

**INTERIM REPORT OF THE
COMMITTEE TO ENQUIRE INTO THE
SECURITIES TRANSACTIONS OF THE
BANKS AND FINANCIAL INSTITUTIONS
(Appointed by Reserve Bank of India)**



May 1992

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सत्यमेव जयते

**Committee to enquire into securities transactions
of Banks and Financial Institutions**

Interim Report

General

On the basis of the information received that some banks were undertaking large-scale transactions in Government securities through the medium of brokers in the course of which they were violating the Reserve Bank of India (RBI)'s detailed guidelines issued to them in July 1991, RBI had started making enquiries into the securities transactions of some of the banks since January 1992. Towards the end of March, information was also received that State Bank of India (SBI) had purchased a large quantity of Government securities on a ready forward basis one day prior to the date on which the coupon rate of Government of India securities was raised. Therefore, the securities transactions of SBI were also taken up for scrutiny immediately. The bank was advised on 2 April 1992 to furnish to RBI a statement of the investments held by it as on 31 March 1992. The bank's response was that only the statement as at the end of January 1992 was available and that it would furnish the particulars as on 31 March 1992 as soon as the statement was compiled. It was observed that the bank was unable to furnish the statement as it had not reconciled the balance of securities held by it as shown in its books with the actual balance held in the Subsidiary General Ledger (SGL) Account with the RBI beyond November 1991. SBI was urged to reconcile the figures. On 23 April 1992, a news item in the Times of India made mention of a

shortfall in Government securities held by the SBI. Even while the scrutiny was in progress, the Governor, RBI set up a Committee on 30 April 1992 to investigate into the possible irregularities in funds management by commercial banks and financial institutions and in particular, in relation to their dealings in Government securities, public sector bonds and similar instruments. The Committee was required to investigate various aspects of the transactions of SBI and other commercial banks as well as financial institutions in this regard. The Committee is headed by Shri R.Janakiraman, Deputy Governor with Shri Y.H. Malegam, Chartered Accountant and Shri V.G. Hegde, Principal Legal Adviser, RBI as members and Kum.V.Visvanathan, Executive Director as Member-Secretary. The orders of the Governor setting up the Committee had authorised the Committee to co-opt experts from other required disciplines. The Committee accordingly decided to co-opt experts well versed in income tax investigations and in CBI procedures. In consultation with the concerned authorities, Shri C.P. Ramaswami, Deputy Director, Income Tax (Investigation) and Shri E.N. Renison, Retired Additional Director, CBI, were nominated as Members.

2. Terms of Reference :

The Committee is required to specifically

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 therefor 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.

3. Basis for the Committee's Preliminary Report.

The Committee has had several meetings. The Committee noted that the RBI has ordered a detailed examination to be carried out by its officials into the securities transactions entered into by banks and other financial institutions with particular emphasis on the aspects which form the Committee's terms of reference. The Committee has had the benefit of the preliminary reports received from the officials of RBI carrying out the examination of books of banks and financial institutions with regard to their

transactions in securities and have also had discussions with a number of concerned officials. The Committee has given directions to the inspecting officers regarding the further investigations to be made and it has also framed a detailed questionnaire to be answered by them after carrying out the examination. The Committee recognises that since all transactions entered into by banks and other financial institutions in securities including completed transactions since 1 April 1991 are to be examined by the officials and the transactions of a particular bank/financial institution are to be verified with the transactions and the relative entries appearing in the books of counterparty banks, it will take some time for the scrutiny to be completed. The Interim Report of the Committee is thus based on the preliminary reports of the RBI inspecting officials, the discussions the Committee has had with them and other material presently available to the Committee. The Committee is continuing its investigations and will submit a further Report.

4. RBI instructions relating to
Investment Portfolio of banks

The investment portfolio of banks in the normal course (given the low yield on them as compared to their opportunity cost) is basically intended to comply with the SLR requirements and accordingly expected to comprise approved trustee securities. Since the bulk of the portfolio consists of Government securities, a major portion of the transactions in securities among banks were expected to be put through their respective SGL

Accounts maintained with the PDOs of RBI. However, since the PDOs of RBI maintain SGL accounts only for Government securities, these accounts cannot be operated by banks for their dealings in PSU bonds, Units and similar instruments. Accordingly, the transactions through the mechanism of BR were expected to take care of exceptional circumstances wherein the seller bank of a non-SGL security was not in a position to give physical delivery of the security to the buyer bank either because scrips were yet to be received from the issuer of the security or the security was held at a different place. Except in cases of such exceptional circumstances, the transactions between banks in non-SGL securities were expected to take place on physical delivery basis.

On the basis of information received by the RBI in March 1991, inspection/scrutiny of investment portfolios of banks was undertaken and it was confirmed that the banks were freely putting through transactions in all types of securities, including SGL securities, through the mechanism of BRs, and that they were not only issuing BRs on the basis of BRs of other banks held by them covering their own Investment Account but also issuing their own BRs covering transactions of their broker clients. In July 1991, therefore, while cautioning the banks in general about the undesirable methods followed by some banks while undertaking transactions in securities, RBI advised the banks to frame and implement a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices and while evolving the policy with the approval of their respective Boards, to keep

in view the guidelines prescribed by it. The RBI guidelines inter-alia stipulated that under no circumstances the banks should hold an oversold position in any security, transactions between banks should not be put through brokers' accounts, banks should adopt the format and strictly follow the guidelines prescribed by the Indian Banks' Association (IBA) for issue of BRs (which inter-alia prescribed that normally BRs should not be issued for SGL securities), banks should issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents including brokers, and that banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on their behalf. The Committee is informed by the RBI that a large number of banks had confirmed that an investment policy had been formulated and approved by their respective Boards.

Earlier, from time to time, the RBI had issued detailed guidelines to banks for undertaking underwriting and other commitments in respect of public issues of corporate shares and debentures and public sector bonds, advances against corporate shares and debentures to different types of borrowers, prohibiting their undertaking buy-back deals (ready-forward) with non-bank clients specifically in public sector bonds and Units of UTI and providing portfolio management services to their clients. Details of various types of transactions in securities undertaken by banks, guidelines/instructions issued to banks particularly the RBI guidelines issued in July 1991 and IBA guidelines of May 1991 on issue of BRs, are furnished in the

Annexure.

5. Preliminary Findings

On the basis of the preliminary examination made by the RBI officials, it has been found that :-

- (a) The following banks, subsidiaries of banks and institutions have made payments for purchase of investments for which they do not hold either securities, SGL forms or BRs to the extent indicated below :-

(Rs. in crores).

National Housing Bank (NHB)	1199.39	
State Bank of Saurashtra	175.04	
SBI Capital Markets Ltd. (SBI Caps)	121.23	(including a BR for Rs.67.83 crores for which the transaction is denied)
Standard Chartered Bank	300.00	

	1795.66	
	=====	

- (b) Banks, subsidiaries of banks and institutions are holding BRs/SGLs issued by the Bank of Karad Ltd. and the Metropolitan Co-operative Bank for which the issuing banks do not appear to have sufficient backing to the extent indicated below :-

(Rs. in crores)

Standard Chartered Bank	755.00
Canbank Financial Services Ltd. (Canfina)	425.00
Canbank Mutual Fund	102.97

	1282.97
	=====

(c) The transactions put through the intermediation of NHB and which are outstanding are, prima facie, connected with the broker, Shri Harshad S.Mehta (HSM) and/or his associate concern Growmore Research and Assets Management Ltd. This is evident from the fact that almost all the payments made by NHB by means of A/c. payee cheques drawn on the RBI and issued in favour of the counterparty banks have been collected and credited to the current accounts of Shri Harshad Mehta maintained with SBI and ANZ Grindlays Bank. A large number of transactions undertaken by SBI on its own investment account (about Rs.17000 crores during 1 July 1991 to 6 April 1992) have been put through Shri Harshad Mehta. Besides, in the current account of Shri Harshad Mehta with SBI several of his transactions appear to have been put through in an irregular manner. The transactions put through by State Bank of Saurashtra and SBI Caps have also a link with the broker Shri Harshad Mehta. The transactions at Standard Chartered Bank and Canfina have been put through the broker Shri Hiten Dalal. The Bank of Karad Ltd. has issued BRs in the account of the broker Shri A.D. Narottam. The BRs issued by Metropolitan Co-operative Bank are on behalf of Dhanraj Mills Private Ltd. and Excel & Co. A large number of transactions of Standard Chartered, Canfina and Canbank Mutual Fund have been put through Shri Hiten Dalal with the help of BRs issued by Bank of Karad Ltd. and Metropolitan Co-operative Bank.

