department, the Enforcement Directorate, the Central Excise—Anti Evasion Department, the Customs Preventive Department and the Directorate of Revenue Intelligence. The Narcotics Wing of the Revenue Department is also associated in these meetings. At present they are reported to be chaired by D.G., Income-tax, Investigation. Further the minutes of meetings are sent every month to the Director General of Central Economic Intelligence Bureau of Delhi who coordinates/investigates if necessary."

17.130 So far as coordination with other agencies are concerned the CBDT representative informed the Committee that "After the CBI was entrusted with this investigation in May, 1992 we have had periodical meetings with the officers investigating the Scam cases on the CBI side. We have been exchanging information but these have been put on a formal footing only since 2nd February, 1993." Earlier the meeting took place whenever the need for such a meeting/exchange of information arose.

17.131 It was conceded by the representative of CBDT during the oral evidence on 28.9.1993 that so far, this coordination had been confined to period meetings for exchange of ideas and information with each agency being copy about what they had discovered or what information they had in their possession. However, we have now enlarged the scope of our coordination to a very close cooperation at operational levels. This coordination is now not formal only, it is more frequent, closer and informal to the extent that we have now virtually been operating as two sides of a coin. The unearthing of benami shares of Shri Harshad Mehta was cited as an example of close coordination between CBDT and CBI. However, the CBDT officials admitted that it would have been better if a joint team had been set up. In fact, this was suggested in February/March, 1993 but the idea was turned down.

17.132 The Committee were informed by the CBI during the oral evidence that the Director, CBI had sent a communication to the Cabinet Secretary as early as on 3rd August, 1992 in which he had stated that:

> "Though three departments of the Government of India are thus engaged in the enquiries, the basic facts are more or less the same. Till now, the three departments have gone on the premise that each department should concern itself with its own priority and leave the rest to the other concerned departments. However, a stage has now been reached where it has become necessary to decide at a high level in the Government regarding the scope of enquiries being conducted by each department and their inter-relationship."

"It is, therefore, requested that the Cabinet Secretary may convene an urgent meeting to be attended by officers of the CBI, Income-tax Department and the Enforcement Directorate so that guidelines could be formulated for coordinating the work of the three departments."

17.133 The Committee were informed that as a follow-up action a meeting was convened by Cabinet Secretary on 7.8.1992. In that meeting, it was decided that the matter will be coordinated at the headquarters level also. For this purpose, Director, CBI, would be convenor. The meetings would be taken regularly which will be attended by Director CBI, Member (Inv.) from CBDT and Director of Enforcement. This will be in addition to the coordination already existing at the field level.

17.134 The position, however, did not improve as is evident from the following notes recorded by the Finance Secretary and Minister of State for Finance in September, 1992. In a note recorded on 29.9.1992, the Finance Secretary observed as follows:

"Each agency, as expected, believes it has put its best foot forward and that if there was any slip up it is because of the less than efficient handling of the other agency. What is important is that the two agencies should work with greater coordination. I have already requested the CBDT to ensure this and I would once again urge them."

17.135 The Minister of State for Finance recorded the following note in this connection on 30.9.1992:

"It has been the Government's policy to give a free hand to the concerned authorities incharge of different wings/agencies connected with investigation etc. However, they must ensure coordinated action and take effective and prompt steps for it."

17.136 The Director, CBI during evidence before the Committee on 25.6.1993, however expressed his satisfaction over the coordination with other investigative agencies and stated before the Committee that "We do not feel any difficulty in exchanging information. Whenever we want information we get whenever they want they take from us. There have been a large number of meetings with Income-tax Department and Directorate of Enforcement". It was however, admitted that "the first formal meeting for effective coordination of the investigation being conducted by CBI, CBDT and Enforcement Directorate was held only on 2.2.1993.

Mohan Khandelwal — Issue

17.137 During the course of the oral evidence on 25.6.1993 the Committee asked the Director, CBI as to whether Shri Mohan Khandelwal (the business associate of HSM) had met him. The Director, CBI confirmed that he met him in June, 1992. He clarified that one of the Shri Mohan Khandelwal's relation Shri R.K. Khandelwal, (retired Sr. police officer) requested him to meet Shri Mohan Khandelwal as he was in trouble and to save him. When Shri Mohan came to meet him he had a brief discussion with him and told him that if he wanted to disclose something he should meet Shri P.C. Sharma, the then DIG (Special Investigation Wing). The Committee were informed by Shri P.C. Sharma that Shri Khandelwal was sent to him as a source. As regard the discussion held with him the Director, CBI stated that "this is principle authority of all the investigative agencies not to betray one's source". Shri Sharma also informed the Committee that he had met Shri Khandelwal only on 3 or 4 occasions, mostly in June, 1992. In reply to a question the CBI also informed the Committee that the question of Shri Khandelwal being used as an

approver was not considered initially as the decision in this regard is taken only at the end of the investigation of a case. It was also denied that Shri Khandelwal was ready to share information about political personalities involved in the Scam, if turned into an approver. Subsequently, the status of Shri Mohan Khandelwal changed and he became an accused in the case of Power Finance Corporation, registered on 23.7.1992.

17.138 The Committee also enquired from the CBDT whether there was any incident of seizure on 25.6.1992 of a large quantity of jewellery from the family members of Shri Mohan Khandelwal. The CBDT informed the Committee that their inquiry into this incident had started only after the receipt by the Ministry of Finance of a petition from one Shri Ramesh Gupta of Delhi on 30.6.1992 claiming reward on account of action taken by him and his associate in apprehending jewellery allegedly belonging to Shri Harshad Mehta and his family members. The CBDT had contacted the DIG, CBI on 21.7.1992. The CBI informed that on 25.6.1992, the CBI officers had visited the house of Shri R.S. Jhalani, father-in-law of Shri Mohan Khandelwal at C-II/32 S.D.A., New Delhi after receiving telephonic information that some persons posing as CBI officers had visited them. They were informed that Smt. Rashmi Khandelwal alongwith her mother had visited SBI, Friends Colony and PNB, Parliament Street, New Delhi to take out some jewellery for valuation. On their way back she stopped at the office of M/s. Growmore Company at Barakhamba Road, New Delhi, leaving her mother incharge of the jewellery. In the meanwhile Shri Nathan, driver of the car made an abortive bid to run away with the jewellery. The CBI team which had gone to verify the information regarding impersonation of CBI officials returned and the jewellery was not seized by them as according to them there was no indication that jewellery belonged to HSM. They also could not inform about the precise quantity of gold/diamond which were contained in the bags.

17.139 Since the content of the petition of Shri Ramesh Gupta was not in confirmity with the version given by the CBI to the CBDT, direct enquiry was made by CBDT's Investigation Wing in Delhi. In a statement recorded on 21.7.1992 by the Income-tax Authorities, Smt. Rashmi Khandelwal stated that the jewellery found in their possession belonged to her and members of the family only. She also stated that CBI after examining the jewellery and valuation report, were satisfied about the ownership and released the jewellery. In this regard, the CBI had questioned them verbally only and no panchnama was drawn up. As per the latest valuation of the jewellery it was stated by Mrs. Khandelwal that the jewellery in question was worth Rs. 20,70,211.

17.140 The CBDT also informed the Committee that since the jewellery found by the CBI on 25.6.1992 had already been returned by them to Smt. Khandelwal and the Income-tax Department had not been contacted by them before the return of the jewellery as far as the income-tax was concerned the primary and basic evidence had been lost to them. It had, therefore, to rely on the statement made by Smt. Khandelwal for determining her and other family member's income-tax and wealth-tax liability and no action was taken u/s 132 of the I.T. Act (*i.e.* search & seizure) in respect of Shri & Smt. Khandelwal.

17.141 To avoid further recurrence of such type of situation the CBDT requested the CBI to coordinate in future with the Income-tax Department regarding seizure and release of valuable assets by the CBI authorities and also to intimate them when they find unaccounted valuable assets before such assets are returned to the custody of the owner. The CBI *vide* their letter dated 8 February, 1993 intimated that necessary instruction as suggested by CBDT had been issued to all the branches of the CBI. **This is yet another incident of lack of coordination between the investigative agencies which has come to the notice of the Committee.**

17.142 From the preceeding paragraphs it can be seen that the investigation of the Scam related cases by the CBI, CBDT and Enforcement Directorate had been handicapped greatly due to a lack of effective coordination and unison of purpose. The instances of Enforcement Directorate being unable to take any action or prevent Shri Niranjan Shah from leaving the country after the Income-tax authorities raided him on 30th & 31st May, 1992 as the information in this regard reached them only on 2nd June, 1992. The failure of the CBI to take up action on the basis of information furnished by CBDT and the delay in setting up of Coordination Committee of the three agencies clearly bring out the failure of three investigating agencies to ensure coordinated action in Scam related cases despite serious concern expressed in this regard at various levels. The Committee can not but express their dissatisfaction at this sad state of affairs. The Committee hope that the three agencies would at least now ensure greater coordination and prompt and effective investigation into the Scam cases.

CHAPTER-XVIII

OTHER ISSUES

18.1 The Committee having examined, in varying detail and depth various other issues, find that some do not conveniently fall under any of the specified Chapters. That is why the Committee have found it necessary to identify the following issues for the consideration under this Chapter :

(a) Alleged payment of Rupees One crore by HSM

(b) End-use of monies;

(c) Coupon rate hike;

(d) Violations of FERA;

(e) Amnesty Scheme;

(f) Transaction with Gold Star Steel and Alloys Ltd.;

(g) Role of Industrial Houses.

(a) Alleged Payment of Rupees one crore by H.S.M.

18.2 On 16th June, 1993, Shri Harshad Mehta held a press conference in Bombay and alleged that he had met the Prime Minister Shri P.V. Narasimha Rao at 10.45 a.m. on 4 November,1991 at his Race Course residence alongwith his brother Shri Ashwin Mehta, late Satpal Mittal and his son Shri Sunil Mittal and handed over a suitcase containing Rs. 67 lakhs to the Prime Minister who in turn instructed that it should be retained in the charge of Shri R.K. Khandekar, Officer on Special Duty. Further, the balance amount of Rs. 33 lakhs was paid on the next day. Shri Harshad Mehta also stated that the mechanics of stock markets was explained to the Prime Minister. The details of these payments, withdrawals and the journey to the PM's residence have all been mentioned in the affidavit. Shri Harshad Mehta had also clarified that these withdrawals were made to enable him to make a political donation of Rs.1 crore for the forthcoming election of the PM for the Parliamentary seat of Nandyal.

18.3 In his deposition before the Committee on 12.11.1992 HSM, in reply to a question stated as follows :

> "Never have I got any favour even from a single politician and nor have I paid any politician."

18.4 With relation to the charge that he had bribed the public servants to secure favours, Shri Harshad Mehta in his additional submissions dated 19th April, 1993 before the Committee stated:

> "I have not secured any favours from public servants but conducted my business on merit. The allegations are totally baseless."

18.5 HSM was summoned by the Committee again on 30.6.1993. During evidence when his attention was drawn to the inherent contradictions between what he had deposed before the Committee earlier and that given in the press conference he stated that he had been 'discrete' about the information given by him to the Committee.

18.6 When asked further as to what credence could be given to his statements he stated:

> "You will appreciate that if I were to make a statement in November without having any back-up or evidence and be ready for anything, then what would have happened to me."

18.7 In response to a query as to whether he had paid money to any other politician, he stated :

> "Yes".

18.8 Asked further, whether he would be able to name them, the witness said :

> "I will be able to give the names once I am ready with the evidence for it. I do not want to make allegation or disclose when I am unable to substantiate it. I am not in a position to substantiate the allegations today in other politicians' case and unless I get immunity against political persecution I will not be able to name."

18.9 Further elaborating on this the witness stated:

> "After naming the Prime Minister and even after giving substantiating evidence I am facing so much harassment. I just do not know what I may have to face when I reveal other names before collecting substantiating proofs. I am definitely looking for immunity. If it is not provided I will not disclose any names or give information unless I am able to substantiate my claim".

18.10 When asked as to what sort of immunity he was seeking, he stated:

> "Immunity from various unjust investigations that are going on one particular path to chase me".

18.11 The affidavit released alongwith his press release on 16 June, 1993 was in fact not prepare by Shri Mehta on 24 February 1993. When asked as to why he went to the press so late and what happened in between 24 February and 16 June the witness stated :

> "I was expecting immunity from CBI or the other higher authorities".

18.12 About the reasons for making the affidavit on 24th February he informed the Committee:

> "In January, Mr.Mohan Khandelwal (one of his associates) gave this information that he had talked (about it) to Mr. S.K. Datta (the then, Director, CBI) and that cleared the picture about why and what is being done to me. How I am being followed, how I am being singled out. I do not want to be just one another case where keeping this information with me was a threat to my life."

18.13 On being queried as to how the payment was arranged by him, the witness stated:

> "Friday afternoon I knew about the requirement of Rs. one crore. In the affidavit also I have mentioned that. I talked to Mr. Mohan Khandelwal. He said he would tell me the next day what exactly he could do. Next day he said that this huge amount of cash was just impossible to be arranged. So, he said better I should bring it from Bombay/or make arrangement at New Delhi itself. Next day was Saturday and hardly any time was left. So, to avoid cancellation of appointment at 10.45, we were to be ready with cheques to SBI

Main Branch. We thought that as much money as we wanted would be available in the SBI Main Branch. One cheque was written for Rs. 80 lakhs because we were having enough cash balance but the SBI said that they had only Rs. 30 lakhs of cash and that if I wanted more cash, I would have to take ten rupee and 20 rupee notes. That would have become very bulky. Then we checked with Grindlays Bank and they mentioned that they were having only Rs.40 lakhs. If we had gone through the route of transfer of funds to Delhi, then the money would not have been available to me on Monday at 9 O'clock because the bank opens at 10 O'clock. Secondly, if the main branch of the biggest bank in the country was holding only Rs. 30 lakhs cash, to rely on any foreign bank here to arrange Rs. 85 lakhs or Rs. 80 lakhs would have been extremely difficult and we were not wanting to take any change."

18.14 When asked further as to how he could carry such a huge amount of money in a flight of Indian Airlines unnoticed and was not the presence of such heavy cash objected to by the security people at the airport the witness informed the Committee:

> "Nobody asked about that. Sir, I think an impression has been created that it is illegal to carry money in aircraft. It is not so. I was having proof regarding the withdrawal of the money from the bank. So there was no problem to carry the money."

18.15 When asked as to who had conveyed him the message regarding payment of this amount to the Prime Minister, Shri Mehta stated:

> "It was conveyed to me by Shri Sunil Mittal that, was the opportunity when the bye-elections were there. He told me, if you want to make a political donation then this is the time when I can fix it up."

18.16 In reply to a question as to why an Income-tax raid was conducted at his premises in February, 1992 when he had paid money to the Prime Minister in November, 1991 and did he not utilise his political connection to get help, H.S.M. stated:

> "I made all efforts to call Shri Mittal and Shri Khandekar."

18.17 As regards the reaction of Shri Khandekar in this regard, he stated:

> "Shri Khandekar's reaction was that I should meet Shri Sunil Mittal who will take me to Shri Thakur."

18.18 In order to further substantiate his allegation Shri Mehta informed the Committee that it was during the early part of January, 1992 when he alongwith his couple of sub-brokers was facing some problems in BSE that he utilised the political patronage of the Prime Minister.

18.19 In order to get over the problems being faced in BSE he requested Shri Sunil Mittal to do something in this regard. He was informed by Shri Sunil Mittal that he had spoken to Shri R.K. Khandekar, OSD to the Prime Minister who had in turn spoken to Shri Dalbir Singh the then Minister of State for Finance. Consequently, instructions had gone to Shri Kamal Pande, Chief Controller of Capital Issues and from him to Shri Paul Joseph, Joint Director (Stock Exchanges), MOF who is on the Board of BSE. The result was that Shri Joseph was the only member on the Board of BSE who at the meeting of the Board on 11.1.1992 took strong objection to any action that was contemplated by the Governing Body against some brokers and thus they were let off leniently.

18.20 "From the evidence tendered before the Committee, it was apparent that HSM was trying to mislead the Committee. 'As prevaricating, giving false evidence or wilfully

suppressing truth or persistently misleading a Committee' are *inter-alia* **treated as constituting contempt of the House and therefore a breach of privilege. As decided by the Committee the matter was referred to the Speaker for considering the question of breach of privilege against HSM.**

18.21 In view of the facts emerging out of Shri Mehta's deposition of 30th June, 1993 interrogatories were sent to the following 16 agencies/individuals:

1. PMO
2. Department of Economic Affairs
3. Cabinet Secretariat
4. CBI
5. MTNL - Bombay and Delhi
6. Ministry of External Affairs
7. Delhi Police
8. Shri R.K. Khandekar, OSD to PM
9. Shri Sunil Mittal
10. Shri Mohan Khandelwal
11. Shri Manmohan Sharma
12. Shri Dalbir Singh, M.P., the then Minister of State for Finance.
13. Shri Kamal Pande, the then CCI
14. Shri Paul Joseph, Joint Director, MOF
15. Shri M.R. Mayya, President, BSE
16. Shri Ashwin S. Mehta

18.22 The record of Prime Minister's Reception Office, SPG, Delhi Police, etc. were also summoned by the Joint Committee.

18.23 The replies from the Prime Minister's Office and P.M. House reveal the following points:

i) No visitor's registers are maintained at PM house and only the daily reception record is maintained. The visitors pass does not have any counterfoil. The daily reception record and visitors pass form part of the P.M. House Reception Access Control Record which are destroyed after 15 days as per the orders of SPG. Similarly, the visitors pass in PMO does not have any counterfoil and the surrendered visitors passes are destroyed after a week as per the instruction contained in the Central Secretariat Security Instructions 1976.

ii) About furnishing the appointment register of 4th November, 1991 in respect of the PM's appointment at his residence on that day it has been stated there are no rules governing maintenance of a diary for the Prime Minister's daily engagements. However, his personal, staff maintain diary/diaries which are destroyed at the year end.

18.24 The wireless log books of Delhi Police submitted by the Ministry of Home Affairs as also the log books of SPG reveal that the Prime Minister started from his residence at Race Course Road at 0910 hours and reached Rashtrapati Bhawan at 0914 hrs. He left Rashtrapati Bhawan at 0935 hrs. and reached his office in South Block at 0955 hrs. The Prime Minister thereafter attended the meeting of the Cabinet Committee on Political Affairs.

18.25 The Cabinet Secretariat have verified from the Minutes of the CCPA meeting that the meeting started at 1000 hours. It is not however, the normal practice to record the time of conclusion of these meetings. However according to them this is possible to ascertain from the "movement records supplied by the Commissioner of Police, Delhi which records the movement of the Home Minister. These records indicate that the Home Minister who attended the CCPA on 4.11.91, are monitored by Delhi Police, arrived at South Block Office at 1008 hrs. and left for North Block office at 1114 hrs. and reached North Block office at 1117 hrs. It would be observed from the above that the CCPA meeting, which started at 1000 hrs. would have concluded a little while prior to the time HM left South Block for his office in North Block."

18.26 It had also been stated in a press report that the Prime Minister had thereafter met a Pakistani delegation from 11 o'clock onwards. The Ministry of External Affairs confirmed that a Pakistani delegation had visited India and according to the communication received from the Indian organiser of their programme, Shri O.P. Shah, the meeting between the Prime Minister and the Pakistani delegation took place at 11.00 AM on November 4, 1991.

18.27 The Log Books of Delhi Police and SPG also reveal that the Prime Minister started from his office for his Race Course residence at 1309 hrs. and arrived there at 13.14 hrs.

18.28 In so far as Shri Mohan Khandelwal's knowledge about the meeting of Shri Mehta with the Prime Minister on 4th November is concerned, he had stated that he had met the Mehta brothers and was with them in the Hotel Holiday Inn in New Delhi on 3rd November, 1991 until mid-night and had also met them in their Delhi office on 4th November, 1991. He did not have any knowledge about the alleged payments which Shri Mehta claims to have made.

18.29 Another related witness to this issue, Shri Manmohan Sharma has stated that he did not accompany late Satpal Mittal to Prime Minister's house on 4th November, 1991 nor had he any knowledge of any such visit by late Satpal Mittal. Asked about his whereabouts on that day he had stated that after this long passage of time it was difficult to say what exactly he was doing, but he could recollect that he was at Ludhiana, at his residence with his parents and other family members on the eve of Diwali which was the usual practice in his family.

18.30 Another witness to the entire episode Shri Sunil Mittal has informed the Committee that he had never taken Shri Harshad Mehta to the Prime Minister or for that matter to any other Minister. Similarly, Shri R.K. Khandekar, OSD to the Prime Minister has stated that "the allegations made, in whatever form by Shri Harshad Mehta and Shri Ashwin Mehta about the reported incident of 4th November, 1991 are false and untrue."

18.31 In regard to the allegation made by Shri Mehta about the political intervention when he was facing problem in BSE the following points have emerged from the analysis of the replies received from the concerned persons in response to the interrogatories sent:

(1) Shri Dalbir Singh, MP the then Minister of State for Finance has denied about Shri Khandekar having spoken to him about the problems being faced by Shri Mehta and/or his associate brokers. Similarly he has also denied having given any instructions in this regard to Shri Kamal Pande, the then Controller of Capital Issues.

(2) Shri Kamal Pande, the then CCI has also stated that he did not at any stage receive any instructions to intervene in the matter orally or in writing from Shri Khandekar or Shri Dalbir Singh. He also denied having received any request in this regard from late Satpal Mittal.

In response to the query as to whether he had asked Shri Paul Joseph, the Government nominee on BSE Board to attend this meeting or briefed him about a particular course of action to be taken, he had informed the Committee that he did not give any instructions to Shri Joseph either orally or in writing to attend the BSE Board meeting of 11 January, 1992. Also that there was no practice of briefing nominee officers before a meeting.

(3) The Department of Economic Affairs, MOF has also informed the Committee that no note was recorded by the Ministry regarding the stand to be taken by Shri Joseph in the aforesaid Board meeting.

(4) Shri Paul Joseph, Joint Director (Stock Exchange) has been the Government nominee on the Board of BSE since August, 1983. About the query as to when he decided to go to Bombay to attend this BSE Board meeting, he has informed the Committee that he had got his tour programme proposed on 7th January, 1992. To the query as to whether he was aware of the import of the meeting before leaving Delhi, he informed the Committee that he was unaware of the items to be discussed in the said meeting. The items which came up for discussion were normal items and there was no particular import as far as this meeting was concerned. About his having obtained any written or verbal instructions from anybody about the stand to be taken as a Government nominee, he had stated that no such instructions were received from anyone in this regard. He has further stated that in fact the agenda notes for the meeting were received by him only on 11th January, 1992 in Bombay.

Another important fact that Shri Joseph has submitted before the Committee is that the questions relating to the disciplinary action to be taken against the associate brokers of Shri Mehta was not an item on the Agenda of the Board meeting held on 11 January, 1992. In fact, the Disciplinary Action Committee in its meeting held on 10th January, 1992 had decided to impose penalties against these brokers. The penalties were later actually imposed by BSE. No discussion took place in this regard in the Board meeting. Therefore, the question of his objecting to the disciplinary action against some brokers does not arise.

All the facts mentioned in the submissions to Shri Joseph also stand corroborated from the replies to the interrogatories furnished by the Chairman, BSE.

18.32 In their deposition before the Committee on 12 October, 1993, on a specific query regarding the action taken by CBI on the affidavit of Shri Harshad Mehta and the letter written by his counsel, the witness from CBI stated:

> "There is no complaint as contemplated under Section 154 Cr. P.C. in writing or orally. The affidavit has not been verified as required under Section 297 Cr. P.C. Cognizable offence under Section 7 of the Prevention of Corruption Act is not made out."

He further stated:

> "Though this is not a statement made by the accused before us, its validity without any corroboration is available under Section 33 of the Indian Evidence Act."

18.33 On the question whether the matter should be investigated under Section 154 of Cr.P.C. the witness stated:

> "The CBI had no affidavit signed by anybody about it and according to 154 Cr. P.C. no case can be registered or investigated, unless the informant either orally or in writing gives a complaint."

18.34 When the CBI was asked as to why they had not asked for an oral or written a complaint, the witness stated:

> "The affidavit as it stands does not make a cognizable offence. Therefore, the question registering a case and inquiring further in the light of various sections which my colleagues have read out to you after a great deal of study, just does not arise."

> "We have examined and we are not in a position to register the case because the complaint does not disclose an offence."

18.35 The CBI informed the Committee that the conclusions drawn have been through investigation and after verification through their own sources.

(b) End - Use of Monies

18.36 The Committee were seized of the aspect of the end use of monies from the very beginning. It appreciated that should the movement of monies, whether from banks or PSUs, through brokers, be traced to the end user than the entire inter-connected ramifications of the Scam would be revealed. In pursuance of this the Committee examined in detail voluminous bank transactions of various brokers and some of the banks. The Committee also sought cooperation and assistance of the CBI and the RBI in this regard. It advised the CBDT also to undertake a similar exercise. The Committee regret that it has not been possible to complete this task to their own satisfaction.

18.37 The tracing of monies to their final destination, particularly when large sums are involved and when intricate mechanisms have been employed to cloak transactions, is the task of a team comprising of specialists in the field of accountancy, taxation and criminal investigation. The Committee had no such expertise and were not equipped for this purpose. They had hoped that the other investigating agencies of the Government would be able to at least partially complete this task before the Committee finalised their report and share this information with the Committee. However, that has not become possible. The Committee, therefore, recommend that such a team be constituted under the overall coordinating responsibility of the MOF and with due and proper representation of such other agencies as it may deem fit, the task of identifying the end-use of monies be entrusted to this Committee it may be directed to report within six months of appointment and the report also be presented to Parliament.

(c) Coupon Rate Hike

18.38 For the borrowings of the Government, through bond issues and such other instruments the rate of interest payable is specified by the Government at the time of issue of the paper. Taking into account an evolving economic situation it then becomes necessary to revise the interest payable on Government's borrowings. An immediate impact of any hike in coupon rate is the instant depreciation of all earlier issues. Thus if knowledge of this rate becomes available to any party or parties before the actual date of revision then not only is confidentiality not maintained but unwarranted speculation in Government paper is

caused. The holder of one kind of security with lower interest for instance would switch to another kind with a higher rate of return. It is in this light that the revision of coupon rates by the Government on two separate dates in September, 1991 and in March, 1992 was looked into by the Committee.

18.39 The Committee addressed itself to just two aspects of it whether confidentiality of the increase of rates was maintained and secondly, if it was not, did any banks, brokers, parties or individuals make any wrongful gain as a consequence of this fore-knowledge.

18.40 Through its own enquiries and the special inspections conducted by RBI, the Committee have reasons to suspect that atleast some people had prior knowledge of these hikes. The Committee therefore suggest that the CBI should investigate this matter further. The MOF should follow it up vigorously.

(d) Violation of FERA

18.41 Considering the amounts involved taking into account inward remittances of monies as received by some of the players in the matter of securities and banking transactions, and having examined other evidence placed before them, the Committee are of the view that the violation of FERA has taken place. In this respect the Committee find that apart from the information that they received from the Enforcement Directorate and CBI they had no other agency to conduct independent investigations. Considering also the limitations of procedures and other aspects that were pointed out by both the CBI and Enforcement Directorate there is need for the MOF to address itself to examine these violations in details.

(e) Amnesty Scheme

18.42 In order to tide over the balance of payments crises the Government enacted the Foreign Exchange & Investment in Foreign Exchange Bonds Act, 1991 on 18.9.1991. Under the scheme the recipient was exempt from disclosing the source of funds, and any investigation/enquiry. Moreover, the funds received were also exempt from Income Tax, Wealth Tax, Gift Tax and also capital gain tax. There are reasons to apprehend that the Amnesty scheme was used for the purpose of bringing monies to operate in the country's securities market.

(f) Transaction with Gold Star Steel and Alloys Limited

18.43 The Committee examined the transaction of Rs. 2 crores advanced by Shri Hiten P. Dalal through ABFSL to GSAL. In the Fourth Report of the Janakiraman Committee, submitted in March, 1993, this transaction was first brought to light. Thereafter the issue was also raised in Parliament. The Speaker was pleased to observe that the matter would be looked into by the Joint Committee. The CBI was aware of this transaction as early as August, 1992 but it did not then share this information with the Committee.

18.44 GSAL is a public limited company with its registered office at Hyderabad. Shri N. Krishna Mohan is the Managing Director of the Company.

18.45 During April, 1992 HPD paid to ABFSL an amount of Rs. 2 crores out of his account with Andhra Bank, Bombay. This amount was paid by ABFSL by two cheques drawn in favour of GSAL on 21.4.92 and 28.4.92. Each of these cheques was for Rs. 1 crore. In a copy of the letter provided to the Committee written by Shri Krishna Mohan to ABFSL on 17 April, 1992 has advised ABFSL to send the payment to GSAL in instalments of Rs.1 crore each. This letter is not signed as M.D. of GSAL. The witness, the Managing Director of the

Company, stated before the Committee that he had taken this 'loan' in his personal capacity. GSAL had opened its Rights Issue on 27th March, 1992. This issue was to close after a month. The response to the issue was not encouraging and in the words of the witness:

> "As a matter of abundant caution I made this arrangement of Rs. 2 crores."

