

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : Now the Finance Minister has to make the statement.

STATEMENT BY MINISTER

Irregularities and fraudulent transactions in Banks and other Financial Institutions

THE MINISTER OF FINANCE (SHRI MANMOHAN SINGH) : Sir, in the last session I had informed the House of certain irregularities detected in the securities transactions of banks and I had assured the House that the matter would be thoroughly investigated and firm action would be taken against all individuals found to have indulged in malpractices. I would like to apprise the House of developments that have taken place since then.

The Reserve Bank of India had appointed a Committee under Deputy Governor Shri R. Janakiraman to inquire into the matter. The Committee submitted an Interim Report on 1st June 1992 and a second report on 6th July. Both reports were made public as soon as they were received.

The findings of the Committee confirm that unscrupulous brokers, in collusion with certain bank officials, have manipulated securities transactions of banks and other financial institutions for their own purposes in a variety of ways and in clear violation of the established rules, guidelines and prudent business practices. Banks' funds ostensibly intended for purchase by one bank from another bank of Government securities, PSU bonds, Units etc., and call money loans of one bank from another bank have been siphoned into the accounts of brokers. In another kind of manipulation, credit has been extended to the brokers through transactions engineered to represent discounting of bills, rediscounting of bills or ready forward deals in shares.

The total amount of transactions for which the banks and financial institutions involved do not have security backing is now estimated at about Rs. 3,542 crores. Against this the Janakiraman Committee has identified securities worth Rs. 350 crores held by one of the banks so that the net problem exposure is estimated at

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Rs. 3,192 crores. The bankwise break up of this amount is indicated in the attached statement.

The transactions resulting in this large level of problem exposure have been in flagrant and deliberate violation of established rules and guidelines. It is also clear that there has been a serious failure of internal control systems in the banks involved. But for this, the senior management of the banks should have become aware of these irregular transactions at much earlier stages. This internal control failure seems to have occurred in all three segments of our banking sector : nationalised banks, private sector banks and also foreign banks.

I share the anger and anguish of Honourable Members at these developments, which reveal serious deficiencies in the operation of our banking system. The fraudulent manipulations which have resulted in large scale misappropriation of bank funds require prompt corrective and penal action. I would like to assure Hon'ble Members that the Government is according top priority to recovering the amounts, punishing the guilty and restoring confidence in the basic integrity of the financial system.

I would like to take this opportunity to apprise Honourable Members of some of the steps which have been taken thus far to deal with the problem :

- (i) Even before the submission of the RBI report, Government had referred the case to the CBI. CBI has been investigating and has registered 5 FIRs. Since 4th June, 1992, 135 places have been searched and twenty five individuals have been arrested, including seven officials of banks and financial institutions. Fifteen individuals have since been released on bail.
- (ii) Administrative action has been taken on the basis of preliminary investigation against officials directly or indirectly involved or felt to be responsible. Chairman NHB had resigned, Chairman UCO Bank and Chairman SBI were asked to go on

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leave as also the Deputy Managing Director of SBI and Managing Director of Can Bank Financial Services Ltd. The Chairman, Bank of Karad and two of its directors were removed. The Board of the Metropolitan Cooperative Bank was superseded. Subsequently, these two banks have been taken into liquidation. The services of Chairman UCO Bank have been terminated. Twelve officials in various banks and other institutions have been suspended.

(iii) The first report of the Janakiraman Committee was received by the Govt. on 2nd June, 1992. The Government moved very quickly to promulgate an Ordinance to set up a Special Court for trying offences relating to these security transactions and appointing a Custodian for attaching the assets of individuals and organisations. The ordinance was promulgated on 6th June, 1992. The Special Court has started functioning and the Custodian has been appointed. The Custodian has since notified 39 individuals/organisations for attachment of assets.