- (d) The reconciliation of investment accounts in some of the individual banks is still in progress and the full picture will emerge only after the reconciliations are completed. However, the preliminary examination seems to suggest that the irregularities are confined to only a few banks.
- (e) There has been a systematic diversion of funds from the banking system to the individual accounts of certain brokers and this diversion is presumably represented by the transactions for which the banks and subsidiaries are not holding BRs or are holding BRs of doubtful value.
- (f) This diversion of funds has been mainly through three devices, namely
- (i) purchases have been made by banks and subsidiaries of securities and other instruments where the counterparty is ostensibly another bank but in reality the proceeds have been directly or indirectly credited to brokers' accounts;
 - (ii) ready-forward transactions have been entered into by banks either on their own account or on constituents' accounts with brokers which have provided funds to brokers at rates which presumably were lower than the ruling "vyaj-badla" rates in the stock market; and
 - (iii) brokers have been directly financed by banks through the discounting of bills not supported by genuine transactions or by purchase of shares by the bank under "ready-forward" terms.
- (g) Some of the "ready-forward" deals by banks have not been completed and in consequence the banks may be holding

investments whose market value may be considerably lower than the amount paid for the purchase of the investments.

- (h) In the case of UCO Bank, bills aggregating Rs.50.40 crores were discounted by the bank. These bills were presumably covering the sale of shares by the broker Mrs. Jyothi H. Mehta (wife of Shri Harshad Mehta) to associate concerns of Shri Harshad Mehta. The manner in which this transaction was effected makes it clear that this was in the nature of a clean advance to the associate concerns. On maturity, these concerns appear to have been put in funds to retire the bills through the purchase by UCO Bank from Shri Harshad Mehta of shares of an aggregate cost of Rs.49.50 crores. The UCO Bank had earlier, on 8 April 1992 also, purchased shares of an aggregate cost of Rs.12.25 crores from his holdings. As against the aggregate cost of Rs.61.75 crores, the present market value is only around Rs.40 crores.
- (i) The major device by which the transference of funds to brokers' accounts has been achieved has been through the issue of BRs which were not supported by underlying securities and by payments being diverted to brokers' 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 and presumably by collusion between the concerned officials and the concerned brokers. There is prima facie evidence of fraudulent ^{misrepresentation} ~~misappropriation~~.
- (j) The diversion has also been made possible by a number of

other factors which are summarised below :-

- (i) There has been a significant increase in the volume of transactions in securities and capital market instruments since July 1991. Thus, in the SBI alone, the volume of transactions increased from about Rs.1000 crores in April 1991 to about Rs.8700 crores in March 1992.
- (ii) These transactions have mainly been for "ready forward" deals between banks, between banks and brokers, and under portfolio management schemes. These are purely financing transactions though they take the form of purchase and sale of investments and appear to be an attempt to bypass RBI directives to banks governing direct advances by banks to brokers. They suffer from the further disadvantage that a broker gets access to bank funds without complying with margin requirements as would be the case when direct loans are given.
- (iii) Since the transactions have been on a "ready-forward" basis, there is no need to permanently transfer the underlying securities and therefore under several excuses, banks have been resorting to the indiscriminate issue of BRs. On reversal of the transaction these BRs would be returned. There have also been cases where SGLs issued have been returned without being deposited with the PDOs.
- (iv) The use of BRs has been justified on the grounds that there is delay in the recording of transactions

- at the PDOs and also that there is undue delay in the issue of scrips after allotment by PSUs. However, a large number of BRs have also been issued for Units.
- (v) Cheques issued in the names of banks by the purchasing banks have been collected and credited to the individual accounts of brokers without any such instructions by the issuing banks. This has enabled brokers to collect monies from purchasing banks under contracts which are ostensibly with banking counterparts.
- (vi) Banks have lent their names to transactions which are not on their own account. Thus, banks have issued BRs at the request of brokers against BRs received or to be received in their favour in respect of transactions where they are neither purchasing or selling investments. These facilities have been provided to earn a fee but without disclosing to the counterparties that the concerned bank is not entering into the transaction on its own account.
- (vii) Special facilities have been made available to select brokers whereby banker's cheques drawn in favour of the bank have been credited to brokers' accounts and against these cheques the bank has issued its own banker's cheques in favour of parties nominated by the broker. These have helped to hide the true nature of transactions from counterparties.

- (viii) In a number of cases there has been total lack or a breakdown of essential discipline regarding the issue and recording of BRs, the scrutiny for genuineness of signatures, the receipt and delivery of securities and the receipt and payment for settlement of transactions.
- (ix) There has been no periodical reconciliation by banks of the investment accounts with the SGL accounts maintained by the PDO and in several cases this reconciliation was in arrears for long periods. If such reconciliation had been regularly done and the investments periodically verified by the internal auditors, the non-availability of BRs would have been immediately detected.
- (x) In the PDO, the records are not computerised. Separate manual accounts are maintained for each scrip held by each bank and a minimum of information is available in the ledger where these accounts are maintained. It has, therefore, not been the practice, nor does it appear feasible (in the absence of computerisation) for a statement of transactions in the individual bank's account to be sent to the bank. If such a statement was available with the bank, it would have the means of regularly reconciling its investment account. Balance confirmation certificates are also not issued periodically but only on request and copies of such certificates are not kept with the PDO.

- (xi) Through the portfolio management scheme, corporate funds have been used to finance brokers in the manner of "vyaj badla" but at much lower rates than the prevailing "vyaj badla" rates.
- (xii) Merchant banking subsidiaries of banks have accepted substantial amounts by way of inter-corporate deposits at high rates of interest and have been under compulsion to earn higher returns. These have been obtained through "ready forward" transactions.
- (xiii) In the case of some merchant banking subsidiaries of banks, the deals are made by the subsidiaries but the actual transactions for receipt/delivery of scrips, BRs, etc., and receipt/payment of monies payable/due are arranged by the parent bank. The subsidiary, therefore, is not able to effectively monitor the transaction.
- (k) Banks, in respect of their transactions with their customers, do issue BRs on account of sales of Units, PSU bonds, etc. This matter is being examined.
- (l) The transactions have been effected by using a large number of banks' accounts in different names in different banks and to establish the trail is a difficult and laborious operation. Therefore, the unravelling of these transactions will necessarily involve considerable time and effort.
- (m) The diversion of funds as reflected in the outstanding

contracts has been mainly in respect of PSU bonds, Units and similar instruments and to a much lesser extent in respect of transactions in Government securities.

(n) The records of the PDO in the RBI show that :

(i) a large number of transfer forms (ranging from 9.9 per cent to 18.2 per cent between March and May 1992) have been returned by the PDO under objection for insufficiency of balance. Almost all the banks have been guilty of issuing SGL forms when there is insufficiency of balance. This is often due to the fact that banks over-sell at the beginning of the day and even though they square their position by the end of the day, the actual SGL forms for the purchase may not have been received by the end of the day.

(ii) The entries in the PDO have normally been recorded on the day the SGL transfer forms are lodged in the PDO but delays upto 10 days have occurred on days following reporting Fridays and when half-yearly interest is due.

(iii) There are a number of corrections for errors in the records.

(iv) Objection memos have generally been prepared on the day of lodgement of the SGL forms or the next day though there are a few cases of apparent delay which need to be examined further. There is no delay in communicating these memos when delivery of the objection memos is made over the counter or

by hand delivery but there is considerable delay when the memos are despatched by post.

(v) There is delay of about 10 to 12 days in preparing credit advices.

(vi) There is no copy of confirmation certificates issued by the PDO to the banks.

Some of the preliminary findings are detailed in subsequent paragraphs.

6. Extent of the problem : -----

The Committee as a first step, suggested that BRs held by banks for purchases and those issued by them for sales and outstanding may be matched so that the extent of transactions which are not backed by BRs could become available and in the process the problem exposures of banks and financial institutions could be assessed. The second step (which is in progress) was to examine the genuineness of the BRs, existence of the securities covered by the BRs and the capacity of the issuers of BRs to honour the commitments. The findings to date, of the exercise are detailed below.

The matching exercise has revealed that, by and large, banks and financial institutions hold BRs in respect of the outstanding transactions except in a few cases. The BRs held have also been confirmed by the counterparty banks. The aggregate quantum of transactions for which no BRs are held by banks/financial

institutions is as under :

(Rs.in crores)				
Name of the bank/ institution	Number of transact- ions	Security covered	Value of the transactions	Remarks
1. National Housing Bank	a) 4	Govt. Securities	302.05	--
	b) 22	Units and PSU bonds	857.47	--
	c) 4	PSU bonds	39.87*	*No BRs held but the concerned counterparty has accepted the transactions which are overdue.
			1199.39	
2. State Bank of Saurashtra	4	Units & PSU bonds	175.04	--
3. SBI Caps	a) 7	Units	53.40	--
	b) 1	Units	67.83@	@Though BR of NHB is held the latter has denied the transaction.
			121.23	
4. Standard Chartered Bank	a) 1	Govt. securities	250.00	--
	b) 1	Units	50.00#	#The bank has a discharged BR.
			300.00	
GRAND TOTAL			1795.66	

It will thus be seen that the aggregate exposure on account of banks not having BRs or securities is significant. Out of the total exposure of Rs.1795.66 crores, contracts in respect of transactions in Government securities amount to Rs.552.05 crores

and the rest are in respect of Units and PSU bonds.