18.46 The closing date of the Rights Issue was also extended till 11th May, 1992.

18.47 The witness said that since he needed money he asked Shri Shasi Kant, Vice-President, GSAL, to contact various financial institutions for a loan. Canfina expressed its inability, but ABFSL agreed to explore the possibility of arranging such a loan. ABFSL was finally able to arrange this money from Shri Hiten Dalal, through its Bombay office. Shri Hiten Dalal was informed that the money was needed by a promoter of GSAL for the Rights Issue. Shri Dalal agreed to give this money without insisting on any documentation or security bearing an interest of 23% interest per annum. In turn ABFSL provided this money after adding 1% as commission.

18.48 The witness informed the Committee that the terms and conditions of the "loan" were settled through two letters that he wrote to ABFSL on the 15th and 17th of April, 1992. As security for this "loan" he deposited with ABFSL 13.5 lakh shares of Goldstar Group of companies amounting at that time to around Rs. 4 crores. The witness also stated that he was not aware of party at the other end from whom ABFSL was getting this money. In support of his contention that it was a personal loan, he has submitted to the Committee, apart from the two letters dated 15th and 17th April addressed to ABFSL, copies of vouchers of GSAL dated 21.4.92 and 28.4.92 stating that the amounts of Rs. 1 crore each were received towards "promoter's contribution credit-share application money-pending allotment". In the Special Audit Report dated 11.3.93 prepared by the Chartered Accountants, at the request of the Managing Director at short notice it has been submitted:

> "It appears that the loan was organised by Shri Krishna Mohan from ABFSL on behalf of himself and co-promoters to meet the expected commitment towards their contribution for the Rights Issue."

18.49 An Audit Sub-Committee of the Board of GSAL which met 12.3.93 "at short notice" and recorded as follows:

> "It was concluded that it is a transaction purely between Shri Krishna Mohan and ABFSL and neither Shri P.V. Prabhakara Rao nor GSAL has anything to do with the transaction directly or indirectly."

18.50 The Board of GSAL in its meeting held later on the same day "was of the opinion that on the basis of information presently available, the facts seemed to establish that this was a transaction purely between ABFSL and Shri Krishna Mohan in which the latter in his personal capacity had taken a loan from ABFSL" and that it was not a loan transaction between ABFSL and GSAL".

18.51 The Committee after examining the evidence on record observe as follows:

1. **The cheques received from HPD were treated as sundry suspense account in ABFSL.**

2. **The original copies of the letters of Shri Krishna Mohan dated the 15th and 17th of April, 1992 are not available with ABFSL. Copies of these letters were subsequently supplied to ABFSL and other authorities by Shri Shasi Kant of GSAL.**

3. There was no application in writing for this loan from Shri Krishna Mohan. The negotiations, if any, were conducted orally.

4. This is the only case of such a "loan" by Shri Dalal and one of the two on the part of ABFSL, the other being a "loan" of Rs. 81 lakhs to Solidaire.

5. There is no loan agreement between ABFSL and Shri Krishna Mohan for this transaction. From the locker of the Andhra Bank, which was opened on 14.9.92, among the documents recovered was a draft Tripartite Agreement in pencil and partly in pen indicating that the agreement was to be entered into on 21.4.92 between HPD and M/s Goldstar for arranging a loan of Rs. 2 crores to GSAL at the interest of 23% against pledge of 13.5 lakhs Goldstar Cement Ltd and other shares envisaging ABFSL as a trustee who shall hold the share certificates and transfer deeds on trust for Shri Dalal until the credit is repaid by GSAL. In this draft agreement there is no mention of Shri Krishna Mohan nor is there any indication that Shri Krishna Mohan was taking this loan in his personal capacity.

6. ABFSL does not appear to have issued any receipt nor does Shri Krishna Mohan appear to have insisted on the issue of such a receipt for the shares of Goldstar Cement that it received as collateral from Shri Krishna Mohan.

7. The witness informed the Committee that the money was taken in two instalments of Rs. 1 crore each, to minimise the interest burden. He and his associate finance companies appear to have received the refund orders from GSAL for a total amount of Rs. 2,20,14,790.00 on 23 July, 1992. Repayment to ABFSL, however, was made only on 3rd and 19th October, 1992.

8. Both Cheques from ABFSL of Rs. 1 crore each were collected personally by Shri Shasi Kant of GSAL and deposited in the current account of GSAL though GSAL had a separate account styled "Goldstar Rights Allotment Money Account" in the same branch of SBI. When asked to clarify, Shri Krishna Mohan said that "Basically it has gone to Rights Issue account like any other account. The entire money has gone to rights issue account subsequently."

9. According to the vouchers prepared by GSAL these amounts were recorded as "promoter's contribution credit – share application money — pending allotment but the entire amount was spent for other purposes well before the rights issue was closed. In fact, the first cheque of Rs. 1 crore was credited into the account of GSAL on 24.4.92 when the balance in this account was only around Rs. 3 lakhs and the entire amount was spent in making payments to various parties bringing the balance in this account on 29.4.92 to only Rs. 1947/-. Similarly, the second cheque of Rs. 1 crore was credited to the current account of GSAL on 5.5.92 and the amount was utilised to make payments to various parties.

10. The witness has claimed that all contributions from the promoters towards their share of the Rights issue were deposited in this current account of the company. The witness has also claimed that "all such proceeds have been utilised for the project payments, which is an accepted practice by companies making Rights Issues". This, however, is not in consonance with the guidelines of Controller of Capital Issues issued on 14.1.92 as well as the Consent Order issued on 26.5.92 by the Office of the Controller of Capital Issues specify:

> "Subscription received against Rights Issue will be kept in specific bank accounts and company would not have access to such funds unless they

have received an approval from the concerned regional Stock Exchanges for allotment."

11. Karvy Consultants who were the Registrars to the issue have stated that the applications in question were not routed through them and have also expressed doubts about the genuineness of the application forms. They have also informed the CBI that refund orders were issued by them pertaining to the Rights Issue in August-September, 1992 and unused blank refund orders were returned to the Company only in October, 1992. How then the refund of the amount of Rs. 2,20,14,790.00 made to Shri Krishna Mohan and his two associate finance companies on 23.7.92 remains a mystery. The Refund Orders Account maintained with the SBI, Industrial Finance Branch, Hyderabad is overdrawn and reconciliation has not taken place till date.

18.52 During the course of the enquiry the Committee found various discrepancies/ contradictions in the statements made by various witnesses. For example, HPD in his deposition maintained that he was informed about the requirement of funds by the Bombay office of ABFSL in the third week of April, 1992, Shri Sundera Babu, ex-Managing Director of ABFSL in his evidence asserted that the actual transactions was "finalised" much earlier.

18.53 The present Managing Director of ABFSL Shri C.V. Siva Prasad stated before the Committee that on 1st or 2nd October,1992 when Shri C. Shasi Kant had called on him to make the payment in discharge of the debt obligation, he was told by Shri Siva Prasad that there were no papers on record pertaining to the transaction with ABFSL and to show whether any such papers had been given by them. Later, the carbon copies of the two letters dated 15th and 17th April were submitted by Shri Shasi Kant to him. While the first letter gave details of the loan arranged, the second letter authorised ABFSL to make payment direct to GSAL. This statement of ABFSL was contradicted by Shri Krishna Mohan during the course of evidence when he stated that the CVO Shri Kamath of ABFSL had approached them and obtained the copies of those letters in September, 1992.

18.54 It was claimed by Shri Sundera Babu that he obtained the copies of the 15th and 17th April letter from ABFSL office in Oct., 1992. Shri Siva Prasad, the present Managing Director denied it before the Committee and stated that neither did Shri Sunder Babu ask for the copies of the letters nor were they supplied by ABFSL to him.

18.55 Further, while HPD maintained that he knew about the identity of the borrower only later, Shri Kalyanaraman of ABFSL who had negotiated the loan with HPD deposed before the Committee that he had conveyed to HPD that the advance was required by one of the promoters for the Rights Issue of GSAL and that ABFSL in turn will be holding the shares of the Goldstar group of companies.

18.56 The contradictory statements made by the various witnesses before the Committee, the curious manner in which the whole transaction was dealt with in ABFSL, the ease with which Shri Dalal agreed to lend this money without any documentation to a promoter of Goldstar through ABFSL, the alacrity with which the Audit Sub-Committee of the Board of GSAL & the Board itself on the basis of an audit report prepared at short notice has given a clean chit to GSAL and Shri P.V. Prabhakara Rao, the manner in which the monies received were spent in clear violation of the instructions of the Controller of Capital Issues, the speed with which refund orders were issued to Shri Krishna Mohan his two associate finance companies on 23.7.92 the day on which the Hyderabad Stock Exchange gave its approval to the allotment of the Rights shares indicate the dubious nature of this transaction. Though the CBI perhaps came to know about this transaction on 20th August, 1992 and on the basis of information collected the Hyderabad Branch of CBI sent a proposal to CBI Head Office on 27.11.92 for registration of this case and a formal

complaint was given to CBI on 14.12.92 by ABFSL, the CBI registered a PE only on 12 March, 1993 when the matter had been raised in both Houses of Parliament after the publication of the Fourth Report of the Janakiraman Committee. The CBI has also expressed their inability to share with the Committee the Source Information Report and the notes recorded by the various officers in the CBI which may explain this delay on the ground that the internal functioning of the CBI cannot be disclosed to the Committee.

18.57 At the instance of the Committee SEBI conducted an enquiry into this matter. A copy of the report of SEBI was received by the Committee from the M.O.F on 9.7.93, which brought out many disturbing facts. SEBI's Report can be seen at *Appendix XLVI*. In their report SEBI have concluded that the enquiries conducted so far justify an inspection of the company's records and books of account and u/s 209A of the Companies Act to verify the application monies received from the promoters, the allotment made and the refund due to them.

18.58 Considering the nature of this case and the complexity of the transactions, the Committee recommend that the matter should be enquired thoroughly by a joint team consisting of CBI, CBDT, SEBI, Department of Company Affairs and RBI.

(g) Role of Industrial Houses

18.59 The Committee have come across various instances of close nexus between prominent industrial houses, banks and brokers. It has come across evidence of banks operating for industrial houses. It has provided several such instances in Chapter on RBI. Particularly noteworthy in this respect are the activities of Vijaya Bank with Reliance Industries Ltd. (RIL) and United Breweries Group. In case of RIL the bank sanctioned sales bills discounting limits to 14 corporate borrowers, front companies of RIL aggregating Rs. 69.35 crores. Similarly it had sanctioned purchase bill discounting limits to 16 borrowers aggregating Rs. 27.05 crore. In case of UB group drawee bills worth Rs. 300 lakhs 'representing the price difference realisable by the drawer' drawn by M/s. McDowell and Co. Ltd. were discounted.

18.60 Similar irregular facilities were afforded by Karnataka Bank to UB group and Fairgrowth Financial Services Ltd. (FFSL). As on 31 Oct., 1991 Mc Dowell and Co., a company of UB Group had an outstanding of Rs. 693.08 lakhs on bill discounting facilities provided by the bank. FFSL was allowed operating limits on the basis of *ad hoc* limits sanctioned prior to 9 May, 1991 and without taking into account the large variations in the performance indicators.

18.61 American Express Bank has like-wise gone out of way to finance RIL. In one instance it sanctioned sales bills discounting limits to RIL for supplies made by them to the dealers outside consortium arrangements, 35 dealers were sanctioned limits aggregating Rs. 40.05 crore without taking into account their networth, sales and working capital requirements. It also provided sales bill-discounting facilities to 16 investment companies of RIL with uniform limits of Rs. 450 lakhs each (except in one case).

18.62 Just as banks had perferred brokers so did industrial houses have brokers operating especially for them. An example is that of Oman International Bank — ONGC case enumerated in the Chapter on PSUs, wherein a sum of Rs. 50 crores was managed by the inhouse brokers of RIL, from ONGC, deposited with Oman International Bank and then used for speculative purposes.

RAM NIWAS MIRDHA
Chairman,
Joint Committee to enquire into Irregularities in Securities and Banking Transactions.

NEW DELHI
December 11, 1993
Kartika 20, 1915 (Saka)

OBSERVATIONS/CONCLUSIONS/ RECOMMENDATIONS

Sl. No.	Para No.	Observations/Conclusions/Recommendations
1	2	3

SCAM — AN OVERVIEW

1	2.7	The scam is basically a deliberate and criminal misuse of public funds through various types of securities transactions with the aim of illegally siphoning of funds of banks and PSUs to select brokers for speculative returns. The latest irregularities in the securities and banking transactions, are manifestations of this chronic disorder since they involved not only the Banks but also the stock market, financial institutions, public sector undertakings, the central bank of the country and even the Ministry of Finance, other economic ministries in varying degrees. The most unfortunate aspect has been the emergence of a culture of non-accountability which permeated all sections of the Government and Banking system over the years. The state of the country's system of governance, the persistence of non-adherence to rules, regulations and guidelines, the alarming decay over time in the banking systems has been fully exposed. These grave and numerous irregularities persisted for so long that eventually it was not the observance of regulations but their breach that came to be regarded and defended as "market practice". Through all these years the ability of the concerned authorities to effectively address themselves to the problems has been tested and found wanting. The consequence of these irregularities in securities and banking transactions are both financial and moral. During the period from July, 1991 to May, 1992 the most glaring proof of the nexus between the irregularities in banks and the overheating of stock market which came to light is explained by the graphic representations of the BSE index and the fact that there was a sharp increase in securities transactions during the corresponding period of the banks involved in serious irregularities related with the Scam. What is more apparent is the systematic and deliberate abuse of the system by certain unscrupulous elements. It is abundantly clear that the scam was the result of failure to check irregularities in the banking system and also liberalisation without adequate safeguards. There is also some evidence of collusion of big industrial houses playing an important role. It is because of these elements that the economy of the country had to suffer and while some gained, thousands of crores millions of investors lost their savings. The criminality of the perpetrators of the scam becomes all the more despicable as it was during this period that the country was passing through most trying times, economically and financially. An observation that the Committee has been constrained to make at a number of places in the succeeding Chapters is that for all these not many have yet been identified and effectively punished.

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2	2.8	It is the view of the Committee that there are several dimensions of this entire episode : The functional one concerns the banks, brokers, PSUs and ministries, etc. Here accountability was largely absent, punishment for a wrong committed was rare, an ethos of non-implementation prevailed all around. The second aspect about which the Committee express its grave concern is the supervisory role and responsibility. That supervision failed from top to bottom is both self-evident and is detailed in the report. What is extremely worrisome to the Committee, however, is an unhappy side effect. Amongst all the witnesses that appeared before the Committee, in all the many hours of evidence taken the Committee seldom came across an instance where responsibility for wrong was forthrightly accepted. Further, and more worrisomely, the Committee found that as of routine, through the entire apparatus of Governmental machinery, a very damaging approach seems to pervade, that of transferring responsibility downwards. This distressing lack of fibre in the apparatus of governance can only debilitate the state. This persuades the Committee to briefly comment upon the third dimension of this entire matter, which is moral. No system can work through regulations alone, of course, it cannot work if they be flouted; but much more than that, if a system be devoid of the moral quotient, of a common sense appreciation of right from wrong, of a sense of public duty particularly when entrusted with public funds, then it cannot work.
		IRREGULARITIES IN SECURITIES TRANSACTIONS — BANKS
3	4.5 & 4.13	In the course of investigation, the Committee found that most of the irregularities in securities transactions that took place in 1991 and 1992 had been indulged in by various banks even much earlier. Certain earlier inspection/scrutiny reports of RBI called by the Committee revealed various irregularities in securities transactions by various banks. It is thus evident that many of the irregularities in securities transactions that took place in 1991 and 1992 had been building up since the mid-80's, if not earlier, and could have been minimised if the authorities concerned had heeded to the early warning signals. The RBI issued several circulars, including the one in July, 1991, prohibiting these misdeeds and yet everything that was sought to be prevented in fact, accelerated and assumed uncontrolled dimensions.
4	4.15	A broad analysis of the information obtained by the Committee from various sources reveals that apart from a direct flow of funds to the stock market through sanction of authorised/unauthorised credit facilities to some brokers by some banks by way of overdraft and discounting of bills covering shares/debentures, there had been fraudulent manipulations of the "Investment Portfolio" in some banks (including their subsidiary financial companies) to divert the funds to certain brokers to fuel the unprecedented rise in share prices.
5	4.21	On the question of exposure there are varying figures. Janakiraman Committee speaks of this as Rs. 4024 crores where as Central Bureau of Investigation have assessed these at Rs. 8,383.31 crores on the basis of cases registered by them. In addition, the Committee examined the figure

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		provided by the office of the Custodian which assessed the amount on the basis of various claims and counter claims preferred by various aggrieved parties. This figure comes to Rs. 3650.60 crores.
6	4.22	The Committee are of the opinion that it is difficult to estimate the huge sums of money which were illegally utilised by various scamsters for their personal gains during this period because the monies were repaid and the transactions completed. The monies 'Lost' represent the deals which could not be completed because either the monies were swindled or BRs/SGL transfer forms held by bank are of doubtful value. Further, because of imperfect contracts/documents, it may not be possible to enforce the contract and recover the money.
7	4.23	The Committee did not independently attempt this exercise as three separate specialists bodies had already attempted it. The Committee are of the view that it is the duty of the Ministry of Finance to undertake this responsibility by either instituting a separate Committee for the purpose, or through the same Committee as has been specified in para 18.37
8	4.30	After examination of the type of transaction by the banks, the Committee regret to note that the banks had in blatant violation of the RBI guidelines relevant thereto entered into a large number of ready-forward/buy-back transactions and indulged in irregularities like misuse of BRs/SGLs/Bankers Cheques etc. A large number of the banks were found having flouted the RBI guidelines issued in 1987 and 1988 regarding entering into such deals. The most disturbing aspect is that top management of the banks concerned had miserably failed to implement the guidelines of RBI particularly the one issued on 11.4.1988 (Appendix XIII) which had emphasised that the top executives in banks should bestow their special attention to inter-bank buy-back arrangements to ensure that the guidelines on the subject were strictly complied with in letter and spirit and any deviations viewed seriously and accountability fixed at all levels. The top management of the RBI appears to have treated the blatant violations of its own guidelines prohibiting ready forward and buy back transaction issued over the years in 1987, 1988 and subsequently in 1991 with as much callousness as the top managements of the banks violating the guidelines.
9	4.31	The RBI in their circular dated 20 June 1992 (Appendix XIV) prohibited all new inter-bank ready forward deals in Government securities except in Treasury bills. Subsequently, however ready forward transactions have been permitted in specific Government securities. The Committee are of the view that continuance of Ready Forward transactions in their present form in government securities inclusive of PSU bonds and units of UTI is detrimental to the system.
10	4.32	The Committee are led to the conclusion that the BR system has been considerably misused. Every step should, therefore, be taken to prevent recurrence of such things in future. There is need for reforms of the BR system, for example, by way of reduction in the period of its validity and imposing of severe penalties for its misuse.

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11	4.33	The SGL form, can be compared to cheques whose bouncing is now a penal offence. Government may examine whether similar provisions can be made with regard to bouncing of SGL transfer forms, or any other suitable measures need to be taken to punish those who are responsible for the misuse of SGL transfer forms.

IRREGULARITIES IN SECURITIES TRANSACTIONS — PRIVATE/CO-OPERATIVE SECTOR BANKS

12	5.2	The RBI circular dated 26.7.1991 had, in fact, cautioned banks that they should be circumspect while acting as agents of their broker clients for carrying out transactions in securities, on behalf of brokers. Despite the RBI instructions, certain banks, continued to act on behalf of the brokers and certain others fell in line on a larger scale where the banks were used as "conduits" eventually resulting in jeopardising interests of the bank and its genuine investors.
13	5.22	The Committee are led to the conclusion that both Bank of Karad and the Metropolitan Co-operative Bank had allowed themselves to be used as conduits by the brokers in violation of all regulations, norms and practices over the years thus endangering the interests of the banks, their depositors and the share holders. It is also strange that the banks including foreign banks accepted BRs of huge amounts from these small sized banks. The serious irregularities indulged in by the banks eventually resulted in their liquidation. The Committee, therefore, recommend that the Board members and the principal executives should be prosecuted and suitably punished.
14	5.23	One fall out of the liquidation of these two banks is the sad plight of thousands of depositors and the employees. In this connection, the Committee note that the maximum amount of Rs. 30,000/- payable under the Deposit Insurance Scheme was fixed as far back as 1980. This limit has now been raised to Rs. 1 lakh per depositor w.e.f. 1.5.1993. However, it would be applicable only in respect of those insured banks taken into liquidation/ amalgamation etc. on or after 1.5.1993 and would not, therefore, be applicable to the depositors of both the banks under discussion. The Committee recommend that the proposals for taking over or merger of these banks with some existing banks should be considered expeditiously in a manner that will protect the interests of depositors and the employees.

IRREGULARITIES IN SECURITIES TRANSACTIONS — NON-BANKING FINANCIAL COMPANIES AND MUTUAL FUNDS

15	6.2	Scrutiny of security transactions in various banks has revealed that the non-banking subsidiaries of major public sector banks such as SBI Capital Markets Limited, Canbank Financial Services Limited, Andhra Bank Financial Services Limited, Allbank Finance Limited etc. indulged in irregular transactions and in imprudent investment of funds into the securities market under the Portfolio Management Scheme and in

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		unauthorised investments on the stock exchanges through brokers. Even though these companies were incorporated essentially for undertaking Merchant Banking and such other activities in a large measure they adopted portfolio management of temporary surplus funds of PSUs and other larger corporate clients of their parent banks. These subsidiary companies violated PMS guidelines of the RBI in various ways and almost as of routine. The funds so deployed became one of the principal sources for fuelling the stock market. Large volumes of unauthorised 'investment' transactions were undertaken by these NBFCs through reports, BRs etc. All these investment operations of public funds were not supervised adequately and there was absence of suitable policies for investment. The transactions also reveal nexus with select brokers through whom sizeable transactions were put through. In many cases brokerage was also not being paid, as the deals were at the instance of the brokers and for their benefit. These NBFCs had the advantage of the names of their parent banks to attract deposits funds and at the same time offered high returns. Each company devised its own schemes to attract funds. Competitive and wholly unverifiable claims about returns were advertised to attract investments. This gross irresponsibility was not checked either by the parent banks, who in fact encouraged it or by the government, who in the ultimate are the trustees of this public asset.
16	6.3	As the subsidiary Non-banking companies were mostly staffed by personnel from the parent banks, RBI expected that they would discharge their responsibilities with diligence and prudence, and that the parent bank would monitor their affairs suitably. However, there were no separate book of instructions/Manual nor was there any internal inspection machinery set up. No regular system of external supervision was introduced. Strangely enough, the Committee learnt during its deliberations that these subsidiaries were not even examined by the RBI at the time of inspections of the parent bank. The subsidiary companies, on the other hand, felt that as they were independent legal entities they were free from the regulatory provisions governing their parent banks. During interrogation by the Committee, the chairmen of parent banks routinely averred that they were unaware of the happenings/transactions in their subsidiaries; conversely officials of the subsidiary companies submitted that they were unaware of any guidelines issued by RBI in respect of investment policy, they also held that these applied only to the parent banking companies. This situation was not simply of omissions particularly as Chairmen of the banks are also Chairmen of the subsidiaries. The Committee observe that to avoid falling within the purview of RBI guidelines, the parent banks knowingly shifted such transactions as they were specifically debarred from undertaking to their subsidiaries. What is worse is that even though the RBI had in one of its circular dated 2.5.1989 stated that transactions prohibited for parent banks could not be put through or carried out by their subsidiaries, this advice was neither followed nor enforced.
17	6.9, 6.11, 6.12 & 6.13	The Committee are led to the conclusion that SBI Caps violated all established norms, that this was in the knowledge of the parent bank, that the company parted with substantial funds in favour of broker (HSM), and that it did so without any security. The Committee are unable to accept the

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		contention that Corporate Office was unaware of what was happening in branches. Further, if it was unaware even then it was derelict in the discharge of its responsibilities and the Committee take a serious view of this tendency to avoid accepting responsibility on ground of ignorance. The parent bank which submits half yearly review on the functioning of subsidiaries to its Board failed to report on the irregularities. It was thus, in addition to other failures, guilty also of not discharging its own direct responsibilities, towards its own subsidiary and its proper functioning. Before the Committee various instances of SBI officials being lured away and employed by the HSM group were cited. In fact, this tendency has been witnessed elsewhere also and is the single largest contributor to collusive practices proliferating.
18	6.16, 6.17, 6.19, 6.21 & 6.22	In the context of a number of Public sector undertakings raising resources by way of floatation of bonds in the market, Canfina took the role of "market maker" and handled 75% of the total PSU bonds issued. It also shifted its activities to 'Portfolio Management' and 'Corporate Investment Advisory Services'. When commissioned by a Public Sector Undertaking (PSU) to raise resources by way of bonds, Canfina would agree to an initial subscription of a substantial portion of the Bonds with the stipulation that the amount subscribed by it was to be kept with Canfina itself, under portfolio management services, Corporate Investment Advisory Services. At times, the rate of interest offered on the investment was lower than the coupon rate of the bonds itself. In the opinion of the Committee, Canfina indulged in unethical risky operation colluding with PSUs through the medium of brokers supposedly for PMS transactions. As, however, there was no actual transfer of funds by PSUs to Canfina, as admitted by them in their written replies to the Committee, these transactions cannot be termed as "Portfolio Management Service" at all. In any event the company has not also admittedly complied with other requirements of the PMS such as minimum lock-in period, prohibition of guaranteed return, risk to investor, etc. The Committee have observed that Canfina had been violating the guidelines of RBI in regard to PMS for long. It had been pointed out by the RBI who inspected it in March, 1991, that the Managing Director of the company had given a false assurance to RBI in terms of his letter dt. 22.9.1989 that the company had been accepting funds with lock in periods of one year and over only. The RBI had, *inter alia*, pointed out several other irregularities. It is obvious that the management of Canfina was well aware of the affairs being conducted irregularly. The company has pleaded in justification of its action and condonation of not having followed PMS guidelines : "We would not have been able to do either market making of PSU Bonds or manage the PSU funds since these guidelines were generally not followed by other competitors, mainly foreign banks who entered this arena in early 1991 as a result of Government's liberalised policy and started offering high yields."
19	6.24 & 6.25	It is observed that an aggregate amount of Rs. 778.17 crores is due to Canfina and the possibility of recovering bulk of these funds is remote. Besides, the company is contingently liable in respect of claims against it for Rs. 223.81 crores. Thus, the company could lose to the extent of about Rs. 1000 crores on its speculative and reckless dealings. This is in addition to facing an extreme liquidity crisis. It is understood that the parent bank

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		has so far accommodated it on a "no profit no loss" basis to the extent of over Rs. 2600 crores against available securities with it. The Committee hope that the nature and extent of the financial assistance being provided by Canara Bank to its subsidiaries are such as could be justified on prudent commercial norms. Further the parent bank cannot be absolved of the responsibility for various irregularities of its subsidiary.
20	6.26, 6.27 & 6.28	The deliberations and evidence before the Committee clearly indicated that there was practically no internal control machinery to check irregularities. The machinery of audit was perfunctory and superficial. It is observed that the parent bank had not conducted any inspection or periodical scrutiny of the affairs of Canfina. To a query whether the irregularities were at anytime discussed with RBI, the Chairman of Canara Bank replied that "only the working of the Canara Bank was discussed and not its subsidiaries". The Committee consider it necessary to underline such self admitted dereliction of duty on the part of those concerned.
21	6.30	The bulk of the funds collected by ABFSL had been from Public Sector Undertakings. Thus as on 31.3.1992 out of total deposits collected by way of "inter corporate" and "security transactions" at over Rs. 500 crores - an amount of Rs. 350 crores were from PSU clients. A substantial portion of these funds raised, had been passed on by it to three parties *viz.* Fairgrowth Financial Services Ltd. (FFSL), Shri H.P. Dalal (HPD) and Standard Chartered Bank ostensibly under ready-forward transactions and without complying with the guidelines of RBI in this respect. Thus the company has merely acted as a conduit for diversion of funds from public sector enterprises to private sector companies and foreign bank thus circumventing the investment guidelines for PSUs which prohibit their investing/ depositing moneys with private sector finance companies.
22	6.35	The Committee find the conduct of ABFSL and its officials, censurable and recommend early and prompt action against all found guilty.
23	6.36, 6.37 & 6.38	As on 30.6.1992 the total liabilities of ABFSL aggregated around Rs. 514.63 crores. As against this it had only the assets of face value of Rs. 30.22 crores. In addition, the company holds certain securities of the book value of Rs. 308.33 crores. Claims and counterclaims of ownership and the depreciated value of these securities make these holdings as of little countervailing value to ABFSL. The Committee seriously view the heavy losses sustained by ABFSL for which the parent Bank cannot be absolved of responsibility.
24	6.40	It is seen that Allbank Finance Ltd. had functioned mostly for the benefit of M/s. V.B. Desai and had in contravention of all principles of safety of funds passed on its customers deposits to the broker for investment and speculative deals in share market.
25	6.60	The Committee wish to underline that FFSL seem to have perfected systems to circumvent all the rules and regulations. It sought to influence public servants—which includes Government officers and Ministers through inducement including that of offering its high value shares at face value. FFSL provided the perfect conduit for collusive activities between broker and banker.