(iv) Income-Tax Authorities are continuing their investigations into the offences of the Harshad Mehta Group. A large number of follow-up searches/surveys have been conducted. In all, about 100 premises have been searched/surveyed. Asset seizure aggregates to approximately Rs. 72.5 crores. Provisional attachment has been ordered under Section 281B of the IT Act for 37 immovable properties with the approximate market value of Rs. 25 crores and shares with market value of the order of Rs. 500 crores as on 28-2-1992. The current value of these shares has to be ascertained. Intensive investigations have been initiated in some other groups of brokers including Bhupen Dalal, A.D. Narottam, Hiten Dalal and connected cases like TB Ruia, Dhannraj Mills etc.

- (v) The Enforcement Directorate has also been investigating the activities of some of these brokers for violations of FERA. They have arrested three persons in the course of their investigation all three of whom are at present in police custody.
- (vi) Ministry of Finance took up with the Securities and Exchange Board of India the issue of action to be taken against brokers found guilty of stock exchange irregularities. Subsequently the Bombay Stock Exchange Board suspended the main share brokers involved.
- (vii) RBI has issued new instructions to regulate transactions in securities by banks. Treasury transactions are now subject to a concurrent audit by internal auditors and results are to be put up to CMD once every month. A special cell in the RBI would also scrutinise these reports.
- (viii) RBI is modifying its inspection procedures providing for detailed annual inspection of all banks with focus on financial evaluation.
- (ix) Lack of computerisation and reliance on manual processing in the Public Debt Office is one of the factors making it difficult for the banks to set up effective internal control system to supervise Government securities trading. A process of computerisation of the Public Debt Office has been initiated. Certain officials in the Public Debt Office have been suspended, and the matter is being investigated.
- (x) Managements of the banks where irregularities have surfaced have taken corrective measures for gearing up internal control machinery and for streamlining fund management operations.
- (xi) Steps are also being taken to improve trading practices in the stock exchanges, with a view to ensuring greater transparency in

transactions and eliminating manipulation of stock prices and insider trading. To this end the Securities and exchange Board of India was given statutory powers with effect from 30th January, 1992. Amendments of the SEBI Act are currently under consideration with a view to strengthening SEBI further in order to increase its effectiveness in achieving its objectives. Government have also decided to set up a new stock Exchange at New Bombay which will act as a model Exchange. It will be completely automated in terms of both trading and settlement procedures and would provide access to investors from all over the country. Government have also decided to set up a National Clearing and Settlement System with a Central Depository Trust and a Securities Facilities Support Corporation which would be entrusted with the task of establishing and maintaining the network among exchanges.

It is relevant to ask whether the scam could have been prevented through greater vigilance and better supervision. There is no doubt that better systems of internal control, or even greater efficiency in operating the existing system, would have enabled the top managements of the banks to have a better feedback on day to day operations, which could have identified the irregularities earlier. The statutory audits in the banks could also have identified some of these problems earlier. The fact that this did not happen underscores the need for thoroughgoing reform and modernisation of the banking system and its procedures.

Questions have also been raised whether RBI, which is responsible for supervision of the banks, could have been more vigilant. In retrospect, it is clear that RBI's supervisory function was not as effective as it should have been. It should be noted however that it is the RBI's own investigations that led to the unearthing of these irregular practices in the banks which had evolved over several years. There have been

references in the Press to a circular issued by the RBI in July, 1991 laying down certain norms for banks dealing in securities transactions and it has been asserted that RBI should have been more vigilant in pursuing compliance with this circular. In fact, RBI had directed the banks to submit compliance reports, and had subsequently received compliance reports from most banks indicating that their procedures were in line with the July circular. Subsequent developments show this was not the case. RBI cannot undertake micro-management in all cases and it is only in identified problem cases that detailed scrutiny, with on-site inspection, is undertaken. The Reserve Bank of India subsequently did undertake inspection of the Bank of Karad, the Andhra Bank and the Bank of Madras and these investigations did throw up evidence of continuing irregularities. Action against these banks was being contemplated when the wider dimensions of the scam became apparent. However, it is true that even these instructions did not reveal the full extent of the problem in the Bank of Karad which surfaced only later when the Reserve Bank undertook inter-bank reconciliation.