However, analysing the backing on the basis of which BRs have been issued and the capacity of the issuer of BRs to honour the commitments, the position is even more serious. It is observed that a number of BRs have been issued which are not backed by security or BRs held. BRs have also been issued on the basis of BRs held, where the capacity of the issuer to honour the BRs is in doubt. A summary position is indicated below :

(Rs.in crores)

Name of the institution holding the BRs	Name of the institution whose BRs are held	No.of BRs	Security covered	Amount	Remarks
Standard Chartered Bank	a)Metropolitan Co-op.Bank	6	Units & PSU bonds	530.00	A very small sized urban co-op. bank (Board since superseded)
	b)Bank of Karad Ltd.	6	Units & PSU bonds	225.00 ----- 755.00	Since taken into liquidation
Canfina	Bank of Karad Ltd.	3	Units & Govt. securities	425.00 -----	Since taken into liquidation
Canbank Mutual Fund	Bank of Karad Ltd.	1	Govt. securities	102.97 -----	SGL dated 27.5.1991 has bounced.
GRAND TOTAL				1282.97 =====	

The BRs issued by Bank of Karad Ltd. have either no backing or backing of doubtful quality. The BRs issued by Metropolitan Co-operative Bank, an urban co-operative bank with less than Rs.10 crores of assets are also of doubtful value.

Thus, taking into account what is stated above, the amount of exposures which banks may find it difficult to realise aggregates to Rs.3078.63 crores. This does not take into account any claims towards interest, etc., which may arise on settlement.

7. Preliminary findings of the scrutiny
of certain banks/institutions.

The preliminary findings of the scrutiny of the investment transactions at certain banks/institutions carried out by the officials of the RBI are given in the following paragraphs :

I.State Bank of India

The scrutiny of the securities transactions of the SBI was taken up towards the end of March 1992 in the circumstances explained in paragraph 1 of this Report. During the course of this scrutiny, the SBI was asked to reconcile the balance of securities held by it as shown in its books with the actual balance held in the SGL account with the RBI.

During the course of this reconciliation, it was noticed that the securities balances in the SBI books exceeded that shown in the SGL account at the end of March 1992 by Rs.1022 crores. It was also observed that the SGL statement as on 29 February 1992 obtained from the PDO of RBI bore an alteration in the amount of securities shown against 11.5 per cent - 2010 Central Government Loan whereby the figure of Rs.1170.95 crores was shown altered to Rs.1670.95 crores. On reconciliation with the books of SBI, the latter showed an excess of Rs.74 crores (Rs.1744.95 crores as per SBI books less Rs.1670.95 crores as per the SGL altered account balance). As the correct figure of SGL account

balance in this security was Rs.1170.95 crores, the excess as per SBI books was Rs.574 crores in that scrip. The excess revealed in the SBI books over that shown in the SGL account balance meant that SGL transfer forms for credit to SBI's SGL account with PDO had not been lodged with the PDO to the extent of the difference.

As far as the reconciliation of the overall difference of Rs.1022 crores in the figures of SBI and PDO as on 31 March 1992 was concerned, it was observed that an amount of Rs.699 crores in 11.5 per cent - 2010 Central Government Loan and an amount of Rs.230 crores in 11.5 per cent - 2007 Central Government Loan were short-credited in the SGL account. Of the former, Rs.200 crores were attributable to the broker Shri N.K. Aggarwal for which SGL/resale was accounted for. The balance viz. Rs.499 crores was attributable to Shri Harshad S. Mehta (HSM). Regarding the second loan, an amount of Rs.60 crores comprised SGL form issued by Standard Chartered Bank for its sale to SBI and the balance of Rs.170 crores was purchased by SBI through HSM. Thus, an amount of Rs.669 crores in all, covering both the loans, represented the value of the securities transactions put through HSM for which no SGL transfer forms had been lodged with the PDO. The net amount after an adjustment of Rs.20 crores in respect of an internal transfer from another SGL account of SBI, representing transactions routed through HSM amounted to Rs.649 crores. Against this, SBI received 9 payment orders of ANZ Grindlays Bank aggregating Rs.574.76 crores and one banker's cheque from Syndicate Bank for Rs.47.76 crores from HSM. Adding a further amount of interest on 182 days Treasury Bills from HSM for Rs.0.20 crore, the aggregate payment received from him

amounted to Rs.622.72 crores. The amounts were received on various dates between 13 April and 24 April 1992. SBI is reported to be pursuing the recovery of the balance amount of Rs.26 crores receivable by it from HSM. The reconciliation of the Investment Account is still in progress.

The sale/purchase transactions undertaken by SBI in Government and other approved securities have been entered into by the bank through several brokers including Shri Harshad S. Mehta (HSM). During the period 1 April 1991 to 31 March 1992 the transactions entered into by SBI in Government securities aggregated Rs.48562 crores, of which the contracts put through HSM accounted for Rs.17300 crores (35.6 per cent of the total). The details are furnished below :

(Rs. in crores)		
Type of transactions	Purchases	Sales
-----	-----	-----
Government Securities		

Ready forward	20368	20007
Outright	3996	932
Switch	1600	1659
	-----	-----
	25964	22598
	-----	-----
Others		

PSU bonds	150	172
Units	82	46
	---	---
	232	218
	---	---
GRAND TOTAL	26196	22816
	=====	=====

The transactions have been generally of three types - (i) outright purchase/sale, (ii) ready forward and (iii) double ready forward. The transaction-by-transaction examination is currently

on, including verification of the records in SBI relating to the transactions and the entries in the relative books, as also verification of the transactions at the PDO of RBI. Besides, to the extent necessary, the transactions as recorded in the counterparty banks are also being scrutinised.

While the individual transactions put through in the Investment Account of SBI are being examined, as mentioned earlier a large number of contracts for sale/purchase of Government securities have been put through HSM as a broker. Besides, the Bombay (Main) branch of the bank also maintains a current account of HSM. This account is used to route transactions entered into by other banks through HSM.

The findings which have emerged so far are briefly as under:

- i) Prima facie, the accounting and passing of entries for the transactions in respect of contracts put through HSM is entirely different from the accounting and passing of entries in the books of SBI in respect of contracts put through other brokers. Basically, in respect of contracts put through other brokers, the Investment Account maintained in the Bombay (Main) branch of SBI is either debited or credited as the case may be, and bankers' cheques are issued to, or payments are received by means of bankers' cheques from, counter-party banks in respect of the transactions. The relative debits and credits to the Investment Account get also duly

reflected in the books of the PDO either on the basis of transfer forms issued by SBI or on the basis of SGL transfer forms issued by other banks in favour of SBI. To the extent it has been possible to verify the transactions, the SGL transfer forms were issued to or received from the counterparty banks named in the contracts entered into through other brokers. In other words, these contracts have been put through in the normal course of business.

ii) As regards contracts entered through HSM, an entirely different set of procedures has been followed and there are certain significant departures in respect of such contracts. These are briefly mentioned below :

- a) To the extent verification has been done, the counterparty banks named in the contracts generally seem to be only in name as the relative contracts do not generally appear in the books of these banks. In other words, the counterparty bank has just been named in the contract.
- b) HSM has been given the facility of collection and credit of the bankers' cheques issued in favour of SBI and issue of bankers' cheques by SBI as per his instructions. This has facilitated the irregular

operations of HSM.

- c) The debits and credits in respect of the transactions appear in the Investment Account maintained at the Bombay (Main) branch. However, in a large number of cases the relative debits and credits do not appear in the SGL account of the bank maintained at PDO. There is no separate record available at the Bombay (Main) branch of the bank to indicate whether the relative SGL forms, if any, have been received and similarly, whether any SGL transfer forms have been issued by the SBI. However, computer print-out copies can be obtained to ascertain whether the Bombay (Main) branch has issued SGL transfer forms in favour of the counterparty banks as mentioned in the contracts. From the computer print-outs obtained, it appears that SGL transfer forms have been prepared but the fate of these SGL forms cannot be ascertained.

- d) There is no evidence to indicate that bankers' cheques have been issued or received in respect of these contracts.
- e) In the current account of HSM, receipts and payments relating to contracts entered into by the other banks through him are put through. A verification of the entries put through the current account of HSM on different dates reveals the following.
- (i) The entries do not relate to the contracts entered into by the bank on its own Investment Account through the broker. The entries relate to certain other contracts entered through HSM by other banks. Certain receipts and payments are reflected in the relative vouchers pertaining to the entries put through the current account of HSM. But the vouchers do not indicate, prima facie, that they relate to any sale or purchase transactions.
- (ii) While in respect of some of the contracts the counterparty banks named do not seem to be the real counterparty

banks, in certain other cases, the bank's name in the contract appear to be genuine. For example, there are contracts entered into by other banks for sale/purchase of Government securities through HSM where the counterparty bank is named as SBI. The counterparty purchasing banks have received SGL forms from SBI and issued bankers' cheques to it. The counterparty selling banks have issued SGL forms to SBI and received bankers' cheques from it. The SGL forms have been reflected in SBI's account with the PDO but these transactions do not appear in the Investment Account in SBI's books. However, the cheques received and issued by SBI are credited and debited in HSM's account with SBI. Thus, officials of SBI have unauthorisedly operated the SGL account of SBI with PDO without any backing transactions entered into by SBI. In other words, while the SGL account maintained at PDO does not

reflect credits or debits relating to the contracts put through by SBI in its Investment Account through HSM, the said account reflects debits and credits in respect of transactions of other banks not put through by SBI.