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26	6.61	The Committee conclude that some non-banking financial companies played a dubious role in the scam. In this connection they note that the powers of the Reserve Bank of India to supervise and monitor the working of non-banking financial companies are derived from chapter IIIB of the Reserve Bank of India Act. However, the control exercised by RBI in terms of the said provisions is not adequate being confined only to deposit taking activities. It is astonishing that no authority, either in the Government of India or in the Reserve Bank of India, appears to have taken stock of the possible role of non-banking financial companies in securities and banking transactions nor of the limitations in the Reserve Bank of India Act to deal with such contingencies. Over a period of several years, an entirely new sector of financial activity was allowed to grow and flourish without giving any thought to the deleterious consequences of the activities of this new sector. In the light of the role of the NBFCs in the current scam the Committee are of the considered view that there is an imperative need to ensure that the financial companies follow prudent practices for inculcating healthy financial discipline and, therefore, their overall functioning, particularly the deployment of funds has to be brought within the purview of some guidelines. The Committee, therefore, recommend that Government should examine whether the provisions in Chapter IIIB of the Reserve Bank of India Act are sufficiently wide to cover the necessary regulation. If not, the question of reinforcing the existing legislation or to enact a separate legislation for the non-banking financial companies be examined so as to ensure proper functioning of NBFCs and also to protect the interest of the depositors.
27	6.64	The Committee regret to note that Canbank Mutual Fund (CMF) has violated almost all the guidelines and regulations of the Ministry of Finance, RBI and SEBI governing the working of the Mutual Funds. The sponsor and its subsidiary have derived benefit through the operations of CMF at the cost of the investors.
28	6.70	The manner in which CMF had invested the funds of the schemes indicates that it had not exercised sufficient care, prudence and diligence in the interest of investors of the schemes and in several instances had exposed the investors in the schemes to high degree of risks without disclosure of it to the investors. This in the view of the Committee, is a serious breach of trust.
29	6.71 & 6.72	When asked to comment on the repeated defaults, the representative of CMF said: "it is true that in some areas the violations continued to take place." Yet again the Committee do find it necessary to underline the self-admitted or the self-evident. Officials managing this fund were negligent, derelict in the discharge of their responsibility and committed breach of trust with investors.
30	6.73 & 6.74	Apart from Canbank Mutual Fund irregularities were also observed in the working of other mutual funds, *viz.* Bank of India Mutual Fund, SBI Mutual Fund, LIC Mutual Fund, PNB Mutual Fund, GIC Mutual Funds and Indian Bank Mutual Fund. The Committee regret to note that several Mutual Funds

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indulged in serious malpractices/irregularities detrimental to the interest of investors. Failure to exercise adequate control by the authorities concerned resulted in recurrence of the same and regrettably, the irregularities came to be regarded as market practice. It is systemic failure of this order that set the stage for the scam. The system is as much in need of rectification as culpable individuals are in need of punishment.

PORTFOLIO MANAGEMENT SCHEME—MISUSE

31 7.5 & 7.21 One disturbing feature noticed by the Committee was that the irregularities in PMS operations had surfaced even as early as 1986 when it was also operated in the form of buy back deals. But regrettably no corrective measures were taken by authorities concerned to stop them. The misuse of PMS began in the mid eightees and progressively increased to climactic proportions in 1991-92. In order to circumvent the RBI guidelines, schemes under various nomenclatures were devised. The schemes have been operated as a "deposit substitute" by banks and clients so as to avoid RBI restrictions on interest rates and SLR/CRR requirements. The irregularities recounted after the sample studies of banks and the subsidiaries clearly indicate violations in respect of the guidelines issued by RBI and also show that the misuse was deliberate and wide-spread. The Committee deplore the impudent flouting by the banks of the guidelines issued by RBI. For instance, banks accepted deposits for less than one year, sometimes even for a day. Similarly, although the portfolio investment is supposed to be at the cost and risk of PMS clients and the banks claimed that no guaranteed returns were offered, in actual practice the returns were indicated. By an ingenious juggling of transactions, the banks paid only the indicated returns and excess profits were skimmed off to their Profit and Loss accounts. The Committee are unhappy to note that the senior management of the banks failed to implement the schemes in consonance with RBI guidelines and were responsible for the serious irregularities noticed and recommend that steps be taken to remove these officers immediately and launch prosecution against them, as per law.

32 7.22 The Committee also deplore the gross negligence and persistent failure of RBI to ensure effective compliance with its guidelines. Evidence led before the Committee makes it abundantly clear that these irregularities were a matter of common and general knowledge, in fact, this was defended as a normal market practice by Banks. It was primarily for the senior management of RBI to have taken note of these irregularities, examined their implications and taken rectificatory action under the RBI Act and in consultation with Government. Little or none of this was done. Red alerts were ignored, reports consigned to the backburner, and market intelligence treated with disdain.

33 7.23 The Committee recommend that an indepth study be made of the whole system of PMS operation, so as to identify the weakness and remove the flaws.

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34	7.24	PMS operations envisage deposit of money for one year. It will be very unusual that public sector Undertakings would have large funds which are surplus to their requirements for a period of one year. There is a speculative element in all PMS transactions. The Committee are, therefore, of the view that PMS is not the proper mode of investment for deployment of surplus funds by PSUs. The Banks should be instructed not to accept funds for PMS and other similar scheme from PSUs.

FOREIGN BANKS

35	8.5	The Committee examined in particular the securities transactions of four foreign banks *viz.* SCB, ANZ Grindlays Banks, BOA and Citibank. The examination by the Committee of securities transactions in banks has, revealed that foreign banks particularly have been deeply involved in the irregularities in securities transactions, they have acted in an unbecoming manner, indulged in large scale security deals, highly disproportionate to their normal requirements and in the process not only violated RBI guidelines, but also, their own set procedures and *prima facie* the laws of the countries of their origin. In the process they have thrown over-board all principles of prudence and safety in management of funds of constituents who had reposed faith and confidence in them.
36	8.10	The Committee note that the foreign banks indulged in issue of BRs without receipt of money or securities, exchanged BRs, issued consolidated BRs, indulged in issue of BRs even where SGL facilities were provided etc. Similarly, they have also grossly misutilised the SGL facilities and permitted large scale bouncing of SGLs. During the period October, 1990 to June, 1992 a total 612 SGLs of these banks bounced. The banks hardly cared to verify the abilities of counterparty banks issuing BRs of high value to perform, despite the fact that some of them were known to have very small resources like BoK and MCB (Both now in liquidation).
37	8.15	All the four foreign banks examined by the Committee have entered into a large number of ready forward deals with non-bank clients in non-SLR securities.
38	8.34	Citibank has regularly used PMS customers accounts for skimming profits over and above the benchmarks indicated to the customers. Further the losses of certain customers as also in the bank's own Portfolio have been also passed on to some of the fiduciary clients.
39	8.37	SCB collected huge amounts (Rs. 695.86 crores at Bombay) under the CCDS in total violation of RBI regulations both on interest rates on deposits and on PMS. The manner in which the scheme has been operated shows that funds collected under the scheme were in the nature of deposits on which interest was paid at rates which exceeded the maximum rates specified in RBI guidelines. For funds obtained in this manner the bank also paid brokerages to parties which was in violation of RBI directives. The funds obtained were also deployed under ready forward deals with non-bank clients including brokers, corporate entities etc. which was also in violation of RBI directives.

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40	8.38	The Committee were amazed to note that even in fairly large sized banks of international standing like SCB the demarcation of responsibilities between the "front" office and "back" office got diffused and controls totally weakened. There has been a complete abdication of responsibilities by the back office which had acted on the oral commands of the 'dealer' and released cheques even without obtaining securities or receipts thereof. This bank had indulged in several 'dummy transactions' to transfer profit or conceal the true extent of depreciation in securities.
41	8.43	The scrutinies of the security transactions of the foreign banks have also revealed that there has been extensive reliance on deals through/with stock brokers. Thus Citibank out of its total of 17,838 transactions worth Rs. 2,15,842 crores carried out as many as 7,560 or 42% of the transaction worth Rs. 92,501 crores through brokers as per its computer output sheets. However, it is felt that transactions through brokers must in reality be much more as it is noticed that in many cases the names of the brokers have not been recorded in the computer system even though these are observed as mentioned in the relative "deal slips" and contract notes held in some cases.
42	8.46	In the case of Citibank it was observed that in many cases broker names have not been fed in the computer system though the concerned dealer (officer of the bank) indicated the name of the broker in the deal slip. Obviously the procedure had been adopted to conceal the turnover/brokerage paid etc. This requires also to be viewed in the context of compensatory payments/ receipts of brokers in respect of loss in transactions. This practice had also resulted in the correct turnover in various securities transactions undertaken through brokers not being ascertainable. The information originally submitted by the bank to the Committee in this regard was not correct. The bank had, therefore, to submit revised figures of securities turnover through brokers to the Committee in January, 1993 after the above lacuna was pointed out by special auditors appointed by RBI.
43	8.47	BoA has routed 65% of its total transactions aggregating Rs. 1,14,056 crores through brokers and 58% of the transactions are accounted for by three broker *viz.* Shri D.S. Prabhoodas, NKA and M/S. Somayajulu and Co. The bank had violated its own guidelines regarding fixing ceiling of monthly gross turnover and contract limits for each broker.
44	8.48	ANZ Grindlays Bank has routed more than 50% of its total transactions worth Rs. 99,439 crores through brokers. HPD appears to be the most favoured broker of this bank having cornered 31% of the transactions. The others having significant volume of transactions are M/S. Somayajulu and Co., HSM and Shri Asit Mehta. Apart from the volume, the manner and style of the operations and surrounding circumstances clearly establish that the major consideration for routing transactions through select brokers was that they alongwith the banks have played mutually serving roles in irregularities and malpractices observed in the transactions.
45	8.51	SCB's investment and accounting records have been manipulated to camouflage the arrangement with HPD and later to record fictitious transactions to bridge the gap in SCB's investment portfolio. Thus, a number

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		of dummy transactions have been recorded, transactions have been recorded at rates different from the rates at which transactions have actually taken place and transactions have been recorded to hold back or book profits, which profits have been later reversed. There is good reason to believe that senior management of SCB was aware of the arrangements with HPD and earlier with VBD.
46	8.52	All the four banks examined by the Committee have well laid out procedures for internal control. However, the moot point is that all these rules and regulations seem to have been followed more in breach than in observance. Some of these banks like ANZ Grindlays and SCB have even violated the guidelines of their Head Offices in certain instances.
47	8.67	Citibank had initially made assertions before the Committee that it had committed no irregularities. But later on they admitted lapses in implementation which have resulted in actions counter to internal policies of the bank as well as in some cases counter to all spirit of RBI guidelines.
48	8.68	The information available with the Committee, however, belies the spontaneity of action as claimed by Citibank with regards to removal of some of its officers. In the case of Shri. A.S. Thiagrajan, Senior Vice President, who was looking after Investment and Corporate areas of the bank, he was relocated outside India at the instance of the RBI when it came to its notice that Shri Thiagrajan was interfering with the ongoing investigations of the bank.
49	8.72	The Committee desire that special scrutiny may be carried out by the RBI in all the foreign banks involved in the recent irregularities and the question of disallowing repatriation of profits through irregular securities transactions and other malpractices be considered. It is necessary that stringent penalties, including suspension of their licences are imposed on these banks keeping in view the extent of irregularities indulged into by each of them. Legal action should be pursued both in India and the foreign country concerned.
		MONITORING AND INTERNAL CONTROL — BANKS/SUBSIDIARIES
50	9.1	The Committee, find that the internal inspection machinery had not been updated to suit the growing needs in the new areas in which banks are venturing. While powers had been delegated, responsibility had not been assigned and accountability of staff for mistakes and irregularities seldom pursued. Information systems vital to banking industry are noteworthy only for their near universal dysfunction. No senior official appearing before the Committee ever admitted to knowing what was happening in their banks, all wrongs were invariably transferred to the misconduct of officials lower in the rung.
51	9.10, 9.11 & 9.12	The Management Audit of SBI conducted by RBI had pointed out certain shortcomings in respect of Funds Management Department of SBI. The Committee regret to note that the comments of the Chairman, SBI on the draft report had been received and the report as finalised by the Inspecting Officer

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		was submitted to the Deputy Governor on 30.11.1991 and to the Governor on 4.2.1992. The report was, however, finalised and issued to the S.B.I. only on 13.11.1992 and this too only after the matter was raised by the Committee during evidence on 18.9.1992. Thus there was an inordinate delay on the part of RBI in finalising the report and issuing it to the SBI. The Governor, RBI admitted the lapse during evidence.
52	9.27	Deficiencies were observed in internal control and supervision in the following areas in banks/institutions in general: (a) the segregation of duties between (i) persons responsible for entering into deals, (ii) persons having custody of investments and (iii) persons responsible for recording the transactions in the books of accounts and other records; (b) the periodic reconciliation of investment account and the independent verification thereof ; (c) controls over the issue of SGL forms and BRs and record keeping in respect thereof ; (d) controls for verification of the authenticity of BRs and SGL forms and confirmation of authorised signatories ; (e) procedures for confirmation with counterparties, brokers' contracts as also of overdue BRs ; (f) the segregation of responsibilities of persons handling the bank's own investments and those dealing on clients' accounts ; (g) fixation of exposure limits ; (h) reporting system ; and (i) laying down of instructions relating to investment in securities in the Manual.
53	9.32	The Committee attempted to look into the role exercised if any, by the Vigilance Departments in some of the banks in the matter under examination. Regrettably, they had not performed the duties that they were required to do. Neither the top management of the banks nor the boards paid sufficient attention to vigilance matters.
54	9.40	The failure of the Chief Vigilance Officers of the public sector banks/financial institutions to perform their preventive as well as detective roles clearly indicate that the functioning of the vigilance system in the banks/financial institutions has been found to be totally unsatisfactory. The Committee trust that the recommendations contained in the Ghosh Committee report will be updated and implemented urgently. The action plan finalised at the meeting of the Ministry of Finance on 8.7.1992 should also be implemented urgently. The Committee further recommend that the Board of Directors of each bank should periodically review the functioning of vigilance set up including the reports of CVOs and the follow up action thereon.

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55	9.45	The Committee regret to note the serious weaknesses in the internal control systems of the banks especially on the treasury and investment side. Not only there was lack of effective control systems, there was also laxity in enforcing strictly even the existing inadequate systems. The Committee strongly feel that a proper and effective system of internal controls in banks whereby irregularities can be obviated and detected immediately, is of utmost importance. They, therefore, suggest that the banks should urgently review their internal control mechanism in the light of the deficiencies noticed to ensure that there are adequate safeguards in the systems.
56	9.46	It is noticed that there is no comprehensive document containing all directives, guidelines, circulars etc. issued by the RBI, which is readily accessible for reference by all concerned. This creates the possibility of banks and/or other officers, by omission or design, claiming ignorance of specific directives, etc. The Committee, therefore, suggest that such a compendium should be brought out expeditiously and kept up-to-date.
57	9.47	The Committee find that there is/no satisfactory mechanism in most of the banks to examine and follow up the observations/suggestions made in the reports by the internal inspection department, Vigilance Cell and Internal Auditor etc. There is also need for proper follow-up action on the inspection reports, guidelines, circulars etc. issued by RBI. They suggest that a Committee of Board of Directors, which may include the Chairman, nominees of RBI and Government of India as also, where available, a professional such as Chartered Accountant or a management/ financial consultant, should be entrusted with the task of overseeing the follow up action on the above mentioned reports.
		STATUTORY AUDIT
58	10.8, 10.9 & 10.10	The various directives, instructions, etc. of RBI are binding on the banks and it is the duty of the auditors to report on the non-compliance of these directives, circulars, instructions etc. which have a impact on the business activity of the bank and the disclosure of true and fair view. Section 30 (3) (e) of the Banking Regulation Act specifically states that the auditor is also required to state in his report: "Any other matter which he considers should be brought to the notice of the shareholders of the company." The Committee have not come across any report where the auditors have reported under this clause even on the weaknesses in internal control, violation of RBI guidelines etc.
59	10.12	The auditors clearly had a duty to verify the existence and quality of investments held by the banks on their own account as well as of their PMS clients. This also required a reconciliation of the investment account, physical inspection of securities on hand, confirmations of counterparty banks for BRs issued by such banks and on hand, confirmation of SGL balances with the PDO, and control and reconciliation of BRs issued by the banks. The irregularities regarding the existence and quality of investments had existed since long and had not been detected by the external auditors for which they must accept responsibility.

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60	10.14	It was incumbent on the auditor to examine in detail at least on test check basis the sale and/or purchase of the securities with the relevant vouchers such as contract notes, bills, receipt etc. as evidence for sale and/or purchase of securities. The auditor should have examined whether payments on account of sale and/or purchase of securities are duly accounted for and correct entries are made in the ledger. It is surprising that the irregularities in securities transactions on such a massive scale were not noticed by the auditors. In a large number of cases, the payments for the sale and/or purchase of the securities were routed through the brokers account which should have aroused the suspicion to have more indepth check. A vigilant and conscientious auditor could have detected the irregularities and an early reporting of them would have prevented their large scale recurrence.
61	10.15	The Committee have come across many examples in RBI Inspection Reports of the last few years which have highlighted the irregular purchase and/or sale of securities, deals in units and bonds of public sector undertakings; gross violation of RBI circulars, instructions, directives etc.; circumvention of CRR/SLR requirements; irregular 'borrowings' and 'lending' by banks in the guise of securities transactions; booking profits on bogus securities transactions; weaknesses in the system of internal control etc. The Committee are pained to note that the auditors did not take into consideration the serious irregularities pointed out in the Inspection Reports of RBI. The highlighting of these irregularities in the auditors' report would have assisted in curbing the proliferation of the irregularities in future. It clearly indicates that the auditors were negligent in the performance of their duties. The Committee suggest that the Reserve Bank of India and the Institute of Chartered Accountants of India should scrutinise the audit reports of the banks involved in the irregularities and initiate suitable action against the defaulting auditors.
62	10.18	The Committee have come across only one Audit Report for the year ended 31.3.1991 of BOI Finance Ltd. where the auditors have highlighted the gross irregularities, violation of RBI guidelines and gave a qualified audit report in relation to management of portfolio funds. If one of the auditors could highlight the various irregularities being committed in PMS transactions, the Committee are led to enquire as to how other auditors in similar circumstances continued to certify without qualifications that the financial statements showed a true and fair view. The Committee desire that all these financial irregularities should be examined in detail for all the banks/ institutions involved and should be rectified and correctly reflected in their accounts. The auditors while auditing the accounts for the year in which these rectifications are made should also report on their accuracy or should qualify their Report in case no such corrective actions are taken by the bank/ institutions involved.
63	10.20	The Committee are unable to appreciate how the auditors of the foreign banks certified that the financial statements for 1990 and 1991 gave a true and fair view when the RBI Reports in respect of the special scrutinies conducted in 1989 and 1990 itself established that the banks were indulging in gross irregularities, violating RBI guidelines etc., which have a material

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		impact on the true and fair view of the financial statements. The Committee suggest that the Institute of Chartered Accountants of India and RBI should initiate necessary action.
64	10.24	The Committee regret to note that the audit report of CANFINA for the year is unworthy of any reliance and it is obvious that the auditors failed in discharging their duties. The Committee suggest that the Reserve Bank of India and the Institute of Chartered Accountants of India should scrutinise all such audit reports and initiate suitable action against defaulting auditors.
65	10.29	The evidence of the Managing Director of FFSL clearly indicates that the accounts for the year ended 31.3.1992 were manipulated. The auditors, it appears, aided and abetted in manipulation of the accounts of the company. The Committee recommend enquiry into the role of the auditors of FFSL and taking of further necessary action.
66	10.30	The Committee are pained to note that the statutory auditors, with rare exception, failed to report the large scale irregularities continuing in the banks, PSUs, companies etc. in the securities transactions, portfolio management scheme, gross violation of guidelines/circulars etc. The entire irregularities discussed in the Report are mainly of financial nature, continuing for a long time and the auditors cannot absolve themselves of the responsibilities of not detecting or reporting the same. Many of the audit Reports were in the nature of collusive cover up operation.
67	10.31	To the query of the Committee to indicate the action taken against statutory auditors, RBI stated that in the light of the serious irregularities observed in securities transactions of some banks and their subsidiaries/mutual funds in the year 1991-92, it has been decided on 12 December, 1992 that bank audit assignment for 1992-93 should not be given to any of the audit firms who had audited securities transactions of these banks in 1991-92. The names of such firms are given in *Appendix XVIII*. RBI, however, admits that some of these auditors had as shown in *Appendix XVIII* already been approved for appointment in 1992-93. The Committee are surprised to find that RBI did not consider it necessary to withdraw the approval in respect of these auditors and to review the matter after the decision of 12 December, 1992. The Committee feel that the action of RBI is wholly inadequate considering the continued serious lapses on the part of the auditors. Necessary action should be initiated by the RBI against all auditors who failed to discharge their duty properly. The Institute of Chartered Accountants of India should also be informed about such auditors so that they may take necessary disciplinary action.
68	10.33	The Committee have come across serious irregularities in investment transactions by PSUs which have been discussed extensively in the Report. For instance, as against the Government instructions to make investments only in Government Securities, public sector bonds, treasury bills, PSUs in the guise of PMS entered into ready forward deals without taking physical possession of securities or at least the details thereof from banks/financial companies. It has also come to the notice of the Committee that in several cases, the investments were made in contravention of the relevant statute,

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		guidelines, memorandum and articles of association etc. Most of the deals were struck on phone and no record was maintained to substantiate reasons for the decision taken. In most cases, funds of the PSUs were exposed to great risk and some of the PSUs may lose heavily because of default in payment by non banking financial companies.
69	10.36	It was the duty of the auditors to obtain details of the investments made under PMS and to report whether the investments made were within the powers of the PSUs and whether the same are correctly reflected in the Balance Sheet. The auditor of a Government company is required not only to verify whether the financial statements give a true and fair view, but has also to look into the efficacy of the system. The Committee regret to note that the auditors failed in performing their professional duties and this failure permitted the officials to play with the funds of the PSUs by irregularly investing/lending them in contravention of the statutes, Government guidelines/decisions etc. The Committee suggest that the Department of Company Affairs, the Comptroller and Auditor General of India should examine the audit reports of PSUs etc., involved in the irregularities and take appropriate action against auditors who were negligent in the performance of their duties.
70	10.37 & 10.38	The C&AG has the power to conduct a test or supplementary audit of company's accounts were he finds it necessary to do so. Apart from this, the C&AG also conducts an efficiency-cum-propriety audit of selected companies. The supplementary audit by the C&AG broadly covers financial statements, systems and performance. The Committee are constrained to observe that none of the Reports of the C&AG except Report Nos. 1 and 3 of 1993, Union Government (commercial) have pointed out the serious irregularities in the investment and other related transactions by PSUs. There are obviously some shortcomings in the methodology of audit which deserve to be examined.
71	10.39	The Committee feel that there are grave shortcomings in the objective and methodology of audit as practised now at present. The Committee addressed itself to some of the aspects of reforms in the system of audit. The Committee are of the view that the present method of appointment of auditors, their actual conduct of audit, their involvement with the bank in other professional assignments and various other practices as highly unsatisfactory. The Committee find that the term of the auditor is only one year. They are sometimes appointed as late as in March and are required to submit their Report latest by June. The Committee feel that the auditors should be appointed well in time and for reasonably long period. Various other improvements are needed in conducting of audit and reporting by the auditors. Rather than detailing a charter of reforms, the Committee suggest that the Government should address itself to the various shortcomings in audit and take necessary corrective measures. The Committee also suggest that with a view to achieving the objective of effective audit, statutory amendments be made wherever considered necessary. The Committee are of the view that the setting up of an independent Central Audit Authority instead of the fragmented system adopted by individual banks, as at present, may be seriously considered.

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ACCOUNTABILITY — BANKS

72 11.1 & 11.2 The Committee would wish to observe that the most noteworthy and unexplained aspect of the accountability of officials has been the absence of prompt and deterrent action against the guilty. Action initiated or taken has been selective, has varied from the reasonably prompt to extremely lethargic and lackadaisical. Thereafter, the disciplinary or punitive aspect of it has traversed the entire spectrum of procrastinatory bureaucratic option : from the evasive and wholly ineffective, "sent on leave", "transfer", "suspension" etc. The Committee have been hard pressed to find instances of immediate corrective action, initiation of legal proceedings, leave alone conviction proper or the actual sentencing of identified perpetrator of this gross abuse of public responsibility. The Committee are not convinced by the standard explanatory arguments advanced about our sluggish legal system. The Committee do wish to place on record their observation that the will to uniformly, and without fear or favour punish the guilty seems to have been absent through the entire sorry episode. And, this observation is being recorded more than one year after the Scam came to light. The above observation is based on the Committee's enquiries about the role of top management/officials/staff of various banks/financial institutions in the irregularities in securities and banking transactions.

73 11.9 The SBI is the premier retail bank of the country. Its very name confirms its status and standing. The Committee, however, find that its officers have done everything to rob it of the status. Worse, they do not even have a residual sense of belonging to accept responsibility for this great wrong that they permitted to happen. The SBI hierarchy from top to bottom was casual in its approach, negligent in the performance of its duties and unpardonable in their collusion with brokers. The Committee feel that the whole matter requires to be enquired into with a view to punishing the guilty.

74 11.12 The Committee are of the view that its observations about SBI hold for SBI Caps as well. The Committee believe that the Corporate office was aware of what was happening in Regional offices and is thus not absolved of its responsibility on grounds of ignorance. SBI Caps has till date taken no meaningful disciplinary action against errant officials. This further proves the fact that everyone concerned in SBI Caps was acting in collusion with each other. The top management of SBI Caps also needs to be proceeded against for dereliction of duty.

75 11.40 At the instance of the Committee, the Ministry of Finance have furnished a consolidated list indicating the latest position regarding departmental action initiated/taken against officers/staff in Banks/institutions for their involvement in irregularities committed in the securities transactions. (List of officials with designation shown as *Appendix XXI*). It was observed that in a vast majority of cases, the action initiated so far was confined either to "explanations called for", or "explanation received, being examined". In certain other cases, the officials were stated to have been "transferred" and in a few other officials were "suspended". There are also institutions were departmental proceedings are yet to be initiated. This is clearly indicative

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		of the lethargic and lackadaisical approach of the banks/institutions. The Committee cannot but express their strong displeasure over the tardy progress in the departmental proceedings. There is no evidence to suggest that there has been vigorous follow-up of the matter in the Ministry of Finance either. They desire that the Ministry of Finance should review the action taken departmentally by banks/institutions with a view to ensuring that the guilty officials are punished adequately without any further loss of time. Parliament should be informed of the conclusive departmental action taken against officers including top management and staff concerned for their involvement in the irregularities committed in the securities transactions, within a period of six months.
76	11.41	The Committee desire that the CBI should also pursue the cases lodged in all their ramifications to their logical conclusions in order to ensure that the guilty are punished.

BROKERS

76A	12.4	The Committee recommend that the whole system of empanelment of brokers by banks especially the public sector banks needs to be examined in detail.
77	12.55	The Committee also came across instance of easy accessibility and influence of brokers on officials in high positions. Serious irregularities were noticed in the functioning of brokers. These included faulty system of empanelment, disproportionate business to selected brokers, crediting of Account payee cheques drawn in favour of banks to brokers accounts, use of banks by the brokers as routing banks, award of special facilities like netting, single point clearance, providing accommodation out of the way, misuse of official position by brokers, etc. The various irregularities noticed were that the banks in general, colluded with certain unscrupulous brokers in a big way. They failed to evolve any clearcut policy regarding the role of brokers in conducting transactions in securities, including their selection, fixing limit over the quantum of business to be given to each one, nature of transactions and system of reporting etc. Regrettably, this had not been done even after the matter was raised by RBI during the course of inspections conducted in several cases in the past at least since 1986. Equally regrettable is the fact that, RBI, despite having been seized of the problem for long did not take any action nor deem it fit to lay down any guidelines for regulating this aspect of the investment function till June, 1992. No wonder, brokers even totally new to the field were able to exploit the lacunae to their advantage resulting in occurrence of various irregularities on a large scale. The close nexus between certain PSUs, banks, and brokers enabled them to have unauthorised access to funds leading to diversion of huge public funds from the banking sector to the brokers to enable them to channelise these funds into the stock market as also the call money market. It was only in the aftermath of the Scam that the RBI issued detailed guidelines on 20.6.1992 regarding the role of brokers. It is only after the matter was highlighted by the Committee during the course of taking evidences that RBI further tightened the instructions to banks/institutions.

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78	12.56	In the context of large scale diversion of funds to brokers, huge amount of money paid to them as brokerage as well as price differential and various other malpractices indulged in by the brokers in the securities transactions, the Committee considered the question whether it is necessary for banks to use the services of brokers for inter-bank securities transactions. The banks need to trade in securities mainly for SLR purposes. The short term requirements of banks in this regard can be met by D.F.H.I. which has developed secondary market in Treasury bills for different maturity periods. The R.B.I. has also announced in April, 1993 the proposal to set up a Securities Trading Corporation of India for the development of a secondary market in Government securities and public sector bonds. Further, the number of players who hold Government Securities to any appreciable extent (RBI, Commercial Banks and LIC reportedly holding 88% of the Government Securities) and who are required to trade in them are a few in number. The Committee, therefore, recommend that Government and RBI should seriously consider whether there is any need for brokers for inter-bank securities transactions which is expensive in terms of commission and offers opportunity for various malpractices and frauds as seen in the securities Scam.