At one level, the banking irregularities and fraudulent transactions need to be treated as deliberate fraud on a large scale perpetrated by individuals who have blatantly violated the law. These individuals must be dealt with severely and Government is determined to do so. I hope Honourable Members will agree that Government has acted speedily in initiating criminal investigation proceedings and in setting up a Special Court. No effort will be spared to bring the guilty to book and that too speedily. At another level, the irregularities have also thrown up a number of system weaknesses which have developed over time in our banking system and which can only be corrected by thoroughgoing reform and modernisation of the system.

Government has been aware of the need for thoroughgoing reform of the banking system and its procedures, if Indian banking

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is to be able to handle the banking requirements of a modern economy effectively. It is for this reason that Government, in the first few weeks of coming to office, had appointed the Narasimham Committee to look into various aspects of the financial system which need reform.

The Narasimham Committee has made a number of recommendations for reform of policy and procedures in the banking sector aimed at creating a more efficient banking system which can serve the needs of a rapidly modernising economy. It has also recommended creation of a separate supervisory authority under the aegis of the Reserve Bank of India. Government propose to act expeditiously on all these recommendations.

The Government attaches high priority to implementing the various recommendations of the Narasimham Committee aimed at financial sector reform. The irregularities and frauds that have come to light are in no way due to financial liberalisation. On the contrary they have surfaced under a regime of apparently tight regulation of banking activity. Over regulation of bank interest rates and an excessive pre-emption of bank resources into low interest assets has contributed to some extent for bank managements looking to non-traditional banking activity to bolster bank profits. Steps taken recently by the Government to rationalise interest rates and to reduce the statutory liquidity ratio will help to correct these imbalances.

It is also necessary to strengthen supervision over banks and other financial institutions. For this purpose, Government is considering the establishment of a high powered Supervisory Board consisting of 4 to 5 full time members, with the Governor, Reserve Bank of India as the Chairman. The Board will have an advisory council with eminent persons from the fields of banking, auditing, law, economics and management. The Board will coordinate the work of supervision of banks, financial institutions and other financial agencies in

the country. It will lay down operating guidelines, look after supervision and enforce compliance. Surprise inspections will be a part of the Board's operations. The Vice-Chairman will be a Deputy Governor of the RBI, who will work exclusively on supervision, follow up and compliance.

The Government is also considering the establishment of a separate special Bureau of Frauds to deal with serious frauds in banks and other financial institutions. Such special agencies exist in some other countries and consist of a multi-disciplinary group with expertise in accounting, law and including representatives of the police and investigative agencies. (*Interruptions*).

SHRI S. JAIPAL REDDY (Andhra Pradesh) : Mr. Vice-Chairman, Sir, when we have the RBI, where is the need for this Board? RBI is meant to be a Board of Frauds.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : The Minister knows very well

SHRI GURUDAS DAS GUPTA (West Bengal) : I must admit that the Finance Minister has committed a big fraud by issuing a statement which is fraudulent in nature. (*Interruptions*)

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : Mr. Minister, go ahead.

SHRI MANMOHAN SINGH : Sir, the Indian banking system has substantial strengths and achievements to its credit. With appropriate steps to reform the system it can emerge from the present situation in a much stronger position. The Government is determined to take all steps necessary to ensure that the integrity of the banking system is preserved and that the system is strengthened to enable it to play its critical role in our economic development.

ANNEXURE

Total size of the problem exposure in Securities Transactions

(Rs. in Crores)

(i) Total value of investments made by banks and institutions for which they do not hold any securities, SGL transfer forms or BRs	National Housing Bank State Bank of Saurashtra SBI Cap Standard Chartered	1,271.20 174.93 121.36 400.35
		1,967.84
(ii) Total exposure against BRs/SGL transfer forms issued by Bank of Karad or Metropolitan Coop. Bank	Canbank Financial Services Ltd. Can Bank Mutual Fund Standard Chartered	435.31 102.97 931.84
		1,470.12
(iii) The estimated shortfall in the securities held by ABSFL		104.83
		3,542.79
Less : Value of securities reportedly seized by Standard Chartered Bank from M/s Hiten P. Dalal		350.00
		3,192.79

SHRI GURUDAS DAS GUPTA : His statement is the biggest fraud.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : At the time of discussion, you can raise all these things.