In sum, the SGL account of SBI maintained at PDO, Bombay appears to have been virtually operated as if it is HSM'S investment account in PDO.

(iii) A very serious implication of this is that on any one particular day the aggregate balance in respect of Government loans as appearing in the SBI'S Investment ledger maintained at the Bombay (Main) branch will not necessarily tally with the relative balances appearing in the PDO'S books even after adjustments are made for items in transit. Prima facie, there has been collusion between the officials of SBI and HSM.

(iv) Certain aspects of the issue and receipt of SGL transfer forms by the SBI need to be noted. SGL transfer forms involving securities worth crores of

rupees are signed by a single official of the junior-most level at the SBI. Generally, it is observed that SGL transfer forms are signed in the case of other banks by two authorised officials. Apart from this, there is no reliable record available at the Bombay (Main) branch to indicate the issue of SGL transfer forms or receipt of SGL transfer forms in respect of contracts. The SGL transfer forms are not issued in a uniform manner. The SGL transfer forms have been issued variously by SBI in computer print-out form, in stencil form, in typed form or in photocopy form with, however, the signature of the juniormost official appearing in ink. Some serial numbers are given which are not according to any system or pattern.

II. National Housing Bank (NHB)

A scrutiny was undertaken by the inspecting officials of the RBI of the current account of Shri Harshad S. Mehta (HSM) maintained with ANZ Grindlays Bank which had issued 9 payment orders to the extent of Rs.574.76 crores to SBI, in part

repayment of the amount of Rs.649 crores owed by him (as set out in the preceding section on the SBI), with a view to ascertaining the manner in which the current account was funded. The scrutiny revealed that a number of cheques drawn by the NHB on its account maintained with the RBI favouring ANZ Grindlays Bank had been credited to HSM's account. During the period immediately prior to the issue of the aforesaid 9 payment orders, 5 cheques amounting to Rs.405.67 crores drawn by NHB on its account with the RBI favouring ANZ Grindlays Bank had been credited to HSM's account in the latter bank. Consequently, the scrutiny of the books of NHB was undertaken to verify the nature of transactions underlying these payments to ANZ Grindlays Bank.

It was reported by NHB to the RBI that from June 1991 onwards it had been undertaking securities transactions not involving deployment of NHB's own funds but acting as an intermediary on back-to-back basis between the banks or financial services subsidiaries of banks. These transactions had increased in magnitude from October 1991 onwards and had peaked in March-April 1992. While the size of NHB's own surplus investible funds and consequently the size of its transactions on its own investment account were not large, its dealings by way of purchase/sale of securities, PSU bonds and Units on direct, back-to-back, ready-forward, etc. basis were on a very large scale. The total number of transactions in PSU bonds and Units during the half-year ended 31 December 1991 was 223. The turnover increased manifold during the first 4 months of 1992, particularly in PSU bonds and Units, the total number of deals being 165 each; however, the amount of turnover was not available

readily.

The preliminary scrutiny undertaken in NHB reveals the following :

The NHB has been undertaking a large number of back-to-back deals. There is no policy note on record giving approval for undertaking such transactions. However, vouchers relating to all such deals were signed by the then General Manager (GM) (now CGM) for some time upto September 1991. Due to his frequent non-availability, the system of signing each voucher was discontinued and instead, a daily statement of deals was put up for sometime and that was also stopped since January 1992. Besides, weekly statements as on Fridays were put up, up to December 1991, which inter alia, included the back-to-back deals without any specific mention in regard thereto and the outstandings thereunder. In addition, a statement was put up to the top management on 18 December 1991, which indicated all the outstanding deals as at that time with a specific mention about the back-to-back deals. There has been no system of reporting to the top management after December 1991. Although NHB had mentioned in its report to the RBI that the relative back-to-back deals have not been put through brokers, the diary maintained by the dealing officer does indicate that the deals have been put through brokers. As mentioned earlier, there are 30 transactions presently outstanding, aggregating Rs.1199.39 crores. The NHB has issued BRs to the banks/institutions purchasing the assets from it, but it does not have the backing of any BRs issued by the banks/institutions which are supposed to have sold these assets to NHB.

There are also no contracts available on record. The deals are stated to have been put through on telephonic conversations with the officials of the purchasing banks. The NHB has issued cheques drawn on its account with the RBI marked "account payee", the payees being the purchasing banks. The purchasing banks have credited the amounts to the account of Shri Harshad Mehta maintained with them after collecting the proceeds of the cheques. There are no specific instructions from the NHB to the banks to credit the amounts to the account of Shri Harshad Mehta.

There are no proper and systematic records maintained in NHB with reference to these transactions. No proper records are available of BRs, if any, received by NHB and the BRs issued. The BRs are not serially numbered.

Apart from dealing with banks and their subsidiaries, NHB has also entered into sale/purchase transactions in Units with certain limited companies. NHB also seems to have entered into certain bills transactions on a back-to-back basis.

The investigation into these transactions and other related matters in NHB is continuing.

III. SBI Capital Markets Ltd.

As part of deployment of the resources raised by SBI Capital Markets Ltd. (SBI Caps) in the form of Certificates of Deposit and inter-corporate deposits mainly from public limited companies and PSUs, the company has been making investments in PSU bonds and Units and has also been entering into ready-forward

transactions in public sector bonds, Government securities and Units. While in respect of transactions in Government securities it does not maintain a position (the sales and purchases match on any particular day), it has been maintaining a position in PSU bonds and Units. The scrutiny of the securities transactions entered into by the SBI Caps has revealed the following features.

The transactions have been put through by the dealer after verbal discussions with the General Manager (Corporate Operations and Leasing). These are subsequently put up to the ED and MD of the company. A deal ticket is serially prepared giving the details of the security, broker's name, counter party/selling bank's name and date of reversal, etc. However, the broker's contract subsequently received does not mention the counterparty's name. The company has, during the period from 1 December 1991 to 31 March 1992 entered into 643 contracts, of which 152 contracts have been put through Shri Harshad Mehta. The deals are entered in a transaction ledger. The company maintains a current account at the Bombay (Main) branch of SBI through which the securities transactions entered into by it are put through. The Securities Department at the Main branch of SBI receives from the broker (in the case of purchases) the securities either physically or in the form of BRs from the counter-party banks addressed to SBI Caps, and in turn hands over the banker's cheques favouring the counter-party (selling) banks. The current account of the company is accordingly debited and a daily statement is forwarded to SBI Caps. On receipt of the statement of account from the SBI Bombay (Main) branch the debits

are verified to ensure that they are backed by bank advices/deal tickets. On the due date, i.e., the date of reversal, the dealer raises another deal ticket recording the sale to the same counter-party through the same broker and advice is sent to SBI Bombay (Main) branch after recording the transaction in the books. The Securities Department at SBI Bombay (Main) branch then receives the payment by banker's cheque and credits the proceeds to the company's current account. The SBI Bombay (Main) branch is expected to discharge the BR and return the same to the broker for handing over to the counter-party.

The scrutiny of the transactions put through Shri Harshad Mehta has revealed the following :

(i) In several transactions it is observed that the counter-party mentioned in the contract is only in name and the transactions do not appear in the counter-party's books. In several of the contracts the counter-party named is Canfina but the relative transactions do not appear in Canfina's books.

(ii) In respect of several such contracts the relative credits have been given to the current account of Shri Harshad Mehta in the books of the Bombay (Main) branch of the SBI. There have also been instances of netting of the contracts of SBI Caps with certain other contracts entered into through Shri Harshad Mehta and net entries appear in the current account of Shri Harshad Mehta with Bombay (Main) branch of SBI.

(iii) In respect of some of these transactions there is no evidence to indicate that the SBI's Bombay (Main) branch, acting on behalf of SBI Caps, had in fact obtained and/or released BRs.

(iv) So far as SBI Caps is concerned, since the parent bank is acting as its agent, it did not verify the actual holding of BRs with the outstanding transactions. As a result, SBI Caps possibly did not know the adjustments made by the Bombay (Main) branch of the SBI in its books in respect of the contracts put through by SBI Caps.

However, certain shortcomings were observed.

a) The management of SBI Caps had not framed a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices.

b) The company had undertaken a number of buy-back deals of PSU bonds and Units though strictly prohibited under RBI guidelines.

c) The format of the BR adopted was not as per standardised format recommended by IBA. The BRs issued were not signed by two authorised signatories.

d) The demarcation line between dealing room and back-up office was not maintained. Several BRs issued were signed by the dealer instead of by the back-up officials.

An examination of outstanding contracts, reveals that the undernoted contracts pertaining to deals through Shri Harshad

Mehta may devolve on the company.