STOCK EXCHANGES AND SECURITIES AND EXCHANGE BOARD OF INDIA — AN OVERVIEW

79	13.10	The Presidents and the Executive Directors of the Stock Exchanges by their own admission before the Committee have said that they are not following Rules, Bye-laws and Regulations as some of them are impracticable. The Committee are of the view that in such cases they should have been amended to make them administrable. The Committee expect the SEBI to examine these difficulties and to take remedial action. SEBI should also ensure that Executive Directors function according to their legislative mandate.
80	13.11	Some of the irregular practices noticed in the Stock Market relate to non-payment of margin money, violations of carry forward limits, violations of trading restrictions, over trading by members, kerb trading, reluctance to publish data on the prices and volume of trading in a more open manner, insider trading, ineffective at times merely notional inspection of books of brokers, insufficient and inefficient income tax surveys of stock exchange operations and actually non-existent punitive action on detection of irregularities, ineffective or no redressal of investors grievances, etc. Violation of trading restrictions is a rule rather than an exception. In the effective imposition of this essential disciplining measure BSE even during the hyper volatile period, for example has failed signally. Inspection by every agency has revealed that virtually every member inspected had violated these trading restrictions. This fact, therefore, that there was rampant violation of them was within the knowledge of Exchange authorities, yet while on the one hand in the hyper-volatile months of 1991-92 various trading restrictions were being imposed, on the other their effectiveness was

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		being completely nullified by allowing concessions relaxing the rigid restrictions, not penalising defaulters, etc.
81	13.12	The Committee's study of BSE reveals a very unsatisfactory state of affairs. The Committee expect the SEBI to pursue this matter with Bombay and with other Stock Exchanges inspected by them with a view to ensuring greater adherence to regulations. It is axiomatic that action be taken against those who contravene the rules, bye-laws and regulations. That this is not done has been stated earlier. The fact that the Committee have to restate such a self evident principle as that the guilty must be punished, is tellingly conclusive of the extent of irresponsibility in stock exchanges.
82	13.1	The Committee observed that until late in 1992 there existed no legal sanction against insider trading. The Committee have come across some instances raising suspicion about such trading. It was as a result of the Committee's observations during investigations that SEBI was empowered to take necessary action.
83	13.16	Looking at the small number of cases in which punishment was awarded to erring/defaulting member brokers, it is apparent that the Boards of the Stock Exchanges are reluctant in taking action against their fellow brokers. Not unnaturally, therefore, even when action is taken the penalties imposed are minimal and hardly of any consequence. The Committee are of the view that brokers over-representation on the governing boards is a contributory factor for this malaise.
84	13.18	The Committee hope that the enforcement of the guidelines to bring reforms in the stock exchanges will not just be closely monitored by SEBI, but strictly enforced.
85	13.19	At present, the Securities Contracts (Regulation) Act, 1956 does not prohibit trading by a member of the stock exchange on his own account. This gives rise to several malpractices. The Committee are of the view that brokers should conduct business as a broker and not take positions. Till such time that SEBI implements the above, they should ensure that brokers maintain separate accounts in respect of their business and that which they conduct on behalf of their clients.
86	13.20	Apart from other agencies, Income Tax authorities should study in depth taxation aspects of the operation of the broker members of Stock Exchanges.
87	13.21	A perusal of the Inspection Reports of some of the major Stock Exchanges like Bombay, Calcutta, Delhi and Madras indicates that there are inordinate delays in resolving the complaints of investors. There are very few cases in which disciplinary action has been taken against the erring brokers. In the case of Bombay Stock Exchange there have been only 2 cases in the past when the Stock Exchange had imposed a one day suspension, each, on one member-broker in February, 1990 and an another in November, 1991.
88	13.22	The Committee feel that an effective system to handle investor's complaints and taking of follow-up action within a specified time frame should be evolved and both the receipt of complaints and the action taken thereon

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		should be regularly reviewed by the Governing Boards of Stock Exchanges and deterrent action taken against persistently defaulting members. SEBI should also call for periodic reports from the Stock Exchanges to monitor action taken by the stock exchanges in investors grievances to discharge its responsibility in this regard.
89	13.23	Many of the investors grievances can, however, only be redressed under the relevant provisions of Company Law. The matter was taken up by the Ministry of Finance with the Department of Company Affairs for delegating to SEBI the powers and functions of the Central Government under Sections 187D, 209A, 247 as well as empowering an officer of SEBI to take action against companies under the provisions of Sections 56(3), 59)1), 63(1), 68, 73(2), 73(2A), 73(2B), 113(2), 118(2), 133(2), 207 and 209A of the Companies Act, 1956. The Department of Company Affairs on 4.11.93 has agreed to delegate powers to SEBI in respect of offences under Sections 56(3), 59(1), 73(2), 73(2B), 113(2) and 207. The Companies believe that with the delegation of these provisions to SEBI there would be better redressal of investors' grievances. The Committee further recommend that the machinery under the Companies Act for the compliance of the remaining provisions be so strengthened that the investor's interests are further safeguarded. The Committee are of the view that the small investor is the most neglected entity. Looking into the large number of such investors due protection of their interests assumes great importance.
90	13.27	The Committee are not the least surprised to find that even after a decade, functioning of Stock Exchanges are still characterised by the very same malpractices that had been prevalent earlier. Indeed, it has been observed by SEBI, in an extraordinary coincidence of phraseology (used by the then Minister of Finance in his letter dated 26.8.82 to present Chairman of Joint Committee) "that the Bombay Stock Exchange is functioning as a private club of member brokers", and is characterised by "lack of financial management, non-enforcement of market regulations, chaotic market operations and absence of proper marketing control." The evidence before the Committee clearly indicates that the successive Finance Ministers and other supervisory/regulatory authorities have done little in the last decade to bring about the order liness in the operations in the Exchange held out as an objective to the present Chairman of Joint Committee more than ten years ago.
91	13.32	SEBI is currently examining the trading practices prevalent in the Indian Stock Exchanges particularly carry forward of transactions and *badla* system. SEBI is of the view that the carry forward/*badla* transactions should be disallowed and transactions conducted strictly on a delivery basis and trading in future and options be permitted in a separate market. According to SEBI, a notice of 6 months to the Stock Exchanges may be given to evolve the structure and the rules for operating trading in future and options and the relevant section under the Securities Contracts (Regulation) Act be suitably amended. As an intervening measure, SEBI has suggested that *badla* can be prohibited on the exchange by allowing transactions to be carried forward at making up prices only subject to carry forward margins.

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92	13.33	The Committee would expect the SEBI in consultation with the Ministry of Finance, to atleast now enforce suitable and effective measures.
93	13.34	In 1988-89 out of 28 meetings, the Officers of Ministry of Finance attended only 6. In 1989-90 of a total of 36 meetings, officers of the Ministry of Finance could attend only 3 meetings and in the case of one particular officer, of the 17 meetings held during his tenure not a single meeting was found as convenient for being attended by him. In 1990-91, the representatives of the Ministry of Finance could attend only 4 meetings out of 65 held. Even at the height of scam in 1991-92, the representative of the Ministry of Finance could attend only 2 meetings out of 40.
94	13.35	Considering the very low level of attendance of meetings of Governing Boards by Government nominees leave alone participation and contribution to deliberations the Committee are of the view that such nominees have contributed precious little in arresting the various malpractices in stock exchanges. The Ministry of Finance and the Government directors cannot be absolved of their responsibility in this regard. The Committee hold that the need for having such Government nominees on the Stock Exchanges needs to be reviewed with the constitution and transfer of regulatory power to SEBI.
95	13.37	The Committee are constrained to note that the Bombay Stock Exchange, which accounts for more than 2/3rds of the total turnover in securities all over the country, is clearly the market leader in all irregularities noticed in the Stock Exchanges at large. It is also noticed that this Stock Exchange was inspected for the very first time, by a regulatory authority, after more than a century of its coming into existence, and that too only in February, 1993, almost a year after the major banking and securities transactions scam had taken place. What has been revealed is that irregularities have been committed not just by the member-brokers but also by the members of the Governing Board themselves.
96	13.38	The Committee are disturbed to note the following observation from the Inspection Report of Bombay Stock Exchange: "The Stock Exchange, Bombay, is governed by a Board which presently consists of 24 members including an Executive Director. From the list of names of the members on the Board, it is noticed that, the Exchange has virtually been under the administrative control and supervision of three persons during the last five years, *viz.*, Shri G.B. Desai, Shri Hemendra Kothari, and Shri M.R. Mayya (Executive Director). Shri Mayya has been with the Exchange for the last almost 10 years."
97	13.39	Before according statutory status to SEBI in February, 1992, the Ministry of Finance was the only authority having vast powers under the Securities Contracts (Regulation) Act, 1956. Not once were these powers exercised, not by way of punitive or corrective action, not even by reprimand, caution or calling for explanation. It is only after SEBI was accorded statutory powers an authority really capable of bringing order into Stock Exchanges came into existence.

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98	13.40	The Committee note that irregularities in the Stock Exchanges are not of recent origin, they have been prevalent for quite sometime now. Regrettably, while the major stock exchanges in the country lent themselves to illegal activities abetted by the controlling authorities of the respective Stock Exchanges, the Ministry of Finance failed miserably to exercise its regulatory authority by neglecting the responsibilities entrusted to it. Despite the fact that the Government had promised to initiate all necessary action, the Ministry of Finance over the years failed not only to discharge its responsibility but also to act on its own assurances. The Committee expect that the Ministry of Finance and SEBI will now address themselves to this responsibility.
99	13.41	It is only in January, 1983 that the Central Government directed that accounts of members of stock exchanges be audited by chartered accountants. This audit now made mandatory, covers books of accounts and other documents as specified under Rule 15 of the Securities Contracts (Regulation) Rules, 1957.
100	13.42	The Committee must observe that it is only after a lapse of 10 years, that the Ministry of Finance have now issued another Circular in March, 1993 on the subject of audit of books of accounts of Members of stock exchanges. This is yet another instance of the Ministry of Finance taking no follow up action on a subject of importance and in an area of its direct responsibility. It is also pertinent to mention that the BSE have also finally issued a notice in May, 1993 directing all the concerned members to submit all pending audit reports for the year upto 1991-92 positively by 30th June, 1993 failing which they have been informed, "they would automatically stand suspended from 1st July, 1993." What the other stock exchanges have done is not known to the Committee. It is, however, Committee's apprehension that somnolent indifference prevails.
101	13.45	The inspection of Mutual Funds by SEBI revealed the following major deficiencies: i) Sale of units after the closure of schemes; ii) Loans to brokers thereby exposing investors to avoidable risk; iii) Poor maintenance of books of accounts and other records; iv) Deliveries for purchase and sale of securities outstanding for long period; and v) Investments were made without any records of the basis of the investment decisions.
102	13.48	It is the expectation of the Committee that the deficiencies identified in the working of Mutual Funds would be set right early.
103	13.53	The Committee have in their study and investigation of Mutual Funds observed serious irregularities in their operations. Some guidelines for regulation of their operations have been recommended by SEBI in January, 1993. The Committee expect that these would be enforced properly.

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104	13.54	The Committee are in agreement with the views of the Ministry of Finance that the mutual fund operations aspect of UTI functioning ought to be brought under the purview of SEBI. If necessary, the UTI Act may be amended accordingly.
105	13.55	Despite market operations of Rs. 35,000 crores, no inspection of any kind, has ever been done about the activities and operations of UTI. To this lacunae, it is the expectation of the Committee, the Ministry of Finance would address itself with despatch.
106	13.56	SEBI has granted approval to the sponsors of Mutual Funds in the private sector also. The Committee desire that SEBI would not only lay down stringent norms for Mutual Funds but also effectively and closely monitor operations of the Mutual Funds.
107	13.62	The Committee regret to note that the Ministry of Finance took $3^1/_2$ years to give the needed statutory backing to SEBI. The Ministry have attributed this inordinate delay to "consultations with the Department of Company Affairs", "Ministry of Law" and with SEBI itself, in view of the complex issues involved. The Committee are not impressed by this feeble explanation. It is unable to appreciate the time lags of Ministry of Finance between decision and implementation.
108	13.63	The Committee are informed that consequent upon becoming statutory body in February, 1992, SEBI framed rules and regulations under Section 12 of the SEBI Act, 1992 for stock brokers and various other financial intermediaries laying down norms and guidelines for their operations in the capital market and forwarded them to the Government for approval and notifications. While some of them have since been approved and notified the following are pending finalisation since October, 1992: 1. Rules and Regulations for Bankers to an Issue 2. Regulations on Substantial Acquisition of Shares and Takeovers 3. Rules and Regulations for Debenture Trustee 4. General Regulations 5. Rules and Regulations for Investment Adviser.
109	13.64	The Committee expect that these will be finalised and notified expeditiously.
		PSUs — Contribution to the Scam
110	14.5	The examination of various PSUs by the Committee have revealed serious irregularities in their investment transactions. For instance as against the Government instructions to make investments only in Government securities, public sector bonds, treasury bills, PSUs through banks/finance companies in the guise of PMS entered into ready forward deals also without taking physical possession of securities or at least the details thereof with banks/financial companies at market driven rates. In many cases, the funds

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		of PSUs have been diverted to brokers and used for purchase of shares of private sector companies in violation of Government guidelines. PSUs have also entered into such transactions with foreign banks prior to January, 1992 *i.e.* before they were permitted to have even normal banking transactions with them.
111	14.12	The Committee are surprised to note that while DPE played an active part in permitting PSUs to have banking transactions with foreign banks they did not consider it their duty to monitor them.
112	14.21	The Committee have noted that the PSUs were the single largest source of surplus investible funds, around Rs. 36,000 crores between April, 1990 and December, 1992 only. In the investment of these funds guidelines and instructions were routinely flouted and no norms were observed. Neither DPE nor the Ministries concerned took any steps to ensure the compliance of their guidelines. Even the Ministry of Petroleum and Natural Gas which had made a review of investment of surplus funds by the PSUs under its administrative control in May, 1990, closed its eyes knowing fully well that PSUs were investing with the foreign banks despite the guidelines of DPE that PSUs could have normal banking transactions only with nationalised banks.
113	14.22	The Committee are of the view that it is the duty and responsibility of Ministries who issue guidelines to ensure their implementation. Further, nodal Ministries who have been entrusted with the overall supervision of the various agencies under it are also expected to monitor the guidelines/ instructions issued through them. The Committee have felt that both DPE and the Administrative Ministries failed in their duties and this failure permitted certain individuals to play with the funds of PSUs by irregularly investing them with foreign banks etc. in contravention of all Government guidelines/decisions.
114	14.23	The Committee suggest that the policy and procedure for investments should be clear cut and transparent. The Committee expect the Administrative Ministries to apply their mind to this question and in consultation with the Ministry of Finance and the DPE lay down a clearly defined investment policy for PSUs.
115	14.28	The Committee noted that while on the one hand budgetary support was sought by PSUs from the Ministries and on the other funds were invested with banks/financial companies thus depriving themselves of those funds for considerable periods.
116	14.41	The Committee have found that the purpose of floating of bonds by PSUs to raise resources to meet their operational requirement was completely defeated as the monies realised through floating of bonds were invested with the banks/financial companies. Thus, these funds remained blocked for a considerable period. Many companies gave concessions and invested monies at rates lower than the interest rate of the bonds thereby incurring losses in the process. Their losses were compounded further as some of the

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		subsidiaries of banks did not return the funds of PSUs which became due on maturity.
117	14.54	The Committee noted that the different Public Sector Companies were following different procedures of inviting quotations and recording them. Most of the deals were struck on phone and no record was maintained to substantiate reasons for the decision taken. Inevitably such dubious practices lent themselves to misuse.
118	14.55	While most of the companies were issuing instructions and getting confirmatory letters periodically from banks/finance companies with regard to investment of funds in many cases instructions to banks were not given at the time of placement of funds. In the case of PSUs like STC, MMTC, OIL, NPCIL, and KRIBHCO funds were invested without issuing specific instructions to banks/finance companies as to how their funds should be invested by them. Thus the funds of these organisations were exposed to risk by leaving the discretion with banks about the manner of investment of their funds.
119	14.56	The Committee have to, therefore, conclude that the mechanism for decision making in such an important area was most unsatisfactory. It is obvious that this needs to be reformed immediately.
120	14.80	The Committee have found that the general control and direction which the Boards of PSUs were expected to exercise was absent. There was neither a proper system of reporting of investment decisions to the Board nor the Board's directives implemented in letter and spirit. The Committee recommend appropriate rules and regulations be prescribed for regular reporting of financial transactions to the Board and sanctioning powers so delegated amongst different authorities as to prevent abuse of powers by vested interests.
121	14.81	The Committee have noted that there have been large scale contravention of statutory provisions and rules/regulations regarding financial matters. It is regrettable that these contraventions were not detected in time by the top management and the Government nominees on the Boards. At least now an enquiry should be held and responsibility fixed on officers who indulged in these malpractices and irregularities.
122	14.85	The Government Directors who were appointed as nominees of the Government for overseeing the work of PSUs in accordance with stated policies did not discharge their responsibilities as expected and remained passive witnesses to irregularities. The Committee have been dismayed to see that attendance in Board meetings was taken by the Government Directors in a casual manner. In sum, the scheme of appointment of Government Directors does not appear to have worked as envisaged.
123	14.87	The Committee have noted that in many cases PSUs had placed funds with banks/banks subsidiaries under PMS or other similar schemes with instructions to invest in Government securities etc. without taking physical delivery. PSUs also did not even keep a tab on how the funds made available

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		by them were invested and it was noticed that in large number of cases funds of PSUs given under PMS had been used for purchase of shares of private companies.
124	14.101	The Committee are of the view that the yields obtained by PSUs on short term investments were suggestive of the fact that the funds of PSUs were irregularly used in call money market through banks or passed on to the brokers for speculative purposes.
125	14.108	When the PSUs were not even permitted to undertake normal banking transactions with foreign banks the Committee find it ironical as to how they could be permitted to make investments with foreign banks.
126	14.110	The Committee have noted that the Department of Company Affairs are responsible for the enforcement of the provisions of the Companies Act, 1956 in respect of the companies registered thereunder. The Committee are surprised to note that as per the existing practice, inspection of books of accounts of Government Companies (PSUs) is not being conducted by the Department of Company Affairs at all. The reasons adduced are that the PSUs were subjected to audit by C&AG and that they were under the administrative control of the Ministries concerned. What is further surprising is that during the years 1991-92 and 1992-93 inspection of books of accounts of NBFCs were also not conducted with regard to irregularities committed under PMS and other similar schemes except in a few cases. In fact, none of the subsidiary companies of nationalised banks which prominently figured in the scam were subjected to any scrutiny at all. The reasons advanced by the Department that NBFCs were subjected to RBI guidelines, they were also inspected by SEBI and there was paucity of staff etc. were untenable and cannot be accepted as valid explanation for the failure of the Department in the discharge of the statutory obligations cast upon them. It is only now, after the matter was pursued by the Committee with the Department of Company Affairs, that the Department decided to conduct limited inspection of books of accounts of PSUs which have entered into PMS transaction for ensuring compliance of provisions of section 370/372 of the Act. The Committee would like the inspection to be expedited. The Department of Company Affairs should also inspect the books of accounts of all the NBFCs including subsidiaries of banks involved in the scam. Necessary Prosecution proceedings should also be initiated against PSUs & NBFCs, wherever violation of the provisions of the Companies Act are detected. It should also ensure that the provisions of Section 370 and 372 of the Companies Act are scrupulously followed in future by Public Sector undertakings and Non-Banking Financial Companies with a view to obviate recurrence of the irregularities committed in the Scam.
127	14.120	The Risk Capital and Technology Corporation (RCTC) deployed funds with Housing Development Finance Corporation (HDFC) a private sector company through brokers M/s. Shah Investments and SJ Financial Investment Consultants. RCTC contended that no brokerage was paid by it to brokers rather it got commission from brokers which was credited to profit and loss account of RCTC. The Committee, however, have found that rate

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		of return on the funds deployed by RCTC with HDFC, wherein brokers were also engaged was 10-11% whereas in cases where in funds were deployed with banks/financial companies other than HDFC the rate of return was even upto 23%. In this background the Committee are unable to understand as to why RCTC choose to place its funds with HDFC at a lower rate of return. The Committee would like that a detailed enquiry be made to ascertain as to why funds were placed with HDFC at a lesser rate of return.
128	14.121	After examining the aspect of deployment of surplus funds the Committee are driven to the conclusion that various irregularities committed by PSUs in the investment transactions were not occasional aberrations but had become an integral part of the system. The irregularities were known to the authority and yet not corrected. Inevitably, and not surprisingly, the unscrupulous elements exploited the situation for their illegal enrichment. In the process it was the common man and the economy of the nation that have paid an enormous price.
129	14.156	From the details of investment transactions of surplus funds made by ONGC large scale irregularities in the deployment of large surplus funds as also the shortcomings in the system have been noticed. In order to circumvent the Government restrictions in regard to the placement of funds with foreign banks, ONGC have sought to make an unsustainable distinction between "short term investment" and "short term deposit". No one at the level of senior officials of the Ministry or in the top management of ONGC or in the legal department of ONGC seem to have bothered to check whether or not such action was compatible with the provisions of the ONGC Act. Cupidity appears to have overcome all considerations of propriety or legality.
130	14.157	Another disquieting feature observed by the Committee was that the funds deployed by ONGC with banks in two transactions one to the Oman International Bank (Rs. 30 crores) and the other to the State Bank of Hyderabad (Rs. 20 crores) had been passed on to the brokers who used them to purchase shares of Reliance Industries Ltd. While in the first case, ONGC authorities failed to obtain from the Bank even a statement of securities in which investments had been made, in the second case, the letters issued by the bank to the Commission did not reflect the correct position of the deployment of the funds.
131	14.158	The representatives of ONGC maintained before the Committee that brokers were never engaged by the Commission in deployment of funds. However, they admitted that certain brokers, in fact, had approached them. The Member (Finance) , ONGC who is currently under suspension had also in a subsequent note furnished to the Committee stated that he had since learnt that some of the cheques were delivered by officers of ONGC to the representatives of the brokers. This clearly suggest that brokers had played a vital role in the deployment of surplus funds of ONGC. The Committee expect that subsequent investigations will take note of the facts narrated above and make further inquiries so as to find out the persons responsible for irregularities.

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132	14.159	The ex-Chairman of ONGC had taken appointment with Reliance Industries after his retirement from ONGC which appears to be in contravention of ONGC Rules. The Committee desire that the matter be enquired into and further necessary action taken, including amendments to ONGC Rules to remove lacunae, if any.
133	14.160	The Committee also desire that ONGC should enquire into the irregularities as well as the shortcomings in the procedures dealt with in this report with a view to streamlining procedures/systems for deployment of funds so that the irregularities do not recur in future. Action should also be taken expeditiously against the officers found guilty of indulging in malpractices.
134	14.193	The Committee have noted that in OIDB in all the files containing investment decisions under the scheme of Certificate of Deposits scrutinised by them, a condition had been added that any better offer received prior to investment was also proposed to be availed of. OIDB quoted this condition to justify some of the discrepancies noted from the test check of files of 26 transactions made by OIDB relating to the period 30.4.1991 to 22.6.1991 under the scheme of Certificates of Deposit.
135	14.194	The Committee regret to note that under the cover of the said condition, revised offers received from banks even after the approval of the proposals by the Chairman, OIDB were entertained and investments made with them. Evidently, this made a mockery of the orders of the then Chairman, OIDB that the deployment of funds should be made with his approval as in the above cases, the said orders were not observed.
136	14.201	After OIDB started making investments in PMS and other schemes from March, 1992 and till 27.5.1992, OIDB had made disproportionate investments in two institutions, *viz.*, Canfina and Syndicate Bank. The manner in which these two institutions had been chosen repeatedly for investment, on several occasions, has indeed exposed the system of processing of offers prevalent in the organisation. It had become a usual practice to entertain revised offers after the last date of submission of quotations and after the files had been submitted to the Chairman, OIDB for final orders. Such practices make a mockery of the tender system and violate the norms of prudent financial management. Unavoidably, such actions have created doubts that some institutions had received preferential treatment at the hands of OIDB. Unfortunately, the explanations offered by both the then Chairman and others from OIDB have in no way helped in dispelling these suspicions.
137	14.202	What has caused considerable concern to the Committee is that OIDB did not possess either the securities or any stamped receipts in respect of the investments made by them, and did not even have any confirmation in regard to safe custody of the securities. Apparently, investments were continued to be made with such banks even after they had failed in submitting the necessary documents. More astonishingly, these funds of OIDB were widely used in making investments in equities of private sector companies. Had OIDB obtained the statements from the banks concerned periodically regarding the manner of deployment of money, the senior officers who were responsible for the management of finances had followed up by obtaining the securities or stamped

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		receipts for the payments made, these facts would have come to light. Unfortunately, the officers failed. The Committee are of the view that the Secretary, OIDB, Financial Adviser and other officers responsible for fund management were negligent in the discharge of their duties, and the responsibilities should be fixed for the lapses.
138	14.203	The Committee have noted that Canfina had already defaulted in repaying the money to the extent of Rs. 70.86 crores which became due in August, 1992, and also Rs. 137.28 crores which matured till 16.4.1993. The recovery of Rs. 71.31 crores which became due in May, 1993 is also doubtful. The efforts made by OIDB so far to retrieve the money back from Canfina have not succeeded.
139	14.204	The Committee find it necessary to observe that OIDB has mentioned the security of investment as one of the criteria. How, when this is found wanting, the Ministry of Finance is to advise about remedial action. The Committee feel that it is an evasion of responsibility on the part of OIDB to approach the Department of Banking now for advice on how to recover the money.
140	14.205	The Committee are of the view that assumption of responsibility for placement of funds by Chairman of OIDB was uncalled for. The Committee are also of the view that Ministers acting as ex-official Chairmen of such organisations is not a healthy practice. In the light of these observations, the Committee consider it a sad duty to conclude that the two Chairmen, OIDB during the relevant period did not discharge their responsibilities in consonance with the high office held by them. Further it is the expectation of the Committee that Government will take necessary corrective action.
141	14.226	The investments made by Air India with Citibank in April, 1991, (Rs. 96.77 crores), SBI Caps, in June, 1991, (Rs. 147.86 crores), both in ready forward deals; deposit of Rs. 35 crores, in January, 1992, with Indbank Merchant Services Ltd., and Rs. 49.28 crores, in February 1992, and Rs. 10 crores, under PMS with Citibank, in May, 1992 were highly irregular and totally violative of the provisions of Air Corporations Act. The manner in which the agreements were signed by the representatives of Air India with Citibank authorising the bank to invest in private equities concealing the said conditions in records of the Corporations and also the manner in which the books of Air India were tampered with so as to show the investments in question as deposits with the State Bank of India, clearly establishes that these actions were malafide. The failure of AI officials to obtain securities, BRs from Citibank/SBI Caps in time, and the complete negligence demonstrated in perusing the periodical statements emanating from Citibank, indicating investments in the equities of Private Sector Companies only reinforces the above observation. It was also demonstrative of the total failure of the officers higher up in the hierarchy to exercise proper control and supervision.
142	14.227	The Committee have noted that Air India had apportioned the blame for the irregular investments on Shri S.R. Gupte, former Deputy Managing Director who was also discharging the functions of Director, Finance,

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		Shri J.A. Sidhwa, Deputy Director (Finance) and Shri K. Raghunathan, Asstt. Financial Controller. The last two have been suspended pursuant to a departmental inquiry. Both of them maintained that they were acting in pursuance of the verbal instructions of Shri Gupte who voluntarily retired on 21.3.1992. Shri Gupte denied having issued oral instructions. However, considering the fact that the weekly statements showing deployment of funds with various banks were stated to have been sent by Shri Sidhwa, Shri Gupte could not have remained unaware.
143	14.228	The Committee desire that the matter be thoroughly inquired into, if necessary with the assistance of CBI with a view to punishing the guilty. The Committee feel that the Chief Executive of Air India should have kept himself informed of the manner of investment of sizeable surplus funds of the Corporation. If that had been done, irregularities could have been detected earlier. The Committee trust that the shortcomings in the existing procedures pointed out in this report, as also by the report of the Special Audit will be set right. It needs, however, to be stated here that the overall responsibility remains that of the Ministry. This was not satisfactorily performed.
144	14.249	The Committee have noted that after getting financial assistance, for different purposes from Air India/Indian Airlines, Vayudoot invested the funds with banks/Finance Company. This was certainly not in consonance with the objective for which financial support was provided by Air India and Indian Airlines. Pertinently, having defaulted in serving its past debts particularly to banks, Vayudoot at the relevant time was being called upon to pay penal rate of interest at 26.5%. On the loan from AI/IA it was paying 10 and 16%. Astonishingly, instead of meeting these heavy interest carrying liabilities, the Company chose to make several new investments which offered a return lower than this said 26.5%. Further, the manner in which Vayudoot had been issuing pay orders for 14 out of the 18 deposits in favour of Canara Bank but obtaining receipts from Canfina is a singular lapse.
145	14.250	In this connection, the Committee have noted that on 14.12.1992 it was decided at the level of the Minister of Civil Aviation and Tourism to seek explanation from the CMD, Vayudoot. However, the formal letter in pursuance of the said decision was issued only on 5.3.1993. The Committee have found it inexcusable that there should be so much delay in an important matter like this. The Committee hope that the Ministry of Civil Aviation will at least in the future ensure a proper system of monitoring with a view to ensuring that funds are deployed by the PSUs under their administrative control strictly in terms of the policy and laid down procedures.
146	14.251	The Committee feel that the role played by the CMD, Vayudoot and all other officers concerned in the entire episode should be thoroughly inquired into with a view to fixing the responsibility.
147	14.254	The funds in short terms investments in Government securities and PSU Bonds placed with banks and financial institutions by the Corporation were

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		in the nature of ready forward deals, and were not investments in Government Securities and PSU Bonds as claimed by it.
148	14.257	The two CMDs, who approved six proposals of investment of funds exceeding delegated powers retired from service on 30.9.1990 and 30.5.1991, respectively. Even a post-factor approval of the Board of Directors having not been obtained, these erring CMDs have not yet been asked to explain why the authorisation was flouted.
149	14.260	The only action that PFC has taken for irregularities in issue of cheques for investments in favour of banks other then with whom investment was made, is to call for explanations of the concerned officers of their Finance Department, and that too after the Committee's examination. The Committee have been informed that appropriate action would be taken by the PFC on receipt of these explanations. The Committee find this manner of dealing with financial irregularity as unsatisfactory and would like very urgent punitive and rectificatory action to be taken.
150	14.265	The Committee need hardly underline the blatant misuse of public funds and of total violation of investment norms. These monies did not fund power projects, they financed brokers, banks and financial scams. That till date, no one has been punished for this swindle, is in view of the Committee, a reflection of the tardiness with which the matter has been dealt with.
151	14.268	The transactions carried out with the foreign banks being of the nature of ready forward, with no securities made available to PFC, these could not be termed as investments in PSU Bonds and Government Securities. The Committee regret to note that the Board of PFC also did not apply its mind to this matter and remained a passive spectator.
152	14.276	As regards placement of funds under PMS it was explained by PFC that the overriding condition of locking of funds for a period of one year, at not less than 14.25% p.a. with Citibank and at 13.5% p.a. with UCO Bank was a prior condition of their agreeing to subscribe to the offered 17% Taxable Bonds of the PFC. The funds (Rs.300 crores) would thus not be available for power projects until at least a year later. For this one year the PFC would be a net loser by around 7% of the total amount.
153	14.278	Almost predictably, an amount of Rs. 17.87 crores of an escrow account was provided to Canfina by PFC, on 19 May, 1992 theoretically for investment in Government Securities and Public Sector Bonds. This was a violation of the principle of escrow accounts, of agreements contracted, of so many other norms and standards.
154	14.280	Out of an amount of Rs. 17.87 crores plus yield thereon, due from canfina under the transaction, only Rs. 9.87 crores has so far been recovered. Efforts to recover the balance amount are stated to be continuing, so the Committee was informed. The Committee would like to emphasize that these as yet, unrecovered dues, were funds originally received from Asian Development Bank and were meant for power projects in Andhra Pradesh and Tamil Nadu.

