

From New Delhi by Ramtanu Maitra

The bank scam shakeup

A slick broker took advantage of a slothful and sometimes corrupt banking system, wreaking who knows what damage.

A massive bank scam that has sent shocks throughout India's financial system has further tarnished the image of India's nationalized banks. A full investigation is now afoot to determine the damage done.

The scam was a simple one which utilized the manual logging of transactions and the corruptibility of the bank chiefs. Although the main culprit is a hot-shot broker from Bombay, there are at least 17 banks which are under investigation. Already, the chairman of the National Housing Board has left. Two other chairmen of major nationalized banks are also on leave. There is no telling how many heads will roll, if the government is serious about cleaning up the corrupt system.

What happened is simply this. According to Indian banking regulations, the banks have to hold 38.5% of their incremental cash deposits in the form of government security (since the last budget, the percentage has come down to 30%). Often some banks may not have the amount in that form, and so, they buy securities from the banks which have surplus securities. However, the banks are reluctant to conduct bank to bank sales: 1) Such transactions will alert the central bank, the Reserve Bank of India (RBI), that reserve regulations are being violated. 2) Such "distress buying" may cause the prices of securities to shoot up. Hence, a broker illegally acts as go-between, on commission.

In a brokered transaction, the selling bank gets the money and gives the broker the bank receipts with the promise of delivering securities in 90

days. When the broker procures a buy order, the bank receipts go to the buyer bank, and then, the buyer and seller bank report to the RBI, which logs the transaction and notifies both banks. The entire process is conducted manually, and it often takes three weeks from the time that the money is transferred until the RBI acknowledges the transaction's completion.

Things blew open in March at the end of the 1991-92 fiscal year, when accounts at the largest commercial bank, the State Bank of India, showed a gap between the securities it is holding and the bank receipts. The gap is reportedly about \$225 million. Under interrogation, the clerk who makes the entries admitted that he had made phony bank receipt entries and the beneficiary in all these entries was the broker Harshad Mehta, who was a raging bull in the Bombay stock market for the last year.

The State Bank of India, the victim, immediately demanded that Mehta pay up; he quickly wrote a check for the amount. However, he failed to produce the securities or the bank receipts he was holding from other banks, and they were never delivered to State Bank of India. The scam was discovered.

Now it appears that Mehta had many of these bank chiefs under his full control, which raises questions about the possibility of insider trading, tinkering with the interest rates of government securities, inside knowledge of interest rate fixing, etc. Mehta took advantage of India's slothful banking system and less-than-vigilant

bank chiefs, who are bureaucrats nominated by the government at the fag end of their careers. It is highly likely that these bank chiefs (and this is being investigated) were skimming off money with the help of Mehta.

What was Mehta doing with the money? Besides his creature comforts, Mehta was buying into the blue-chip companies. With public money, thanks to our generous government "bankers," Mehta picked up large blocs of shares of such top companies as Reliance, Apollo Tyres, and ACC, and created a stock market bubble. The day the scam was discovered, the shares began to fall, and more exposés are about to hit. Discovery of fake bank receipts in the units market on May 18 has created new worries. Reports indicate that banks, financial institutions, and their corporate clients may be holding onto fake bank receipts worth about \$100 million.

Although Finance Minister Dr. Manmohan Singh, under severe attack from members of Parliament, has tried to downplay it by calling it a "breakdown in the system," very few agree with him. It is evident that RBI, which is supposed to monitor all kinds of activities, failed to end the scam when there were tell-tale signs that Mehta was becoming too big. A tax raid last February on his home apparently was not followed up.

Clearly, despite political opposition created by the trade unions, computerization of the banking system is urgent, and bankers with a commitment to clean banking, and not political beneficiaries, must be appointed to run the banks. A good deal of damage has been done: The securities market, unit market, and share market have been contaminated, and people are worried that if the nationalized banks can get embroiled in such scams, what is the difference between a private and a public sector bank?