(Rs. in crores)

Sr. No.	Date	Security	Transaction amount	Counter party	Remarks
1.	29.7.91	Units 0.25 cr.	3.38	Standard Chartered Bank	No BR held. Deal ticket missing. Counter-party doubtful and their confirmation of transaction not received. Delivery long overdue.
2.	2.9.91	Units 5.00 cr.	67.83	NHB	Though BR of NHB is held, counter-party has denied the transaction.
3.	31.3.91	Units 1.25 cr.	18.75	Canfina	No BR held. Canfina has denied the transaction.
4.	6.4.92	Units 1.00 cr.	15.15	Canfina	No BR held. Canfina has denied transaction and receipt of any payment.
5.	30.3.92} 3.4.92} 21.4.92} 20.4.92}	Units 1.08 cr.	16.12	Private parties	All contracts are overdue for reversal but no delivery/payment is forthcoming.
TOTAL			121.23		

The examination of the transactions at SBI Caps is continuing.

IV. UCO Bank

While the enquiry into the investment transactions of UCO Bank had already commenced, there was a report in a section of the press on 1 May 1992 regarding a bill discounting transaction

at UCO Bank. Thereupon a scrutiny of the records at the Bombay (Nariman Point and Hamam Street) branches of the bank was taken up on 2 May 1992. The scrutiny revealed the following facts.

Discounting of bills

(i) On 24 March 1992, the branch discounted two bills for one month - both drawn by M/s. J.H. Mehta (JHM), one on Growmore Research and Assets Management Ltd. (GRM) for Rs.14,44,41,000 and the other on Mazda Industries and Leasing Ltd. (MIL) for Rs.35,95,20,000 both of which are associated concerns of JHM.

(ii) The proceeds at Rs.49.42 crores were credited to the current account of JHM and thereafter transferred on the same day to the current accounts of GRM and MIL. All the three current accounts were opened on 24 March 1992 (i.e. the date on which the bills were discounted) with nominal amounts.

(iii) On 24 March itself the proceeds were withdrawn by means of pay orders, issued by UCO Bank for the credit of GRM and MIL with ANZ Grindlays Bank.

(iv) The bank earned a net income of Rs.21.35 lakhs in the transaction.

(v) The bill discount facilities were extended by the Assistant General Manager of the branch without any specific sanction from Head Office. In his letter dated 26 March 1992 to Head Office he has mentioned that "as instructed by the Chairman and Managing Director during his last visit to Bombay, we have discounted both the above bills of exchange at a rate of 22.5 per cent on 24 March 1992".

(vi) The parties were not having any dealing with the bank prior

to 24 March 1992. Nor did the bank receive any written application from JHM for the discounting facility.

(vii) The underlying transactions of the bills discounted relate to sale of shares of various companies by JHM to GRM and MIL. The bills were clean.

Adjustment of bills discounted

(i) The bills discounted were adjusted on 27 April 1992 by means of cheques issued by GRM and MIL on their accounts with ANZ Grindlays Bank.

(ii) It is, however, observed that the bank had on the same day (i.e. 27 April 1992) purchased in its investment account the following shares - (a) 8 lakh shares of Gujarat Ambuja Cement Ltd. and (b) 77,150 shares of Castrol Ltd. Originally the shares to be purchased were 11 lakh shares of Gujarat Ambuja Cement Ltd. The broker M/s.V.B. Desai, however, could not give delivery of the entire lot of Gujarat Ambuja shares and instead delivered 8 lakh shares of Gujarat Ambuja Cement Co. Ltd. Instead of the balance of 3 lakh shares of Gujarat Ambuja Cement Co. Ltd. 77,150 shares of Castrol Ltd. were delivered by the broker only on 2 May 1992. The total purchase consideration of Rs.49.50 crores was paid by the bank by means of a banker's cheque dated 27 April 1992 in favour of ANZ Grindlays Bank - Account JHM. This was done as per instructions of the broker, M/s. V.B. Desai. Thus, the proceeds of the shares purchased by the bank on its investment account had gone to the account of JHM. The amount of Rs.49.50 crores credited to JHM's account with ANZ Grindlays Bank was transferred to the accounts of MIL and GRM with that bank.

This credit enabled ANZ Grindlays Bank to meet on 27 April 1992 the cheques drawn by GRM and MIL towards payment of the bills discounted by UCO Bank for JHM.

It is evident that the bills discounted by UCO Bank were purely accommodation bills. This is clear from the fact that the drawer and the drawees belonged to the same group and the proceeds of these bills were immediately credited to the current accounts of the drawees. Moreover, on the due date for adjustment of the bills the bank found a way out to adjust the outstanding bills and accordingly made the investment by purchasing the shares standing in the name of the members of HSM family. Incidentally, the value of the shares held in the bank's investment account has also depreciated considerably.

The scrutiny of the securities transactions in the bank is continuing.

V. Bank of Karad Ltd.

The scrutiny of the investment transactions put through by the bank is continuing. There have been very few transactions undertaken by the bank on its own Investment Account. However, it maintains accounts of 19 brokers of whom only a few are active accounts. A large number of transactions have been put through in the accounts of M/s. Bhupen Champaklal Devidas and Abhay D. Narottam. It may be mentioned that Abhay D. Narottam was until recently a Director of the bank. Prima facie, the bank has issued on brokers' accounts BRs without any backing or against non-existent securities. It is also observed that BRs were issued in anticipation of the broker procuring as backing, BRs of

other banks representing purchase of relative securities from those banks. In certain cases, BRs have been issued by the bank against the backing of BRs issued by Metropolitan Co-operative Bank, a small sized urban co-operative bank. Prima facie, BRs issued by that bank did not have any backing. The funds raised against these BRs have been credited to the account of the broker. The BRs have been used mainly to put through transactions with Standard Chartered Bank, Canfina and Canbank Mutual Fund. By and large, the relative transactions in the banks/institutions mentioned above have been put through M/s.Hiten Dalal, as broker. The BRs issued by Bank of Karad Ltd. and presently outstanding of the value of about Rs.750 crores are those issued in the account of A.D. Narottam. Apart from verifying the linkages, the scrutiny will also trace the use to which the funds raised on the BRs of Bank of Karad Ltd. have been put.

8.Functioning of the
Public Debt Office (PDO)



The Inspection Department of the RBI took up a scrutiny of the working of the SGL Section of the PDO at Bombay during the period July 1991 to 15 May 1992, soon after the reconciliation of the balances in the Investment Account of SBI with the SGL balances of the SBI in the PDO books in different loan accounts was commenced by that bank.

The Inspection Department has observed as under :-

(i) Under the reorganised set-up of PDO, which came into effect in 1987, the SGL Section which was a sub Section of

Accounts Section was given an independent status as a separate Section by centralising all transactions connected with SGL Accounts with a view to ensuring better customer service to the investors. The main activities of the Section relate to:

- (a) opening and maintaining of SGL Accounts in the names of banks, financial institutions, corporate bodies, provident funds, brokers, trusts, etc.,
- (b) examination of securities tendered for credit to SGL Account, issue of scrips by debit to SGL Account and transfer of SGL balances from one account to another on the basis of transfer deeds submitted by SGL Account holders (intra PDO transfers);
- (c) preparation of advices/accounting vouchers;
- (d) effecting inter PDO transfer of balances. as per advices of holders;
- (e) payment of half-yearly interest on balances held in SGL Accounts on the due dates;
- (f) payment of amount to SGL Accounts pertaining to loans notified for repayment;
- (g) furnishing of balance statements to the account holders periodically.

(ii) Due to the policy of restricting the issue of scrips only in the form of stock certificates and SGL and dispensing with the issue of scrips in the form of GP notes, and liberalisation and extension of SGL facilities to provident funds, trusts, etc., bulk of the transactions in Government securities is accounted for in SGL Accounts resulting in increase

in the number of SGL Accounts and the volume of work. Thus, the number of accounts which stood at 228 as at the end of June 1989 increased to 332 as at the end of June 1990 followed by an increase upto 394 by the end of June 1991. As at the end of April 1992, the number of operative SGL Accounts stood at 438, the particulars of which are as under :

- (a) SGL Account of banks - 116
(including Bank's investment a/c.)
- (b) Financial Institutions like - 25
LIC, GIC, NABARD, DFHI, etc.
- (c) Others, i.e. Provident Funds, - 297
trusts, etc.

The figure at item (c) above includes accounts of three brokers viz., Narandas & Sons, J.G. Shah and Co. and M/s.V.B. Desai. The transactions in these accounts are, however, meagre.

(iii) The objection memos have been prepared on the same day/next day but there has been delay in the preparation of credit advices ranging upto 10 - 12 days. There has also been considerable delay in some cases in the despatch of advices and objection memos.

(iv) There have been several instances of wrong postings which have been corrected subsequently, indicating that due care has not been exercised in the postings. It is also observed that some of the banks have been executing SGL transfer forms although adequate balance is not available in their accounts. The Chairmen of some of the banks in whose case the transfer forms had to be returned under objection frequently had been advised by means of a D.O. letter from the Manager of the Bombay Office of the RBI in August 1991 to ensure that banks do not execute SGL

transfer forms for amounts in excess of the actual balance available in the relative SGL accounts. Despite this, the percentage of SGL forms returned under objection to total receipt was very high during the months of March, April and May 1992.