DR. MURLI MANOHAR JOSHI (Uttar Pradesh) : Is it for prevention of frauds or for perpetration of frauds. (*Interruptions*)

SHRI GURUDAS DAS GUPTA : Why is the Finance Minister not speaking about the personal responsibility of the Governor of Reserve Bank? Why is he protecting him? Let him explain that.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : About these things, everybody has his own views. I have also my own views which I will put at the time of the discussion.

SHRI S. JAIPAL REDDY : We can have a Board for prevention of frauds. We cannot have a Bureau of Frauds.

DR. MURLI MANOHAR JOSHI : Is it that the Government wants to perpetrate some frauds? (*Interruptions*)

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : You know something about that. I also know something about that. And the Committee on Government Assurances has also said something about that. I myself will raise it. (*Interruptions*) It is a known fact that the frauds are committed. The Committee on Government Assurances has given a Report on that. (*Interruptions*)

THE LEADER OF THE OPPOSITION (SHRI SIKANDER BAKHT) : It is a very unhappy statement.

THE MINISTER OF HOME AFFAIRS (SHRI S.B. CHAVAN) : The understanding was that he should be allowed to make the statement. And you can raise all these points in the discussion. I don't think it will be proper now.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : You raise this thing in the discussion.

SHRI S. JAIPAL REDDY : Tomorrow it will go into the press.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : He will explain it.

AN HON. MEMBER : The whole world will laugh at us that this Government is having a Bureau of Frauds.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : This Board is for investigation.

SHRI DIPPEN GHOSH (West Bengal) : Bureau of Investigation is one thing but Bureau of Frauds is another thing.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : You have to see the intention.

SHRI G. SWAMINATHAN (Tamil Nadu) : It was decided that the statement will be made today and discussion will be tomorrow only. (*Interruptions*).

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : Only at the time of discussion you may raise these points, not at this stage.

SHRI S. JAIPAL REDDY : May I make one point ?

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : Nothing will be allowed now. You may raise only at the time of discussion.

SHRI S. JAIPAL REDDY : It is a wrong anxious to have the language corrected.

SHRI SIKANDER BAKHT : It is a very bad expression. His intention may be different, but it is a bad expression.

SHRI S. JAIPAL REDDY : It is a wrong expression.

SHRI DIPEN GHOSH : There is a fraud on the English language. It is a Bureau of Frauds; but who will head the Bureau of Frauds ?

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : When there is a discussion, you may raise it and the Minister will reply.

SHRI S. JAIPAL REDDY : I am not raising a substantive issue. I am raising a semantic issue. It is about the knowledge of English language.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : No, no. Nothing will be allowed.

SHRI S. JAIPAL REDDY : How can there be a Bureau of Frauds ?

SHRI V. NARAYANASAMY (Pondicherry) : This is Special Bureau on Frauds.

SHRI MANMOHAN SINGH : I think I do not have any monopoly on the use of the words but my meaning is quite clear that this Bureau will be a Bureau which will detect frauds if they occur, then investigate them, and as we have a Crime Branch in the police ; this does not mean that that Crime Branch perpetuates, crime. So they should not take objection to the use of the words.

THE VICE-CHAIRMAN (SHRI JAGESH DESAI) : Now we take up special mentions.

SPECIAL MENTIONS—contd.

Alleged gang rape of a Harijan woman by the police officials at Annamalai

SHRI TINDIVANAM G. VENKATRAMAN (Tamil Nadu) : I would like to bring to the notice of the House the gruesome and flagrant violation committed by the guardians of law in Tamil Nadu. Sir, the occurrence took place on the 2nd of May at Annamalai Nagar police station. One Nandgopal was taken as a suspect in a theft case and he was kept in the lockup for four days. His wife used to visit him and feed him. It so happened that on that particular night, the Sub-Inspector and four police constables on duty committed rape on that woman within the precincts of the police station. The Station House Officer, the Sub-Inspector, wanted to have preference. He raped the woman first and then the four constables gangraped the woman. When the husband came to the rescue, he was beaten black and blue. When he objected to this, he was dragged and he was beaten black and blue.