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155	14.282	The Committee find pending CBI investigations the present position of taking no formal disciplinary action against three PFC officers, who have only been placed under suspension as completely unsatisfactory. In the face of all the many documented and established misdeeds and gross violations by the PFC, not one single person has been punished so far by the Government. The past and present Boards of the PFC, and the various concerned officials and others of the Ministry of Power have shown little sense of concern or urgency in meting out punishment to the guilty.
156	14.295	The Committee are constrained to observe that in such a serious matter as investment of funds raised through Bonds, the Ministry of Railways instead of obtaining formal approval of the Ministry of Finance for investing in securities not covered by Government instructions, chose to act on its own after the so called 'informal enquiries'. This resulted in a reversal of the established policy of the Ministry of Finance. The Committee find no justification for the conclusions drawn and the instructions issued by the Ministry of Railways. The Committee also find no evidence to indicate whether even the approval of the Board of IRFC was obtained for this purpose.
157	14.296	The Ministry of Railways is also guilty of firstly of not obtaining formal clearance from the Ministry of Finance for what amounted to total reversal of well established policy. Thereafter, it is guilty of issuing vague instructions to IRFC and finally it failed even to monitor these instructions. In consequence IRFC has virtually lost over Rs.866 crores. The Committee recommend that the whole matter should be thoroughly enquired into and responsibility fixed.
158	14.301	The Committee find as totally unsatisfactory this explanation furnished by the IRFC for investment of funds with Canfina after the scam had broken out. The committee must observe that IRFC engaged in questionable investments and continued to do so well after the full dimensions of the scam had surfaced.
159	14.302	For the loss of over Rs. 445.37 crores the IRFC and Ministry of Railways are accountable.
160	14.307	The Committee regret to note that IRFC made investments with foreign banks when not authorised to do so. Further IRFC permitted the banks to invest their funds in securities other than those approved. This was in violation of Government guidelines for investment.
161	14.322	KRIBHCO which is a Society registered under Multi-State Cooperative Societies Act, 1984 can make investments as per the provisions contained in Section 62 of the Act. Accordingly, the Society was required to take permission of Central Registrar of Cooperative Societies before making investment/deposit of surplus funds. The Society however, made all investments without seeking the permission of Central Registrar. The Committee found that on the one hand KRIBHCO had taken loan from Department of Fertilizer and other financial institutions and on the other it

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made investments also. The Board of Directors of the Society authorised the M.D. to make investments; however the M.D. in turn delegated this power to Finance Director without the approval of the Board.

The Committee noted that Department of Fertilizer allowed KRIBHCO to make investment with Indian branches of foreign banks even though the Society did not seek any such permission. The issue of investment by KRIBHCO with Indian branches of foreign banks was not discussed in Department of Fertilizer at all and only at the stage of issue of letter signed by an Under Secretary dated 23.7.1990, Department permitted KRIBHCO to make short term deposits in foreign banks as well. The Committee would like the matter to be thoroughly examined to ascertain as to how such permission was deemed to be granted when the matter was not deliberated upon at all.

The Society made huge investments with subsidiaries of banks like Canfina, ABFSL without taking permission of Central Registrar of Cooperative Societies.

Canfina & ABFSL defaulted KRIBHCO to the tune of Rs. 47 crores and Rs. 92 crores respectively.

The Society exposed its funds to risk by leaving discretion with banks/ finance companies with regard to utilisation of its funds. The Society did not take care to obtain the details or the physical delivery of securities at all.

Four months after the Scam became public, the Board of Directors of KRIBHCO issued revised guidelines for investment of surplus funds of the society. The Committee regret that Ministry concerned which has the ultimate accountability for the observance of financial rules and regulations did not properly discharge their responsibility.

162 14.346 The Committee have noted that as per provisions of section 62 of MSCS Act, 1984, IFFCO was required to take approval of Central Registrar of Cooperative Societies to make investments of surplus funds. However, pending approval of the Central Registrar the Society had already invested funds to the tune of Rs. 155.92 crores. There was no systematic pattern of investments made by the Society under short-term and PMS. The Society invested funds under PMS for a very short duration which was in contravention of RBI guidelines, according to which funds under PMS could be placed only for a minimum period of one year. Further, return of funds placed under the PMS was guaranteed. The Committee have also noted that the Society placed funds for utilisation in call-money market.

163 14.347 During the period 1.2.1991 to 22.4.1991 the Society made investments at a lower rate of interest although higher rates were available for these investments. Such a practice led to a loss of Rs. 15 lakhs to the Society. The Board of Directors gave their *ex-post facto* approval to these investments. Surprisingly no action was initiated against the officers who committed this lapse. The Society has also made investment in excess of Rs. 35 crores which was the limit granted to it for making investments in any one single scheme.

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		These investments were approved by the Board of Directors of the Society on *ex-post facto* basis. However, no action was taken by the Board against erring officials.
164	14.348	The Committee recommend that at least now an enquiry be made in the matter and action taken against the officers found guilty of indulging in acts prejudicial to the interests of the Society. The Committee also suggest that the Government should enquire into the role and responsibility of the Registrar of the Cooperative Societies in regard to functioning of the two important cooperative societies (KRIBHCO & IFFCO).
165	14.349	The Committee have found that one important fact which emerged from the foregoing and from the replies of various heads of PSUs is that non-financial PSUs were indulging in financial transactions of such an order that interest income quite often was more than interest expenditure and in some cases the profit of the enterprises were more due to such financial transactions rather than from productive activities. This formed part of profit and was regarded as an index of success.
		RESERVE BANK OF INDIA
166	15.9	The Government can under Section 8(1)(c) of RBI Act nominate ten Directors (non-official). At present there are 8 non-official Directors on the Board of RBI. 7 of these Directors were appointed on the Board in March, 1983 and one Director in January, 1986. The Committee are astonished to note that a Board overloaded with representatives of industries and business is still continuing well beyond its normal term of four years and a decision on its replacement is still to be taken. The Committee were informed that 49 meetings of the Central Board took place during the period January,1986 to December, 1992, out of which, the Government nominee (Secretary, Economic Affairs) was present in 15 meetings only.
167	15.10	Agenda for the meetings of the Central Board of the RBI normally include review of the weekly reports of Issue and Banking departments, developments in exchange and exchange control and review of the working of various of RBI namely the DBOD, RPCD, DFC, Vigilance Unit etc. Apart from these other items discussed also include economic reviews of different states, reviews of working of public sector banks/foreign banks operating in India, Annual Reports of working of RBI etc. The Committee note with concern that the irregularities in securities transactions in banks that had surfaced as early as 1986 did not engage the attention of the Board despite the fact that the scrutiny reports, the AFRs of banks as in the case of State Bank of India, Canara Bank, Syndicate Bank, Vijaya Bank, UCO Bank and the annual reviews of 1990 and 1991 on the foreign banks had brought out serious irregularities in their operations, malpractices in securities transactions and violation of RBI guidelines. This is all the more a matter of concern as the Ministry has confirmed that the reviews of the working of public sector banks/foreign banks operating in India is a normal item of the agenda of the Central Board. In this sense, the Central Board has failed to discharge the responsibility entrusted to it.

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168	15.17	The number of SGL accounts with PDO, Bombay has steadily grown from 160 in 1987 to 455 upto June, 1992. Similarly the number of SGL transfer forms received has also grown from 3902 in 1987 to 4971 in 1988, 5778 in 1989, 6434 in 1990, 12838 in 1991 and 5623 during the first semester of 1992. It is apparent that while during the first three years the increase in the number of SGL Transfer Forms received is gradual between 15 to 20 percent per annum, it shows a quantum jump of almost 100 percent from 1990 to 1991 and almost the same levels are visible in one semester of 1992.
169	15.18	It is relevant to note that this is the period when the massive irregularities in securities and banking transactions had taken place.
170	15.21	A very common feature observed by the Committee in the securities transactions of the banks involved in recent irregularities is that SGL transfer forms of several banks were not honoured due to insufficient balance in their respective SGL account with PDO, Bombay.
171	15.24	The Committee find that the figures for corresponding months in Table A relating to issue of objection memos and in Table B relating to SGL forms returned due to insufficient balance remain unexplained
172	15.25	It is further noted by the Committee that out of these a substantial number of the bouncing have taken place in the SGL accounts of the Banks, etc. which are figuring prominently in the recent irregularities as shown in the statement below :

(July, 1990 to June, 1992)

Andhra Bank	172
UCO Bank	123
SCB	276
ANZ Grindlays	53
BoK	138
BoA	112
Citibank	171
Bank of Madura	110
Canfund	41
Canfina	82
Total	1278

173 15.28 The Committee are informed that in the absence of any enabling provision in the Public Debt Act, 1944/Public Debt Rules, 1946 and the PDO Manual to penalise defaulting banks for such defaults, the Central Office (Department of Government and Bank Accounts) advised PDO, Bombay on 11 March, 1991 to write D.O. letters to the Chairmen of such banks and suitably advise DBOD in the matter. The Central Office also decided to assess the comparative position of default by different banks after issue of the D.O.

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		letter to the Chairmen and for this purpose it advised PDO Bombay to submit statements in this regard on a quarterly basis. No concrete action however was taken by the Central Office on the statements pertaining to the quarters ending September, 91, December '91 and March '92 under the plea that impact of the measures could not be correctly assessed for the first quarter as the D.O letters were issued only on 22 August '91 and in so far as the two, subsequent statements are concerned they were received only after the irregularities surfaced. It is significant to note that PDO functioned under Shri R. Janakiraman, Deputy Governor, during this period.
174	15.31	The Committee are unhappy to note that such an important circular like the July 1991 circular had not even been sent to the Regional Offices of RBI which are expected to monitor the workings of the banks.
175	15.32	By not taking concerted action on the bouncing of SGL forms the two important departments of the RBI headed by two Deputy Governors Shri R. Janakiraman and Shri Amitava Ghosh respectively, principally concerned with SGL displayed insufficient concern in the matter contributing greatly to subsequent damage to the system. It is this gross dereliction of duty in PDO and DBOD which greatly contributed to the scam.
176	15.35	The computerisation of PDO which was recommended in February 1986 did indeed take place but in June, 92 only, after a lapse of almost six and a half years and that too in the aftermath of the scam.
177	15.40	The Committee are informed that though periodic inspection of PDO is supposed to be done once in a year, the last 2 inspections were carried in 1990 and 1992 and the latter was subsequent to the surfacing of the scam. The Committee are of the opinion that a set procedure of inspections at regular intervals of the Public Debt Offices should be evolved and strictly followed so that any shortcomings/irregularities that are observed and rectified within the shortest possible time.
178	15.44	Four Grade 'A' Officers of PDO Bombay were put under suspension on the basis of irregularities that were revealed during the inspection in May, 1992. Subsequently the Committee have been informed that the Enquiry Officer had submitted his report and on the basis of that the Competent Authority has proposed tentative punishment. This has been conveyed to the four officers. Simultaneously their suspension orders have been withdrawn and they have joined duties. These officers have made written representations on 10 April, 1993 and have appeared for personal hearing on 8th and 11th May, 1993. Their submissions are under consideration of the Competent Authority. The Committee urge that as it is already more than a year since the offences were noticed, the authorities concerned proceed with all deliberate speed to secure prosecution/punishment of the guilty at all levels. The Committee are not satisfied that the necessary speed consistent with the gravity of the situation has been demonstrated.
179	15.49	A committee was setup by Governor, RBI in 1985 to review the Public Debt Act 1944 and Public Debt Act Rules 1946. The committee gave its report in Feb. 1986. The draft amendment to the Public Debt Act was submitted to the

Government after a delay of $6^1/_2$ years in August, 1992. This draft amendment also became unavoidable in the wake of the malfunctioning of PDO becoming public knowledge. There is something terribly wrong with a system of governance which recognises, as far back as 1985, that the Public Debt Act, 1944 has been rendered "obsolete" but requires such a long period to rectify obsolescence. In the view of the Committee this alongwith the delay in computerisation highlight the importance of timely decision making. If delays and such delays — $6^1/_2$ years are permitted between a decision taken and its implementation then malfunctioning of systems is inevitable, it will spread as it has done; ultimately robbing the institutions of the ability to take and implement any decisions at all. The paralytic reaction time of governmental institutions is another major contributory factor to this scam, and the Committee would wish to emphasize it.

180 15.59 The Committee find that in almost all cases of follow up of inspection report by the RBI that have been examined by them, there have been inordinate delays in finalising and forwarding the inspection reports and pursuing them with the banks for compliance. The Committee note that in the case of SBI the Report of 1986 was finalised and forwarded to the bank almost after a lapse of one and a half years and discussed with the bank management more than three years after the inspection. The AFRs of SBI have likewise been finalised and discussed after long delays. The same kind of inordinate delays are noticeable in the case of Andhra Bank, Canara Bank, etc. In case of AFRs of certain banks like Bank of Baroda, Canara Bank, Vijaya Bank, etc., that were conducted in 1986 and 1987; the discussion between the representatives of RBI and the top management of the banks are still to take place (as on October, 92). Interestingly, delays are noticed in the case of the foreign banks also who have emerged alongwith certain select Indian banks as the major players in the recent irregularities in securities and banking transactions. The RBI has indicated that discussion in quite a few cases have not been held on account of commitments on the part of the top executives of the RBI, inspection deficiencies in the case of public sector banks being generally covered in Action Plan meetings held by the Governor and discussions having been held with the bank's management even prior to finalising of the report or sending the same for their compliance. The reasons cited by the RBI are far from convincing and hardly explain the inordinate delays that have occurred. The Committee are highly perturbed over the fact that while junior officers of the bank have been pointing out numerous irregularities in their reports, the top management of the Bank failed to act over a period of several years. Rectificatory action was relegated to a low order of priority and under taken with great casualness, even negligence, thus contributing in significant measure to setting the stage for the scam.

While noting that the RBI set up the Padmanabhan Committee in 1991, the Committee are constrained to stress that such action should have been taken years earlier.

181 15.64 Shri Amitava Ghosh was the Deputy Governor in charge of DBOD for 10 long years. He must be held largely responsible for turning a Nelson's eye to the continuing irregularities in the banking sector, ignoring the inspection

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		reports prepared by the various RBI teams and being extremely casual and lackadaisical in his approach to his responsibilities. The Committee wonder how such an officer continued to occupy such a high office for such a long period. The Committee are even more amazed that RBI have found Shri Ghosh's services so indispensible that even after his retirement they have accorded him an important assignment.
182	15.65	The serious inaction of RBI in dealing with the Kurias report only highlight the manner in which the responsibilities are discharged by the senior officials in RBI. If only the then top management of RBI had taken action in 1987 on these recommendations the abuse of BRs/ SGLs/Bankers cheques which were instruments of scam could have been considerably moderated. The Kurias report had also referred to the possibilities of transactions been based on BRs without underlying securities.
183	15.66	The manner in which the Augustine Kurias report had been dealt with is not an isolated instance of the way the RBI has been functioning. It is inconceivable that a relatively junior official of RBI should have been able to unearth such a long set of malpractices unless there was general knowledge in the system of the existence and persistence of these malpractices. Yet, no one at the level of the Central Board, the Governor or the Deputy Governor appears at any time between October, 1986 and March, 1991 to have addressed the problem with the seriousness it warranted. As things went, the country had to pay a heavy price in thousands of crores of rupees for the lapses on the part of the RBI top management during the crucial years.
184	15.73	The RBI carried out scrutiny of PMS operations of Vijaya Bank during August-September, 1989. It also undertook the bills portfolio of Vijaya Bank during January-February, 1990. Serious irregularities were noticed during these scrutinies. The CO, DBOD submitted before the Committee that though he had recorded a note that scrutiny of a few banks in specific areas like Bills, PMS, Investments including call money operations and securities transactions was required, no action thereon had been taken by section concerned. This is another instance relating to PMS which has come before the Committee where virtually little action has been initiated by the DBOD on documented irregularities that had taken place. Neither was the functioning of banks in these limited areas reviewed nor any other corrective action taken after the Governor made his recommendation to the Government. The Committee would like stern action to be taken against the erring officials.
185	15.76	The Committee have noted that the foreign banks have treated the RBI in a casual manner. Exchange of correspondence between Citibank and the RBI provided an illustrative case as to the kind of response RBI gets from foreign banks in India. In the present case the financial inspection of Citibank was conducted on 25 May, 1990 and the Report on its findings sent to the bank on 24 April, 1991. As the bank had not furnished their comments within the stipulated period of 2 months, the bank was reminded on 9 July 1991, 19 August 1991, 30 September 1991, and 23 October 1991. The bank thereafter

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		furnished, its comments on 29 November 1991. Citibank was further reminded by RBI on 7 April 1992, 18th June 1992, and 16 July 1992 in response to which it furnished further compliance on 3 August, 1992, and the views of the bank relating to investment were furnished only on 27 August, 1992. As regards adherence to PMS guidelines, the bank had offered the revised views on 12 September, 1992.
186	15.79	While it is obvious that the Central Bank of the country has been taken lightly by the foreign banks, there are unfortunately no traces of the strong action against them.
187	15.80	The Committee have to comment upon the casualness with which Citibank persistently responded to the queries of RBI. It prevaricated, answered partially or inadequately, perhaps deliberately and never had a ready response to the requirements of the Central Bank of the country. Unfortunately the Committee have to also observe that this failure on the part of RBI to have its instructions obeyed is reflection of the loss of authority that the RBI has brought upon itself. The Committee have no doubt that no foreign bank would have responded with such indifference to directions/queries from the Central Bank of the country of its origin. It is the excessive accommodation shown to foreign banks by top management of RBI that imparted arrogance to these banks to describe as 'market practice' what was infact the blatant flouting of RBI directives. The foreign banks eventually emerged as the originators as also the biggest players in the scam.
188	15.101	At the instance of the Governor, RBI undertook scrutiny of transactions of 12 banks during the first quarter of 1991. A note giving the findings of the above scrutinies was put up by Special Investigation Cell on 14th May, 1991 highlighting various irregularities in securities transactions. In the light of the findings a circular was finally issued on 26 July, 1991, with the approval of Governor, RBI. The Committee have highlighted this instance only to accent its earlier observation on the follow up initiated on inspection reports. They regrettably conclude that even the high office of Governor RBI did not remain unaffected by the all pervasive malaise. In retrospect, the Committee are sadly led to the view that the Governor RBI could have demonstrated greater decisiveness at critical moments.
189	15.103	It is observed that out of a total 78 banks who were to respond to this D.O. Letter, 16 merely acknowledged the letter and there was no response from 27 others even after more than five months of the issue of the D.O. letter.
190	15.105	Even as late as July, 1992, 18 out of these 37 banks were still in the process of framing the policy in accordance with the July 1991 circular. Despite these circulars, the RBI has admitted before the Committee that though most of the key players in the recently surfaced irregularities in securities, transactions like Citibank, BoA, SBI, American Express Bank, Vijaya Bank, Syndicate Bank, etc. had admitted compliance with the D.O. letter of July 1991, it was subsequently proved that all of them had actually ignored the instructions incorporated in this D.O. letter and had indulged in the

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		irregularities on a massive scale. Nothing proves better, if further proof were indeed required, of the collapse of RBI's supervisory functions and the need for a thorough overhaul which will restore the position and authority of RBI at the pinnacle of our banking system. The Committee find that the functioning of the departments of PDO and DBOD has been totally unsatisfactory. If the concerned Deputy Governor/ senior officers in these departments had appreciated the implications of numerous reports that came before them, beginning with the Augustine Kurias Report of October, 1986, the effect of the scam would not have assumed such dimensions. Further, if Governor, RBI had taken serious note of these irregularities the ambit and depth of the scam might have been moderated. As it turned out, the entire system of regulation and control over the banking system in the very body charged statutorily to exercise regulation and control, completely broke down over a period of several years. With no one in authority, the RBI or at the level of Governor/Deputy Governor, or in the senior echelons of PDO and DBOD taking any determined action to put a stop to irregularities, criminals and scamsters were given the run of the land. It is this failure that is the root cause of the scam.
191	15.111	The Committee notice from the relevant records that a detailed note on bill discounting was put up by DBOD on 1 October, 1990 enumerating serious irregularities in the bills discounting operations of certain Indian and foreign banks; the likely ramifications of such irregularities; as also the course of action to be pursued to curb this unhealthy practice. A draft circular to the banks was also appended for approval and issue. The Committee however note that the circular relating to bill discounting facilities was issued only on 28 July, 1992, after a characteristic delay of 22 months after the scam came to light.
192	15.116	As regards not issuing the circular during 1992, RBI has informed the Committee that in the first half of 1991-92 there was a virtual cessation of credit and even in the full financial year 1991-92 the credit expansion was substantially below that of the previous year. If the measure of bill discounting/rediscounting have been implemented in 1991-92 there would have been a total disruption in the flow of credit. The Bank has further stated that though such credit drawals would be in the nature of irregular drawals, it was felt necessary to choose the appropriate time for implementing this measure. Accordingly a circular was issued after the credit policy was issued in the first half of 1992-93.
193	15.117	The Committee do not find as satisfactory the explanations offered by the RBI. Bill discounting was a means of finance resorted to by a number of borrowers who wished to avail of credit without going through the rigours and delays of consortium appraisal. While it is a desirable method of financing, it is important that particular groups or individuals should not get access to additional financing through this method without being eligible for additional credit. Irregularities in bill discounting had come to the notice of the RBI as early as January, 1990, if not earlier, when a detailed scrutiny

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		of Vijaya Bank had been undertaken. The reports of the RBI also clearly pointed out the misuse of the scheme by large industrial groups. The Study of Vijaya Bank, Indian Bank, SBH , American Express Bank exposed Reliance Group as a key player in these operations through a host of financial companies - 34 in one case, 16 in another. Others included the Kotak Mahindra Group and the Vijay Mallya Group. These grave shortcomings in the bill discounting scheme were again highlighted by the nominee RBI Director of the Karnataka Bank in December, 1991. This note quoted several instances where industrial houses were given irregular bill discounting facilities outside the consortium arrangements. Significantly, the Reserve Bank admitted in its report in which the Vijay Mallya Group and Fairgrowth were indicted that "some industrial groups shift from one bank to another as and when their dealings come to our knowledge and sort of restrictions are placed on them". With all this information already available, RBI chose to delay even issuing a circular for a period of 22 months, despite the fact that this was the period during which there was a credit squeeze. This resulted in irregular flow of funds to large industrial houses. It is possible that the bill discounting irregularities may have been another component of the supply side of the scam an aspect that has hitherto not been looked into. This lapses seems unpardonable and needs to be investigated.
194	15.125	The Committee find that because of the fragile foreign exchange situation and the BOP crisis the RBI had not been assertive enough in the action taken against foreign banks. Both the RBI and the Ministry of Finance by not taking deterrent action against them early enough enabled the foreign banks to exploit the situation and commit large scale irregularities in total violation of the guidelines laid down by the RBI. In fact, the Governor, RBI has gone on record to say that "for the past failures we have to take action against them". The Committee recommend that such deterrent action be taken without any further delay. It is also learnt that the regulatory authorities of these foreign banks in their countries of origin are examining whether any of their laws have been contravened. RBI should pursue this matter with the concerned authorities. The Committee would also recommend that in future any action taken by RBI against the branches of the foreign banks in India should be reported formally to the regulatory authority of the country of their origin. In addition the Government should take the matter with the counter part Governments concerned.
195	15.128	As against the priority sector lending targets of 10%, 12%, 12% and 15% respectively, the achievements of the foreign banks have been 7.67%, 9.84%, 9.45% and 7.86% respectively. No penal action has been taken against these banks for failure to achieve priority sector lending targets but the same is now under consideration of the RBI. The Committee hope that necessary action will be taken soon. Incidentally the Committee note that recently the Government have directed the foreign banks to use the amount representing the difference between the target laid down for priority sector lending and their actually lending for buying SIDBI Bonds at 10% interest. This is however applicable from the current financial year only.