The three non-RBI members of the Committee viz. Sarvashri Y.H. Malegam, C.P. Ramaswami and E.N. Renison, visited the PDO at Bombay on 25 May 1992 to familiarise themselves with the functioning of the PDO. The officers in-charge of PDO apprised them of the procedures followed in PDO. The Members went round the SGL Section and made a sample scrutiny of various registers and files.

The preliminary findings of such scrutiny are :-

(a) The functioning of the SGL Section in the PDO in general is satisfactory. All the SGL accounts are maintained manually.

(b) SGL transfer forms received on a given day are generally disposed of on the same day.

(c) Particularly, where there is adequate balance in the SGL account and there is no technical irregularities in respect of an SGL transfer form, all the relevant ledger entries are posted on the date of its receipt itself.

(d) Where there is an objection due to some defect in the SGL transfer form (on account of signature, nature of loan, etc.) or there is inadequate balance in the account, the objection memo is prepared on the same day and delivered either on the same day or within a week. In some cases, where there has been undue delay in the preparation and despatch of objection memos, the RBI

officials concerned have been asked to look into the causes for the delay and furnish reasons for the same.

(e) No statements of SGL Account transactions are furnished to the banks.

(f) Half-yearly statements of balances are sent. Besides, as and when any bank asks for balances on any given date, such balances are furnished, without keeping any office copy.

(g) Personnel from constituent banks are not allowed to see their SGL accounts.

(h) Scroll number given at the receipt counter to the SGL transfer form is not referred to either in the ledger or in the day-book.

(i) In a given SGL ledger account debit entry is made by one official and credit entry, by another.

The Committee would undertake a detailed study of the procedures in the PDO. While certain recommendations have been made on the basis of the preliminary study, additional measures to the extent necessary will be suggested after the detailed study is completed.

9. Recommendations

Based on the Committee's preliminary findings it would like to make the following recommendations.

(1) The diversion of funds has been largely facilitated by the practice of banks executing a large number of "ready-forward" and "double ready-forward" transactions. Since there is no permanent sale or transfer of investments in such cases, there is no real need to effect transfer of actual scrips or SGL forms or

to deposit SGL forms, when issued, with the PDO. These transactions have, therefore, presumably been supported by BRs or SGL forms not intended to be deposited with the PDO. As the transactions effectively get reversed on the due date, it is also possible that the transactions were effected without the issue of BRs or SGL forms, or by the issue of unauthorised BRs or SGL forms. A "ready-forward" transaction in substance could also be a mere lending of funds for the period of the contract in the guise of a purchase/sale of investments. The Committee would recommend that -

a) the practice of banks entering into "ready-forward" and "double ready-forward" deals with other banks be restricted to Government securities only (as permitted by the RBI) and guidelines be laid down specifying the circumstances in which such transactions would be permitted;

b) banks be prohibited from entering into "ready-forward" and "double ready-forward" deals in other securities including PSU bonds, Units and shares; सत्यमेव जयते

c) the prohibition regarding banks entering into "buy-back" deals with non-bank clients (already imposed by the RBI) be strictly enforced and action be taken against banks which have violated this direction;

d) banks be prohibited from entering into "ready-forward" and "double ready-forward" deals on behalf of customers under portfolio management schemes (PMS).

(2) The internal control procedures of banks regarding their treasury functions be immediately reviewed by the RBI, inter alia, with regard to -

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 of 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.

(3) Banks should be required to formulate and get approved internal exposure limits for transactions. These should include limits which ensure that there is no undue reliance on a few brokers. These limits should also cover the maximum amount of outstanding BRs or SGLs issued by other banks which can be accepted by the bank.

(4) Brokers contract notes should be required to indicate the counterparty so that direct communication with such parties is possible. The notes should also indicate separately the brokerage charged on the transaction.

(5) When banks act as custodian of brokers' or other parties' securities, all transactions effected for such customers

(including all documentation) must clearly disclose that the bank is acting as a custodian and not as a principal.

(6) The existing prohibition on banks issuing cheques drawn on their account with the RBI for third party transactions should be strictly enforced. Such payments should be made through normal instruments like bankers' cheques, drafts or a transfer advice which clearly discloses the identity of the person on whose behalf the transfer is made.

(7) When banks exercise custodian functions on behalf of their merchant banking subsidiaries, these functions should be subject to the same procedures and safeguards as would be applicable to other constituents. Therefore, full details should be available with the subsidiaries of the manner in which the transactions have been executed.

(8) The issuance of a large number of BRs in respect of transactions in PSU bonds may have been justified by the banks on the ground that there has been undue delay in the issue of scrips by the PSUs and therefore trading in such bonds has been possible only through BRs. The issue of a large number of BRs in respect of Units may also have been justified by the banks on the ground that the transfer of the Units in the name of the buyer involves stamp duty and therefore transfers need to be effected only when the Units need to be lodged with the UTI for payment of dividend. These are no doubt valid assertions but the practice of issuance of BRs in respect of these instruments has been largely responsible for the divergence of funds to the brokers. The Committee would, therefore, recommend that banks may be required to conduct all their transactions in PSU bonds, Units and similar

securities through a separate institution like the Stock Holding Corporation which can be established. This would obviate the need to issue BRs in respect of such securities.

(9) The issuance of BRs in respect of Government securities as also the apparent short-trading has been sought to be justified by the banks on the grounds of the inability of the PDOs in the RBI to speedily record the transactions effected and to communicate the credit advices in time to banks. Banks, therefore, do not know the fate of SGL forms lodged when they in turn issue SGL forms. The Committee is not convinced that this justification is valid particularly since objection memos have generally been communicated in time. However, the work of the PDOs needs to be considerably speeded up and more relevant information furnished to banks. This information should include -

a) immediate advice of all objection memos. Unless a bank makes arrangements on a regular basis to collect objection memos over the PDO counter, the advices should be by courier for which acknowledgement would be available with the PDO and the courier cost should be debited to the account of the concerned bank;

b) a weekly statement of all transactions in individual ledger accounts together with the balance thereof.

It is also necessary that there is a daily verification of all securities held in the SGL accounts of all banks in the aggregate and that on a weekly basis the PDO submit to the Department of Banking Operations & Development (DBOD) of the RBI a report giving bank-wise details of all SGLs returned for want of sufficient balance.

The Committee believes that given the large number of accounts, the large number of individual securities and the number of transactions, the work of the PDO cannot be done manually and needs to be immediately computerised.

(10) The Committee recognises that with 80 banks having over 60,000 branches it is virtually impossible for the RBI's inspection procedures to examine individual transactions of banks. At present, the RBI carries out an Annual Financial Review (AFR) and a Financial Inspection once in four years. Even the Financial Inspection is largely concerned with the advances portfolio of the banks and the adequacy of provisions. The Committee understands that the inspection system and procedures of the DBOD have been recently reviewed by a Committee appointed by the Governor, and that its recommendations are in the process of being implemented. However, the primary responsibility in this regard must remain with the bank managements which must ensure that there are adequate internal control (including internal audit) procedures. The Committee would, therefore, recommend that :-

a) On-site inspection by the RBI should be supplemented by reporting of compliance by banks with prudential and other guidelines. To lend authenticity to this compliance reporting, banks should be required to get compliance in key areas certified by the statutory auditors of the banks.


b) The scope of the RBI inspection should be widened to include greater emphasis on the treasury function.

c) The RBI should review the adequacy of the Internal Audit Departments of the banks and the scope of their operations.

d) The portfolio management operations of banks should be subjected to a separate audit by the banks' statutory auditors as these operations are in the nature of trusteeship functions.

e) The RBI should strengthen its organisation responsible for market intelligence so that early action can be taken when there are market rumours of irregularities.

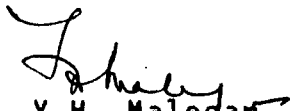
11. Though the National Housing Bank is a wholly owned subsidiary of the RBI there are not at present any institutional arrangements for the inspection of its operations. It is necessary that these arrangements be made at an early date.



R. Janakiraman
Chairman



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Y.H. Malegam



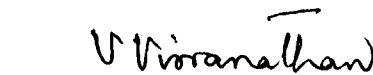
C.P. Ramaswami



V.G. Hegde



E.N. Renison



Vimala Visvanathan
Member-Secretary

BOMBAY
31 MAY 1992.

ANNEXURE

Banks have been undertaking transactions in securities (i) on their own Investment Account (ii) on account of PMS Clients' Account in their fiduciary capacity and (iii) on behalf of their other constituents including brokers purely as an agency function.

The investment portfolio of banks (in respect of their own Investment Account) primarily comprises Government and other Trustee securities (except a very small fraction consisting of PSU bonds, shares and debentures which would have devolved on them on account of their underwriting commitments) which are intended to comply with the SLR requirements. Therefore, in the normal course banks' transactions in securities on their own Investment Accounts are expected to be in Government and other Trustee securities. Further, since bulk of the portfolio comprises Central Government securities, a major portion of the securities transactions among banks is expected to be put through their respective SGL Accounts maintained with PDO of the RBI.