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196	15.137	The Committee find that the delay in the constitution of the Board had adversely affected the functioning of the NHB and resulted in gross misuse of the funds of the bank. In the absence of the Board of Directors the complete management was in the hands of the Chairman-cum-Managing Director of the bank. The silence of the RBI regarding its own subsidiary having violated the RBI guidelines relating to buy-back transactions and the commissions/ omissions which have come to the fore are a telling commentary on the manner in which RBI through its Informal Advisory Group had taken care of the interests of its subsidiary.
197	15.143	RBI has maintained that the nominee directors not having reported about the irregularities to the bank management may be on account of the Board not having been informed about such matters and that generally, only matters of policy, especially in the investment portfolio, are brought to the notice of the Board of Banks. The actual manner of execution of investment contracts, return of SGLs etc., do not generally get reported at the Board level.
198	15.144	The Committee's examination of certain banks has revealed that the volume of the transactions in securities/statement regarding management of funds is reported, to the Board periodically. The RBI inspections/scrutinies of banks had in several cases indicated irregularities in securities/PMS transactions which are invariably required to be placed before the Board. In view of the above, the position taken by RBI that it was nowhere possible for the Board of Directors to know about the irregularities does not stand to reason. The reasoning is all the more untenable in cases like Andhra Bank, Vijaya Bank, BoK, Bank of Madura etc., where RBI inspection had consistently pointed out irregularities in securities/PMS transactions etc.
199	15.147	The Committee note with surprise the fact that except in one case the RBI nominees have never reported any of the irregularities related with the present security scam previously. This is despite the fact that they are better equipped with the knowledge of monitoring and regulatory procedures and virtually have access to a mine of information available within the RBI in the form of reports of financial inspections, scrutinies, reviews, etc.
200	15.148	In the opinion of the Committee the nominee directors of the RBI have neither noticed the irregularities nor effectively discharged their role on the Board of nationalised banks and their presence at best has been symbolic. The Committee concur with the views expressed by the previous Governor, RBI and the Narasimham Committee regarding discontinuing the practice of having RBI nominees on the Boards of nationalised banks and recommend that the RBI nominees can be dispensed with.
201	15.149	The Committee are constrained to observe that it was the top management of the RBI which was wholly responsible for RBI's contribution to the scam. If the RBI had not turned a blind eye to the massive irregularities in the banking transactions between the period July 91 to April 92 when thousands of crores of bank funds were diverted to the stock market it would not have been possible for some brokers to play havoc with the system. Shri S. Venkitaramanan as the Governor of the Bank during this crucial

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		period must be held no less responsible. The suggestion to treat the foreign banks differently, the delay in the issue of the circular of July 1991, failure to incorporate all the deficiencies noticed even in this circular and the absence of any follow-up action subsequently, the delay in the issue of the bill discounting circular for 22 months, his recommendation to appoint people in top position which proved to be a liability, subsequently, display of unusual interest in the account of HSM, his acts of omission and commission cannot be overlooked in any of their ramifications.
		Similarly, the large number of SGL bouncings, the deficiencies in the functioning of the PDO and the goings-on in both SBI and NHB of which he was a director clearly indicate that there was dereliction in performing his duties by Deputy Governor, Shri R. Janakiraman.
		Shri Amitava Ghosh was the Deputy Governor in-charge of DBOD for ten long years. He must be held primarily responsible for the continuing irregularities in the banking sector, ignoring the various inspections reports prepared by the teams of RBI inspectors over the years like the Augustine Kurias report, the Ranganathan report etc. and for being casual in his approach to his duties.
		Shri N.D. Parameshwaran, the Chief Officer of DBOD should also be held responsible for the lapses of the DBOD. He also need not have played any role regarding the account of HSM.
202	15.150	The Committee find that despite an elaborate machinery available with the RBI for conducting inspections, scrutinies, reviews of the banks and a detailed mechanism to follow up shortcomings noticed in their working the RBI has signally failed as a regulatory and supervisory agency necessitating a thorough overhaul to restore the position and authority of RBI at the pinnacle of our banking system. Inspection of banks by RBI is a major instrument of supervision. The Committee find that this has become almost routinised and the documented irregularities reported by their own inspectors were not given due attention or effectively followed up. Further the annual AFRs and inspections which have traditionally concentrated on banks' credit operations should now undertake detailed scrutiny of treasury operations following the growth in the financial market. The Committee are of the view that a separate Board of Financial Supervision should be created under the aegis of the RBI to ensure effective supervision of banks. The Finance Minister in his written submission to the Committee had indicated that a board of this kind could provide integrated supervision not only over the banking system but also over the financial institutions and NBFCs. The Board will also cross check transactions and undertake direct verification of areas like inter bank balances, assessment of the performance of banks and financial institutions in key areas such as assets liabilities management securities transaction and credit management.
203	15.150	The Committee recommend that the Board to be constituted for the purpose should draw on the experience of eminent persons in the spheres of banks, management, economics and related segments to provide the requisite

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		advice as and when necessary. The annual report of the Board may be presented to the Parliament.
204	15.153	The irregularities in the banking sector have revealed that there has been large scale violation of RBI guidelines and instructions. For these violations it is possible to impose penalty under Section 46 of the Banking Regulation Act, 1949.
205	15.154	The Committee are of the view that more deterrent and penal action should be taken in order to ensure that all banks fall in line with the guidelines/ instructions of RBI. The Committee suggest that the penal clauses in the BR Act and other relevant Acts should be reviewed with a view to enabling RBI to impose graded penalties and other types of punishments commensurate with the seriousness of the irregularities. It is also necessary to review all relevant legislations relating to banks and other financial institutions so that they keep pace with the technological changes and other developments.
206	15.155	The Committee feel that the enquiries already initiated against top management of certain banks and financial institutions be conducted expeditiously. Similar enquiries should also be conducted in respect of other banks/financial companies etc. involved in the scam. In the light of the findings of these enquiries, suitable action may be taken against the top management at the earliest.
		MINISTRY OF FINANCE
207	16.8	In the context, of the banking sector the Government being the owner (or trustees on behalf of the people of India) of the entire nationalised banking industry and given that there exist various methods and mechanisms of information and control, the MOF failed to: (a) anticipate the problem; (b) respond to it purposefully when it first surfaced; (c) manage adequately thereafter the consequences of it; (d) apply the needed correctives with despatch; and (e) punish the guilty in time and resolutely.
208	16.14	The FM addressed the Presidents of Stock Exchanges on the 28th of March, 1992 regarding better control of stock exchanges. At this meeting, the FM had expressed the need for proper administration of exchanges to prevent price rigging and better transparency needed for maintaining capital adequacy norms, increasing corporate membership etc. However, it is sad that, the spurt in share prices or the abnormal behaviour of the stock market had not been discussed, despite the fact that he was stated to be greatly concerned about the rising share prices and had remained alert to the behaviour of the stock market from even as early as September, 1991.

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209	16.15	The FM while replying to a Call Attention Motion on the strike by share brokers had stated in Lok Sabha on 30th April, 1992 it seems in a lighter vein that "but that does not mean that I should lose my sleep simply because stock market goes up one day and falls next day". Similarly the Committee would like to observe that 'it is good to have a FM who does not lose his sleep easily but one would wish that when such cataclysmic changes take place all around some alarm would ring to disturb his slumber'.
210	16.16	The Committee are inclined to conclude that despite MOF being aware of what was happening in the Stock Market did not address themselves seriously to check the unhealthy trend believing this phenomenon to be a beneficial consequence of their policy. Even after holding the market behaviour as unreasonable, the MOF did not act decisively in the matter.
211	16.18	At present there are 8 non-official Directors on the Board of RBI. 7 of these Directors were appointed on the Board in March, 1983 and one Director in January, 1986. The Committee note that all of them are still continuing well beyond their normal term of four years and a decision on their replacement is still to be taken. In reply to a specific query the Ministry has furnished the reasons for delay in reconstitution. A perusal of this reply reveals inordinate delay at various levels, total indecisiveness and an utter lack of urgency in dealing with a matter of such importance. The Committee have expectations of some remedial action, even at this stage.
212	16.19	The Committee must also comment that this existing Board has a predominance of representatives of industrial sector.
213	16.20	The Committee were informed that out of the 49 meetings of the Central Board of RBI, held since 1st January, 1986, the Government nominee director on it has attended only 15 meetings. When this was pointed out during evidence, the witness admitted: "I have seen the record. I also feel that we should have been present more in the meetings. There is no doubt about it."
214	16.21	The Committee find it difficult to appreciate this obscure, self-condemnatory evasion. Considering that Government nominees have participated in less than a third of the meetings held since 1986, it is difficult to establish as to what they have actually contributed towards achieving the original purpose of their appointment. The Committee also note with regret that the irregularities in securities transactions brought out in AFRs of individual banks like UCO Bank , Andhra Bank, Canara Bank or the Annual Reviews of select foreign banks like American Express Bank, Citibank, BOA, ANZ Grindlays etc. of 1990, and of 1991; which had adversely commented on the performance of these banks, did not even engage the attention of either the Central Board or the Government nominee on it who after all are there to ensure adherence to policy and guidelines of the Government. The Committee hold this as one of the contributory factors for the scam.

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215	16.25	From the information furnished by the MOF the Committee note that of the 28 vacancies for the posts of Chairmen-cum-Managing Director and Executive Directors since July 1991, only 16 have been filled up as of date. Of the remaining 12 vacancies 6 are of CMDs and 6 of EDs.
216	16.26	The Committee find that the time consumed in processing a case for appointment is inexcusable. Further no basic qualifications for appointment have been laid down or criteria to be followed formalised. Even the convention of appointing as Chairmen only those who have put in 2 years as Executive Directors have been discarded with a routinised appointment of Indian Administrative Service officers on these technical posts. Obviously no panel is being maintained to fill up the senior level posts without delay. Equally obviously this has seriously affected a proper functioning of these nationalised banks. As for full-time Directors a case has to be initiated three months prior to the date of occurrence of vacancy in the post of Chief Executives in any of the nationalised banks. The Department of Personnel and Training also issues instructions regarding appointment to these posts. A scrutiny of the appointment files called for by the Committee from the Banking Division of MOF has clearly established that this advance planning of three months has not been fulfilled in a number of cases. This has resulted in the granting of *ad hoc* extensions on several occasions.
217	16.27	The Committee take a serious note of such inordinate delays in appointing Chief Executives/Executive Directors of the nationalised banks. The Committee have also noticed that Banking Division's processing of the case of a Chief Executive has not always been in order, for instance, the circumstances under which Chairman, NHB was asked to demit the office of Chairman, UTI has not been brought on record. The system therefore requires to be thoroughly reformed.
218	16.28	The Committee feel that a Board on the lines of the Public Enterprises Selection Board for appointment of Chief Executives/EDs of nationalised banks be created under the aegis of the RBI to process the cases for appointment. The composition of the Board could be broad-based by including proven professionals and men of renown in it. At present the selection of CMDs/EDs is largely confined to the officers of the nationalised banks. The Committee suggest that the area of selection for the posts of CMD/EDs be widened to include persons with outstanding qualifications and experience from the financial sector.
219	16.31	10 top ex-Executives of the 20 nationalised banks have during the past few years been found as involved in serious irregularities is a telling commentary on the process of selection and appointments by the Government.
220	16.32	Irregularities committed by this top management have not only adversely affected the functioning of their respective banks but have also contributed to the malaise spreading over the entire banking system.

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221	16.33	The Committee are of the view that if this entire system of selection and appointment of executives/directors is not totally revamped our nationalised banking industry will not only not recover it will pull our entire economy down with it.
222	16.34	Officers of the Banking Division serve as official Directors on the Boards of the nationalised banks as well as on that of the SBI, a practice based on the recommendations made by the Economic Administration Reform Commission, which felt that this would facilitate liaison and promote a channel of communication between the Government and the public enterprises. There have, however, never been any clear guidelines or directions on the actual role to be performed by the official director or their manner of reporting the deliberations of the Board to the Ministry. They have of course not done this ever. More tellingly the MOF has never felt the lack of such reporting either.
223	16.35	The Committee find that official directors on the Board have not given any significant feedback to the Ministry about the actual working of the banks on which they are appointed. Their presence on the Boards of the banks has also not helped in detecting any serious irregularities or malpractices.
224	16.36	In fact, in one case the Committee noted with surprise that the Government Director on the Board of UCO Bank, against all canons of propriety, recommended the black listing of the auditors of that bank, characterising their attitude as vindictive and unco-operative, and amounting to harassment of the management, when they sought detailed information from branches of the bank.
225	16.37	The Committee also find that at present an official director is represented on the Boards of several banks. This needs to be reviewed. The Committee were informed that this system of reporting has atlast been recently reviewed. The Committee are constrained to observe that this detailing of functions now is an abject admission of earlier defaults. This too was a contributory factor to the scam.
226	16.38	Examination by the Committee have revealed that many of the foreign banks have been deeply involved in the irregularities in securities transactions and with their tremendous resources, their undoubted clout, their aggressive policies and posturing, they can if they choose, play havoc with the economy.
227	16.39	The very fact that such an important indicator as non-achievement of target of lending to priority sector has been taken up by the Ministry with RBI only on 18th January, 1993, clearly brings out the deliberate lack of action on the part of the Government to bring the foreign banks in line with the policy of the Government. Even the precarious BOP position during 1990-91 and 1991-92, should not have deterred the Government from taking stern action within the policies laid down by them. Penal action should be taken against foreign banks if they do not fall in line with our banking policies.
228	16.40	Non-compliance of governmental regulations on the part of foreign banks has been highlighted time and again. The MOF has failed signally in enforcing their Rules and Regulations of the country. Underplaying the

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		whole thing, in fact while deposing before the Committee, the representative of the MOF stated, that "while he was not minimising the extent of irregularities, these were because of by-passing of Rules". The seriousness of the transgressions by the foreign banks is apparent from the observations of the representative of the Ministry who when asked whether the Government was ready to tell the foreign banks to pack-up, replied with a resounding "yes sir". The Committee hope that the Government would take necessary action in this regard.
229	16.42	The Committee take serious note of the inordinate delay in the constitution of the Board of NHB which has affected the functioning of the bank and resulted in gross misuse of the funds of the bank as discussed elsewhere. As of date, NHB is saddled with claims of more than Rs.1200 crore by several banks/financial institutions. The reasons advanced by the Ministry for the inordinate delay of almost 3 years in the constitution of Board are not convincing. This is another instance where the Ministry has displayed lack of seriousness. The Committee find that no inspection has been conducted of NHB since its constitution. In fact it is noticed that there exists presently no system of inspection of financial institutions. Since these institutions are entrusted with huge public funds, it is imperative that a mechanism for periodic inspection of these institutions be desired by the Government.
230	16.44	The Committee's examination of the issue of PSU Bonds has revealed that Government has been losing revenue on account of these bonds being tax free, a rough estimate being loss of income tax on Rs. 900 crores. The objective of mobilising savings to generate additional resources has not really been fulfilled as public response to the entire scheme has been poor. Though the allocation of bonds are decided at the beginning of the year in consultation with the Planning Commission, Administrative Ministries and the Department of Economic Affairs, apparently during the course of implementation, distortions occur which the concerned Ministries have neither monitored nor addressed themselves to.
231	16.45	From the information received by the Committee regarding floatation of bonds by PSUs and the placement of funds raised thereby with banks/financial companies during 1990 to 1992, the Committee cannot but comment adversely on this practice in which everyone from the MOF to the parent Ministry of the PSU, the undertaking itself and the management, and of course the banks have engaged in a make believe exercise of raising funds from the public for meeting development requirements but did nothing of the sort. It is such systemic deficiencies that have allowed irregularities to surface, persist and remain unrectified.
232	16.46	This hoax was perpetrated on a number of occasions and over the years. The funds thus released became a principal source of finance for all varieties of speculative and illegal transactions in the securities market, as well as the stock market. There were then many unwholesome consequences of it. The State ended up by paying more interest on the borrowings. These were placed on inequitous terms with the banks and what is worse the schemes

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		for which the bonds (Power, Railways etc.) were issued were delayed. The scheme thus has not resulted in the desired mobilisation of resources particularly rural savings and the resultant additionality of resources as originally envisaged for the intended purposes. The Committee find this as a serious transgression by the Government in the discharge of its supervisory responsibilities, as indeed in the fiscal management of the nation's economy. Further, the Committee have sufficient reason to believe that placement of PSU funds became the single great contributor to the scam. What the Committee find as condemnable is that all this was public money and all who were playing with it were public servants.
233	16.49	The Committee are of the view that by disposing of the shares of PSUs before their listing on stock exchanges the condition 15 imposed in the guidelines by the DPE has been violated; As the shares were not listed, it is not known whether the price obtained was the best price.
234	16.50	The Committee find that while seeking the approval of the Cabinet on the issue of disinvestment of shares of PSUs in December 1991, the modality of sale or the guidelines to be given had never been placed before the Cabinet for its consideration. Further while the Ministry took the note for Cabinet consideration, the DPE was the executing agency for the Government decision regarding sale of PSU shares. It is not clear as to how there has been no inter-action between the DPE and the MOF on such a crucial issue such as resale of these shares. It is also surprising to note that DPE considers the whole transaction as a commercial deal and is not engaged with the legality or otherwise of it. The Committee have not examined this question of disinvestment of PSU shares at length. The Committee note that the method and procedure adopted for disinvestment of PSU shares had been adversely commented upon by the Comptroller and Auditor General in the Report entitled "Disinvestment of Government share holding in selected public sector enterprises during 1991-1992" (for the year ended 31st March, 1992) and this has been taken up for examination by the Public Accounts Committee.
235	16.51	The Committee find that the Stock Exchange Division, prior to the constitution of SEBI had not inspected any of the Stock Exchanges in the country despite the prevalence of serious malpractices in some of them particularly BSE. In fact, the Ministry has stated, 'prior to the establishment of SEBI no formal assessment regarding alleged irregularities in the stock market was undertaken by the Government.' Inspite of being the only authority overlooking the functioning of Stock Exchanges and the fact that Government nominees are on the Boards of all Stock Exchanges, the Committee regret to note that not even an effort was made to monitor the stock markets or ensure their orderly functioning. The abysmally low level of participation by Government nominees on the Boards of Stock Exchanges have been dealt with earlier in the report. The Committee also find that after directing the accounts of members of Stock Exchanges to be audited by chartered accountants in 1983, the MOF made no effort to monitor the progress and it was after a decade in March 1993 that the MOF issued another circular on the subject.

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236	16.52	The powers to regulate, supervise and control mandated in the SCR Act have since been transferred to SEBI through the SEBI Act, 1992. With the constitution of SEBI and delegation of wide powers to the SEBI, the Ministry need to closely examine the continued relevance of the Stock Exchange Division in the MOF.
237	16.58	The Committee are firmly of the view that the working of all banks - Public, Private and Foreign should be subject to scrutiny by Parliament. This task can be performed by the newly established Standing Committee on Finance or any other similar Committee to be appointed. The Committee feel that such a scrutiny will keep in view the special features of banking activity and the need to maintain confidentiality regarding individual banking transactions. The Committee suggest that Governor, RBI may be invited to appear before the Parliamentary Committee and apprise it about its monetary and fiscal policies. The secrecy clause in the B.R. Act is to be reviewed.
238	16.59	The witness of the Ministry informed the Committee that while systems failure was one of the contributory factors towards the Scam, there was also a definite collusion between brokers and top-management of banks. The Committee concur in the view expressed by the representative of the MOF about how the fact of systems failure does not absolve the culpability of individuals. Whatever may be the view about the system, the Committee urge that the guilty must be punished.
239	16.61	The vast responsibilities of the Ministry make it one of the most important centres of governmental authority and decision making. It is axiomatic, therefore, that not only does this Ministry have the authority to manage crisis effectively but it must also anticipate and thwart them before they arise. Every decision of the MOF directly affects the well-being and economic health of every citizen of our country. (a) For the MOF to have asserted that the rising share prices in early 1992 was among other things, a consequence of the liberalisation policies was misplaced. (b) Moreover for the MOF to have dealt in terms of relative unconcern with excessive speculation on the stock market is not appreciated by the Committee. (c) Effective regulation was hindered by the prevailing atmosphere in the Ministry that what was happening, far from being bad for the economy, was a reflection of the successes of the new policies. Its failure to ensure adherence to its own instructions contributed significantly to irregularities in the securities and banking transactions. (d) The Committee regret to observe that the MOF could have exercised much closer supervision of the entire securities and banking transactions. Had that been done, the subsequent disorder in our economy, could have been avoided. (e) The Committee agree with the contention of the Ministry that the solution does not lie in increasing the control of the MOF but in having

greater professionalisation of the Boards. One way of doing it would be to replace the Government nominee directors, who are at present from the civil services with persons possessing professional qualifications and experience.

(f) The Committee strongly feel that in view of their conduct and activities in the Scam, the working of foreign banks has to be strictly supervised. In a way, they have been the initiators of the Scam as well as the major players. With their tremendous resources, their undoubted clout, their aggressive policies and posturing, they can if they choose, play havoc with the economy.

In the light of the above, the Committee feel that the responsibility and accountability of the Minister of Finance to Parliament cannot be denied.

240 16.62 The FM has raised a point to which the Committee feel they should react. In his written submission the Hon'ble Minister has stated :

"As regards the functions of the FM, he oversees the work of the Ministry and provides overall policy guidance to the officials. Revenue and Expenditure decisions are the direct responsibility of the Finance Ministry. As such, FM has more direct responsibility in these areas. He is also responsible for broad policy decisions affecting the financial system where the Finance Ministry is involved. However, FM cannot be held responsible for administrative failures or management deficiencies in the case of individual banks and other financial institutions".

The Committee feel that such a distinction cannot be sustained by the constitutional jurisprudence under which the Parliamentary System works.

241 16.63 "The principle of constructive responsibility is equally applicable to other Departments and Ministries where acts of ommission and commission have taken place in the discharge of function and duties at different levels.

242 16.64 The Finance Minister in reply to the general discussion on the Budget 1991-92 on 6 August, 1991 stated *inter-alia*:

"Our strategy has been two-fold. First to release the entrepreneurial spirit and animal energy of our businessmen, industrialists and entrepreneurs to create wealth....."

The Committee note that while the predatory instinct inherent in a system of free enterprise does release the entrepreneurial spirit and animal energy, which if properly directed can do a lot of good to the economy. But to make the process of liberalisation a success it is necessary to have strategic checks and effective implementation of regulations. While the mood of the Government is upbeat on liberalisation, their orientation towards strict enforcement has yet to manifest itself. De-regulation without effective checks and balances would in the view of the Committee be an unmitigated disaster.

243 16.65 In the light of the developments that have taken place the relevance of continuing in its present form the Banking Division and the Stock Exchange Division needs to be examined.

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INVESTIGATIVE AGENCIES

244 17.11 The Committee have observed instances of inordinate delays in making preliminary enquiries and non-registration of regular cases by CBI in spite of enough evidence to support it. A glaring examples of this are the cases relating to late B. Ratnakar, former CMD of Canara Bank and the instance of Rs. 2 crores given by HPD through ABFSL to GSAL in April, 1992.

245 17.14 When the Committee drew attention to various irregularities in advancing a loan of Rs.2 crores to GSAL by HPD through ABFSL and its utilisation and the adverse comments in the Report of SEBI on this deal, the Director, CBI, assured the Committee that in the light of the observations by the Committee, they will have the matter re-examined as the case has not been closed so far.

246 17.36 The CBI investigation of Bank Scam cases have also disclosed that a large number of PSUs had placed huge amounts with various banks under the PMS through HSM. The Committee recommend that the CBI may examine the cases of other brokers also who may have similarly received funds from PSUs through banks. They would also emphasise that the enquiries against the concerned officers of PSUs including the top management be expedited and the necessary follow-up action taken against those who are found guilty.

247 17.37 The CBI has also been able to establish violations of the Company Law and the Stock Exchange bye-laws by the brokers. These have been taken up with the Company Law Board, the concerned Stock Exchange authorities and the SEBI. The Committee would like the necessary follow-up action by the authorities concerned to be expedited.

248 17.41 The Committee regret to note that the CBI has taken a long time to register P.Es against the suspected individual/officials who were involved in the leakage of information regarding coupon rate hike and disinvestment of P.S.U. shares in advance. They would urge upon them to expedite the investigation in this regard and launch prosecution against those found guilty including the higher ups in the decision making process.

249 17.50 The Committee are constrained to observe that although some vital information about cash withdrawal by HSM was with the CBI since February, 1993 it chose not to share the same with the Committee in either the Status Reports submitted by it to the Committee nor in the course of the informal consultations till clarifications were sought by the Committee.

250 17.56 In connection with cash withdrawals by the Dalal Group of brokers the CBI had informed the Committee that HPD had cash withdrawals amounting to Rs.1.21 crores, which has been explained by him to them and was found to be correct. It may be pointed out that during the oral evidence on 28.9.1993, the CBDT had informed the Committee that the total cash withdrawals by HPD during the period 1.4.1991 to 30.6.1992 amounted to Rs. 1.39 crores and out of this amount he has been able to explain the purpose of cash withdrawals for Rs. 9,60,000/- only. In light of this, the Committee recommend that CBI may re-examine this in coordination with the CBDT.

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251	17.57	The Committee regret to note that the investigation of Scam related cases by the CBI has been marked by inordinate delays extending up to years in some cases in even making preliminary enquiries, non-registration of regular cases in spite of enough evidence to support it and abnormally long time taken in finalisation of cases registered by them. Even in nine cases registered by CBI more than one year ago in May-July, 1992 and which according to them were the high priority cases, the progress made in investigation has been tardy and in the first case (No. RO 41(A)/92-Bombay relating to UCO Bank) which was registered on 11.6.92, two charge-sheets have been filed only on 24.6.93 *i.e.* after more than one year of the registration of the case. There are 27 cases which were registered more than six months back and which are still under various stages of investigation by the CBI.
252	17.58	The Committee are unhappy to be informed by the CBI that it would take them at least one year more to finalise the cases already registered. They would stress the need for early finalisation of all the cases. If any strengthening of the organisation whether by way or proving additional staff or otherwise is required the same may be urgently considered by Government.
253	17.59	The Committee also regret to note that there was difference in perception within the CBI about the role of CBI *vis-a-vis* Enforcement Directorate in regard to investigations abroad in connection with Scam related cases which led to loss of valuable time in taking up investigation of these cases. Enquiries which are still going on need to be expedited and conclusive follow up action taken.
254	17.60	The Committee are also unhappy that the CBI have failed to investigate the connection that the brokers had with the various politically important persons and Report the results to the Committee.
255	17.65	The Committee find that the file containing the note of the member (Inv) was sent to the Minister of State - Revenue MOS(R) on 8.4.1992. However, this file remained pending with the MOS(R) for quite some time *i.e.* till 6.5.1992 before sending to the Finance Minister. As regards the reasons for the delay the argument advanced by the MOS(R) was *inter-alia* that the note "was actually a routine monthly report of income tax raids for information only". The fact however is that this file also contained a couple of paragraphs on the misdoings of HSM. The Committee express their unhappiness over this delay. They find that the MOS(R) signed and forwarded this note to the Finance Minister on 6.5.92 and the latter also recorded his note on 9th May, 1992 *i.e.* only after the news of the Scam broke out in the press and was referred to in the Houses of Parliament.
256	17.97	The Committee regret to note the inordinate delays in investigation of the cases and lack of proper follow-up action by CBDT in Scam related cases. In the case of HSM Group, searches were first carried out in September, 1990. Follow up action was, however, admittedly tardy. The Department failed to launch a single prosecution for various default and levied only a paltry penalty of Rs. 6.4 lakhs. No action was however taken against the officers responsible for various lapses. Even after the second raid on this Group in

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		February, 1992 there was lack of coordinated approach and no serious efforts were made to introduce systems and procedures to ensure expeditious finalisation of assessments especially in big cases involving huge revenue. The Committee find that the assessments of various brokers for the year 1990-91 have only been completed till March, 1993 and in some cases even the assessments for this and earlier years are still pending finalisation. The Chairman, CBDT informed the Committee that it was their desire that all Scam related cases should be completed by the end of financial year 1993-94. The Committee would urge that steps should be taken to ensure that the target date is adhered to. Follow up action may also be taken expeditiously to recover the amount due and to launch prosecution proceedings wherever necessary.
257	17.98	The Committee would also like to point out that as the Govt. revenue is the first charge on the assets of the notified persons the delay in finalisation of income-tax and wealth tax assessments and filing of claims with the Custodian would result in delays in settlement of the claims of other parties *i.e.* banks, etc. It is therefore imperative that a time bound programme is drawn up by the CBDT to finalise the cases assessments of notified persons.
258	17.99	The Committee have noted that CBDT have not examined the role of industrial houses with respect of Scam. The representatives of CBDT during the oral evidence stated before the Committee that although the activities of every industrial houses are scrutinised thoroughly before any assessment is made, however, they have not taken 'any specific step' regarding their involvement in the Scam. The Committee recommend that the CBDT may do so now expeditiously.
259	17.107	The Committee regret to note that although the companies of the Fairgrowth Group "were earlier assessed by a number of assessing officers at Bangalore" it was only after the CBI's search on 30th July, 1992 and the scrutiny of the documents seized during this raid that it was found that the members of the FFSL had committed various defaults which are punishable under the Income-tax Act 1961. The Committee recommend that prosecution proceedings be launched expeditiously both against the corporate/non-corporate assessees of this group a matter which "is still under active consideration of the Assessment Wing".
260	17.109	The Committee recommend that the case of PMS transactions of foreign banks namely Citibank, BOA & BBME may be seriously pursued and CBDT may examine the cases of other banks also who had carried out similar transactions under PMS.
261	17.127	It has been observed by the Committee that money has also been received under the Immunity Scheme - 1991, by others like for example - HSM's Mother, Smt. Rasila Mehta, T.B.Ruia, etc. The Committee feel that the Scam money which may have flown out of the country have been channelised back through this scheme. The Committee strongly urge the Enforcement Directorate that the whole matter may be thoroughly investigated.

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262	17.128	The Committee have observed that the contribution of the Enforcement Directorate to Scam related investigation has only been marginal. The Committee are constrained to note that Directorate has not shown the required initiative to investigate the Scam related cases independently. Their helplessness and being at the mercy of the other two investigative agencies is borne out by their own submission during the course of the oral evidence on 29.9.1993 when the representative of the Enforcement Directorate admitted that "we are largely dependent on the clues and the evidence thrown up by other parties....whatever evidence, they could throw up, we can follow it up. We are not able to uncover any significant lead on our own".
263	17.142	From the preceeding paragraphs it can be seen that the investigation of the Scam related cases by the CBI, CBDT and Enforcement Directorate had been handicapped greatly due to a lack of effective coordination and unison of purpose. The instances of Enforcement of Directorate being unable to take any action or prevent Shri Niranjan Shah from leaving the country after the income-tax authorities raided him on 30th and 31st May, 1992 as the information in this regard reached them only on 2nd June, 1992. The failure of the CBI to take up action on the basis of information furnished by CBDT and the delay in setting up of Coordination Committee of the three agencies clearly bring out the failure of three investigating agencies to ensure coordinated action in Scam related cases despite serious concern expressed in this regard at various levels. The Committee cannot but express their dissatisfaction at this sad state of affairs. The Committee hope that the three agencies would at least now ensure greater coordination and prompt and effective investigation into the Scam cases.
		OTHER ISSUES
264	18.37	The tracing of end-use monies to their final destination, particularly when large sums are involved and when intricate mechanisms have been employed to cloak transactions, is the task of a team comprising of specialists in the field of accountancy, taxation and criminal investigation. The Committee, therefore, recommend that such a team be constituted under the overall coordinating responsibility of the MOF and with due and proper representation of such other agencies as it may deem fit; the task of identifying the end-use of monies be entrusted to this Committee; it may be directed to Report within six months of appointment and the Report also be presented to Parliament.
265	18.40	Through its own enquiries and the special inspections conducted by RBI, the Committee have reasons to suspect that atleast some people had prior knowledge of the coupon rate hikes. Following the suggestion made by the Committee the CBI after verification have registered a preliminary enquiry in this regard. The Committee recommend that the CBI should investigate this matter further and The MOF should follow it up vigorously.
266	18.41	Considering the amounts involved, taking into account, inward remittances of monies as received by some of the players in the matter of securities and banking transactions, and having examined other evidence placed before it, the Committee are of the view that the violation of FERA has taken place.