However, composition of the portfolio in respect of PMS Clients' Account is expected to generally consist of high coupon bearing capital market instruments like PSU bonds, corporate debentures and shares. Accordingly, the transactions on account of PMS Clients' Account are expected to be primarily in the above securities and in the absence of SGL Account facility for them, the transactions are expected to be on actual delivery basis.

The transactions in securities on behalf of their other

constituents like brokers undertaken as an agency function would be both in Trustee securities and other corporate bonds, debentures and shares because the broker client may be dealing in both Trustee securities as well as corporate bonds, debentures and shares.

Banks' transactions in Trustee securities are generally on outright basis and ready-forward basis. The outright deals would also be in the nature of switch deals. Outright sales are undertaken generally when the bank has surplus SLR security and it wants to get rid of the security because of its low yield and its opportunity cost is higher than the yield and it is in a position to book the loss arising therefrom. Similarly, when a bank is short of SLR security and it has long-term funds, it prefers to buy a security on an outright basis, whereas when the bank does not have any surplus SLR security, as a long-term strategy of improving the overall yield from its SLR securities held in its investment portfolio, by deliberately booking a loss at the short-end, the bank may undertake a switch deal by selling a low coupon security and buying a high coupon security, provided it is in a position to book the loss arising out of the sale. However, given the maturity pattern of their resources and uncertainty about their future requirement of SLR securities, the banks have been generally managing their short-term cash requirements either for maintenance of CRR or for other purposes and SLR requirements, by entering into ready-forward (buy-back or repose) deals in SLR securities. In this type of transaction, a bank buys/sells a SLR security ready with the

undertaking to sell back/buy back the same security on the specified future date (normally a fortnight and rolled over from fortnight to fortnight) at a mutually agreed pre-determined rate. The rates agreed upon (ready and forward rates) have no relevance to the market rates of the security but are related to the call-money rate prevailing on the date of putting through the first leg of the transaction, as this type of transaction is basically a fund management/ SLR management exercise (i.e. raising funds against a SLR security which is in excess of the SLR requirement or temporary borrowing a SLR security for a cost). Thus, the difference between the ready and forward rates in a ready forward deal is supposed to represent the cost of funds. Thus, by this method, a bank which has a surplus security but wants cash prefers to borrow temporarily because it would be cheaper as compared to call-money borrowing as it has an additional cost of maintenance of CRR thereon. It may not like to sell the security outright because it may not be sure about its future SLR requirements and in such a situation, if it is required to buy outright later on to comply with future SLR requirements, it may have to pay a higher price. In so far as buying the security ready is concerned, it may be short for complying with SLR requirements and it may have no long-term resources to buy outright or it may not be sure about its future requirements and therefore, it prefers to buy short and roll over. Further, raising funds in the call-money for purchasing a security on outright basis may be costlier than buying it on a ready forward basis. Earlier, as there was no short-term maturity SLR securities available to banks to enable them to use such

securities for short-term management of their cash/SLR securities requirements, (before the introduction of 182 days Treasury Bills), the banks have been permitted by the RBI to undertake ready-forward deals in Trustee securities among themselves. However, RBI has prohibited banks from entering into such ready-forward deals with their non-bank clients. In fact, as far back as in 1988, the RBI had instructed the banks that ready-forward deals should be undertaken only among banks and that too only in approved Trustee securities and that no ready-forward deals should be undertaken in public sector bonds and Units of Unit Trust of India (UTI). The RBI had also clarified to the banks that they should not enter into any ready-forward deals even with financial institutions and bank subsidiaries. Normally, all the deals in securities are expected to be settled between the parties to the deal either through their SGL Accounts maintained with PDO (where SGL Account facility is available) or by physical delivery of securities. Even the ready-forward deals which are very short-term in nature are expected to be settled through their respective SGL Accounts with PDO because normally these are only among banks and that too in Government securities. Use of BRs (which represent a certificate issued by the selling bank to the effect that it has been holding the relevant securities on behalf of the buyer bank for value received and would be delivering the same within a very short period) is expected to be in exceptional circumstances when the seller bank is not in a position to give physical delivery of the security either on account of delay on the part of the issuer of security to issue

the scrips or because the security is held by the selling bank at a place other than the place at which the transaction has taken place and it is likely to take some time to transfer the security from the place where it is held to the place where delivery is to be given. In any case, BRs are expected to be used only in such exceptional circumstances and that too only in the case of such securities for which no SGL Account facility is available and the BRs issued are expected to be liquidated within a very short time by physical delivery of securities.

Banks while undertaking the business of their clients including brokers as an agency function are expected to collect the instruments on behalf of their broker clients to the account of the brokers maintained with them and receive or give physical delivery of securities kept with them for safe custody against payment, strictly as per their specific instructions, and are not expected to commit themselves on behalf of their broker clients by issuing their own BRs/SGL forms.

During the course of inspection/scrutiny of securities transactions of some banks it came to the notice of the RBI that some banks had been freely issuing BRs in respect of their sale transactions in securities irrespective of whether SGL Account facility was available in respect of that particular security, some banks had been issuing their own BRs against the BRs of other banks held by them and that some of the banks were unnecessarily committing themselves on behalf of their broker clients by issuing their own BRs covering broker transactions. With a view to cautioning the banks in general about the undesirable systems followed by some banks while undertaking

transactions in securities, particularly issue of BRs and undertaking of broker business, in July 1991, vide then Deputy Governor, Shri A.Ghosh's D.O. letter DBOD.No.FSC.46/C.469-91/92 dated 26 July 1991 addressed to all the Chairmen/Chief Executives of commercial banks (copy appended), the RBI had advised the banks to frame and implement a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices and while evolving the investment policy with the approvals of their respective Boards, to keep in view the following guidelines :

- (i) Under no circumstances, the banks should hold a oversold position in any security, that is to say, that no sale transactions should be put through without actually holding the security in its investment account.
- (ii) All the transactions put through by the banks either on outright basis or on ready-forward basis and whether through the mechanism of SGL Account or BR should be reflected on the same day in their investment accounts and accordingly for SLR purposes, wherever applicable.
- (iii) Transactions between banks should not be put through the brokers' accounts.
- (iv) For issue of BRs, the banks should

adopt the format prescribed by the Indian Banks' Association (IBA) and strictly follow the guidelines prescribed by them in this regard (copy appended) and banks should issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents including brokers.

- (v) Banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.
- (vi) Any instance of return of SGL form from the PDO of the RBI for want of sufficient balance in the account should be immediately brought to the notice of RBI with the details of the transactions.

The IBA Rules on BRs mentioned earlier, inter-alia provided as under :

- (a) The BR should be issued in the prescribed format only. Receipt issued in any other format should not be accepted.
- (b) Normally, no BR should be issued where SGL facility is available.
- (c) A separate BR should be issued for each type of security.

- (d) BR is non-transferable.
- (e) BRs should be issued serially numbered on security paper.
- (f) BR must be exchanged with actual scrips as early as possible and in any case within 90 days of issue.
- (g) BR should be signed by two authorised signatories whose signatures should be registered with the buyer-bank to verify the signatures.
- (h) BR can be accepted from any of the following institutions:
 - i) All member bank of the IBA.
 - ii) Financial Institutions like IDBI, IFCI, ICICI, NABARD, UTI, GIC, LIC.
 - iii) Public Sector Undertakings.
 - iv) Any other institution specified by the IBA/RBI.

The RBI had also issued guidelines and prudential exposure limits to be followed by banks for undertaking underwriting of corporate shares, debentures and PSU bonds and other commitments in the nature of safety net for public issues of convertible debentures and shares and devolvments arising therefrom, advising them to make periodical review of such business and apprise their respective Boards. As far back as in October 1986, the RBI had issued a Memorandum setting out guidelines/safeguards to be followed by banks in granting advances against corporate

shares and debentures to different types of borrowers and the maximum advance that could be granted to different types of borrowers. In 1989, the RBI had instructed the banks that they and their Subsidiaries should not finance badla transactions. In the light of the steep rise in the prices of corporate shares during the second half of 1991, the RBI Governor during his Credit Policy meeting with the Chairmen/Chief Executives of banks had instructed that banks should limit their aggregate advances against corporate shares and debentures to the level which prevailed as on 7 October 1991. Subsequently, in the light of the unprecedented rise in the prices of shares during March/April 1992, the RBI Governor during his Credit Policy meeting with Chairmen/Chief Executives of banks held on 22 April 1992 had instructed the banks that while they should continue with the earlier cap on aggregate lendings against shares and debentures, in the case of advances against shares and debentures to individuals, they should hike the margin requirements to 75 per cent.

The RBI had also issued detailed guidelines to banks and subsidiaries for providing Portfolio Management Services (PMS) to their clients which inter-alia stipulate that PMS should in the nature of investment consultancy for a definite pre-determined fee not related to actual yield on the portfolio, purely at customers' risk, without guaranteeing any pre-determined minimum return on the portfolio. As per RBI guidelines only such banks which have the necessary expertise to provide the PMS on their own should undertake the activity, maintain client-wise record of

portfolios, and should furnish the clients periodical statements of their portfolio. Any transactions between the banks' Investment Account and PMS Clients' Account should be at market rates.





D.O.DBOD No.FSC. ५६ /C 469-91/92

26 July 1991
४ Sravana 1913(Saka)

SECRET

Dear Shri

Investment portfolio of banks
- Transactions in securities

It is a matter for great concern for us that certain banks are engaged in types of transactions in securities which they should not be undertaking. A list of such transactions is appended.

- (i) Ready forward (buy-back) deals at rates which have no relevance to the market rates, inter-alia, with a view to window dressing their balance sheet/ compliance of SLR requirements.
- (ii) Double ready-forward deals with a view to covering their oversold position in a specific security.
- (iii) Sale transactions by issue of Bank Receipts (BRs)/ SGL forms without actually holding the securities/ without having sufficient balance in their SGL accounts.
- (iv) Issuing BRs/SGL forms on behalf of their broker clients without safeguarding banks' interest.

2. You may be aware that with a view to helping the banks to overcome various deficiencies in the long-term securities market and to enable them to manage their short-term cash deficit/surpluses more efficiently, we have permitted banks to enter into buy-back deals in Government securities among themselves (and not with their non-bank clients). It was our

expectation that such deals will be undertaken by the selling bank, only if it holds sufficient securities (either in the physical form or in SGL account), at market related rates and such deals will be properly reflected in their books of account. However, we observe that certain banks have been resorting to this type of transactions, without actually holding sufficient securities either in physical form or in their SGL account (resulting in substitution of BRs/return of SGL forms for want of sufficient balance), at rates which have no relevance to market, with a view to window-dressing their profitability/maintenance of SLR requirement with the tacit understanding with the counter party banks. Some of the banks appear to be taking outright oversold position in securities and in their desperate bid to cover the oversold position in a particular security/ies enter into double ready forward deals and other banks oblige them in the matter.

3. Another disquieting feature observed is the extensive use of BRs by banks. It has been our intention to ensure that the banks do not undertake sale transactions in securities without actually holding them and do not issue BRs unless they are in a position to deliver the securities within a reasonable time. Contrary to our above expectation, banks have been issuing BRs freely (without regard to whether they will be in a position to deliver the securities thereagainst within a reasonable time) and against an initial outstanding BR, a series of transactions are put through by further issue of BRs and in ~~the final~~ analysis only the BRs are exchanged and no security is delivered. Some of the banks have also been issuing BRs on behalf of their broker clients, without verifying whether their broker clients hold the securities covered by the relative BRs.

4. It will be absolutely essential for your bank to frame and implement a suitable investment policy to ensure that operations in securities are conducted in accordance with sound and acceptable business practices. While evolving the policy you are requested to keep in view the following guidelines :

- (i) Under no circumstances, the bank should hold a oversold position in any security, that is to say that no sale transactions should be put through without acutally holding the security in its investment account.
- (ii) All the transactions put through by bank either on outright basis or ready forward basis and whether through the mechanism^{or}/SGL Account or Bank Recript should be reflected on the same day in its investment Account and accordingly for SLR purpose, wherever applicable.
- (iii) Transactions between your bank and another bank should not be put through the brokers' accounts. The brokerage on the deal payable to the broker, if any, (if the deal is put through with the help of a broker) should be clearly indicated on the notes/memorandum put up to the top management seeking approval for putting through the transaction and separate account of brokerage paid, broker-wise, should be maintained.
- (iv) For issue of BRs, the banks should adopt the format prescribed by the IBA and should strictly follow the guidelines prescribed by them in this regard.

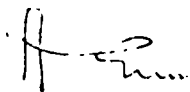
subject to above , the banks should issue BRs covering their own sale transactions only and should not issue BRs on behalf of their constituents including brokers.

- (v) The banks should be circumspect while acting as agents of their broker clients for carrying out transactions in securities on behalf of brokers.
- (iv) Any instance of return of SGL form from the Public Debt Office of the Reserve Bank for want of sufficient balance in the account should be immediately brought to our notice with the details of the transactions.

5. We shall also be glad if a copy of the policy framework for undertaking transactions in securities approved by your bank's Board, is forwarded to us.

6. Please acknowledge receipt.

Yours sincerely,



(A. Ghosh)



INDIAN BANKS' ASSOCIATION

Stadium House, 6th Floor, Block 2, Veer Nariman Road, Bombay-400 070.

Phone Office: 22 23 66 ★ Grams: 'BANKSLINK' ★ Telex No. 011-6146 011-2373

No. OPR.C/52-201039

6th May, 1991

Chief Executives of All Member Banks

Dear Sirs,

STANDARDISED FORMAT OF BANK RECEIPT (BR)

In the inter-bank market, large number of transactions in securities are concluded by means of BR deliveries, particularly when the selling bank is not in a position to effect physical delivery of scrips for various reasons. It is common practice among banks to issue BRs which acknowledge receipt of funds for the securities sold and undertake to hold the same in trust, until these are physically delivered. There is, however, no uniformity in the format of the BR being used by the banks at present.

It was considered necessary to devise a standard format of BR and frame rules therefor for uniform adoption by member banks, financial institutions, public sector undertakings and other IBA/RBI specified institutions. Accordingly, the standardised formats etc. for the above evolved by Investment Dealers' Club and reviewed by the IBA Committee on Funds and Investments (COFI) were placed before the Managing Committee of the IBA in its meeting on 23rd April, 1991 for approval.

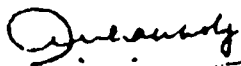
The Managing Committee approved the standard format of the BR, BR Rules and monthly statement of BRs held and issued and recommended these for uniform adoption by member banks, financial institutions like IDBI/IFCI/ICICI/NABARD/UTI/GIC/LIC, public sector undertakings and other IBA/RBI specified institutions.

At present, different BR formats are being accepted by the IBA non-member institutions; there should, therefore, be no difficulty in their accepting the uniform BR format which is being recommended

now. The RBI is being informed and requested to consider advising the eligible institutions from its end also.

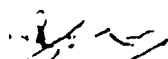
Member banks may adopt standard format of BR, BR Rules and monthly statement of BRs held and issued, the specimen of which are enclosed.

Yours faithfully;


(A. K. BAKSHI)
SECRETARY



Encl: A/a


RWD/Sp

PROFORMA

BANK RECEIPT

NON TRANSFERABLE

B.R.No. 1.

DATE :

Name of the Bank _____

Issuing Office Address _____

We confirm having this day sold, out of our holding, the following security on outright basis/buy back basis to be repurchased after _____ days, i.e., on _____ (date)*.

Name of Security	Interest Date	Face Value (Rs.lacs)	Rate % a.	Sold to
_____	_____	_____	_____	_____

The delivery of above security cannot be effected due to _____

In consideration of the above, we confirm having received Rs. _____ (Rupees _____) by cheque.

Scripts relating to the said security will be delivered within _____ days on surrender of this receipt duly discharged and in the meanwhile the security sold would be held by us in trust for _____ (buyer). This receipt is issued in terms of rules framed by the IBA and subject to realisation of cheque.

Delete
*Date which is not applicable.

For _____ (Seller Bank)

Revenue
Stamp

1. _____ 2. _____
(Authorised Signatories)

BANK RECEIPT RULES

1. The Bank Receipt should be issued in the prescribed format only. Receipt issued in any other format will not be accepted.
2. Normally² no BR should be issued where SGL facility is available. In all other cases, the scrips shall be delivered to the buyer as soon as possible, except for R/F transactions.
3. A separate BR should be issued for each type of security.
4. BR is non-transferable.
5. Banks should issue BRs serially numbered on Security Paper.
6. BR must be exchanged with actual scrips as early as possible, and in any case within 90 days of issue. However, it would be open for banks to issue fresh receipt in the event BRs are not discharged within 90 days and the reason for the same should be mentioned in the renewed BR.
7. BR should be signed by two authorised signatories whose signatures should be registered with the buyer-bank to verify the signatures.
8. BR can be accepted from any of the following institutions
 - a) All member banks of the IBA
 - b) Financial institutions like IDBI, IFCI, ICICI, NABARD, UTI, GIC, LIC
 - c) Public Sector Undertakings
 - d) Any other institution specified by the IBA/RBI.

MONTHLY STATEMENT OF BANK RECEIPTS FOR _____

Branch _____

BR No.	Date of BR	Particulars of Security	Face value (Rs. lacs)	Rate ₹ p.a.	Name of bank	Broker
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A : BRs held & Outstanding

For Purchases

- i) on outright basis
- ii) on buy-back basis



B : BRs issued & Outstanding

For Sales

- i) on outright basis
- ii) on buy-back basis

C : BRs held but returned during the month

Date of reversal	BR No.	Date of BR	Particulars of security	Face value (Rs. lacs)	Whether SGL received or scrips received or reversal of buy-back	To whom returned (Bank)

D : BRs issued but received back during the month

Date of reversal	BR No.	Date of BR	Particulars of security	Face value (Rs. lacs)	Whether SGL given or scrips delivered or reversal of buy-back	From whom received (Bank)