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		Apart from CBI and Enforcement Directorate, there is need for the MOF to address itself to examine these violations in details.
267	18.42	The Committee have reasons to apprehend that the Immunity Scheme 1991 was used for the purpose of bringing monies to operate in the country's security market.
268	18.51	The Committee after examining the evidence on record the Rs. 2 crore 'loan' deal between ABFSL, HPD and GSAL observe as follows : 1. The cheques received from HPD were treated as sundry suspense account in the ABFSL. 2. The original copies of the letters of Shri Krishna Mohan dated the 15th and 17th of April, 1992 are not available with ABFSL. Copies of these letters were subsequently supplied to ABFSL and other authorities by Shri Shasi Kant of GSAL. 3. There was no application in writing for this loan from Shri Krishna Mohan. The negotiations if any, were conducted orally. 4. This is the only case of such a 'loan' by Shri Dalal and one of the two on the part of ABFSL, the other being a 'loan' of Rs. 81 lakhs to Solidaire. 5. There is no loan agreement between ABFSL and Shri Krishna Mohan for this transaction. From the locker of the Andhra Bank, which was opened on 14-9-1992, among the documents recovered was a draft Tripartite Agreement in pencil and partly in pen indicating that the agreement was to be entered into on 21-4-1992 between HPD and M/s. Goldstar for arranging a loan of Rs. 2 crores to GSAL at the interest of 23% against pledge of 13.5 lakhs Goldstar Cement Ltd. and other Shares envisaging ABFSL as a trustee who shall hold the share certificates and transfer deeds on trust for Shri Dalal until the credit is repaid by GSAL. In this draft agreement there is no mention of Shri Krishna Mohan nor is there any indication that Shri Krishna Mohan was taking this loan in his personal capacity. 6. ABFSL does not appear to have issued any receipt nor does Shri Krishna Mohan appear to have insisted on the issue of such a receipt for the shares of Goldstar Cement that it received as collateral from Shri Krishna Mohan. 7. The witness informed the Committee that the money was taken in two instalments of Rs. 1 crore each, to minimise the interest burden. He and his associate finance companies appear to have received the refund orders from GSAL for a total amount of Rs. 2,20,14,790.00 on 23 July, 1992. Repayment to ABFSL, however, was made only on 3rd and 19th October, 1992. 8. Both Cheques from ABFSL of Rs. 1 crore each were collected personally by Shri Shasi Kant of GSAL and deposited in the current account of GSAL though GSAL had a separate account styled "Goldstar Rights Allotment Money Account" in the same branch of SBI. When asked to clarify,

1	2	3

Shri Krishna Mohan said that "Basically it has gone to Rights Issue account like any other account. The entire money has gone to rights issue account only not subsequently."

9. According to the vouchers prepared by GSAL these amounts were recorded as "promoter's contribution credit - share application money pending allotment" but the entire amount was spent for other purposes well before the rights issue was closed. In fact, the first cheque of Rs.1 crore was credited into the account of GSAL on 24-4-1992 when the balance in this account was only around Rs. 3 lakhs and the entire amount was spent in making payments to various parties bringing the balance in this account on 29-4-1992 to only Rs.1947/-. Similarly, the second cheque of Rs. 1 crore was credited to the current account of GSAL on 5-5-92 and the amount was utilised to make payments to various parties.

10. The witness has claimed that all contributions from the promoters towards their share of the Rights Issue were deposited in this current account of the company. The witness has also claimed that "all such proceeds have been utilised for the project payments, which is an accepted practice by companies making Rights Issues". This, however, is not in consonance with the guidelines of Controller of Capital Issues issued on 14.1.1992 as well as the Consent Order issued on 26.5.92 by the Office of the Controller of Capital Issues specify :

"Subscription received against rights issue will be kept in specific bank accounts and company would not have access to such funds unless they have received an approval from the concerned regional Stock Exchanges for allotment.."

11. Karvy Consultants who were the Registrars to the issue have stated that the applications in question were not routed through them and have also expressed doubts about the genuineness of the application forms. They have also informed the CBI that refund orders were issued by them pertaining to the Rights Issue in August-September, 1992 and unused blank refund orders were return to the Company only in October, 1992. How then the refund of the amount of Rs. 2,20,14,790.00 made to Shri Krishna Mohan and his two associate finance companies on 23.7.1992 remains a mystery. The Refund Orders Account maintained with the State Bank of India, Industrial Finance Branch, Hyderabad is overdrawn and reconciliation has not taken place till date.

269 18.52 During the course of the enquiry the Committee found various discrepancies/contradictions in the statements made by various witnesses. 269 18.58 Considering the nature of this case and the complexity of the transactions, the Committee recommend that the matter should be enquired thoroughly by a joint team consisting of CBI, CBDT, SEBI, Department of Company Affairs and RBI.

270 18.56 The contradictory statements made by the various witnesses before the Committee, the curious manner in which the whole transaction was dealt

with in ABFSL, the ease with which Shri Dalal agreed to lend this money without any documentation to a promoter of Goldstar through ABFSL, the alacrity with which the Audit Sub-Committee of the Board of GSAL & the Board itself on the basis of an audit report prepared at short notice has given a clean chit to GSAL and Shri P.V. Prabhakara Rao, the manner in which the monies received were spent in clear violation of the instructions of the Controller of Capital Issues, the speed with which refund orders were issued to Shri Krishna Mohan his two associate finance companies on 23.7.92 the day on which the Hyderabad Stock Exchange gave its approval to the allotment of the Rights shares indicate the dubious nature of this transaction. Though the CBI perhaps came to know about this transaction on 20th August, 1992 and on the basis of information collected the Hyderabad Branch of CBI sent a proposal to CBI Head Office on 27.11.92 for registration of this case and a formal complaint was given to CBI on 14.12.92 by ABFSL, the CBI registered a PE only on 12 March, 1993 when the matter had been raised in both Houses of Parliament after the publication of the Fourth Report of the Janakiraman Committee. The CBI has also expressed their inability to share with the Committee the Source Information Report and the notes recorded by the various officers in the CBI which may explain this delay on the ground that the internal functioning of the CBI cannot be disclosed to the Committee.

271 18.57 At the instance of the Committee SEBI conducted an enquiry into this matter. A copy of the report of SEBI was received by the Committee from the M.O.F on 9.7.93, which brought out many disturbing facts. SEBI's Report can be seen at Appendix XLVI. In their report SEBI have concluded that the enquiries conducted so far justify an inspection of the company's records and books of account and u/s 209A of the Companies Act to verify the application monies received from the promoters, the allotment made and the refund due to them.

272 18.58 Considering the nature of this case and the complexity of the transactions, the Committee recommend that the matter should be enquired thoroughly by a joint team consisting of CBI, CBDT, SEBI, Department of Company Affairs and RBI.

273 18.59 The Committee have come across various instances of close nexus between prominent industrial houses, banks and brokers.

NOTES

(1) Note by Sarvashri Jaswant Singh, Ram Naik, T.N. Chaturvedi, Harin Pathak, Sushil Chandra Varma, Nirmal Kanti Chatterjee, Rabi Ray, George Fernandes, S. Jaipal Reddy, Gurudas Das Gupta, Murasoli Maran, Sukomal Sen and Digvijay Singh, MPs.

Introduction

This note briefly highlights such issues as have not been fully covered in the Report adopted by the Committee. It is the view of the signatories to this note that aspects covered hereunder will supplement the Report, will better subserve the purpose of highlighting issues of crucial public importance, will better enable the Parliament to examine and appreciate the various ramifications of the Committee's Report, and, in our view will facilitate follow-up action. We hold that for the sake of complete openness, for probity in the affairs of the State and for establishing true accountability in our public life, the following aspects must also be examined by the Parliament when considering the Report of the Committee:

a) Allegations relating to payment of Rs. 1 crore by Shri Harshad Mehta;

b) the matter relating to the conduct of Shri Romesh Bhandari, presently Governor of Tripura on issues concerned with the Scam;

c) certain vital and additional lacunae in the functioning of the investigating agencies;

d) question of Audit of public funds and banking institutions; and

e) cooperation with the Committee and powers of the Committees of Parliament.

Each of the above issues will be dealt with separately in the succeeding paragraphs:

Allegations relating to payment of Rs. 1 crore by Shri Harshad S. Mehta.

While examining Chapter XVIII of the Committee's Report it is necessary to highlight that even though all concerned have tendered written evidence before the Committee, other than Shri Harshad Mehta no other witness could be called for oral evidence before the Committee. Further, and more importantly, even key witnesses like Shri Ashwin Mehta who had volunteered to appear before the Committee, and the Committee at one stage had called him for evidence, Shri Mohan Khandelwal, a key witness, Shri Sunil Mittal, alleged to be a principal actor in the episode, could not be examined by the Committee. Statements attributed to an officer of the SPG, then posted in the Prime Minister's residence complex and present there on 4 November, 1991 was not even asked for leave alone recorded.

In this particular matter the CBI's response to both the investigation and to enquiries in this regard by the Committee was not marked by any degree of purposefulness or despatch. Infact the CBI was not entirely forthcoming in sharing information with the Committee. It would dilate on shortage of staff and overwork. It would even talk of their mandate being particularly related to public officials and not politicians. It tended to be excessively legalistic. Its enquiry into the allegations was conducted in a manner that was unnecessarily and unduly secretive. It arrived at its conclusions with unnatural haste. In this respect the CBI's treatment of Shri Mohan Khandelwal, first as a "source" and thereafter as an accused is mystifying, to say the least. No satisfactory explanation about this was ever forthcoming. It needs to be emphasised that Shri Khandelwal was alleged to be Shri Harshad Mehta's principal operational instrument in Delhi.

In turn Shri Harshad Mehta, when examined by the Committee, was not forthcoming about placing full facts before the Committee. He was selective, not entirely co-operative and withheld crucial information.

We are thus led to the view that in this entire matter of allegations of payment of Rs. 1 crore by Shri Harshad Mehta, there is need for further detailed investigation under the Commission of Enquiry Act. We also hold that the findings of such enquiry ought, thereafter to be submitted to the Parliament within six months of institution.

The matter relating to the conduct of Shri Romesh Bhandari, presently Governor of Tripura, on issues concerned with the Scam.

Considering the implications of Shri Romesh Bhandari's efforts at obtaining affidavits, even from a foreigner and smuggler relating to the Committee's work; his attempts to influence witnesses and to tamper with evidence; his attempts to keep crucial information relating to allegations about "havala" transactions of Shri Harshad Mehta from the Committee; his failure to share any of this with the Committee; also that in this matter, explanations by the Government were wholly unsatisfactory, that no explanation could be obtained from Shri Romesh Bhandari himself about his conduct which is highly incriminating, that neither he nor any other witness could be examined in person by the Committee; it is our considered view that a thorough and detailed investigation under the Commission of Enquiry Act be instituted in the matter immediately. Further, that a Report about the investigation be submitted to the Parliament within six months of its institution.

Certain vital and additional lacunae in the functioning of the investigating agencies

Of particular concern is the high degree of selective subjectivity exercised by the CBI in the discharge of its responsibilities and obligations in investigating the securities and banking transaction matters. The premature retirement of Shri K. Madhavan at a crucial stage of the investigation, despite all efforts by the Committee, still remains not satisfactorily explained. This needs to be examined further. In addition and for example the CBI's enquiry into the matters of Goldstar, ABFSL, Shri Hiten Dalal have been far from satisfactory. The CBI has also failed to carry conviction about its handling of Shri Mohan Khandelwal, inclusive of the manner in which a bag full of jewellery reportedly seized from a driver working for Shri Khandelwal and the hasty and surreptitious manner in which the entire matter was hushed has left a great deal to be desired. We would further wish to record that Shri Madhavan's reported assertion of important persons of India being paid abroad through some accounts has also remained largely unsatisfactorily explained. The Chairman and the Committee repeatedly asked the CBI to look into the alleged nexus between politicians/ Ministers and industrial houses as beneficiaries as well as to identify the ultimate recipients/ repository of the scam funds. This was not done.

We would, therefore, recommend that such aspects of the investigation conducted by the CBI as have remained unsatisfactory ought to be re-examined more closely and thoroughly through the agencies of a separate enquiry.

Question of audit of public funds and banking institutions

The Committee has appreciated the need for sustained and scientific audit of the banking sector, and have recommended the creation of a centralised authority like that of C&AG. There are certain implications that require to be pointed out. Any authority as may now be created by the Parliament, or even though constitutional amendment, will take much too long to acquire the historical ethos, rationale, tradition, status, experience, countrywide

contact with the community of chartered accountants which has been the unique attribute of the authority of the C&AG of India. Even the statute establishing the Reserve Bank contemplates that C&AG of India could be appointed the statutory auditor of the Bank by the Board. Somehow it was not done. The fact as revealed during our enquiry underline the need for the same. We also point out that the C&AG is largely concerned with the audit of public enterprises and this further justifies the need for extension and strengthening of the authority of C&AG by entrusting the audit of public sector banks and financial institutions. The C&AG will make full use of the expertise of chartered accountants in the country and is in a position to provide full autonomy to the auditors to function without pulls and pressures in the discharge of their duties. The C&AG has the authority to ask for documents not only from the bank under audit but also the related information from the Government and the public sector and facts about inter-linked institutions can be brought forth to ensure accountability to Parliament. The fragmentation will only dilute, through duplicating the existing authority for united audit as enshrined in the Constitution, without lending significance and adequacy as required, to the novel innovation of the proposed centralized authority for audit.

A note (Annexure) indicating the broad framework in this regard has been supplied to the Committee by one of the signatories, and be appended to the Report and which can be discussed by the Government with the C&AG of India and others concerned.

Co-operation with the Committee and powers of the Committees of Parliament

We are led to observe that on a number of occasions witnesses including those of the CBI, other departments of the Government, Banking officials, even the principal accused repeatedly and deliberately withheld information from the Committee. It is our sad duty to point this out without listing the name of all those who did not co-operate with the Committee. There were occasions when witnesses, in fact, attempted to mislead the Committee, were selective in the disclosure of facts, indeed, even attempted to plant wrong information.

In our view, therefore, it is necessary that since a Committee of this nature is appointed in matters of utmost public importance, that the Parliament addresses itself to these very major lacunae in the functioning of Parliament Committees and addresses itself to the task of so strengthening the existing mechanism as would enable the Committees to function more effectively. The powers of Committees of Parliament in respect of obtaining information, of censure, and of awarding punishment for default before the Committee must be augmented.

Conclusion

We submit the above note as we hold that the points that we have listed supplement the efforts of the Committee. Consideration of these points by the Parliament rather than detracting from the Committee's effort will in fact add to it. It is our expectation that this note will be treated by the Parliament as a continuation of the Committees's full Report.

Sd/-

Shri Jaswant Singh, MP
Shri Ram Naik, MP
Shri T.N. Chaturvedi, MP,
Shri Harin Pathak, MP
Shri Sushil Chandra Varma, MP
Shri Nirmal Kanti Chatterjee, MP
Shri Rabi Ray, MP
Shri George Fernandes, MP
Shri S. Jaipal Reddy, MP
Shri Gurudas Das Gupta, MP
Shri Murasoli Maran, MP
Shri Sukomal Sen, MP
Shri Digvijay Singh, MP

ANNEXURE

The legal frame work for audit by the Comptroller and Auditor General of India of public sector banks and financial institutions owned or controlled by Government should be so designed as to provide on an enduring basis, an authority to the Comptroller and Auditor General of India. It should be sufficiently comprehensive and should above all secure to the Comptroller and Auditor General of India the right of access to records and information, to inspect, to determine the scope and extent of audit and to report the results of audit. His authority in this respect should in no way be inferior to that available to him in respect of the accounts of Union and the States. The confidentiality of clients' accounts and investments by banks/financial institutions will be maintained in the same way as in audit of Income Tax or Institutions of Defence or Atomic Energy etc., during and after audit. Any checks by a supervisory body under the Government or Reserve Bank of India will be only in the nature of an internal check and will not lead to same degree of public confidence as audit by C&AG. C&AG need not displace or duplicate the audit done currently by statutory auditors but may ensure, through his audit, compliance with the directions issued by the Reserve Bank of India to the statutory auditors. The legal frame work should also secure to the Comptroller and Auditor General of India the right to oversee the performance of statutory auditors so as to provide a check over them and ensure their accountability to the highest standards of professionalism in audit. The relevant provisions of the Companies Act, 1956 for supplementary audit by C&AG of the Government companies which has stood the test of time, should provide the paradigm for a legal frame work for audit of public sector banks and financial institutions by the Comptroller and Auditor General of India. This would continue the audit currently done by the statutory auditors and at the same time make them accountable to the highest professional standards of audit.

2. Under the Companies Act, the auditors of Government companies are appointed or reappointed on the advice of the Comptroller and Auditor General of India and the Comptroller and Auditor General of India has the powers to direct the manner in which the companies' accounts shall be audited as well as to conduct a supplementary or test audit of the accounts. The Comptroller and Auditor General has also the right to comment upon or supplement the audit reports of the statutory auditors. Similar provision must be made in regard to audit of banks/financial institutions also. The criterion whether a bank or a financial institution is a public sector *i.e.* Government bank/financial institution should also be similar to those for determining which are Government companies.

3. In regard to the appointment of auditors of banks, the role of the Comptroller and Auditor General of India need not extend to the appointment of bank auditors for the branches of the banks which will be very large in number. So far as the audit of branches is cocerned, the present system of appointment of branch auditors by the Banks and Reserve Bank of India may continue. However, the statutory auditors for the Head Offices of the banks for audit of the compiled accounts for the Bank as a whole must be appointed only on the advice of the Comptroller and Auditor General of India. The Comptroller and Auditor General of India should have the authority to issue directions to the statutory auditors, who obtain the reports of the branch auditors.

4. The Comptroller and Auditor General of India may be given a year's time to arrange for placement of staff in position and their training before starting on supplementary audit of all Nationalised Banks and financial institutions. Alternatively, the Comptroller and Auditor General of India can take up the audit of all Government banks and financial

institutions, in phases, covering all of them within a period of 2 years from the date the necessary legal frame work is created.

5. Some of the other countries where audit of banks and financial institutions is currently entrusted to their Auditors General (Supreme Audit Institutions) are given in the annexure.

Sd/-
Shri T.N. Chaturvedi, MP

Annexure

AUDIT BY SUPREME AUDIT INSTITUTION OF BANKING SECTOR IN FOREIGN COUNTRIES

Country	Banking Institutions/ Other Financial Bodies	Status of SAI Audit
1. Australia	1. Reserve Bank of Australia is the Central Bank of Australia established by the Reserve Bank Act, 1959. 2. Commonwealth Bank Ltd. and its subsidiaries; a commercial bank established by the Commonwealth Banks Act, 1959 and Corpn. Laws. 3. Telecom Finance Company and Australian Film Finance Corporation established under Corporation Law, 1992, Australian Industry Development Corporation, Export Finance and Insurance Corporation etc., statutory corporations established by their respective statutes.	Audit by SAI under the relevant statutes.
2. Austria		The SAI conducts audit of Banks but not of Insurance Companies which are mostly mutual Insurance Companies or companies owned by private majority shareholders. The scope of audit is comprehensive.
3. China	People's Bank of China Industrial and Commercial Bank of China, Agricultural Bank of China etc. are economic entities.	Audit by SAI under constitution and Audit Regulations.

Country	Banking Institutions/ Other Financial Bodies	Status of SAI Audit
SAI : Supreme Audit Institution		
4. Canada	1. Central Bank 2. Canada Deposit Insurance Co. 3. Export Development Corporation 4. Farm Credit Corporation 5. Federal Business Development Bank	Not audited by SAI. These are statutory Corporations and are under jurisdiction of SAI.
5. Israel	Bank of Israel is a statutory authority.	SAI carries out comprehensive audit without any limitations.
6. Japan	Bank of Japan - Central Bank - Japan Public Sector Banks Public Sector Financial Institutions.	Audit by SAI where 50 per cent or more of the equity is provided by Government.
7. Jordan	Central Bank of Jordan and other institutions established by specific laws.	SAI responsible for audit of most Public Corporations.
8. Korea	— Bank of Korea (Central Bank) — Specialised Banks more than half of whose capital has been invested by the State. — Korea Development Bank — Korea Housing Bank — Citizens National Bank — Small and Medium Industry Bank	Audit by SAI
9. Malaysia	Central Bank of Malaysia Development Bank and Financial Institutions.	Audit by the SAI
10. Pakistan	— National Bank — Life Insurance Corporation — Commercial Banks	Audit by SAI Audit by SAI Audit is constrained by limitations of resource & expertise. In any case these banks are again reverting to private control under 'on-going' privatisation process.

Country	Banking Institutions/ Other Financial Bodies	Status of SAI Audit
11. Phillipines	1. Central Bank of Phillipines 2. Other Public Sector Banks like Land Development Bank and other financial institutions	Audit by SAI According to the Constitution of Phillipines "No law shall be passed exempting any entity of the Government or its subsidiary in any guise whatever, or any investment of public funds from the jurisdiction of the Commission of Audit."
12. Sri Lanka	Bank of Ceylon	Audit by SAI
13. Thailand	— Krug Thai Bank Ltd. (Central Bank of Thailand is a statutory authority) — The Government Housing Bank — Bank for Agriculture and Agricultural Corporation — Dhipaya Insurance Co. Ltd. — International Finance and Consultants Company Ltd. — The Government Saving Bank	Mandatory by SAI These are all subjected to audit by SAI
14. U.A.E.	i) UAE Central Bank (Statutory Corporation) ii) National Bank of Abu Dhabi (Company with State Share Capital).	Audit by SAI SAI carries out current and post-audit of all financial operations

Remarks : Audit comments issued to the Banks/financial institutions separately are treated as classified documents as their public knowledge may affect Banks/institutions/business adversely.

(2) Note by Sarvashri George Fernandes, Rabi Ray and S. Jaipal Reddy, MPs.

The JPC Report is as comprehensive a document as was possible under the circumstances. If the JPC had the full-time services of an investigating agency at its disposal, it would have produced a more comprehensive Report. The investigating agencies of the Government suffered from two inhibiting factors. First, their subordination to the Executive and the abuse they have been subjected to by the Government over a period of time, thereby making them surrender their objectivity to serve the expediency of the political establishment. Second, inadequacy of staff, which despite several formal and informal requests from the JPC the Government did not care to make good.

Even as the JPC began taking evidence, the witnesses bankers, brokers, public sector executives, bureaucrats and businessmen were quick to discover that they could bluff their way out of the witness stand, and they did it with impunity and aplomb. Not only did they resort to the time-tested method of *suppressio veri suggestio falsi*, but, in several cases, they took to uttering blatant falsehoods. Most of them seemed to be chronic patients of amnesia when replying to inconvenient questions. The Committee did not have the powers to arraign such persons for contempt of Parliament which they had committed. Of course, it was possible to request the Speaker to refer these matters to the Privileges Committee of the House. But this was not done. If a few of the early witnesses who lied or otherwise obstructed the Committee from doing its work had been sent to jail for breach of privilege and contempt of Parliament, it would have had a salutory effect on subsequent deponents. In that event, the JPC Report would have acquired a wholly different dimension.

The Report would have been better if the Committee had the services of a group of experts in various matters that came up for investigation. Most Members of Parliament, whatever may be their political acumen, do not possess expertise in banking, stock markets, securities transactions, insider trading and a whole lot of related subjects, which went into the making of the scam. Even those who had the academic knowledge could not have found it easy to unravel the fraud, cheating and manipulation which the scamsters had raised to a fine art. Due to several reasons, it was not possible to have a group of experts whose constant advice would have enabled the Committee to give a thoroughly professional touch to the Report and make it more incisive.

With these and several other handicaps, the JPC had to fall back, to a considerable extent, on the six reports produced by the Committee to enquire into the Securities Transactions of the Banks and Financial Institutions appointed by the Reserve Bank of India (RBI), headed by its Deputy Governor, R. Janakiraman. With the Finance Ministry — the prime culprit of the scam working overtime to cover up its responsibility, and the RBI, whose guilt is only second to that of the Finance Ministry, itself becoming the principal agency to enquire into the scam, the hurdles in the way of the JPC unearthing all the ramifications of the scam can be well imagined. More so, when Mr. Janakiraman was directly associated with the National Housing Bank as Director when it was playing a leading role in the scam, and the RBI Governor, Mr. Venkitaraman had directly intervened on behalf of Harshad Mehta with the State Bank of India at the height of the scam. That the Attorney General of India, Mr G. Ramaswami, had to resign in disgrace because of his unethical conduct in advising Standard Chartered Bank on how to cope with the investigation into its malpractices and illegal transactions also is but a small pointer of the manner in which the entire establishment tried to protect, to the extent it could, those involved in the scam, thereby making the task of the JPC to identify the guilty doubly difficult.

The JPC, for obvious reasons, has not been able to do justice insofar as the investigations into the role of the Unit Trust of India and the Life Insurance Corporation including its

subsidiary, LIC Mutual Fund are concerned. These two premier financial institutions of the country have been important props of the capital market and have been used by the unscrupulous among the industrial houses for their manipulative games and for many other illegitimate deals, with or without collusion by the officials of both the institutions. A proper investigation into the manner in which these two institutions and particularly the Unit Trust of India have made their investments, their role in speculative trading in shares, and the companies they have chose to patronise, will help in unearthing certain aspects of the scam that have still been hidden from public view.

The Report has made an observation on the close nexus between industrial houses, banks and brokers. Reliance Industries Ltd., the United Breweries Group and Apollo Tyres Ltd. are among the prominent industrial houses which have been involved in the scam. Among these, the role of Reliance has surfaced more often than those of others, though what has come to light must necessarily be only the tip of the ice-berg. One area which needs thorough investigation is the nexus between these industrial houses and politicians and bureaucrats. Mr. S.L. Khosla, who took a lucrative assignment with Reliance Industries immediately after he retired from the post of Chairman of the ONGC, is not the only case of bureaucrats who have cultivated links with industrial houses by doing favours to them when in government service to reap the benefits after retirement. The extent to which industrial houses like Reliance Industries have used their dubious links with politicians and bureaucrats to get money out of the public sector enterprises into specified banks to use it for speculative purposes in share transactions and for insider trading needs to be specially investigated.

Insider trading is considered as an offence in many countries, and companies and individuals who indulge in it are given severe punishment including long jail terms and heavy fines. In India, there is no law which prevents insider trading, and this lacuna needs to be filled immediately. There is a lot of illegitimate money generated by some of the unscrupulous among industrial houses through insider trading which can be stopped only with legislation banning this patently criminal activity. Pushing up or bringing down share prices through insider trading is also tantamount to cheating the share holders. Instances have come to notice during the investigation into the scam, of how share prices of certain companies were pegged high for a certain period before fresh issues, to cheat the new investors.

In the continuing public debate on the amount of money lost in the scam, what has been overlooked is the fact that several lakh small investors lost tens of thousand crore rupees they had invested in the stock market. Much of this money has gone into the pockets of brokers and industrialists who indulged in insider trading, while some has gone as profits booked by the not-so-greedy investors who off-loaded their share-holdings before the market collapsed when the scam came to light. The government would do well to issue an immediate ordinance banning insider trading activity. Investigation into income tax evasion on profits made through insider trading must also be launched immediately. Reliance Industries Ltd. and Apollo Tyres Ltd. should be among the first to be investigated for such tax evasion.

The JPC investigation brought to light the fact that while many of those who master-minded the scam, and were its biggest beneficiaries are scot-free and enjoy the fruits of their robbery, some innocent persons who had no hand in the scam but were some small cogs in the wheel, have been targeted for prosecution. The most glaring of such cases, where the criminals have turned into complainants and innocent persons are paying a heavy price for having been in the employment of such criminals, is of Standard Chartered Bank, where men who were the brains behind the scam have been let-off and two junior level functionaries, Jaideep Pathak and Arvind Mohan Lal are being prosecuted. In all such cases where the CBI

is acting on complaints filed by the bankers or other big players in the scam, the Government should make a quick review and protect the innocent victims from being financially and mentally destroyed.

The scam may not have acquired such a big dimension with so many players and such great ramifications if economic offenders, whatever be their social status, were treated as common criminals which is what they are — under the laws of the country. Unfortunately, in India there is no equality before the eyes of the law where criminals are concerned. The rich get away literally with murder, and if they are people who cheat and commit economic crimes involving money counted in hundreds of crore rupees, there are instances where the state has conferred on them national honours. To go to jail and face the humiliation which is rightly the due of criminals, one has to be small-time pick-pocket or a wagon breaker. If the JPC report generates a campaign to see that the law deals with the big economic offenders, whose crimes, like the present scam, have the potential to give a set-back to the nation's economic growth, as has happened in the instant case, with the same ruthlessness that it displays towards the poor and helpless, who resort to petty crimes because there is no other way for them to feed their families, it may mark the beginning of a less corrupt society in India.

Sd/-
Shri George Fernandes, MP
Shri Rabi Ray, MP
Shri S. Jaipal Reddy, MP

(3) Note by Shri Gurudas Das Gupta, MP

The JPC report while describing in detail the market malpractices, has not followed through with its findings, to establish where the illegal funds went, and falls short of indicating some of the individuals in the bureaucracy who played foul with the system. But the biggest failure of the report is in having overlooked the sordid business of promoter quota shares, whereby all sections of bureaucracy and banking, perhaps even the Cabinet as was evident in the P. Chidambaram case — were influenced. It would have been in order for the JPC to have ordered an enquiry into the entire mechanism of promoter quota shares. The fact that this has not been done, despite my specific plea to do so, gives rise to the fear that too many names would have been exposed in too sensitive places.

To consider the background, the service rules in the public sector clearly prohibit acceptance of shares under the promoter's quota by members of the bureaucracy. The exposure of the fact that Mr. Mahadevan, the former managing director of the State Bank, did so in violation of his service rules led to his dismissal, indicates the seriousness of the crime. In not investigating similar share holding by others, the JPC has been unfair in its investigations, or at least is guilty of conducting incomplete investigations.

I have now evidence that the Finance Secretary, Mr. Geethakrishnan, himself had promoter quota shares, among others, in DCM Toyota, Modi Xerox, Indo Matsushita, Ramganga Fertilizers and India Glycol.

That industrial houses have been known to buy favour by distributing the promoter quota shares is well known and other proven players of the scam have been found to be in possession of promoter quota shares. Mr. K. Margabanthu of the UCO Bank, Mr. Mahadevan, M.J. Pherwani, B. Ratnakar were all bribed by the industrial houses to win their favour. Mr. Bansi Mehta, the leading auditor, who manipulated the final accounts of Fairgrowth, held promoter quota shares of the same company.

Others who have found to be holding promoter quota shares include Mrs. Janaki Kathpalia, former Additional Secretary, Ministry of Finance, who held shares in Daurala Organics. Mr. Ravi Kathpalia, Controller General of Accounts, her husband, also had promoter quota shares in Daurala Organics and Pashupati Tauro. Mr. G.C. Iyer, Additional Controller General of Accounts, also had promoter quota shares in Indo Count and Y.S. Porcelain.

In the RBI, I have definite information of Mr. I.T. Vaz, Executive Director, possessing shares in Matrix Materials and Kotak Mahindra, (which has featured in the scam in an unfavourable light). Mr. P.B. Kulkarni, also RBI executive director, held shares in Gujarat Godrej.

The Committee has not specified that such possession of promoter quota shares was illegal and that it should be specifically banned henceforth.

Despite my repeated suggestions, this aspect of serious aberrations have not been looked into by the Joint Parliamentary Committee. In fact, the holding of promoter quota shares in some cases establishes the nexus between the industrial house and delinquent officials, that defrauded the country.

The role of the industrial houses, which may even have engineered the scam, and the collusion at the top has also been handled in a totally disjointed fashion. While there is information on the bill discounting scandal, the extent of the machination of big business has been unexposed. The brokers manipulating market often did so with funds mobilised by the industrial houses to push up their own shares for greater creditability. The seriousness

of the deed has been underplayed by the JPC Report. In fact, such trading in one's own shares helped companies get their own issues oversubscribed in the primary market. Even worse, funds for such efforts were usually stolen from banks through fraudulent bill discounting. The JPC Report fails to state unambiguously that the securities fraud was not the bi-product of the irregularities of the system and the outcome of unguarded liberalisation only but also the outcome of the collusion between the brokers, industrial houses, banks, bureaucrats and people in high position.

The Report in my opinion has not been able to laybare the collusion with all its ramifications. It is not only an abuse of power and position to commit the crime but also to cover up the criminality to escape penalty. The Committee has not succeeded in doing its job in this regard.

Coming now to the role of the Finance Ministry, which along with the RBI failed to read the ominous signal and understand that the money market was being manipulated to benefit industrial houses and brokers. Let alone issuing of a public warning to the manipulators, the Ministry was unconcerned, it did not ask the RBI to find out the source of funds. When the SEBI was advised to undertake the necessary corrective measures, it was too late and even SEBI was not by then granted adequate powers.

The Government now pretends that it was ignorant about the fraud being perpetrated, though it was sitting on the reports of inspection from the RBI to the Banking Division of the Finance Ministry. Who were the officers who should have taken note? Why has the JPC, with knowledge of their names, kept silent? When the former Chairman of State Bank of India was advised to quit the office by the Finance Ministry, owing moral responsibility for the short fall in the securities held, should the Minister in charge of the Department and his Secretary be spared?

I understand that the guilty officials are very precious to the Ministry. I understand the Finance Minister is indispensable for the nation. But how does one judge the usefulness or otherwise of a person who did not do the job he was appointed to do? The roles of Mr. Montek Singh Ahluwalia and that of Mr. K.P. Geethakrishnan have not been commented upon, while the overall responsibility of the Finance Minister has been diluted. It is difficult to exonerate Dr. Singh of the charge of serious lapses. When the country has lost so heavily should we talk in terms of parliamentary responsibility only and refrain from identifying the personal accountability of the person occupying highest executive office in the Ministry of Finance? While deposing before the Committee Mr. Ahluwalia, Secretary, Banking and Economic Affairs took pains to explain that the security scandal was product of the system failure. He showed no regret, no remorse, no sense of shame, nor a keenness to learn from the Scam, nor any willingness to admit failure of his own department. He said he did not know that the financial review of the banks were reaching his department regularly. On the matter of the resignation and reappointment of Mr. M.J. Pherwani, who created such havoc subsequently, he was economical with the truth.

Yet, throughout the deposition the then Economic Affairs Secretary, Mr. Ahluwalia, gave the impression of the Government being a great respector of RBI and F.I. autonomy; of a hand-off approach to management of banking system, which he pointedly said was entirely left to the Reserve Bank. Mr. Ahluwalia said:

> "The RBI is set up under its own Act. It is an exclusive body which has exclusive responsibility for the supervision of the banking system — there is no mechanism whereby the Department (of Banking) supervises the RBIs."

Mr. Singh was clearly attempting to mislead the Committee, for notwithstanding the apparent autonomy of the RBI, the senior appointments owe themselves to the Government, which appoints the statutory auditors (except in the case of foreign banks) and through a process of constant interaction keeps itself informed about policy matters. Significantly, the Ministry in another context informed the JPC that as far as banking policy matters, decisions are taken in mutual consultation between the Government and RBI.

What the JPC failed to do is to look into the reasons for the Economic Affairs Secretary's equivocation on the control and autonomy issues. On the one hand the bureaucrat wished to impress the JPC that the Ministry had discharged its duties as 'owner' responsibly but when it was clearly established that it did not, it assumed an holier-than-thou stance about the sanctity of the RBI's autonomy.

The Finance Ministry's role in sponsoring and perpetuating the scam has not been adequately dealt with. The mischiefs of Mr. Ahluwalia have been ignored.

Despite the serious shortcomings listed above, the work of the Committee in my humble opinion, is not without success. It has been able to focus the serious irregularities in the national financial system. It has been able to identify the personal accountability in some cases. The prolonged work of the Committee, its deliberation and the evidence it has been able to collect has made the country more concerned and the Parliament more conscious of the responsibilities, of the need to make the system more transparent and accountable. The urgency of the structuring has been made imperative. The Committee under Shri Ram Niwas Mirdha succeeded in many ways, but it has not lived to the expectations it has generated. It had a far greater responsibility in changing the future of Indian Financial System; in emphasizing the need to prosecute all the guilty players, especially in the Government and to make them pay for the massive securities scandal.

Now the question arises as to why I have not given a dissent note. Since the parliamentary investigation, as sought to be done by the Joint Parliamentary Committee under the Chairmanship of Shri Ram Niwas Mirdha had almost arrived at the consensus on the basis of minimum agreed points, I thought I should go with it so that unanimous report, even with its limited and partial findings, can make the necessary impact in the country. This I thought was reasonable in the larger context of making parliamentary investigations effective for the future. Many of the points I thought to be important have been excluded from the report and the Committee has not moved into the number of sensitive areas, I feel extremely unhappy with the report and while doing so I submit my difference in the form of a parallel note.

Sd/-
Shri Gurudas Das Gupta, MP

(4) Note by Sarvashri A. Charles, Mani Shankar Aiyar, Vijaya Kumar Raju Bhupathiraju, P.C. Chacko, Sqn.Ldr. Kamal Chaudhry, Murli S. Deora, M.O.H. Farook, (Dr.) Debi Prosad Pal, Sriballav Panigrahi, Shravan Kumar Patel, S.S. Ahluwalia, Jagesh Desai, H. Hanumanthappa and Ram Naresh Yadav, MPs.

There are several inherent contradictions in the depositions made by Shri Harshad S. Mehta before the Committee on 12 November, 1992 and on 30 June, 1993. After intensive interrogation on 30 June, 1993, the Committee felt that Shri Harshad S. Mehta was trying to mislead the Committee but in view of the grave charge of the alleged pay-off of Rs.1 crore to the Prime Minister, the Committee thought it prudent to call for further information and records to verify the authenticity of his allegation. The records available with the Committee do not substantiate the allegations made by Shri Harshad S. Mehta regarding payment of the said pay-off to the Prime Minister on 4 November, 1991 at 10.45 A.M. His other charges that he received political patronage in exchange of the alleged payment made to Prime Minister which enabled him to wriggle out from the problems faced by him in the Bombay Stock Exchange also has not been substantiated. In view of the above, there is no truth in the allegations of Shri Harshad S. Mehta regarding the alleged pay-off.

Sd/-
Shri A. Charles, MP
Shri Mani Shankar Aiyar, MP
Shri Vijaya Kumar Raju Bhupathiraju,MP
Shri P.C. Chacko, MP
Sqn. Ldr. Kamal Chaudhry, MP
Shri Murli S. Deora, MP
Shri M.O.H. Farook, MP
Dr. Debi Prosad Pal, MP
Shri Sriballav Panigrahi, MP
Shri Shravan Kumar Patel,MP
Shri S.S. Ahluwalia, MP
Shri Jagesh Desai, MP
Shri H. Hanumanthappa, MP
Shri Ram Naresh Yadav, MP

(5) Note by Sarvashri A. Charles, Mani Shankar Aiyar, Vijaya Kumar Raju Bhupathiraju, P.C. Chacko, Sqn. Ldr. Kamal Chaudhry, Murli S. Deora, M.O.H. Farook, (Dr.) Debi Prosad Pal, Sriballav Panigrahi, Shravan Kumar Patel, S.S. Ahluwalia, Jagesh Desai, H. Hanumanthappa and Ram Naresh Yadav, MPs.

"During their deliberations, a few Members drew attention of the Committee to a series of write-ups published in a national daily from 27 August, 1993 onwards alleging that Shri Romesh Bhandari, Governor of Tripura had masterminded a conspiracy in collusion with certain other individuals with a view to maligning some political leaders by attempting to link them to certain pay-offs from the foreign accounts of Shri Harshad Mehta. After examination of the clarifications/comments obtained on the newspaper reports from the Government agencies concerned, we are of the firm conclusion that the subject matter does not fall within the purview of this Committee in terms of their terms of reference."

Sd/-
Shri A. Charles, MP
Shri Mani Shankar Aiyar, MP
Shri Vijaya Kumar Raju Bhupathiraju, MP
Shri P.C. Chacko, MP
Sqn. Ldr. Kamal Chaudhry, MP
Shri Murli S. Deora, MP
Shri M.O.H. Farook, MP
Dr. Debi Prosad Pal, MP
Shri Sriballav Panigrahi, MP
Shri Shravan Kumar Patel, MP
Shri S.S. Ahluwalia, MP
Shri Jagesh Desai, MP
Shri H. Hanumanthappa, MP
Shri Ram Naresh Yadav, MP

(6) Note by Shri K.P. Unnikrishnan, MP

When an enterprising young journalist broke the story of large scale discrepancies in the investment portfolio account of the State Bank of India's main branch in Bombay; little did the media or the Parliament or the public suspect that it would be the beginning of unravelling of a massive and unprecedented fraud in dealings of securities by the Banks, Indian and foreign; the Financial Institutions; Public Sector Organisations and above all the brokers who acted as intermediaries between these Institutions. Though it was an unprecedented Scam as far as India was concerned; there have been numerous similar scandals in the United States, Europe and Japan and one tends to think of this as an integral part of unregulated economies and inherent in the capitalist system itself. And naturally the alarm bells had rung and the Parliament in its wisdom decided to probe into the scam and its ramifications and entrusted JPC with this tremendous task of conducting an unparalleled enquiry.

The terms of reference refers to 'fixing of responsibility' and indeed individual culpability, which naturally added a critical dimension to the deliberations of the Committee.

There were agencies like the CBI which were asked to enquire in depth; into the numerous criminal acts and acts of omission and commission and fraudulent behaviour of and the nexus between various institutions and individuals involved in these shady transactions. This naturally can only be undertaken by an investigative agency with a background; but personally I have grave doubts whether the CBI in the context of their training and as it is constituted today can perform this function adequately. That is not to cast any aspersion on the splendid work they have done in this case, inspite of certain gaping holes and omissions, to which we have referred in the report.

The RBI also set up the JANAKIRAMAN COMMITTEE and the Committee's tortuous labours have indeed been very significant. As a matter of fact, Janakiraman Committee's report helped the JPC enormously, and gave it a referral framework.

But however, may I point out, that the JPC erred in the beginning by not requesting the Government to allow the CBI to be guided by the Committee and its Chairman, as was done earlier in the Bofors JPC. This created certain "parallelism" which could have been avoided and better coordination achieved in this very difficult and arduous probe. The JPC's probe would have been far more meaningful and acquired a diffirent thrust, if the CBI had been brought in under the control of the JPC for the purpose of this enquiry.

The constitution of the JPC raised a great degree of expectations in the Parliament, the media and among the people. It was obvious that the Committee would not be able to meet the expectations of everyone. For indeed, the media and the people looked at it from different angles; very often forgetting the limitations imposed on the JPC by the constitutionally regulated procedures and various other limitations. But inspite of everything, I think JPC has performed a unique and unprecedented task. It has not allowed itself to be buried under the debris of mountains or reems of papers laid before it including the ledgers and books of accounts and complex documentation which is impossible or very difficult for ordinary persons to understand or much less to comprehend. But as one who has had the privilege of being associated with several Parliamentary Committees for nearly a quarter century, I would like to say that this JPC was unparalleled! The devotion and dedication of the Chairman and the members to the cause led them to stand the strain of working for several hours and days at a stretch for more than a year assisted by an equally dedicated and competent Parliamentary staff.

2. The formation of the JPC and the terms of reference formulated by Parliament raises some basic questions, while undoubtedly, fixation of individual culpability and the responsibility of many of the players were important, the JPC cannot forget the fact that it was dealing with a problem which was *sui-generis*, but one which had its roots in the very system itself. Frauds have occurred everywhere. Frauds have also been detected and the guilty punished in many cases. But the question before the Committee was something more, to which I wish the Committee had paid greater attention in detail for the sake of the future of the National Banking System institutional structure and the economy. In short, what are the linkages between the frauds perpetrated and the permissive environment in which the perperators found a hospitable climate to implement their designs? The Banking System would have benefited a great deal, if we had conducted a probe into the fissures of the system rather than taken an obsessive interest in the role of individuals. What was its linkage to the policy regime of the immediate past and the environment it created? While fixation of individual culpability and responsibility was important, preoccupation with some VIPs would only create a myopic view of the problem. For example, in March, 91 the market capitalisation of equities in Bombay Stock Exchange was Rs. 75,648 crores, it climbed upto a staggering figure of Rs. 2,76,434 crores by the end of the March, 92. Obviously, the steep increase in the trading volumes went unnoticed for several months and massive irregularities and speculative trading took place encouraging the treasury operations of the banks resulting in a massive scam. This also established a new linkage between the capital and money markets which had great consequences for the future of the Economy.

What is important to note is that this was happening at a time when tremendous changes were taking place in the economic policy perspective and policy framework of the Government of India. The regulatorty framework and strategic perspective which we had built up in the previous four decades was being discouraged and dismantled and steps taken for 'opening the wombs of national economy' to higher levels of Foreign investments, and infusion of new technology and greater involvement in international trade. What was happening was a right about turn in the strategy of the developmental process itself and with the end of the interventionist state as its goal. This is not an occasion to discuss the merits and demerits of this strategy and policy framework, but I am only underlining the fact that there were far too many linkages which the Committee has failed to explore. These measures known also as process of liberalisation created a misleading impression that encouraged or pushed the 'Bulls' and 'Bears' to a level of unprecedented and feverish market activity.

I have no doubt that it was not the intention of the Government or the Finance Minister to initiate overheating of the market. For example, the Finance Minister in his Budget speech of 1991, in July, 1991, deregulated interest rates on floatation of bonds. The banking sector, both Indian and Foreign on their own account and on behalf of portfolio management scheme clients were holding huge stocks of the PSU bonds which plunged to record low levels in value by nearly 25% with his announcement! The Mahanagar Telephone Nigam case is a classic example and it very nearly killed the market of the PSU bonds. Banks with excess holdings could not divest and had to resort to 'ready forward deals' on high rates of interest. This resulted in massive losses to the banking sector.

I am not suggesting that the Finance Minister did it deliberately, but both the Ministry of Finance and the RBI could not follow the signals of the market. And at times they were under the spell of a Euphoria! None of them had 'market experience', to judge or respond quickly to the Boom of disaster. There was also a race for achieving levels of adequate profitability among the Banks and the PSU's and they found raising funds in the market through floatation of the Bonds was a way out. But as it turned out it went beyond the market

capacity to absorb these new issues and therefore the surplus funds could not be recycled contributing to massive irregularities in the securities market.

I wish Committee had explored this line of enquiry in detail to the question of missing millions, rather than allowing itself to get involved by pursuing certain cases of 'individual responsibility' beyond the limits warranted by the evidence or terms of reference. And this preoccupation prevented a deeper and meaningful probe into more relevant issues, I wish to come to these questions later. The Committee should also have looked into the RBI statute more closely. These are some of the negative aspects of the JPC's work which though not deliberate has caused considerable misgivings. It is a pity that the Committee did not find enough time to discuss these questions with some of our leading Economists including some of the former RBI Governors.

The JPC has rightly identified principal players of the Scam like the PSUs, the foreign and Indian Banks and Financial Institutions. But it is my feeling that we spent more time in probing into the regulatory agencies and particularly the RBI and its omissions and commissions and we did not try to go into depth on the need for an active market in public debt instruments within responsible and reasonable limits of trading which has to be recognised as necessary. It is true that the RBI knew right from 1987 the malaise which was hidden into the malaises of the banking system. Kurias report gives a vivid account but no action was taken in 1987 and it was passed over. It is clearly established that this was an area of responsibility of the then Deputy Governor, who kept on pushing the file back and forth. Inspite of the fact, that he had carved out a powerful niche in the structure of the RBI and remained so far nearly ten long years dealing with the Banking, Exchange control, large industrial accounts and the administration of the RBI and rendering even the Governors of the period feeble and ineffective. The transactions based on BR's without the sanction of underlying security became a feature of the trading system, during this period. Kurias's lone but vigilant voice went unheard, a cry in the wilderness.

I strongly feel that the Committee should have proposed a statutory sanction for the banker's receipt (BR). Such an important instrument cannot be without any firm legal basis and remain as an informal arrangement of the Bankers club like the IBA. It is upto the RBI and SEBI and indeed the Government of India to look into this and bring forward suitable amendments to the relevant statutes.

Similarly the question of Management of Public Debt and the archaic method of maintaining "SGL Transactions" have to be totally changed. Two other questions have arisen in the context of the evidence before the Committee. One is about the portfolio management scheme. It is closely related to the overall policies of management of the economy and the PSUs. The system calls for a thorough review of the PMS scheme, though not necessarily for a termination of the Scheme; taking into consideration the short term capital needs of the PSUs as well. Suggestions have been made that the 'Bill discounting' should also be seriously curbed. It is a means of finance resorted to by a number of sectors who wish to avail of credit without going through the rigorous provisions of consortiums. While it is important to see that it is not used as a device to siphon out funds for certain influential groups and individuals; it is necessary that the need for credit in the small-scale industry and exporters are fully protected. It has been the experience of many, that the Consortiums never meet on time and this banking instrument should be made available to small and medium companies even outside the Consortium facilities.

In the wake of this massive scam a lot of discussion has obviously centred around the role and activities of the share market brokers. Many of these brokerage houses have been "FAMILY HOUSES" and these have grown and acquired a traditional profile. Many of them

had fair levels of integrity. Some of them were also tied to certain business houses. They also controlled and manipulated the Indian Stock Exchanges and both the Government, Parliament and the media ignored or overlooked the behind the scenes activities in the Stock Exchanges. In this context, the development of the SEBI and the regulating authority entrusted to it, and their positive steps in the right direction; can go a long way.

But suggestions to exclude brokers from their legitimate areas of activities would only be counter-productive. On the contrary, it is the duty of the SEBI and the Government to see that brokers turn into good PROFESSIONALS. This also calls for far reaching reforms of the Stock Exchange practices.

A vital and relevant area into which the JPC could have gone into in depth was the insiduous and unhealthy practice of "INSIDER TRADING" in the Indian Stock Exchanges. It was admitted in evidence before the Committee that most Big Houses are guilty of this practice and some witnesses even went to the extent of saying that most of the share trading done in Indian Exchanges was 'Insider Trading'. It is amazing to note that there is no statutory ban on this corrossive activity which has eaten into the vitals of the system. Therefore, I would urge the Finance Ministry to initiate vigorous steps to curb insider trading and introduce early legislative enactments to this effect.

Now question that has been raised about the individual responsibility of certain high functionaries. As I have pointed out earlier, our report would not gain much in credibility, or contribute to the health of the banking system and national economy by focussing the issue as one only around certain individuals like the Finance Minister or the then Governor of the Reserve Bank.

There is nothing in the evidence to suggest in either of these cases that they have colluded in any way and brought about the Scam. As far the perpetration of the Scam with its principal actors identified by the Committee; sweeping generalisations based on 'market gossip' and narrow interpretation of actions done in good faith — even if they had led to errors of judgement or mistakes — would only create a situation where nobody would take any decision.

I would only comment on few aspects of this question. Reference has been made to the appointment of late Mr. Pherwani as the Chairman of the National Housing Bank. It was certainly not expected of the RBI Governor or any one else in the selection panel to conduct an 'enquiry' before choosing or empanelling any one for any responsible job. That is the job of an investigative agency or a vigilance department or the Ministry or organisation concerned and it is their business to bring such information to the notice of the Selection Committee. To say that the RBI Governor did not find out the background of the person is rather ridiculous.

Similarly, it is rather strange that the then RBI Governor who sounded note of warning as early as March'92 on heating up of the stock markets and convened a meeting of the heads of the financial institutions for curbing speculative trends in equity prices be hauled up for colluding with some brokers - which to say the least is extremely unfortunate. Again, it is on record that as early as on 9th March'92 he made a statement in Hyderabad and on 10th March he convened a meeting of the financial institutions and it was this initiative of the RBI Governor which finally resulted in an enquiry into the source of funds of the artificial stock boom — tracing it to a current account of Harshad Mehta in the Bombay main branch of the SBI with large transactions. On 16th March '92 ledger of Harshad Mehta's account in Bombay main branch was seen by the Governor, who asked the SBI — as admitted by Mr. Goipuria, the then Chairman of the SBI — to continue 'monitoring'. The then RBI

Governor reiterated his concern on 17th March at Pune and again during last week of March instructed that an Inspector be sent to the SBI to look into its investment account of the SBI and it is this Inspector's note which led to the discovery of non-reconciliation of accounts. How then was the then RBI Governor responsible or how did he collude to create a Scam — such unwarranted inferences are beyond one's comprehension.

Harshad Mehta called on the RBI Governor on 1st April, 1992 and much has been made out of this meeting and also of Mr. Parmeswaran's meeting with the SBI Managers. It is relevant to note that no facilities were sought either by the client or anybody on his behalf nor any sanction extended after this meeting as per the evidence before the Committee. Anybody familiar with the banking procedures would know that it is only an account holder who can operate a current account. It can not be "activated or reactivated" by any third party. It is indeed strange that transactions are called 'activation' on the basis of feeble or no evidence and persons sought to be maligned.

Therefore one would have to do violence to facts to suggest that the then RBI Governor had 'reactivated' Harshad Mehta's SBI current account which lead to the Scam. There is absolutely no evidence of this kind on record to warrant any such conclusion. It has to be remembered that Mr. Mehta had not closed the account nor were the operations under the account suspended by the bank. It was only being 'monitored' with the knowledge of the Governor. Above all by intervening to stop the roll-over from the NHB, the then Governor had taken a concrete step in reducing the magnitude of the scam. Therefore, I cannot accept the contention of some friends that the then RBI Governor has been guilty of any dereliction of duty or his conduct need to be subjected to yet another probe. It would only be a case of witch hunting.

It is a moot question in the changed context of the national economy whether the RBI should continue to supervise the banks through the instrument of inspection systems or a new system be evolved. Inspite of the creditable record of the inspecting agency, fraud cannot be detected by any audit or inspection team in the normal course. "Fraud detection" require a specific training to identify patterns of malfeasance and violations. Therefore, it is up to the Government of India and RBI to set up a fraud detection and supervision agency which would look in particular at the Banks frauds and security frauds and also exercise vigilance over the system.

Questions have also come up about the parameters of the role and Authority of the RBI. While the Reserve Bank should continue to exercise overall control of monetary policy and currency and foreign exchange, it is a moot question whether they should continue to exercise control over the operations of individual banks. In many western countries, these two functions have already been separated. In our country, the RBI has gone a long way since 1936 and many new roles and responsibilities added to the original ones. Such multiple functions would only disorient what was once a prestigious institution and a well structured Central Bank. Thus it was entirely wrong on the part of the Government of India to have asked the RBI to invest funds in the corpus of the National Housing Bank. It is such a casual approach which damage institutions like the RBI. For the last few decades, it has been the lot of the RBI to be subjected to arm twisting by junior and middle-level officers of the department of banking or the Ministry of Finance. This has also seriously and severely compromise the autonomy of the Reserve Bank of India. It is upto the Government of India to take a clear and determined decision to end this practice and allow the RBI Governor to act and fulfil their statutory commitments.

One of the more amazing features of the scam has been the nature and extent of the involvement of the foreign banks in brazen violations of law. The foreign banks had always

enjoyed an aura of great respectability, efficiency and were much sought after as "enclaves" of professional excellence. Their high profile existence, however, was confined to the metropolitan cities and rather leading urban centres. They had successfully avoided social responsibilities like priority rural lending, imposed on the Indian Banks after the nationalisation in 1969. But they had their own magic wands of influence in the corridors of power in Delhi as the evidence before the JPC strongly suggests and with the smart sons and daughters of the TALL bureaucrats safely ensconced in PLUM jobs they assumed that they were a law into themselves.

It is true that we do need; and there is no harm in encouraging the leading international banks to operate in India and play a constructive role in our Banking System particularly in helping our international trade but obviously they have to function within the four walls of our laws and regulations. Our probe clearly reveals that it has not been the case and banks like the Stanchart and the Citibank were calling the shots.

The Standard Chartered Bank, for example, entered into total transactions of Rs. 1,67,014 crores which they would easily admit were far in excess of norms of prudent banking and what is more essentially of speculative nature. The very fact that 90% of these transactions were routed through one broker, Mr. Hiten Dalal and there were large number of dummy and fictitious deals entered into by the Bank exposed their active involvement in this scam.

The Citibank, the Bank of America, the American Express Bank and the Hong Kong Bank it appears, figure in many transactions but since they have not lost any money or made any such claim, they have managed to remain outside the network of investigations.

It is upto the Ministry of Finance and the RBI to take note of this and see how they can discipline these international giants. These foreign banks also would do well to do a little introspection and remind themselves that they are not operating in a 'Banana Republic'.

The total exposure in the Securities Scam is calculated to be of the order of Rs. 4,800 crores and after 19 months of combined efforts of the CBI and the Income Tax Authorities, it has not been able to locate the money, although all the transactions have gone through channels and except some cash withdrawals.

The Banks, both Foreign and Indian, had been flagrantly violating the Portfolio Management Scheme rules and hold a very large amount on PSU Bonds in the portfolio account. On 24th July, 1991 the Government de-regularised the interest rates and abolished the office of Controller of Capital Issues. As a result, the PSUs started issuing bonds at higher coupon rates resulting in a sharp fall in values of existing bonds. The loss in these bonds was of the order of 15 to 20% which should have been accounted either in the portfolio account or in that of the bank. The banks active in Portfolio Management Schemes in fact reported higher profits for the year ended 31st March, 1992 and therefore, it is a mystery as to where the huge losses due to fall in prices of PSU Bonds were actually accounted.

In the year 1991-92, the velocity of the transactions were usually high because of the total breakdown of supervisory control by the Reserve Bank of India as well as the banks' own internal systems. It is likely that the securities are either lying unclaimed in banks who have received payments but neglected to deliver them to the purchasers or siphoned out of the system may be kept hidden.

I am firmly of the view that the Government should undertake a thorough audit of the ownership of PSU Bonds to unearth the discrepancy. Perhaps, re-issue of PSU Bonds may help to locate these bonds. The holders who surrender the bonds with proof of title and payment should be issued fresh bonds within 90 days. The holders of Bonds who are unable

to come forward to claim and the amount not so claimed would partly account for the missing funds.

The report of the JPC is awaited with great expectations and its recommendations would go a long way in restoring confidence in a shaken system. While the JPC can take full credit for a job well done or adequately done it need not get into the vortex of needless and fruitless controversies. On the contrary the report should finally bury the controversies and allow the agencies to complete the tasks and end the nightmare through which the system has passed.

This JPC report is a landmark in the history of our Parliamentary system. It has opened up a new dimension of our Parliament's strategic rule in the Indian polity. It is to the credit of the Chairman and members of the Committee that they have tried their best to keep the prestige of Parliament high and supreme and the proceeding stood the LITMUS test of being fair, impartial and judicious. Whatever may be the other limitations of this report, I have no doubt that this itself is a historic achievement.

Sd/-
Shri K.P. Unnikrishnan, MP